THE SPECIALIST IN TRADING AND INVESTMENT

Dieselgate and a not-so-dovish Yellen

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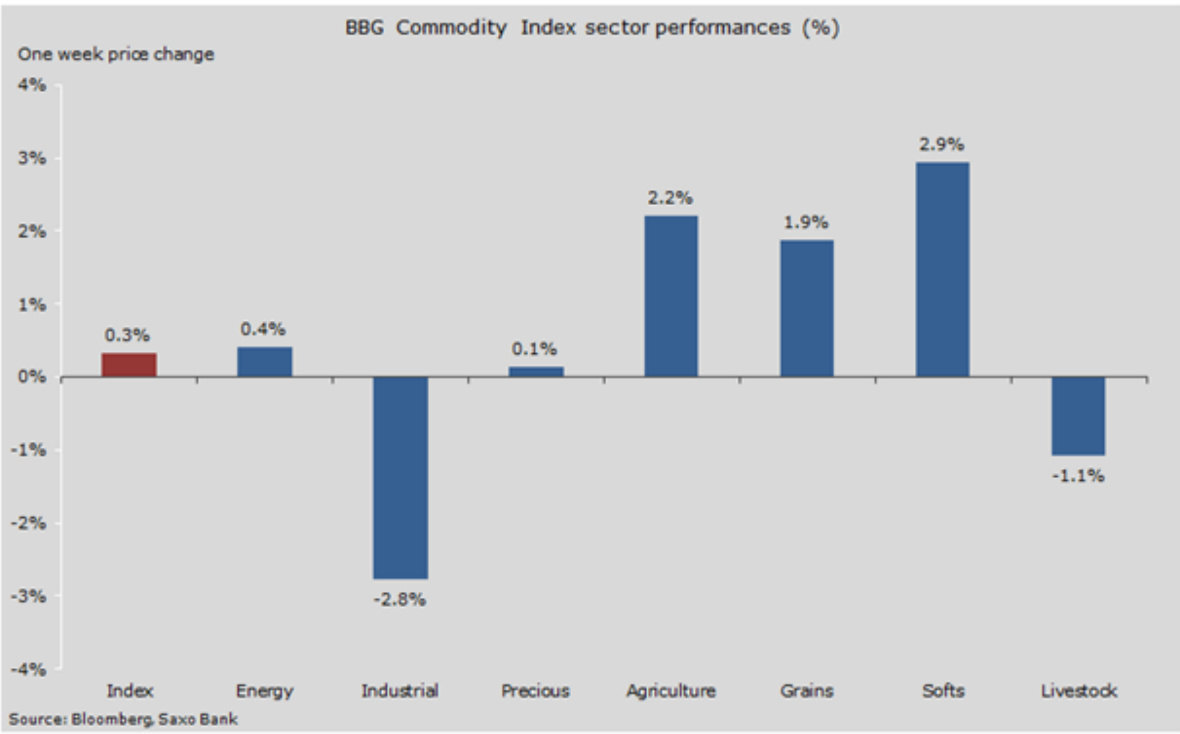
Chinese growth worries, an automotive scandal and a not-so-dovish Federal Reserve chair were some of the key commodity drivers this past week. Oil markets continue to settle into a range with the outlook, at least from a technical perspective, showing signs of improving.

Platinum and palladium went their separate ways as the scandal that engulfed the automobile sector (and Volkswagen in particular) could potentially signal a shift away from diesel to less-efficient gasoline engines.

Gold held onto the gains achieved following the September 17 Federal Open Market Committee meeting despite a stronger dollar and a change in tone from the Fed. The dovish statement following the latest meeting surprised investors and the market reaction seems to have surprised the Fed in turn to the extent that Janet Yellen had to come out and reiterate that the FOMC stood ready to raise interest rates this year.

