



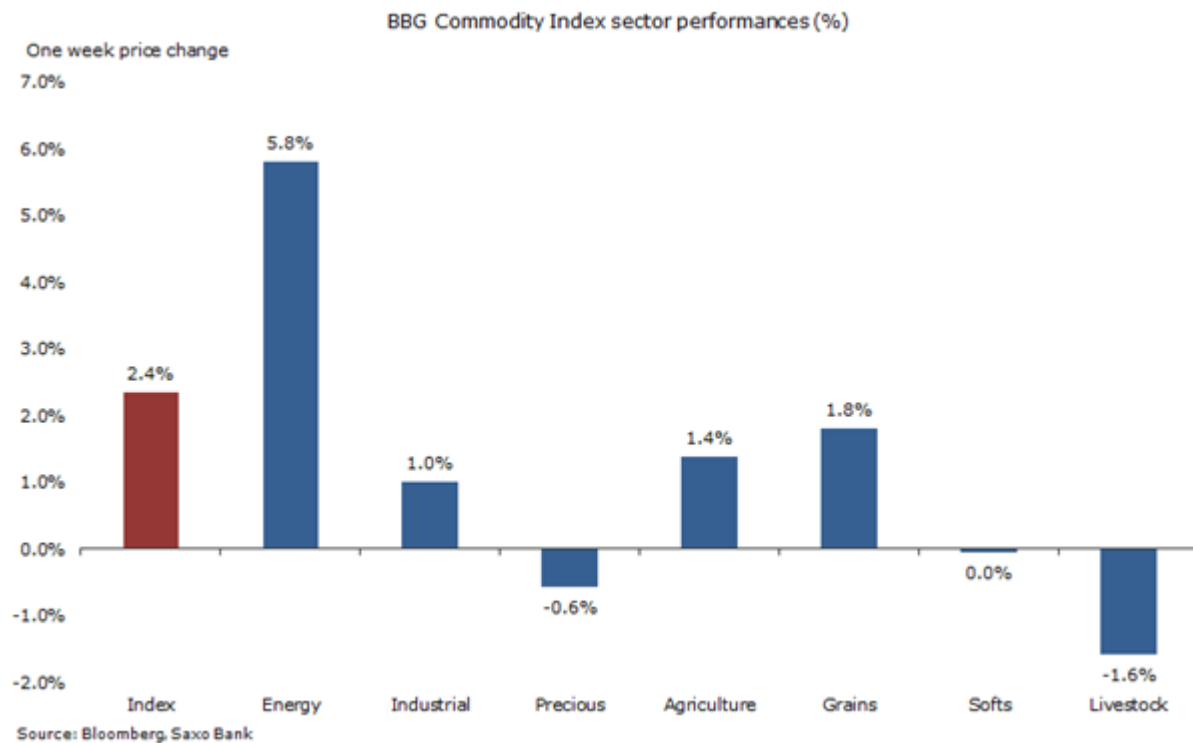
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## WCU: Mission accomplished as oil returns to \$50/b

*By Ole Hansen*

Commodities were on track for their best weekly performance in seven weeks. The dollar continued to weaken, driven by a global system awash with cash seeking higher yields and riskier assets, but it was the continued short-covering in the oil market that provided most of the gains.

A look at the price action, in fact, shows crude rallying at a pace normally only seen during times of major feared or realised supply disruptions.



The grain sector showed a positive return for the first time in 10 weeks. This despite the recent WASDE report from the US Department of Agriculture forecasting a bin-busting corn and soybean crop this year.

Strong export demand and doubts about whether the projected yields can be achieved help the sector recover. This was particularly true in the case of corn, where hedge funds had been non-stop sellers in the weeks leading up to the report.

