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## WCU: Gold bears stung as global equity and currency rout intensifies

By Ole Hansen, Head of Commodity Strategy

The **Chinese devaluation** earlier this month helped set off a negative chain reaction across global markets. The outlook for global growth and demand has suffered a setback and this has raised speculation on whether the US Federal Reserve will be able to carry out a September rate hike.

Growth dependent commodities such as energy and industrial metals remain under pressure while gold led precious metals higher as investors looked for alternatives while others were forced to buy cut back a record short positions in the futures market.

### Emerging market pain

Most noticeably, the market rout has been hurting emerging market currencies and stocks. The table below shows the changes across asset classes since China devalued the currency for the first time on August 10. Although the change in **USDCNY** has been negligible the reaction in other currencies and asset classes has been profound.

Surprisingly for many, the euro has managed to climb against the dollar, going against current expectations. And with full blown **quantitative easing** in the euro area keeping interest rates ultra low, many investors have been doing carry trades where the euro was sold against higher-yielding currencies such as EM currencies and the US dollar. With these trades now unraveling, the euro has been the surprise winner in recent weeks and we are now approaching key technical resistance levels.

Billions of dollars' worth of value being destroyed:

Instrument	10-Aug-2015	21-Aug-2015	Change	Change (%)
<b>FX</b>				
USDCNY	6.2097	6.3889	0.1792	2.89%
EURUSD	1.1019	1.1295	0.0276	2.50%
AUDUSD	0.7413	0.7346	-0.0067	-0.90%
USDRUB	62.9487	68.3897	5.4410	8.64%
USDBRL	3.4376	3.4802	0.0426	1.24%
<b>Equities</b>				
S&P 500	2100	2019	-81	-3.85%
DAX 30	11600	10288	-1312	-11.31%
China A50	11380	10020	-1360	-11.95%
Nikkei 225	20790	19450	-1340	-6.45%
<b>Bonds</b>				
UST 2Y	109.391	109.563	0.172	0.16%
UST 10Y	127.016	128.531	1.516	1.19%
<b>Commodities</b>				
Gold	1103.80	1155.60	51.80	4.69%
WTI crude	44.96	41.14	-3.82	-8.50%
Copper	240.00	229.40	-10.60	-4.42%

Source: Saxo Bank

A more competitive China (from a currency perspective) combined with the increased risk of further slowdown has sent emerging market stocks and currencies into a tailspin. This past week the unease

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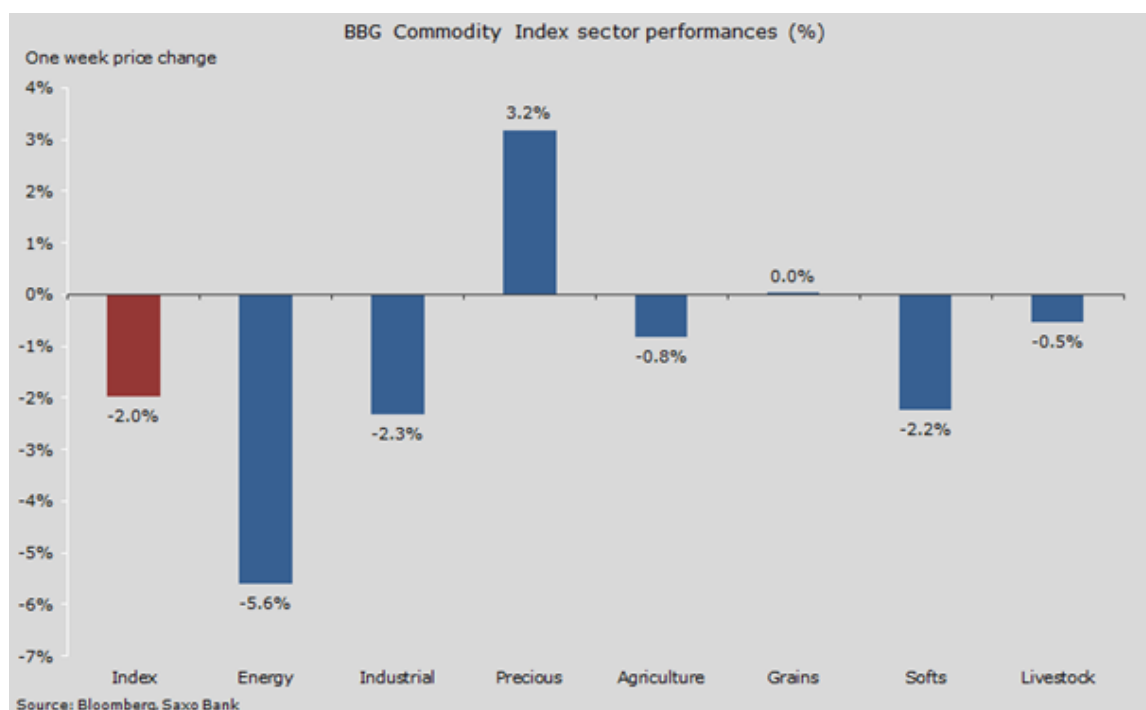


