



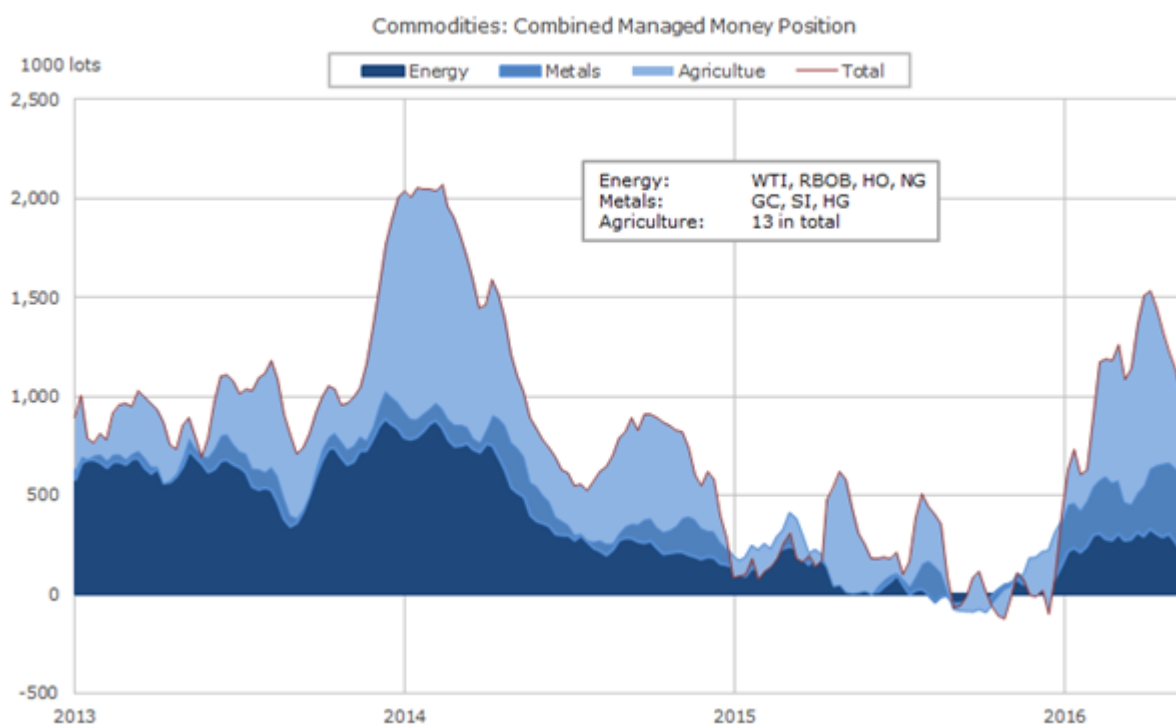
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WCU: Saudis lifting oil and gold remains range-bound

By Ole Hansen

Commodities were broadly unchanged for a third consecutive week but plenty of individual action was seen. We are well into the peak summer vacation month of August where activity – but not necessarily volatility – tends to slow down. Following a strong first half of the year for commodities, gains this quarter (with the exception of metals) have been harder to come by.

In response to the continued delay of oil markets' rebalancing and the prospect of another bumper US crop, hedge funds have cut bullish commodity bets by 40% during the past six weeks. These developments have left some markets exposed to the risk of contrarian trades triggering renewed strength, not least in oil markets where a record gross-short was seen before the latest recovery.



Source: Bloomberg, Saxo Bank

With this in mind the Saudi energy minister on Thursday weighed in to support oil prices saying that large short positioning in the market had caused the oil price to undershoot. His comments sent oil, still reeling from a huge overhang of supply, sharply higher. Saudi Arabia's rejection of a deal in Doha back in April made the market take note of this verbal about turn. A new deal to support the market is not expected but once again traders will be thinking twice about going aggressively short and that was probably the main goal of the statement.

Gains in energy and the metals helped offset a tough week for soft commodities. This sector has seen continued demand all year resulting in some major positions developing, first in sugar and lately in cotton. Grain markets took a breather ahead of the most important report of summer. The monthly World Agriculture Supply and Demand estimates (WASDE) report due late Friday will be the first to cast a more accurate light on expected yields and production this season.

