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Six Voices on What's Going on in Oil ETF Engulfed by Blowup

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(Bloomberg) -- The suspension of new share issuance by the biggest exchange traded fund tracking oil is adding layers of complexity to what was once a simple bet on the crude market.

Investors buying the United States Oil Fund right now aren't just contending with supply and demand dynamics in oil, they're navigating wrinkles in the mind-bogglingly complex mechanics that underlie ETFs. Those proccesses are usually invisible to the public and when shaken can have dangerous real-world consequences.

Several things are complicating matters right now. Among them are massive inflows to the oil fund at a time when it has run out of capacity to issue new shares to meet investor demand. Another factor is the fund's link to futures markets where costs associated with storing abundant oil has been distorting prices. Here are six analysts on what it all means to the price of USO, as the ETF is known, and the price of oil.

Benn Eifert, chief investment officer at QVR Advisors:

USO is at risk of coming untethered from investor expectations about oil prices in ways that hearkens to past dislocations in ETFs, most memorably those linked to stock volatility in 2012, Eifert says. In those cases, retail investors eager to make bearish bets against rallying equities bought notes linked to the VIX without fully understanding how they interacted with futures markets, particularly the cost of rolling ownership from one contract to another.

"The same thing is happening here, with the difference that oil is extremely low and VIX wasn't necessarily extremely low back then. There's a huge cost of carry in the front of the curve and the average Robinhood USO buyer and USO call buyer doesn't know that, doesn't understand that, or doesn't care, and thinks they're just buying oil at a low price."

Dave Lutz, macro strategist at JonesTrading:

"Retail investors should have a way to trade the price of oil, but USO has such problems with the roll effect that I'm not sure that's the best vehicle. Problem is, it's really the only one," he said. In addition, "the fact that creations are suspended means that this is no longer going to track properly."

Joseph Saluzzi, Themis Trading LLC partner and co-head of equity trading:

"Some ETFs are not exactly what you think they are -- the rule for any investor is to know what you own. Some folks may have thought that USO was simply a proxy for the current oil price, and they didn't really understand the mechanics of the oil futures market."

Matt Maley, equity strategist at Miller Tabak + Co.:

“There is no question that this is a tool for investors of all sizes to bet on the price of oil. Many of these investors -- again, of all sizes -- have tried to pick the bottom in oil several times over the past week or two and they’ve all gotten burned. This has caused these buyers on weakness to become forced sellers. When the dust settles, it’s going to create an unbelievable opportunity for buyers. Until we get a better feeling of when the demand side of the supply/demand equation is going to improve, it tells me that the risks are still much too high compared to the potential rewards,” said Maley. “I worry that it’s going to have a negative impact on liquidity in the oil markets, and thus have a negative impact on confidence in that market.”

Jeremy Senderowicz, a partner at law firm Dechert:

“Once creations are suspended then the arbitrage process cannot work as normal, as new shares cannot be created to meet increased demand,” he said. “The 8-K says they are suspending creations because they’ve used up all the shares they’ve registered (they filed yesterday to register more shares but the SEC needs to declare it effective and they haven’t done so yet). That indicates that demand for the shares was quite high. If that demand continues, then until new shares can be created you can fill in the blank as to what might happen in trading…(which may be why they had the trading halt). That seems like the big takeaway to me.”

Dan Genter, CEO of RNC Genter Capital Management:

“The ETFs that are dealing with the contracts in the commodities are never going to take physical delivery, they can’t take it. There’s not a doubt the oil ETFs distorted the market. It was across the board but the ETFs, in our opinion, were the biggest problem,” he said. “The panic is because there are people invested in that commodity and in the contracts that not only have no intention of taking delivery, they have no capacity for taking delivery. All of a sudden, you’re up against a wall. They call it a contract for a reason.”

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