Markets

In a Risky World, Oil Traders Bet on $100 a Barrel

- Trading of $90, $100 and $110 calls swelled in recent sessions
- Iran, Venezuela, Libya, Nigeria all present political risks

Photographer: Callaghan O'Hare/Bloomberg

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Whether it's the U.S. sending military warnings to Iran or tensions in Venezuela, some oil traders have started to gear up for a possible price surge as political risks escalate.

Trading in relatively cheap option contracts that would profit from crude soaring to as much as $110 a barrel has taken off in the past two weeks. In total, the equivalent of more than 45 million barrels of $90, $100 and $110 calls, have traded in the last 9 sessions.

Those trades come against the backdrop of disruptions to supply in major oil producing nations. U.S. sanctions have forced output in both Iran and Venezuela sharply lower, while America has also dispatched an aircraft carrier to the Middle East in a warning to its Persian Gulf nemesis. With turmoil in other OPEC nations, some are looking at political risks as a source of potential value.

Bull Bets Rise

Open interest on Brent $90, $100 and $110 calls has been climbing higher

Source: ICE Futures Europe
NOTE: Compares close on April 29 with close on May 9

"Geopolitical risk offers good risk-reward to hedge or trade right now," said Thibaut Remoundos, founder of Commodities Trading Corp. in London, which advises on hedging strategies. "High conviction views on anything else are difficult in this market at the moment."

The oil market has been here before. In September, a flurry of $100 calls traded as top executives talked up the potential for prices to soar as U.S. sanctions on Iran were set to take effect. With crude subsequently slumping as President Trump wrong-footed the market by granting sanctions waivers to key Iranian customers, and prices tumbling more than 40%, such trades then disappeared.

It's not just the intensifying tensions between the U.S. and Iran that have revived the trades. There's also civil unrest in Algeria, and a spiraling conflict in Libya, neighboring North African members of the Organization of the Petroleum Exporting Countries. At the same time there's been major disruption to Russia's giant Druzhba oil pipeline, while one of Nigeria's principal export grades has been put under force majeure after a trunk line shut down.

Tight Market

In a sign of just how tight physical oil markets have become as a result of the disruptions, traders are willing to pay large premiums to secure immediate supplies. Brent crude for July cost 97 cents a barrel more than for August, according to ICE Futures Europe data. The equivalent spread over three months is at its strongest in five years.

Balancing these bullish factors, there's the possibility that oil demand may be hit by the trade battle between the U.S. and China. While the combination of risks has seen a key measure of crude volatility rise to its highest since February this week, the premium traders are paying for bearish put options over bullish calls remains steep.

"Out-of-the money calls are a good trade for a fund," said Richard Fullarton, founder of London-based oil hedge fund Matilda Capital Management Ltd., observing that for now, the trade dispute is offsetting the combined geopolitical risks. "It's all about Trump now and what he does next."