Five things you need to know about trading oil

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Oil is an important commodity that investors track with great interest, but how best to judge the key trends—and what are the main nuances of the market? At the end of last year, OPEC agreed a deal where the cartel would cut production by 1.2 million barrels a day while the non-OPEC countries also agreed a further reduction of 558,000 barrels a day.

This news sent Brent crude prices above the US$50/barrel mark but the success of these cutbacks has been significantly blunted by US shale producers ramping up production. Renewed political risk in the Middle East has also created price movement.

With such volatility in the oil markets, what do you need to know before you begin trading?

1) Know your major benchmarks: Brent Crude v WTI

There are two key oil prices that the market tends to follow: Brent Crude, which refers to the 'sweet light crude' oil extracted from the North Sea and is used as a benchmark globally. WTI refers to West Texas Intermediate light crude oil extracted from the US, but because it's landlocked, it can be expensive to transport to the rest of the world. There are other benchmarks as well—like Dubai/Oman which is used as a benchmark in Asia.

2) Keep an eye on what OPEC does

The 13 member countries (Indonesia has recently suspended its membership) who produce approximately a third of the world's oil may have reached an agreement at the end of November, but markets were waiting to see what the key oil producing countries who are not part of OPEC were going to do. These non-member countries, like Russia and the US are ones to watch. The next OPEC meeting takes place on 25 May 2017.

3) Monitor what's happening in China

China's the second largest economy in the world and next to the US, the largest consumer of oil. They are also the largest importer of liquid fuels. Whilst China's growth may not be what it was, they're still targeting 6.5% growth.

4) Focus on macro information

The oil price is susceptible to not just supply side economics but other variables such as stock piles and inventory. Weather related vagaries in Europe and North America can play a significant part as can geopolitical risk. The latter has the potential to cause disruption in a number of ways.

5) Oil trading is both a mixture of fundamental and investment flows

While you can look at some of the macroeconomic fundamentals, a lot of oil contracts are traded by short term traders. It means that prices aren't determined just by supply and demand nor by sentiment alone. The Commodity Futures Trading Commission (CFTC) in the US publishes a report of the net positions held by non-commercial investors allowing to track investment flows.

So how can you trade oil?

It's possible to express either a long or short view. If you want to manage a position in oil, either WTI or Brent, there are Exchange traded products (usually ETNs or ETFs) which allow you to do this. exchange traded products are passive, open-ended instruments that are traded on an exchange like a stock. Those tracking commodities, as in this case, can be aptly called exchange traded commodities (ETCs). With ETNs/ETCs, it's also possible to have a leveraged long position if you feel bullish about the trade or even a leveraged short if you're feeling bearish.

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