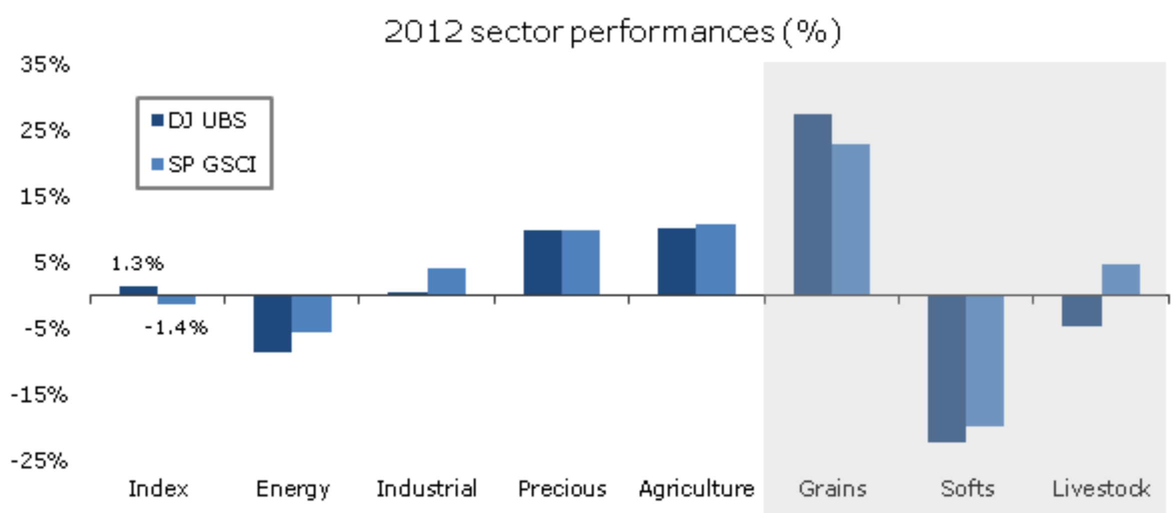
**Commodities lose momentum as fiscal cliff and stronger dollar bite**

The first week of December saw commodity markets lose some of the positive momentum witnessed in late November, not least due to on-going concerns about the US fiscal cliff as the January 1 deadline approaches. If left unresolved, the pressing budget issue it will lead to dramatic spending cuts and tax rises which could send the US and potentially the global economy back into recession. Europe, which has already entered into recession, is struggling to see much light at the end of the tunnel following the European Central Bank's downgrade of its Eurozone growth forecast for 2013 to -0.3 percent. This downgrade raised the possibility of further near-term rate cuts from the ECB and helped send the EURUSD lower, thereby removing support for commodities priced in dollars.

**Energy sector the worst performer**

The two major commodity indices both posted negative returns during the week resulting in their year-to-date performance continuing to hover around zero. Industrial metals have seen a strong recovery in recent weeks primarily helped by improved economic data from China, the world's largest consumer. This now leaves the energy sector as the worst performing sector and it has primarily made an impact on the performance of the S&P GSC, with its almost 70 percent exposure to this sector. Precious metals are neck and neck with agriculture, with the latter driven almost solely by strong performances of key crops, such as wheat, corn and soybeans.

