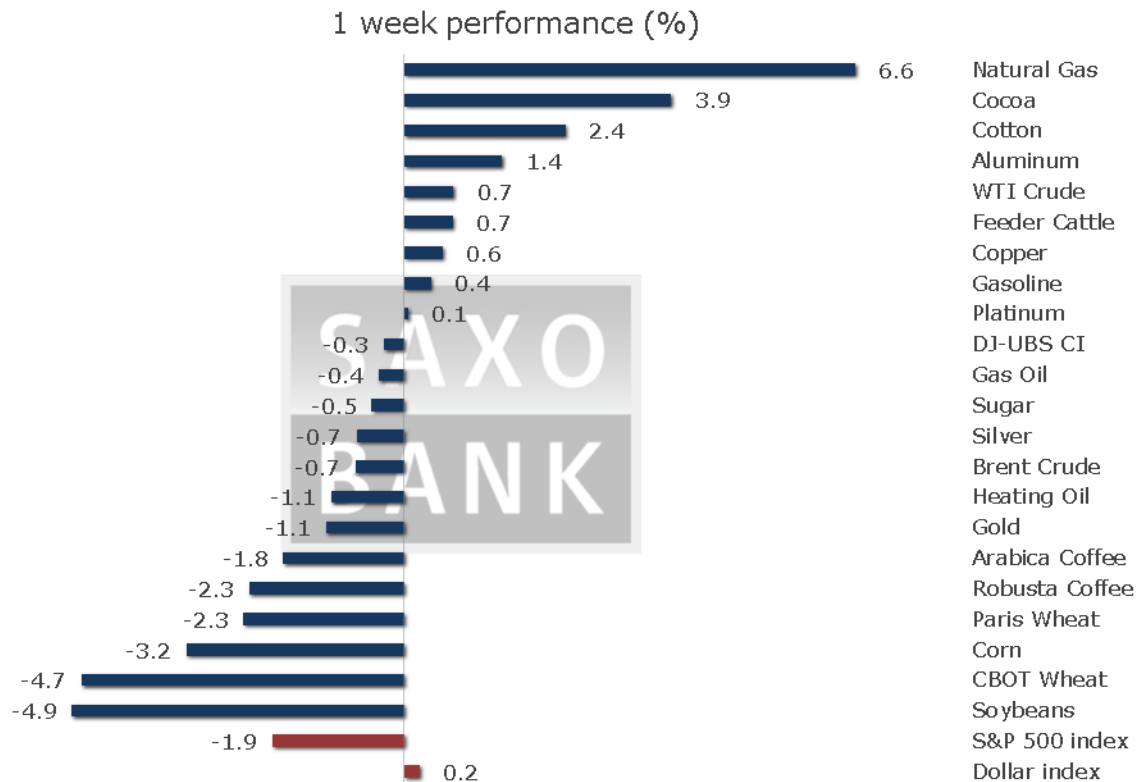


Brent hovers, gas spikes, copper stabilizes and palladium shines

Risk adversity caused by worries about the outlook for global economic growth continues to set the agenda for most financial markets. On-going concerns about the US President's ability to reach an agreement with Congress on how to avoid the now famous fiscal cliff are very much in focus. If this issue is not resolved before the January 1 deadline it could trigger a return to recession - not only in the US but across the world. During the past week the S&P 500 index dropped to a three-month low and the dollar rose against an index of currencies.

These market movements created a lot of headwind for commodities with only a handful managing a positive return during the past week. As a result, the DJ-UBS index keeps hovering near a four-month low with the agriculture sector, especially grains, continuing to show weakness. The energy and industrial metals sectors showed small gains primarily driven by natural gas and aluminium respectively.



Source: Bloomberg and Saxo Bank Strategy & Research

Brent Crude stuck between Mideast tension and risk-off

Middle East tensions briefly gave crude oil a lift this week but overall the focus remains on the weak economic outlook and general risk adversity that is currently driving most asset classes. As a result Brent crude continues to trade in its now well established range between 105 and 112 USD/barrel, the latter being the 200 DMA. Likewise, we see WTI crude trading around 85 USD/barrel hovering just a few dollars above levels where new extraction techniques begin to make less sense from a profitability point of view.



