

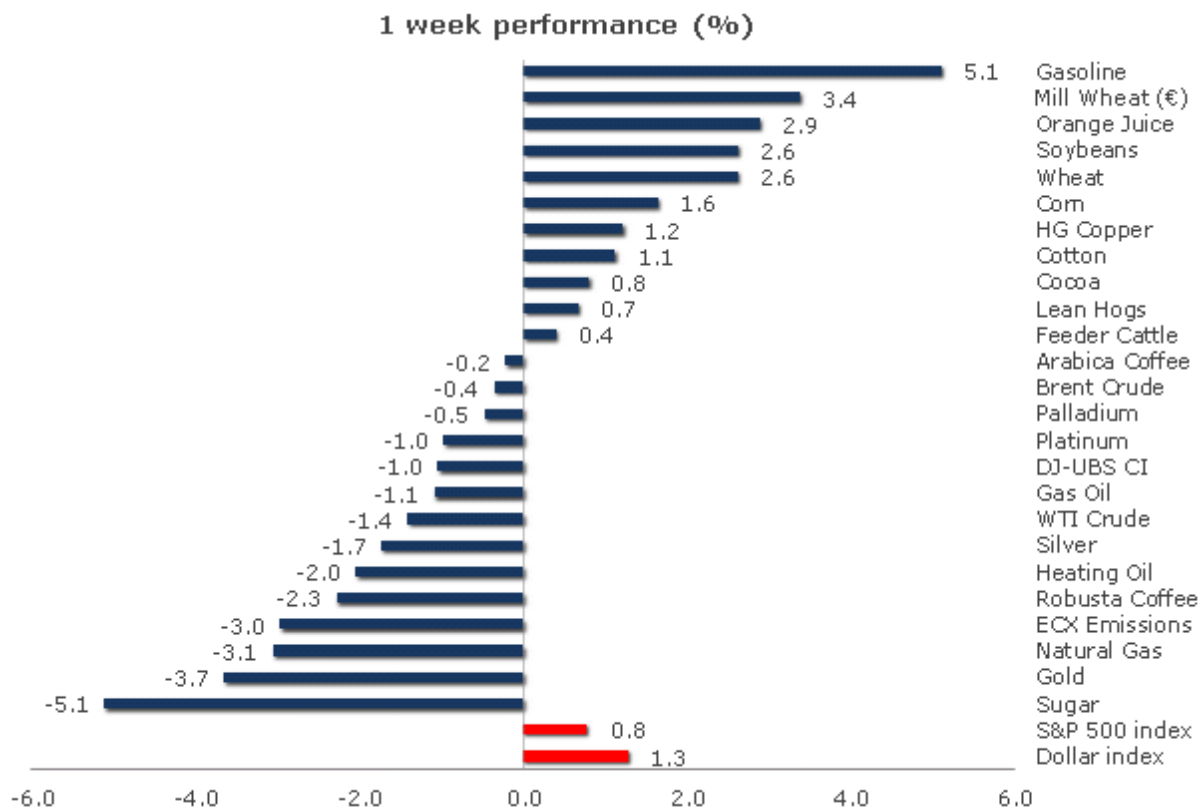
Sharp correction hits gold, oil soldiers on

Ole S. Hansen, Head of Commodity Strategy

A mixed week for commodities where the markets were driven by another injection of cheap money from the European Central Bank, upbeat economic outlook comments from the Federal Reserve Chairman and continued geopolitical tensions. Stock markets rose again with the S&P 500 reaching the highest level since 2008 and the Nasdaq 100, heavy on technology stocks, reaching the highest level since 2000.

Next week elections in Russia and Iran, Chinas national congress meeting to prepare for new leadership, seven central bank meetings and US employment data will be watched closely by commodity traders. Furthermore, should the recent spike in US retail gasoline prices continue an announcement soon concerning the release of strategic reserves cannot be ruled out.

The DJ-UBS index lost one percent on the week as gains in many agricultural commodities and the above mentioned gasoline price developments were off-set by corrections among some of the index heavy constituents, such as crude oil and gold. The dollar ended higher following the allocation of EUR 530 billion by the ECB on the assumption this would be the last central bank induced sugar rush for a while.



Silver rollercoaster tests investors' resolve

The silver bull carriage almost left the station on Wednesday when multiple technical bullish signals triggered a strong rally once 35.70 was broken. The break had investors piling in and before long a near-term target of 37.30 was reached and breached. What followed Thursday after Fed Chairman Bernanke failed to signal further quantitative easing sent the market into a flux as it dropped by 9 percent in just two hours. The sell-off was exacerbated as many new short-term tactical long positions had been initiated within the previous 24 hours and it now leaves many scratching their heads wondering what kind of foundation the rally had been built upon, apart from technical.

