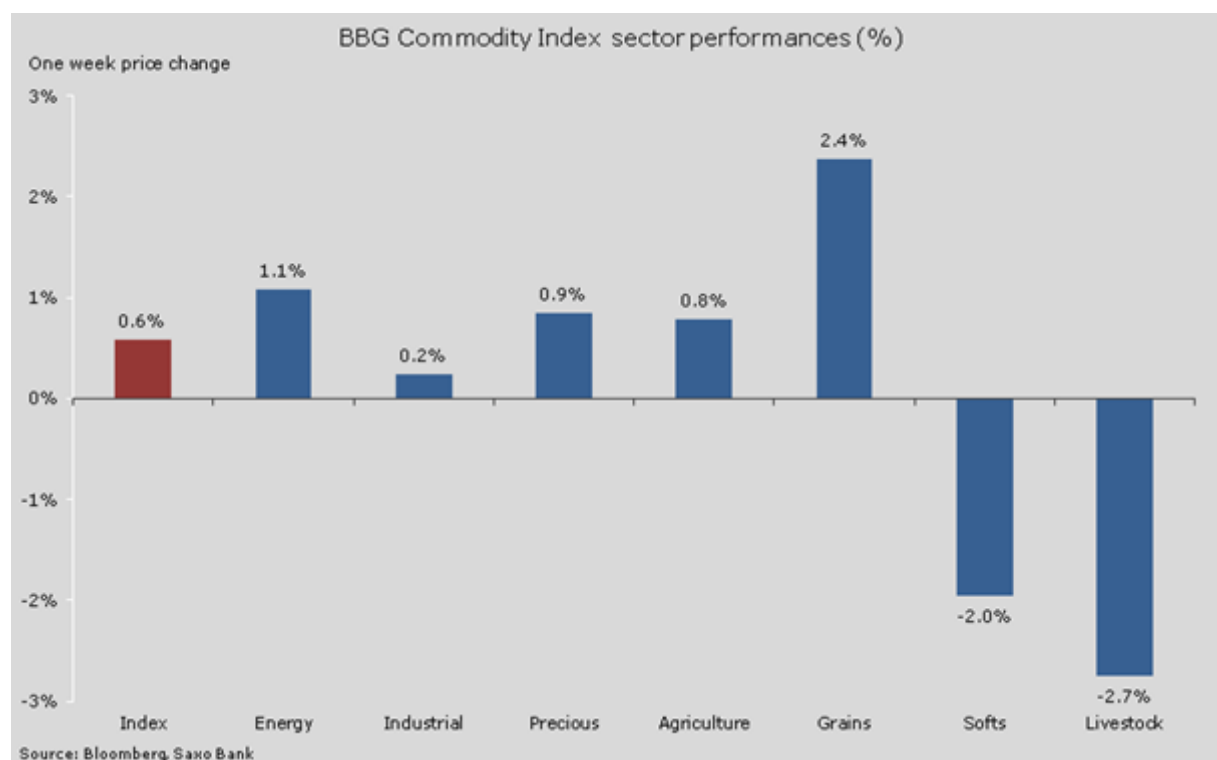




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Escalating geopolitical discord lifts commodities after dismal July

After hitting a sixth month low at the end of July, the broad based Bloomberg Commodity Index (formerly known as DJ-UBS) managed a small comeback this week. Multiple geopolitical worries halted the slide in crude oil and gave precious metals a lift while industrial metals took stock following disappointing economic data from China and Europe.



The agriculture sector was higher as the grain sector returned from the abyss, thereby helping to offset losses in soft commodities, not least coffee and sugar, while livestock fell for a third week.

CBOT wheat jumped the most in almost five months as the focus on ample global supply was somewhat overshadowed by worries that persistent rain in key European growing regions could hurt quality. The renewed tensions in the Black Sea region were an additional worry. With the prospect for a very large global harvest of both corn and wheat, further upside potentials seem limited. The latest move has to a large extent been driven by financial traders who held an almost record short position as of July 29.

