

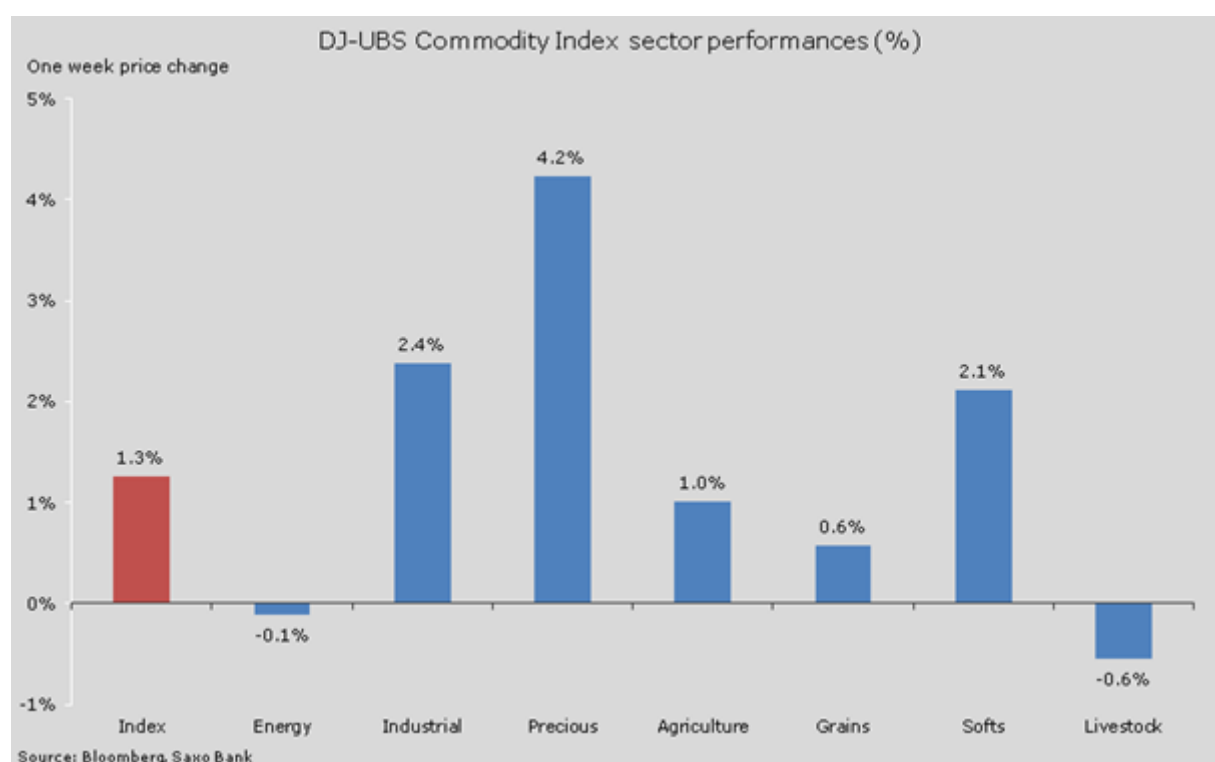


THE SPECIALIST IN TRADING AND INVESTMENT

Hellerup, 20 June, 2014

## Iraq casts shadow over oil; silver goes on the rampage

Commodity markets were generally higher for a third week with last week's winner, the energy sector, being a small loser during the past week. This, however, is primarily due to weakness in natural gas while crude oil and products remain supported by the tense situation in Iraq. Precious metals were a major winner as a several key events and some technical developments lend support.



Industrial metals also recovered with HG copper heading for the first weekly gain in four on news that stockpiles monitored by the major futures exchanges in New York, London and Shanghai have fallen to the lowest since 2008 as Chinese demand remains robust and US manufacturing data continues to show a promising development.

The agriculture sector was relatively quiet apart from the soft sector where cocoa reached the highest since August 2011 while sugar rose strongly back towards the highs within its current range between 17.5 and 19 cents/lb.