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spread to developed market stocks, not least in Europe, which must both deal with continued worries about Greece (where a snap election has been called) and the prospect of weaker exports to China.

### Supply outstrips demand

Falling commodity prices are increasingly one of the root causes behind the malaise seen across many emerging market countries. Supply of key commodities such as crude, copper and iron ore continues to outstrip demand and the selloff seen these past few months have yet to show signs of halting. This past week the Bloomberg Commodity Index covering the performance of 24 major commodities fell by 2% and in the process hit a new 13½ year low.



Gold and platinum came out on top as raised market uncertainty increased demand for alternative investments. The trend was intensified by a big dose of short covering from tactical investors who saw the July gold collapse as the beginning of an even bigger selloff.

At the bottom of the commodity rankings we find energy related products, not least gasoline which by now has surrendered most of the strong gains seen earlier this year. Falling gasoline prices also kept crude oil under pressure as it highlighted the expectation that the seasonal slowdown in refinery demand will soon begin.

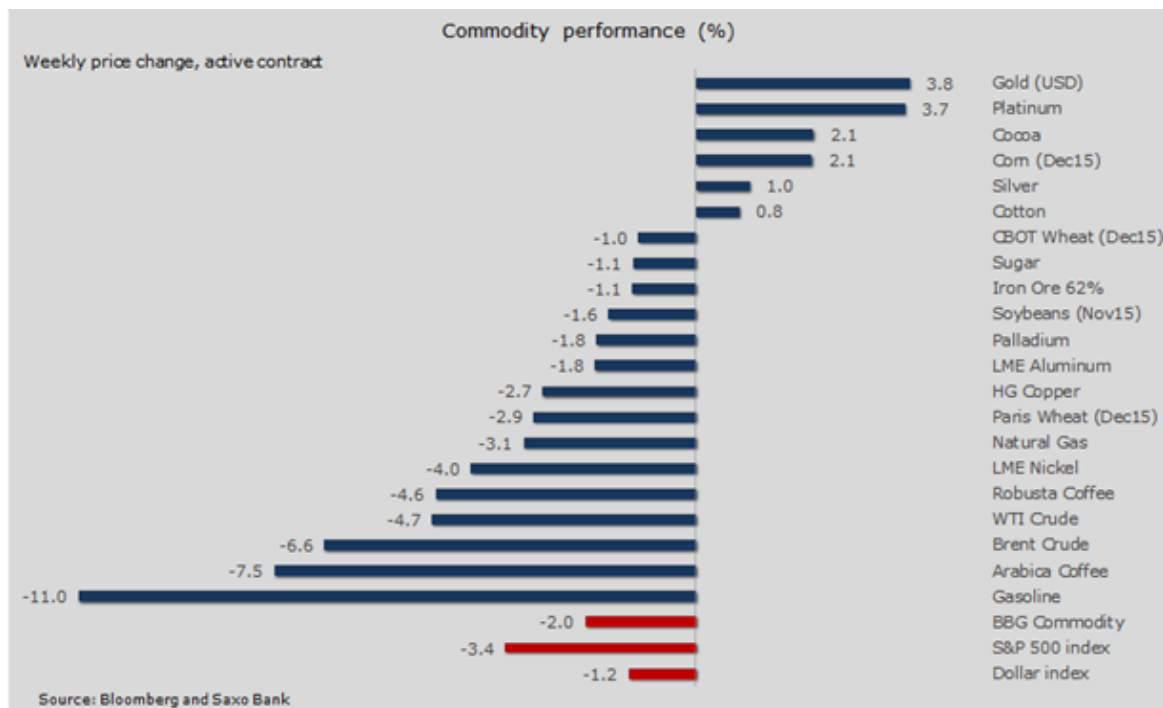
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## Gold in demand as stocks falter

The yellow metal reached a six-week high on the back of short covering and buying from investors seeking an alternative amid falling currency and stock markets. Following the July 20 crash below \$1132 gold sellers rushed into the market and this triggered a record short position held by hedge funds.

