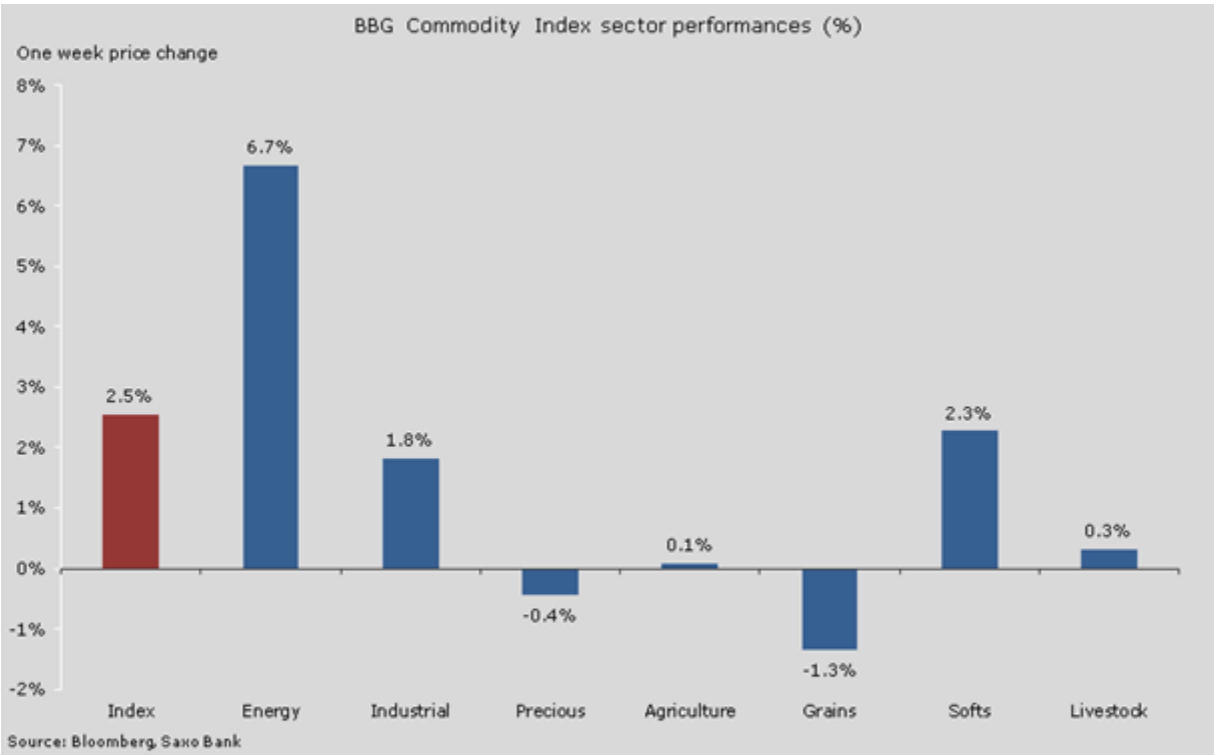
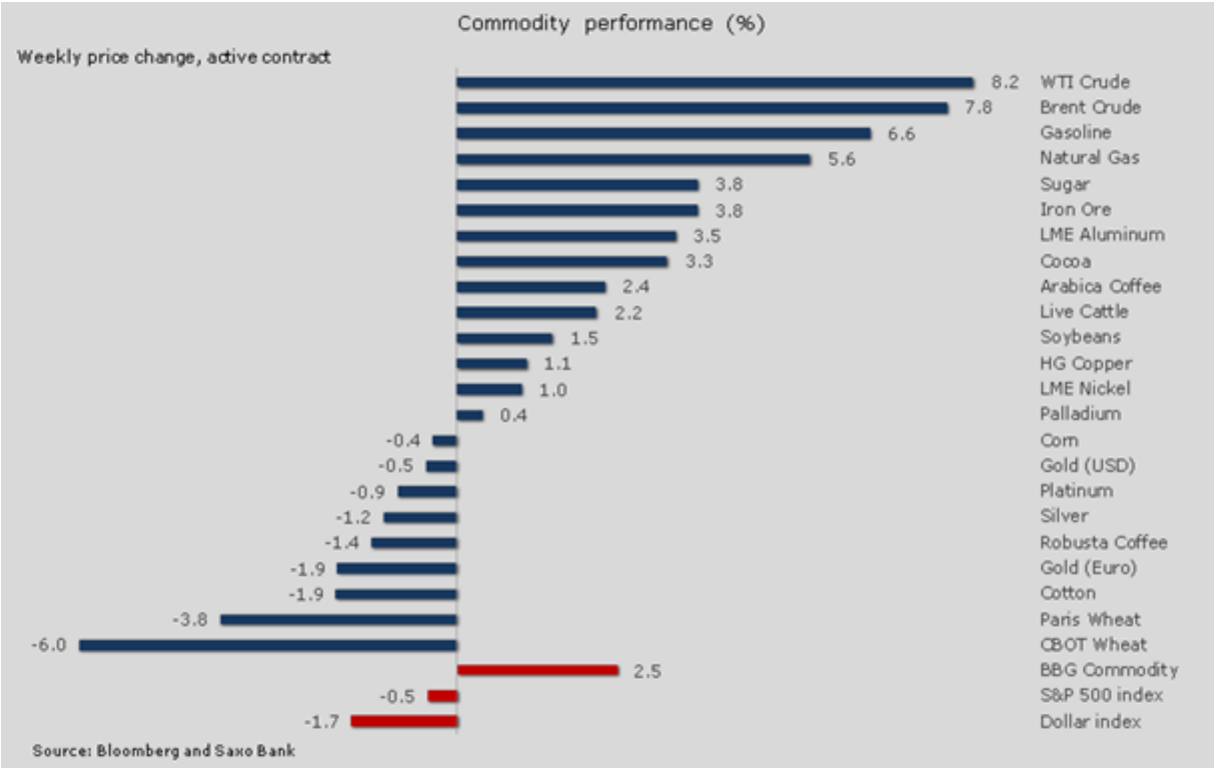
THE SPECIALIST IN TRADING AND INVESTMENT

