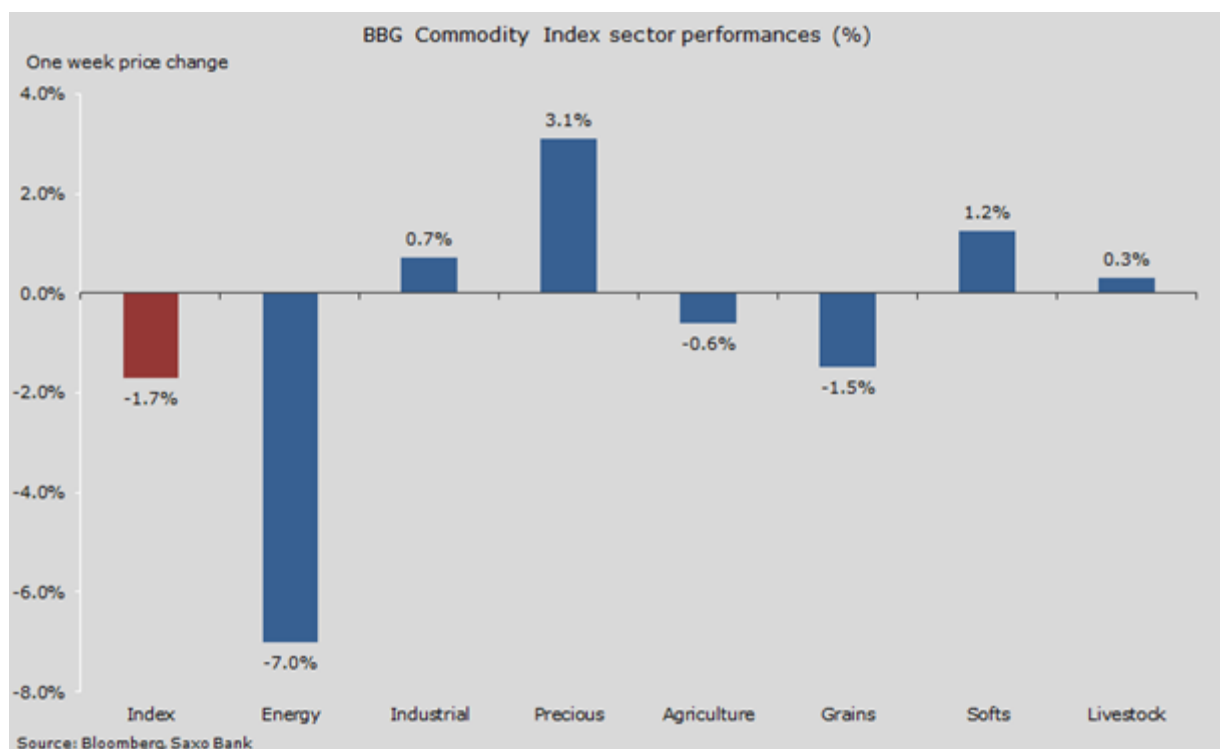


WCU: Weaker dollar makes precious metals shine

By Ole Hansen

The US dollar attracted a lot of attention this past week and the weakness that was seen following some dovish comments from members of the Federal Open Market Committee helped support precious and industrial metals. This support lasted until Friday when emerging signs of wage pressure in the monthly US jobs report helped trigger some profit taking.

