



THE SPECIALIST IN TRADING AND INVESTMENT

Hellerup, 28 February, 2014

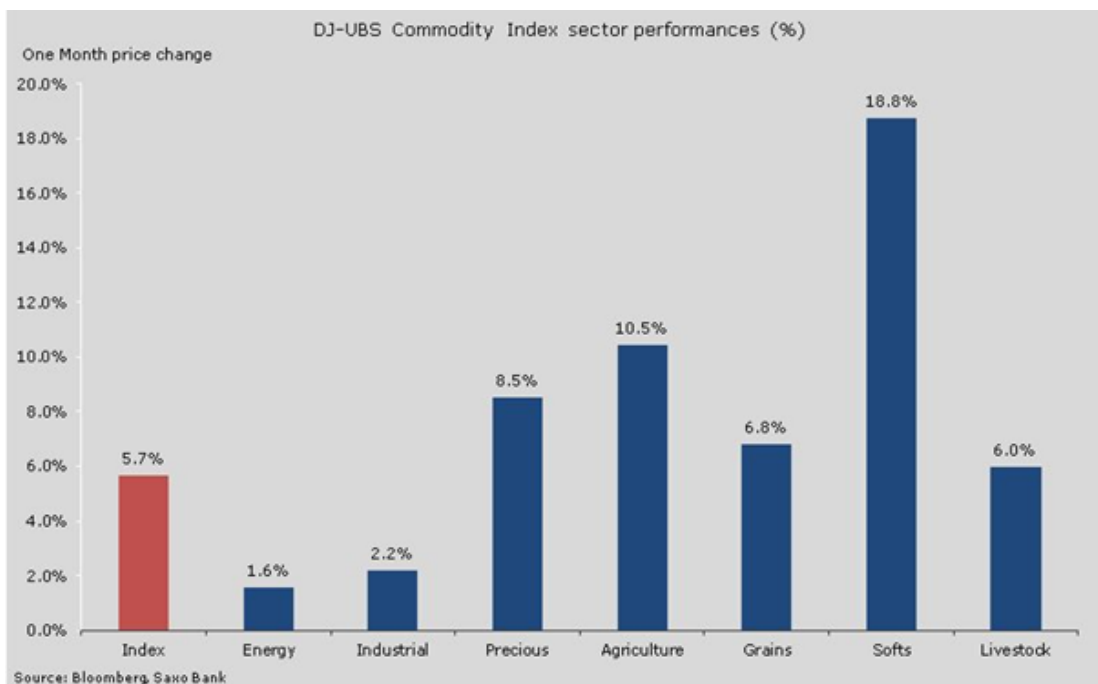
March unlikely to repeat February's surge in commodities

February was a strong month for commodities, with the broad-based DJ-UBS Commodity index returning more than 5 percent. This was more than the S&P 500 Index, which reached even a new record high thereby moving in the opposite direction of bond yields and the macro data. Some of the major themes and factors behind this performance were:

- Adverse weather in Brazil and the US supporting multiple commodities from coffee and sugar to soybeans and WTI Crude.
- Concerns that growth in the world's two biggest commodity consuming nations, US and China, are losing momentum.
- Risk adversity related to turmoil in emerging markets, not least Ukraine.
- Traders having to deal with the implications of the biggest weekly drop in China's Yuan on record.

Several of these themes will continue to drive commodities into March but as the US winter steps aside to allow spring to take hold, some of the weather-related factors may ease. US and Chinese economic data continue to be important variables, together with worries over the wider implications of the situation in Ukraine.

The agriculture sector rose by more than 10 percent, not least driven by a spectacular rally in Arabica coffee. Sugar had a double digit return as the extreme drought in Brazil threatened crop yields from the world's biggest producer and exporter of the two commodities. In the US, the cold weather lifted the price of wheat after concerns that the winter crop could be damaged while brisk export demand for soybeans was driven by a delay to the Brazilian harvest.



