Investors Betting on Oil Price Drop Flee as Production Cuts Near

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Oil investors seem to have less reason to doubt that OPEC and other producers will make the cuts needed to balance the market.

Money managers trimmed bets on falling West Texas Intermediate crude prices to the lowest level since August 2014 as the Organization of Petroleum Exporting Countries and other crude-exporters prepare to start curbing output in January. Oil market volatility dropped to the lowest level in more than two years on Dec. 20 and futures settled at a 17-month high on Friday.

"People are excited that OPEC is going to hold firm and there will be a substantial reduction in inventories," Michael Lynch, president of Strategic Energy & Economic Research in Winchester, Massachusetts, said by phone. "The market should rebalance in 2017."

Hedge funds reduced short positions, or wagers WTI will drop, by 10 percent in the week ended Dec. 20, U.S. Commodity Futures Trading Commission data show. WTI declined 1.4 percent to $52.23 a barrel in the report week. Prices settled at $53.02 a barrel in New York on Friday, the highest close since July 2015.

OPEC agreed to reduce its supplies by 1.2 million barrels a day, while 11 non-members including Russia and Kazakhstan pledged to curb output by almost 600,000 a day.

"The market is falling embracing the OPEC, non-OPEC agreement," John Kilduff, a partner at Again Capital LLC, a New York-based hedge fund that focuses on energy, said by phone. "They are being given the benefit of the doubt now. The big test will come with the new year when we'll see if they make the promised cuts."

Confident Ministers

Oil prices are set to recover next year as OPEC fulfills its output agreement, Saudi Arabia's Energy Minister Khalid Al-Falih said in Riyadh on Dec. 22. Al-Falih's outlook was echoed by comments made by his counterpart from the United Arab Emirates, Energy Minister Suhail Al Mazrouei, who also predicted the same day from Abu Dhabi that OPEC's actions will result in higher prices in 2017.

Money managers' short position in WTI dropped by 5,699 futures and options to 50,613, a fifth week of decreases. Longs, or bets the benchmark will rise, slipped 0.8 percent. The resulting net-long position climbed 1 percent to the highest level since since July 2014.

"This represents the market being in an overbought situation," Tim Evans, an energy analyst at Citi Futures Perspective in New York, said by phone. "They are very well prepared for a rise in prices, but are left vulnerable for any negative shocks."

Fuel Markets

In fuel markets, net-bullish bets on gasoline rose 11 percent to 42,879 contracts, the highest since February 2015, as futures advanced 2.8 percent in the report week. Money managers increased net-bullish wagers on ultra-low sulfur diesel by 1.6 percent to 27,406 contracts, the highest since July 2014, as futures slipped 0.4 percent.

U.S. oil companies had been using the rally to hedge their price risk for the next two years, potentially boosting output next year. Producers' short positions, protecting against a drop in prices, decreased to 622,395 contracts, the first decline in four weeks. The number of bearish wagers had climbed to the highest since August 2007 in the prior week.

"The shale producers rushed in at the first sign of viability," Kilduff said. "That's played out. They locked in their profits and are now waiting to see what happens before hedging more."