

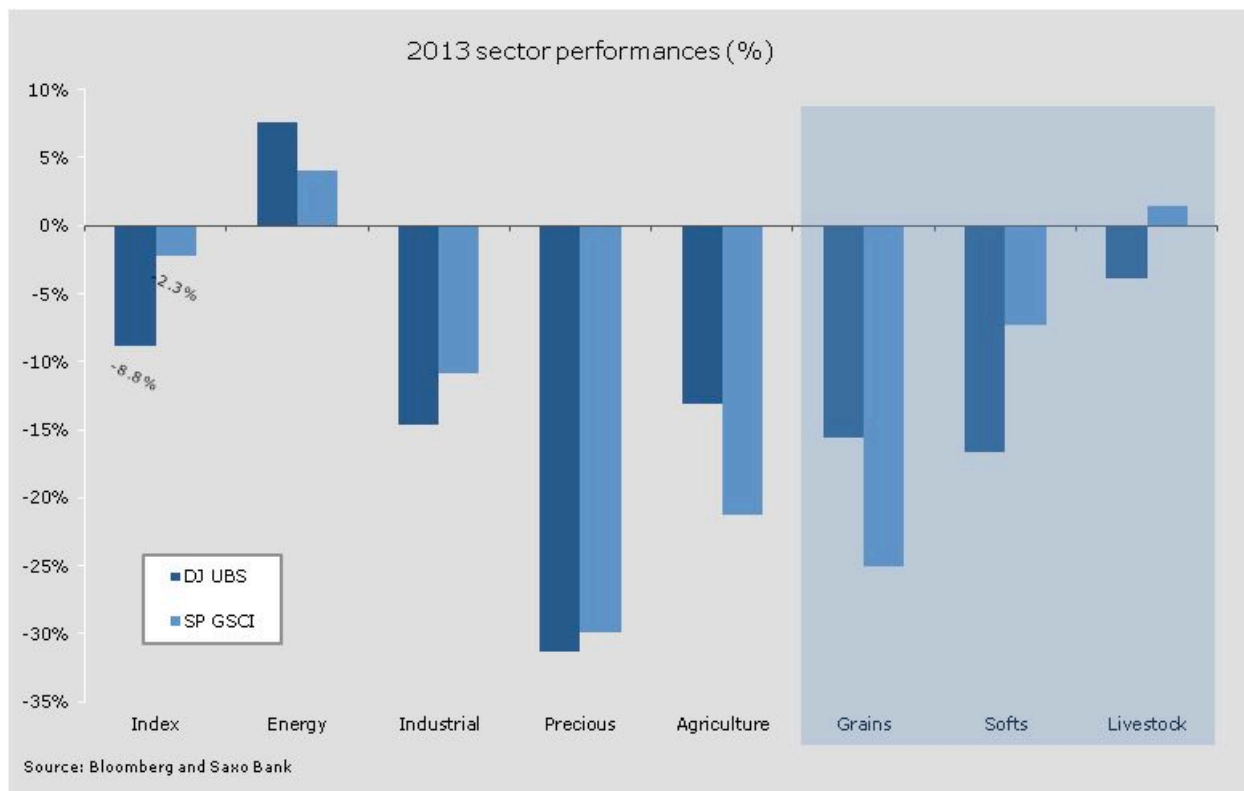
# Taper impact: Precious metals hit as energy gets a FOMC boost

By Ole Hansen, Head of Commodity Strategy, Saxo Bank

The last major roll of the financial dice in 2013 was carried out by the US Federal Reserve on December 18 when it sprang a semi-surprise on the market deciding to begin tapering its asset purchase program. Although the market had spent the past six months getting ready for this announcement, precious metals took it badly and ended up being the worst performing sector on the week while the energy sector once again performed well with the six best performing commodities all belonging to this sector.



As the table shows, the energy sector was generally positive while metals were negative and the agriculture sector, though unaffected by the Fed taper announcement, ended up a bit all over the place. With the year coming to a close, the sector performances of the two major commodity indices, the Dow Jones UBS and S&P GSCI clearly shows what a difficult year it has been. Precious metals lost more than 30 percent while industrial metals and agriculture also suffered losses primarily due to increased availability of supply. On top is the energy sector, which has seen a general positive performance among its major components, not least natural gas and both crude oils.



This week gasoline and natural gas led the gainers as demand for both rose resulting in lower supplies. Gasoline's rise was due to a pickup in demand ahead of the holiday season and natural gas due to very cold weather across the US which has seen demand from gas driven power plants rise strongly. Last week stockpiles of natural gas in underground storage facilities across the US fell by a record 285 billion cubic feet as production was being disrupted by shut-ins caused by the current frosty weather conditions. This highlights the risk of increased gas volatility during the peak winter period as supply is increasingly driven by inland production compared with off-shore which in the past led to heightened volatility during the peak hurricane season over the summer.

Robusta coffee, which rallied by one-quarter during November and reached a three-month high on December 13, ended up the biggest loser the following week on signs that Vietnamese growers had finally begun to release supplies. The recent rally was driven by a slump in stockpiles in exchange tracked warehouses to the lowest since 2002 primarily due to lack of supply from Vietnamese farmers holding back what is expected to be a record production in order to achieve higher prices.

Gold's downward trajectory was extended following the US Federal Reserves announcement that tapering was now beginning from January. The selling below 1,210 USD/oz has so far resulted in the lowest close in three years and it has returned the focus to this year's low at 1,180 USD/oz while a potential break will put the next level at 1,155 USD/oz into focus as shown on the chart below. The

renewed selling has, however, lacked the sense of panic witnessed during similar situations over the past year and it could be explained by the fact that those investors wanting to leave the metal behind have already done so. Technical selling and some weak longs bailing out and booking their losses before year-end has so far been the main drivers. Liquidity across all markets, not least gold, are increasingly becoming scarce as trading books are closed and traders vacate their desks to spend the festive season with their friends and family.