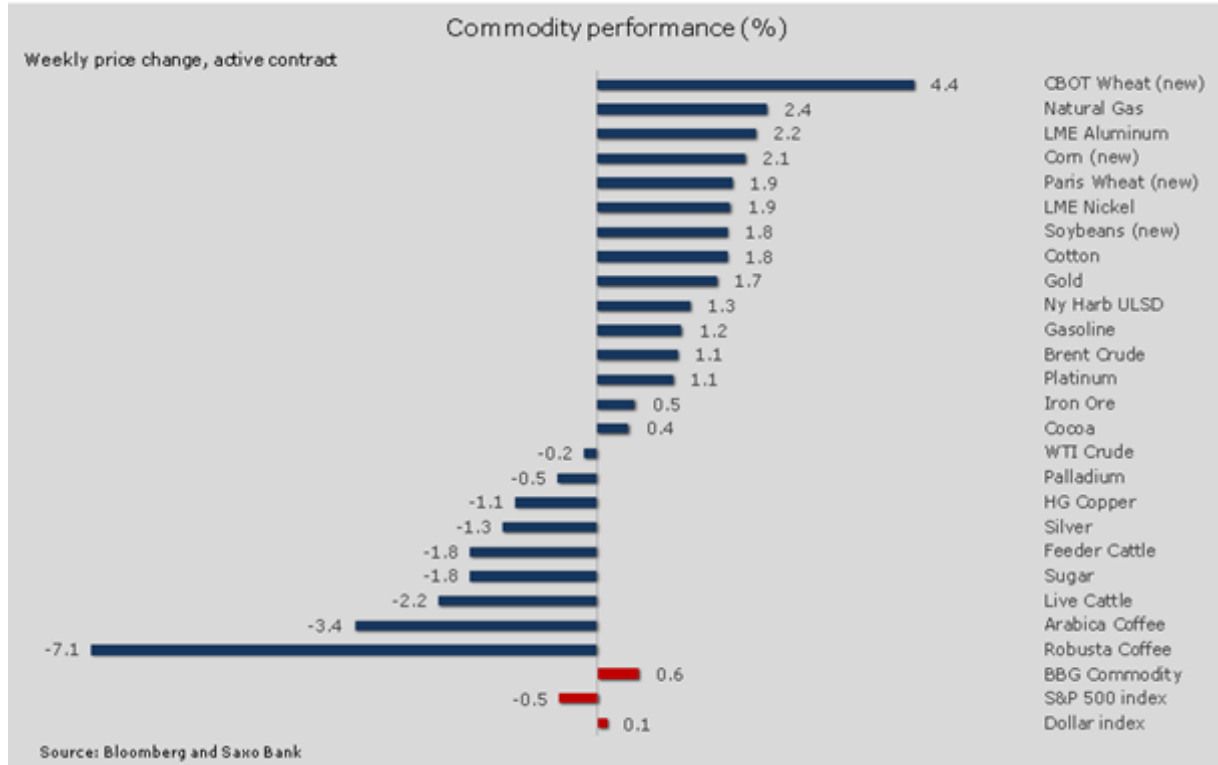
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Oil markets remain torn between the near-term outlook for ample supply against persistent worries about the impact from multiple geopolitical events, most recently the continued advance of Islamic militants in northern Iraq and subsequent announcement by the US that it has authorised targeted airstrikes across the area.

As a result of this Brent crude oil has bounced off important support at 104 USD/barrel following a week long sell-off. This downturn had been triggered by financial traders reducing bullish bets amid weak demand and an Atlantic basin which is currently oversupplied. The bounce has led to a renewed focus on the upside with the potential currently limited to 108.50 USD/barrel. Not least considering the near-term outlook for stable supply at a time of slowing demand as we move out of the period of peak demand. US airstrikes could potentially also help the Kurdish Regional Government in northern Iraq reassert its effort to increase oil production from a region which has remained relatively stable up until recently.

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Source: Bloomberg, Saxo Bank

Returning to the subject of ample supply, we have now seen the prompt spread between the first and second futures contract on Brent crude remain in contango for more than one month. This is a relatively rare event for Brent crude and one this size hasn't been seen since before the Libyan war back in 2011.

