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WCU: Oil defies USD bulls, gold puts up a fight

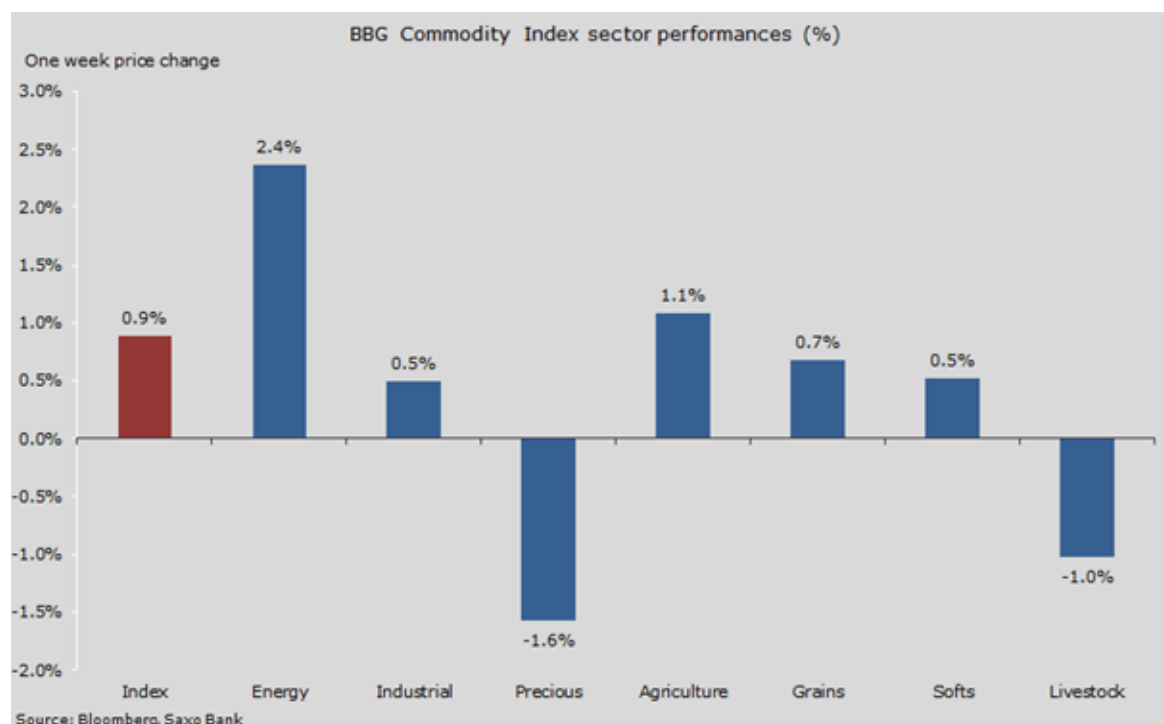
By Ole Hansen

With the exception of energy, commodities were back on the defensive during the past week. Precious metals came under particular pressure as the dollar reached a seven-week high against a basket of major currencies.

In the minutes from the April US Federal Open Market Committee meeting released this past week, the Federal Reserve hinted that a June rate hike could be on the cards if market developments permit. This was much more hawkish than what investors had been led to believe.

As a result, the likelihood for a June rate hike shot higher from 4% to almost 30% in a matter of days.

The dollar strength and subsequent market weakness have forced some position adjustments from speculative traders such as hedge funds. At the beginning of May they had accumulated a net-long position of more than one million futures lots across 13 major commodities.



The energy sector managed to shrug off the negative impact of the stronger dollar with multiple major supply disruptions around the world continuing to attract most of the attention.

