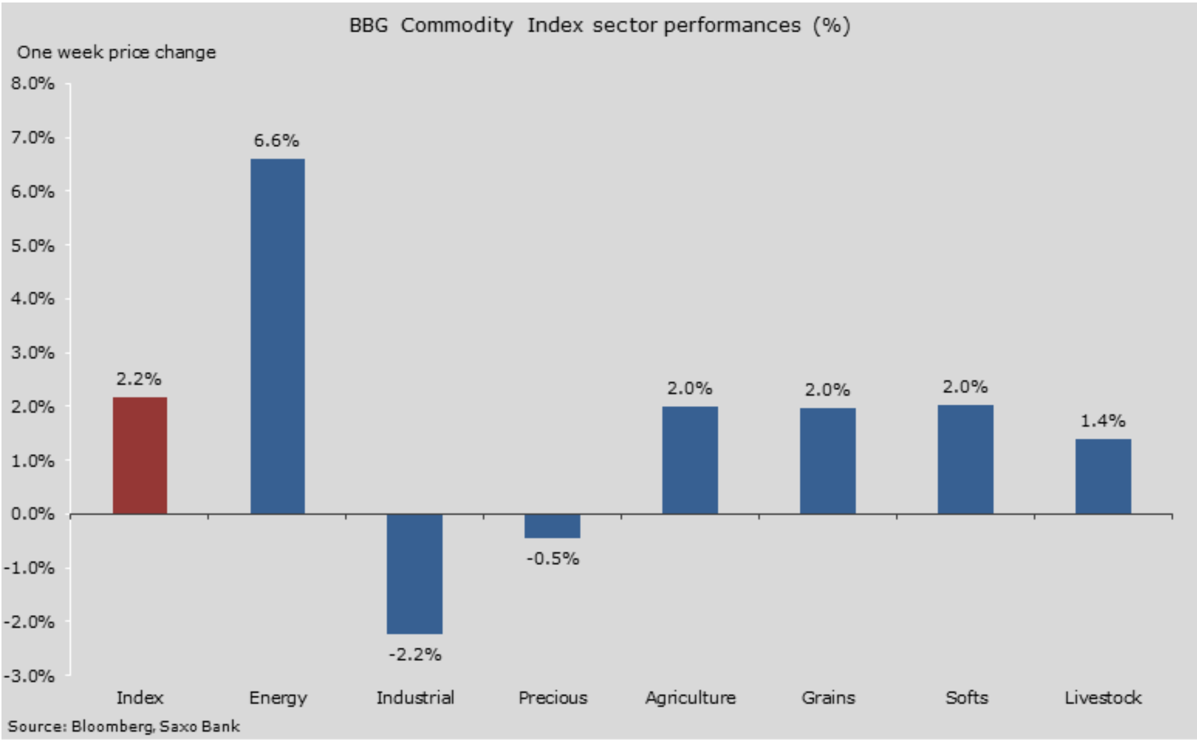
WCU: Strong week for oil but challenges remain

By Ole Hansen

After three weeks of sideways trading the Bloomberg Commodity index, which reflects the price development of many key commodities, broke higher and reached three months high.
The charge was led by the energy sector. Gasoline surged and crude showed the fourth consecutive weekly gain. After heading for the abyss in mid-January, crude oil has recovered, leading many, including the International Energy Agency, to believe that a low has been established.
Rising US gasoline demand and weaker production combined with supply disruptions within OPEC have more than off-set growing stockpiles and worries that the March 20 meeting between OPEC and Russia may disappoint.



Industrial metals had a reality check following recent strong gains on the back of raised hopes that China would announce additional initiatives to support growth and subsequent demand for key commodities such as metals. Iron ore had a crazy week after seeing the biggest one day jump in history on Monday. This concluded a month-long rally which had been driven by restocking by Chinese smelters and supply disruptions from major ports in Australia and Brazil.
Gold reached a new one-year high following another dose of stimulus from the ECB, which against expectations sent the EUR higher at the expense of the USD. Hedge funds called a halt on buying after accumulating gold for eight consecutive weeks. The buying frenzy from investors using exchange-traded products however continued with many anticipating that further gains awaits just around the corner.

