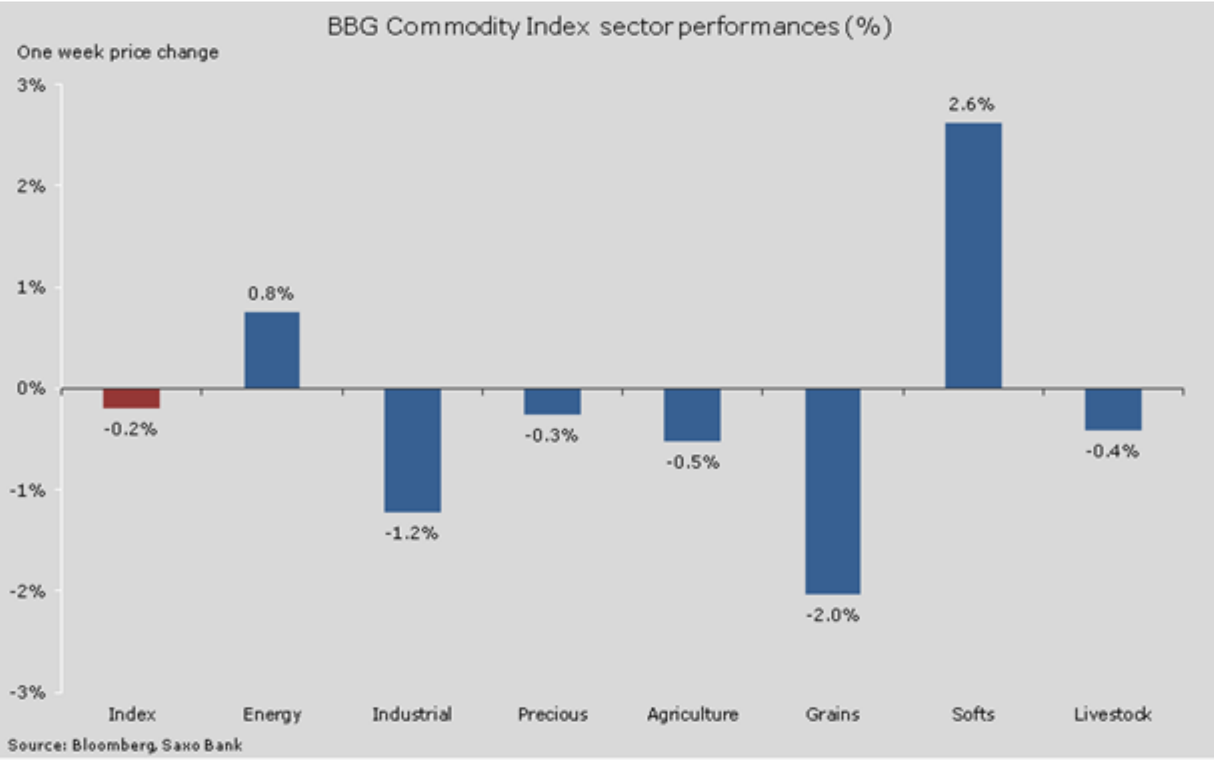
THE SPECIALIST IN TRADING AND INVESTMENT

High supplies, fading demand and Ebola fears hit commodities

The broad-based BBG Commodity Index, which tracks the performance of 22 major commodities, reached a new five-year low before trading close to unchanged on the week. Performances across individual sectors are very mixed, with gains in energy and soft commodities offset by losses in industrial metals and grains.

Stock market weakness, falling bond yields and the strong dollar (which continues to reach new heights) were some of the overall drivers, with geopolitical worries holding steady on the horizon.



Refinery shutdown supporting gasoline

Gasoline reached its highest levels since July as the fuel received a boost from reduced availability around the northeastern US (a region that includes New York, the delivery hub for RBOB Gasoline futures). Several refineries on the Gulf Coast and in eastern Canada have shut down for unscheduled repairs, which is bad timing considering that this the time of year when other plants conduct seasonal maintenance.

Iron ore slumped to a five-year low as increased supply from the major mining companies left the metal struggling to find buyers. This is especially true in China, where steel demand is on track to show its first annual reduction since 2000.

