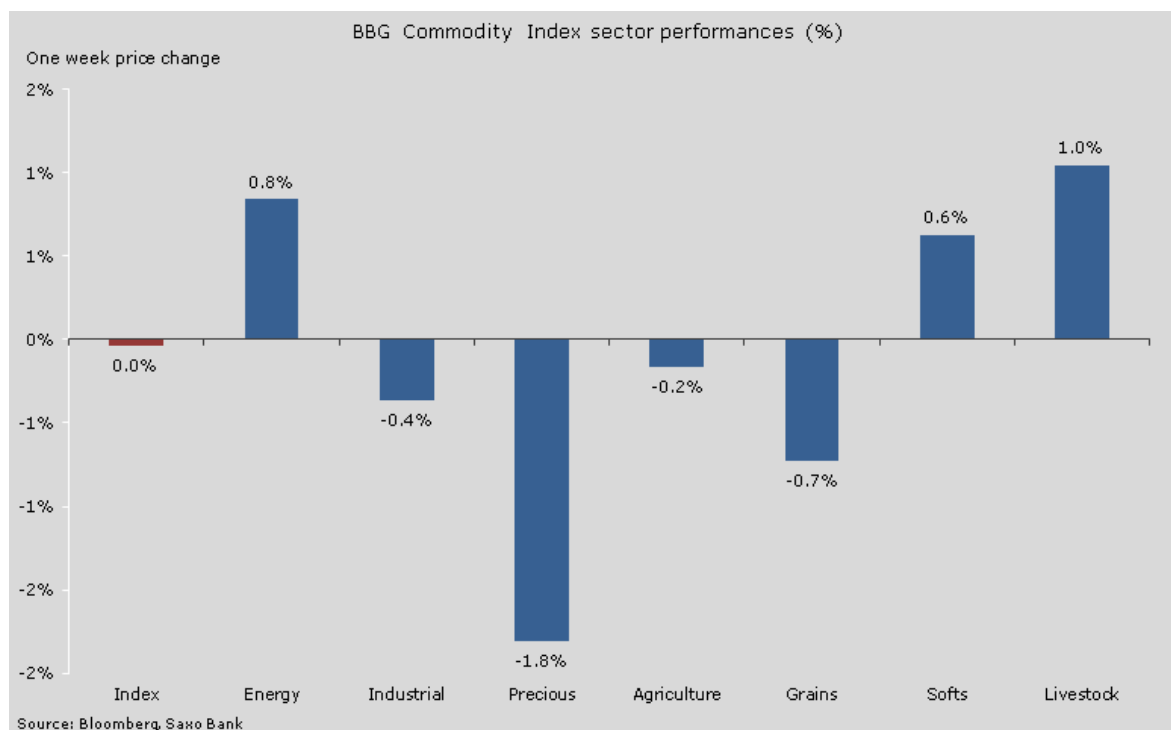


WCU: Crude at four-month high, but bad week for metals

By Ole Hansen

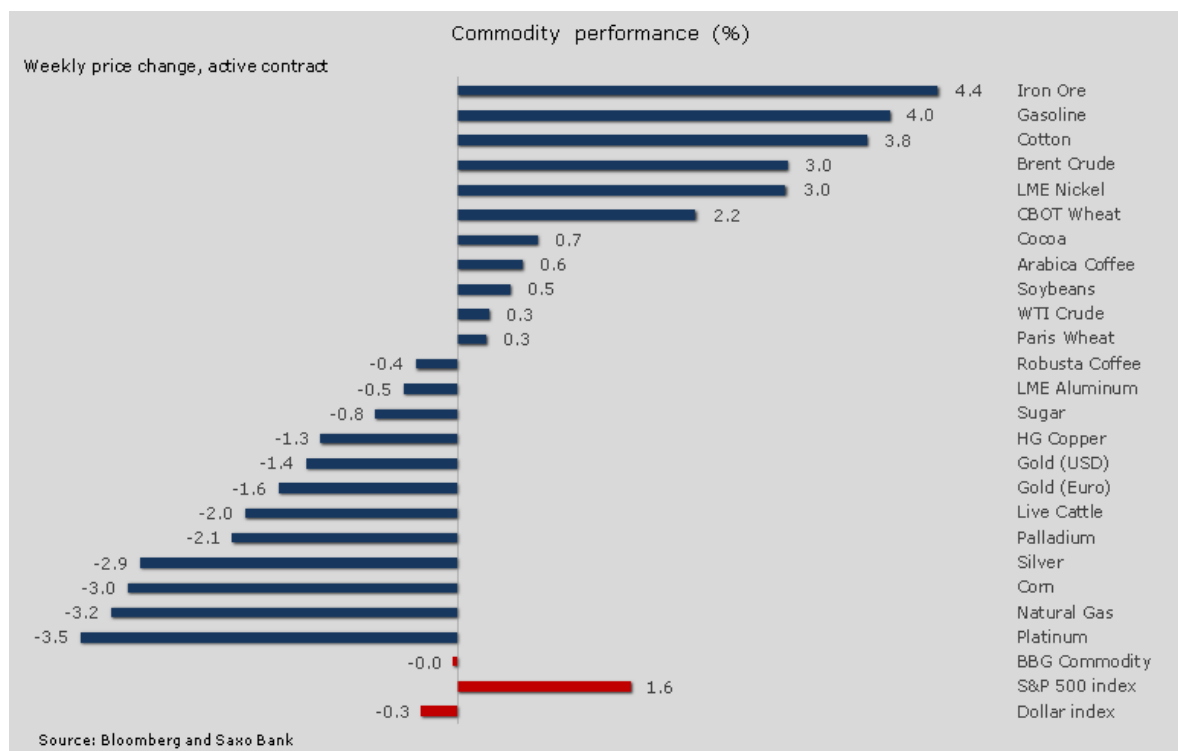
The rally in crude oil and related products continues, and during the week it helped offset losses in industrial and precious metals, leaving the BBG Commodity Index flat on the week.

Weaker-than-expected economic data from around the globe helped set a slight negative tone for industrial metals, especially copper and aluminum, while rising geopolitical risk has helped removed the focus from the current oil glut, thereby supporting crude oil.



Commodities relationship to the movements of the dollar has also been clouding the near-term outlook. Following an impressive dollar rally since last June, the greenback continues to settle into a range, especially against the EUR where a 1.05 to 1.10 range continues to develop.

Traders and investors already holding a very extended dollar long position are finding it increasingly difficult to determine which theme to focus on. Is it potential dollar weakness related to poor US economic data, or the euro-negative quantitative easing in Europe which has sent interest rates to a record low?