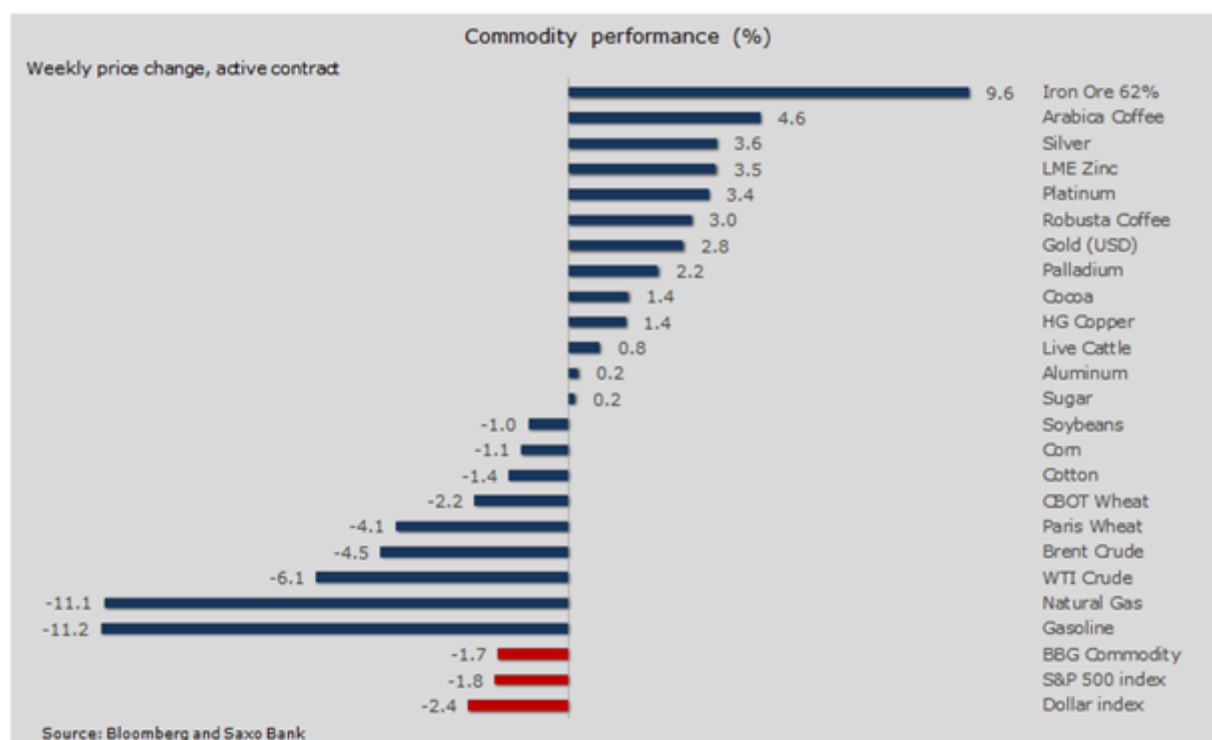
Industrial metals led by zinc also benefited from the early weakness of the dollar which helped attract short-covering from funds. Not all sectors, however, managed to jump on the weaker dollar => stronger commodity bandwagon with the energy sector continuing to suffer from oversupply. Continued noise about a potential co-ordinated cut to supplies however helped crude oil to establish a floor for now.



Iron ore jumped the most since last May on increased demand from Chinese smelters during what is seasonally a strong period for demand. The key is whether demand will continue to hold up following the Chinese Lunar New Year holiday next week.

Coffee has been in demand since hitting a low in mid-January as the fundamental outlook has begun to improve. Hedge funds have held a net-short almost constantly for the past year. But

reports of falling output and very low stocks together with this week's rally in the BRL as the dollar weakened further supported the sentiment.

