THE SPECIALIST IN TRADING AND INVESTMENT

Oil benchmarks diverge – gold makes its stand

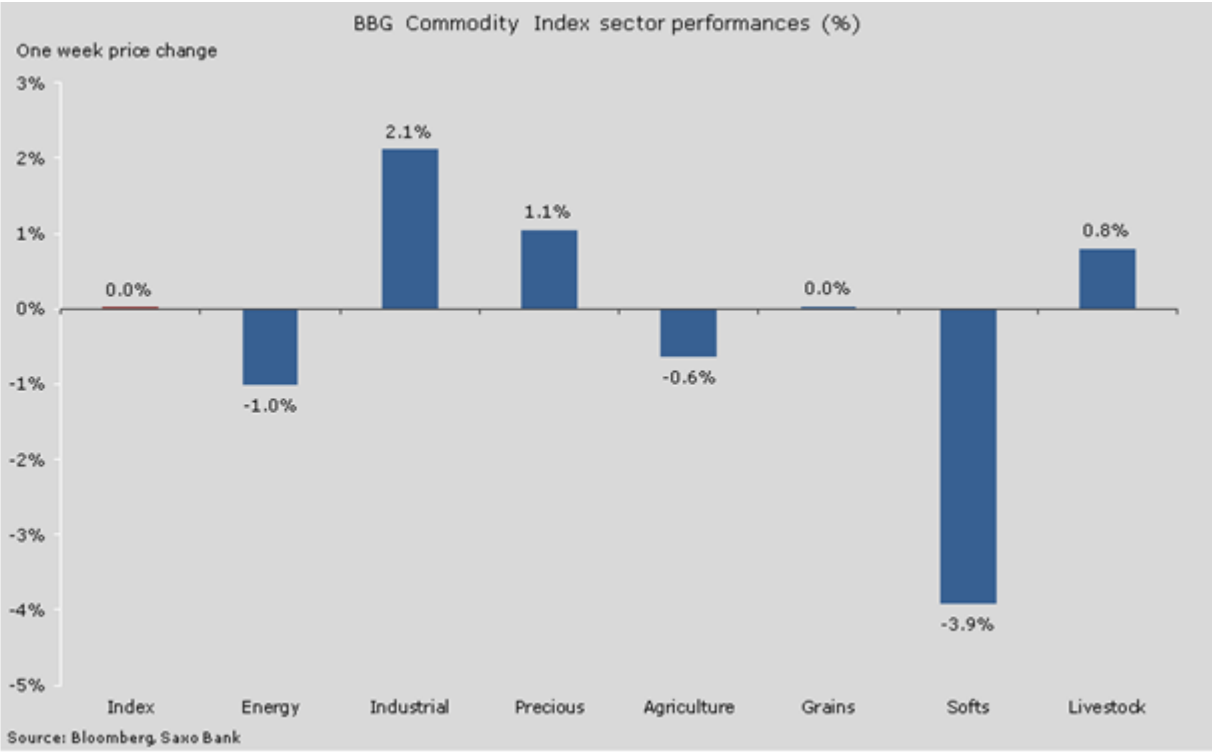
It's an open and shut case for WTI as the relentless rise of US oil inventories leaves it chasing Brent's shadow. Photo: istock

China returned from their week long new year celebrations while the dollar resumed its ascent on a combination of stronger US data and the soon-to-begin period of quantitative easing in Europe.

The Bloomberg Commodity Index traded sideways as stimulus speculation supported industrial metals, most noticeably copper, but against this we saw losses in energy (Natural gas and WTI crude oil) and softs (coffee and sugar).

The cost of crude oil on either side of the Atlantic continues to diverge with the spread between WTI crude and Brent crude reaching a 13-month high at around $12/barrel.

The relentless rise in US inventories and lack of reaction to the sharp reduction in US rig count has put WTI crude oil back on the defensive while Brent crude has benefited from European refinery demand and supply outages in Libya and Iraq.



Natural gas prices on either side of the Atlantic also diverged as prices in New York fell in response to a lower-than-expected draw on inventories while in Europe, uncertainty related to gas supplies from Russia and a prolonged period of winter demand sent UK gas prices higher.

