



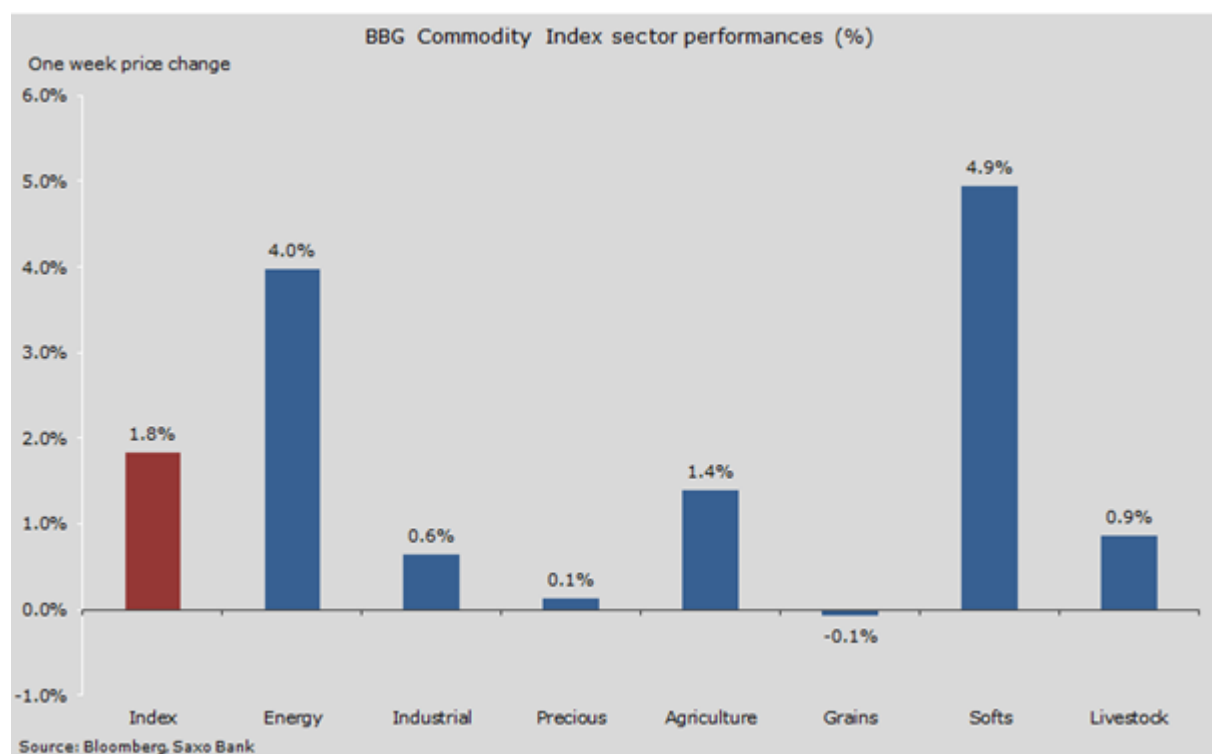
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WCU: Self-defeating oil rally continues

By Ole Hansen

The commodity recovery extended into its third week with the Bloomberg Commodity Index reaching a three-month high. The dollar's negative correlation to commodities provided the sector with a general boost following the surprisingly dovish Federal Open Market Committee meeting Wednesday. The lowering of rate hike expectations for 2016 from four to just two sent dollar bulls running for cover while cheering investors in raw materials.

Crude oil continued to recover with slowing US production and inventory build combining with continued hopes of a production freeze to provide bulls with enough ammunition to force continued short-covering.



Gold failed to reach new highs despite seeing the US FOMC turn more dovish, and this signals the need for a prolonged period of consolidation after having rallied 18% so far this year.

Silver had a great week reaching a five-month high and in the process outperforming gold by 2%. The yellow metal received a lift from the weaker dollar, but the failure to reach a new high for the year following the dovish FOMC is another indication that it needs to consolidate its gains further before having another go at new highs.