## Spot gold, weekly



Source: Saxo Bank

The early stages of the new year will undoubtedly become another challenging time for precious metals as positive fundamental price drivers are hard to come by. Investment holdings in exchange traded products backed by gold have seen increased reductions during December and whether this is a sign of investors gearing up to another year of losses or just some long liquidation in order to book losses and meet 2014 with fresh eyes remains to be seen.

One silver lining during this latest round of weakness has been the relative resilience of silver which has managed to outperform gold this past week. Silver is currently down by more than 36 percent in the year-to-date and some selling fatigue may have started to emerge. Investor sentiment is already

very negative which the sharp reduction in ETP holdings and limited net-long positioning in futures bares witness to.

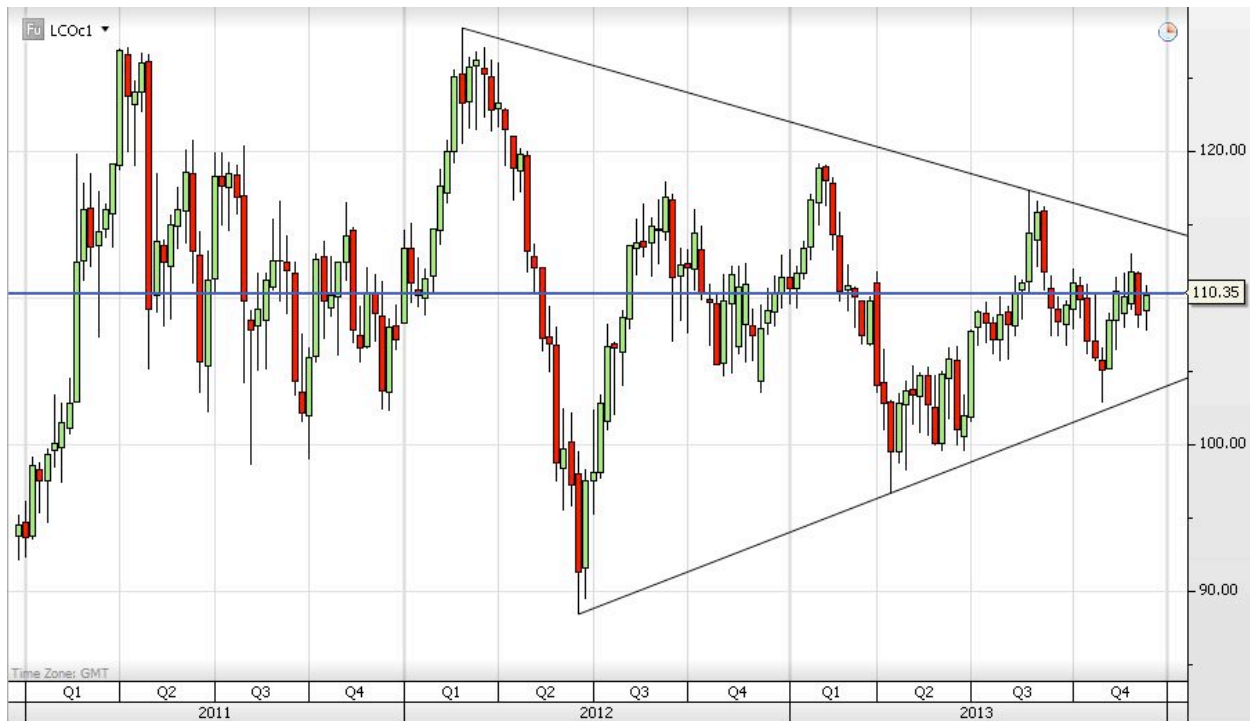
A year ago, most analysts were busy outbidding each other in their expectations for how high gold could climb while this year, expectations are all over the place. The majority expect continued weakness with one looking for 900 USD/oz while others won't rule out a move higher towards 1,500 USD/oz. With such a wide spectrum of expectations, it is no wonder investors are confused and feel uncertain about what happens next.

I believe 2014 will be a year of consolidation following a dramatic slump at the end of a 12-year bull market. We could see some additional weakness during the first quarter as the taper theme and some potential dollar strength erode support but later in the year, gold could well recover as some of the negative drivers fade and finish up on the year. A more detailed outlook will be available on January 7.

### **Crude oil - another January rally?**

The week turned out to be a dead heat between WTI and Brent crude with both seeing a positive performance. Traders concluded tapering was a good thing since it confirmed that economic activity is picking up which would help stimulate demand. We are in other word's once again beginning a year with raised growth expectations, something that together with geopolitical tensions helped drive Brent crude higher during January for the past three years by an average of 4.7 percent. We suspect that this time round it will not be that easy to repeat this strong performance. Not least due to the lack of any new geopolitical issues but also the fact that supply is expected to outstrip demand over the coming year with non-Opec production continuing to rise strongly.

### **Brent crude, first month cont**



Source: Saxo Bank

The move higher recently was also supported by increased refinery demand as the winter begin to bite together with the continued removal of Libyan oil from the market. Brent crude has returned to the USD 110/barrel area which corresponds with the average price for the past three years. Although we have seen peaks and troughs in 2013, they have all been smaller than what was seen in previous years.

Will this trend of lower volatility continue? Probably not from looking at the chart. It shows how the the room for maneuver within its current support and resistance is diminishing and eventually fireworks will return. The current expectation is that the market may once again run ahead of itself during the early stages of 2014 but with supply being plentiful together with some uncertainty about the outlook for some emerging market economies, we expect to see oil spending most the time at the lower end of the range seen during 2013.

***Happy holidays everyone.***