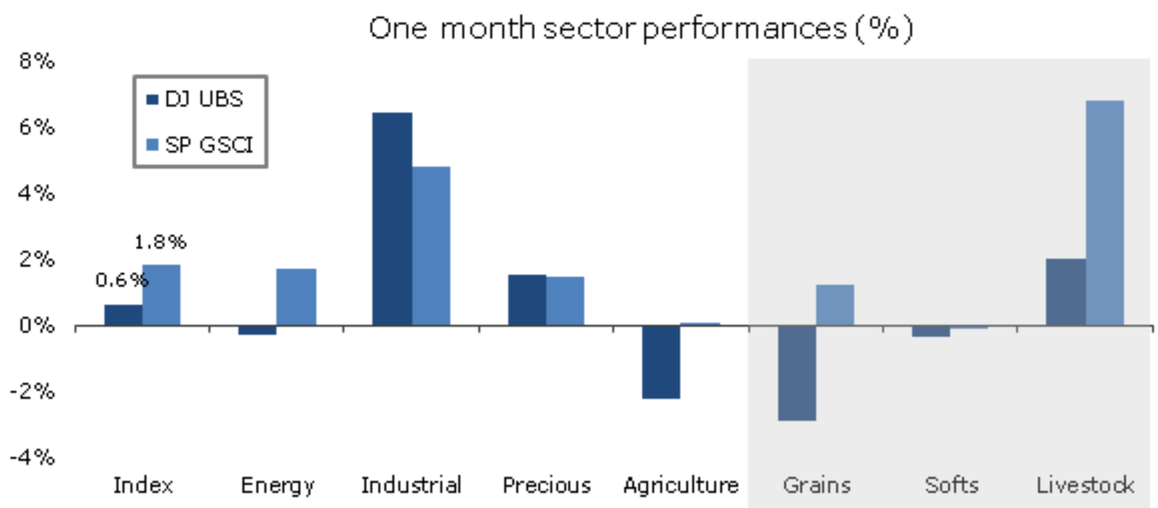
Oil set to pop while gold suffers confidence crisis

November returned small gains after a month during which several key events occurred such as the US Presidential election, renewed worries about Greece and most importantly the US fiscal cliff. The latter was the main driver this past week and at times caused some knee-jerk reactions in both commodities and financial markets due to the confusing signals coming from the President and the Republican led Congress. The uncertainty surrounding this issue will continue to drive markets as we head into December and as the January 1 deadline moves even closer. So far however the markets are pricing in a respectable solution with failure not an option despite the current lack of progress. The potential threat of the US economy tumbling over its fiscal cliff leaves the door open for some additional volatility in December, even more so as we enter a time of year where market liquidity is at a premium.

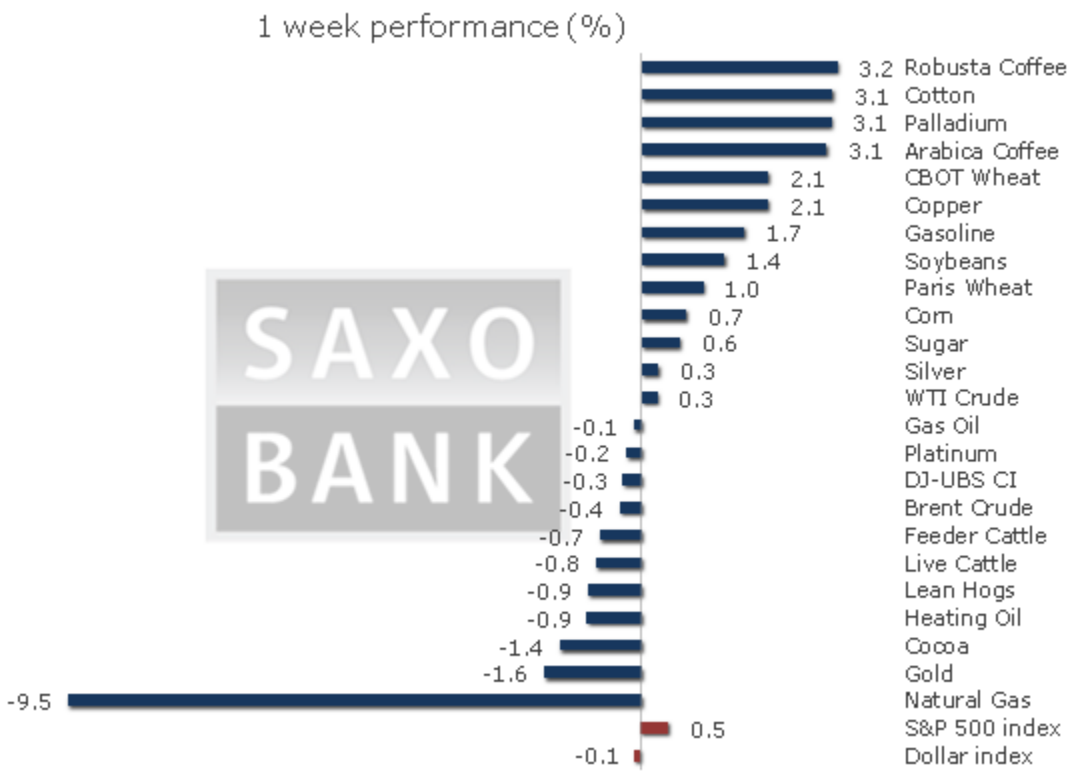
As seen below the two major commodity indices that we follow returned a profit during November. The S&P GSCI performed the best with the discrepancy in performance primarily caused by different allocations in the grains sector. The DJ UBS struggled primarily due to its much bigger exposure to the soybean complex which suffered a major setback during the month. A strong month for aluminium, zinc and lead helped the industrial sector to become the top performer of the month after having been the laggard during most of 2012. Increased hopes that China, the world's largest consumer, has turned the corner and could see its demand begin to pick up was the main reason but also Hurricane Sandy, which left thousands of homes without electricity for days, triggered a rise in battery consumption, supporting lead.