Following the Chinese devaluation gold sentiment has improved. But it may still be too early to state that a low has been established with money managers and other paper investors in futures and exchange-traded funds still not seeing any clear reason for holding bullion.

What is clear, however, is that some of the negative drivers for gold has either slowed or disappeared. Competitive devaluations across emerging markets will trigger an increased demand for gold and other tangible assets as a hedge. The below chart shows the development of gold priced in the currencies of the world's biggest consumers. Since the recent lows, gold priced in CNY and INR have both jumped by more than 11% which is some 3% more than what gold has managed to gain against the dollar.

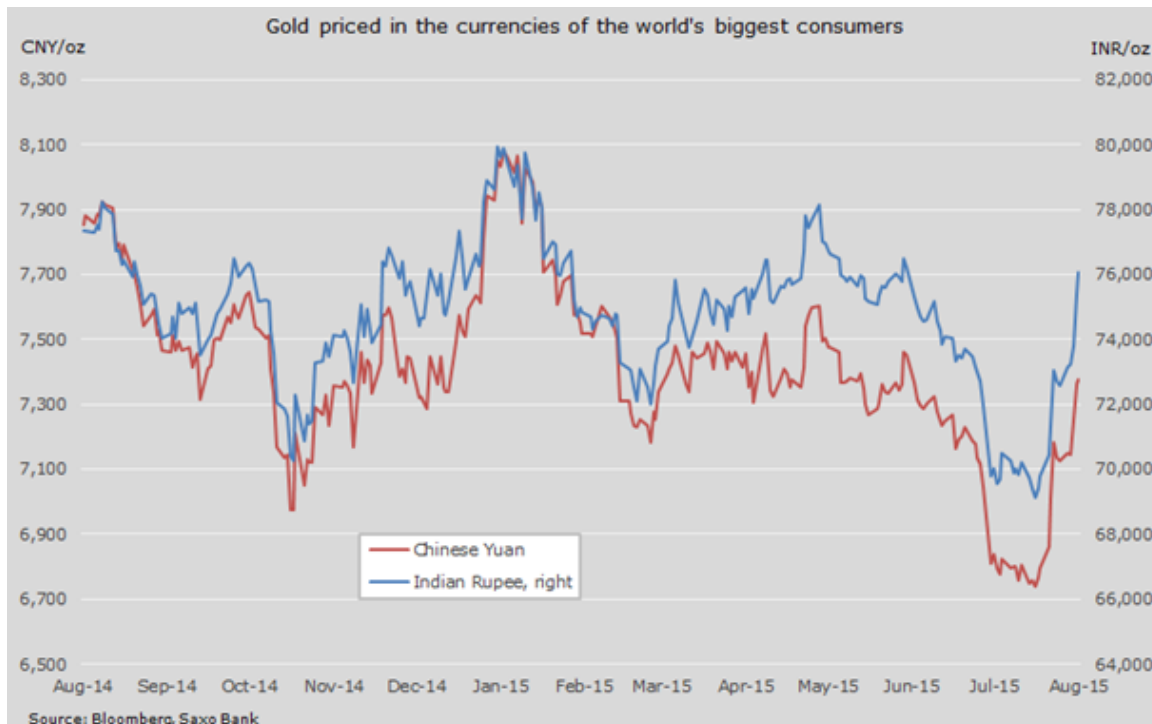
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After reaching a six-week high gold retraced some its gains on Friday as the market ran out of shorts to cover. Trend-line resistance at \$1169 stopped the advance and the coming days and weeks will tell whether a low in the market has been established. Weak stock markets and the continued exit of euro carry trades should keep the dollar on the defensive in the near term.

This, together with reduced expectations of when and by how much the Fed will hike rates can see gold settle into a range before eventually moving higher towards our end of year target at \$1275.