Brent Crude Oil, first month cont. – Source: Saxo Bank

The International Energy Agency's latest World Energy Outlook triggered some headlines by its bold prediction that the US, due to the shale oil revolution, would overtake Saudi Arabia and Russia to become the world's largest global oil producer before the end of this decade. But as mentioned above, shale oil extraction comes with a much higher price tag than Saudi oil. High oil prices will be required to make shale oil extraction both profitable and expanding. Only then can the prediction come true. In the same report the IEA also lowered its 2012 demand forecast as weak global economic activity combined with the impact of hurricane Sandy will weigh on US consumption.

Natural gas spikes as withdrawal season begins early

US Natural Gas was another strongly performing commodity. It rallied particularly before the weekly inventory data from the Energy Information Administration (EIA) which showed the first decline of the season as below-normal temperatures have increased demand. The withdrawal of 18 billion cubic feet from underground storage was the earliest seasonal decline since 2007 compared with a five-year average injection of 17 billion cubic feet for this particular week.

Forecasters are expecting the coming US winter to be colder than last year, which should help support prices as stockpiles will be reduced, especially during January and February when gas consumption for heating peaks. That said, the price will likely remain within a USD 3.5 to USD 4.25 range as coal to gas switching would be negatively impacted above USD 4.25 because natural gas needs to remain competitive against US coal. Last winter was the fourth warmest on record and it helped trigger the collapse in natural gas prices earlier this year as inventories were not withdrawn at the normal speed. This raised worries that maximum storage capacity would be breached during this year's injection season from April to November. As we all know, this did not materialise as an unprecedented switch from coal to natural gas helped stabilize prices and inventory levels.

Inadvertently, this switch from dirty to cleaner fuel has made the US the 2012 global champion of reducing carbon emissions. The EIA estimates that this year's expected CO₂ emissions will drop to the lowest level in 20 years and will be 14 percent below their 2007 peak. Natural gas emits less than half the carbon per energy unit than coal and the reduction in the use of coal has been unprecedented.

Gold and silver up against a stronger dollar

The strong rally following the US election ran has run out of steam as both metals looks for a driver to move the price forward. Until a driver emerges, they are both back to being just another risky asset taking direction from weaker equity markets and a dollar which rose to a ten-week high against a basket of currencies. ETF investors are undeterred by these current headwinds and have now taken their total gold holding to a new record of 2600 metric tons (Bloomberg). Leveraged investors continues to sit on the fence waiting for a clearer picture to emerge but will undoubtedly be keeping a close eye on the market impact of a break out of the current range between 1700 and 1740 USD/oz.

Copper stabilizing on China outlook

The once-in-a-decade handover of power in China occurred this past week and with a new leader and a new Politburo in place expectations have been raised that additional stimulus could be announced thereby supporting demand from the world's biggest consumer of copper. A recent improvement in economic data out of China together with speculation that Japan could be considering further means of stimulating its ailing economy also helped copper to halt its six-week slide. Whether this recent price action is a sign that we have reached a turning point is still too early to say but traders will be keeping an eye on trend line support at 3.40 USD/lb. which stands in the way for further losses while a move above 3.51 USD/lb. will further help sentiment.



High Grade Copper, first month – Source: Saxo Bank

Cocoa spikes on Ivory Coast trouble

Cocoa is another top performing commodity despite hitting some profit taking towards the end of the week. Two pieces of news have been supporting the bean. Initially the price began to recover following reports that cocoa grinders have increased production by the largest amount in two years to meet record demand for chocolate, especially from developing nations. Reduced supply from West Africa could lead to the first shortage of beans in three years. The rally gathered pace on Wednesday when it jumped by 70 dollars to 2457 USD/MT after the President of the Ivory Coast dissolved the government after it rejected a bill proposing that woman would have the same rights as men to head a family.