Weekly Commodity update: Beware this false dawn in oil markets

Commodities had the best week in more than two months, not least due to a strong rally across the energy sector, led by WTI and Brent crude oil.
The dollar continues to settle into a range, especially against the euro dollar between €1.05 and €1.10 and the 1.7% weakness seen this week was driven by a continued downward adjustment by the market as to when and by how much US official interest rates eventually will rise.
Recent economic data from the US has surprised negatively and this has helped drive down these expectations thereby, at least for now, helping erode some of the extreme bullish sentiment currently seen towards the dollar.



WTI crude rose for a fifth consecutive week and the 8.5% weekly gain was last seen in February 2011. The prospect of a slowdown in US production combined with geo-political worries related to the fighting in Yemen together with forecasts for rising demand all helped diverge the attention away from swelling US inventories and a sharp rise in Opec production.



Natural gas was another winner as speculation grew that a floor could be in the process of being established following several months of weakness. An overall pick-up in demand some of which is due to switching away from coal combined with price friendly weather in the near-term has helped trigger short covering from traders holding a record net-short position.

Industrial metals generally received a boost, not least following the release of Chinese growth data which during the first quarter dropped to 7%, the lowest since 2009. The rally which apart from the weaker dollar was triggered by increased speculation that China will increase stimulus measures to support the economy.

Tin was a notable exception, dropping to a five-year low.