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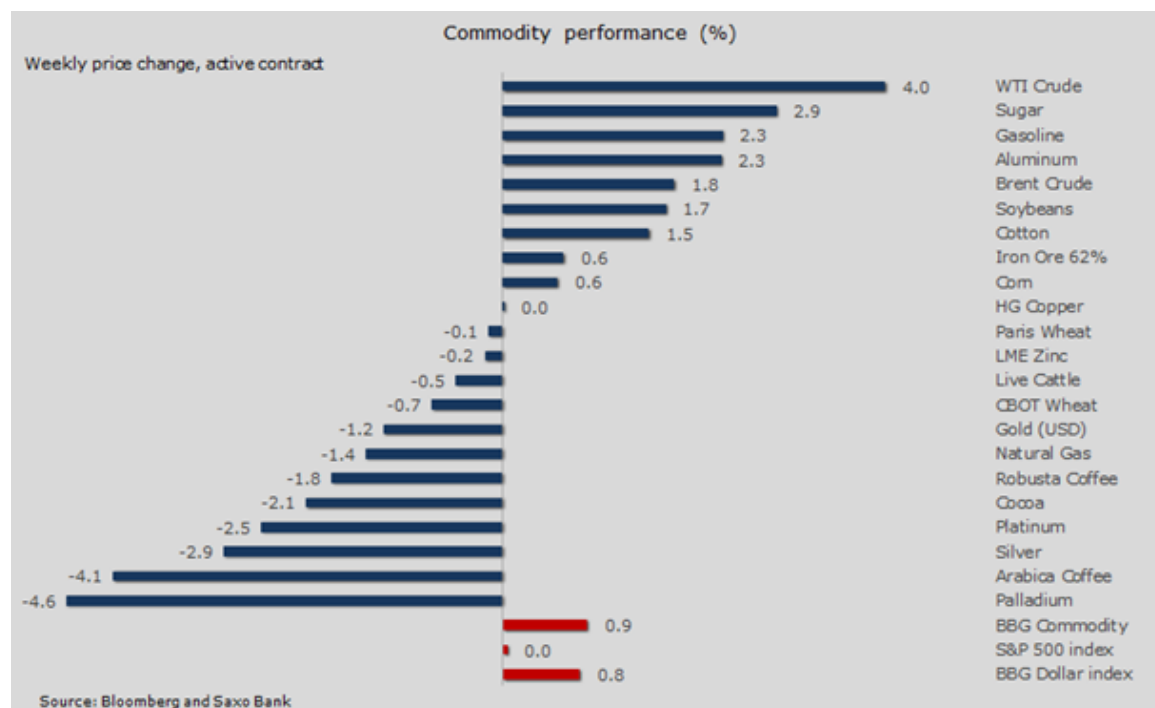
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Precious metals traded weaker led by the minor and less liquid metals. Worries about the impact on investment demand from higher than expected US rates have triggered what could be called a healthy and long overdue correction in the market.



Industrial metals traded softer with aluminium being the only exception. Copper touched a three-month low on concerns that rising US interest rates and demand worries in China would hurt demand from the world's two biggest consumers.

The agriculture sector was mixed with the recent strong gains in the soybean complex continuing to leave wheat and corn behind.

The weaker Brazilian real helped put a halt to recent strong gains in both sugar and coffee. The latter pullback was also aided by news that rain returned to the drought-impacted growing regions of Vietnam.

Gold still shiny, though challenged in the short term

Precious metals, led by palladium, and silver suffered the biggest setback as the prospect for a stronger pace of US rate hikes triggered profit-taking. Gold traded weaker for the third week in a row and the recent weakness has undoubtedly been attracted some tactical short selling from bears now increasingly frustrated by gold's lack of a proper correction following the strong surge at the beginning of the year.

