



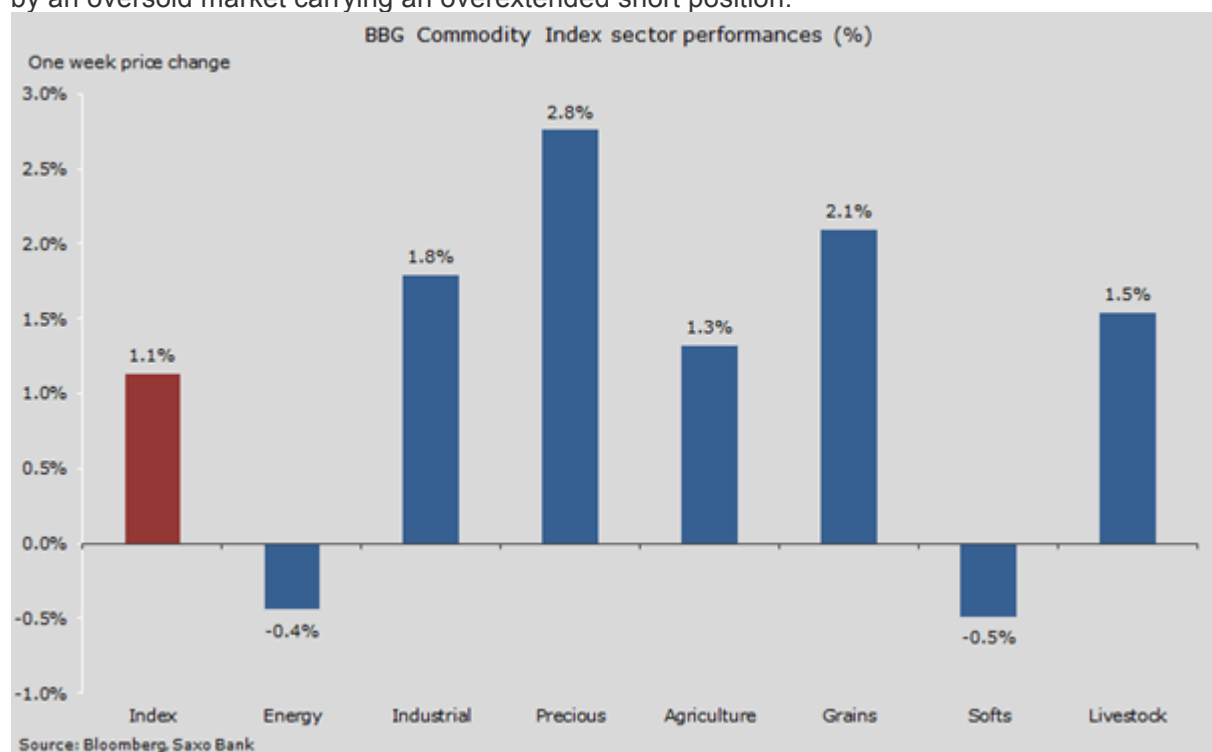
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WCU: Selling fatigue and Draghi save the day for oil

By Ole Hansen

Crude oil touched a new multi-year low at the beginning the week as it was weighed down by the removal of the Iran sanctions and the "drowning in oil" comment from the IEA. The bounce – when it came courtesy of European Central Bank chief Mario Draghi's continued focus on stimulus and winter storms in the US –was aggressive, with Brent crude oil rallying by more than 15% within 24 hours.

Negative oil fundamentals remain and until we see clear signs of the oversupply being capped, the upside at this stage remains limited. While Draghi provided the spark the aggressive reaction was driven by an oversold market carrying an overextended short position.



On the week, however, energy remained the worst performer while precious metals came tops as the sector received a lift from the hopes of additional stimulus from central banks and a slowdown in the speed of expected US rate hikes.

