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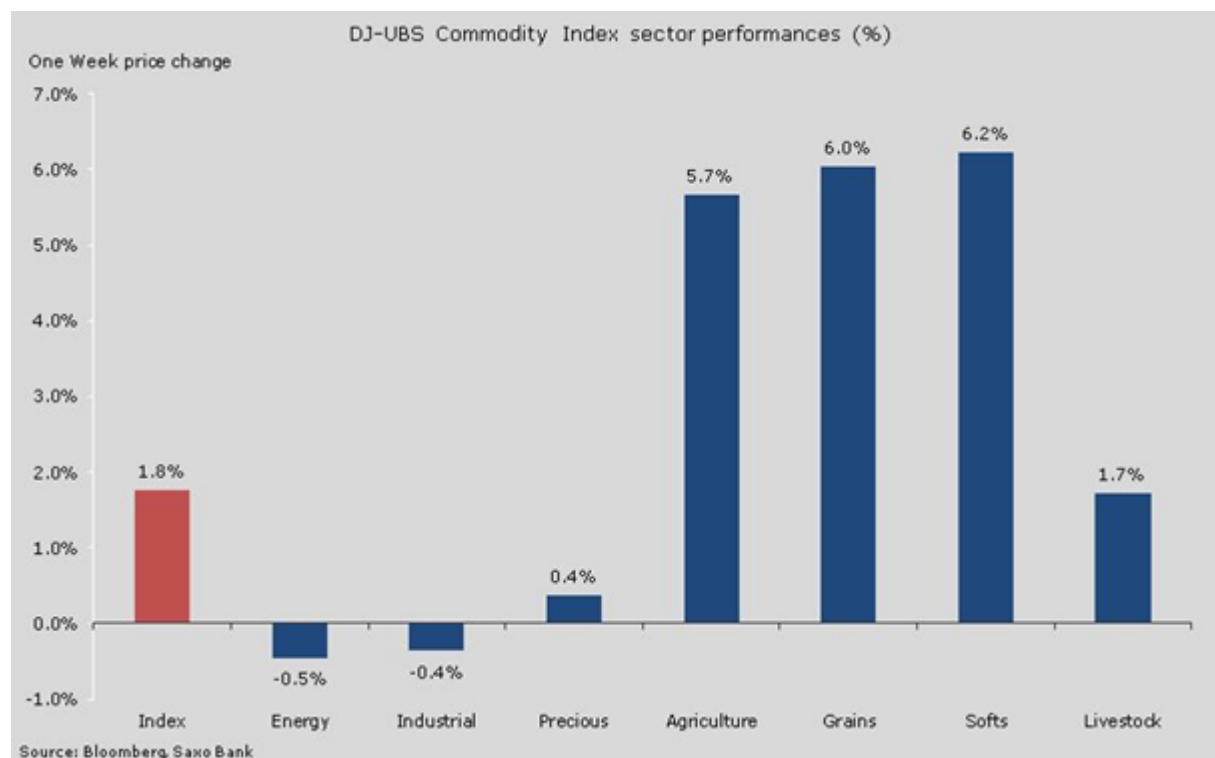
Hellerup, 7 March, 2014

## Agriculture sector underpins commodity rise as Ukraine risk fades

- Agriculture sector continues to push higher
- Gold volatility sharpens as event risk unable to set direction
- Oil gives back early-week gains on easing of Ukraine tension

By Ole Hansen

The escalating tensions between the West and Russia over Ukraine received most of the attention this week as worries about an armed conflict at least short term had the markets reeling on fears that it could negatively impact key commodities such as gas, oil and wheat. As the week moved on, energy markets softened on increased US supply and lower demand while the agriculture sector continued to rally hard to dominate the top ten list of this week's strongest performers.



Precious metals also benefited with gold lifted again on its safe-haven status, but the failure to break key resistance triggered some profit taking before dancing to the tune of the dollar weakened on the back of a European Central Bank-inspired rally before strengthening on improved US job data. Palladium rose to a one-year high as the availability of supply from Russia and South Africa was put into question. These two countries account for 80 percent of global supply and the combination of mining strikes in South Africa and the risk of sanctions against Russia left the white metal with nowhere to go but up.