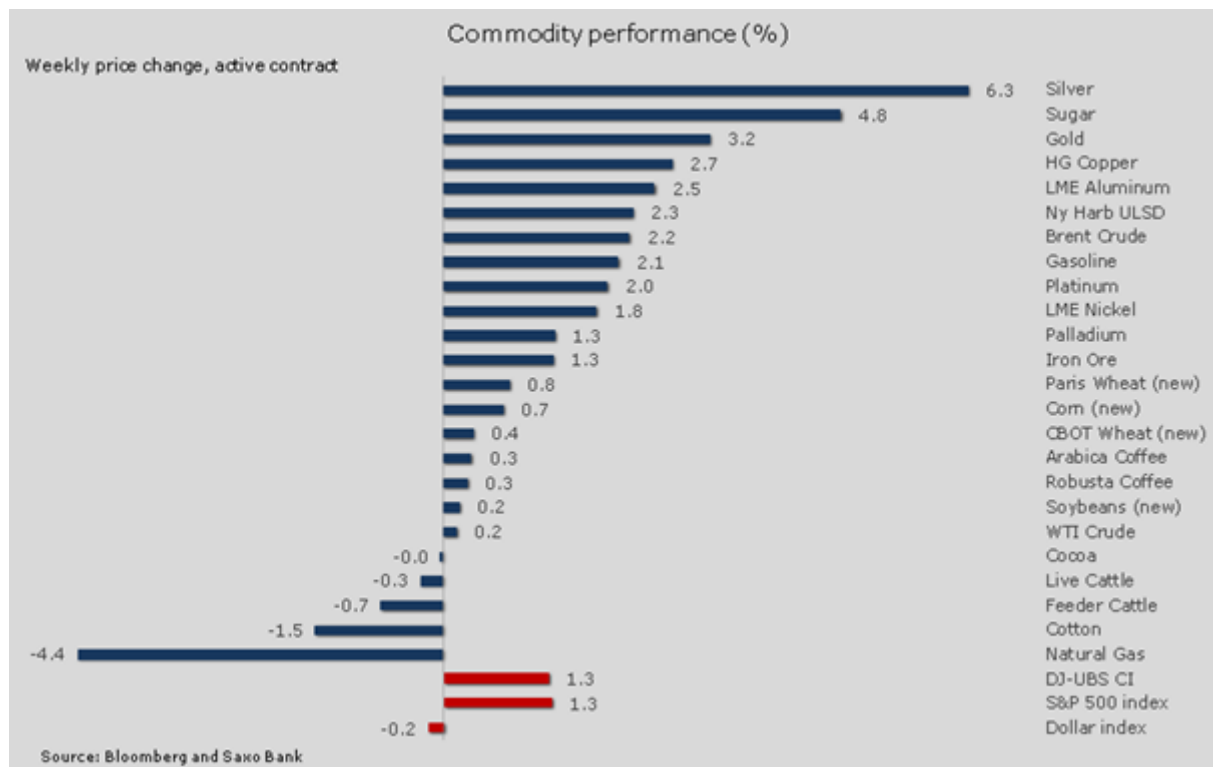
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**WWW.SAXOBANK.COM** SAXO BANK A/S Philip Heymans Allé 15 2900 Hellerup Denmark

Telephone: +45 3977 4000 Telefax: +45 3977 4200 Reuters Dealing Code: SAXO Cvr. nr. 15 73 12 49 info@saxobank.com



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The big focus, however, remains on the oil markets and after the spike the previous week, crude oil markets continue to be well supported by ongoing tensions in Iraq and the country has unfortunately now joined the already long queue of oil-producing countries where production has already been reduced or are at risk of being reduced.

Although supplies from Iraq are yet to be disrupted, the oil market and central bankers will be worried about rising oil prices and its impact on a global economy which is still trying to recover. Iraq has risen to become OPEC's second biggest producer and exporter during the past three years, notably overtaking Iran where exports remain restricted due to the current disagreement with the west over its nuclear intentions.

Crude oil markets have been a relative sea of calm during the past three years despite some major geopolitical events. These have only been able to keep prices elevated for relative short periods thereby ensuring a stable price of Brent crude close to 110 USD/barrel since the Arab spring in 2011.

This complacency about supply risks has to a large extent been driven by the strong increase in alternative supply channels from non-OPEC producers such as Canada and especially the US. Just this week it was announced that Dakota shale oil production had reached one million barrels per day compared with less than 300,000 barrels three years ago. The three major US shale plays which include Dakota has risen from 1.5 million barrels per day to a current rate above 4 million and it is still rising.

