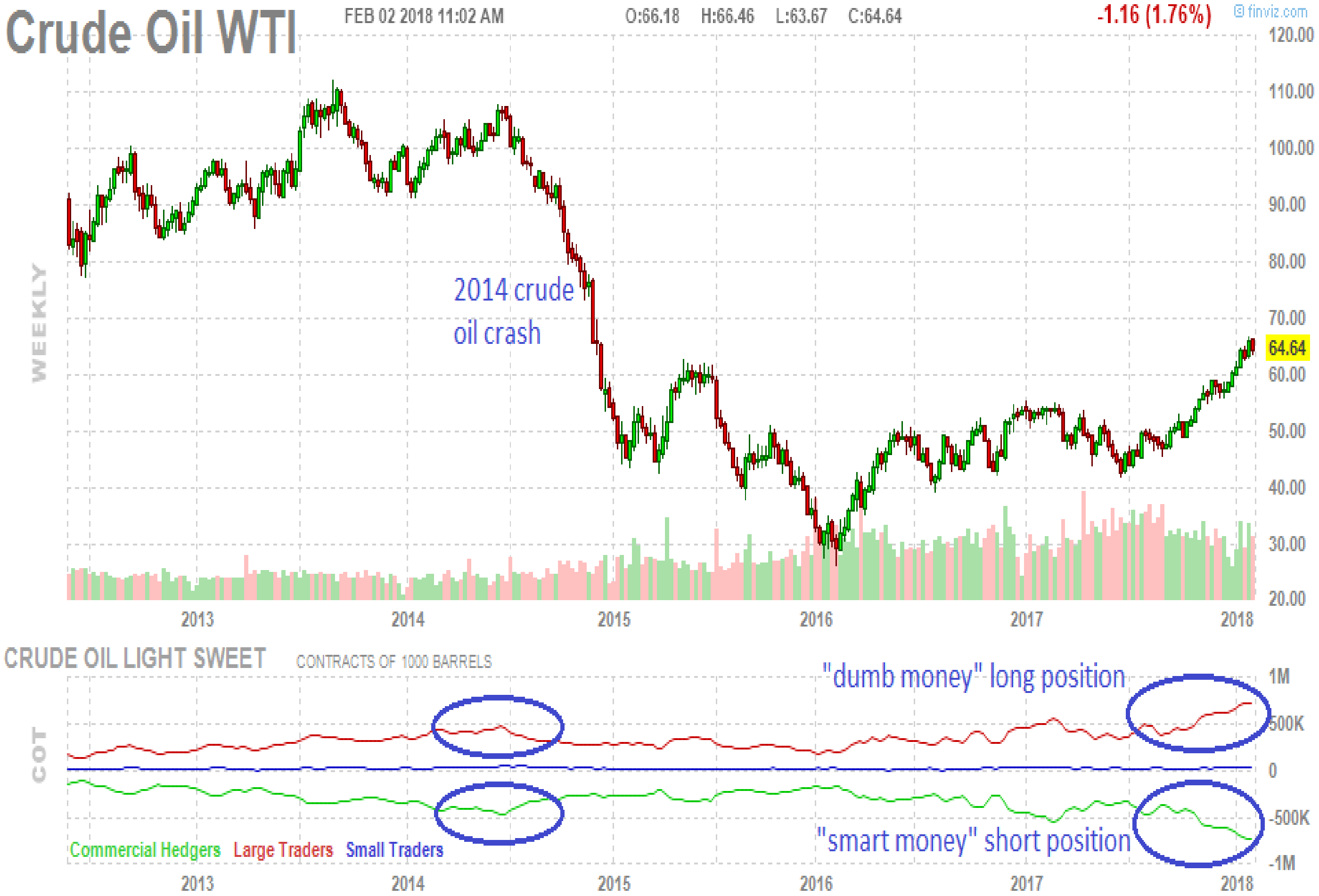
Like many other risk assets, crude oil has been on a tear since the summer and is up by nearly 50 percent. The main reasons for this sharp rally are the weakening U.S. dollar, synchronized global economic growth and optimism, as well as aggressive bullish positioning by large funds. Interestingly, these large funds are considered to be "dumb money" and are typically wrong at major market turning points. While these funds have become ultra bullish on crude oil, the "smart money" or commercial oil futures hedgers have been betting the opposite way and have built their largest bearish crude oil position in history. The West Texas Intermediate crude oil chart below shows how the commodity has been climbing within a channel pattern since September. A breakdown from this channel would be a reason for concern. The chart below the price chart shows the positioning of the "dumb money" versus the "smart money." The "dumb money" have a record bullish position of over 700,000 net futures contracts, while the "smart money" has a record bearish position of over 700,000 net futures contracts.