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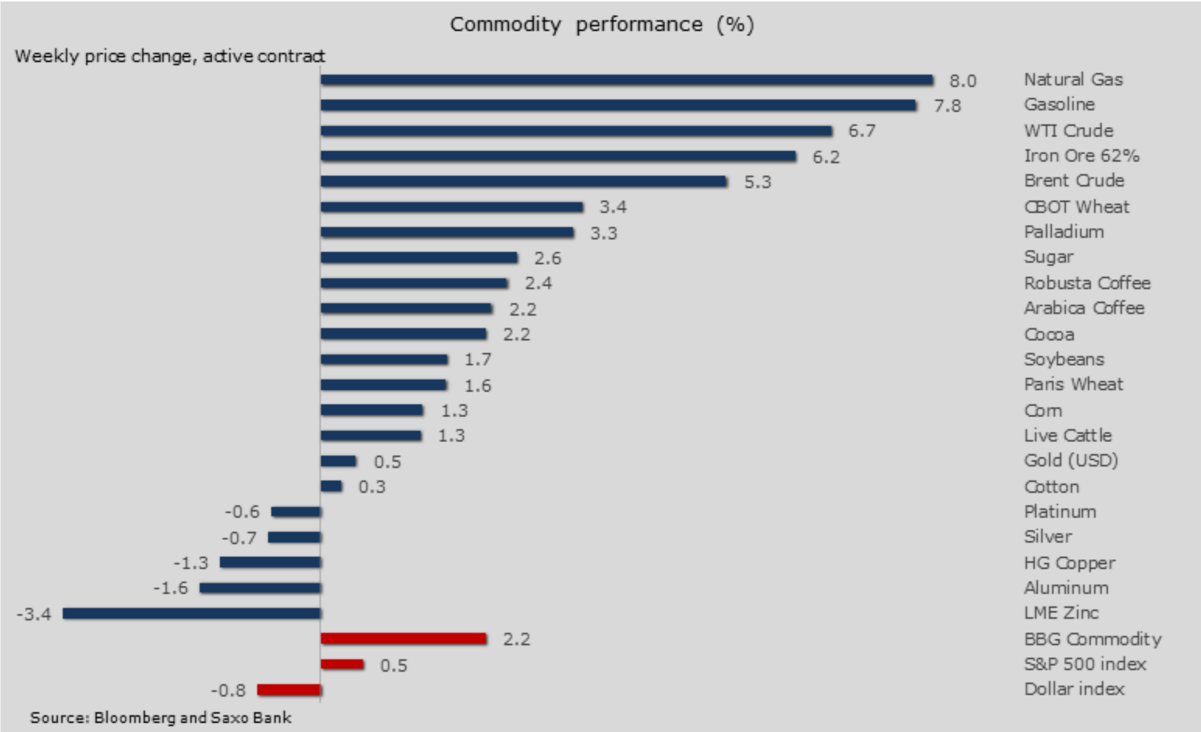

Brent crude oil reached a high close to $41.50/barrel and has now retraced 50% of the sell-off since last October. The sideways trading this past week indicates that an area of resistance has been reached. A rally well into the 40's may prove to be counterproductive as it could attract increased production at a time where the global supply glut has only just begun to show signs of easing.

Once again the risk is growing that the market has run ahead of fundamentals thereby increasing the risk of a setback. Not least considering the chart below which shows that money managers are now holding a combined record gross-long in Brent and WTI crude. A total of 726 million barrels are currently owned by traders looking for higher prices, so it is not just short covering which has been driving the market higher during the past month.