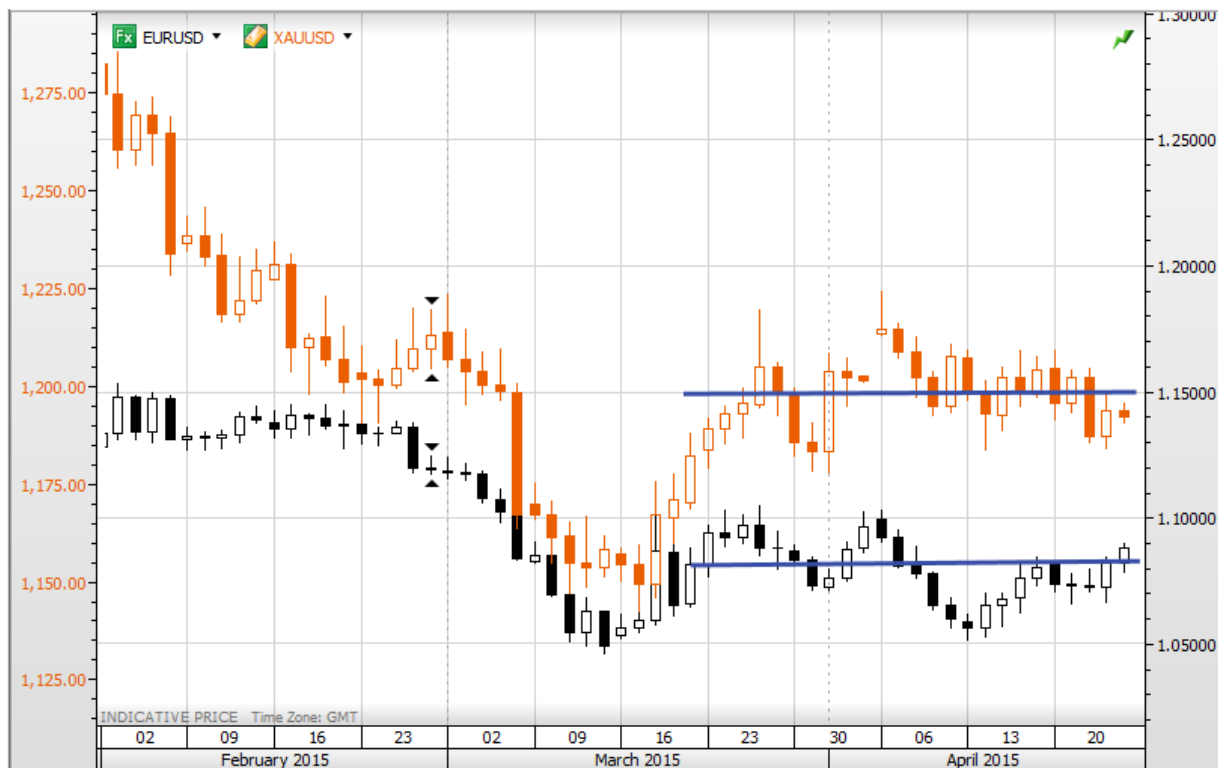
Gold looking for direction

Conflicting news has so far managed to keep gold range bound at \$1,184-1,209/oz for the past month. US economic data continues to surprise negatively and this has further clouded the outlook with regard to when the US Federal Open Monetary Committee will hit the rate hike bottom.

At the same time the risk related to Greece has retreated somewhat. Coupled with the dollar, which also remains range bound, traders and investors have been left pondering what leg to stand on.

The range bound nature of gold has occurred during a period of sideways action on the dollar so a potential breakout on that front could provide the yellow metal with the direction it currently needs.

Having failed to respond favorably to gold supporting news this past week, there is currently an increased risk that the next move in gold will be lower. News that euro-area finance ministers hurled abuse at the Greek Finance Minister at a meeting on Friday leaves the chance of a breakthrough in debt negotiations hanging by a thread. Any deterioration could hurt the euro thereby offsetting potential safe-haven flows into gold. On that basis, a bullish view on gold related to Greek worries is therefore best expressed through XAUEUR.