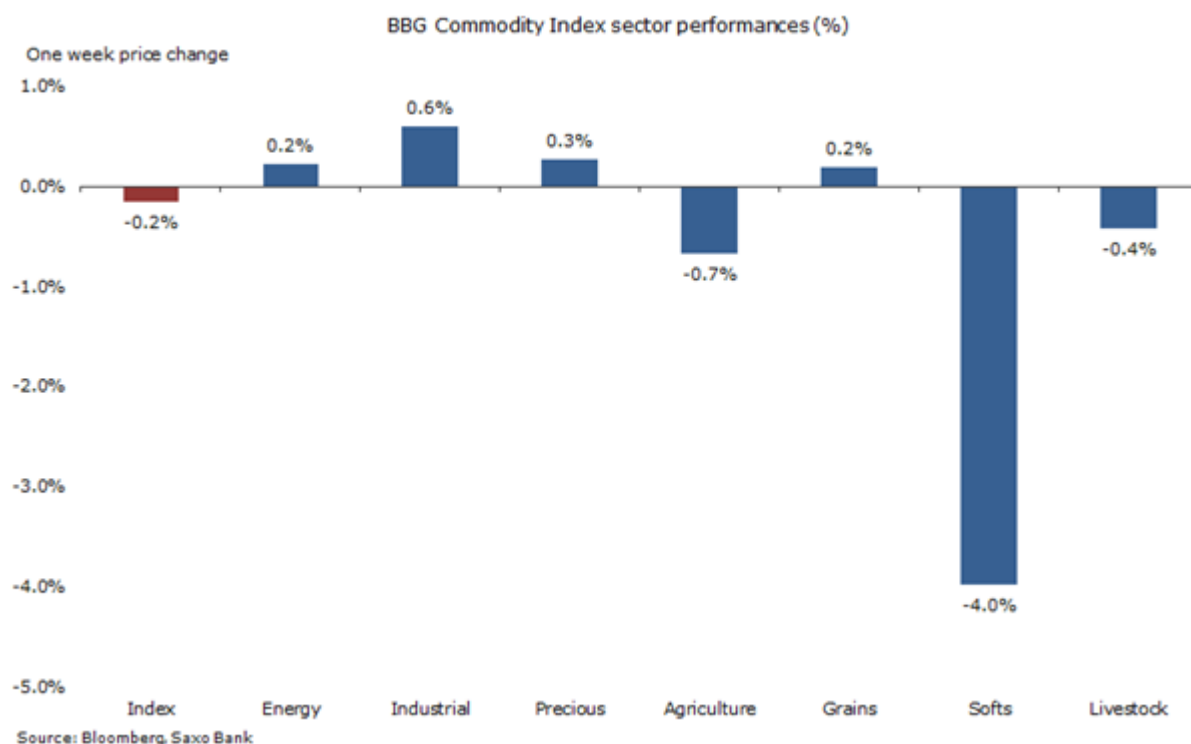
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The week, however, belonged to oil which advanced for a second week by the most since April. A major build up in short positions during June in response to rising inventories of both oil and products had set the stage for a comeback. When it came it was provided by renewed verbal intervention from oil producers, not least the above mentioned comments from the Saudi Arabian energy minister.

