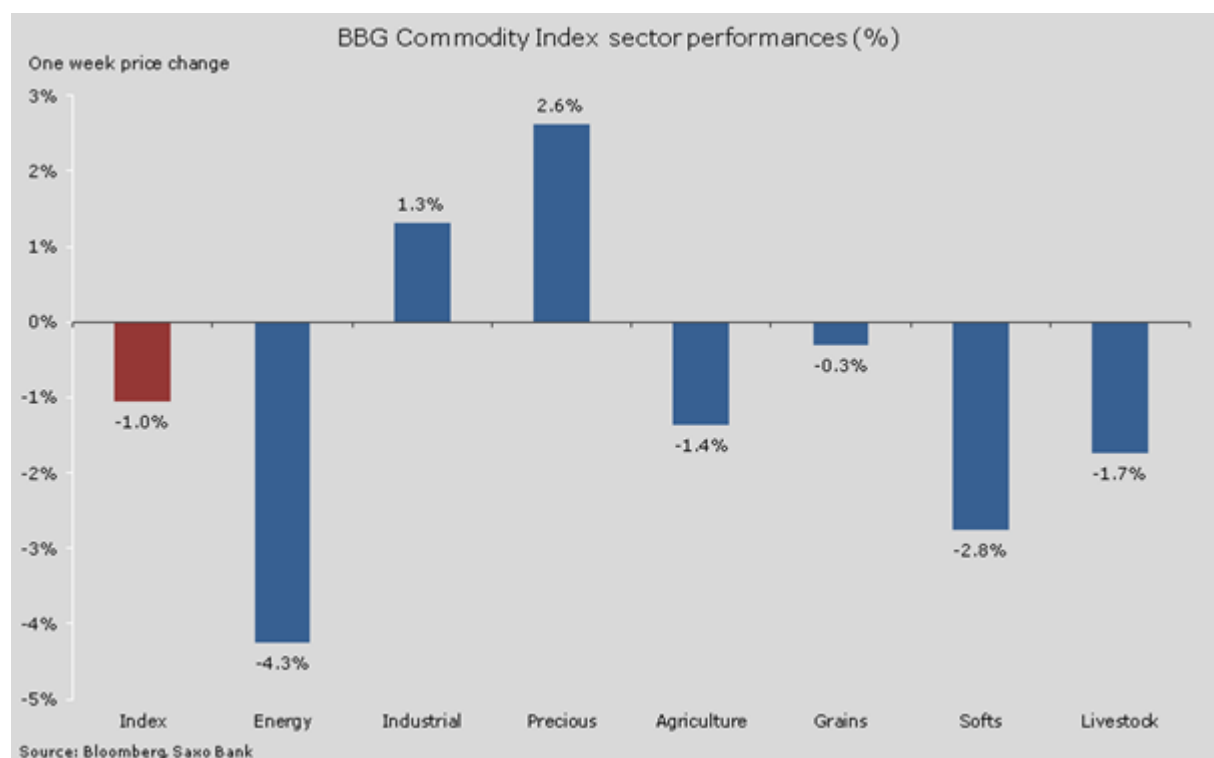




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Commodities walloped by ample supply, weak growth and strong dollar

The energy sector continues to drive down overall performance by commodities and during the past week some early signs of recovery quickly ran out of steam. The Bloomberg commodity index, which tracks the performance of 22 leading commodities, reached a new 5½-year-low because of the headwind whipped up by the adverse combination of ample supply, a subdued growth outlook and an ever-strengthening dollar



Precious metals were the surprise performer despite the Swiss No vote in the gold referendum and the continued rally in the dollar. The US currency particularly gained against the Japanese yen where it reached a seven-year high. Following the gold referendum on November 30 the opening in Asia last Monday saw only sellers. But the sharp recovery following Moody's slight downgrade of Japan gave a clear indication that gold, and especially silver, had run out of sellers and the focus suddenly turned towards limiting losses on sold positions.