This once again highlights the volatile political state of the Ivory Coast, which continues to be the world's biggest and most important supplier of cocoa and currently accounts for 37 percent of global supply. A civil war less than two years ago triggered a spike in cocoa to a 32-year high and this is still fresh in the minds of consumers and traders hence the reaction in the market. The speculative interest in cocoa has gone from a bet on falling prices up until June after which point net-long positioning has risen to levels almost equalling what was seen during the civil war induced price spike in early 2011.

Demand depending on economic outlook

Whether the projections for strong demand will be carried into 2013 depends on the economic outlook because chocolate is a luxury item as well as a comfort food. Demand for luxury items, of course, depends on the economic outlook, especially in Europe and US which account for more than half of global demand. Further price advances hinge on political developments in the Ivory Coast but for now, some resistance up ahead on the March 2013 futures contract at 2500 and 2531 USD/MT could cap any further advances.



Cocoa, Mar 2013 – Source: Saxo Bank

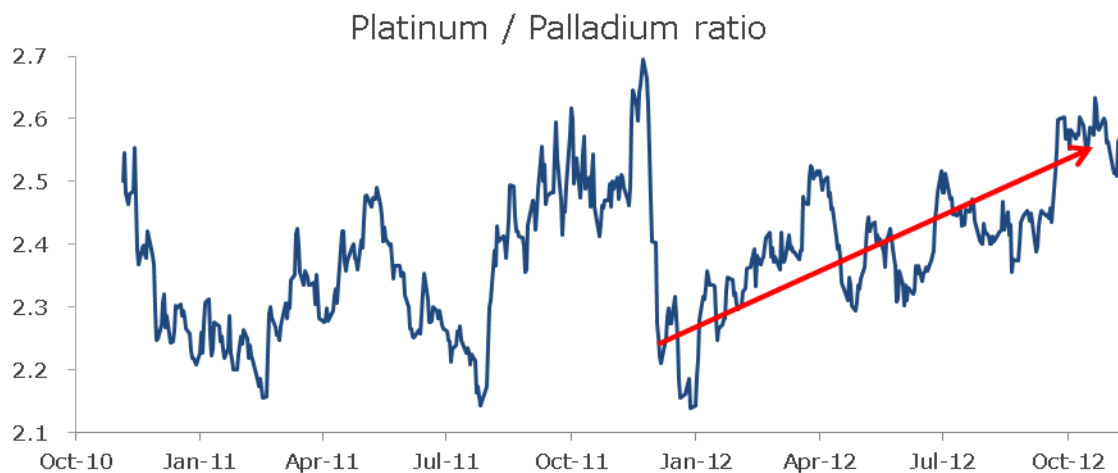
Palladium in rare outperformance

Both platinum and palladium received a boost from a report by Johnson Matthey, a world leader in platinum distribution. In their "Platinum 2012 Interim Review" they helped give palladium a unilateral boost by projecting a shortfall of 915,000 ounces for 2012 due to lower mine supply, reduced Russian stock sales (down to 250koz from 755koz in 2011) and record demand auto catalytic manufacturers. While platinum is very dependent on mine supply from South Africa, palladium's biggest single source of supply for many years has come from the release of stocks accumulated by the former Soviet Union. These reserves, whose size has never been released, are dwindling and could be gone within a few years leaving mine and scrap as the two main sources of supply.

Palladium, being part of the platinum group metals, has a reasonable strong correlation to platinum but also takes direction from other precious metals such as gold and silver. The price action during the last couple of months has therefore primarily been driven by the rally and subsequent retraction of gold and platinum. But this pattern was halted this when Johnson Matthey's report triggered a 7 percent jump for

palladium and only a 2 percent on platinum. The market will maintain its focus on the supply deficit but whether it will result in an outright or even relative better performance compared with platinum remains to be seen.

Palladium is the least traded of the two and often suffers from lack of investor interest due to its illiquidity and ability to trigger sharp price moves in both directions. It remains the worst performing metal this year as it is down five percent compared with plus 10 percent on platinum. The chart below shows the price relation between the two. So far during 2012 platinum has outperformed from costing 2.13 ounce of palladium in January to a recent peak of 2.63 ounce.



Source: Bloomberg L.P. and Saxo Bank Strategy & Research

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