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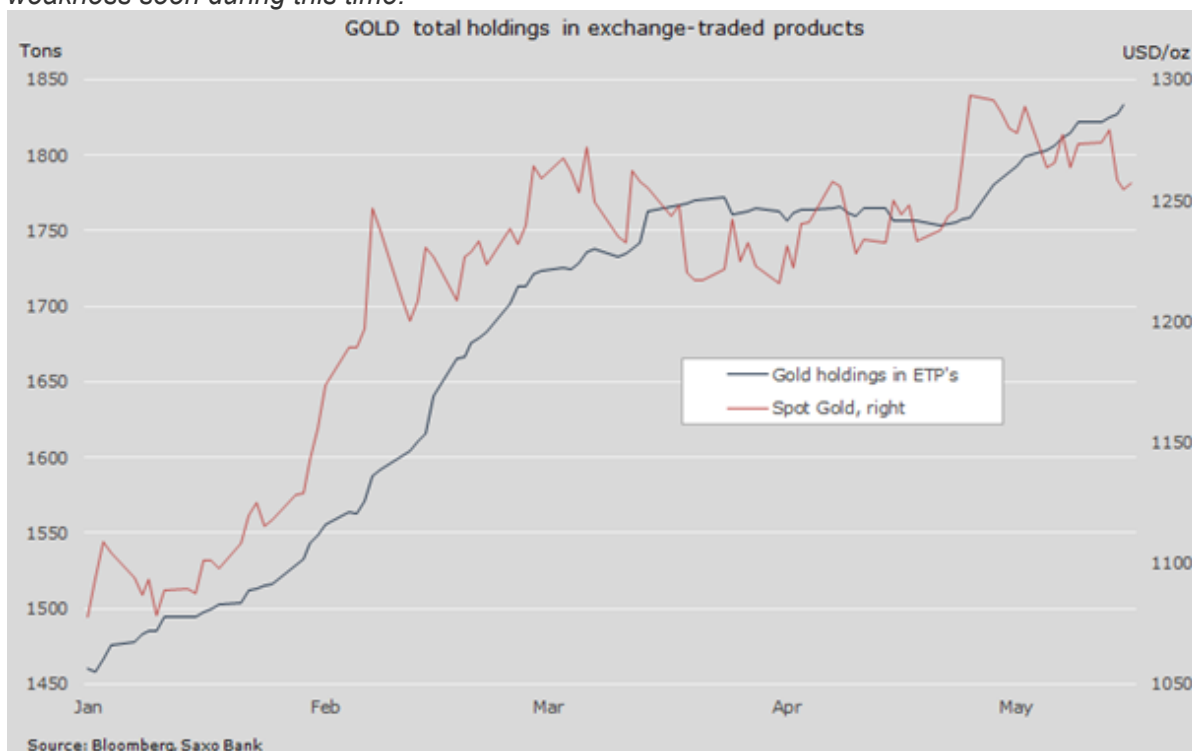


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Whether shorting gold will pay off at this stage, however, remains a big question. While gold is down by around 3% this month, we have seen demand for gold through exchange-traded products rise by 4%.

Total holdings in ETPs backed by gold have, according to data from Bloomberg, reached 1,833 tons, a 2½-year high. Seeing investment demand rise while the price drops indicates that recent buyers are looking at the long-term prospects rather than being put off by short-term adversity.

The accumulation of gold via exchange-traded products has continued this month despite of price weakness seen during this time.



There is no doubt that gold had become increasingly frustrating to trade during the past three months. Bulls have been disappointed by gold's lack of progress despite continued strong demand from institutional and retail investors through futures and exchange-traded products. Short sellers, meanwhile, had been frustrated by the lack of correction following such a strong rally.

Others have given up the wait for a correction and have entered gold at what now looks like uncomfortably high levels above \$1,280/oz. The reduction of these positions probably played an important part in the weakness seen this week.

