THE SPECIALIST IN TRADING AND INVESTMENT

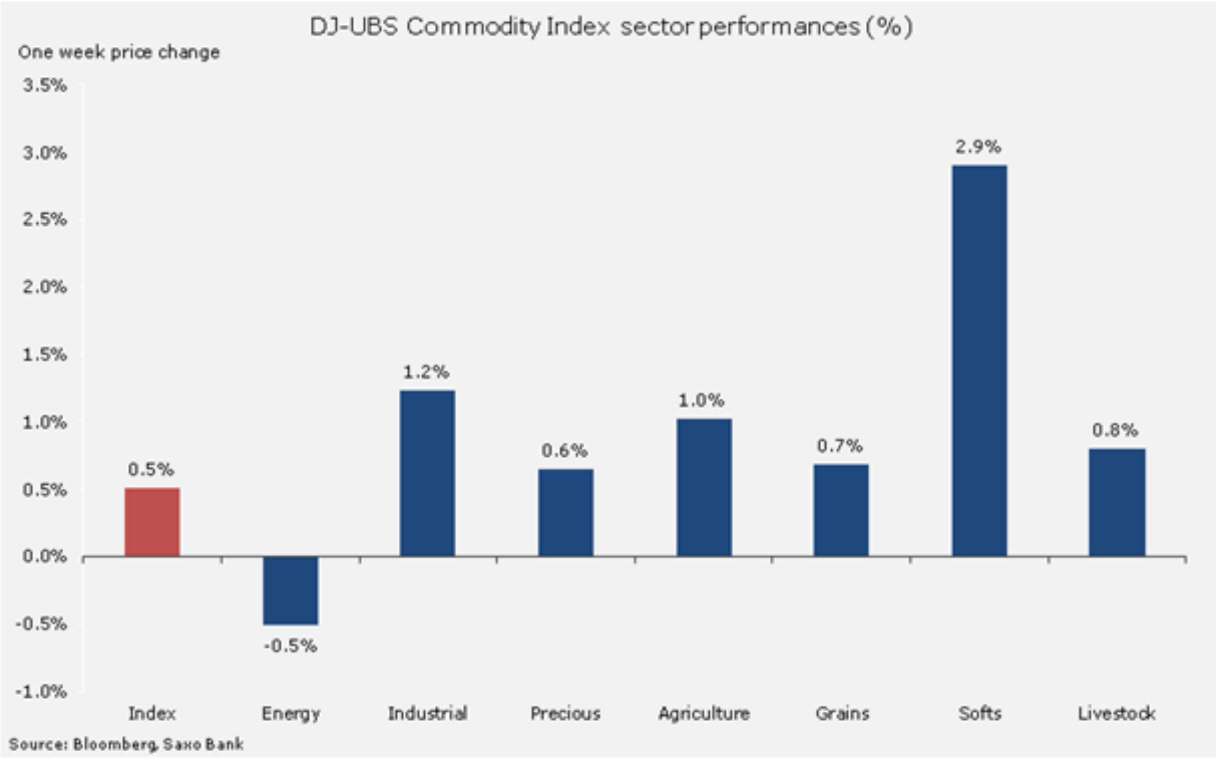
Hellerup, 25 April, 2014

Preoccupation with weather and Ukraine supporting commodities

The ongoing sabre rattling in Ukraine remains a key driver for commodities such as oil, gold and wheat while weather-related concerns continue to support the agriculture sector.