The agriculture sector remains the most supported but also the most overbought at the moment. Strong gains across the board have seen this sector already rise by 17 percent so far this quarter and with supply concerns for some and strong demand for others, traders have so far not been presented with any reason to book profit. This despite some staggering performances such as the 76 percent rise in Arabica coffee, 32 percent in lean hogs and 17 percent in corn.

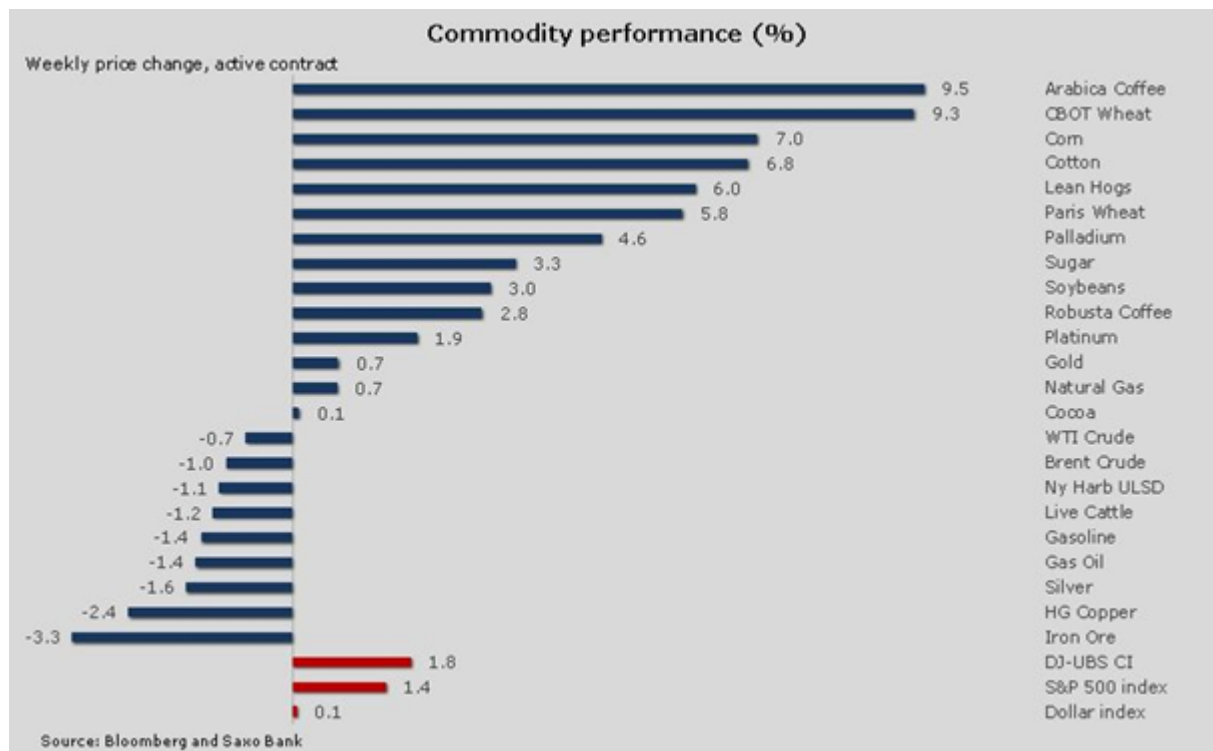
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### Strong exports eats into bulging US crop inventories

The price of the three major US crops of corn, wheat and soybeans continues to rally in response to strong export demand, especially for corn and beans which is helping to reduce the overhang of inventories left over from last year's bumper crop. The most active futures contracts of corn and soybeans have rallied to levels seen last summer. Wheat has also recovered strongly on the back of worries about future supplies from the Black Sea region. But uncertainty about the production levels of US winter wheat following a very cold winter has also been a key price driver as it has reduced the quality of the crop in the ground. Speculative traders in wheat were still net-short CBOT wheat futures as of February 25 and the reduction of these positions has helped boost the rally.