Silver rallied an astonishing 18.7% from bottom to top and in the process wiped out many recently established short positions while gold managed to climb back above USD 1,200/oz – its largest rise since February. This positive performance indicated a slight dislocation from the recent drivers such as the rising dollar, falling crude oil prices and the belief that an improving US economy, highlighted in the much stronger than expected job report for November, will trigger an official rate rise from the US Federal Reserve within the next six months.

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Oil market under pressure as Saudi Arabia calls the shots

Crude oil prices managed to stage a small comeback from their price collapse and oversold conditions that were seen following Opec's surprise decision to maintain production at unchanged levels. The recovery, however, has so far proved short lived with both WTI and Brent crude remaining firmly stuck in a bear market.

From a technical perspective, both crude oils only managed to retrace some 38.2% of their most recent sell off which is a clear indication that upticks are still being viewed as a selling opportunity. This despite the 36% collapse below the average price of USD 109/bbl that has prevailed for the past four years in Brent crude, the global benchmark. On that basis, the near-term price risk remains skewed to the downside, something the options market is also showing via the elevated cost of buying protection against further price slumps.

Once again, it was the combination of comments and action from Saudi Arabia and other rich Gulf state producers which helped drive the price lower. Opec's biggest producer announced a cut in its official selling price of light crude to both the US and Asia for January. Asian customers will be able to buy light crude from the Kingdom at a discount of USD 2/bbl below the Oman/Dubai crude oil benchmark. This represents the biggest discount to Asian customers in 14 years and is an indication of how much the competition for market share has risen as demand growth has slowed in a region which up to recently had an insatiable appetite for energy.

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Oil prices were even lower back in 1960. Photo: Opec archive

Comments from a Gulf oil official to the [Wall Street Journal](#) indicated that they were prepared to let the price of crude oil slip to USD 60/bbl in order to trigger a reduction in non-Opec production, not least from the US where shale oil production has risen dramatically since 2011. On that basis the market is now assuming that Opec is unlikely to react to further price losses and only a sign that production elsewhere is slowing can support the price at this stage.

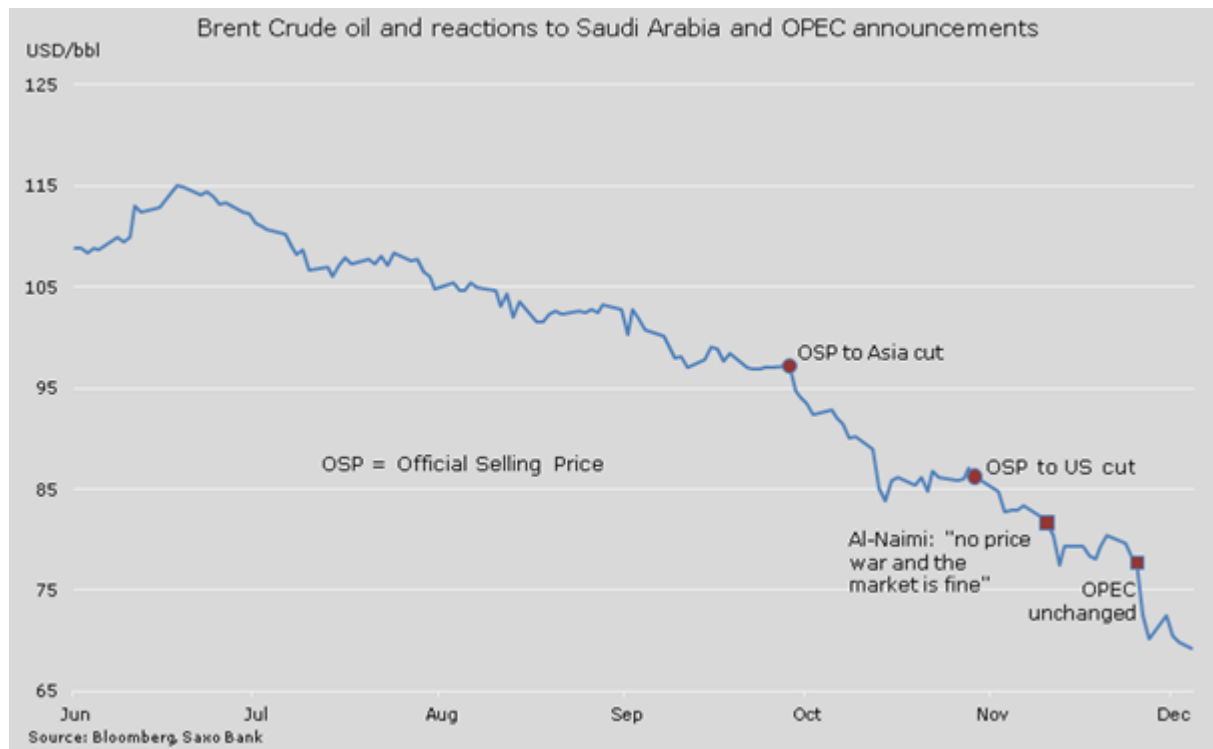
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On that basis, we continue to monitor developments in the US shale oil market. No one knows for certain where the pain threshold among some of the weaker marginal producers lies, so from now on we'll see a great deal of focus on refinancing costs among non-investment grade companies. Since June, high-yield corporate bond yields for non-investment grade energy companies have more than doubled while some major shale oil companies have seen their stock market value more than halve.