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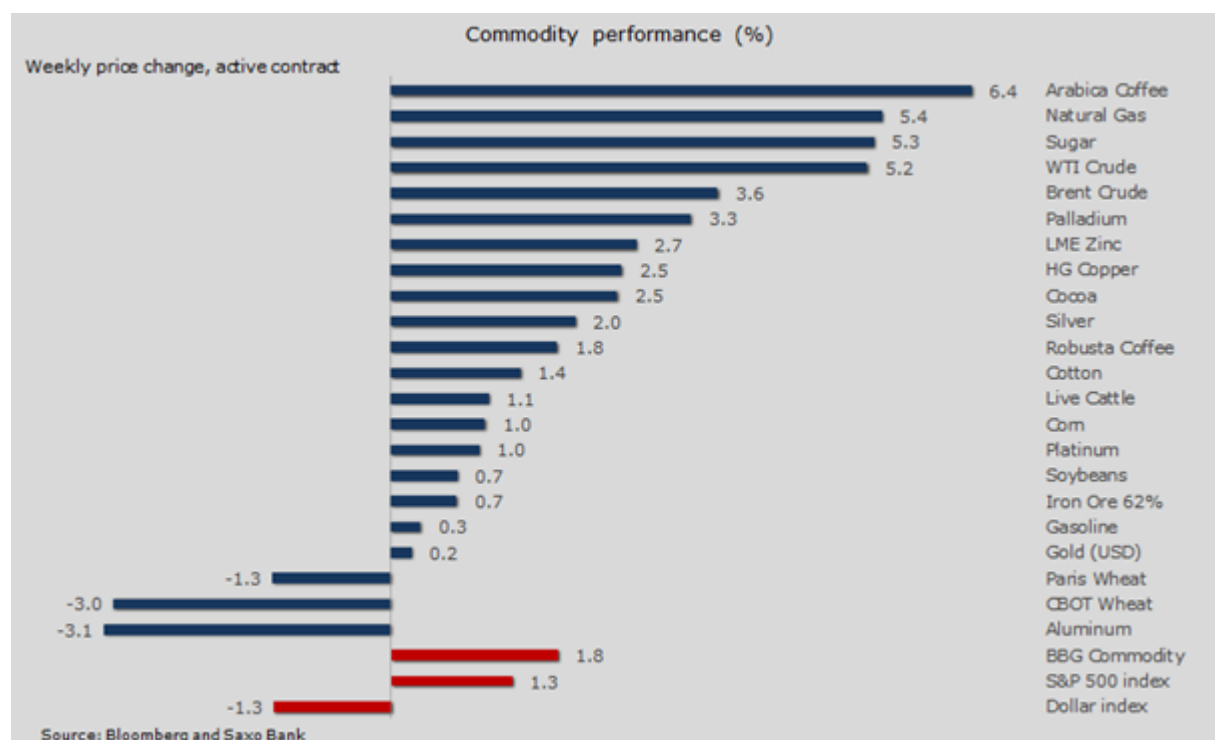
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Drought concerns in the US wheat belt eased and it helped make CBOT wheat one of the weakest performers on the week. As a result, its price premium over CBOT corn reverted to the lower end of its current \$1.0 to \$1.3 range.

Corn has seen signs of selling fatigue after money managers accumulated a record short position in the futures market.



The big winners on the week were soft commodities, not least Arabica coffee. Drought conditions in Brazil, Columbia, and Vietnam have been known for weeks, but only now are we seeing this potential crop-reducing factor being widely reported.

After breaking above its 200-day moving average for the first time since December 2014, Arabica Coffee has witnessed a strong jump which now has the potential of reversing the downtrend seen for the past year.

