

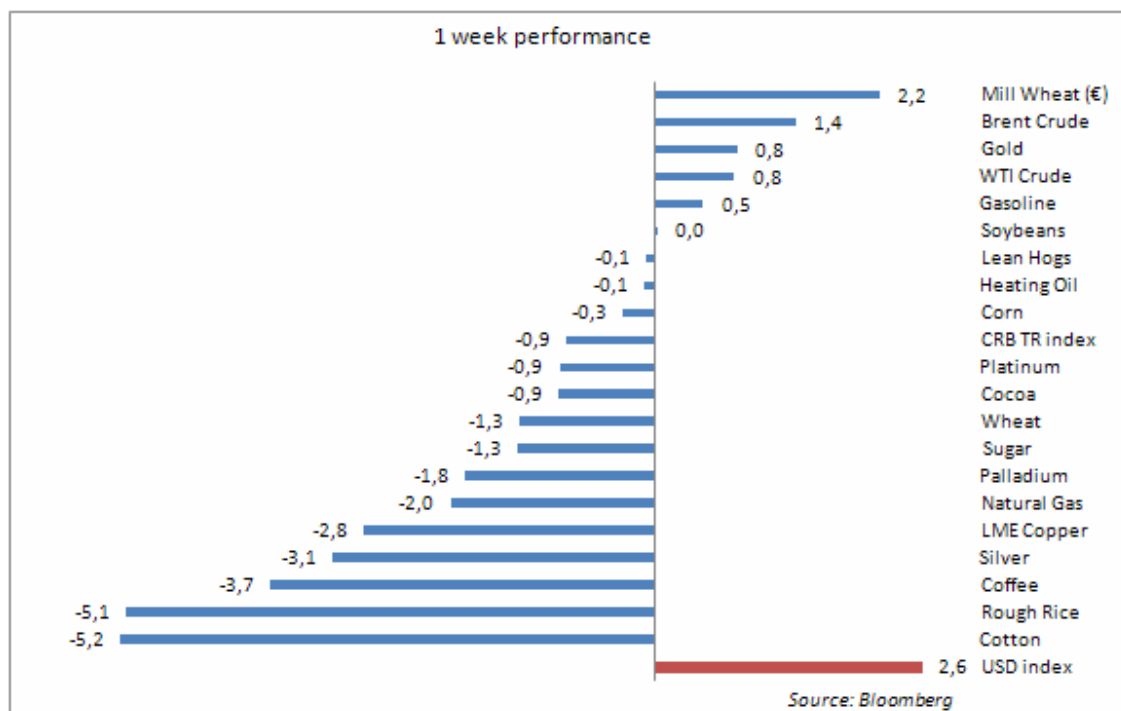
Gold regaining safe haven status

The political shenanigans played out by the Greek Prime Minister this week renewed worries about the health of the European financial system. Mr. Papandreou initially called for a referendum which could have led to Greece rejecting the debt plan agreed to just a few days ago. This could have triggered an unruly default which would have had serious consequences for the Euro area and beyond.

In the end the referendum was scrapped after other European leaders in no uncertain terms told Greece that it was not going to get any more money if the referendum passed and it would effectively amount to a decision on whether Greece would remain in the Euro zone.

In a spectacular resemblance to 2008 the European Central Bank under the new President Draghi slashed official rates by one quarter of a percent, just a few short months after having raised them. All previous rate changes in the ECB's twelve-year history have all been "pre-announced" while this one came out of the blue highlighting the worries about downside risks to growth, which are now taking hold within the region.

Traders across all asset classes struggled to make heads or tails of all the headlines and events of the week with volatility staying at elevated levels making trading increasingly difficult. The decision to scrap the Greek referendum, the ongoing G20 meeting and the ECB rate cut however all helped risk sentiment ahead of the weekend with stocks and commodities winning back some of what was lost earlier.



