

Oil-natural gas trade reappears, roiling US energy markets



Last week's stunning reversal in oil and natural gas markets brought out of the shadows a trade that used to be commonplace – a so-called relative value trade the two commodities. Oil reached a four-year high in early October on speculation prices could reach \$100 a barrel as Iranian exports dried up. Meanwhile, natural gas burst out of its doldrums earlier this month, but the rally was being threatened by record US production. While it may not have been intentional, investors recreated what was once a popular trade based on a correlation between natural gas and crude oil markets. Crude's decline from its high turned into a rout and a cold-weather rally in gas grew into the biggest surge in nine years as large energy traders raced to unwind bullish crude and bearish natural gas bets, market participants said. The rush to the exits pushed the price ratio between the commodities to the narrowest since the financial crisis. "The crude-natural gas trade hasn't been a thing in a very long time, I'd say maybe a decade," said John Kilduff , a partner at Again Capital. "It appears to be inadvertent. The sentiment around the natural gas market got incredibly bearish because of the record production numbers. Then, all the analysts on the Street were calling for \$100

oil.” A relative value trade bets on a price relationship between two commodities, rather than taking an outright position on a single one. In theory, it might be less risky. While crude and natural gas were fairly well correlated in the middle of the previous decade, due to direct competition for drilling resources at the wellhead, that has faded in recent years due to the US shale gas boom and subsequent oil boom. Earlier this year, the CME Group Inc wrote in a post on its website that the crude and natural gas link reached an inflection point in 2008, and have since decoupled. That all reversed last week in a hurry, with crude dropping 7.1% November 13, the biggest one-day decline in more than three years, the culmination of a record slide. The same day, natural gas jumped 8.3% to exceed \$4 per million British thermal units for the first time in almost four years, followed by a spike of 18% on November 14. “It’s not a fundamentally driven rally,” said Stephen Schork, president of Schork Group Inc, a consulting group in Villanova, Pennsylvania. “This rally is driven by someone large who had the wrong position.”