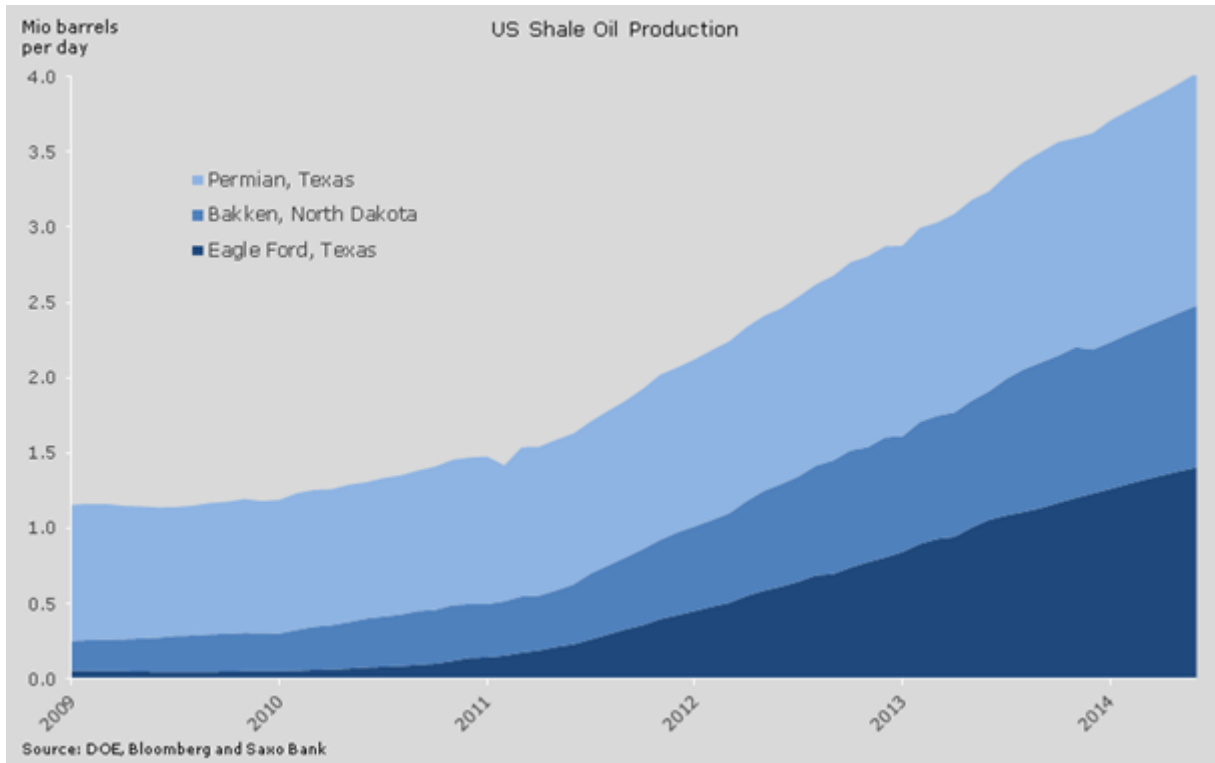
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The potential resumption of US exports of crude oil, currently prohibited by law, has together with increased production from Saudi Arabia helped keep oil markets stable despite current supply disruptions from especially Libya and Iran where production has slumped by a combined 2.4 million barrels per day since 2011.

Iraq is currently divided into three areas, the Kurdish-controlled northeast, Sunnis to the west and Shi'ites to the south. The vast majority of Iraq's oil production is concentrated to the Shi'ite controlled south where exports are carried through the port at Basra. Exports from the Kurdish-controlled north are currently only running at few hundred thousand barrels per day due to constant disruption of the major 600,000 bpd Kirkuk pipeline going north through Turkey.

What makes this crisis so potentially explosive is once again the strife between the Sunni and Shi'ite population groups with the toppling of the Sunni-supported regime of Saddam Hussein giving way to a Shi'ite-controlled government which has struggled to include Sunni representatives into its government.

This lack of inclusion is currently one of the big obstacles that needs to be addressed before a lasting solution to the current crisis can be achieved.

In the meantime, we have seen Iran come to the verbal defence of the Shi'ites and Saudi Arabia which is Sunni warning foreign powers not to meddle. This involvement by two of the world's major oil suppliers once again leaves the US stuck in the middle and its potential involvement will be followed very carefully over the coming days and weeks.