Source: Bloomberg, Saxo Bank

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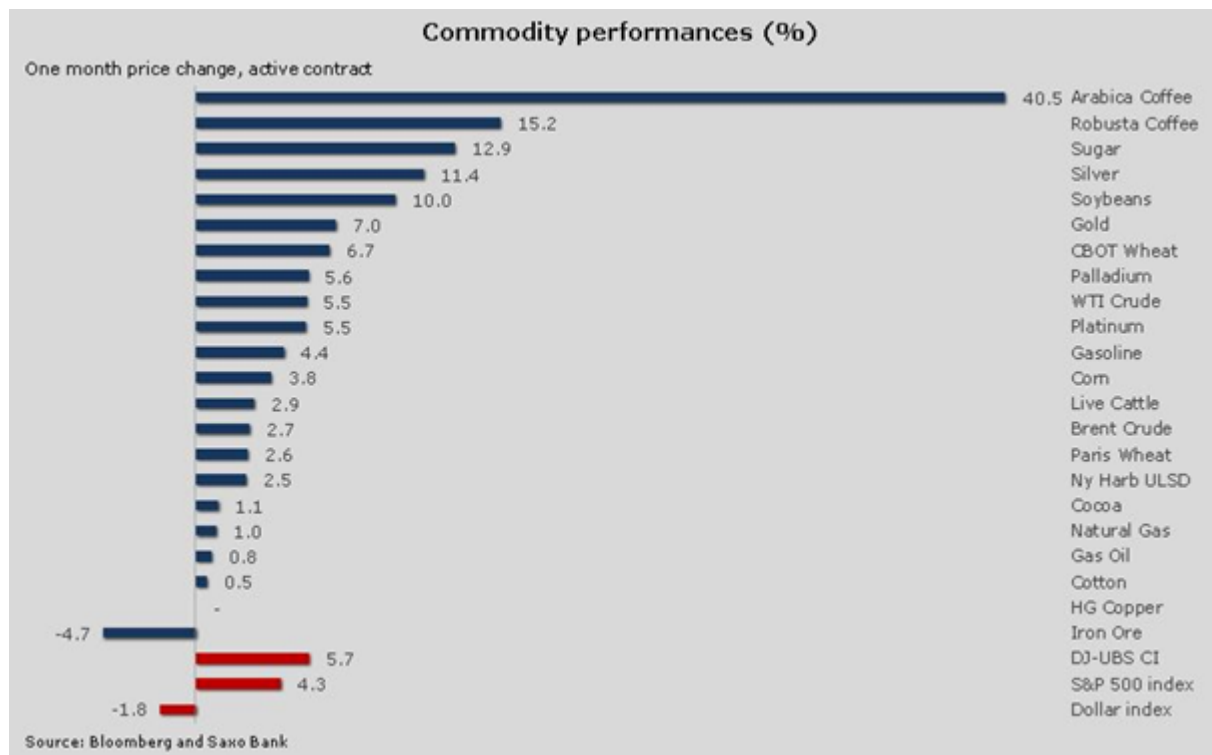
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Precious metals continued their strong performance from January with many traders being forced to change their negative expectations, not least when resistance at the important technical 200-day moving average on both metals was broken. Falling bond yields on the back of disappointing US economic data and the first, albeit small, monthly rise in ETP holdings since December 2012 are lending support. Signs of slowing physical demand at current higher levels may limit the upside potentials.



Source: Bloomberg and Saxo Bank

The energy sector was mixed, with natural gas receiving much of the attention considering the extreme volatility witnessed during February. In the end, the price ended up almost unchanged on the month but not before jumping by more than one quarter and then collapsing the most it has ever done in one week since 1996. WTI Crude received support from the unseasonable cold weather, which raised refinery demand above the seasonal norm. Improved pipeline infrastructure from the US Midwest to the Gulf of Mexico led to a 14 percent reduction in inventories at Cushing, the delivery hub for WTI Crude futures in New York, and this supported the relative outperformance over Brent with the spread narrowing by more than USD 2.

Copper struggled and ended near the lowest in more than two months after concerns over China's slowing growth. The recent weakness of the Yuan may reduce demand for the metal, both from commercial buyers and those using the metal to obtain finance from sources other than regular banks from which lending has become much more difficult to obtain.

Hedge funds raise bullish commodity bets to a 34-month high

The strong performances and multiple technical breakouts during February triggered a rush into commodities by hedge funds. Since the first week of January, bullish bets on 24 US traded commodities have risen by 59 percent. These culminated during the week of February 18 when the total net-long position rose to the highest since April 2011 and an unprecedented 23 out of 24 commodities were bought. The strong buying may eventually leave several commodities exposed to long liquidation on any signs of falling momentum or changing fundamentals, not least WTI Crude where the net-long is just a few thousand contracts short of the record from last summer. As a percentage of total open interest, the position