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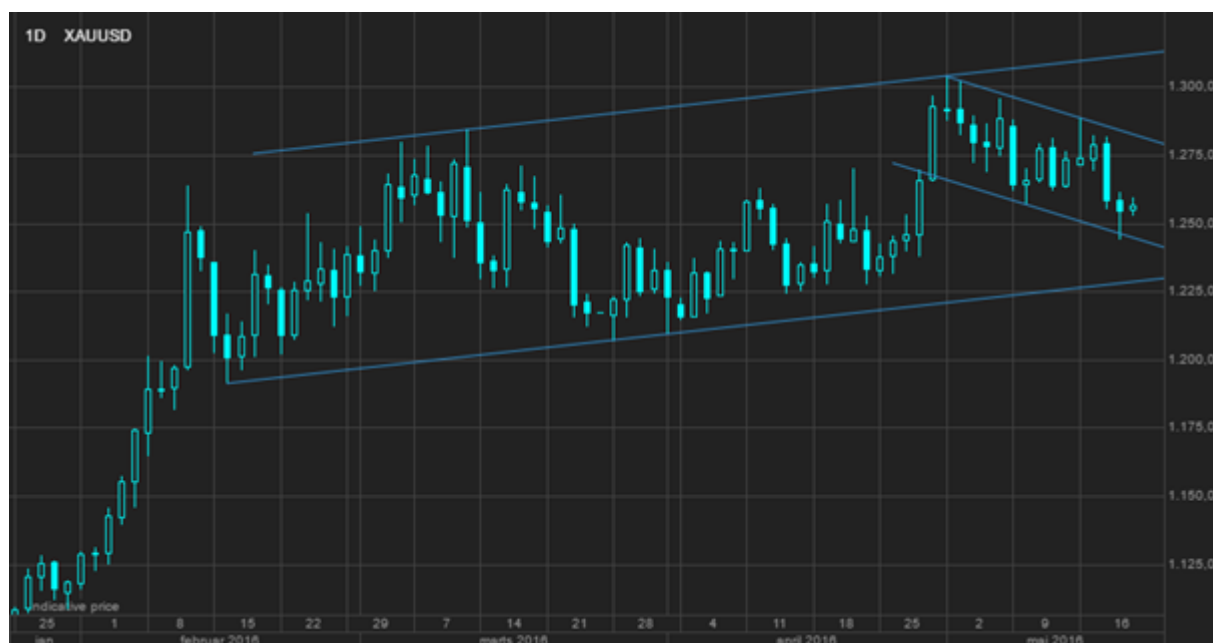
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Despite the stronger dollar and weaker price action, demand for gold through futures and ETPs has been particularly strong this month. This indicates that the reallocation to gold continues and that it remains relatively insensitive to short-term price movements.

The renewed focus on US rate hikes, however, will now test the strength of this underlying demand.

With around two-thirds of global government debt trading at negative or very low yields and with signs that inflation may begin to return, the aforementioned demand for gold seems justified. Bumps on the road cannot be ruled out, especially if the dollar strengthens further, but with financial, political and economic uncertainties still very much extant we believe that gold eventually will make a break above \$1,305/oz after which it could target \$1,380/oz.

Since February, gold has established a trading range, currently between \$1,228/oz and \$1,310/oz. Further weakness could challenge support but it would take a break below \$1,205 for it to get bearish.



Source: SaxoTraderGO

Crude oil focused on supply disruptions

Canadian wildfires, Nigerian unrest and evacuation of drilling facilities, the political and economic mismanagement of Venezuela, and continued problems in Libya have probably helped remove more than 2.5 million barrels of daily production from the global market during these past few weeks.

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A few years ago, disruptions on this scale would easily have sent the price soaring by more than a quarter. This time around, however, they have probably added less than 10% to the price.

This is testament to the impact of the global supply glut built up since 2014. It has, and will continue to, ensure that no refinery or consumer will run out of supplies while these disruptions exist.

The dollar weakness seen up until the beginning of this month helped support the strong recovery from the multi-year lows seen back in January and February. The hawkish FOMC minutes, which helped drive the dollar higher, only managed to negatively impact oil prices for less than a day.

It does indicate that market focus is currently on these supply disruptions; without those, oil would have traded lower.