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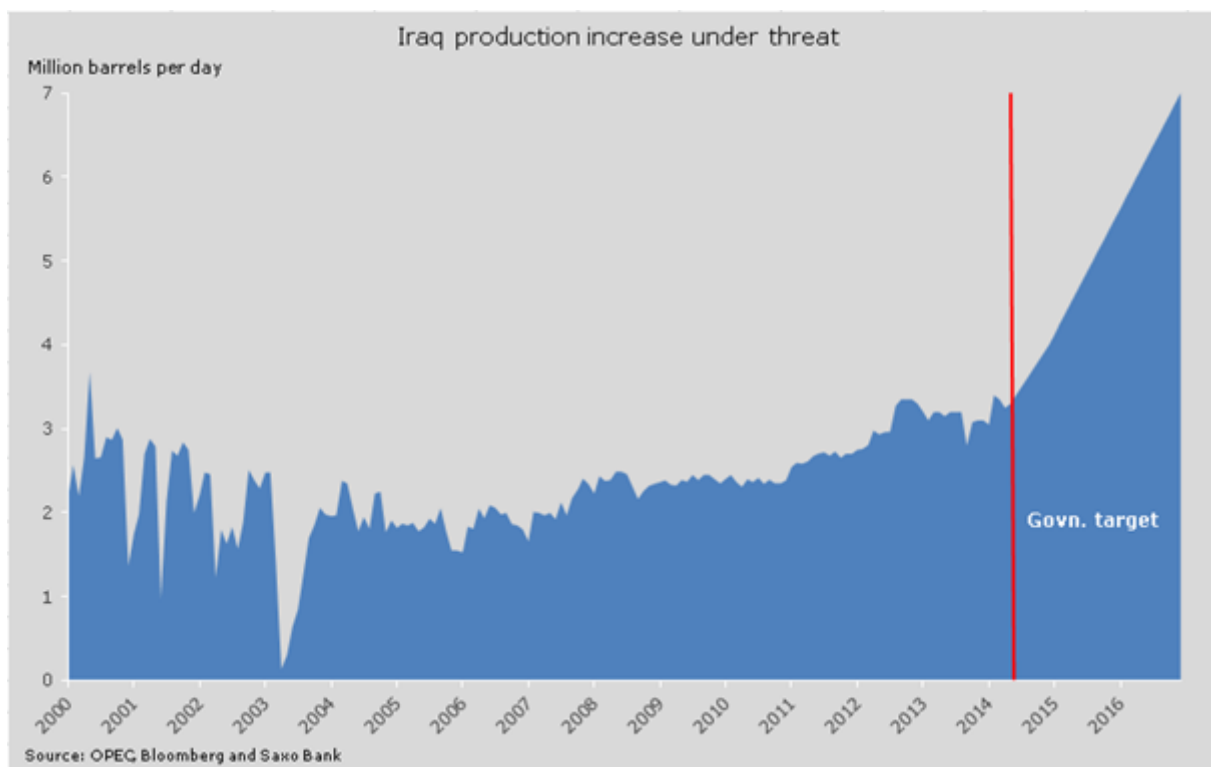
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So far the Sunni insurgents have managed to break into Iraq's largest refinery and some damage has been reported which potentially could result in the Iraqi government having to look abroad for essential supplies of products such as gasoline and diesel.

Since late 2010, Iraq's oil production has risen by almost one million barrels per day which, as mentioned, has helped offset the reductions from Libya and Iran. The government's very bullish forecast of reaching 4 million at the end of 2014 and 7 million by 2017 has, however, now been put into doubt by the prospect of months if not years of political instability similar to what we have seen in Libya following the toppling of Moammar Gaddafi.



Crude oil volatility has risen from a record low but so far the market remain relative calm with the Shi'ite south so far not being impacted. For the coming week, the established ranges for Brent and WTI crude should probably remain intact, but with the risk still skewed to the upside, not least considering the ongoing problems in Ukraine which also continues to casts a spell over energy security.

Only a break back below 111 USD/barrel on Brent crude and 105 USD/barrel on WTI crude could indicate that the tensions have begun to ease. Any realised threat to supplies could see a return to the 2011 and 2012 peaks above 125 dollars per barrel and possibly beyond.

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Source: Saxo Bank

The above-mentioned support levels, however, also carries increased importance as nothing ever just goes in one direction. Hedge funds are once again holding a record net long exposure, especially in WTI crude, and a move towards a potential solution resulting in a break of the mentioned levels of support could trigger a major price reversal due to long liquidation just like we witnessed during May 2011 and May 2012.

A correction would, however, only remove some of the elevated geopolitical risk premium as we still have Libya producing less than 15 percent of capacity and Ukraine posing a potential risk.

Gold and especially silver also showed sign of life during the week with gold racing back above its 200-day moving average and silver reached a three-month high.

Several individual events laid the foundation for the this strong performance. First of all the geopolitical uncertainty related to Iraq and also Ukraine had already helped lift the price from its recent lows. Adding to this, a relative dovish statement from the US Federal Reserve following its recent Federal Open Market Committee meeting helped both metals break previous levels of resistance which gave both metals an added boost from momentum and technical traders.

Fourthly and probably equally important, was the speculative positioning held in the market by tactical traders such as hedge funds and money managers. As of 10 June, they held a record net-short in silver and only a relative small net-long in gold due to the biggest held gross short position since January.

Silver has shown the strongest performance of the two and looking at the chart below we are currently in the process of breaking the trend line which has been providing resistance ever since it almost reached 50 USD/oz back in April 2011.

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