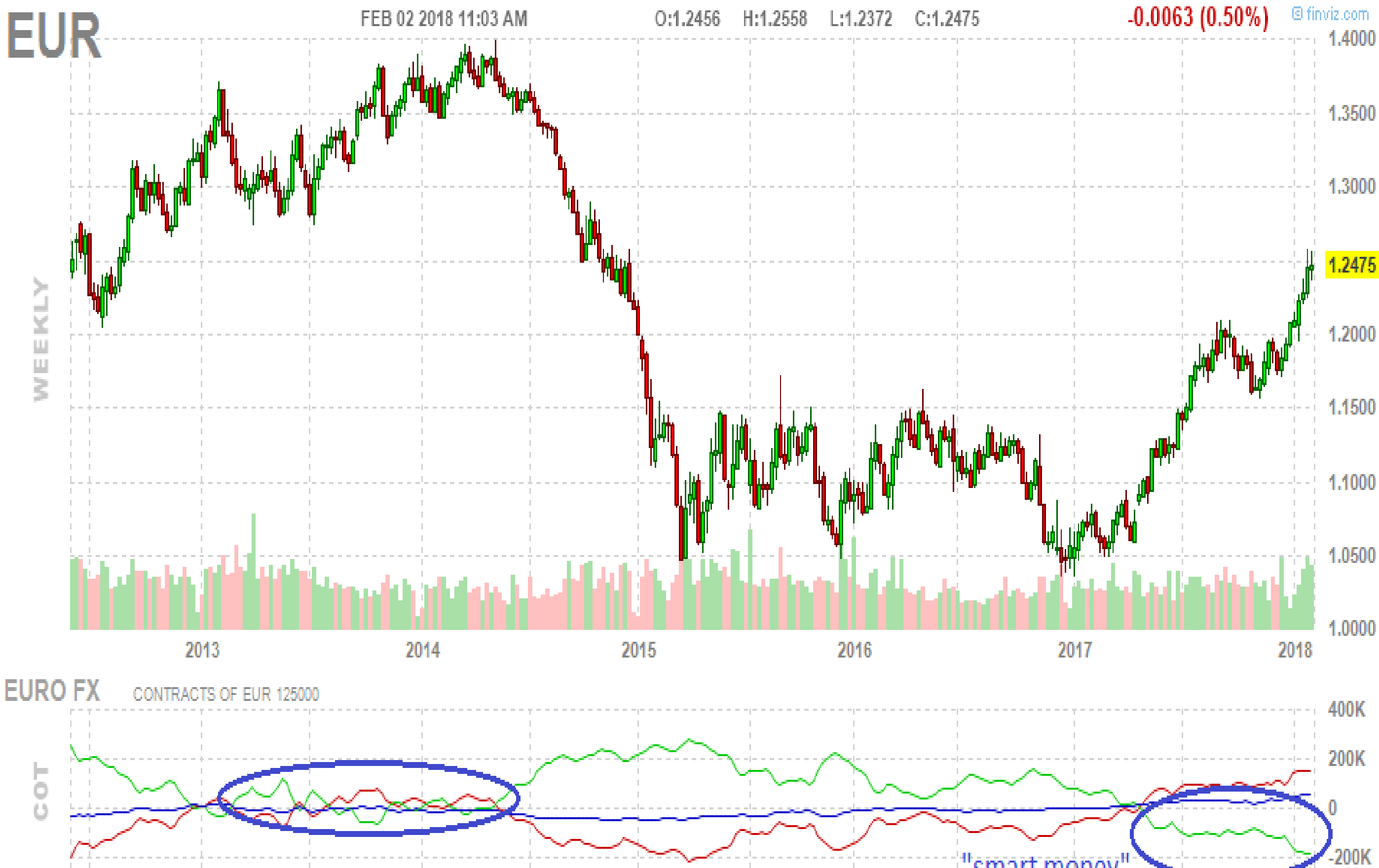
Source: Finviz.com The weekly WTI crude oil chart puts the current "dumb money" and "smart money" positioning into perspective. The 2014 crude oil bust was preceded by similar positioning, but the current position is *even more extreme*.



Source: Finviz.com The long-term WTI crude oil chart shows just how unprecedented the current situation is:

Source: Finviz.com As mentioned earlier, the weakness in the U.S. dollar in the past year has been one of the major drivers of the crude oil rally (the dollar and crude oil trade inversely). The "smart money" has been bullish on the dollar despite its weakness, which means that a rebound is likely in the not-too-distant future. A rebounding U.S. dollar would likely cause a correction in crude oil.

Source: Finviz.com The euro is also worth watching, and is positively correlated with crude oil and inversely correlated with the U.S. dollar. The "smart money" has been building a sizable bearish position in the euro, which increases the chances of a correction in crude oil and the euro, and a rebound in the U.S. dollar.



Source: Finviz.com For now, the trend in crude oil is still up, and we respect the trend. But, when that trend finally rolls over, it could certainly lead to violent action to the downside simply due to the large bullish speculative position that needs to be liquidated - "when everyone gets to one side of the boat, it tips over." Another crude oil bust is a major risk that the economic recovery and bull market faces, and tightening monetary policy may be the catalyst that pushes this market over the edge. As fund manager Jeff Gundlach has said, the Federal Reserve will continue to hike interest rates until "something breaks." Will that "something" be crude oil and the energy sector? There is no guarantee, of course, but that is certainly a major risk scenario that we are looking out for.