Instead we are faced with an oil market where the daily gap between demand and production has, at least temporarily, disappeared. It has triggered a renewed attack at the psychological \$50/barrel mark. This price acts as a magnet, but also the invisible line traders are cautious about crossing.

While the prompt month in WTI crude has so far reached a high of \$48.95/barrel, the average price at which producers can hedge their 2017 production has almost reached \$51/b. The market may therefore not yet be ready to move into the \$50s for fear of what it will do to the rebalancing process.

The weekly US inventory report was mixed with a surprise and counter-seasonal inventory rise being offset by a phenomenal strong demand for gasoline. US implied gasoline demand is currently running at levels higher than what was seen during the peak driving season last summer.

In February, according to the most recent data, US motorists drove 12 billion vehicle miles more than a year earlier. This trend, supported by low prices and rising employment, should continue into the summer driving season which officially kicks off on May 30.

Where do we go from here?

As mentioned, we continue to view oil prices above \$50 as being to high at this stage. While \$50 is the big number that catches the headlines, the proper resistance is to be found slightly higher at \$50.9 on Brent crude, the peak from last November.

Supply disruptions will remove focus from rising supply elsewhere for as long as they continue to attract attention and the potential is for the US rig count to stabilise and production cuts beginning to slow.

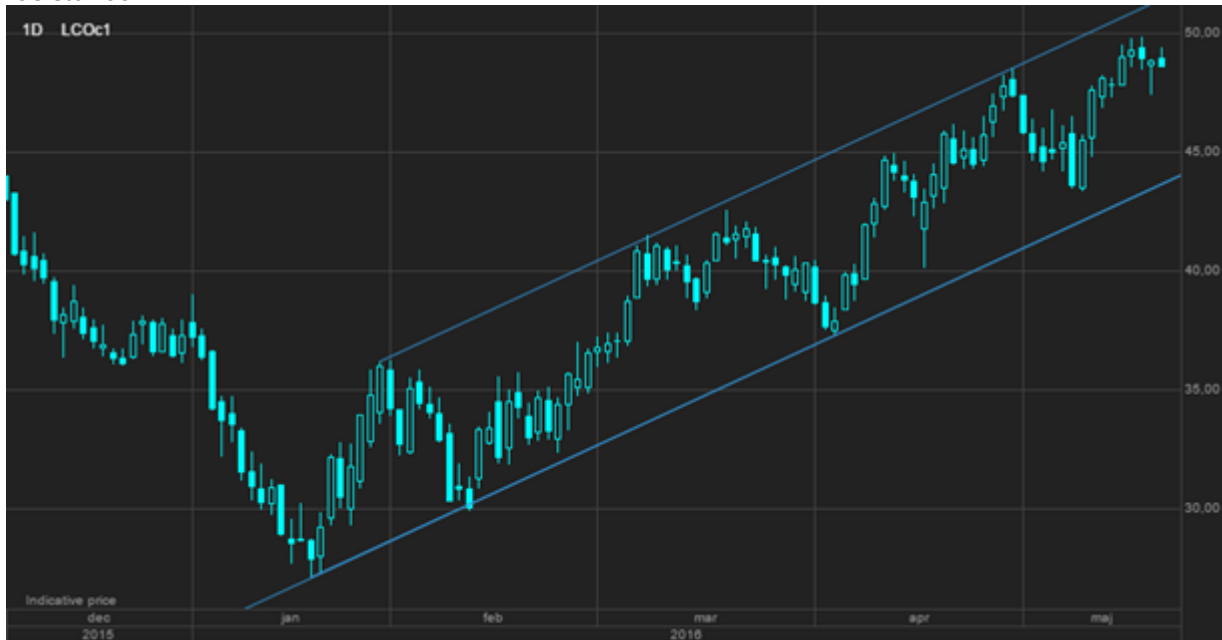
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Crude oil showing signs of losing momentum with the \$50/b level continuing to act as a major area of resistance:



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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