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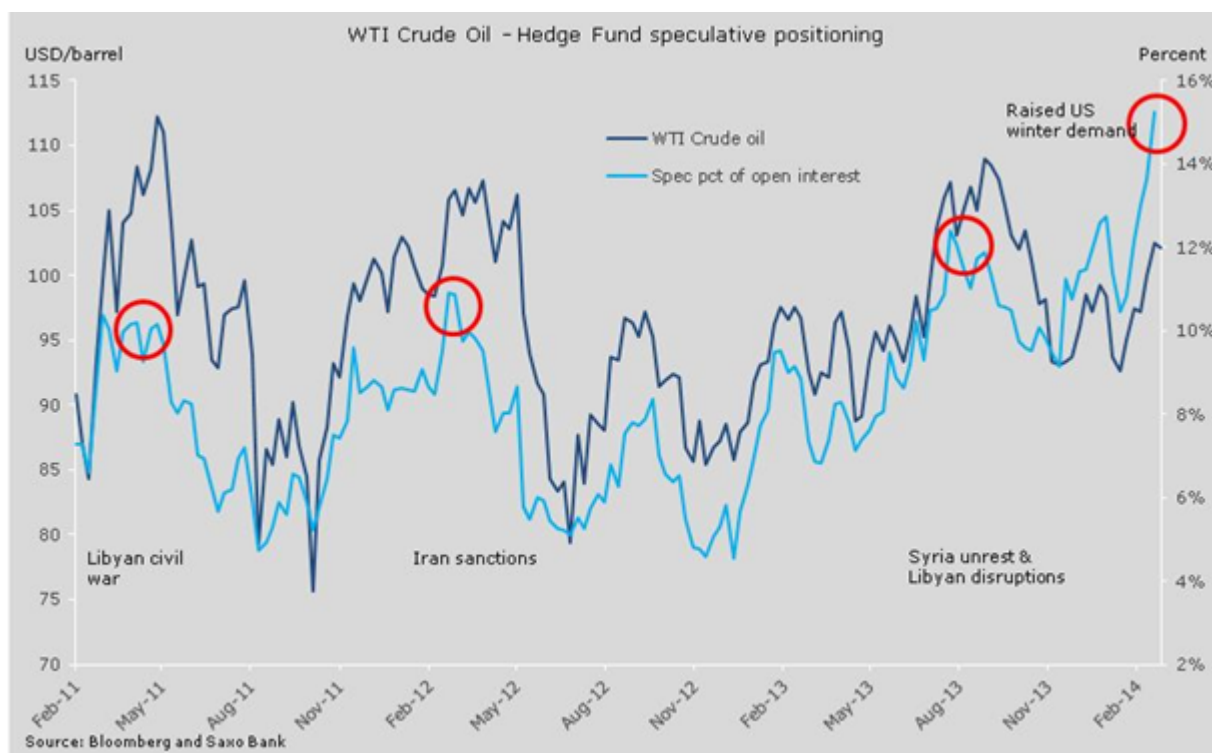
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becomes even more extreme as we have reached levels not seen since recent periods of geo-political risk, such as the Libyan war in 2011, Iran nuclear sanctions in 2012 and last summer's Syria chemical war crisis and Libyan supply disruptions.



Source: Bloomberg and Saxo Bank

Gold consolidating as physical demand eases after the rally

The yellow metal reached a four months high this past week before taking time off to consolidate after a second monthly gain. The metal has been supported this year firstly by strong physical demand out of Asia and then by the investment community, such as hedge funds who found themselves underweight the metal on the expectations that gold would fall even farther this year. The recent move above the 200-day moving average, currently at USD 1,300/oz., triggered a one-third weekly rise in net-long futures position held by hedge funds. Although it is showing signs of slowing momentum, it remains positive and some further support could arise from the current crisis in Ukraine. On the flip side, we have seen physical demand from China and Japan begin to slow following the recent rise above USD 1,300/oz. and this confirms the continued price sensitivity when it comes to physical demand. The Chinese Yuan saw the biggest weekly drop on record this past week and that may also dent what, up until now, have been very strong Chinese gold imports. The speculative community is happy to hold onto long positions at the moment, and it would probably require some renewed weakness below USD 1,300 to change that sentiment.

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Demand for crude to slow as the US eventually warms up

Crude oil prices on both sides of the Atlantic eased ahead of month end. The elevated demand for heating during the past couple of months should begin to ease as milder weather approaches and this should help ease the pressure on refineries which can now begin their seasonal period of maintenance. This period normally sees lower demand for crude oil and as a result the upside potential seems limited to USD 110.5/barrel and USD 104.0/barrel on Brent and WTI crude as we move into March. As mentioned earlier the speculative positioning in WTI Crude has reached levels only seen last September when the world was battling worries about the western airstrikes against Syria and the sharp drop in supplies from Libya as strikes began. On that basis the risk of a deeper correction has risen especially when the impact of the US winter begins to fade.



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Ole Sloth Hansen is a specialist in all traded Futures, with over 20 years' experience both on the buy and sell side. Hansen joined Saxo Bank in 2008 and is today Head of Commodity Strategy focusing on a diversified range of products from fixed income to commodities. He previously worked for 15 years in London, most recently for a multi-asset Futures and Forex Hedge fund, where he was in charge of the trade execution team. He is available for comments on most commodities, especially energies and precious metals.

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