

Japanese Candlesticks Can Help Cut the Airlines' Jet Fuel Cost

There are fewer things more uncomfortable than being caught between a rock and a hard place. That's exactly the situation in which the airlines find themselves today: they are unable to raise fares sufficiently to recover the increased cost of jet fuel, because the market rebels, while at the same time most of them have limited ability to control their price they pay for fuel delivered into the wing tank.

In the past, a few of the airlines had engaged in a "hedging" program, by which they locked up future costs by entering into long-term delivery contracts for fuel; but over time, those programs have been expiring and therefore the leverage is being gradually lost. Some of the airlines never engaged in such programs at all, and were satisfied just to pay for fuel at the current price upon delivery into the airplane.

There ought to be more to a hedging program than that. The term can also be deemed to include an active program of investing in the futures markets, betting on future rises and falls in the price of the product.

Here's one example of actions which the airlines could have taken, if they had made use of this device. We will use "heating oil" as the basis for comparison, since that product is very close to jet fuel in its composition. In January a year ago (2007), prices of heating oil hit a low of just under \$1.52 per gallon. Following that month of January, it was seen that prices during the month had formed what is called a "Morning Star" pattern in Japanese Candlesticks parlance. That particular pattern forecasts a significant price rise, when it appears after an extended decline in prices. Following the appearance of the Morning Star formation, prices of heating oil rose to about \$3.33 per gallon, whereby the cost of the product had roughly doubled within a year and a quarter. If an airline had bought a contract of heating oil in January 2007, it could have made a profit of about \$76,000 through the middle of April 2008.

Of course, it would have required substantial capital in order to place the trade. Margin requirements have increased, along with the increasing price of the product; and the airlines' cash requirements might have precluded such a transaction. In such a case, that would be unfortunate; since cash on the barrelhead in order to enter into a contract would have resulted in significant profit at a time when airlines' need for the product remains elevated while the cost of the product has risen to levels which the airlines probably never anticipated in their planning.