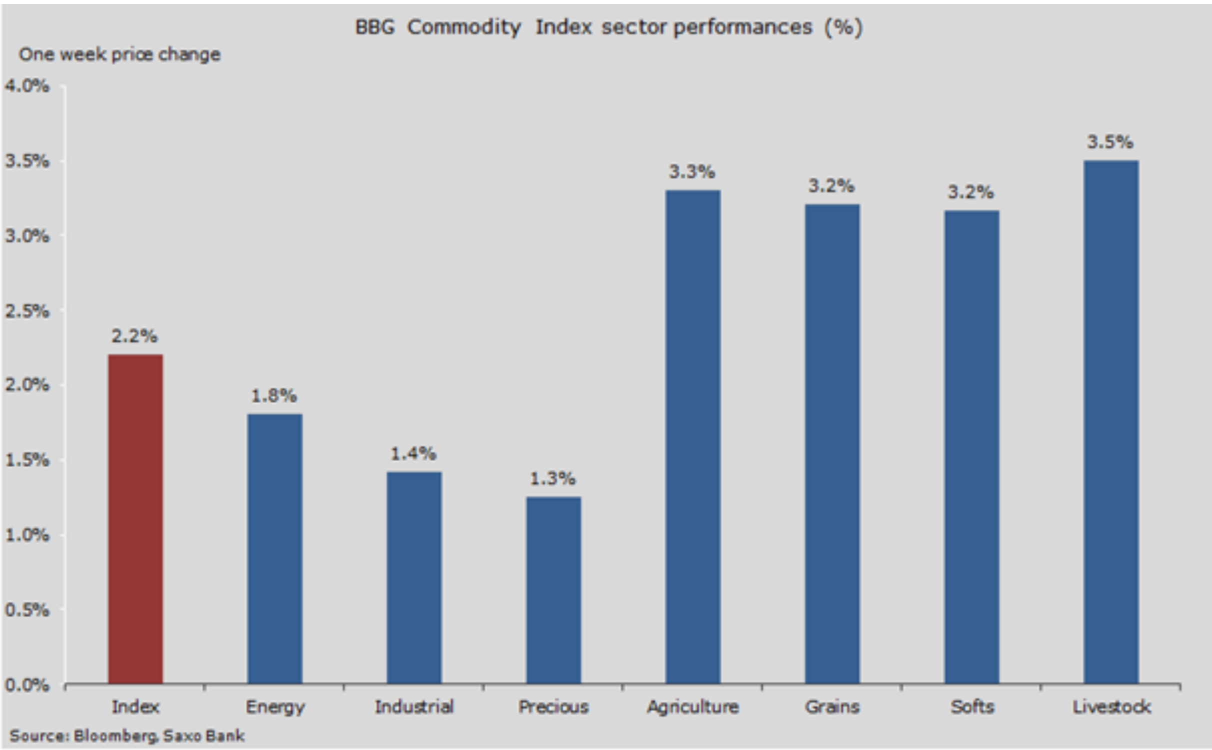
WCU: US jobs shocker kicks gold back to life

