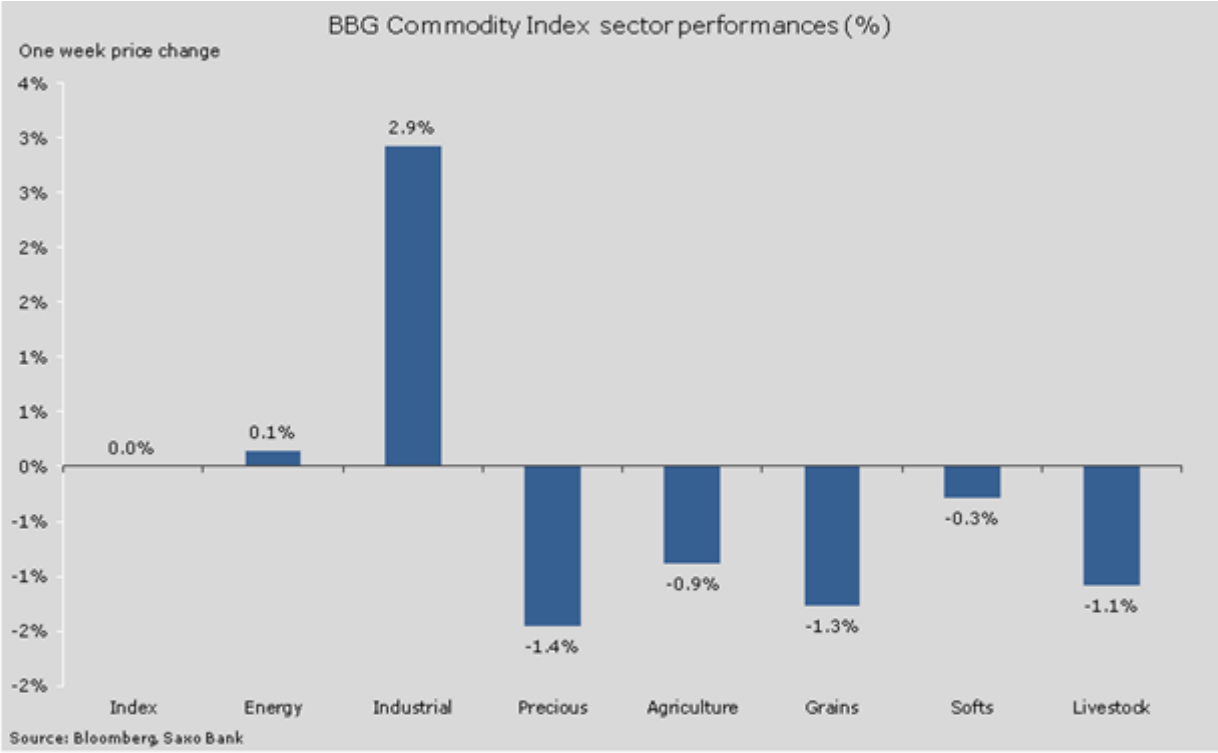
THE SPECIALIST IN TRADING AND INVESTMENT

