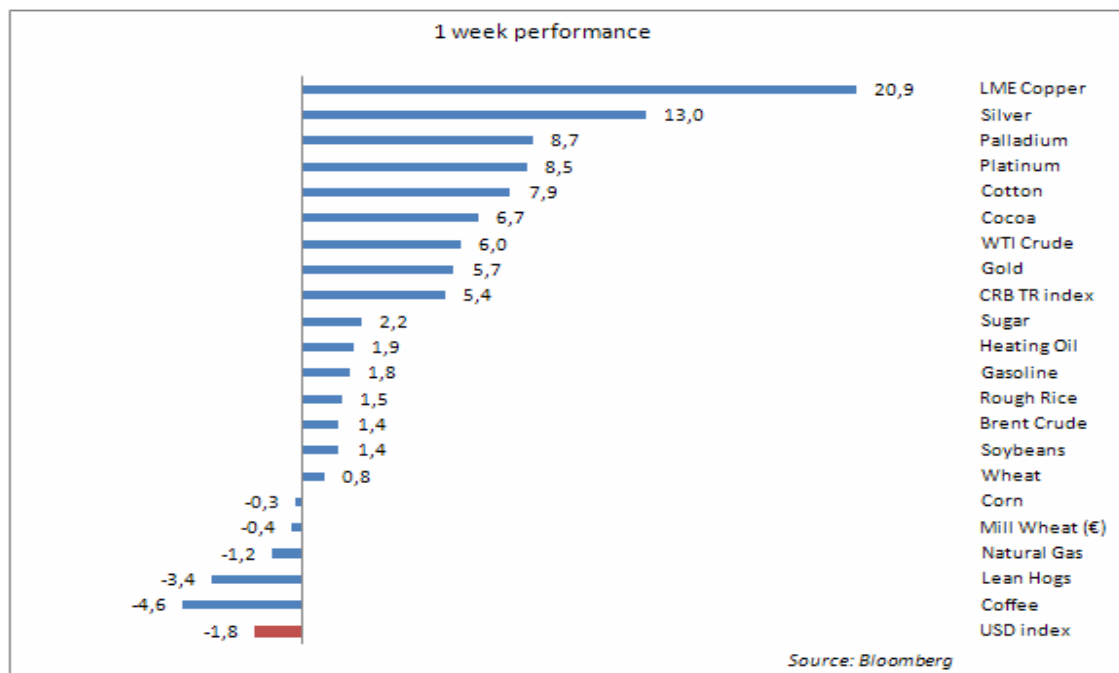


## Commodity relief rally – will it stick?

The news from Europe that its leaders (after two years of turmoil) finally delivered what looks like a useful set of tools to bring the crisis, if not to an end then at least under some sort of control triggered huge rallies across riskier assets. The S&P 500 erased all of its 2011 losses and is now on course for the best monthly performance since 1974. Commodities meanwhile also took another major step away from the lows seen last month with the Reuters Jeffries CRB index surging by 5.5 percent and almost moving into positive territory for the year.

The big question now is whether Europe has done enough in order to bring back investor confidence in the Eurozone or whether, once the dust settles, the market once again comes to the conclusion that the can has once again been kicked further into the long grass. While stock markets rallied Eurozone bond markets seemed less convinced with the 10 year yield on Spanish and Italian bonds falling by much less than what could have been hoped for. These markets will be the focus in the weeks ahead and will determine whether the rally in stocks and commodities will continue.

All in all a good week though, especially for riskier assets which on top of the European result took direction from improved economic data from the US and China which has further reduced the risk of recession. This changed environment forced many investors and funds to re-enter on the long side thereby adding additional upside pressure to the market. According to Barclays, investors globally pulled 10 billion dollars out of commodities during September with speculative investments held by hedge funds through futures and options on U.S. exchanges falling by 44 percent to 900,000 lots. Rebuilding these positions has been felt across all commodities this week, especially in copper, silver and WTI crude.



### Copper goes berserk

The highflier has undoubtedly been copper with its 20 percent rally in just one week, the biggest weekly gain since at least 1986. Much of the recessionary fears during September were expressed through copper after hedge funds turned outright bearish on the metal for the first time since October 2009. The changed environment following better economic data and a weaker dollar triggered a major scramble to cover shorts and rebuild long positions thereby giving prices a dramatic boost. Further support has come from China as demand has returned after imports rose to a 16 month high in September, combined with falling supply due to labour unrest at mines in Peru and Indonesia.

### Iron ore tells a different story

Iron ore however continues to tell a different story after the price has dropped by one third since early September on weakness in global steel markets. Unlike copper Chinese demand for iron ore has been slowing and with miners in Australia and Brazil continuing to produce at full capacity the market has been flooded and prices have suffered as a consequence. Prices are still more than double the big miners' production costs so further losses are likely if demand does not pick up soon.

### U.S. crude gaining on Brent crude

The price of prompt WTI crude has broken above previous resistance after a 21 percent rally since early October. The rally has primarily benefitted the front end of the oil curve with the price of oil for December delivery surging above previous resistance at 91 dollars per barrel. The change in the shape of the forward curve over the last seven days has been quite dramatic resulting in the spread between current month and next month turning positive for the first time since September 2008.



WTI Crude December 2011, Source: Bloomberg

In the process the discount to Brent crude has begun to shrink moving from a recent high of 25 dollars down to 18.50 dollars as the recovery in North Sea production and increase in Libyan crude production continues to ease the tightness seen in European crude markets over the summer.

After the initial spike higher oil prices however failed to move further ahead after the European debt announcement, probably highlighting a belief that much higher prices from here are not supported by fundamentals. WTI crude has now moved from a negative to a neutral stance after the move above 91 and technically could be targeting the 100 to 105 area over the coming weeks although we find limited value above 95 dollars for now.

### Gold broken the 1,700 dollar shackle

Investors in gold finally seem to have recovered from the sharp correction witnessed during September as gold took out resistance at 1,700 dollars before reaching a five-week high. With the safe haven aspect of gold investment currently not the focus it will be difficult to make much further progress beyond 1,772 for now. Not least because strong equity markets and a falling dollar have been the main drivers behind the recent rally and some risk of profit taking in these markets now looks increasingly likely over the coming week.



Spot Gold, Source: Bloomberg

### Silver and platinum back to life as industrial metals shine

Both silver and platinum experienced a reversal of fortunes this week both outperforming gold as they, just like copper, reacted to improved economic data which points toward improved demand for industrial metals. During the last couple of months hedge funds have reduced their long exposure to the lowest level in 30 months and the rebuilding of positions has been a factor behind the rally and further improvements on the economic front are required for the outperformance to continue.

### Thai flood removes global rice glut

The worst flood to hit Thailand in more than 50 years has the potential of wiping out between 15 and 20 percent of the country's main rice harvest, which represents about 70 percent of annual production. The impact on global prices has been felt over the last few weeks especially considering its role as the world's biggest rice exporter. Rice is Asia's leading food crop and the world's most widely consumed staple food and a further deterioration carries the risk of spilling over into higher food inflation at a time where inflation had just begun to come under control among emerging economies.

Earlier this month the United States Department of Agriculture projected a global rice surplus of nearly 4 million tonnes but the flood now carries the risk of removing this glut thereby adding to the upside pressure on prices. US production was already suffering after farmers had a torrid summer with an early flood being followed by a drought, thereby reducing the crop by almost one third.

All however is not lost as Thailand could replant once the flood recedes and India could ramp up its rice exports. But until further news about potential crop destruction reaches us the price of rough rice for January delivery, traded in Chicago, carries the risk of moving higher as it prices in this increased uncertainty.

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