By Ole Hansen

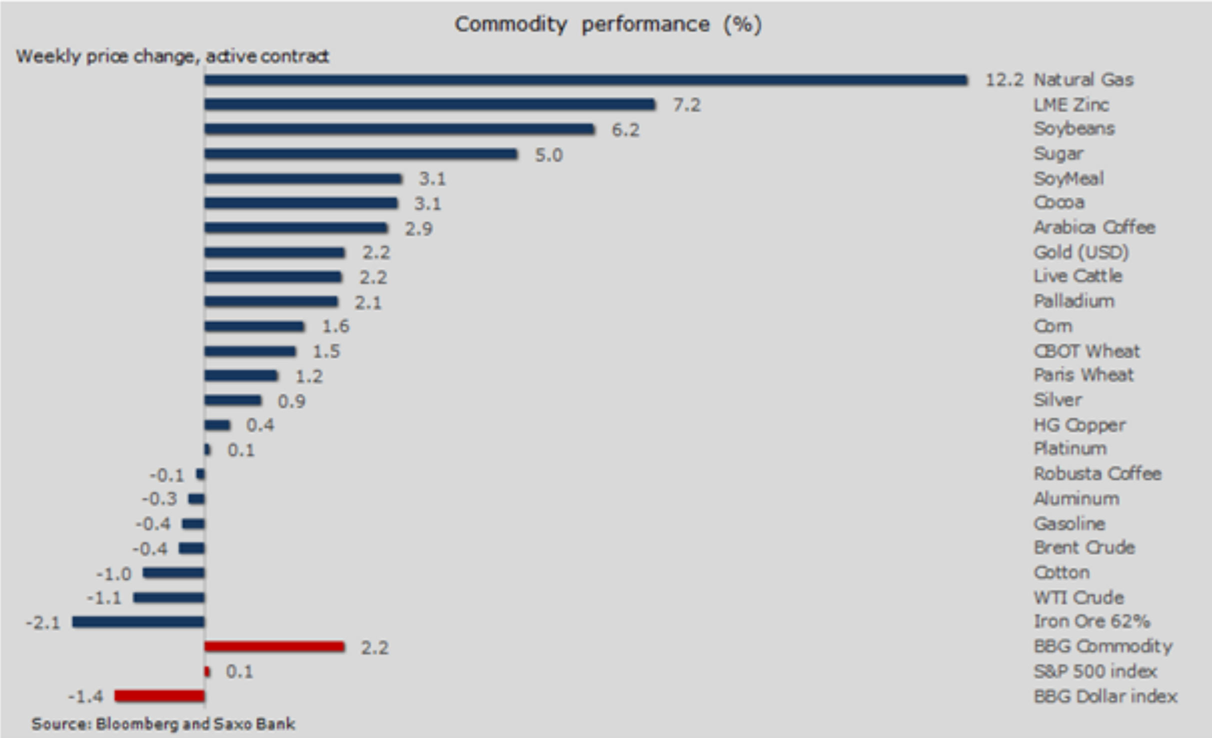
Commodities continue to recover with the Bloomberg Commodity Index reaching a seven-month high. During this process the index, which reflects the performance of 22 major commodities spread evenly between the three sectors of energy, metals and agriculture, has returned to a technical bull market. This after rallying by more than 20% from the 17-year low reached back in January.

While oil markets have stabilised around $50/b and precious metals tried to recover after receiving a boost from a very weak US jobs report, the agriculture sector have continued to accelerate higher. Since the March low the sector has rallied by 22% not least due to strong performances from sugar and especially the soybean complex.



Soymeal remains the star performer having jumped by more than 60% during this time as flooding in Argentina and now drought worries in the US continue to spark concern about the availability of supply.

Natural gas stands out with its double digit percentage rally. Expectations for above normal temperatures in US Midwest and Gulf Coast during the next few weeks have not only been supportive for grains but also natural gas. Rising temperatures increases the demand for cooling and thereby demand for natural gas. This pick-up in demand comes at a critical time where worries about storage facilities peaking out in October have kept prices under pressure.



The slump in iron ore continues and the break below $50/t has been driven by concerns that rising supply from low cost producers, especially in Australia, will not finding enough demand to be absorbed. After hitting a peak above $70 during the Chinese led speculative bubble back in April there is a risk that all of the gains for the year – above $43.5 can be wiped out.

Opec harmony returns - for now

The 169th meeting of the Organisation of Petroleum Exporting Countries (Opec) came and went without the usual disagreements that we have grown used to. Talk prior to the meeting of a new production ceiling being introduced failed to materialise. But with the market already well on the way to balance the need for new initiatives at this meeting were unnecessary.