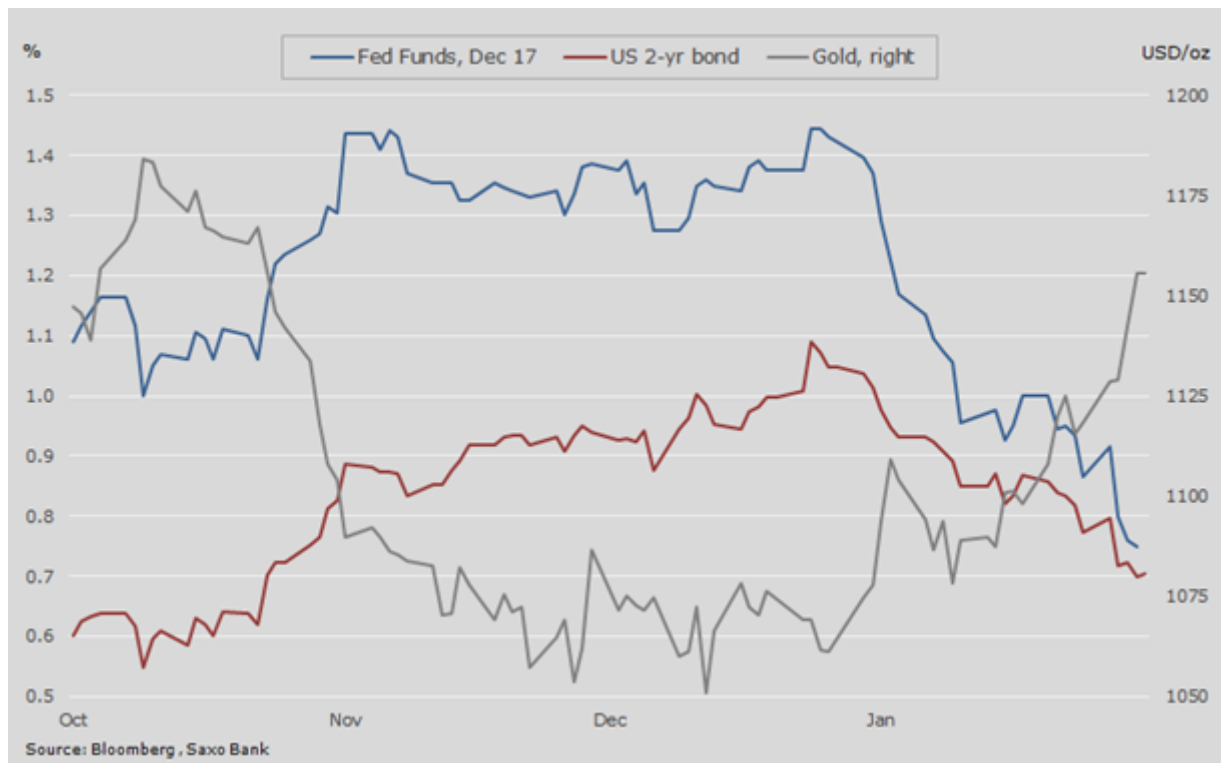


Gold comes in from the cold as macro scene weakens

Relentless turbulence in equity and oil markets in early 2016 is supporting a month-long recovery in gold. The struggling US oil and gas sector was a major contributor to slowing US growth during the final quarter of 2015, and it is now leading to a quiet shift among US Federal Reserve policymakers as to how aggressive the Fed will be on future rate hikes.

Fed vice chairman Stanley Fischer said that the US economy could suffer if the recent volatility in financial markets persists and triggers a slowdown in the global economy. Instead of expecting four US rate hikes this year, we could now see the Federal Open Market Committee consensus move towards two or three rate rises or even lower at the coming meetings. This would bring the thinking close to the market where no rate hikes are now priced in for the coming year.

Gold was under pressure during and after the US rate hike in December, but since then the outlook for other asset classes has deteriorated dramatically. As a result, the December 2017 Fed Funds future has collapsed to just 0.75% today from 1.45% back then, while the 2-year government bond yield has fallen by 0.40%-point since December 29.



Investors have also returned in droves to exchange-traded products, and Bloomberg has recorded a flow of \$2.4 billion into gold ETPs so far this year. The biggest inflow has been into the SPDR Gold Shares (GLD) which alone has received \$1.8 billion.

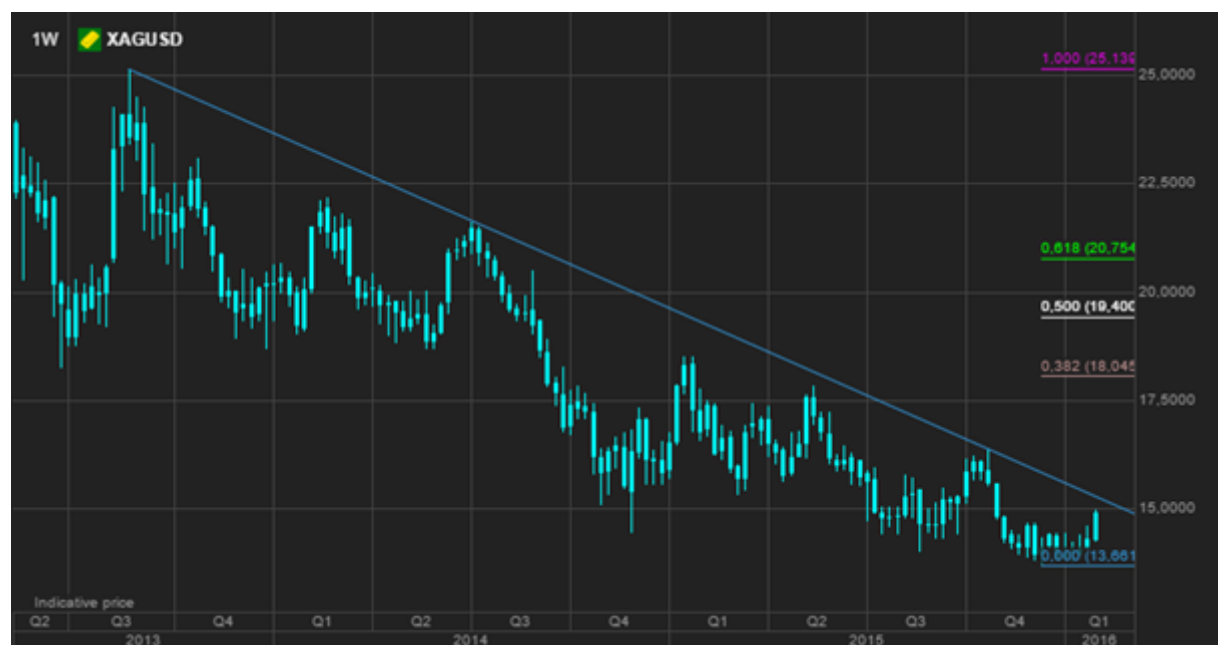
These positive flows resemble what we saw the same time last year when the first five weeks of 2015 yielded a pick-up in total holdings of 84 tonnes compared with 90 tonnes so far this year.