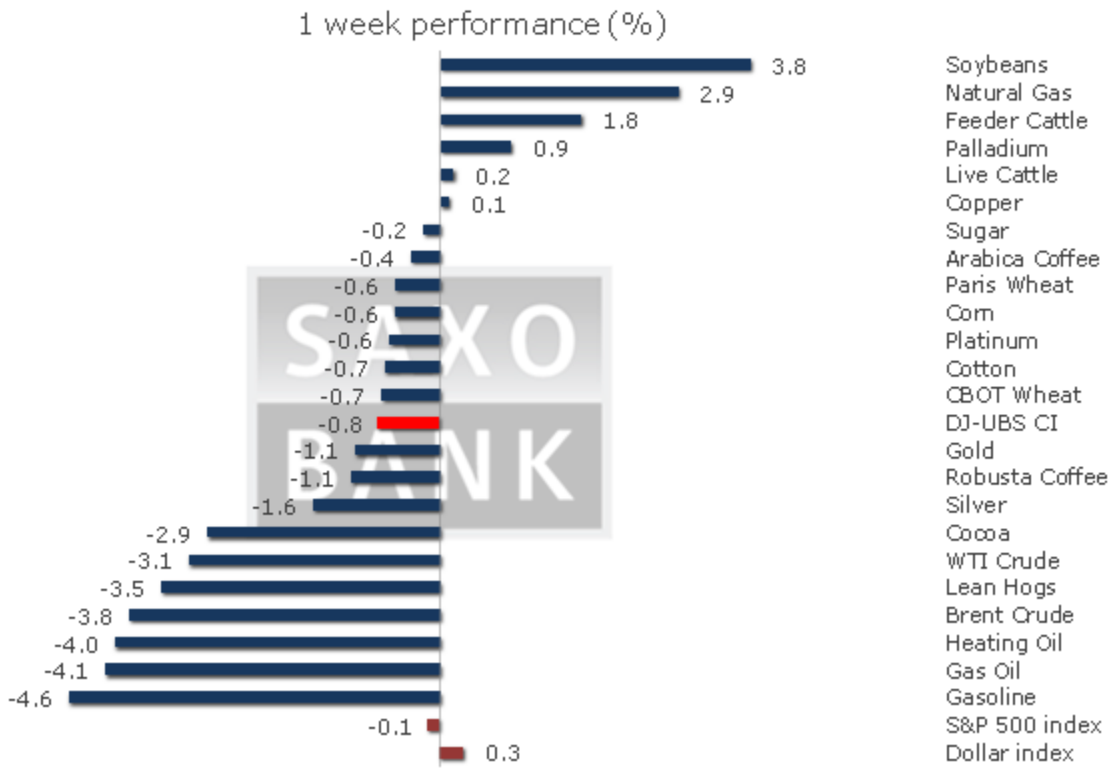



Source: Bloomberg L.P., Saxo Bank Strategy & Research

**Soybeans recover from November sell-off**

Turning to the performances of individual commodities only a handful saw a positive return, especially soybeans as the price continues to recover from the November sell-off, during which period the net-long participation from money managers more than halved. Recently, the fundamental picture has shifted back towards being supportive on the prospect of a smaller crop in South America due to adverse weather. At the same time, the export of US soybeans, which has been picking up, is at risk of being hampered by low water levels on the Mississippi River, the main transportation route from the Mid-West to the Gulf of Mexico.

**Gasoline – worst energy performer**
The bottom four performers all relate to the energy sector with gasoline being the worst, following weekly inventory data which saw inventories jump by the most since the 9/11 terrorist attacks in New York. The move lower has benefitted US motorists with the price of retail gasoline falling to the lowest level in five months. Once again, this shows how this paradigm shift in global energy supplies due to the increased output from advanced production methods in the US is having a profound impact on the competitiveness between regions and countries - with US industry and consumers benefitting the most from low crude and gas.



Source: Bloomberg and Saxo Bank Strategy & Research

**Precious metals led lower by silver**
The precious metal sector continues to experience some trading fatigue with gold and silver trading on the weak side all week, while palladium continues its month-long rally on the back of expectations of an emerging structural deficit. Silver has been underperforming with the price of 1 oz. of gold rising to 51.8 oz. of silver compared with a recent low 50.6 oz. Gold traded below 1700 USD/oz. but found support as comments from the ECB President raised the likelihood of a Eurozone rate cut early in the New Year. The feeling, however, is that many traders, both through futures and especially Exchange Traded Funds may be tempted to refrain from adding to existing positions or even reduce exposure as the year closes - thus creating some headwind for gold and silver, which could last until late December.

**FOMC may add support**
Precious metals ran into some additional weakness Friday following the US jobs report for November which turned out to be stronger than expected with the jobless rate continuing to drop. This report is the last this year and as such the last indicator before the final US Federal Reserve meeting for 2012 on

December 12. Due to this factor, expectations have increased for additional quantitative easing measures being announced at this meeting on December xxx. Market talk at the moment points towards the expiring Operation Twist, by which the Fed sold short-term bonds to buy longer maturities, possibly being replaced fully or partly by a conventional bond-buying programme. Such an action would effectively increase the money-printing programme already seen from the third round of quantitative easing (QE3), which was launched back in September. If an announcement to this effect occurs it could bring back a much needed bid to gold and silver and should lend further support to the belief that gold still has good upside potential. Increased uncertainty and lower liquidity will make the next couple of weeks very tricky from a trading perspective. The main area of support can be found between 1672 and 1661 - the recent low and the 200-day moving average, while resistance is at two Fibonacci levels of 1711 and 1728.


**Crude oil lower on ample supplies and strong dollar**

Both crude oils (Brent and WTI) moved lower during the week although the improved US jobs report helped cushion the fall. Overall the stronger dollar removed support while additional selling pressure came from another weekly build in US energy inventories, especially gasoline which saw the strongest weekly rise since the 9/11 terrorist attack. Further selling was triggered by the ECB's subdued outlook for growth in Europe, which pushed a return to growth further into the future.

Saudi Arabia's petroleum minister once again expressed satisfaction about current prices ahead of the next OPEC meeting in Vienna on December 12. OPEC will undoubtedly have to significantly reduce its production which has been running at elevated levels for months amid signs that global supply is now beginning to outstrip demand, not least due to the continued sharp increase in US production which is now back up to levels not seen for almost 20 years. Though unlikely to occur at this meeting it is highly probable that such an announcement will come during early part 2013.This is causing a paradigm shift in oil markets with traditional producers risking the gradual loss of their influence. The increased amount of spare capacity will be good for all though as it will reduce oil price volatility and most likely prevent prices from moving much higher for the foreseeable future.

Brent crude oil moved back below 108.50 during the week and could now settle into a lower range centred around 107 USD/barrel with the risk of end-of-year long liquidation from speculative traders once again weighing on prices.

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