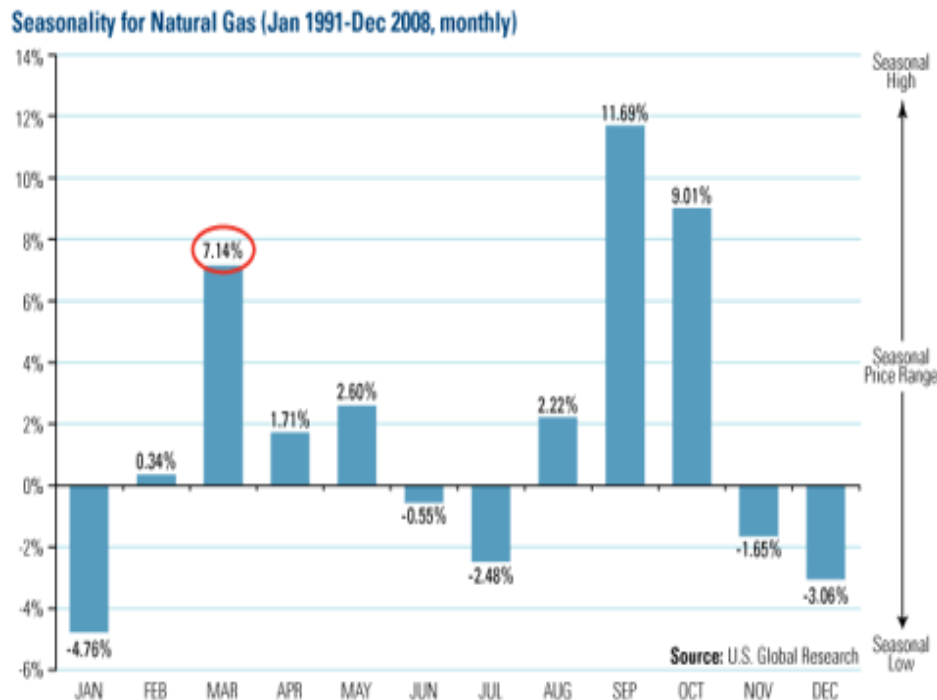


# March Madness in Natural Gas

By Julian Murdoch

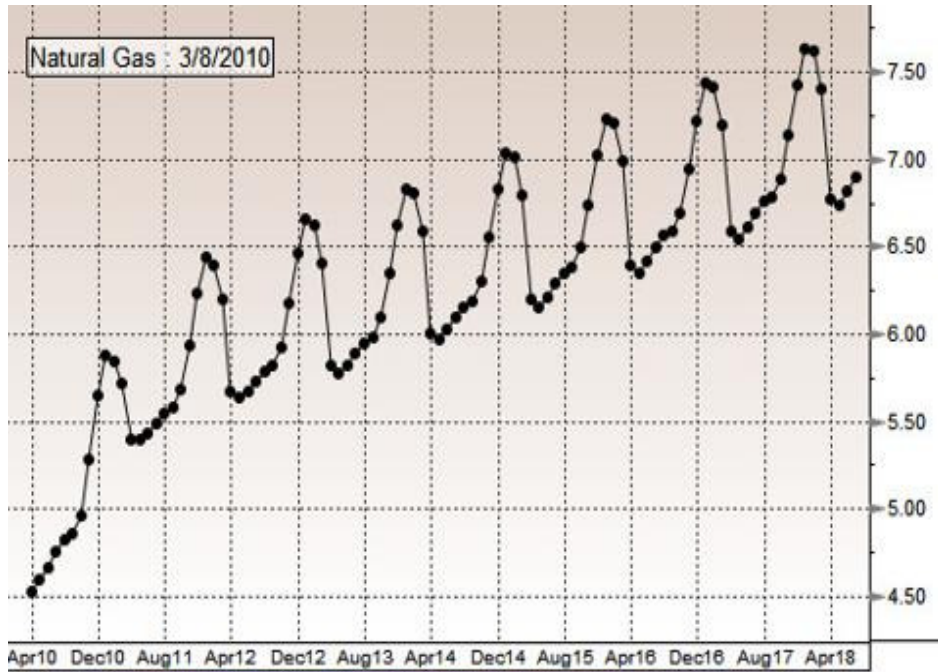
## Is Seasonality Something To Bet On?