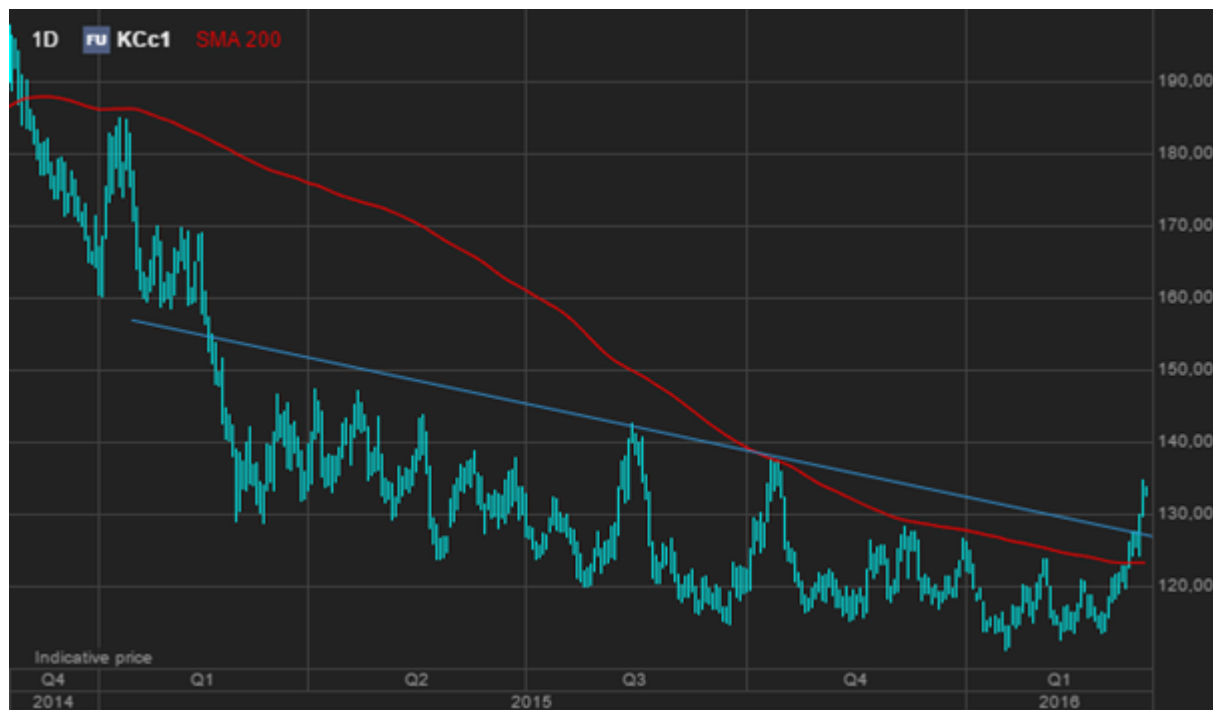
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Source: SaxoTraderGO

Crude oil rally at risk of self-defeat

WTI crude oil traded back above \$40/barrel for the first time this year, leading the continued recovery which this week was driven by a triple dose of price-supporting news.

The weaker dollar, as mentioned above, added to the support provided by slowing US production and inventory build. Following their unsuccessful attempt to meet on March 20, Opec and non-Opec members announced a new meeting on April 17 in Doha. This meeting could pave the way for the announcement of a production freeze.

Since the price tumbled below \$30/barrel, producers have been increasingly willing to intervene, at least verbally, to support the price. By doing so, they have been able to buy themselves some time without actually changing anything.

Oil markets are currently in a race against the clock based on the belief that the price will recover over time. Slowing US production and a continued, albeit slower than previously, rise in demand will eventually tip the balance. Once this happens, the market's focus will switch from a surplus to the potential of a price-supporting deficit in a few years' time.

Buying time while keep pumping at full throttle makes sense as long the market plays ball.