Instead we saw the new Saudi Energy Minister Khalid al-Falih embark on a highly successful public relations exercise. This helped win over several under pressure producers looking for new initiatives to boost the price even further. With the re-balancing process well underway courtesy of mostly involuntary supply disruptions and slowing production from high cost producers outside Opec this was not the time to rock the boat.

The Saudis can rightfully claim that the pump and dump strategy has been successful in the sense that market shares have been restored. Billion dollars' worth of capex reductions from oil majors across the world will help support the price of oil return to a higher and longer-term more sustainable level over the coming years. This in order to attract renewed investment which otherwise could trigger a potential shortfall as we move towards the end of the decade.

However, before we get that far the overhang of more than 1 billion barrels of global supplies and the expected resumption of supply from Canada and Nigeria will make it difficult for oil to rally much further in

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the short term. Increased hedging activity from high cost (shale) producers in the US does indicate that an oil price rally much above $50 could be counterproductive towards the efforts of creating balance in the market. This because it will increase the potential of production declines in the US being halted or potentially even reversed.

Iran has a long-term target of producing 4.6 million barrels per day compared with 3.5 million bpd in April and just 2.8 million during the years of sanctions. Such a statement could in previous meetings have triggered threats of like-for-like increases from Saudi Arabia but not this time around. Al-Khalid even promised not to shock the oil markets. This probably in the knowledge that the new found unity could break as fast as it emerged if the price of oil reverts to lower levels.

Opec produced an estimated 33.2 million barrels per day during April, some 1.7 million more than last year. The drive towards balancing the market therefore hinges on rising demand growth and the reduced supply from non-Opec producers not least in the North America.

While oil markets have been trading relatively calmly during the past few weeks we continue to see a buildup in demand for downside protection through the options market. The difference between what traders are paying for puts relative to calls has been rising leaving the volatility curve skewed to the put side.

WTI crude oil rising within an ascending wedge with a break-out to the downside signaling renewed weakness towards $47 followed by $45. Resistance centered around the October high at $50.90.

Source: SaxoTraderGO

In the short term we see both WTI and Brent crude maintain the established trading range between $45 and $50. This leaves the risk in the short-term skewed to the downside with stabilising production in the US and the return of oil from the mentioned supply disruptions risk triggering a reductions in speculative bets held by hedge funds and other speculative traders.

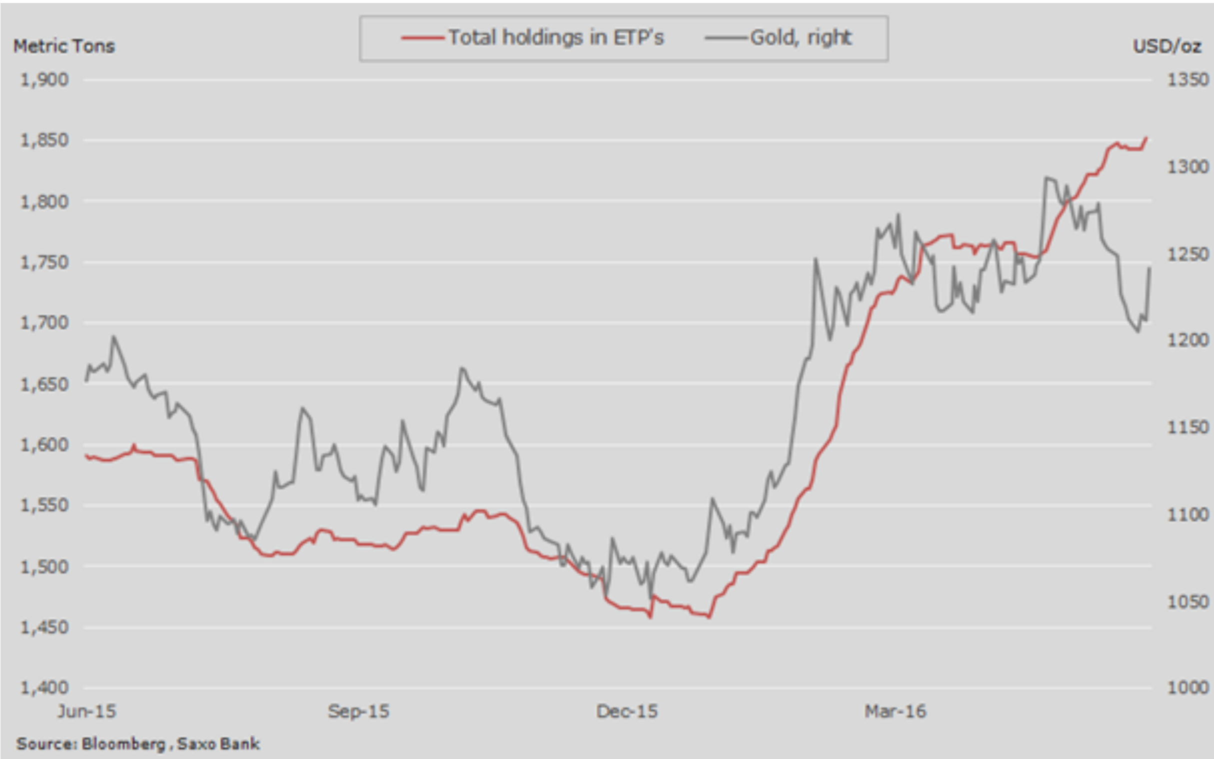
Shocking US job report giving gold a boost