Geopolitics trumps supply glut

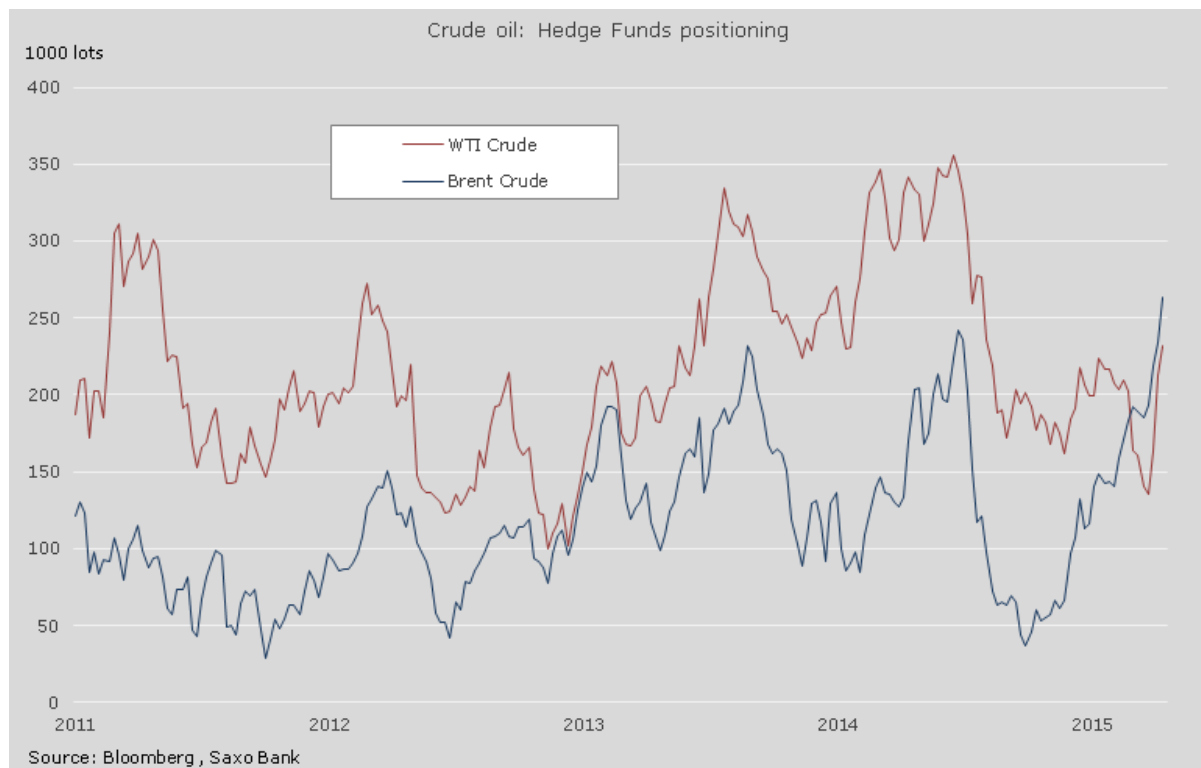
Crude oil had another strong week with the gains on WTI crude since the March low now almost reaching 40%. Geopolitical concerns related to the Saudi Arabian bombing campaign in Yemen have begun to add a risk premium to the price of oil.

These developments, combined with continued signs that US oil production has begun to slow, has given the market enough momentum to race higher this past month.