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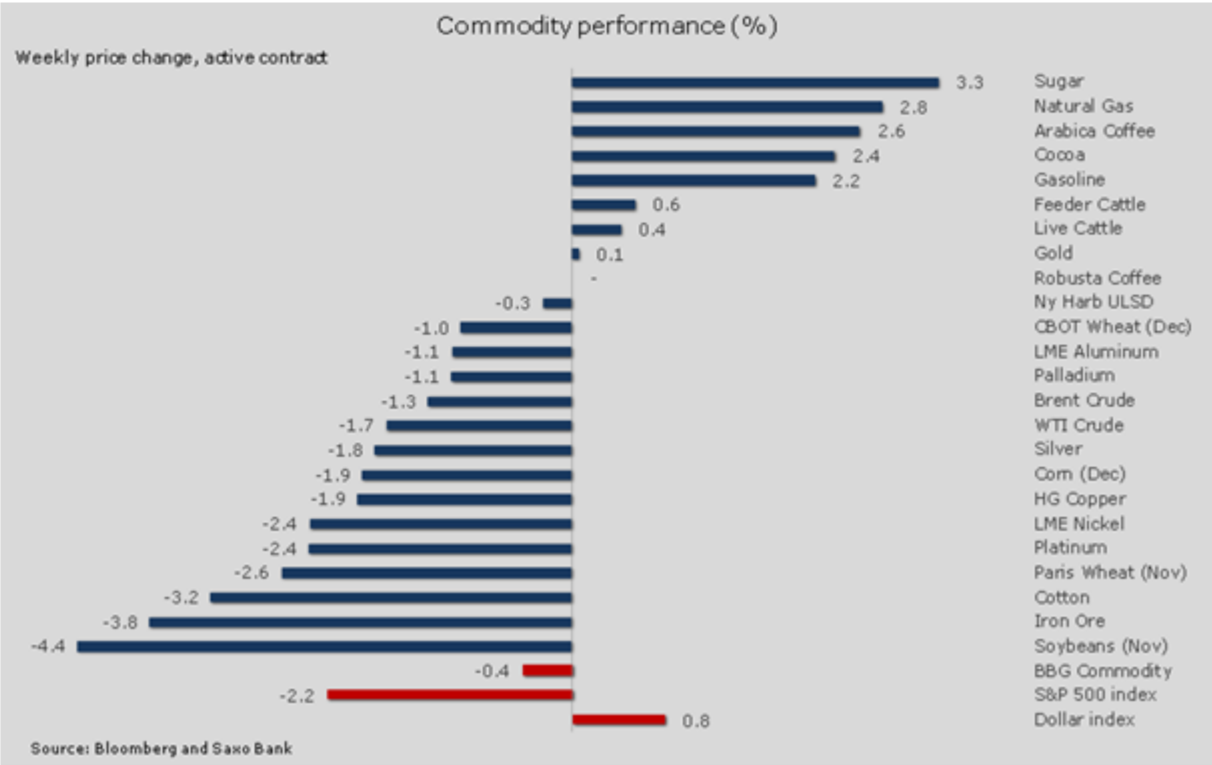


Crude oil markets still focusing on rising supplies

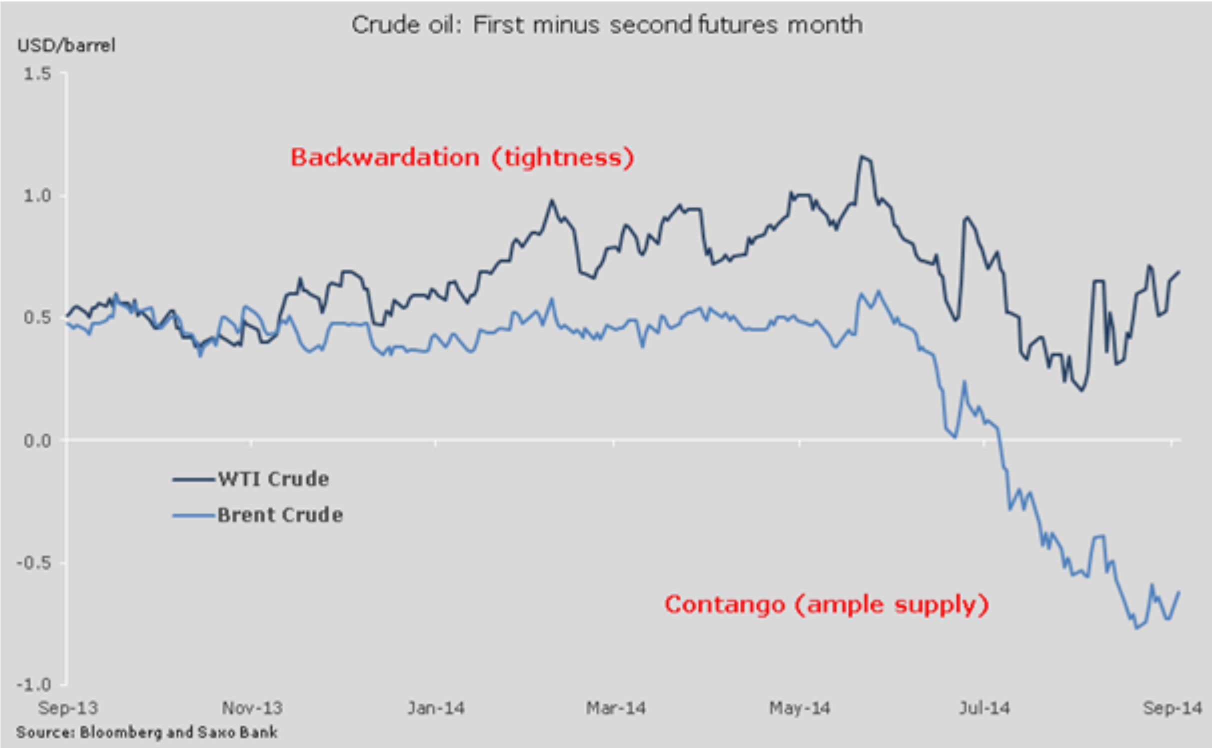
Crude oil markets continue to focus on rising supplies with news from producers focused on increased output. Libya, Iraq and Nigeria have all reported production rises in recent weeks and this gain in supply availability is hitting the global market at a time of seasonally lower demand.