Precious metals rose, primarily driven by palladium and silver, while the energy sector's performance was mixed due to the different allocation between gasoline and natural gas, the best and worst performing energy commodities respectively.



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

During the last week of November we saw strong performance in both coffee contracts as they recovered from a week-long sell-off which had increased the amount of speculative sold positions to an unsustainable level. Palladium continued its ascent despite a mid-week wobble and copper rose as an accelerating Chinese economy helped lift the demand outlook. Gold went through a small investor confidence crisis after a mid-week sell-off which saw the price drop by 25 dollars within seconds and natural gas slumped as the near-term weather outlook promised warmer than usual temperatures, thereby reducing the demand for heating and electricity.



Source: Bloomberg and Saxo Bank Strategy & Research

Gold experiencing confidence crisis

A renewed push towards 1,800 USD/oz. looked assured for gold after it broke higher through recent resistance at 1739 USD/oz. That was up until this Wednesday where a violent sell-off caught many traders off guard and help dent confidence. The 25 dollar sell-off that followed the break below 1737 resulted in the liquidation of more than 1.5 million ounces within seconds, most of which probably had been bought above that level the previous days thus leaving many with a hole in their pockets.

Having seen a drop in forward US inflation expectations during November gold has for now returned to trade just like another risky asset, taking its cue from stock markets and the dollar. And with the sentiment in stock and forex markets being disturbed due to confusion about the (lack of) progress in the fiscal cliff negotiations gold was pushed over the edge following pessimistic comments which saw stocks drop and the dollar rise. Later that same day more optimistic comments emerged and the moves were reversed. Gold recovered a bit of its poise which also helped to confirm the existence of good support in the 1705 area.

Despite the sell-off investors continue to buy into Exchange Traded Funds with gold held by these rising to a new record of 2,619 tonnes (Bloomberg). During the last three months alone where the price of gold has risen by just 2.3 percent investors have been adding 160 metric tonnes compared with 90 metric tonnes during the previous three month period. With investors willing to support the market during sell-offs but at the same time reluctant to take it higher when the opportunity arise gold is most likely going to stay put within the established November range between 1705 and 1750 while waiting for an outside driver to emerge.

Spot Gold, daily chart – Source: Saxo Bank

Such a driver could be the next US Federal Reserve meeting on December 11-12 in which the FED may be preparing to take further steps to stimulate the economy by replacing the expiring Operation Twist Program with a new bond-buying program. Such an initiative of additional quantitative easing could lend support to precious metals while the danger of risk aversion still lingers until we see a solution to the fiscal cliff problem.

Palladium reveals it best and worst sides

The flash crash in gold on Wednesday highlighted very clearly why palladium, despite a strong fundamental outlook, is very difficult to trade. While gold at one stage lost two percent from the previous close, palladium slumped by nearly twice that before bouncing strongly going on to finish higher on the day. This move continued for the rest of week making palladium one of the best performers as it continued to react to recent revisions in the outlook from a supply surplus to deficit in 2012 and 2013.

Crude oil still on a road to nowhere

Both WTI and Brent Crude oil were headed for the first small monthly gain since August following a month of predominantly range-bound trading. While markets have been keeping a close eye on Washington, which apart from any geopolitical event will be the main driver for the remainder of the year, recent improved economic data from both China and US, the world's two-largest consumers of oil, have also been lending support. Against this elevated uncertainty oil markets are witnessing slowing demand and ample supply which all in all is helping to keep the price of Brent crude stuck near 110 USD/barrel with especially the 200-day moving average having provided resistance during the last couple of weeks.

Brent crude has been stuck in a relatively tight trading range around USD 110 per barrel over the last quarter. With the room to manoeuvre contracting by the day we would expect a breakout during the first week of December, initially to the upside as traders who already hold speculative long positions will try to support such a move in order to create some window dressing which tends to be a favourite market driver ahead of year-end. However our belief is that such a move, which could see the price test trend line resistance below 114 USD, will fail as it will not be supported by fundamentals at this point in time and Brent Crude will eventually revert back to its 105 to 112 dollar range.

Brent Crude, eight-hour chart – Source: Saxo Bank

Wheat strong as US winter crop suffers

CBOT wheat rose strongly during the week continuing what has become the longest rally since July. A combination of strong export demand combined with a deteriorating outlook for winter wheat in the US southern plains has helped lift the price of March wheat back towards 9 USD/bushel. The crop is in its worst state on record as drought conditions have played havoc before approaching winter dormancy. The outlook for reduced US production at a time of limited available supply from other exporting nations, such as Ukraine and Russia, has supported the price in Chicago, but also in Paris, with the January Milling wheat future trading near its contract high.

Hedge funds rebuilding soybean positions after slump

The price of soybeans continues to move higher following the early November slump which saw the speculative involvement from hedge funds dropping to the lowest level since February. The fundamental outlook for soybeans, which had weakened following a recent US government report on estimated inventory levels, has begun to change again as concerns have been raised about the South American crop at a time of continued strong export demand to China, which does not seem to slow down despite the higher prices that has been witnessed throughout 2012.

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