### High RSIs posing a threat to further advances in agriculture

While the agriculture sector has continued to rise, so have the signs that the sector is getting increasingly overbought. The Relative Strength Index (RSI) is a technical-momentum indicator which attempts to determine when a market is in an overbought or oversold condition. It is deemed to be overbought when above 70 and oversold when below 30, but traders often have individual preferences and set their parameters accordingly. The default setting by most traders for the RSI is 14 days. As the table below shows, we are currently seeing a majority of the most-traded agriculture commodities being overbought and this could potentially be a near-term obstacle for some of these commodities further advancing.

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	Ticker	Month	Last	RSI 9d	RSI 14d	RSI 30d	5 DMA *
Soybeans	ZS	MAY 14	1,456.00	85.8	81.6	72.0	1.9%
Soymeal	ZM	MAY 14	457.00	71.5	69.4	64.3	1.2%
Bean Oil	ZL	MAY 14	44.79	84.2	80.2	69.2	2.4%
CBOT Wheat	ZW	MAY 14	658.25	76.0	71.0	61.0	2.2%
KCBT Wheat	KE	MAY 14	198.90	73.9	75.2	73.9	2.0%
Corn	ZC	MAY 14	495.75	83.3	79.3	68.5	2.3%
Rough Rice	RR	MAY 14	15.33	42.6	44.6	46.3	0.0%
Milling Wheat	EBM	NOV 14	199.50	83.9	79.2	66.6	1.8%
Rapeseed	ECO	MAY 14	414.75	85.6	81.9	72.7	1.8%
Live Cattle	LE	APR 14	143.25	53.4	56.6	59.5	-0.5%
Feeder Cattle	GF	MAY 14	173.30	52.9	56.3	58.1	-0.4%
Lean Hogs	HE	APR 14	113.25	90.3	87.8	80.5	1.7%
Coffee "C"	KC	MAY 14	198.90	73.9	75.2	73.9	2.0%
Coffee Robust	RC	MAY 14	2,105	77.4	75.6	69.8	1.0%
Cocoa NY	CC	MAY 14	2,960	55.9	57.3	57.8	0.2%
Cocoa London	C	MAY 14	1,845	53.5	54.8	55.9	0.2%
Sugar	SB	MAY 14	18.28	75.1	71.9	63.7	1.1%
Cotton	CT	MAY 14	92.88	71.9	67.9	63.2	3.1%
Orange Juice	OJ	MAY 14	156.35	81.6	74.3	63.8	1.6%

Source: Bloomberg, Saxo Bank

\*Last relative to 5 DMA.

#### WTI crude spikes before ending the week lower

Both WTI and Brent crude oils spiked on the back of the Ukraine escalation, but as the fears of an armed conflict eased, so did the price of these two global benchmarks with both ending up lower on the week. While economic sanctions and counter measures were introduced, the energy market concluded that neither side wanted to risk disruptions of the flow of gas and crude oil. The West needs Russia's oil and gas while Russia needs the West's money to fund a troubled economy and, even during the height of the Cold War, oil and gas still flowed uninterrupted.

The back of this renewed rally was broken by the weekly inventory data from the US which showed crude inventories rose for a seventh week in a row while refinery demand finally began to slow. Refineries have kept production and thereby demand for crude higher than usual following a very cold winter which ate into distillate supplies such as heating oil. With spring and milder weather now finally making an appearance, the refineries should now be able to undergo the much-needed annual turnaround from winter to summer production of gasoline. During this time demand for crude oil tends to drop and inventories rise unless imports slow at the same time.

