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SWISS PRIVATE BANKING

FALCON PERSPECTIVES

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THE OIL MARKET IS NOT IN EQUILIBRIUM

After reaching an all-time high of roughly 150 USD per barrel in the middle of last year, commodity prices, including oil, have plunged dramatically. This happened as it became clear that the financial market crisis would affect the world economy, leading to a severe recession. The oil price reached a bottom at around 32 USD in early 2009. By the middle of June, it touched 72 USD; hence oil more than doubled in four months only! **Such gyrations tell us that equilibrium has not been reached.** The question going forward is whether the oil price will keep trading at above average volatility or if a new trend will emerge.

Looking at the fundamentals, it can be concluded that the negative scenario of a depression most likely could have been avoided, at least for now. This means that the **demand for energy and oil will stabilize and most likely grow again**, as the world economy starts to turn around. A further boost will come from the emerging countries, which grow faster and are more energy consuming. In the developed world, however, **some substitution effects and energy saving efforts can be expected.** But since the supply in the next few years will grow slower as less capital has been and will be invested in oil exploration, the fundamentals point - at least in the medium term - to higher oil and energy prices.

Investors and speculators have become an ever more important factor over the past years. Investment banks, hedge funds but also private and institutional investors through exchange-traded funds are playing the oil market. Although hard statistics are missing, it has become clear, that speculative demand has helped the recent rally in commodities. Because futures prices have been substantially higher than cash prices, **it has paid for big sophisticated investors to buy oil and store it in tankfarms.** Also, a weakening of the US dollar has provided an incentive for big oil consuming countries to fill their strategic reserves. Therefore, in the shorter term, some downward pressure on the oil price looks likely.

What are the takeaways for private investors in the current situation? Short term, some profit taking in oil and other commodities as well as commodity shares is advisable. For long term US dollar based investors, **it looks attractive to invest in energy and energy producing companies** since there is a substantial probability that US dollar inflation will start to pick up in 2011. On the back of a more broadly accepted recognition of an increasing urgency to protect the environment, successful companies in the area of clean energy and clean technology offer a good opportunity for the future.

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