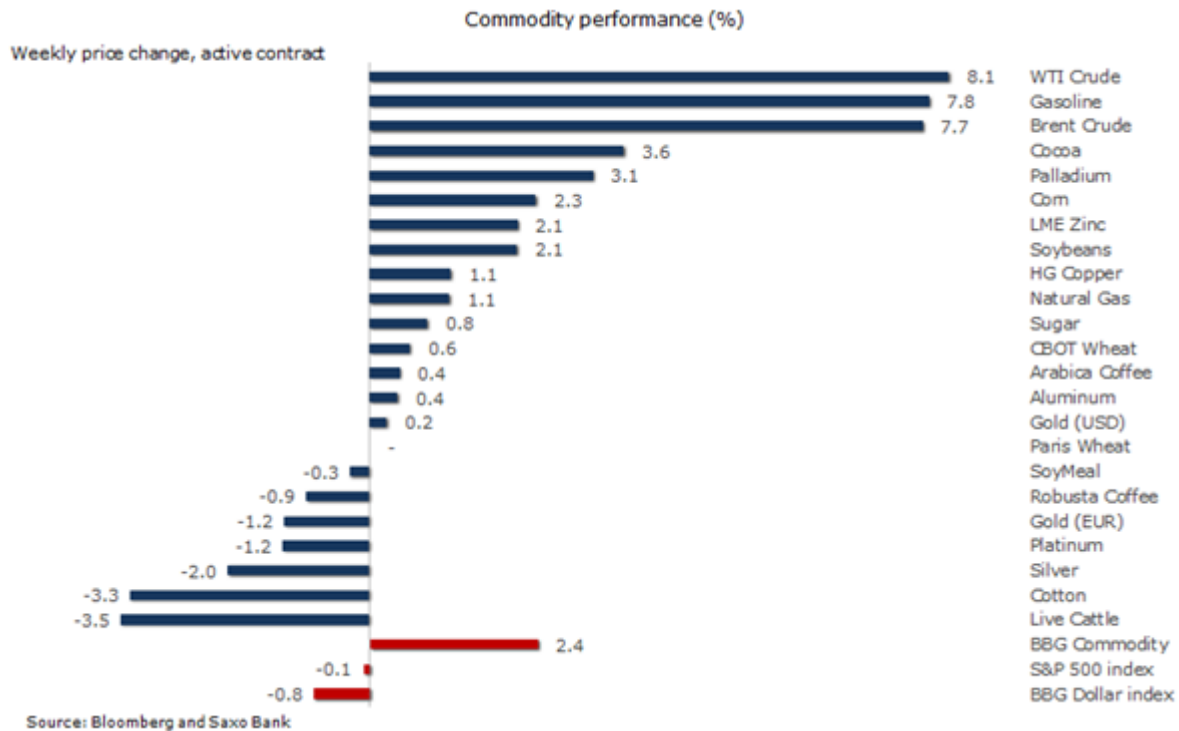
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Once again, however, it was the energy sector which attracted most of the attention this past week.

Following the Brexit vote on June 23, oil dropped more than 20% thereby moving into a technical bear market. Within the past few weeks, however, a 22% rally has taken it straight back into bullish territory.

The weakness seen during July was driven by concerns that high inventories of oil and products would further delay the rebalancing process, not least considering that we were heading towards the time of year when refinery activity normally begins to slow thereby adding additional pressure on oil storage facilities.

This combined with a rising number of US oil rigs and rising production from several major Opec producers helped to support a major accumulation of short positions by hedge funds. Oil production in Iran and Saudi Arabia has also risen by 1 million barrels/day since January, [reports Bloomberg](#).

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The verbal intervention in the oil market which initially came from weaker Opec members got a strong boost when Saudi Arabia's energy minister joined in. While weaker members desperately need higher prices, Saudi Arabia's agenda was more likely to try and stabilise the market after having oil reverted to a bear market in the weeks following the Brexit vote.

What the Saudis actually succeeded in doing was to influence market sentiment and thereby force a reduction of what was a rapidly expanding speculative short position in the futures market. This reduction – and *not* the potential impact of a freeze deal – is what has triggered this recent, phenomenal rally.

August and especially September tend to be challenging months for the oil market with supply rising as refinery demand slows. By preempting these developments, then, a better sentiment has been engineered.

The fear of freeze action will potentially be enough to dissuade traders from going aggressively short into September, a month that has been host to oil price declines for the past five years.

Having seen the price of oil return to \$50/b Opec is now (if it is maintained) unlikely to do anything at the late-September meeting in Algiers. Once again, we have seen Saudi Arabia's ability to move markets supported by an impeccable timing.

It was undoubtedly oil minister Khalid al-Falih's "ready to take action" comment that did the trick in helping squeezing the shorts out of the market.

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Source: Saxo Bank

We see the upside as being limited from here and expect Brent crude will find resistance in the \$50 to \$52/b area before correcting lower back into our preferred Q3 range between \$45 and \$50/b.

The next set of speculative data covering the week ending August 16 – which I will publish on [TradingFloor.com](http://TradingFloor.com) - should give an indication of the extent to which this rally has been driven by short covering or new long positions.