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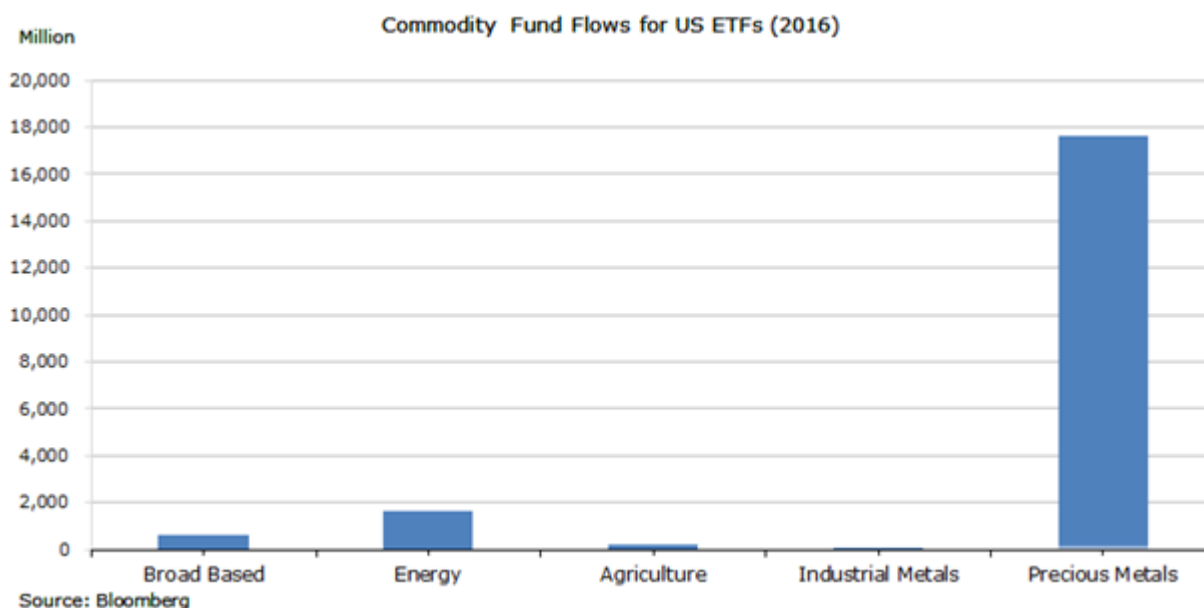
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Real money investment demand for commodities has seen a strong revival this year but as the table below shows most of this demand has been going towards precious metals, not least gold. The SPDR gold shares (GLD) which is the world's biggest gold ETF have so far this year seen net flows of more than \$13 billion with the iShares Gold Trust (IAU) in second place receiving \$2.8 billion.



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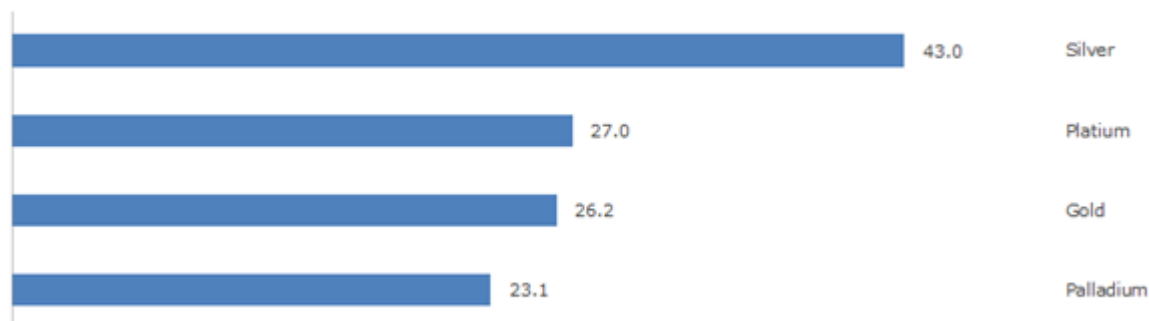


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The performance across these sectors has been very impressive so far this year. Not least the white metals of silver and platinum which following the Brexit vote back in June have seen a phenomenal run higher. Earlier this week platinum hit a level where its discount to gold was \$175 narrower than it was in June.

The latest move was driven by a sudden 10% surge in palladium during Asian hours on Wednesday. This speculative burst from buyers taking advantage of low liquidity failed to stick and the return to unchanged for the week also helped trigger profit taking in platinum.

Precious and White Metals 2016 Performances



Source: Bloomberg and Saxo Bank

In order for these impressive gains to be maintained all eyes are clearly on gold. Following two failed attempts to challenge the \$1,375/oz high from July 11 the yellow metal has started to look exposed and the risk of another correction is lurking.

Demand in response to the continued contraction in global sovereign yields is real and is likely to continue as long central banks continue experimenting with negative rates and massive asset purchase programs. Hedge funds maintain a near record long position in Comex gold and while the underlying support remains the risk of long liquidation similar to the 33% reduction in May can not be ignored.

Gold has spent the post-Brexit period settling into a new and higher range between \$1,315/oz and \$1,365/oz. The failure to mount a new attack at the highs, not least this past week when the dollar turned lower, could indicate that the search for support is back on. However elevated longs in the futures market are not likely to take cover unless we break \$1,300, a key retracement level of the post-Brexit rally.