Money managers held a record short position at the beginning of the year and the adjustment back to a net-long has supported gold these past four weeks. Having reached the highest level since last October some consolidation can now be expected ahead of the next key resistance level at \$1177/oz. unless the dollar continues to weaken.

The white metals strike back

Silver, platinum and palladium all benefited from the weaker dollar and rising gold prices before being hit by profit taking as the dollar recovered into the weekend. Platinum has after reaching a record discount of more than 25% to gold a few weeks ago seen demand pick up once again. The break above \$900 is the first indication that the rout is over and it should now be able to reclaim some lost ground, not least against gold.

Silver is also beginning to look interesting on the charts with an increased potential of an upside extension. A weekly close above \$15.20 could signal a move initially up to \$18. Such a break would also help trigger a contraction in the XAUXAG ratio and this could be a less volatile way to play a continued rally in metals. Not least considering the negative impact should we see renewed dollar strength.

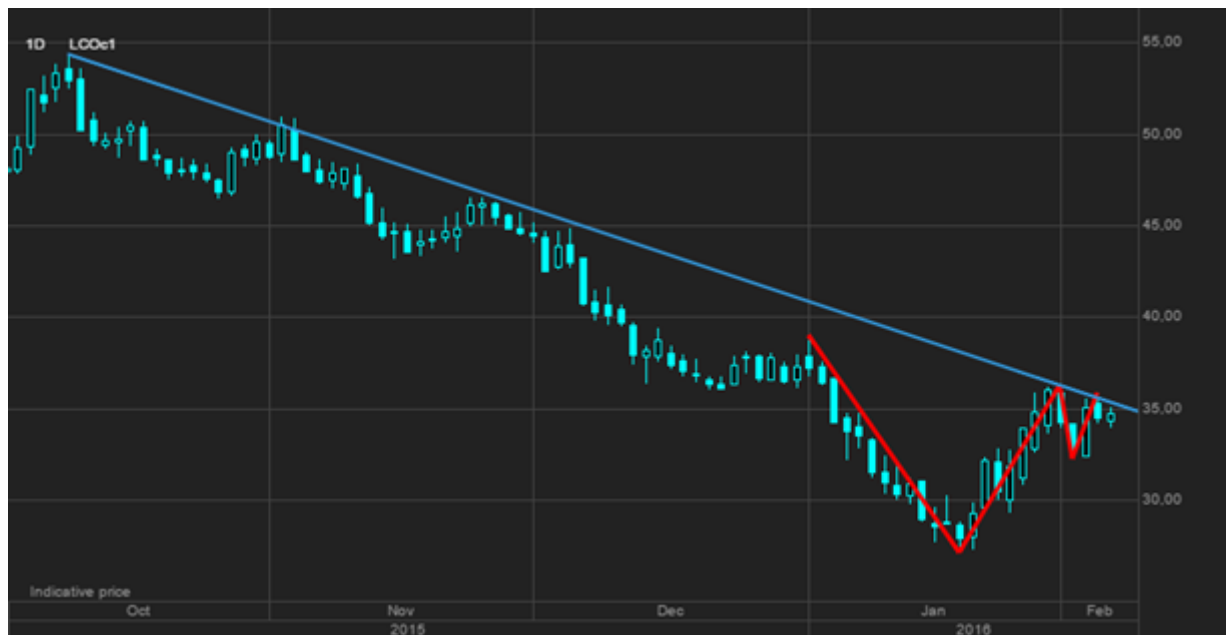


Oil bottoming but not yet ready to rally

A high level of uncertainty continues to create a challenging environment for oil traders. This week began with the biggest two-day drop in seven years followed by an equally strong recovery. The first signs traders getting wary about being caught to short was seen on Wednesday following the weekly US inventory report.

On almost all accounts this report was price negative with inventories of oil and gasoline both rising by more than expected. Crude oil inventories breached 500 million barrels to the highest in 80 years while gasoline stocks continue to rise strongly. Although some of the increase was due to lower demand triggered by the winter storms it nevertheless did not support the strong rally which followed the announcement.

Year-to-date Brent crude is down by 3 dollars but during this time it has travelled almost 30 dollars to get there. Speculative bets continue to rise on long and short positions both in futures and through exchange-traded products. These developments all show how the market remains very split on whether it will be \$30 or \$40 next.



Negative fundamentals and worries about slowing demand continue to attract short-selling, not least from hedgers. In the options market this past week we found that 9 of the 10 most traded options strikes being put options. Against this the market has nevertheless managed to stabilise with some believing that a worst case scenario has already been priced in.

Producers desperate for higher prices continue to entertain the idea of a meeting between Opec and non-Opec oil countries. However slim the chance of such a meeting coming to a successful conclusion a deal would send the price sharply higher as it would signal a bottom.

Brent crude is likely to settle into a wide range with sub-\$30 offering support while the upside seems unsupported above \$37.

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.