Gold has been struggling to break free of the range it has been stuck within for more than a month now. The weaker dollar has provided some if not the only support during the past couple of weeks as the yellow metal continues to show signs of buying fatigue following the initial extension after the Brexit vote.

Central banks' continued experiment with negative yields and subdued growth has triggered demand for alternative assets such as investment metals. The rally this year has therefore been driven more by investment demand than physical demand.

On that basis, we keep a close eye on demand for ETPs and futures.

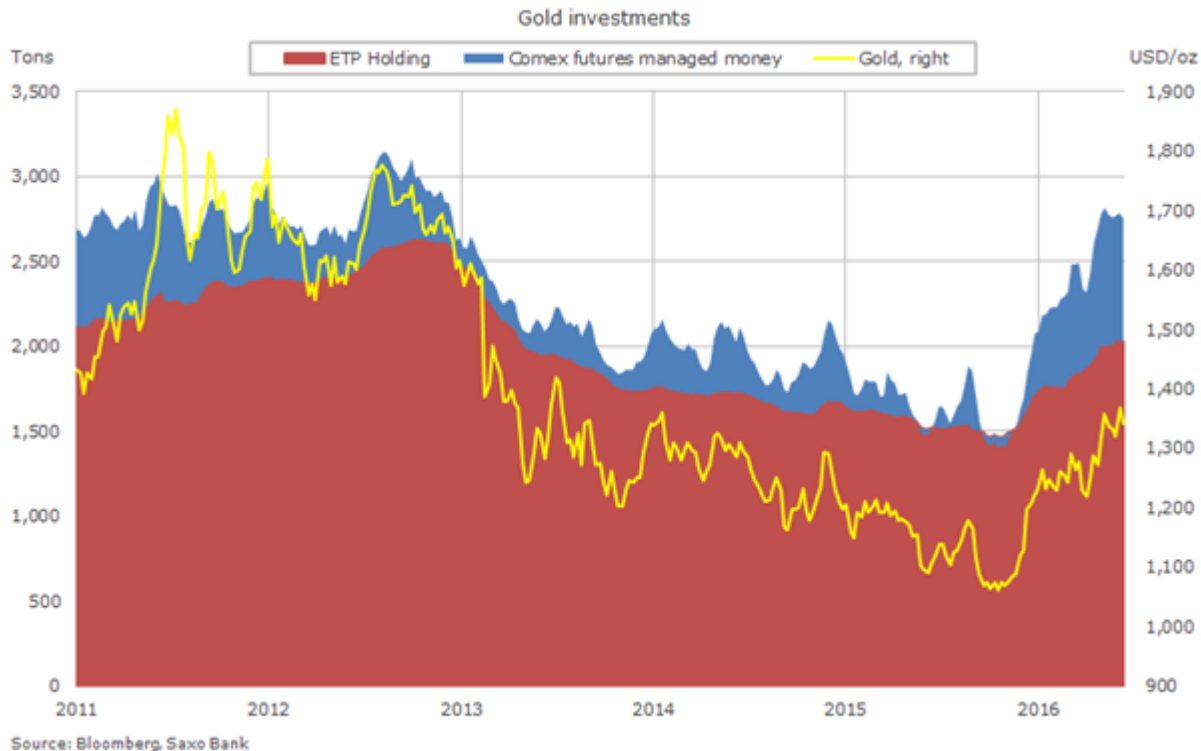
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Holdings in exchange-traded products backed by gold have been flat during the past two weeks while hedge funds have been net-sellers in four out of the past five weeks. These developments are not necessarily an indication that the rally is over, but more that the market – just like back in May – needs reassurance that the 27% year-to-date rally has further upside potential.

A correction would provide the market with a healthy test of where and how strong the underlying support for gold actually is.

The white metals are also showing signs of weakness after acting as precious metals' main bullish driver during the past few weeks. The gold-silver ratio has widened back to 69.5, a six-week high, while platinum's discount to gold has widened by \$60 since August 10.

The annual central bank summit at Jackson Hole, which is being called the "Davos for central bankers", includes a speech by Federal Reserve chair Janet Yellen. Following several conflicting statements from various Federal Open Market Committee members with regards to the timing and pace of further interest rate hikes, this speech will be main focus over the coming week.

Considering the potential impact of any major Fed move, not only on gold but most other major asset classes from bonds and stocks to currencies, the centrality of this speech is obvious.

We see the near-term risk as being skewed to the downside. A break of the increasingly narrow range could signal a retracement back towards the key area of support between \$1,300 and \$1,315/oz.

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