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HD **Investors anticipating energy downgrades**

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Expectations that the Australian sharemarket would see sustained strength on the back of an improving outlook for the global economy proved a bit too optimistic this week.

The market barely stayed positive as commodity prices suffered from oversupply worries and the Australian dollar resumed its slide amid a growing probability that deteriorating commodity prices will **lead** to interest rate cuts.

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Expectations of an interest-rate cut next August rose to 60 per cent yesterday, based on overnight indexed swaps. And the three-year bond yield fell to 2.39 per cent versus the 2.5 per cent cash rate.

While offshore markets surged as **China** cut interest rates and Europe vowed to fight deflation by printing money to buy financial assets, Australia's S&P/ASX 200 only managed a slight gain as spot **iron ore** hit a 5½-year low, and crude **oil** dived as much as 12 per cent.

Economic stimulus measures in **China**, Europe and Japan, together with lower **oil** prices and a weaker exchange rate and lower interest rates may eventually improve the earnings outlook for many Australian companies, but the market may be at risk of another down leg.

One thing is clear — consensus **oil** price forecasts are too high. The consensus forecast for Brent crude is at least $US92 a barrel next year, according to Bloomberg data, yet the commodity dove to $US72.58 after OPEC refused to cut production this week.

That means earnings estimates for Australian **oil** and gas producers are also too high.

The market was busy anticipating downgrades yesterday, with the **energy** sector falling 7.6 per cent versus a 1.6 per cent fall in the benchmark S&P/ASX 200 index. The viability of the massive Gladstone liquefied natural gas projects was increasingly coming into question, with Origin **Energy** down 7 per cent and Santos plunging 13 per cent yesterday.

Santos indicated this week it's considering a 50 per cent **equity**-credit European hybrid capital raising to shore up its balance sheet before the projected start of output from its $21.8 **billion** LNG plant in the second half of 2015. Rival Origin **Energy** raised $1.2bn in a similar issue in September.

At the rate the **energy** sector is falling, it may be ready for a bounce by the time the analysts slash their **oil** price forecasts and subsequently lower their **energy company** earnings estimates.

Of course, crude **oil** could stay under pressure until the higher cost producers are squeezed out of the market, or OPEC cuts production, but it doesn't meet again until June.

Brent crude has potentially major Fibonacci retracement support near Thursday's low at $US71.12.

It could spike down to $US68.15 and still regain the retracement support on a closing basis. But a sustained break would leave no strong chart support until the global financial crisis low of $US36.20. If crude **oil** continues to decline, it will increase pressure on other commodity prices.

It's true the strongest correlations occur when global demand expectations change, and the prevailing view is that the US is taking up the slack from slowing growth in Europe, Japan and Asia, and that stimulus in those areas will offset reduced stimulus in the US.But commodities and commodity currencies usually follow the same path, and **iron ore** and **oil** could well **lead** other commodities and the dollar lower.

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