Oil rises on supply fears as overall commodities' advance stalls

Weekly Commodity Update
by Ole Hansen, Head of Commodity Strategy, Saxo Bank

Following stronger than expected economic data from the US, the weaker job report Friday heightened the focus on the US Federal Reserve meeting on September 18. The market still expects a timeline for when it will begin to scale back its massive stimulus program but speculation about a smaller reduction will now add to nerves in financial markets during the next week.

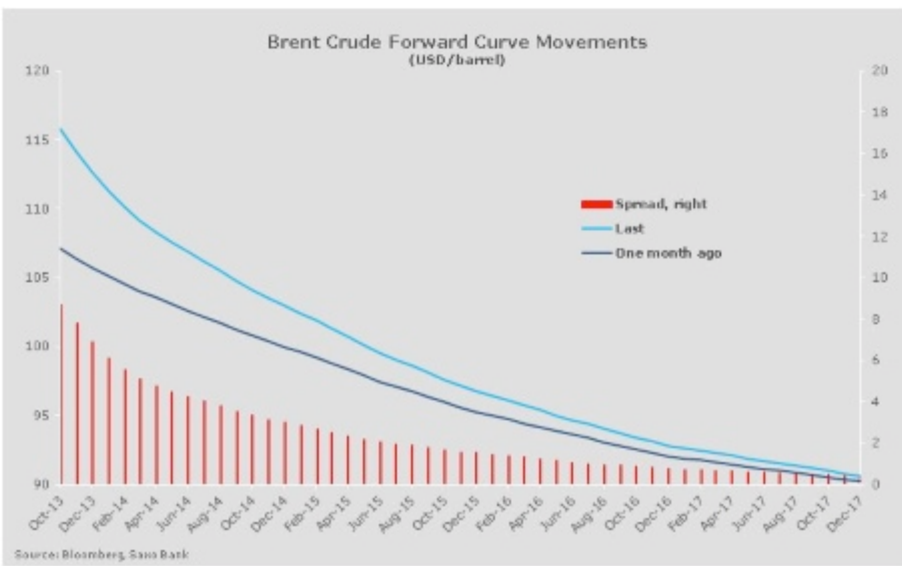
The dollar reached a seven-week high and US ten-year government yields came to within a whisker of three percent which in the process put further downward pressure on emerging market currencies and their respective economies. As a result of these and with no additional escalation in the Middle East crisis, commodities ended with a small weekly loss, the first in four weeks.

All sectors were lower, particularly precious metals, as safe-haven buying related to Middle East concerns were more than offset by the negative impact from a rising dollar and bond yields. On the second anniversary of the 1,921 USD/oz peak, we are looking at a gold price down by 30 percent and still looking to establish proper support against several unfolding headwinds.

Geopolitics keeps oil firm
The energy sector remains propped up by current and potential future supply disruptions. The port strikes and protests at oilfields in Libya combined with the lowest supply from the North Sea in 10 months are causing problems especially for European refineries with margins under pressure as they have to source more expensive crude from other countries, such as Nigeria where theft and disruptions have already reduced oil production to a four-year low.

Add to this the geopolitical tensions associated with Syria and the potential fear of contagion to other Middle Eastern oil producers the price of spot crude, both Brent and WTI, remains well supported. The price of Brent crude futures for immediate delivery, or prompt as it also called, has rallied strongly over the past month compared with deferred contracts and it highlights the current supply issues which is adding relatively stronger upside pressure to prompt crude oil.

The steep backwardation which this type of futures curve is called, has played into the hands of investors holding long positions, either through futures or exchange traded funds. The shape provides the investor with a positive roll carry meaning that for each month the price remains unchanged, a positive return is created when prompt futures positions are rolled to the next month. The current spread between prompt futures month of October and the January 2014 contract is USD 4.60/barrel or the equivalent of a positive carry of almost four percent during this time. As an example of this the DJ-UBS Brent crude index is currently up 8.3 percent year-to-date compared with a 4.2 percent increase using the first month continued performance of the Brent crude oil future.