The monthly pace of US jobs being created during May slowed to just 38,000 against expectations of a rise of 160,000. This was the lowest monthly figure since August 2011 and apart from putting a June and potentially a July rate hike on ice it also helped send dollar longs looking for cover.

A stronger dollar and US rate hike fears were the main reasons behind the weakness hitting precious metals last month. With this number some traders now see the Federal Open Market Committee deferring a rate hike until late 2016.

Gold was weak throughout May, with the yellow metal giving back just over one-third of the rally that was seen between the lows last December up until May 3. The near 8% top-to-bottom correction was primarily driven by the readjustment in expectations for when and by how much US interest rates would have to rise.

Friday's job report vindicated those longer-term investors who had continued to accumulate gold while the price weakened. While hedge funds reduced exposure during May, another investment group could not get enough: investors using exchange-traded funds (ETFs) were continuous buyers throughout May. And while the price of gold retraced, total holdings rose by 88 tonnes or 5% to a 2.5-year high.



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The trend of buying into weakness has so far been repeated during the first few trading days of June. That indicates that long-term investors, who are less price-sensitive, continue to look at other drivers than just US rate and currency developments.

The biggest driver behind the rally in precious metals earlier this year, in our opinion, was driven by the continued reduction in the number of sovereign bonds offering a positive yield return. Quantitative easing from the European Central Bank and the Bank of Japan – to mention the two biggest – has seen trillions of dollars' worth of bonds hitting negative yields.

According to Fitch, the rating agency, negative yielding government debt has risen above $10tn for the first time. According to an **article** in the Financial Times the amount of sovereign debt trading with sub-zero yield rose by 5% during May. The search for high quality bonds offering a return has become increasingly difficult leaving money managers across the world scrambling to find other secure alternatives.

We find that these developments are and will continue to be the main reason why gold demand has been and continue to be strong.

From a technical perspective, gold has so far found support at $1,205/oz, the first critical support level ahead of $1,175 and $1,145. Meanwhile a break back above $1240/oz would be the first sign or confirmation that a bottom has been established. These levels are all based on Fibonacci which has provided good guidance in recent weeks and months.

Source: SaxoTraderGO

At the time of writing this report gold was testing the mentioned $1,240 level above which we expect to see renewed buying interest from short-term tactical traders such as hedge funds.

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