The return of Chinese traders following a week long Lunar New Year celebration triggered a jump in copper on speculation that more government support could boost growth and with it demand for industrial metals. Signs that supply could be cut back following the recent slump also helped the white metal recover and post the best monthly performance in more than one year.

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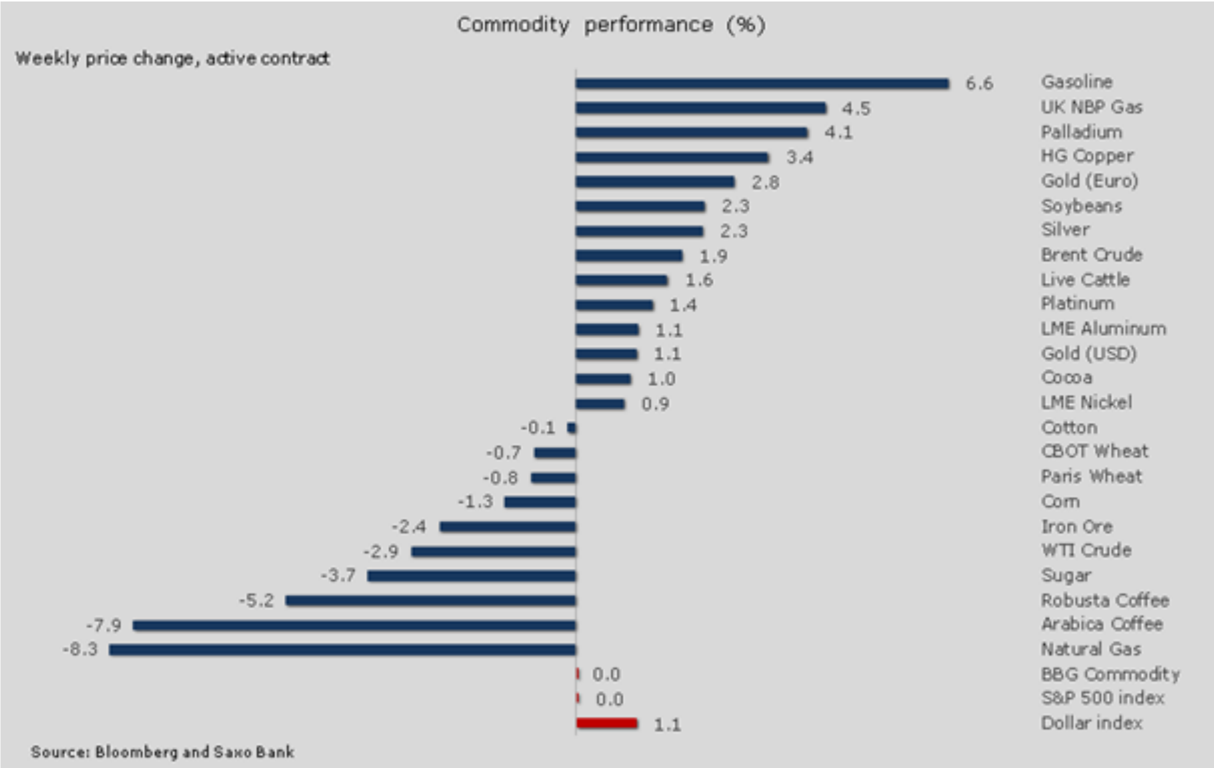

Arabica coffee which at this time last year had rallied by 60% on Brazilian drought have so far this year lost 14% and most that loss was seen this week. This time round its the prospect for rain in Brazil that have been driving the price lower and during the week the price hit a one-year low at 140 cents/lb, a 37% reduction from last years peak.

There is rarely a looser without a winner and when it comes to coffee look no further than Starbucks. Since the direction change last October, coffee has slumped by 37% while Starbucks has rallied by one-third.