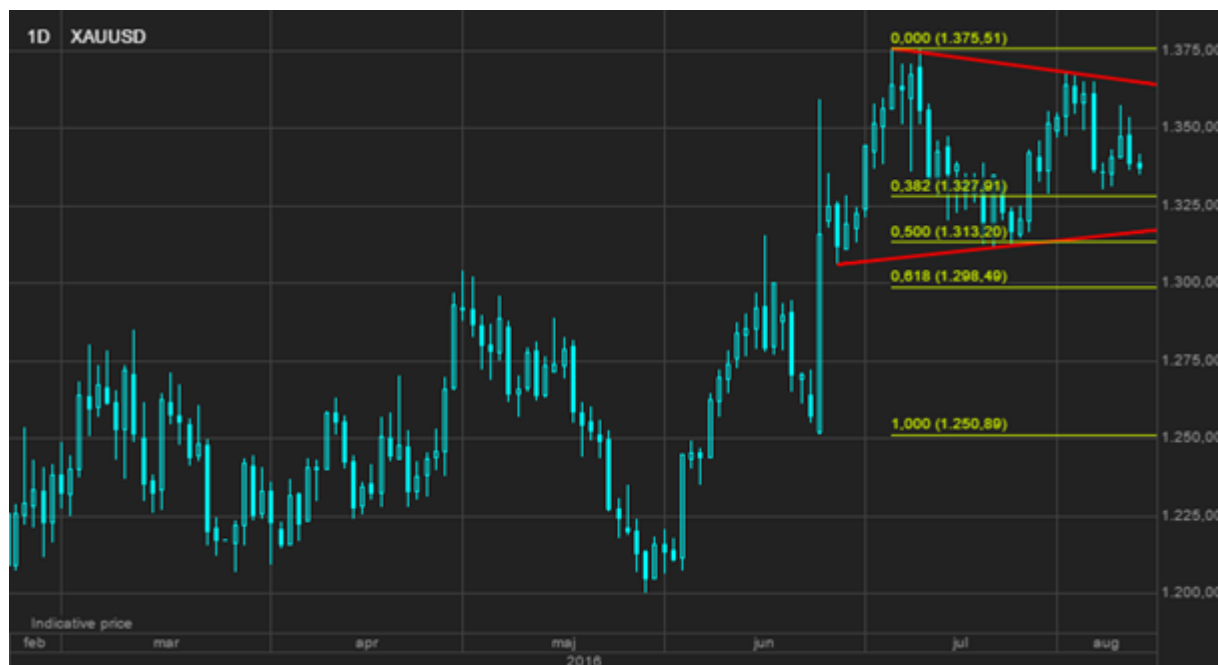
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Source: SaxoTraderGO

The longer-term prospects hinge on the direction of the dollar and the actions and intentions of central banks, not least the US Federal Reserve. Fed chair Janet Yellen is due to speak at the annual Jackson Hole Policy Symposium on August 26. This annual event in the Wyoming mountains has become the Davos for central bankers and will be keenly watched with bonds, equity and commodity markets all looking for additional guidance.

Crude oil torn as short-term and long-term conflict collides

It was a big week for reports and forecasts as the three major oil institutions of EIA, Opec and IEA all released their monthly views on energy markets.

The EIA continues to see the global oil market being oversupplied deep into 2017. In their update they also raised US average production for 2017 by 100,000 barrels/day to 8.3 million, still some 400,000 b/d below 2016.

Opec also saw the rebalancing of world markets being delayed. Instead of a small average deficit for 2017 in the previous report, it now expects the global oil market will see a 100,000 b/d average surplus.

The IEA was a bit more upbeat on the rebalancing process, despite record Gulf production. Citing the report Reuters wrote that "oil markets will begin to tighten already during the second half of 2016 but process will be slow and painful as global demand growth declines and non-Opec supplies rebound".

These developments add to the concerns that current high inventories of both oil and products will take longer to reduce back to longer-term averages. Refineries have, to put it simply, for a while now, been producing more products than global consumers have been asking for. With the end of the driving season upon us, some additional pressure could arise from this overproduction during the coming weeks.

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With this in mind and following the recent selloff back towards \$40/b several Opec members once again stepped up support through verbal intervention. A similar approach had already proven successful on a couple of occasions this year but with the focus on oversupply and a surprise weekly rise in US inventories it needed the support from Saudi Arabia's Energy minister Falih to succeed.

Frustrations about the return to \$40/b and increased speculative selling triggered renewed verbal intervention from both weak and strong Opec members.