Industrial and precious metals go their separate ways

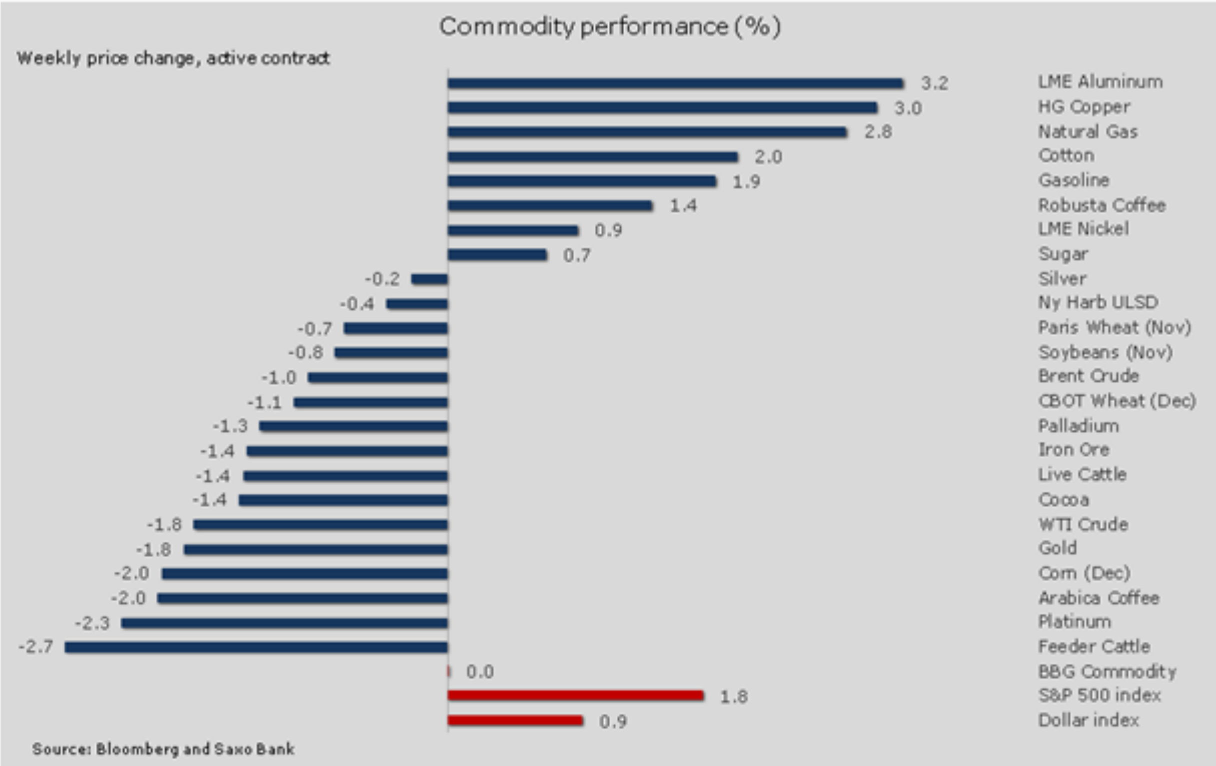
By Ole Hansen

Commodities have been generally flat this the week as a rise in industrial metals was offset by losses across other sectors such as metals and grains. The energy sector was flat as natural gas and gasoline rose, while both crude oils were lower on the outlook for rising supplies. Precious metals suffered, but still managed to find support despite a near perfect storm of non-supportive news. A massive US crop continues to suppress grain and soybean prices as hedging activity from farmers and speculative selling from traders continue to weigh on prices.

The Bloomberg Commodity Index was unchanged, as a near 3% gain across the industrial metal sector help offset declines in both precious metals and agriculture commodities.



While commodities were mixed, the S&P 500 index rose to a new record high and the dollar reached its highest level against a basket of currencies since last September.



Platinum, which found support in the first half of the year on the back of a five-month mining strike in South Africa, the world's biggest producer of the metal, has since been increasingly running out of steam.

The spot price has been falling for the past 10 trading days, the longest stretch of losses since January 1987, according to Bloomberg.

Copper, along with aluminum and zinc, rose strongly despite mixed signals from the world's two largest consumers: China and the US. Factory activity and house price developments in China disappointed, while activity across US factories expanded at the fastest pace in four years and three housing activity indicators all beat consensus estimates.

As a result, HG copper rose for the first time in four weeks after finding support at 3.10 USD/lb and it should now settle into a range with 3.30 USD/lb offering resistance.

HG Copper, December 2014 future

Source: Saxo Bank

US natural gas futures have settled into a range between 3.75 and 4.00 USD/therm. A strong weekly injection into underground storage in the past 18 weeks has all but removed worries about potential supply shortages following a significant depletion last winter.

However, in order to reach a safe level of 3.5 trillion cubic feet by October, when demand will begin to outweigh supply, the weekly injections will have to run significantly above the average seen in recent years. On that basis, there will be little room for error, which would favour higher prices.

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The near-term outlook also looks supportive as higher then usual temperatures in late summer may increase demand from power-plants, while the first storm threat of the current hurricane season may also create some attention.

Hit on all fronts

Precious metals hit an almost perfect storm of adversity this week as the dollar, stocks and bond yields all rose and US economic data remained robust. These all helped further remove some of the support seen during the past few months, not least from geopolitical worries and falling bond yields.

Gold has now almost gone full circle, with the price returning to the area from where the rally kicked off back in June when Islamic State insurgents began their move into Iraq. Gold nevertheless managed to stay above trend line support at USD 1,271/oz., which could indicate limited selling appetite.

Some attention now turns towards the expected seasonal pick up in physical demand from India ahead of its festive season. Although demand is expected to be lower than previous years due to import restrictions, the recent drop in prices may have improved the outlook for demand.
Silver now seems to have come through what has been five weeks of almost non-stop long liquidation, during which time it has dropped by more than 10%. Back in July, the speculative net-long position reached unsustainable levels and once sentiment turned several weeks of selling followed.

The price pick up seen in industrial metals, to which silver partly belong, has helped stabilise the price and triggered some renewed outperformance relative to gold. The XAUXAG ratio (which expresses the cost of one ounce of gold in ounces of silver) recently peaked at 66.8 and could now be heading back towards 65, followed by 64.50.

XAUXAG ratio chart

Source: Saxo Bank

Crude oil markets remain under pressure with increased supply - and even talk of supply gluts - continuing to hurt sentiment. This comes as poor global economic growth prospects has left the outlook for demand growth relative subdued. Brent crude spot prices remain depressed relative to forward prices. This resulted in Brent crude reaching a 14-month low, while WTI crude has seen the longest losing streak in nine months.