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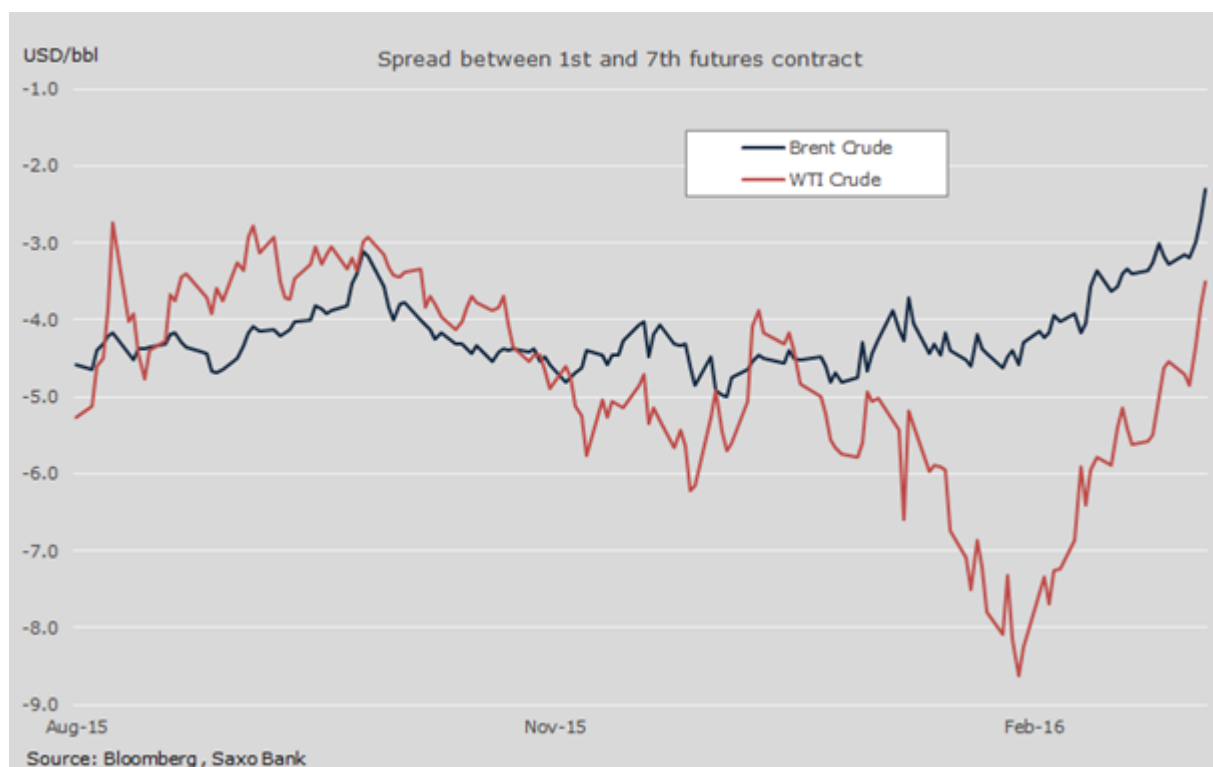


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A rise much above \$40/b – as seen last week – helped trigger renewed hedging activity from producers in the forward market. This is a clear indication that under-hedged US producers are willing to lock in forward prices not far from current levels. A major rally at this stage therefore carries the risk of ruining the "buying time" strategy as US production may not fall as much as projected.

The rally combined with renewed hedging activity in the forward market has triggered a flattening of the oil forward curve. With spot prices rallying faster than deferred, the contango as seen below in both Brent and WTI has contracted.

Owners of storage facilities have been riding the contango curve but as it begins to contract, the economics of this trade goes out the window. As a result, a too-narrow contango at a time of continued oversupply (US inventories remain the highest in at least 80 years) carries the risk of oil being sent out of storage into an already oversupplied market.



Cushing, the delivery hub for WTI crude oil futures based in Oklahoma, has seen inventories move within reach of capacity. The pace of US inventory rises are expected to slow during the coming weeks but actual reductions are not expected until April.

Current momentum in oil markets remain positive with money managers holding a gross long of more than 700 million barrels combined in WTI and Brent crude. We however view the upside increasingly limited at this stage as it carries the risk of reversing some of the recent positive drivers such as the slowdown in US production.

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From that perspective we view the upside on Brent crude oil limited to \$44/b which represents a 61.8% retracement of the October to January selloff. A break below \$38.3/b would signal renewed weakness towards \$35/b.



Source: SaxoTraderGO

Following a healthy correction where gold found support at \$1,227/oz it rallied strongly on the back of the surprisingly dovish statement from the FOMC. But despite the tailwind from lower interest rate projections and a weaker dollar, gold failed to make a new high.

