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REPORT WRITTEN APRIL 16, 2003

SPECIAL REPORT
FROM THE DESK OF PHILIP GOTTHELF

As the War Ends, What's Next?

With unprecedented speed and security, United States armed forces swept away Iraq's regime, secured oil resources, and demonstrated to the world that the only power authorized to use weapons of mass destruction is the U.S. With less than 200 coalition casualties compared with estimated Iraqi deaths in the tens of thousands, the Middle East should finally hunker down to the business of making peace and joining the rest of the world in the 21st Century.

The problem with our optimism and anticipation is that it fails to account for the tremendous ideological differences between fundamentalist Islam and Western Judaic/Christian practices. Simply put, some societies are not interested in the 21st Century. They prefer the religious adherence associated with the First Century. While Westerners presume the clash is between "our standards and theirs," the actual conflict is between their standards and those within that wish to change. This is why we see the political structures that exist among the Arab nations.

I have been intrigued by recent news analysis that attempts to define a post Saddam Iraqi structure. One commentator pointed to Egypt as an example of a "successful" democracy. However, Egypt is actually a hybrid since Egyptians have not really considered themselves Arab. The demographics are substantially different.

A more appropriate and disturbing example is reflected by the Balkans. Under Russia's dictatorial authority, Serbs, Croats, Muslims, and Christians were all forced to get along or suffer the wrath of the central authority. Once left on their own, the ethnic diversity became self-consuming and required intervention. There are no less than eight "factions" occupying Iraq. Conflict with the Kurds is well documented. The animosity runs deep and the geography is extremely delicate when considering where the Kurds reside and where the oil fields are located… not to mention the potentially explosive dynamic with the Turks.

When all is said, we are forced to understand that the ethnic diversity represented in the United States is the exception rather than the rule. Yes, it is a big exception. None the less, other regions do not have the luxury of integrated societies. Even within our own borders, social and economic differences drive wedges between blacks, whites, Hispanics, Asians, Christians, Muslims, and Jews.

The challenge of Iraq is frightening and exciting. If it can work, it will set an example for the rest of the world that will be difficult to avoid. Dictatorships will lose their grip because there will be a functioning example of a viable alternative. Alternatively, the U.S. is doomed to a long, expensive, and politically difficult occupation that is bound to bring down the wrath of the global community.

What does this have to do with trading commodities? Clearly, oil will become a political football as interests jockey for position and the U.S. asserts control over the flow with modest help from England. Already, the "illegal" spigots to Syria have been turned off as a favor to OPEC and, in particular, Saudi Arabia. While the few million barrels escaping U.N. sanctions do not amount to a negotiating tool, it is a sign that Middle East oil has a Westernized swing producer. In the name of rebuilding Iraq and for the good of the Iraqi people, the U.S. and U.K. intend to lift sanctions and allow a more uniform flow to feed the West, of course.

The factional fighting is actually anticipated. Such instability provides the needed excuse to assert authority for an extended period. During this uninvited stay, the speed and conviction with which Western oil companies boost production capacity and energy infrastructure will be impressive. Iraq is an energy-producing dream come true with huge reserves and extraordinary additional resources represented by the Tigress and Euphrates rivers. Iraq is the jewel in the rough and the West has the stonecutters that will reveal this gem's true potential.

Arab perception is essentially correct. The West wants a friendly democratic government that will stand outside of traditional OPEC ties. Iraq needs money to rebuild. Iraq needs money to run a new government. Iraq has oil. The picture is obvious.

May crude oil has moved into a wide trading range between 3150 and 2750. As mentioned in previous REPORTS, a bust below 2750 signals the next phase of a retracement that will probably test $22 as an interim reference low.

The immediate political assumption is that the U.S. and U.K. will dump on oil prices. This is not an accurate assessment. The higher the price, the quicker Western interests get paid back… either for the war or for reconstruction and development. Further, the U.K. does not want to see its own North Sea oil devalued. The 2200 April 2002 reference low is likely to be the target that gives us relief at the gas pumps while providing sufficient income for Iraq to accomplish *our* goals.

Having been stopped out of back-to-back shorts, I wisely became gun shy last week. May heating oil continued its advance and probed 7900 today. The two-pronged resistance has suspiciously held despite crossing the 20-day average. Meanwhile, the 40-day lags too far and represents an unrealistic upside objective for this time of year.

I am inclined to try again. My instincts tell me there is a chance prices will finally track the normal seasonal. While another cold front threatens the Northeastern corridor this week, the minimum lows are still in the mid 40s… hardly enough to really set off the oil heaters. Thereafter, the probability of cold snaps diminishes to almost zero.