Gold consolidating around $1,200/oz

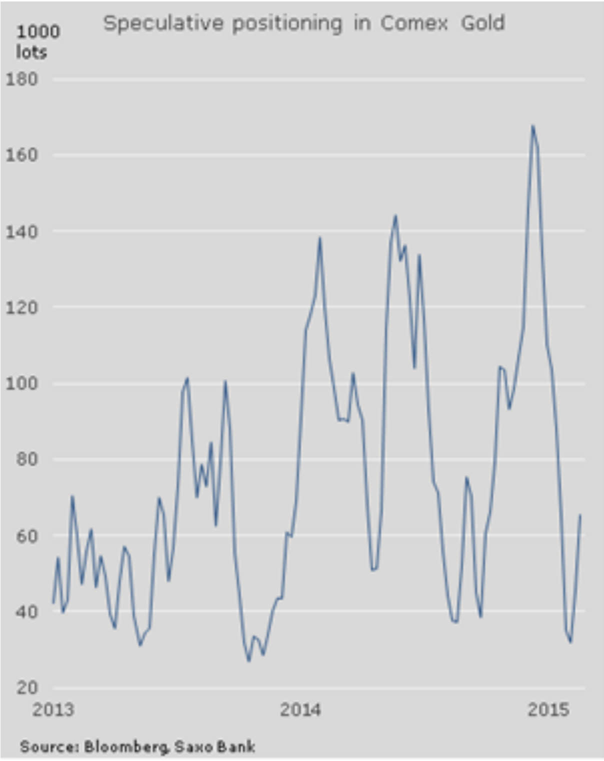
Precious metals had a quiet week with gold continuing to consolidate around $1,200/oz.

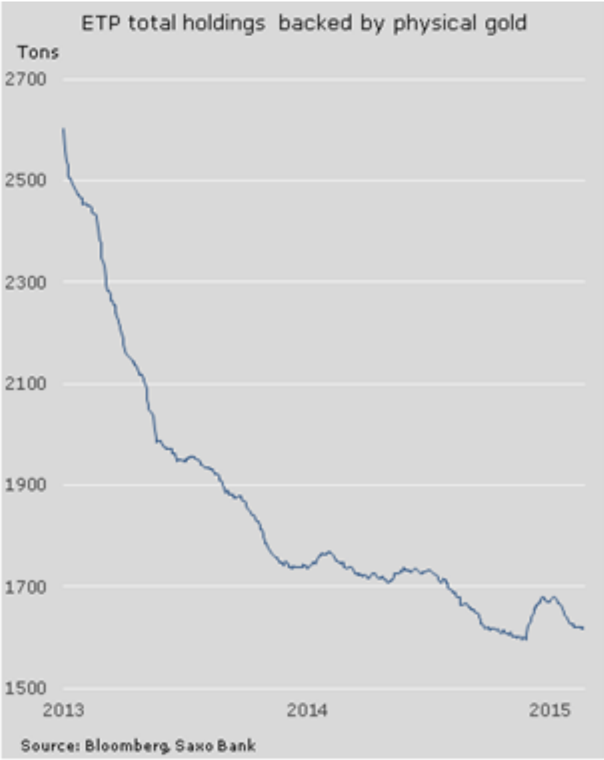
Support is coming from the contraction in global bond yields, not least in Europe where 10-year German government bond yields are only a few basis points away from hitting zero. This has increased support for alternative investments such as metals, especially at a time where weaker economic data from the US raises the prospect for a potential stock market correction.

After finding support at $1,184, gold recovered only to find resistance at $1,209.40 (61.8% retracement of the recent 1,225 to 1,184 sell-off). This level is currently keeping the yellow metal from advancing further towards the key level at $1,225.

On that basis and with a general lukewarm attitude to gold prevailing, it would require a break above $1,225 to swing the sentiment back to positive from the current neutral position.

While hedge funds have covered shorts and entered into new long gold positions during the past few weeks we are still to see any pick up in holdings of exchange-traded products backed by physical gold.





Crude oil recorded one of the biggest weekly rallies in more than four years with expectations of a soon to come slowdown in US production and geopolitical tensions in Yemen more than offsetting the fact that US inventories remain stuck at the highest level since the 1930s while several Opec producers continue to ramp up production.

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In their monthly reports, both the International Energy Agency and Opec revised higher their demand growth estimates and that further helped support the rally which for WTI crude oil has been 34% during the past month.