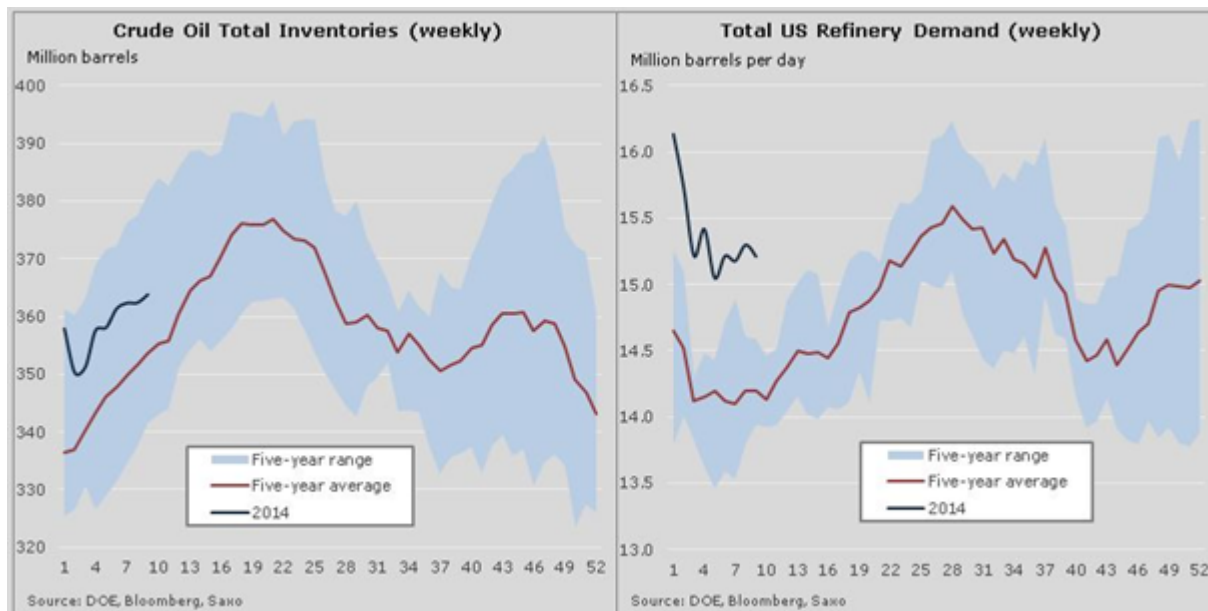
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Brent crude's premium to WTI crude has now stabilised at about USD 6 per barrels following a sharp contraction during the past couple of months. The relative better performance of WTI crude has been driven by the sharp reduction of crude inventories at Cushing, the delivery hub for WTI crude oil futures traded in New York. Following the opening of improved pipeline infrastructure from Cushing to the Gulf of Mexico (GoM), inventory levels at the landlocked storage hub in Oklahoma have dropped by 10 million barrels to the lowest in almost two years. While the "emptying" of Cushing may support WTI crude in the short term, it carries the risk of moving the bottleneck south to the GoM area. Unless refinery demand resumes its recent strong trend, the price may either have to go lower or imports will have to be lowered.

These developments still point to a well-supplied market which, geopolitical tensions notwithstanding, should make further price rises hard to achieve. Support has come from the chronic and elevated amount of crude production currently disrupted in countries from Iran and Libya to Nigeria and Sudan but against this, there is still a question mark about future demand from China, the world's biggest importer of crude. Hedge funds have accumulated a record net-long position in WTI crude during the past month and any signs of weakness below the key USD 100/barrel level could trigger an aggressive round of long liquidation.

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An escalation of tensions in the Ukraine could see oil prices spike again despite the market being well supplied. Photo: Thinkstock

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### Gold maintains positive momentum but correction looms

Precious metals have once again found support from geopolitical uncertainty with the tensions in Ukraine and Crimea lifting the price to October 2013 levels. These events together with a European Central Bank inspired rally in the EURUSD helped gold before a stronger-than-expected US job report triggered some profit-taking ahead of the weekend. The metal is trading comfortably above the 2013 lows and its 200-day moving average, currently at 1,300 USD/oz. The main buying since the break above **that level** has been technically driven by hedge funds which have been hesitant about getting involved amid expectations for another tough year for gold. With the failure to make it through important resistance at 1,360 USD/oz the risk of some profit-taking has increased, especially if the price makes it back below 1,320 USD/oz. The strong physical buying seen at the beginning of the year has been sharply reduced so while this still signals continued demand for bars and coins buyers are not ready to get involved at any price.

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Silver has been struggling to keep up with gold during a week where other metals with an industrial use, such as copper, fell to a 15-week low as China's first onshore [default](#) once again raised concerns about the financial system in the world's largest consumer of industrial metals. The move back below its 200-day moving average at 20.96 USD/oz, following the US job report, leaves the metal exposed to some additional long liquidation.

*Ole Hansen is an expert on all commodity-related issues. To keep track of Ole's commentary, go to our [online social trading platform](#).*

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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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