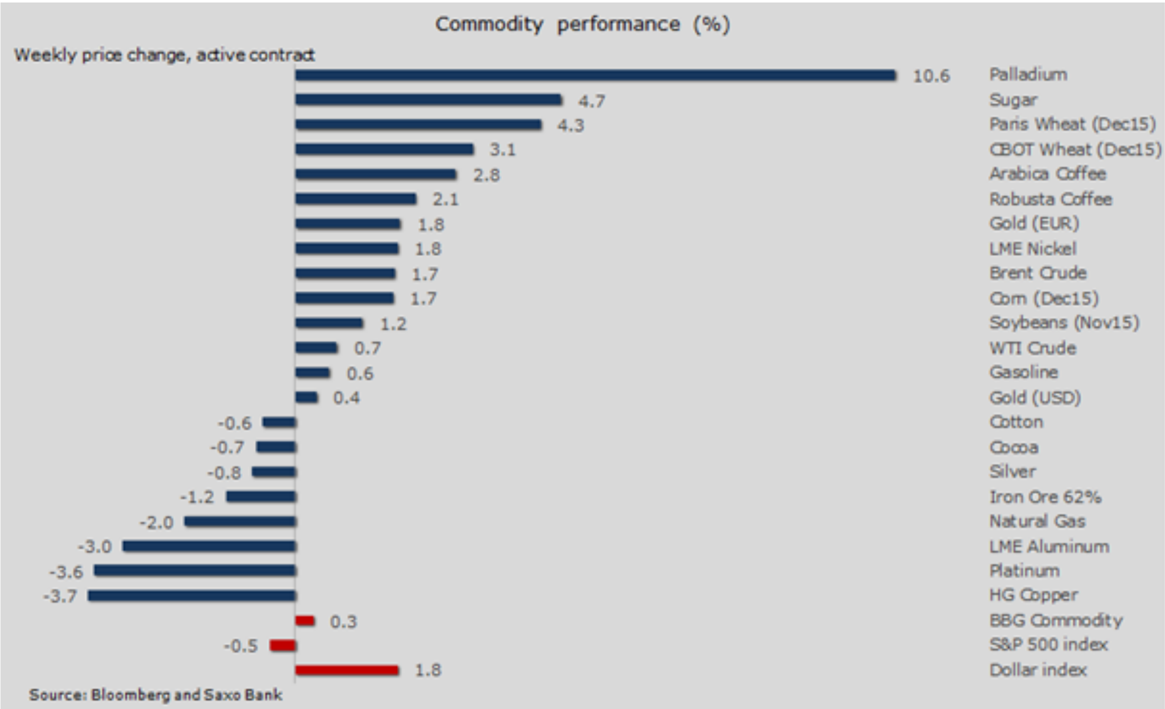


Overall the Bloomberg commodity index was closed to unchanged over the week but still down by more than 15% year-to-date, with all sectors apart from precious metals showing double-digit losses.

This past week, however, losses among industrial metals – not least copper and aluminium on China worries – were offset by gains in energy and agriculture. Wheat reached a one-month high on adverse crop weather in Australia and the Black Sea as well as a potential easing of the Russian export tax which could lead to more exports from that country.

Sugar and coffee, which have been hostage to the months-long collapse of the Brazilian real, received a small boost on Thursday. Both of these soft commodities, which are very price-dependent on events in Brazil, jumped when the BRL rallied the most in seven years, surging by 5.8%. The rally came after the central bank president pledged to use all the tools he has to tame the volatility.

Brazil is by no means out of the woods yet and although we see improved fundamentals for sugar and to a certain extent coffee, it highlights the BRL's importance as a driver for these soft commodities.