That armed conflict in Libya was the first of several geopolitical events since then to create a perception of tightness in the spot market. The current situation where the price of spot crude trades 65 cents below the next futures contract has been triggered by ample supplies and increased competition for buyers in the Atlantic basin. This is not least due to the ongoing rise in US shale oil production which limits the amount of crude the US needs to import while simultaneously increasing the amount of products being exported.

Until we see either refinery demand in Europe pick up or the removal of excess supplies in the Atlantic basin, the upside for Brent crude will remain limited as financial traders will be balking at the prospect of buying a contract which incurs a negative rolling cost.

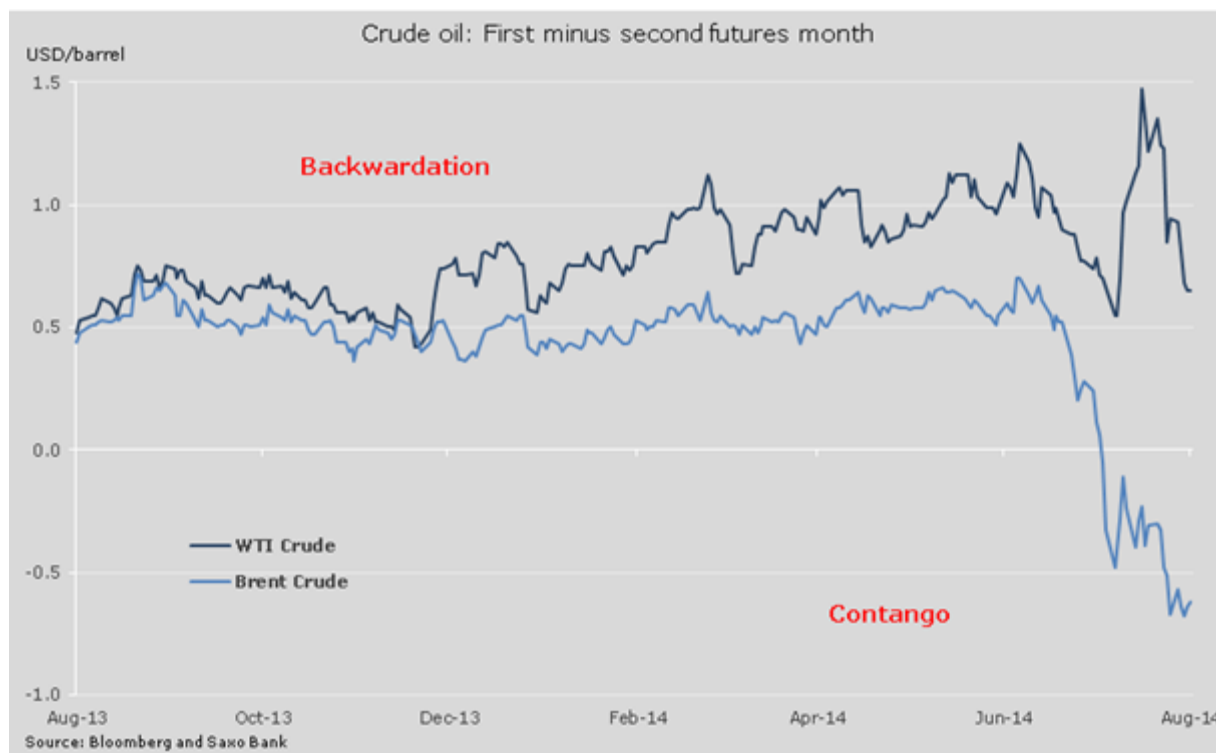
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WTI crude has not been exposed to the same headwind as the prompt spread remains in backwardation with 65 cents following a period of strong refinery demand which has helped deplete inventories at Cushing, the delivery hub for NYMEX WTI crude oil futures. Looking ahead, however, we expect the rapid pace of refinery demand will begin to slow and with it demand for crude which should help reduce the current tightness as expressed by the abovementioned backwardation.

With geopolitics back in the driving seat, WTI crude's discount to Brent crude has nevertheless managed to widen and it is now approaching resistance at -9 USD/barrel, a level through which it has been reluctant to penetrate over the past five months.