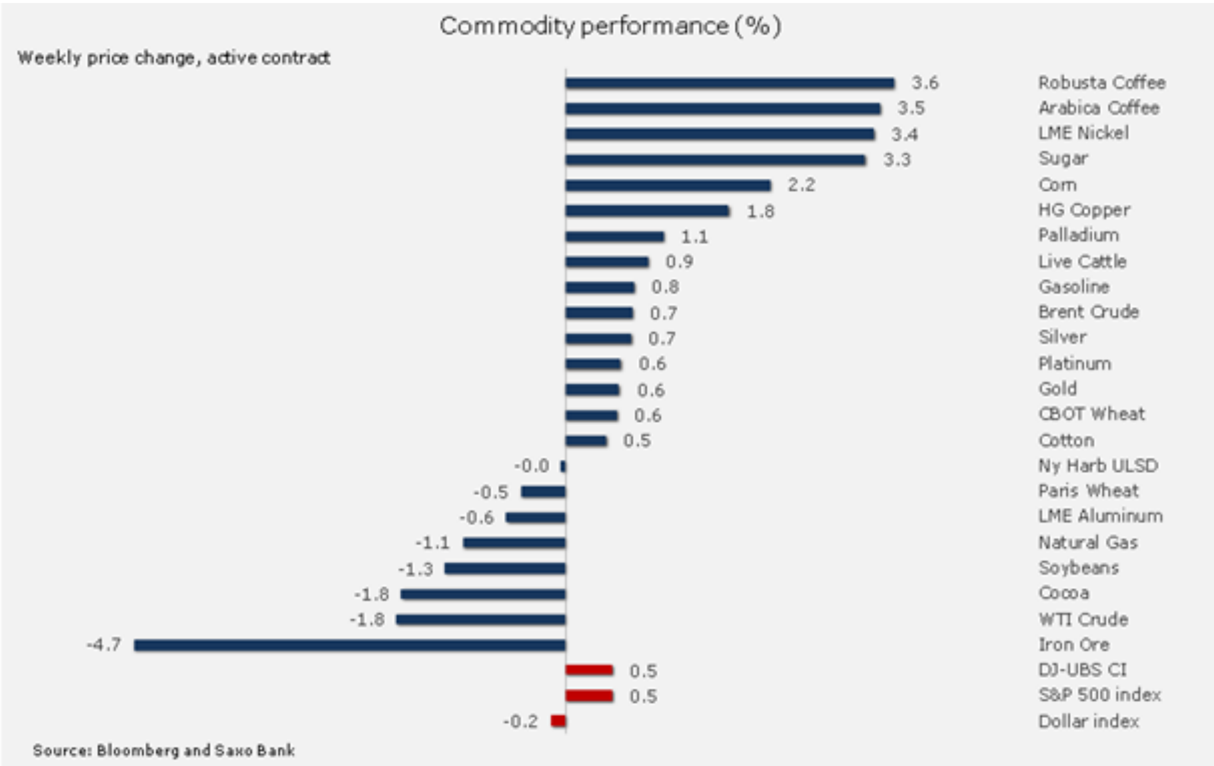
The broad-based DJ-UBS Commodity Index is on track for a fifth consecutive week of gains, with the index reaching the highest level in 13 months. Once again, the positive performance was driven by gains in agriculture where coffee, sugar and corn stood out. A continued recovery in industrial metals also helped not least copper which reached a 10-week high while nickel, now up by one-third since December, has risen in 11 out of the past 12 weeks.

Small losses were seen in energy with losses in WTI crude and natural gas more than offsetting gains in Brent crude and gasoline. US crude inventories reached a new record high while Brent found support from the continued geopolitical tensions and delays in getting Libyan exports back on track. Precious metals were mixed after a roller coaster week but generally managed to stabilise as they recovered from a major round of technical selling on Thursday which particularly hit silver.

