Oil and Gold

Forecasting is a losing game. Forecasting commodity prices is a particularly risk losing game. So here goes.

The price of oil in gold has traded in a range 0.04 – 0.06 from 1989 to 1999. In 1999 it rises to a new range. 0.08 – 0.12 breaking to 0.15 in 2005. Currently the ratio trades at 0.12, near the top of its range.

A research study by Purvin and Gertz, an energy consultant has the oil price at 60 – 70 USD per barrel if you exclude non economic demand, that is speculative demand and accumulation of strategic reserves.

A plausible explanation for elevated oil prices is that the Middle East peace process (a misnomer clearly) was derailed in 1999 and the new Intifada began in 2000. Accumulation of strategic reserves provides a base line of support for oil prices.

The Intifada isn’t ending any time soon. If anything the region has become less stable and there has been an escalation in posturing in recent weeks and months. On the other side, India and China are operating disinflationary policy, the US and Europe are in recession. Economic demand for oil is likely to fall.

Short oil spot. Long out of the money call on oil to hedge. Long gold futures spot, hedge with short call on gold. Alternatively long put spread on oil, long call spread on gold. More expensive but less exciting. All strikes and notionals to reflect the view that oil quanto gold will fall from 0.12 to 0.08.