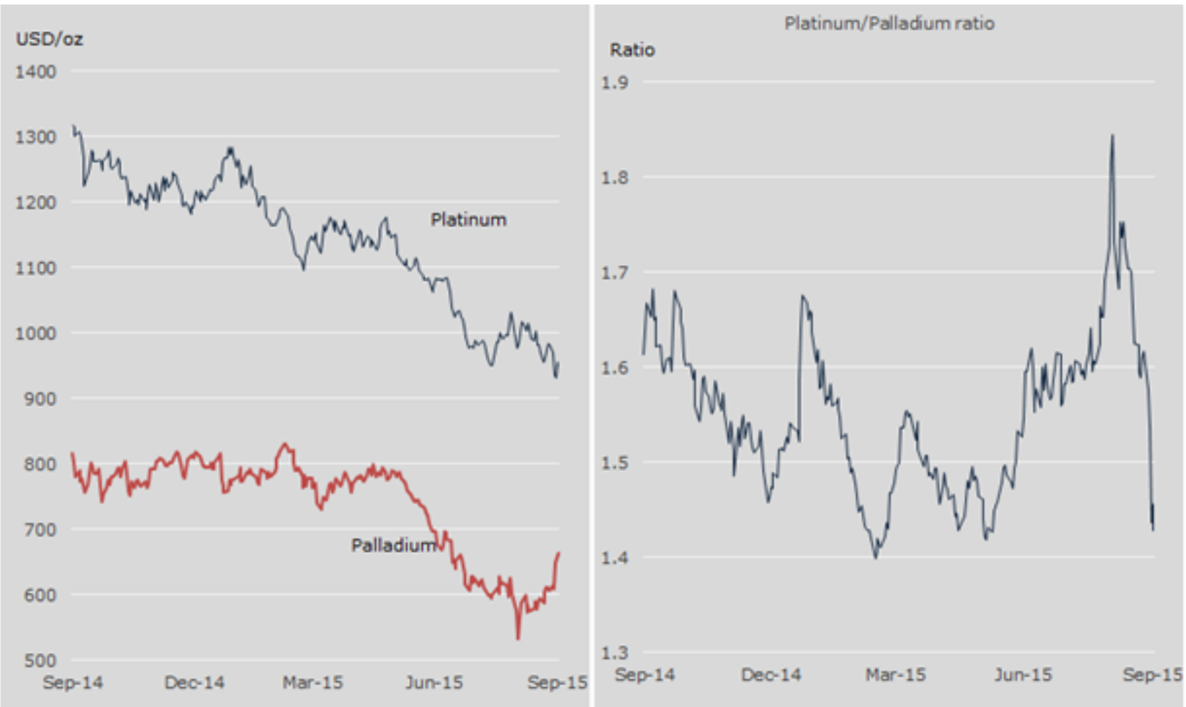
Battle of the engines

The VW scandal was undoubtedly *the* big news of the week and it helped to trigger another round of stock market weakness as well as a major reaction in platinum group metals. The realisation that emissions from diesel engines have been higher than expected has raised speculation that it could led to the demise of diesel engines or at least slow down the demand.

With platinum being a key component in diesel converters and palladium being the preferred metal used in gasoline engines, the price of these two metals witnessed a dramatic divergence.

While platinum dropped to a six year low, buyers chased palladium higher and this led to a difference in price performance of more than 12%. Platinum currently trades at a 43% premium over palladium and some speculated that a major abandoning of diesel could trigger a move to price parity.

Palladium and platinum price converging following the VW scandal:



Source: Bloomberg, Saxo Bank

A change in demand will most likely be driven by political initiatives to make diesel engines less attractive through taxation either of the fuel or the cars. Platinum managed to stabilise, however, not least after seeing the discount to gold rise to 20%, the widest on record. This compares with an average 20% premium during the past 10 years.

Gold holding onto gains as bears retrace

As noted, gold held onto the gains achieved following the FOMC meeting despite a stronger dollar and a change in tone from the Fed. Stock market weakness, EM worries and improving physical demand from India helped the yellow metal break resistance at $1,150/oz, But it retraced after Yellen came out Thursday to reiterate that the FOMC stood ready to raise interest rates this year.

Options data related to the SPDR Gold Shares – the world's biggest ETF tracking gold – and COMEX futures show that bears have become a bit worried about the near-term direction. The put-to-call ratio on the SPDR Gold Shares has seen the number of puts relative to calls drop to the lowest level since 2012.