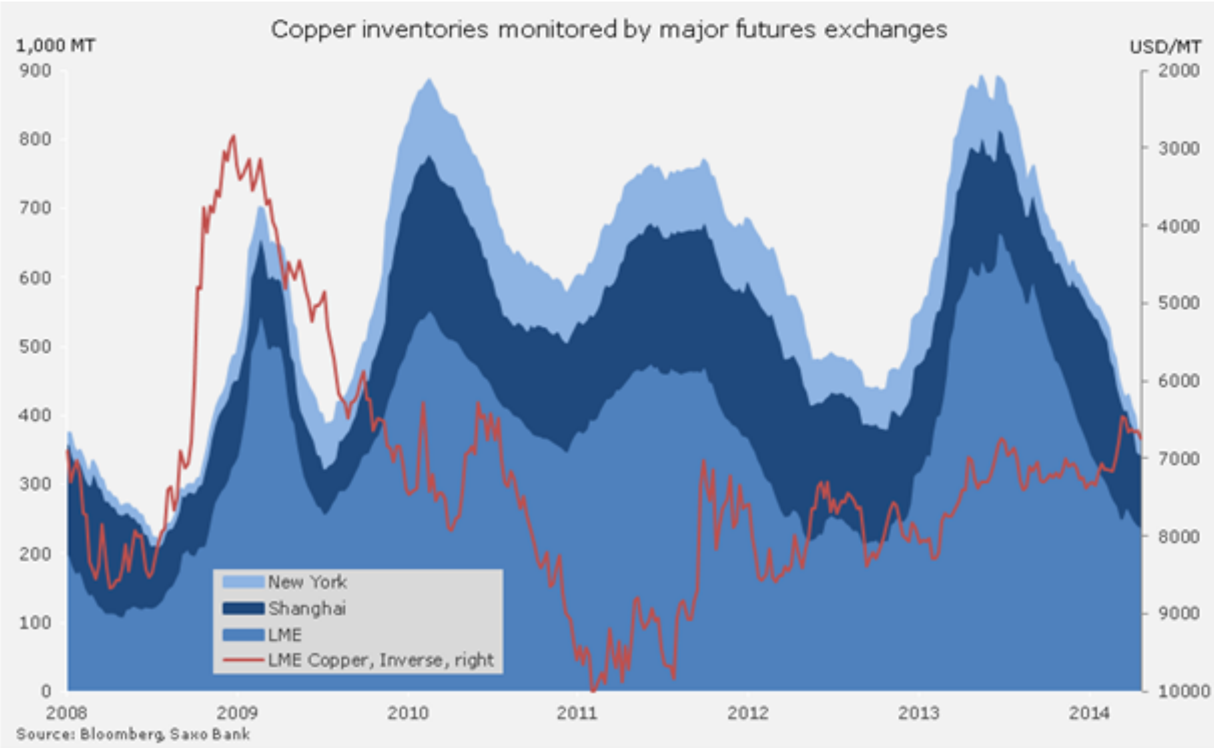


Both coffee futures came top once again as the extreme Brazilian drought during January and February continues to trigger downgrades in the estimates for output of Arabica coffee this season and this will add to the expected global supply deficit over the next two years. Robusta coffee which is primarily produced in Vietnam could see next seasons output being negatively impacted by the increased likelihood of an El Niño event later this year. Sugar was another strong performer and looking ahead an El Niño event could negatively impact production in both South Asia with too little rain during the monsoon season and South America where the problem would be too much rain.

The key grains markets were mixed with gains in corn and wheat being somewhat offset by losses in soybeans. Corn jumped on continued delays to spring planting due to wet and cold weather in the US Midwest. As of April 20 only 6 percent of the corn crop was planted compared with a 14 percent five year average. A continued delay could result in a larger soybean acreage due to its later planting cycle and this combined with reduced soybean demand from China which has seen South American cargoes being diverted to the US and this is helping reduce the upward price pressure that has been created from the tightest supply situation in decades. Wheat recovered from an early Easter sell-off as tensions in Ukraine still raises questions about the potential output from this key production region while the US winter crop on the southern Plains are still short of rain to ensure a proper yield.



HG copper climbed to a seven week high at 310 cents/lb on speculation about further Chinese easing and rising demand in both US and China, the world's two biggest consumers, as stockpiles monitored by global exchanges in London, New York and Shanghai fell to the lowest since 2009. Copper is currently the only commodity out of 24 where hedge funds maintain a net-short position and the supportive fundamental news helped trigger short covering. Further upside on the May futures contract from continued short covering may be limited above 314.5 cents/lb while support is now anchored at 308 cents/lb.



Gold continue find little to cheer about although the sharp 32 dollar bounce on April 24 was a clear sign that although long positions are being scaled back, the geopolitical worries related to Ukraine should restrain many from going aggressively short at the moment. Silver dropped through trend-line support at 19.30 and wiped out all the gains for the year but strong buying interest below resulted in a sharp recovery and the ratio to gold contracted after blowing out to 67 the relative cheapest silver level since August 2013.

Improving US data, a weaker dollar and lower bond yields have not prevented the outflow from exchange traded products to continue while hedge funds reduced net-longs for a third week during the week of April 15. The market look range bound for now with the risk of an escalation in Ukraine remaining the biggest supporting factor. On the other hand we see a potential negative impact from the focus on the US economy combined with worries that a continued weakening of the Chinese yuan may trigger some additional supply from the unwinding of financing deals where gold has been used as collateral.

A report before Easter from the World Gold Council (WGC) forecast that China's 2014 demand for gold would likely be unchanged after the surge in 2013. More worryingly for bulls relying on Chinese demand to offset reduced demand from global institutional investors were the Councils estimate that more than 1,000 tons of gold may have been tied up in financing deals within China's growing shadow banking sector. The government recently allowed the Chinese yuan to weaken and some see this as a way of trying to reign in some these rogue lending practices where natural resources such as gold and copper are used as collateral to secure offshore US dollar loans which then gets converted into yuan and invested domestically. When the yuan slides the cost of these dollar loans rise and this has increased speculation about liquidation of deals and the selling of the assets supporting the loans.