Commodity traders love patterns, and over time, natural gas has exhibited one of the asset class's most consistent patterns: seasonality. Frank Holmes pointed this out on a recent article on [U.S. Global Investors' Frank Talk](#) blog:



Data aggregated between 1989 and 2008 reveal that in March, natural gas prices increase, on average, 7 percent over February's levels. On one hand, it makes sense: Toward the end of winter, natural gas inventories have been drawn low, but there's usually at least one or two more big snowstorms remaining in the season helping to jack up prices.

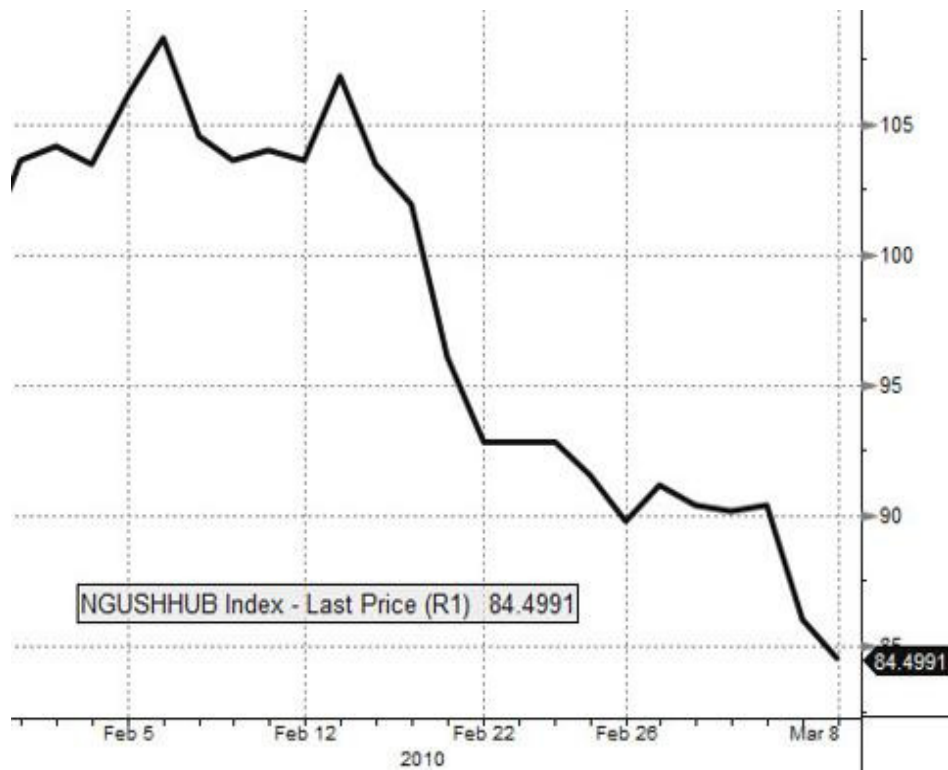
On the other hand, the natural gas futures market doesn't seem to follow the same pattern. In fact, natural gas offers one of the more bizarre contango curves on the market:



This futures curve looks out really long term: over the next 100 contracts. And those peaks are for the January contract, precisely when spot natural gas prices are at their lowest.

Of course, if prices truly followed such a predictable pattern, we could all pack up and go home—but it just doesn't work that way in real life. This year, the tail end of winter has been pretty dismal so far for natural gas (although those of us with spring fever may love the warm temps):

### Henry Hub Natural Gas Spot Prices



Despite severe storms in the Northeast late last month, demand remains weak, and the EIA [recently reported](#) that less natural gas is being withdrawn from storage than usual.

But over the past year, the weather hasn't been the only thing costing natural gas investors money. Enter contango.