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Source: SaxoTraderGO

### Oil market remain under pressure as seasonal slowdown in demand begins

Crude oil markets remain under pressure from an overhang of supply and the point of when we will see the market balance is fading further and further into the future. This is creating a lot of stress among oil exporters and the weakest of these being called the **"Fragile Five"** are well into crisis territory.

Oil producers, including some of the wealthiest in the Middle East, are burning cash at an alarming rate and the only medicine being applied at the moment is to pump as much as possible. When at the same time we are about to witness a slowdown in US refinery demand due to maintenance and subsequent rise in crude inventories the near-term outlook remains challenging.

The current market turmoil has also triggered worries about global growth and this could eventually call into question whether the market's view on oil demand growth is too optimistic. Add to this a likely increase in supply from Iran next year we may have to wait until 2017 before the market begins to balance, thereby allowing the price to tick higher.

Just like gold a month ago one can argue that oil's best friend right now is the fact that most traders see it going even lower and have positioned themselves accordingly. The chart below shows the ratio between those hedge funds holding long against those holding short positions. As of last week this ratio declined to just 1.6 meaning that for each short in the market only 1.6 long exists.

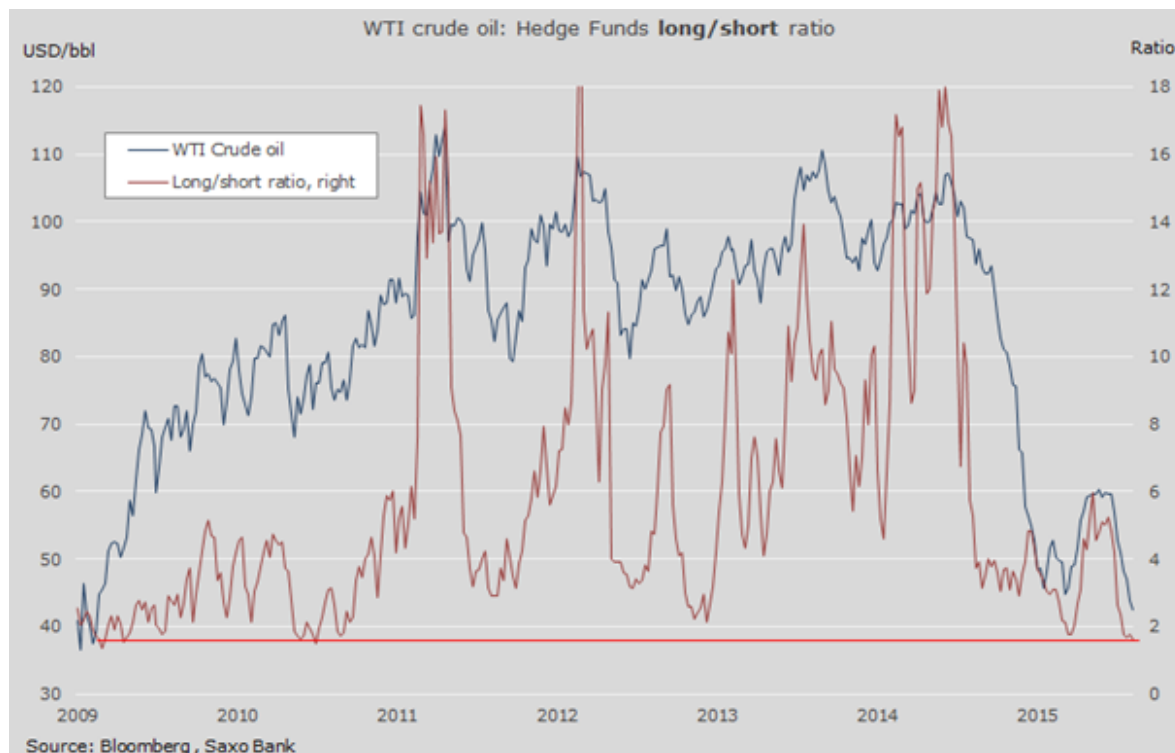
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A ratio this low has on several occasions in recent years created a strong response and price reversal, most recently in March when the market recovered strongly after hitting a multi-year low. This time the sentiment feels different and the overall sentiment is that it has to get worse before it gets better.

Email: [olh@saxobank.com](mailto: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.*

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