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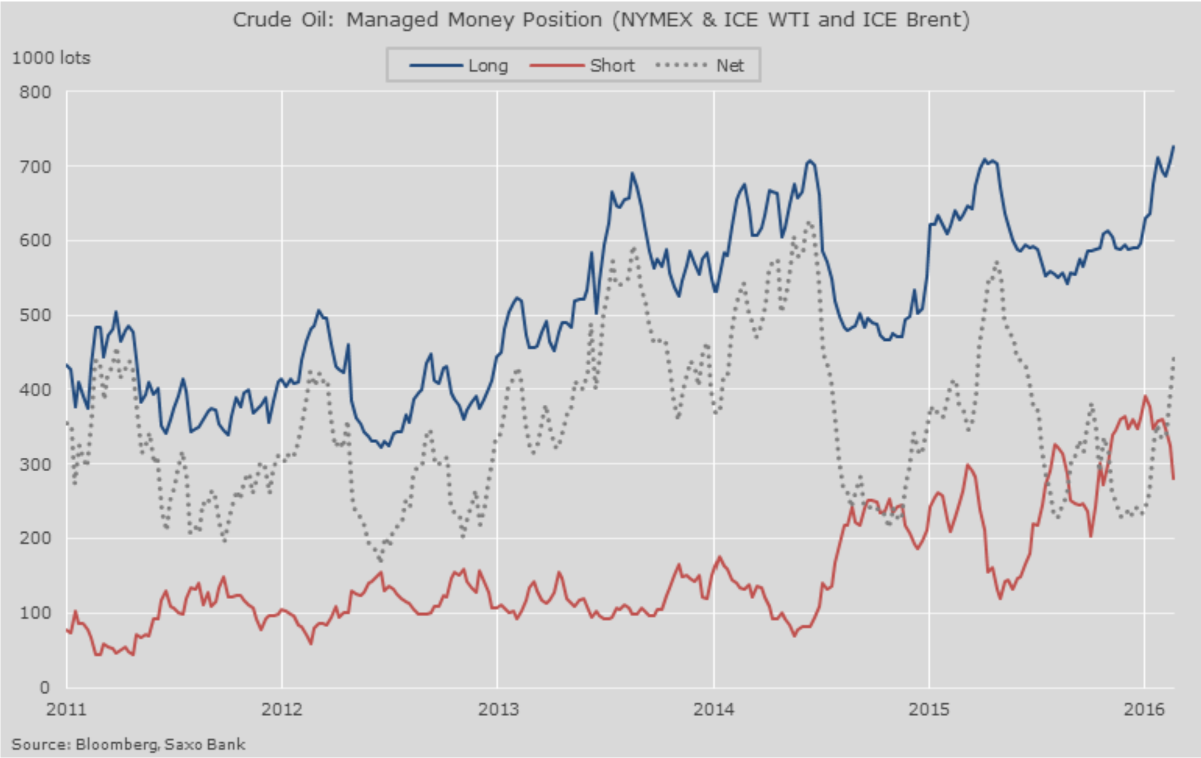

The chart below shows that a battle is currently being fought around $40.70. This level represents a 50% retracement of the sell-off from last September until January. Above $40 the market is increasingly at risk of running ahead of what is being supported by fundamentals.
In the short-term momentum may carry Brent crude higher towards a maximum of $44 before once again running into renewed selling. A break below $39 would signal a renewed weakness towards $36 or potentially as low as $34.25.

Gold remains well supported, not least by investors using exchange traded products. During the week it corrected lower but found support at $1237 after retracing 50% of the latest rally. However no signs of panic selling were detected. This confirms our belief that despite some headwind being created by rising stocks and stabilizing commodities the psychology in the market has changed.
A major portion of the 275 tons investors have bought since beginning of the year are likely now to be in the hands of longer term investors returning to gold amid low or even negative deposit rates.
The ECB meeting on Thursday resulted in another dose of rate cuts and asset purchase. This helped gold to recover, not least considering the gold friendly and surprise weakening of the USD. At the end of another busy week, gold retraced some of its gains as both the USD and stocks recovered.
We continue to see gold consolidating in a wide range with resistance at $1310 likely to attract some long overdue profit taking while it will take a break below $1190 before tactical traders like hedge funds would begin to consider reversing back out of long positions.

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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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