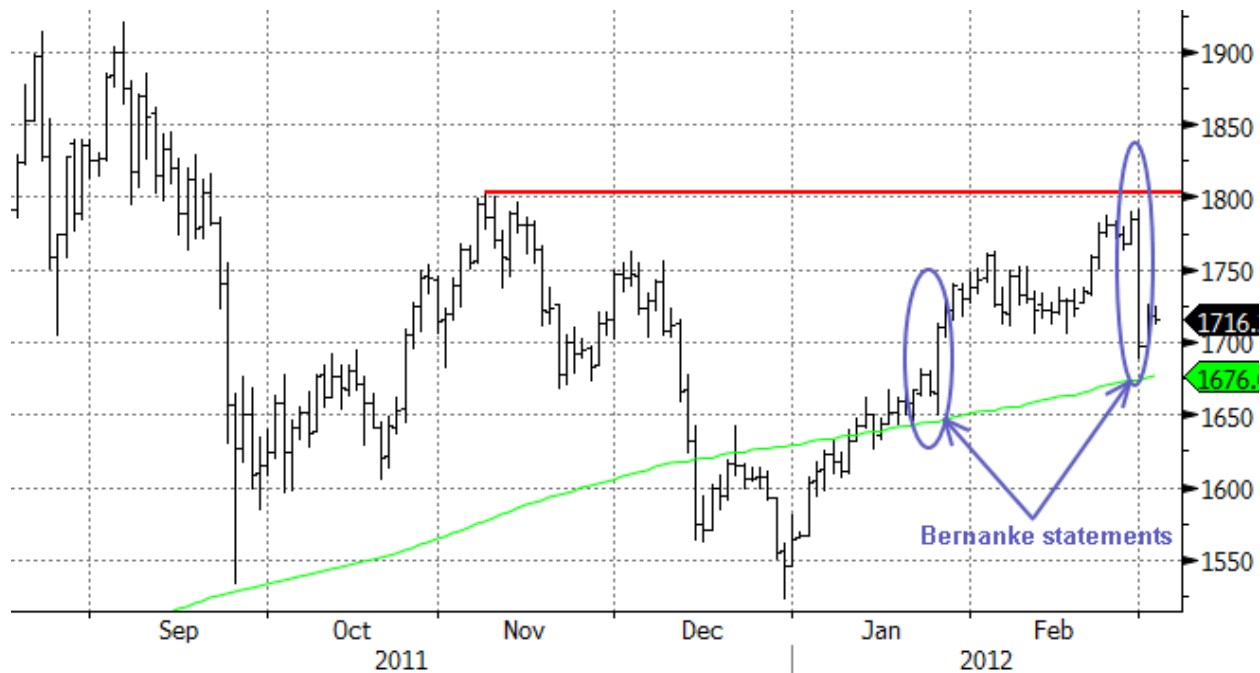


Spot Silver – Source: Bloomberg

However on a relative basis to gold silver continues to do well with the price of one ounce of gold reaching a low of 48.5 ounces of silver after having been trading in a 50 to 55 ounce range during the last five months. The dramatic sell-off once again shows the vulnerability of silver, given its relative low level of liquidity, especially during times of adversity. The uptrend from the December low is still intact and a close back above 35.70 will remove some of the nervousness that has resurfaced.

Gold correcting following failure to break 1,800

Just like silver investors, gold investors also got caught out by the relative upbeat comments from Bernanke which caused some revisions to previous expectations about low interest rates until 2014. It was the introduction of this forecast by the Federal Reserve on January 25 that triggered an upward shift in gold back above 1,700 and which saw money managers slowly beginning to engage.



Spot Gold – Source: Bloomberg

The 100+ dollar drop, the largest daily percentage loss since 2008, has just like silver dented investor belief in another strong year for precious metals and some consolidation can now be expected with the near-term risk pointing towards a recheck of the 200-day moving average, currently at 1,676 on spot gold. All new positions that were initiated during the last month are currently under water and this represents the biggest risk to prices near term as further weakness could trigger additional long liquidation.

On a positive note, investments in exchange-traded products have risen to a new record of 2,404 metric tonnes according to Bloomberg, indicating that long-term and retail investors still have not dropped their love affairs with gold. Whether hedge funds and other large tactical investors have been put off by this move remains to be seen. You can follow these investors' speculative positioning across all major US traded commodities in my weekly CFTC update, published every Monday with data from the previous Tuesday on www.tradingfloor.com/blogs/cftcs. Another factor that could help support prices would be the re-emergence of physical demand which has helped cushion previous sell-offs and which has been mostly absent during the recent rally.

Crude oil reaching 2008 levels

Crude oil traders began the week booking some profits following the strongest monthly performance since February 2011. The fear of supply disruption and continued strong demand from emerging economies and not least financial speculation has kept the price of Brent crude elevated above 120 dollars per barrel for a couple of weeks now. Just how big the fear is was seen Thursday when an *Iranian* report about a pipeline explosion in Saudi Arabia, later denied, caused a five percent spike to 128.40, the highest level since August 2008. If the report was deliberately planted by Iran in order to achieve even higher prices to compensate for lost exports they initially succeeded in taking advantage of the heightened nervousness.

The above mentioned profit taking prior to the new spike was also driven by increased attention to the potential economic impact of ever higher oil prices. In the US politicians are becoming increasingly vocal in calling for the release of strategic reserves following a 16.5 percent spike higher in retail gasoline prices since mid-December. The average price currently stands at USD 3.74 per gallon, the highest price on record for this time of year and with the switch towards more expensive summer blends in March and April US motorists could be facing record prices this summer just as the campaign for the Presidential election kicks off.



Brent Crude front month continuation – Source: Bloomberg

A golden moment in crude oil?

Money managers have further increased speculative long positions during the week, accordingly to our calculations. The combined speculative long in Brent and WTI crude is now approaching 450 million barrels and the risk of a sharp correction, just like the one that hit gold and silver this week, has thereby further increased. It would however require a change in the perception of the risk associated with the situation surrounding Iran before such an event occurs. Investors will probably be able to cope with a correction to 119 without reducing exposure while a deeper correction could trigger a rout. For the week ahead we expect that Brent crude will stay within its established range - a band between 119 and 121 - providing support while 128 will provide resistance.

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