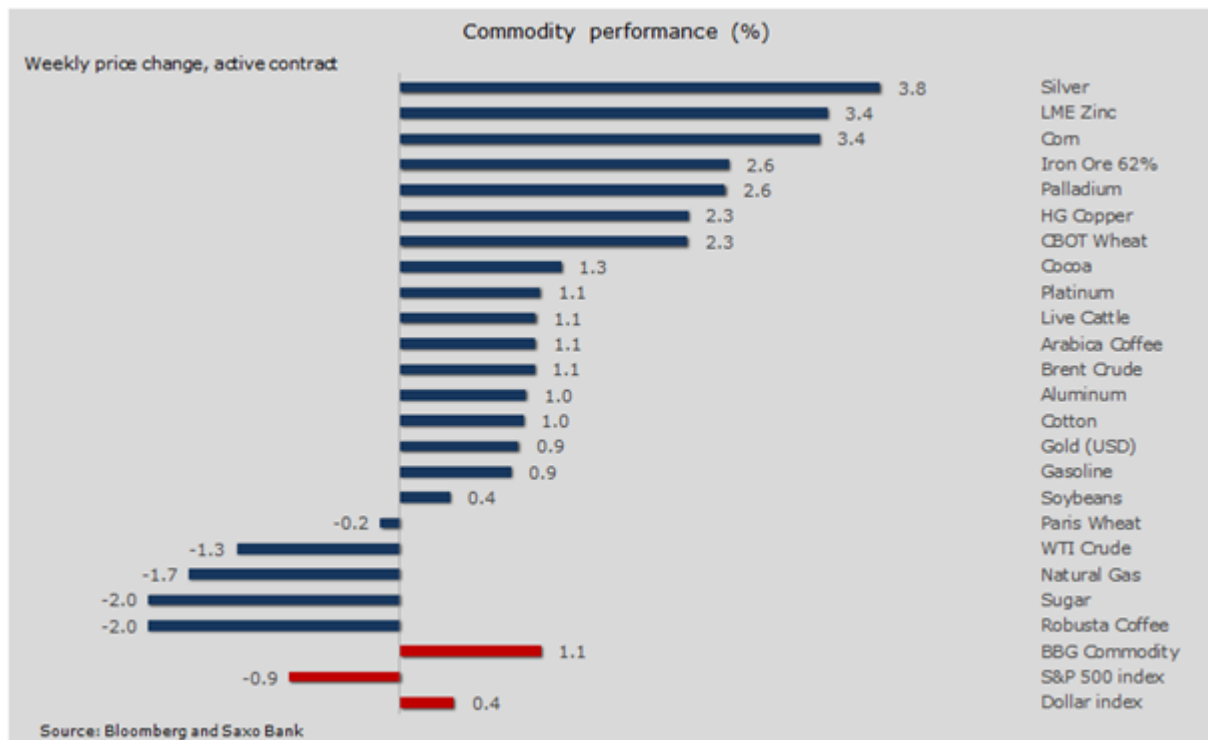
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Raised hopes that central banks will do more to support economic growth and dampen market turmoil supported the first weekly gain in three among industrial metals. All of the six major industrial metals, led by nickel, moved higher in line with recovering stocks while copper received a boost from news that China's largest utility company is planning to increase spending on the national power grid.

Crude oil: A week in two halves

Confirmation that sanctions against Iran had been lifted helped send crude oil down to the lowest level in 13 years. The focus on rising supply at a time where demand growth is being called into question have been the two main driver behind the extreme weakness seen since the failed Opec meeting on December 4 last year.

This was brought home by the International Energy Agency (IEA) which in its monthly report said that the world could find itself "drowning in oil" this year as rising Opec supply, not least from Iran, would not be met in time by falling production elsewhere. With 2016 becoming the third consecutive year with overproduction, the IEA did not rule out that the price could go even lower.

Nothing ever goes in a straight line forever and as the week wore on selling fatigue began to emerge. The combination of colder weather in the US, talk about additional stimulus from the European Central Bank and a better than expected US inventory report all helped trigger a major rally by the end of the week.

Hedge Funds versus retail investor

Money managers and hedge funds earlier this month had accumulated the biggest short position ever seen. At almost 400 million barrels combined in Brent and WTI crude the market was increasingly exposed to a sharp reversal. Last time the short became too extended was last August and back then it triggered a 25% rally in just three days.