Meanwhile, the one-month risk reversal on Comex gold, which reflects the additional cost of hedging the downside relative to the upside cost, has fallen to the lowest level since February.

Key level remains at $1,170/oz

The near-term outlook for gold will continue to be determined by the health of the global economy and its subsequent impact on stock markets and bond yields. Adding to this the focus on when (or if) the FOMC presses the rate hike button.

At this time, the upside potential will be determined by gold's ability to break back above the August high at $1,170/oz. If successful, it could signal a market low has been reached and it would support our end of year call of $1,250/oz.

Alternatively, renewed weakness below $1,100/oz could be a strong enough signal to attract renewed selling and potentially see the break below $1,080/oz. A break through this level would force us to lower our targets as it opens the risk of a move towards the triple digits.

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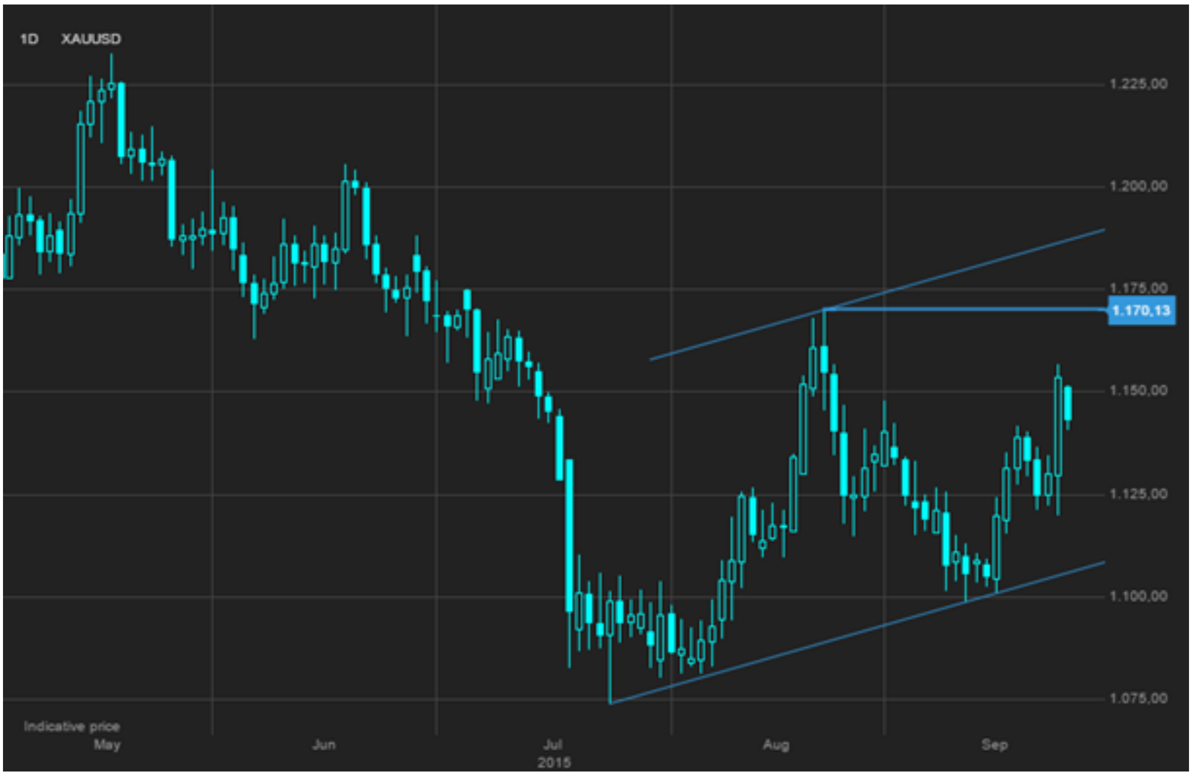
Gold upside potential limited to $1,170/oz while bears will strike on a return below $1,100/oz:



Source: SaxoTraderGO

Crude oil continues to stabilise following the wild gyrations witnessed during the past couple of months. The overriding theme is still the continued supply glut which has been brought about by rising Opec production as members seek to protect their revenue base while at the same time defending market shares.