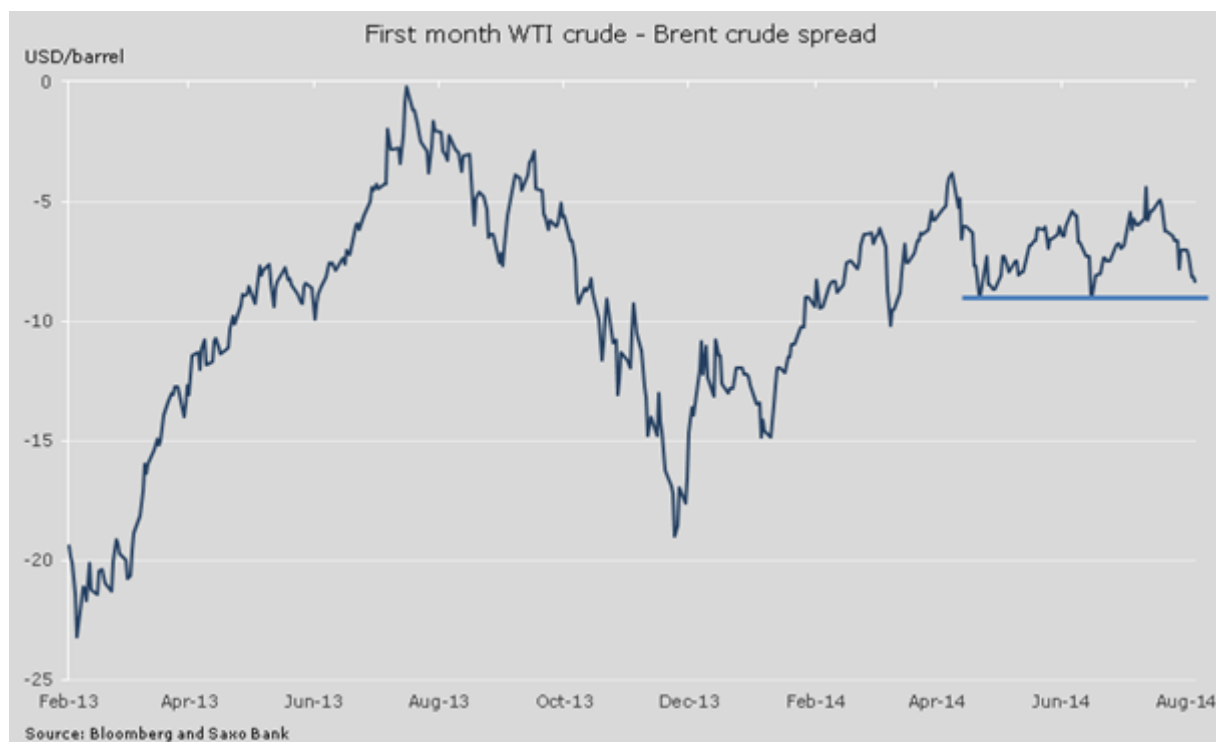
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Gold held key support early this week and the continued focus on an array of geopolitical issues, falling stocks and rising bonds, have provided the metal with a new lease of life. This triggered a four-day rally resulting in the price hitting a three-week high and in the process slicing through several layers of resistance.

The tit for tat standoff between the West and Russia over Ukraine will hurt economic growth on both sides, not least in Russia and Europe, and as a result stock markets continue to sink deeper into the red while bond yields continue to fall, both of which play into the hand of those looking for reasons to buy gold.

The latest developments in Iraq, whereby the US authorised targeted airstrikes against Islamic State fighters in the northern part of the country, triggered this latest move higher. As we have seen on several occasions during the past few months, geopolitics tends to only have a short term supporting impact on gold.

But as we watch stocks slide and bond yields tumble another dimension has been added at this stage. The option market is also telling a story considering we are now seeing options traders pricing a standard three months risk reversal trade in gold with a 25 percent delta in favour of the upside by the biggest margin since January 2012. With geopolitical events and worries about further stock market losses

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back centre-stage, gold's prospects have improved and for the week ahead traders will most likely be looking to buy gold on any significant dips.

Silver managed to find support at the key technical level of 19.76 USD/oz following a three-week slide which took the metal down by 8.5 percent. Having been a distinct underperformer relative to gold during this time it now has the potential to play catch-up.



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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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