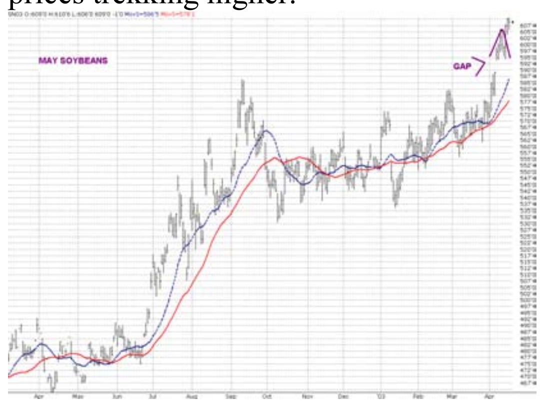
Notice how 7900 is touched twice. It is difficult to imagine 80¢ heating oil for May delivery! Powerful consolidation support exists at 70, but I anticipate a breach below this level with a new range between 6200 and 6800. This corresponds to a slow decline in crude.

My surprise come from the relatively weaker gasoline performance. The "U:" bottom is more technically constructive, but 8000 looms as powerful resistance. The action has been mild compared with heating oil's strength even as we approach the driving season.

Although the charts look similar (for obvious reasons), there are subtle differences that raise concerns. In particular, gasoline might push above resistance to substantially confuse the picture. Traders have been waiting for some indication that Iraq's oil will hit the market. The delay caused some to cover short positions. Fundamentally, little has changed except the battle status. Our inventories are steady and the appropriate price is lower rather than higher. This logic was costly two weeks ago!

Grains

Alas, soybeans were more constructive than I anticipated. The correction did not come and spring weather has not discouraged buying. The reports indicate a smaller carryover and planting intentions are less than last year. This provided a one-two incentive to ignore the gap established last week and keep prices trekking higher.



Recall I was anticipating the gap would fill, but was cautious about a breakout above 6.07. The breakout preceded the fill and we could be seeing a breakaway. I still feel a $6+ soybean is expensive under present conditions. Apparently, I am alone. The alternative strategy is to buy with a conservative stop. According to Murphy's Law, the gap will fill immediately after we go long.

Fundamentals place us somewhere around 1998. If so, I suppose a price above $6 is justified when referencing the July chart.

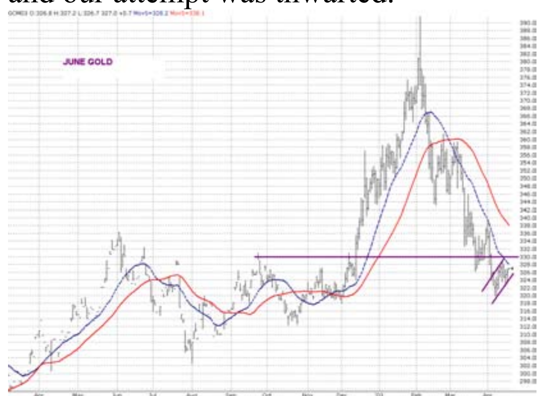
We would be in the April channel as indicated. Prices plunged once planting was underway and, then, made an erratic recovery… if you can call the pattern a recovery. By September, prices plunged to 5.15.

Record temperatures will combine with a descending cold front to create severe weather potential tomorrow across much of the plans. Still, we are early in the season for this to have an impact upon prices. Some field preparation is underway, but whatever is undone can be quickly resurrected. Admittedly, the map displays a whopping low. The key will be patterns in May that some climatologists say will be very wet. Too wet to plant? We'll see!

Gold

The Saddam factor has been removed and the alleged flow of gold from the Middle East has slowed to insignificance. Having removed the Saddam factor with his death, incapacitation, or exile, the U.S. has clamped down on gold transport and is keeping a keen eye on depository transfers.

Having expected this and other stalling factors, I sensed the potential for a small upward channel. There was simply too much negative news. Admittedly, I searched for an opportunity to sell calls and puts, but the premiums deteriorated and our attempt was thwarted.



Currently, we are up against 32800 resistance in June. A thrust above this could provide enough technical momentum to make a 33800 test. Do I think gold will rocket to $400? No. However, if 33800 is achieved, the call premiums should fatten sufficiently to place a short strangle.

Gold advocates warn that Iraq is still extremely unstable. But, there is no buying power left in that region. Who wants to accumulate gold. Our next focus is on Syria and Iran. However, the U.S. assurance that they are not targets (yet) gives sufficient calm to avoid conspicuous gold purchases or movement.

The risk/reward for our long position may be questionable, but gold can sneak higher under present circumstances. ☺