Against this backdrop commodities gave back some of the gains from the previous couple of weeks with the Reuters Jeffries CRB index losing 0.9 percent. The dollar recovered sharply as euphoria turned to despair thereby removing the support commodities normally receive from this adverse relation. The soft sector, especially cotton, sugar and coffee, was knocked back while gold having fully recovered from the September onslaught regained some of its safe haven status, while some geopolitical tension supported oil.

Gold receives fundamental and technical boost

Gold received a boost from renewed worries about the stability of the Eurozone and the Euro. Some analysts raised the possibility that the European Central Bank, much against the wish of some of its members, could begin some sort of quantitative easing in order to help pull the Eurozone out of the deep freezer. Real bond yields (adjusted for inflation) remain negative in more than half of the G20 nations thereby supporting non interest/dividend paying assets like gold.

Having spent the last month recovering from the sell-off during September this week saw a move back above 1,700 dollars which pleased both technical and fundamental traders with most now believing the worst is behind us. During the previous two major corrections since 2008 it took 6 1/2 and 5 months respectively to climb back to a new high. Considering the latest correction was the greatest of the three we would therefore be surprised to see a new high before year end. Further consolidation seems to be in order ahead of our year-end target of 1,900 with gold already showing an impressive 24 percent return on the year.



Spot gold, source Bloomberg

Crude oil consolidating above 90 dollars

The price of WTI crude oil reached the highest level in three months as it managed to hold onto recent gains above 90 dollars despite the strengthening dollar and renewed worries about Europe. The discount to Brent crude has stabilised around 17 dollars from an October peak above 25 dollars as the tightness in the European market continues to ease. Fundamentally we do not see

much value above current levels given the uncertain economic climate but with speculative longs back to the highest level since June the completion of a technical move towards the 100-105 dollar area on WTI cannot be ruled out while a close below 90 dollars would signal consolidation in between 85 and 95 dollars.

Iran posing a geopolitical risk

With the Libyan conflict over attention has turned back to Iran and its nuclear programme with Israel and US rhetoric rising ahead of a report next week from the International Atomic Energy Agency. Talks about a pre-emptive strike against its nuclear installations are being voiced again by Israel on concerns that Iran's nuclear programme is aimed at developing nuclear weapons, something that Tehran has denied. If the report from the IAEA should conclude that Iran is working on developing weapons the risk of an attack would increase thereby raising the potential for a spike in oil prices.

Natural gas is one mild winter away from further declines

The price of US produced natural gas remains stuck near the lowest levels in nine years as the inventory levels ahead of the winter withdrawal season are close to last year's record. The revolution in shale gas extraction which the market has witnessed over the last few years has increased production and lead to a year long decline in prices. Shale gas is natural gas that is trapped within shale formations and the US Energy Information Administration predicts that production will continue to grow over the coming decades.

With production continuing to increase demand will have to follow suit in order to avoid further price declines. Price bulls will therefore have to bet on a pick-up in industrial use combined with colder than expected weather in the coming winter in order to see higher prices. The chart below shows the average price over the next twelve months is trading near the October 2010 lows and could become entrenched unless the above mentioned demand picks up.



NatGas 12 month strip, Source: Bloomberg

Global food prices eased further during October

Agricultural commodity prices continued the month-long decline in October with the UN FAO World Food Price Index falling 4 percent to an 11-month low, with the year on year change now running at 5.5 percent. The decline due to farmers having reacted to higher prices by increasing production and economic uncertainty is a welcome boost to emerging economies which have been struggling with high inflation, not least due to elevated food prices.

High prices still seen ahead

The decline which took the index down by 9 percent from the February high reflected sharp decreases in international prices of all the commodities included in the index, especially Oils and Fats due to ample supply from the respective growing regions of soybeans, palm oil and sunflower seeds. The FAO sees continued strong underlying demand with prices expected to remain high while next year's production will have to increase in order to meet expected demand. Risk to production comes from adverse weather, higher cost of energy and fertilisers and access to loans.

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