# Natural Gas Backwardation Buying Opportunity?

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By Ray Franklin

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My reports focus on Natural Gas because it is now the largest source of energy for the generation of Electricity; therefore, Natural Gas and Electricity rates are highly correlated.

Starting with my ***March 7th Energy Alert***, as shown in the chart below, I warned Natural Gas was forming a similar pattern to what we experienced in the ***spring of 2012***, and based on past performance prices would likely trade much higher before reaching a final high in this cycle:


In my ***September 21st Energy Alert***, I explained why Natural Gas closing above ***its previous 2016 high of $2.998*** per MMbtu***, increased the risk*** of higher prices near-term.

Since September 21st, Natural Gas has remained close to $3.00 per MMbtu, and as I write this report Natural Gas is ***holding above $3.00*** despite a higher than expected ***80 Bcf*** increase in supplies as reported by the EIA in their weekly storage report. The EIA report should have pushed prices lower, but when a market ***ignores negative news***, it is signaling the path of least resistance is to the upside.

***Why are prices moving steadily higher in the face of negative news?*** Simply stated, based on past performance large hedgers are aware prices will likely be higher on average long-term.

***Why do large hedgers believe prices will be higher on average long-term?***

**I believe primarily for 2 reasons**:

1) Over the last 20 years Natural Gas traded close to the low reached in March 2016 seven times, and each time, rates were higher on average the following ***12, 24 & 36 months.*** Past performance does not guarantee future results, but large hedgers are fully aware of this historical tendency.

***The chart below contained in my March 7th Energy Alert pointed out this historical tendency:***


2) Long-term traders are also aware of another important factor. Natural Gas and in most regions Electricity are experiencing backwardation. ***Backwardation*** occurs when nearby contracts are sold at a higher price than contracts further out. Some traders mistakenly believe this is a bearish configuration, but large hedgers understand this historically is a bullish pattern.

***The chart below*** is example of a Bull Market in Natural Gas from ***2002 to 2008,*** which was also a period of backwardation in the forward markets:

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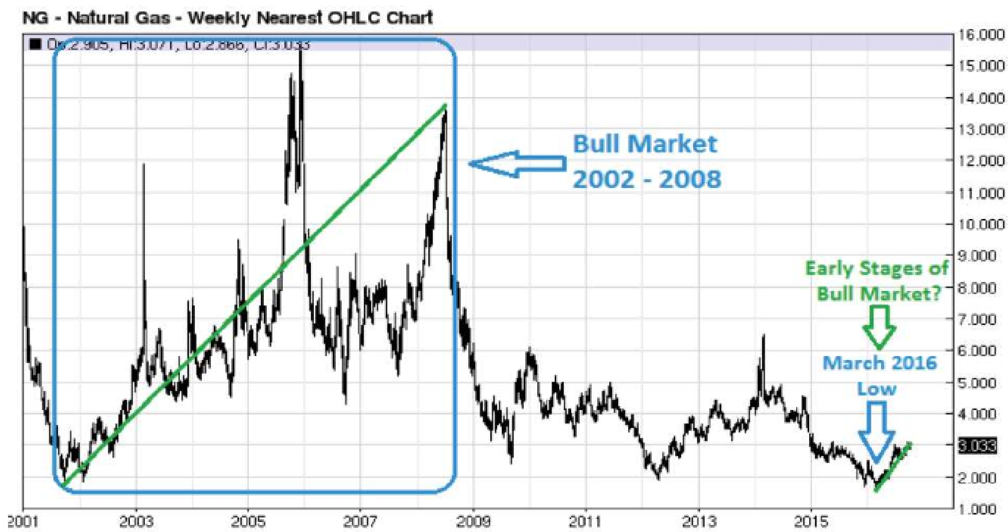


***During the Bull Market from 2002 thru 2008, the*** Natural Gas and Electricity markets were consistently in backwardation and ***hedgers who hedged longer-term benefited by reserving the lower rates further out in the forward markets.***

Based on all the factors I have delineated in reports since my ***March 7th Energy Alert***, I believe, we are in the ***early stages*** of a Bull Market, and hedgers taking advantage of backwardation in Natural Gas and Electricity, similar to 2002 to 2008, will benefit by reserving the lower rates presently offered in the forward markets.

***Below is an example of the present backwardation in Natural Gas's April Contracts.***

***April 2017 – $3.110 per MMbtu***

***April 2018 – $2.841 per MMbtu***

***April 2019 – $2.700 per MMbtu***

The price of Natural Gas is lower in the forward markets, and astute hedgers understand the benefit of reserving rates in the forward markets when they are below nearby rates, especially when, over the last 20 years, rates were always higher on average the following ***12, 24 & 36 months*** after trading near the lows we experienced in March 2016.

Therefore, if you have not already hedged your cost of Natural Gas and Electricity, ***based on the above 2 factors***, ***I recommend you do so near present levels.*** As a hedger your objective should not be to catch the exact bottom, but to reserve a rate lower than the expected average rate over the term of the hedge.

**Not every client's risk tolerance and hedging strategy is the same, but we trust the above report will help you put into perspective the risk/reward opportunities at this time. I invite you to call one of our energy analysts to help you plan a hedging strategy appropriate for your situation.**

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**Ray Franklin**
Senior Commodity Analyst
727-400-3170