



Crude Oil and the Hurricane Season June 2007

The arrival of the Atlantic Hurricane season marks an exciting time for futures and options traders. June 1st is the official start to the season. What used to be called summertime is now more of an "event" in some trading circles. The news media is in full swing as well. Just being able to talk about hurricanes makes a great ongoing story for both weather and financial media. Experts at the National Oceanic Atmospheric Administration (US government body) Climate Prediction Center are projecting a 75 percent chance that the Atlantic Hurricane Season will be above normal this year—showing the ongoing active hurricane era remains strong. The hurricane season in the North Atlantic Ocean runs from June 1 to November 30. NOAA has forecast 13-17 named storms, 7-10 hurricanes and 3-5 major hurricanes. The Gulf of Mexico is home to about a third of the US Oil and Gas producing facilities. Out of the 9 hurricanes that are forecast, even if one passes over this patch in the Gulf where the oil facilities are concentrated, it could impact crude prices by a significant \$3-5 a barrel. Then there is the issue of Louisiana Offshore Oil Port (LOOP), which is a port in the Gulf of Mexico. LOOP provides tanker offloading and temporary storage services for crude oil transported on some of the largest tankers in the world. Hurricanes that strike the Louisiana coast could well put this out of order. Besides, the bad weather that precedes a hurricane may keep these tankers waiting for endless days without unloading. So a hurricane in the Gulf means not only a third of the US production does not reach the shore, even the imported crude is shut off, creating windows of opportunity that may send crude soaring. One must remember that hurricane forecasting is still not a perfect science. Last year, only about half of the expected hurricanes turned out and none of them made a landfall. So its anybody's guess whether 2007 will go the 2006 way. Since 1945, the US has had only two consecutive-year periods when there were no hurricane landfalls. The hurricanes surely carry the potential to give inflation watchers some unexpected jitters.

Financial media focus on the topic because storms, or even threats of storms, can move markets, especially commodities markets. Anyone seeking examples can look at a Natural Gas chart from the days immediately following Hurricane Katrina following the Florida storms of 2004. Storms in the Gulf of Mexico can knock out oil and gas rigs. Despite the lost 2005 Natural Gas shut ins, a hurricane having a significant impact on the supply of a commodity is rare. Thus, if you are positioning yourself to take advantage of storm related price rallies, the odds are against you. This is largely because a lot of the risk is priced in before the season starts and the event occurs.

Even in a year where an "active" season is predicted, the odds do not improve much. Betting on the weather is pure gambling. A very relevant example in recent times is that of the failed hedge fund Amaranth. The fund bet big on natural gas prices in the summer of 2006, banking on hurricane forecasts for an active year. The storms never came. Amaranth paid the price.



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Natural Gas

Natural gas is arguably the most hurricane sensitive commodity. In a market where the US meets nearly all of its demand needs through domestic production, up to 25% of that production comes from Gulf of Mexico rigs - most scattered off the coast of Texas and Louisiana. In addition, coastal regions from Texas to Alabama are covered with natural gas storage facilities. Anyone trading energies in 2005 will never forget the price move in natural gas following hurricane Katrina.

It was a worst case scenario. A category 5 storm roared right through the heart of gas production areas. The market initially rallied over fears of damaged rigs and supply disruptions. But, the market continued to rally for many weeks after the storm had passed and not only from production loss due to damaged rigs. Storage and processing facilities all along the Gulf Coast were heavily damaged as well, meaning loss of stored supplies and the ability to process gas from the rigs that were still operational. Katrina may turn out to be a once in a lifetime storm. We can only hope. But the memories of how prices reacted will be etched onto traders' minds for a long time. Volatility from that price move is still priced into natural gas options.

Last Word

The Hurricane season brings with it great anxiety in energy markets every year and with it, possibly many trading opportunities. However, we would conclude this report with one caveat. It's very important that a trader distinguishes between 'expectations' and pure 'hope'. Betting on weather is more of the latter.

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