This softness has been spreading to other crude oil markets, not least the Middle East where the discount of Dubai crude relative to Brent crude is at a four-year low. This should eventually help crude oil from the Atlantic basin to compete for customers in Asia and potentially help move more oil east, thereby reducing the supply glut that has negatively impacted crude oil from the North Sea and West Africa.

But for now the focus remains firmly on the continued rise in supplies. In July, Libya's main export terminal opened following a one-year blockade. It has since gone from producing 400,000 barrels per day to 612,000 b/d this week. Meanwhile, the Iraqi Kurdistan pipeline to Turkey will reopen following an upgrade which should double capacity to at least 200,000 b/d.

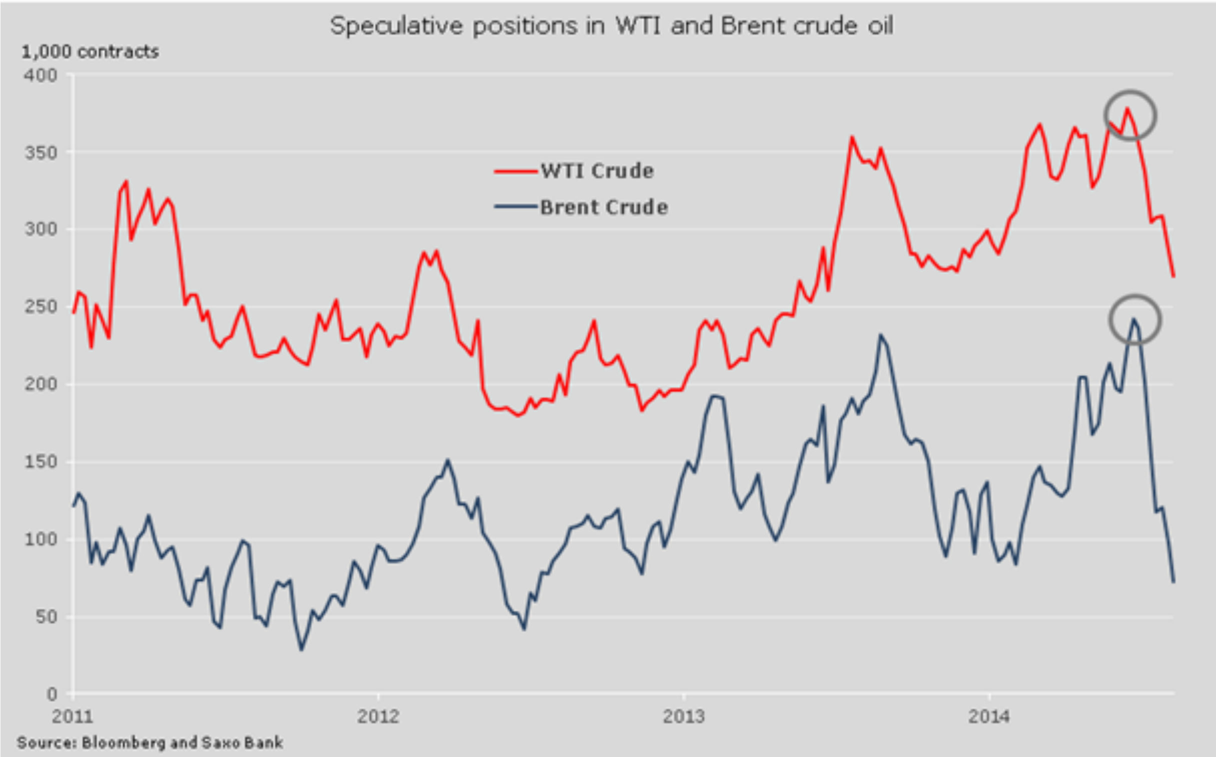
Continued price weakness could eventually trigger a reaction from OPEC where Saudi Arabia has been pumping hard to meet the shortfall that up until recently had prevailed following the blockades in Libya.

Gold can expect a fillip from India's upcoming festival season. Photo: kurkul \ Thinkstock

WTI crude feels the heat in the US

In the US a surprise rise in inventories at the delivery hub for WTI crude oil futures traded in New York helped trigger a relative bigger fall in WTI crude compared with Brent crude oil. Despite a more supporting structure in WTI crude where strong refinery demand has kept the relative cost of prompt crude higher than deferred, the price nevertheless came under pressure.

Another reason for this underperformance can be found by looking at the speculative positioning in crude oil by hedge funds and money managers. After reaching record net-long positions on both crude oils back in June the subsequent slump resulted in bullish bets on Brent crude being cut 70%, while WTI crude only witnessed a 38% reduction, both up until August 12. This week essentially saw investors in WTI crude reacting to the continued price slump and the weaker structure by cutting back further these bullish bets.



By how much will be revealed at the close of Friday when the latest Commitment of Traders report will be made available by the US Commodity Futures Trading Commission. An update will, as usual, be available on TradingFloor.com the following Monday.

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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.