A year-to-date rally of 18% which has seen holdings in exchange-traded products boosted by 280 tonnes could indicate that the yellow metal now requires a longer period of consolidation than the one seen so far. Demand from investors disillusioned by an ever-increasing mountain of sovereign bonds trading at negative yields will continue to provide support.

With the price of gold stabilising, we are seeing renewed interest in silver which just a few weeks ago hit a seven-year low relative to gold. After reaching 84 ounces of silver to one ounce of gold on February 29 it has since retraced and towards the end of the week it reached 78, representing a 3% outperformance on the week.

Up towards 50% of mined silver comes as a byproduct of the mining of other industrial metals from copper to zinc. With output of these expected to slow, silver production should also slow and this is adding some fundamental support to those looking for relative value. Silver's long term average ratio against gold is 60 which leaves the white metal with plenty of space.

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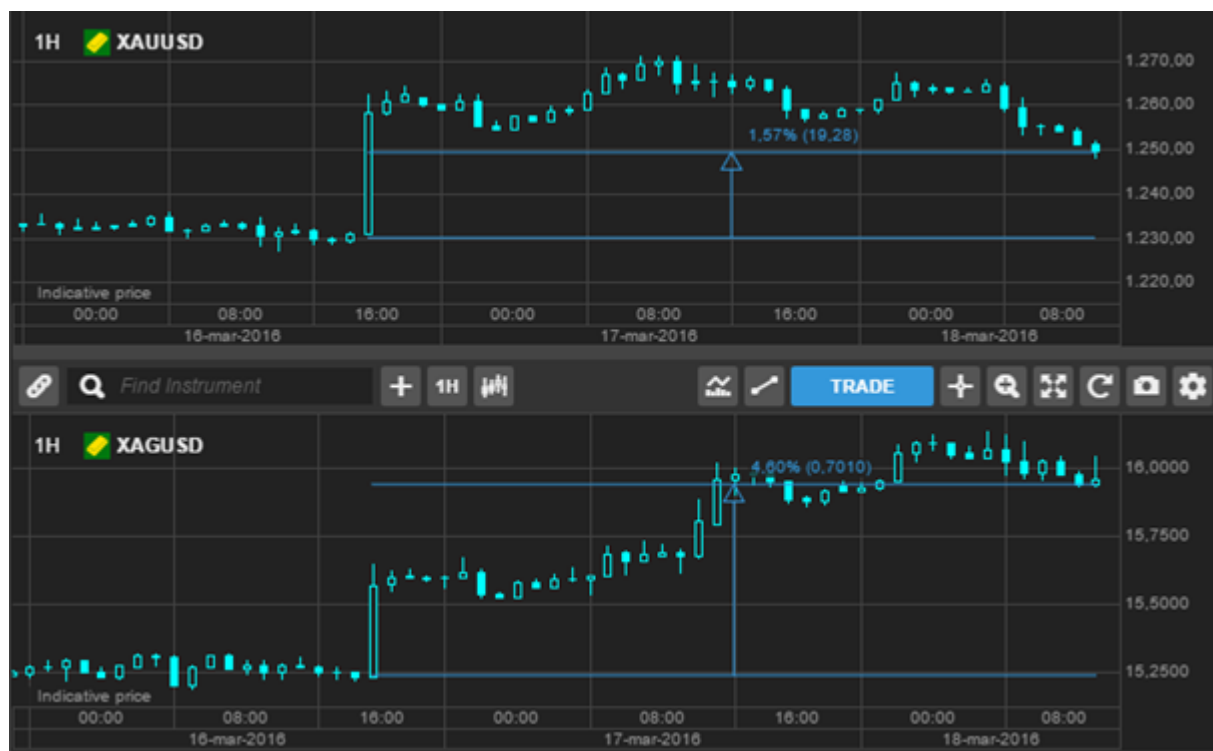
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Following the FOMC-led spike, we have seen silver reach a five-month high and in the process it outperformed gold



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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