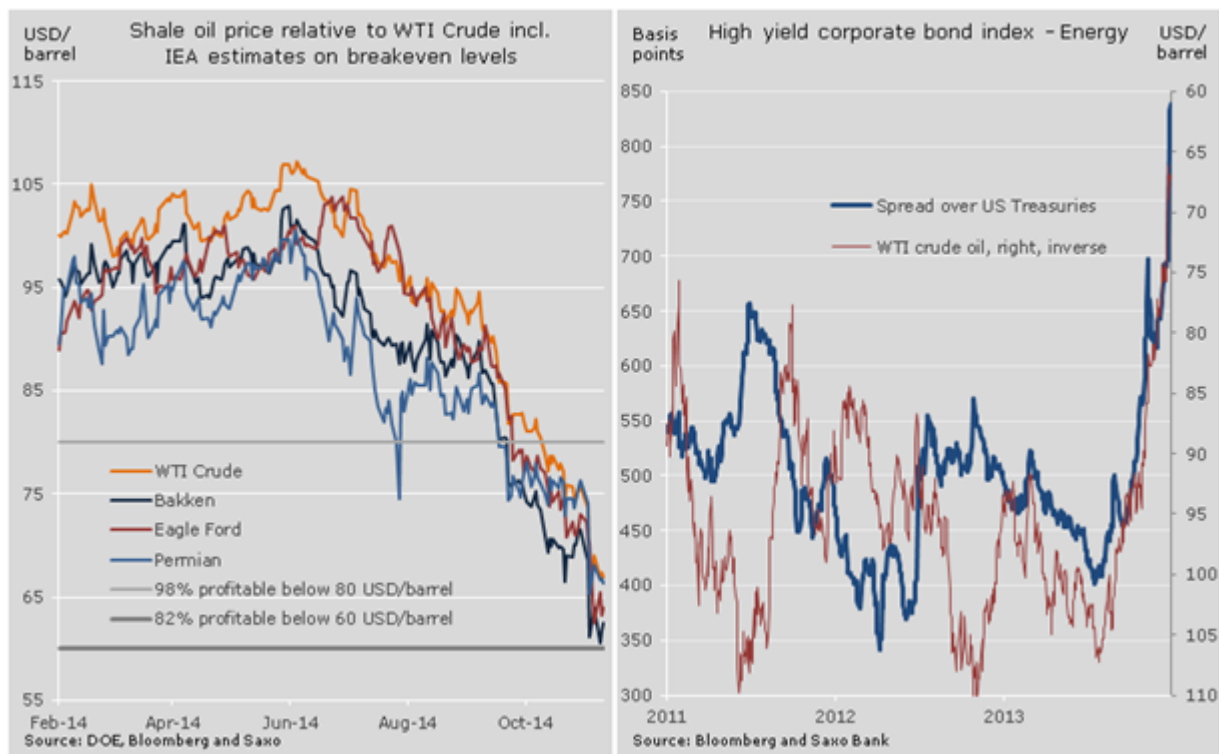
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Global food prices at three-year low