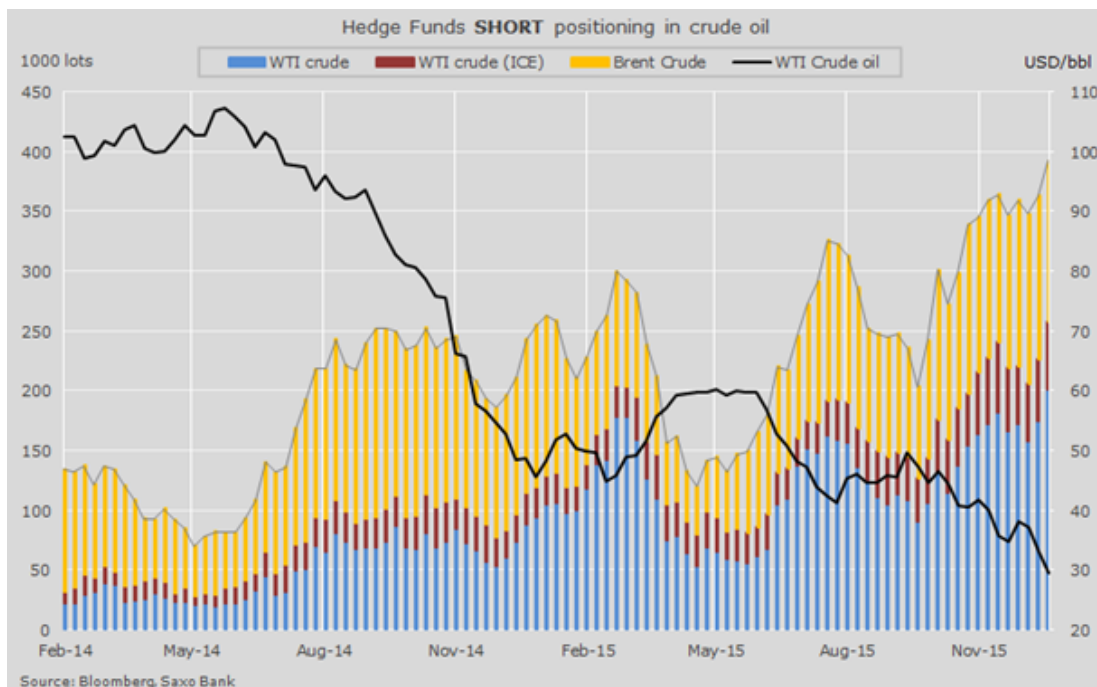
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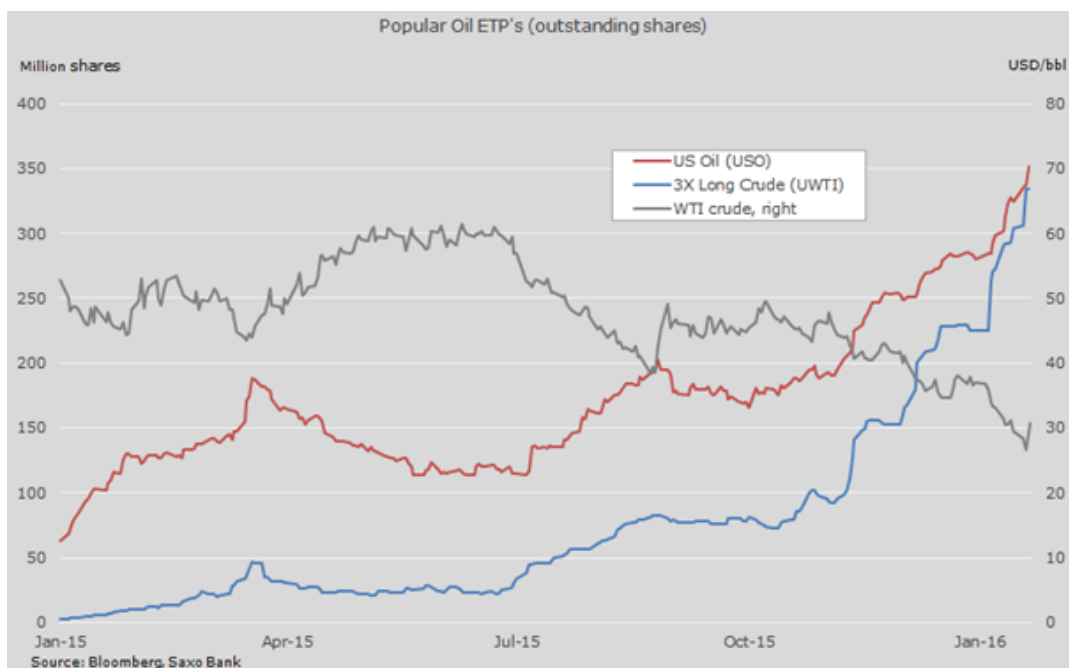
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Retail investors who typically use exchange-traded products to trade commodities have been trying to pre-empt the recovery for the past couple of months. So far this January the buying has intensified with two of the most popular, the United States Oil Fund (USO) and the more exotic sounding Velocityshares 3X long Crude (UWTI) seeing holdings rise by almost \$1 billion.