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A geopolitical risk premium of between 5 and 10 US dollars continue to support crude oil futures and this is leaving hedge funds — which once again are holding near record net-long positions in WTI crude oil futures — with little interest in reducing exposure at this time. A surge in US crude inventories to a record high did leave the price of WTI crude underperforming Brent crude which found support from the Ukrainian tensions and Libya's continued failure in re-opening its ports for shipment of crude. As a result, Brent has seen its price premium over WTI crude widen back out to 8.5 USD/barrel after touching 3.25 USD/barrel two weeks ago. So far both varieties are being well supported by the escalating uncertainty about what could happen next in Ukraine. We see continued range bound behaviour near-term with Brent crude stuck between 108 and 112 USD/barrel and WTI between 100 and 104 USD/barrel.

US crude inventories rose to a record of 397.6 million barrels which is the highest level since the Energy Information Administration began recording this data back in 1982. The improved pipeline infrastructure from the shale oil producing regions inside the US to the Gulf of Mexico has triggered a rise in inventories to a record of 209.6 million barrels. Despite this region being the world's biggest refining hub the continued strong flow carries the risk of overwhelming storage facilities and this could eventually either lead to reduced flows from Cushing (the massive storage hub and delivery point for WTI crude oil) or force a reduction in imports which at 7.8 million barrels per day is running close to its 52-week moving average. Either would be seen as price negative for crude oil which barring any additional flare up in Ukraine leaves oil prices exposed to weaker price action this quarter.

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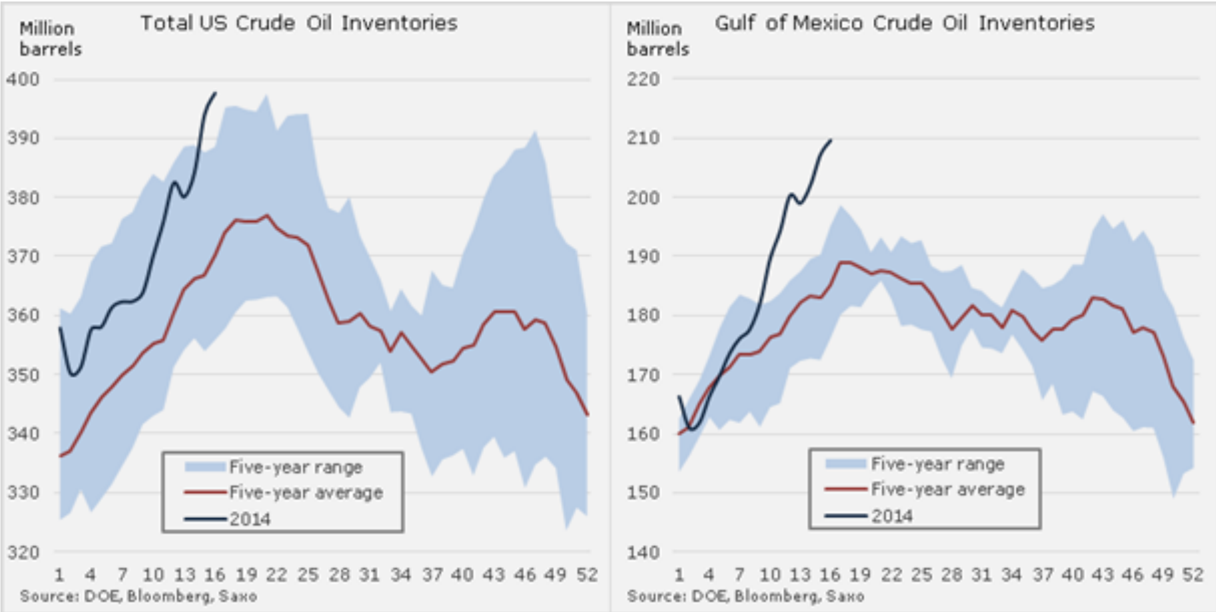

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Ole Sloth Hansen is a specialist in all traded Futures, with over 20 years' experience both on the buy and sell side. Hansen joined Saxo Bank in 2008 and is today Head of Commodity Strategy focusing on a diversified range of products from fixed income 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.