Consumers across the world who are currently receiving a boost from the fall in oil prices can also take comfort from the fact that global food prices continue to ease. The UN FAO index of 73 food commodities has during the past three months been easing towards the lowest level since November since 2011 and is now 6.4% cheaper than last year.

Taking the the dramatic rise of the dollar during the past few months into consideration not all consumers, especially those in poorer countries, may have felt the full impact of this decline. The FAO also noted that "The index appears to have bottomed out with higher probabilities for a rise in its value in coming months" so we may have seen the most of these reductions for now.

The main drivers behind the recent price weakness has come from record grain harvests, especially in the US these past few months, combined with falling sugar and milk prices. Against this we have seen a continued rise in meat prices which are up by more than 13% year-on-year.

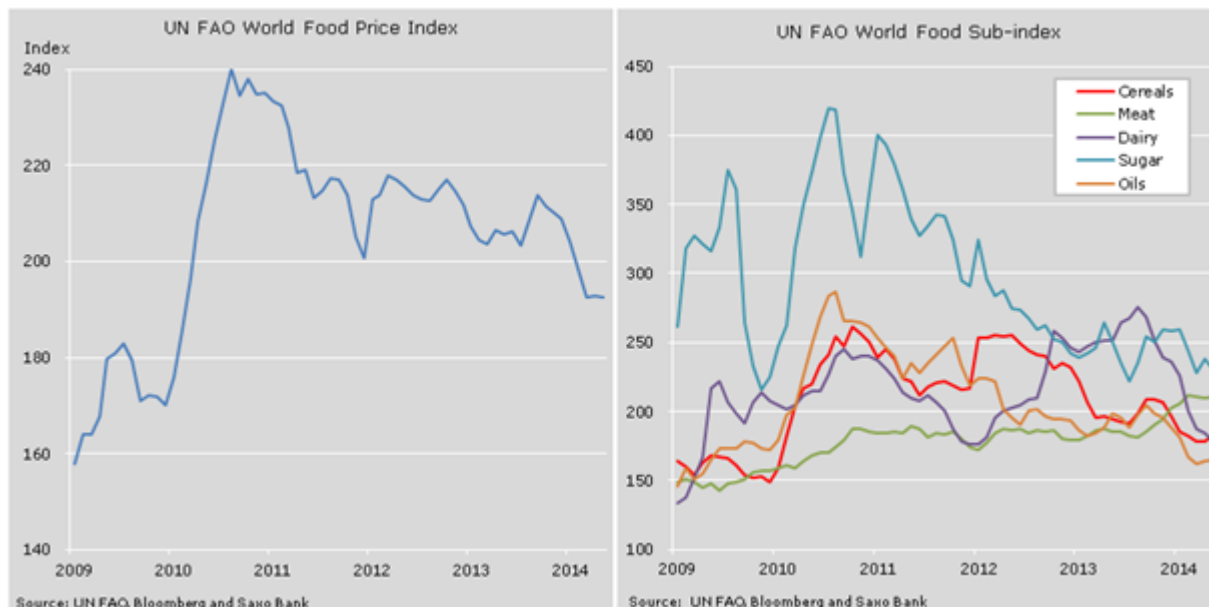
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Ole Sloth Hansen is a specialist in all traded Futures, with over 20 years' experience both on the buy and sell side. Hansen joined Saxo Bank in 2008 and is today Head of Commodity Strategy focusing on a diversified range of products from fixed income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