Source: SaxoTraderGO

Clearly frustrated by the fact that oil had returned to levels last seen in April when Saudi Arabia rejected calls for action, Falih in an interview to the state news agency SPA said that Saudi Arabia would be prepared to discuss measures to stabilise the price at the meeting next month in Algeria of the International Energy Forum (IEF).

He singled out speculators who during the past three months had accumulated a large gross-short position in WTI and Brent crude oil, the world's two most traded benchmarks. "The large positioning in the market has caused the oil price to undershoot" he said and carried on by saying that this was unsustainable as higher prices were needed to reverse the declines in investment and output.

While bullish oil bets (blue line) have remained relative stable the past couple of months have seen a sharp increase in the number of gross-shorts (red line). An unwind of a position of this magnitude carries the potential of lifting the price between \$5 and \$10.

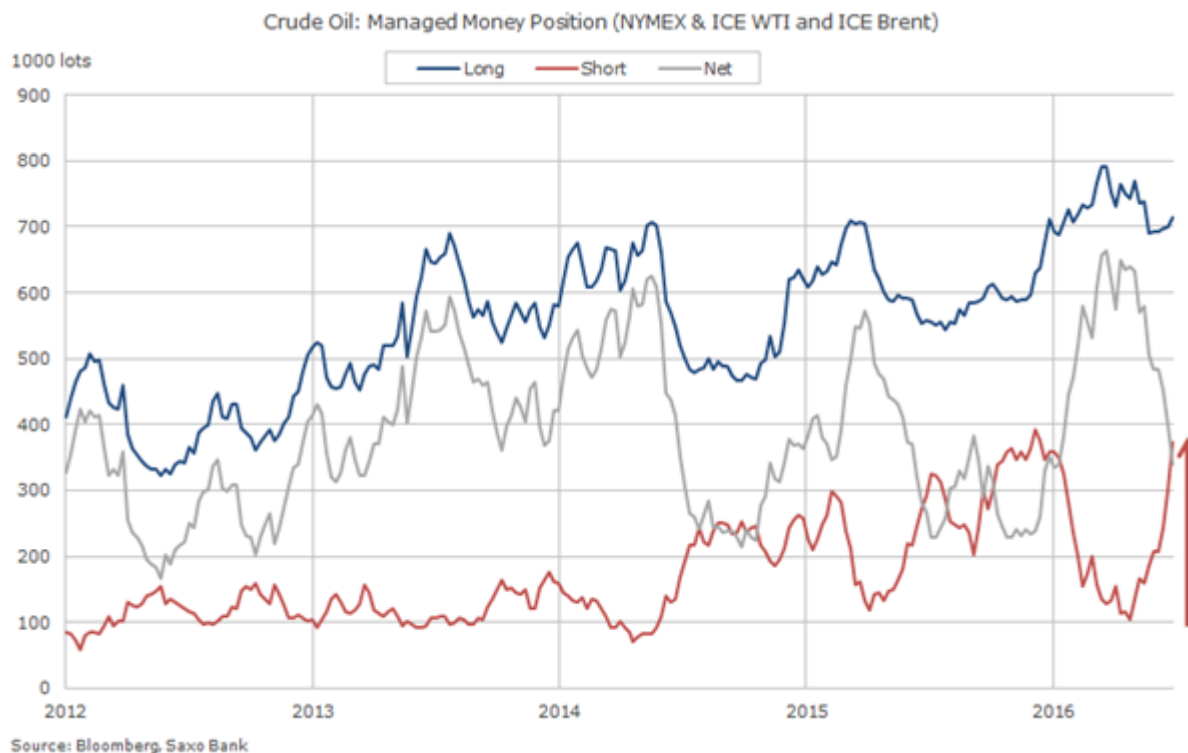
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Recent developments highlight the continued battle between those holding short-term and long-term views on the market. Once the glut begins to fade, investors will turn their attention to the billions of dollars in lost investments having been removed during the past two years. These, combined with continued rise in demand, will eventually create the need for higher prices in order to incentivise new production, both from traditional and non-traditional production techniques.

We do not see Opec taking any action at this stage but the delay to the process of achieving balance will ensure continued comments from members to prop up the price as we approach September, a month which has yielded negative oil returns for the past five years.

We maintain our Q3 call for Brent crude to trade mostly within a \$45-50/b range. An end-of-year price much higher than \$50/b will be hard to achieve with the additional price recovery likely having been delayed well into 2017.

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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