The price of Brent crude has been hovering around USD 115/barrel for the past week which is still, despite all the above mentioned uncertainties, only five dollars above the average price over the past couple of years. With regard to Syria, a wait-and-see approach currently prevails but it still leaves the near-term price risk skewed to the upside unless we see Libyan oil production and exports resume.

Future demand growth expectations are also now being looked at with analysts trying to gauge the impact of recovering developed economies against the risk of a slowdown in emerging economies. The current range on Brent crude is in a USD 112-117.35/barrel range with a break above opening up for a revisit to this year's high at USD 119.17/barrel.

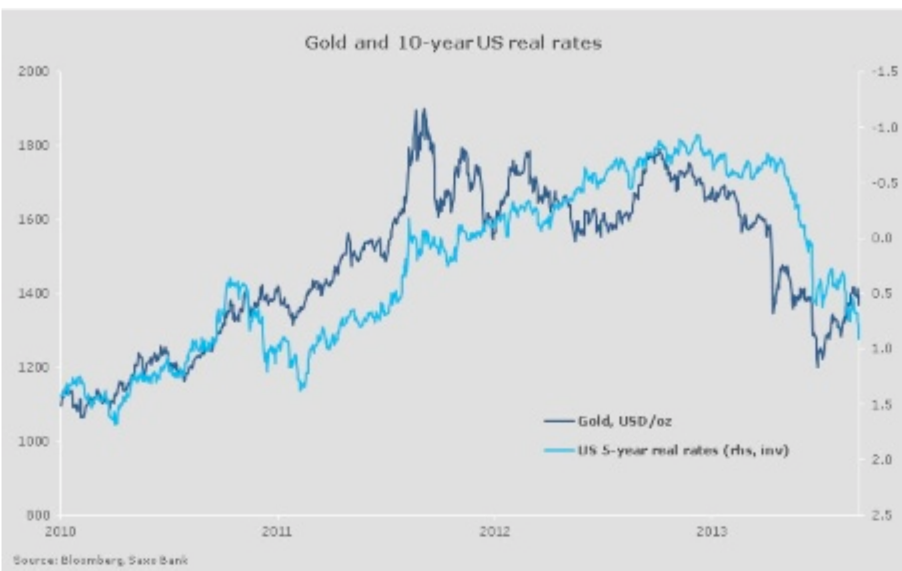
Precious relief
A weaker than expected US job report Friday helped precious metals regain some of the support that was lost earlier in the week when rising bond yields and a stronger dollar more than offset the continued worries about what happens next in Syria. Although weaker than expected, the job report will

probably not sway the US Federal Reserve away from setting out the timeline for when stimulus will be withdrawn/reduced.

What it may do however is to provide the decision-makers with a chance to taper less than what the market currently expects. This would lend a hand to emerging economies who are reeling under a massive flight of capital which has put their currencies and current account balance under pressure over the past month.

Gold rangebound
Gold remains stuck in a key support/resistance range of 1,350-1,417 USD/oz followed by the August high at 1,434 USD/oz. Near-term, the risk of further long liquidation looms as the institutional investor remains lukewarm with flows into Exchange Traded Products not picking up while the increase in net-long futures positions has so far primarily been driven by short-covering.

We will be keeping a close eye on bond yields which have rallied strongly during the quarter with any signs of this move being overdone potentially putting some support back into gold. Until September 18, many investors will be inclined to hold back on new investment decisions as they await clarity on what intentions the Fed may have with regard to tapering.



Silver, which has seen a dramatic recovery during August, ran into trouble early in the week when some of the previous strong support from Copper faded but having managed to hold onto support at 23 USD/oz it quickly resumed its outperformance against gold and it is currently the best performing metal, also versus platinum and palladium.

Cocoa was the best performing commodity during the week after jumping to an 11-month high. The driver is the current weather situation in West Africa where the world's two largest producers, Ivory

Coast and Ghana, have been receiving less rain than normal. This is putting in doubt the size of the next harvest which is due to begin next month.

Potential record crop for corn

Corn prices retraced from a late August spike and hit a three week low as the harvest began to accelerate. Current projections still points towards a potential record crop despite the lack of rain during the final weeks before the crop reached maturity and harvest.