OIL RALLY LIMITED BY RESISTANCE

By Daryl Guppy

The sudden fall of Iraq into the hands of extremists has the market talking about extremes in the oil price. Extreme may be too strong a word, but there is slightly more bullish pressure than was around at the time of the last oil crisis. The developments in the Ukraine had the potential to affect oil and energy supplies in Europe but they failed to ignite the oil price.

The Ukraine crisis accelerated the rally in NYMEX oil that started in the week of January 18, 2014. It was a short term rally in the environment of a slow longer term uptrend. The current Iraq driven rally has a similar nature but it is starting from a higher base.

The weekly NYMEX oil chart shows an uptrend starting 2012 June shown with trend line A. Uptrend line A starts in 2012 June. This trend line connects the lows in 2012 November. It also joins the low in 2013 April. This is the underlying secular trend and it is located within the context of well defined trading bands.

The weekly NYMEX oil chart shows four levels of support and resistance that define the trading bands.

The first level is near $78. The second level is near $88 and the third level near $98. The fourth level is near $110. Starting in 2012 July oil has traded in a sideways trading band between $88 and $98. The breakout above this trading band in 2013 July was not the start of a new uptrend. It was a temporary rally towards resistance near $110. This type of behavior is likely to be repeated in the current crisis environment.

Starting 2014 March oil developed a temporary resistance level near $104.50. This created a small up sloping triangle and this chart pattern can be used to project the upside target for the current rally. Thu upside projection target is $110 which is the level of long term historical resistance since 2011.

The current rally breakout above $98 has the same pattern of behavior as the rally breakout in 2013 July. This past behavior suggests there is a high probability that resistance will again be strong near $110. There is a high probability the current rally will be limited to $110 with the potential to spike to previous historical highs near $114. This has the characteristics of rally behavior rather than a long term trend change.

Traders will trade from the long side as the rally moves upwards. When the rally move near to the resistance level at $110 then traders will tighten stops to protect profits. There is a high probability the price will consolidate near $110 and perhaps establish a trading band between $110 and $114. The downside target for the retreat from resistance is near $98.