In recent weeks, however, we have seen more and more signs that crude's current price level has reached a level low enough to trigger a supply-side adjustment. Such an adjustment could, according to the IEA, trigger the biggest non-Opec supply cut in 24 years next year and will go a long way to support a sustained price recovery towards the end of 2016.

Although the data have yet to show it in full, there is no doubt that US shale oil production is slowing and that many smaller and bigger drilling companies are struggling.

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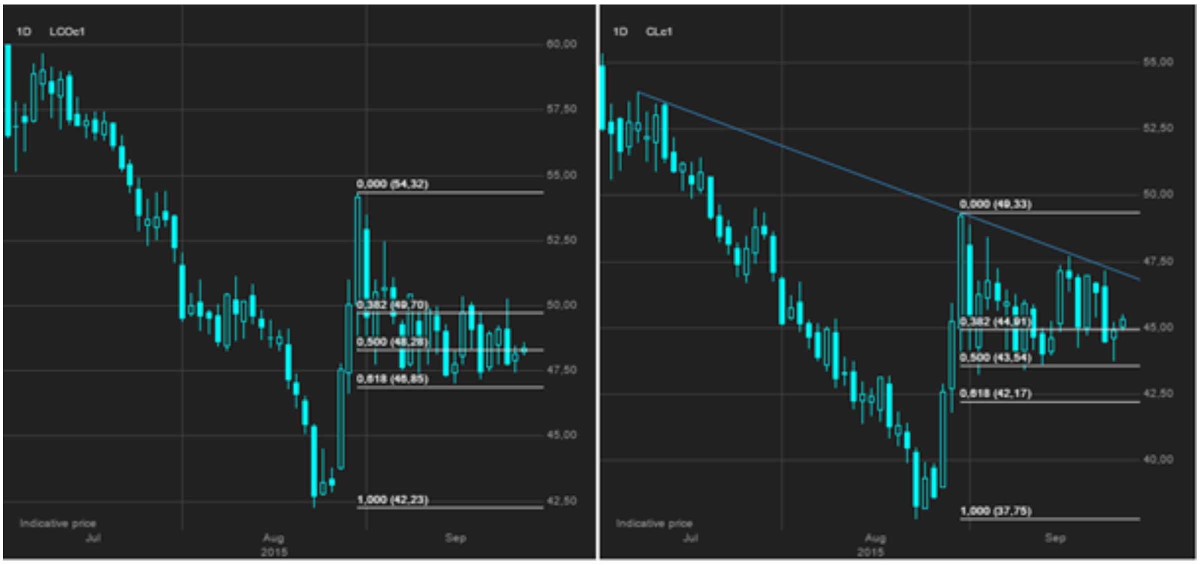
Adding to this continued belt-tightening from some of the large international oil companies such as Total SA, the market should continue to balance itself thereby leaving enough room for increased supplies from Iran next year.

Against this supportive background, the market will also have to deal with economic data from China which continues to slow and which potentially could trigger a price-damaging reduction in demand.

It is in this environment that both WTI and Brent crude oil remain range bound. Recent sell attempts have been rebuffed with WTI crude finding support at $43.50/barrel which represents a 50% retracement of the August-September rally. For Brent, the support level to look out for is at $46.85/b which is also an important fibonacci level.

Both Brent and WTI crude oil finding support during the past couple of weeks:



Source: SaxoTraderGO

The direction of energy prices during the coming weeks will be determined by the market's ability to withstand the seasonal slowdown in crude oil demand from refineries, especially in the US but also in Europe and Asia.

This process is now under way and last week it triggered the biggest reduction in US refinery activity since January.

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