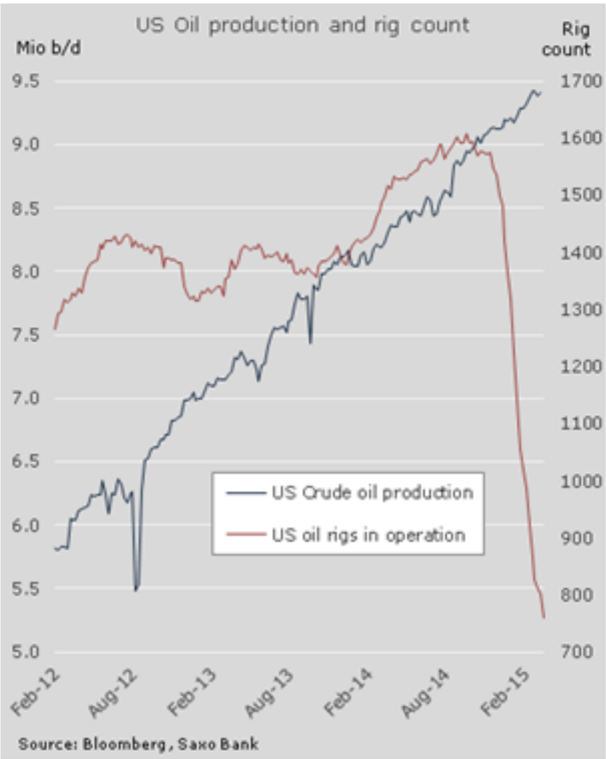
At the same time it was also highlighted that Opec now at 31 million barrels/day are producing close to 2.5 million b/d more than the market actually needs during this current quarter.

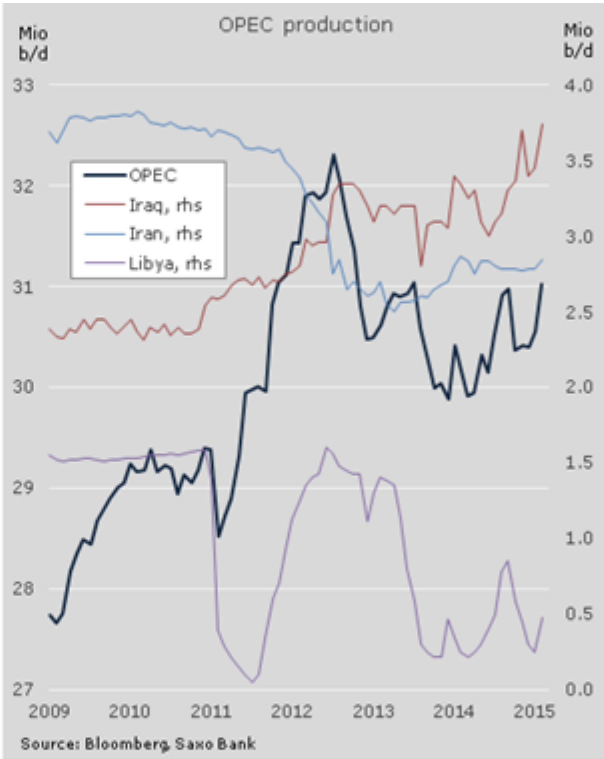
False dawn in oil markets

Rising demand is all good for the future prospects of rising oil prices but pricing it in at this early stage in the recovery increases the risk of a false dawn in oil markets.

The 20,000 barrel reduction in US crude production last week has to be seen against an 800,000 barrel increase by Opec members during March.

And this number does not include the potential return of Iranian oil which according to the US Energy Information Administration could reduce the price of crude by $5-10/b.





It's a 'W', not a 'U'

Furthermore, rising oil prices could slow the expected reduction in US production as the price reaches levels where shale oil producers may see profitability return.

On that basis a spot month crude oil price approaching $60/b could very well result in the price later reversing straight back down again.

The famous oil historian Yergin expressed this view in a recent **interview** with Bloomberg where he highlighted the risk of the price of crude being locked in a "W" shaped formation.

Unsustainable

The return of positive momentum and the break above previous resistance at $54.25/b on WTI crude oil could signal some additional upside in the near term. We believe this move to be unsustainable and will be looking for put options or selling opportunities below $54 to capture renewed price weakness.

Source: 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.