Hedge funds have returned as buyers believe that a low point in oil prices has been seen and that the focus on continued oversupply is fading with the outlook for demand rising.

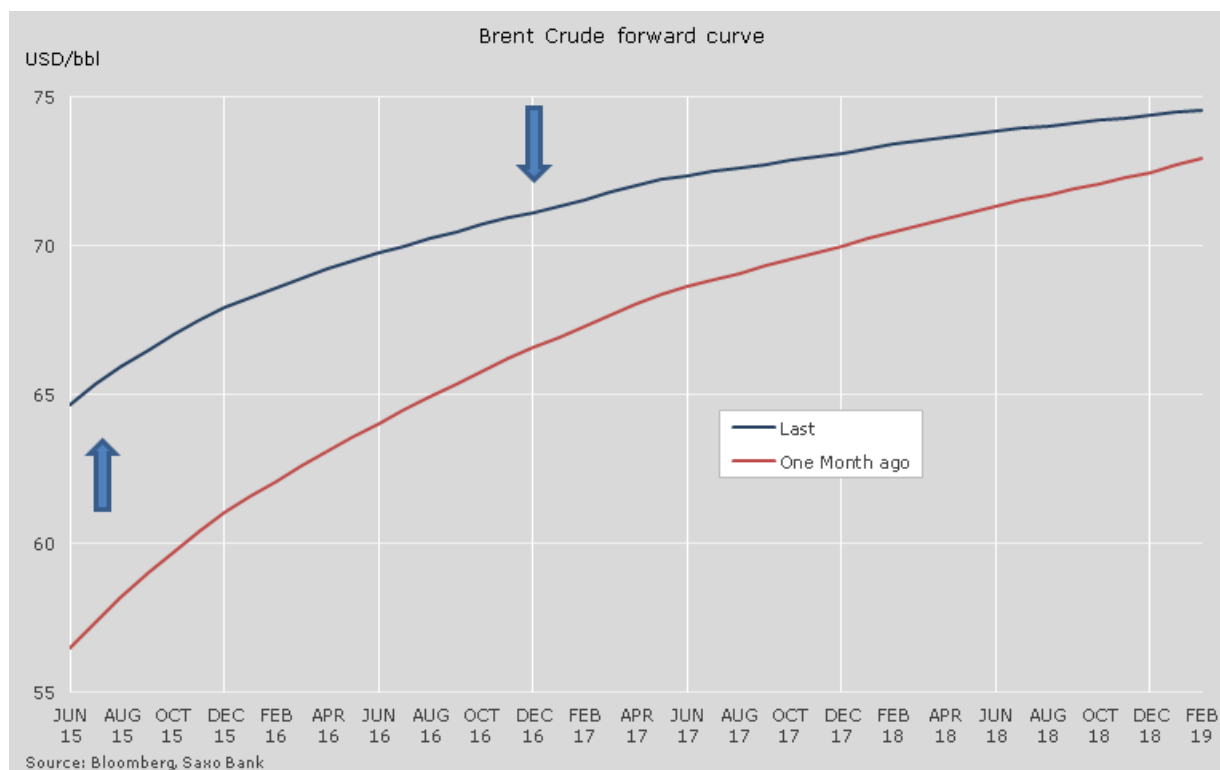
As the chart below shows, hedge funds and money managers have been almost continuous buyers of Brent crude oil since last September while the pickup in WTI buying has mostly been during the past month.