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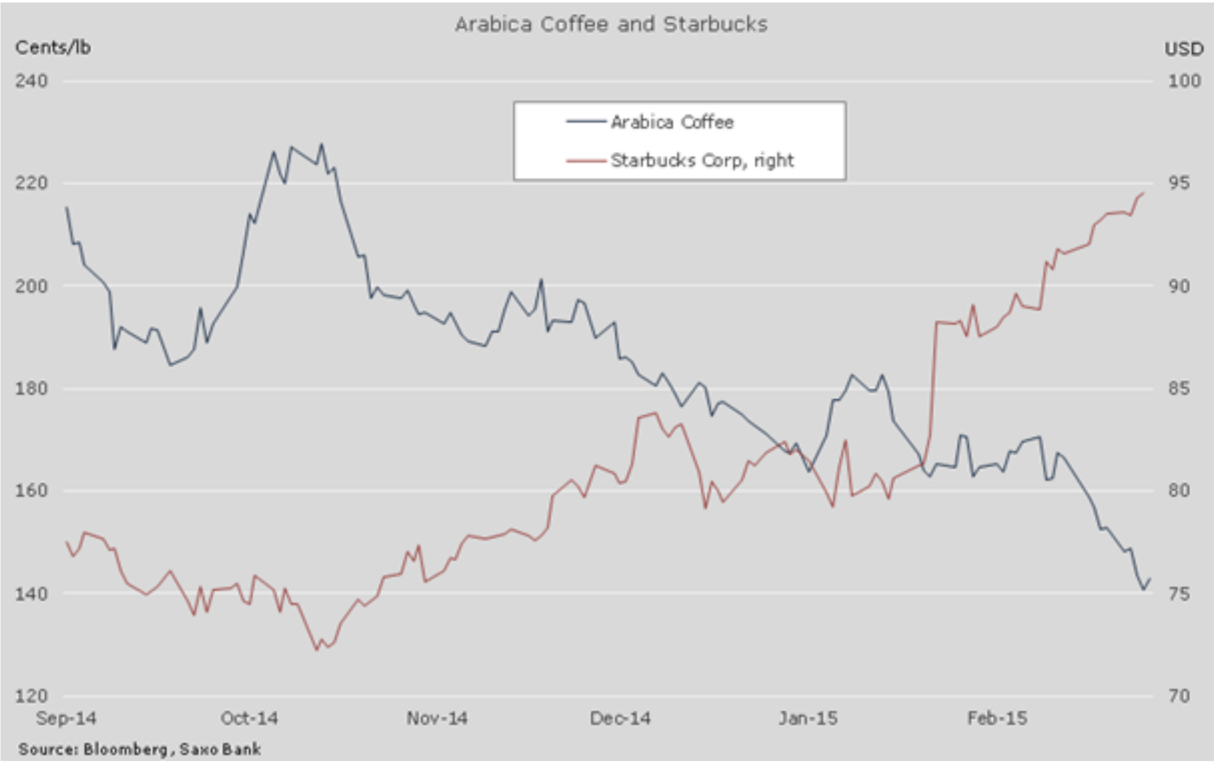


