

Gold and oil looking for a floor while gas prices spike



The commodity sector remains on the defensive with rising supply hurting a diversified group of raw materials from crude oil to grains. Growth concerns in the world's two biggest economies into 2019 put industrial and semi-precious metals under pressure while gold struggled to build on the recent recovery amid a strong dollar with a hawkish Federal Open Market Committee staying on course to hike rates further over the coming months. The US midterm election yielded no major surprises with the Democrats, while taking control of the House, failing to create a 'Blue Wave'. The Republicans did not see a 'Red Repeat' but still managed to strengthen their Senate majority. A relief rally was seen in stocks, bond yields resumed their climb while the dollar, after some initial weakness, strengthened once the Federal Reserve indicated it would keep raising rates gradually over the coming months. The initial impact of the election on commodities has been limited but over time we may keep an eye on the following: Late-cycle US economic growth not receiving a further boost through tax cuts Unfunded infrastructure spending impacting industrial metals, budget deficit and bond yields Opposition against Trump's deregulatory energy agenda could impact the long-term prospect for US oil production growth A divided US government potentially weakening the dollar over time The biggest headline grabber was crude oil,

which continued its slump as Iran sanctions worries faded and the world's biggest producers continued to ramp up production. Overall the energy sector was close to flat on the week with the strongest natural gas surge in two years helping to offset the weakness in crude oil and products. Natural gas is up by more than 10% on the week as a cold blast across the eastern part of the US has increased the focus on stock levels which will enter the winter peak demand period at a 15-year seasonal low. In just six weeks market speculation has seen a dramatic turnaround from focusing on Brent oil at \$90/barrel before year end to the current speculation of \$60/b. WTI crude oil was the biggest loser of the two crude oil benchmarks as surging US production and rising stocks and lower refinery demand, due to maintenance, saw the price slump by more than 22% from the October peak and thereby returning to bear market territory.

The ebb and flow of the current trade war remains a concern and its impact is being felt across several key commodities from soybeans to copper and even gold through its strong correlation to the Chinese renminbi. With the US midterms out of the way, and with Trump having lost some of his room for manoeuvre on the domestic stage, he may choose to double down on his international efforts. Not least the trade war and this has led to some pessimism as to what Trump and China's Xi Jinping can achieve when they meet at this month's G20 summit in Argentina. US soybean farmers continue to feel the impact of a season which has both yielded a record crop and a collapse in demand from China due to tariffs. The price of CBOT beans continues to linger below \$9/ bushel, some 20% below the peak back in March when the outlook was much different. The impact can be seen in the monthly supply and demand estimates from the US Department of Agriculture. Since June they have continued to raise their forecast for how many beans will be left over in US bins by the end of this current marketing year, which runs to October 1 next year. Industrial metals, more than other sectors, have felt the pressure from a

prolonged trade war's potential negative impact on global growth and demand. Copper has, however, managed to settle into a wide \$2.55/lb to \$2.85/lb range following the June to July sell-off with support coming from signs a tightening physical market. Chile's Codelco, the world's largest copper producer, posted the lowest quarterly output this year after reporting declines across all its mines due to lower ore grades. A challenging outlook for supply due to lower grades and lack of investment has already led to speculation that a structural deficit may emerge over the coming years, something that could see copper and other industrial metals move higher.

Not least if both China and the US were to opt for increased investment in infrastructure projects. Gold is currently stuck in a range between \$1,210/oz and \$1,240/oz with the October recovery primarily driven by short-covering from hedge funds. Back then they found themselves holding a record and, in the end, unsustainable short position amid emerging signs of safe-haven and diversification demand as the stock market rout unfolded and bond yields jumped. Following a 55% reduction during the past three weeks the tailwind from buyers covering bearish bets has now faded. With risk appetite for stocks and the dollar returning together with the Federal Reserve continuing to hike rates, the bears at this stage are once again looking to take control. Not helping the sentiment has been and even bigger sell-off in silver, which remains troubled by its link to under-pressure industrial metals. In the belief that the stock market recovery is on its last leg and that a strong dollar remains unsustainable we maintain the view that investors will continue to look for alternative investments. This will be done both as a hedge against the risk of inflation and an emerging positive correlation between stocks and bonds. Gold is currently trading within a 31-dollar range. A break below \$1,201/ oz and more importantly \$1,191/oz would see the bears back in charge. Potential buyers, meanwhile, are likely to sit on the fence and wait for a break above \$1,243/ oz, a move that would force renewed fund short-

covering. The rout in crude oil extended into a fifth week driven by the themes of rising supply from the world's three biggest producers, the US, Russia and Saudi Arabia, together with rising US stocks. WTI crude oil entered bear market territory after slumping by more than 22% while Brent crude broke below the psychologically important \$70/b level.

This was otherwise the week when the US re-introduced sanctions against Iran, an event that back in early October helped drive Brent crude above \$87/b on worries that the global market would be left shorthanded. In order to provide other producers enough time to increase production, the US administration chose to grant waivers to eight countries to carry on buying Iranian crude for up to six months. Adding to the weakness this week was the US Energy Information Administration which in its Short Term Energy Outlook for November raised its US crude output forecast for 2019 by 0.3mn barrels/day to a record 12.06m b/d while cutting global demand growth by 0.1m to 1.4m. However, the EIA also said that global refinery demand, estimated to be lower by 2mn barrels/day due to maintenance, would begin to pick up and return to normal during the coming weeks. Having responded to Trump's request for additional barrels to prevent the price from spiking, the subsequent 17-dollar selloff since early October has now instead increased the likelihood of production being scaled back to support the price. Ole Hansen is head of commodity strategy at Saxo Bank.