In Brent crude the net-long has reached a new record of 264 million barrels while WTI crude is still struggling relatively amid high inventories. These have reached 232mn barrels, which is close to the five-year average.



While speculators have been busy buying the front-end of the futures curve, oil producers and other physical market players have rushed to lock in prices by selling crude forward. They are currently holding record short positions in Brent crude of more than 500mn barrels, an 80mn barrel increase during the past month.

These opposing forces have resulted in Brent crude, as well as the WTI crude, forward curves flattening. In the US, this is particularly interesting as the rise in WTI crude could result in a slower-than-expected drop in shale oil production as some producers have seen the price almost reach levels where hedging and thereby production can be maintained or perhaps even increase.



ETF investors reducing longs as contango trap eats away profits

While hedge funds have moved back into crude oil, we have seen investors using exchange-traded funds beginning to get out. The energy sector witnessed an inflow of \$6 billion into US traded ETF's up until a month ago but since then \$1.4bn dollars has been pulled.

The contango, especially in WTI crude, has created some headwinds for ETF investors as the providers of the ETFs hedge themselves through futures. The monthly roll from a lower priced front month futures contract to a higher priced deferred has been reflected in a lower return compared to the expected performance when looking at how WTI crude oil has moved.

Year-to-date WTI crude oil is now higher by more than 8%, while the world's biggest oil ETF, the United States Oil fund (USO), is showing a loss of 2.6%. With the upside from here becoming increasingly limited, the current monthly cost of 2.5% of holding a long position in WTI crude - the roll spread between the June and July futures - may have persuaded some investors to take whatever gain they have managed to get.

Another popular ETF, the VelocityShares triple long (UWTI), has obviously fared even worse and is currently down by 30% year-to-date and as a result this fund alone has seen more than \$500 million being pulled this past month.

Near-term outlook

With the current positive momentum being supported by the addition of a geopolitical risk premium, sellers have had limited success for several weeks now. As long as WTI crude remains above \$54/barrel and Brent crude above \$60/b, the potential for further upside gains remain intact.

However we remain skeptical about how much further the market can travel at this stage, especially as the futures curve continues to reflect an oversupplied market.



Head of Commodity Strategy at Saxo Bank **Ole Sloth Hansen**

Email: olh@saxobank.com

Phone: +45 3977 4810

Twitter: [@Ole_S_Hansen](https://twitter.com/Ole_S_Hansen)

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.