As a result of both this and demand outlook worries from Europe and China, the price of Brent crude continues to see relatively more selling pressure than WTI crude. This drove the front month futures spread between the two benchmarks below $4 per barrel — near its lowest levels seen so far this year.

Surging oil production and floundering demand are holding crude prices under water. Photo: SanerG / iStock

WTI crude continues to be in demand, with imports slowing and refinery margins and profitability remaining healthy. This demand for spot crude (as opposed to the opposite situation in Brent crude) has been supporting a contraction of the spread between the two benchmarks despite the continued rise in US shale oil production.

An expected increase in pipeline infrastructure leading more oil into Cushing (the delivery hub for WTI crude oil), together with the seasonal maintenance-related slowdown in demand should help alleviate the currently tight market conditions here and help the spread stabilise. It remains difficult to see much upside for Brent crude, however, as long the spot market remains under pressure from slowing demand and increased supply.



Investors looking to oil as an investment — either through futures or exchange traded products — currently prefer WTI crude due to the structure of the futures curve. The curve is presently in a relative deep backwardation of $0.80 USD per barrel compared with the backwardation of $0.64 USD per barrel currently seen in Brent crude.

This basically means that the monthly futures roll of a long position favours WTI crude by more than $1.40 per barrel. Until we see a change in this relationship — which could occur due to the aforementioned changes in seasonal demand and pipeline infrastructure — WTI crude will continue to be favoured from a long-only investment perspective.

Gold slide halted by weaker stocks

Gold reached its lowest level since January as the dollar continued to break higher against a host of currencies. Eventually, the yellow metal *did* manage to find some support from renewed risk-off sentiment, which drove equity market and bond yields lower. Reports that Iraq had received credible intelligence concerning planned Islamic State attacks on subway systems in Paris and the US also added some support to a market where short positions have been building rapidly in recent weeks.

The current lack of appetite for gold is also reflected by in the total holdings in exchange traded products backed by physical gold. Holdings there slumped to a new five-year low after seeing 41.6 tonnes of reduction during the past month. The main driver, however, continues to be the dollar, with the alternative euro-priced gold reaching a two-week high. In the near term, the combination of a stock market wobble and rising bonds may support a retracement back towards the first major level of resistance at $1251 per ounce before sellers are likely to take control once again.

Swiss gold referendum receiving some attention

One potential source of support over the coming months could come from the Swiss gold referendum scheduled for November 30. If passed, this could mean that the Swiss National Bank would need to hold at least 20% of its assets in gold, would refrain from selling any of its gold reserves and would have to store all its gold within Switzerland.

Gold's share of Swiss currency reserves has fallen from 30% in 2000 to 8% currently and if the referendum is passed, the SNB would need to buy a substantial amount of gold over the next three years. So far, the Swiss parliament has overwhelmingly rejected the initiative as it would curtail the SNB's ability to conduct monetary policy.

The results of a November 30 referendum could see Bern embarking on a gold-buying spree. Photo: iStock

In late November, however, Swiss voters get their say, and though this event has not yet received much attention outside Switzerland, it could quickly become a major story in the gold world.

Cocoa market driven by fear as Ebola spreads

Cocoa is another strong riser during the week as the market reacts to the fear of potential supply disruptions from Ivory Coast. Ebola continues to spread across West Africa and as it approaches the world's largest cocoa production region in Ivory Coast and Ghana, worries of supply disruptions have increased.

October is a critical month for the cocoa market as it signals the beginning of the harvest. Any transportation disruptions or labour shortages in the world's two largest producers could have a significant positive impact on the price. As a result of these worries (and speculative buyers jumping in), the price reached a three-and-a-half year high with price action now being driven more by fear than fundamentals.

The 2014/15 harvest result still looks very healthy and when you consider that the market is up by more than 10% over the past few weeks, one cannot rule out the risk of an equally brutal sell-off on the December futures contract if Ebola stays out of Ivory Coast.

While this fear remains the key driver, however, the price could potentially revisit its 2011 record of $3733/tonne, which occurred when civil war in Ivory Coast caused real supply disruptions.

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Source: Saxo Bank

All graphs: Bloomberg and Saxo Bank

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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.