The near-term outlook remains very challenging as the market has to deal with rising supply from Iran and a seasonal rise in US inventories. Emerging signs of increased stress among high cost producers will increase speculation that a big shake-out is coming in the US shale industry which will ultimately lead to a

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slowdown in production. The IEA is forecasting non-Opec production will fall 600,000 barrels/day in 2016 and this will eventually help offset rising export from Iran.

The head of Saudi Aramco was speaking at the World Economic Forum in Davos this week and he believed that current oil price was irrational and that the market had overshot on the low side. An irrational low price is the response to an irrational high level of production and until the latter is brought down the market can remain irrational longer than oil producers around the world would like to see.

Brent crude oil heading for a weekly close above \$30 but it needs to break above \$35 before triggering the belief that a low has been established.



Source: SaxoTraderGO

Gold remains a top performer against most assets

Although gold had a relatively quiet week amid all the turmoil elsewhere both metals remain two of the best performers against most other asset classes so far this month. Investors have started to return, not least those using exchange-traded products while hedge funds have returned to neutral from a record net-short position at the beginning of the year.

Total holdings in exchange-traded products backed by gold have jumped by 42 tons since January 6 thereby recouping half of what was sold during the October to December selloff. This was the biggest jump since last January where the Swiss franc debacle and the ECB quantitative easing introduction triggered a strong rally in gold and with it increased demand for ETPs.

Two of the major reasons for staying out of gold at the beginning of the year are currently posing less of a threat than just a few weeks ago. The turmoil in global markets have dented the dollar's appeal with traders instead opting for JPY and to a certain extent euros. Worries about a global slowdown and declining inflation due to low oil prices have also reduced the expectations for how aggressive the US Federal Reserve can and will hike interest rates during the coming months.

Last January gold rallied by \$118 during the first three weeks only to slump by \$150 during the remainder of the quarter. Back then ETP holdings were 180 tonnes higher than now while hedge funds had accumulated a net-long of 17 million ounces compared to zero now. These changes both fundamentals and market positioning has left gold more immune to renewed attempts to weaken it.

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Our view remains that the combination of a stronger dollar and recovering stocks will continue to pose a challenge to gold during the early parts of 2016. But recent events have highlighted some of gold's credentials that had been lost for a while. We may see another attempt to sell gold down towards \$1,000 but the improved sentiment and lackluster performances elsewhere will eventually be the driver that takes gold higher later in the year.

Gold is currently trading within an uptrend that began back in December. A break above \$1,113 can pave the way for an extension to \$1,125.

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Source: SaxoTraderGO

Ole Hansen is head of commodity strategy at Saxo Bank. His [Twitter account](#) was cited by [MarketWatch](#) as one that investors should follow in 2016.

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