WTI discount to Brent hits 13-month high

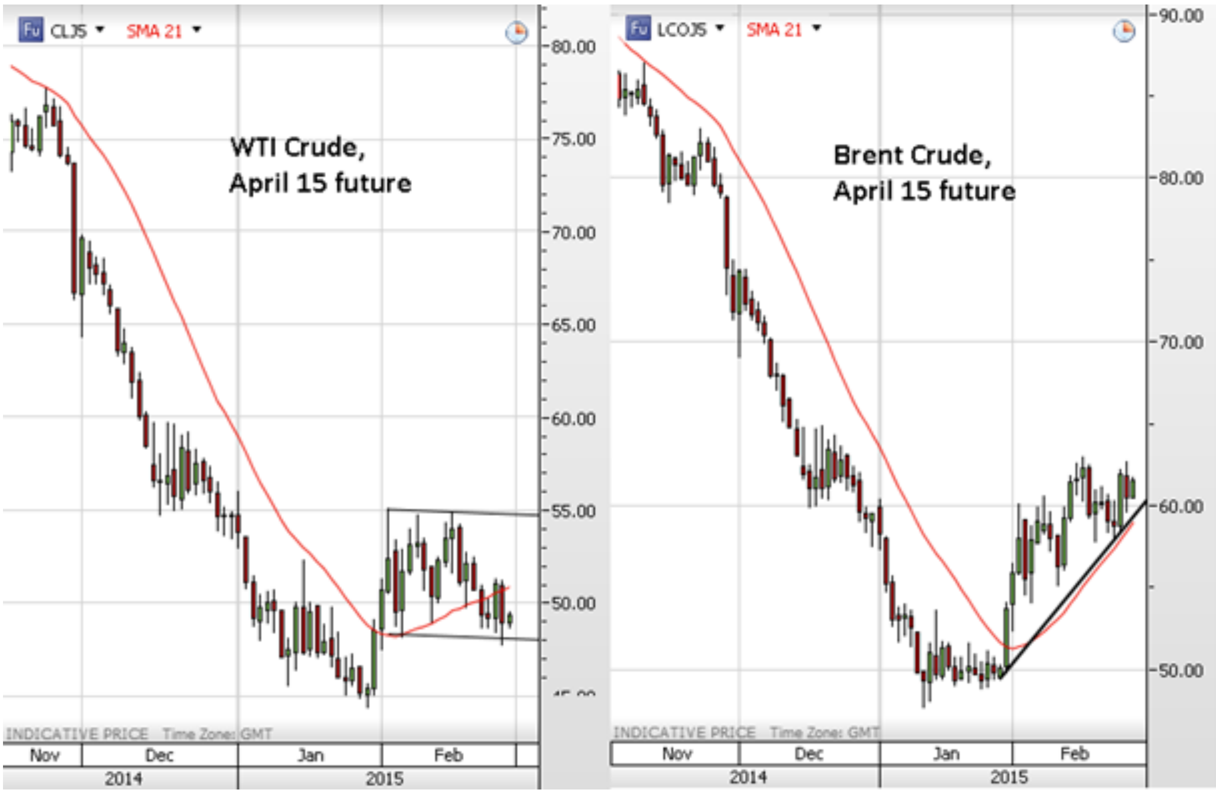
US crude oil inventories have jumped to a new multi-decade high of 434 million barrels while production has reached 9.3 million barrels/day.

We are yet to see and adverse impact on production from the 36% reduction in the number of US rig count since last October.

Some of the big inventory jumps witnessed during the past couple of weeks can be be viewed as temporary due to reduced refinery demand. This has either been triggered by operational problems due to arctic cold weather, strike action or seasonal maintenance.

It nevertheless highlights the fact that while oversupply is easing elsewhere, the US continues to see rising inventories which can only be stabilised either through rising demand and/or a cut back in production.

Selling of spot crude has kept WTI subdued while Brent crude has been able to react to more favourable news from the global market, such as this week's comments from Saudi Arabia that demand is picking and from the International Energy Agency that the oil market will rebalance in the next several months as consumption will rise while supplies will be curbed. Recent supply disruptions from Iraq and Libya has helped suppress supply.



Current developments a boon for Opec

These recent events are all good news from Opec's perspective. Opec members have their oil priced against international benchmark Brent while US shale oil producers receive payment for their oil based on the price of WTI crude.

Brent has now rallied $15/b from its January low outstripping WTI's meagre $6/b rise.

Gold finds support on China return, ECB QE start

Following a top-to-bottom move of $117/oz during the past month, gold managed to establish support at $1,190/oz before signs of some pent-up demand from Chinese traders returning from holiday took it back above $1,200/oz.

A test of this new-found support was already tested on Thursday when the dollar resumed its rally and reached a one-month high against the euro. The move higher for the dollar was triggered by US data showing a rise in core consumer-price inflation.

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Now New Year is over, the Chinese love of gold is back in the frame. Photo: istock

The US Federal Open Market Committee is expected to begin raising rates later this year and at the moment, the timing very much depends on incoming economic data.

Investors began returning to gold back in January and during the recent three-figure correction, only a small percentage of new investments in exchange-traded products was sold and just this past week, total holdings reached the highest level since last October.

Traders and investors are once again looking for alternative investments to bonds and to a certain extent stocks, where the continued rally has left many hesitant of getting involved at this stage.

The real yields on US bonds are falling again, not least due to rising expectations for inflation and as the chart below shows, this tends to add support to gold.

Gold's defiance against getting dragged down by a rising dollar triggered a rally in gold priced in euros. This make sense considering the imminent onset of the ECB's quantitative easing program.

The downtrend from the January high has been broken and with the double bottom at $1,190/oz now established, the first upside target will be $1,235/oz ahead of the 200-day moving average at $1,246/oz.

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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.