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Inflation X Food and Energy – Get Real!

September 7, 2007

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Crude oil has put on an impressive rally in the last two weeks advancing almost 9.0% and now is one refinery glitch, hurricane or surprise out of OPEC at their September 11th meeting from making new contract highs. With no policy changes expected on an upcoming OPEC meeting we will still continue to buy breaks.

Last week the Department of Energy reported that U.S. gasoline supplies were down 3.6 million barrels to 192.6 million barrels. That represents a 20 day supply, which is the lowest on record. Even more frightening yesterday gasoline supplies were reduced further to 191.1. Bottom line, the U.S. refining activity is not keeping up with demand and this most likely will lead to higher prices. Heating oil supplies are down roughly 30% from a year ago as we head toward winter. With the clock ticking refiners are not able to switch over to heating oil because we still have over a month of hurricane season and the driving season is just winding down. That being said if you have the staying power and patience we would recommend buying heating oil a couple months out on pullbacks looking for a grind higher in prices in coming months. On a break in the Energy sector we feel the weak sister will be RBOB gasoline; we are looking to get short if Crude fails to hold \$75 RBOB could find its way back to \$1.75 in a hurry. For all you chartist you had a bearish engulfing candle yesterday as well.

Although current supplies may not be ample for heating oil or gasoline that is not the case for natural gas. So far this season, there have been no damaging hurricanes in the Gulf of Mexico and temperatures have been typical so supplies remain abundant. October natural gas made a run for \$6.00 yesterday and ran into significant resistance at the 61.8% Fibonacci retracement level from this summer's high and low. Although not our favorite play, buying call options at this level is an attractive proposal as we view when the reversal happens it will be violent.

As a side note inflation does exist and why the Fed may not cut rates at their September 18th meeting is the very real fear that high energy prices are here to stay for the foreseeable future.

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