### Feeling Contango's Bite

Regular readers will remember that contango refers to the condition when a futures contract costs more at a later date than it does presently. This means higher costs during "rollover," or when investors sell out of the current month's contract ahead of its expiration and buy the next available month.

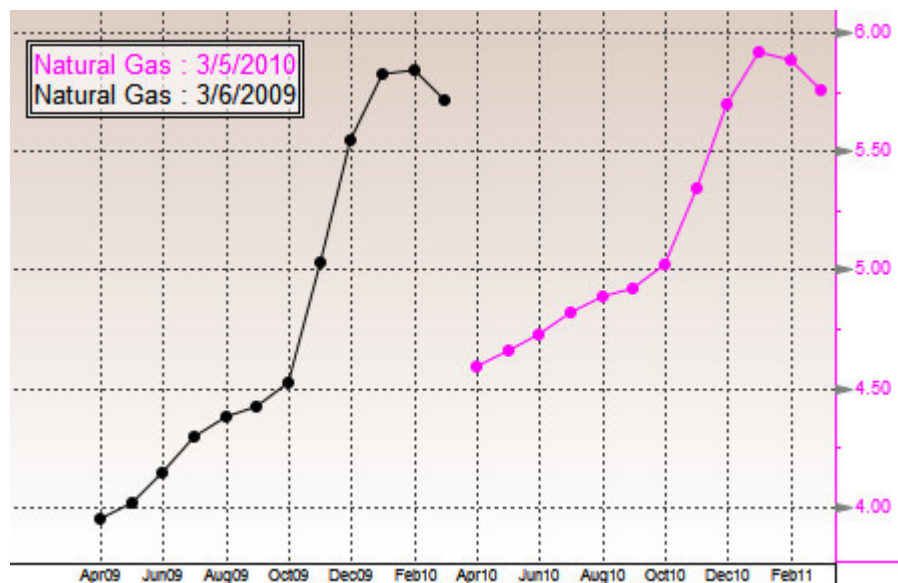
Unfortunately, certain futures-based funds that hold only one month's contract at a time, like the U.S. Natural Gas Fund (NYSE Arca: UNG), get slammed during rollover during times of contango. A steep contango curve can quickly eat away any profits that might be made on rising prices.

For example, let's imagine you'd invested in natural gas via both spot prices (the Henry Hub spot price) and futures contracts ([UNG](#)) back in March of 2009:



In that span of the last year, if you could have somehow invested in the Henry Hub spot price, you'd have actually made a little over 2 percent. But since that would mean you'd need to take delivery of physical goods, and you can't exactly back up your tanker in Nebraska, your only real play was UNG (let's ignore UNG's 12-month cousin, the U.S. 12-Month Natural Gas Fund (NYSE Arca: UNL), since it only launched in late November). If you'd invested in UNG, you'd be down over 50 percent for the year—almost entirely due to contango's effects.

The way things stand right now, UNG investors will still lose money at nearly that rate:



When compared side-by-side, the natural gas contango curves for last year and this year look remarkably similar. And while the contango we are currently experiencing isn't quite as steep as it was this time last year, it is still pretty daunting.

### **More Supply, Less Contango?**

Still, contango is easing and current prices are falling, and one reason may be tied to a growing supply. For starters, the [number of active natural gas rigs is rising](#), with 926 rigs currently drilling. While this is 42 percent off of the record of 1,606 rigs set in September 2008, it is the highest level seen since February of last year.

Although this additional source of supply won't immediately impact the price of natural gas—the rigs take time to ramp up and send product down the pipeline - it does indicate that more natural gas is on the way. And so are more rigs. In a recent [Edmonton Journal article](#), author Peter Tertzakian notes that exploration and drilling in big shale areas continued even during the economic downturn. Therefore, more supply is coming, a fact that the market may already be taking into account:

"Long-dated prices for natural gas—prices being paid for delivery one-year out and beyond—have fallen by over \$1.00/MMBtu (about -15%) in the past six months, with most of the drop being recorded in the last few weeks. Clearly the market is expecting more cheap gas to come to market next year and beyond."

All in all, this doesn't bode well for natural gas—or its investors.