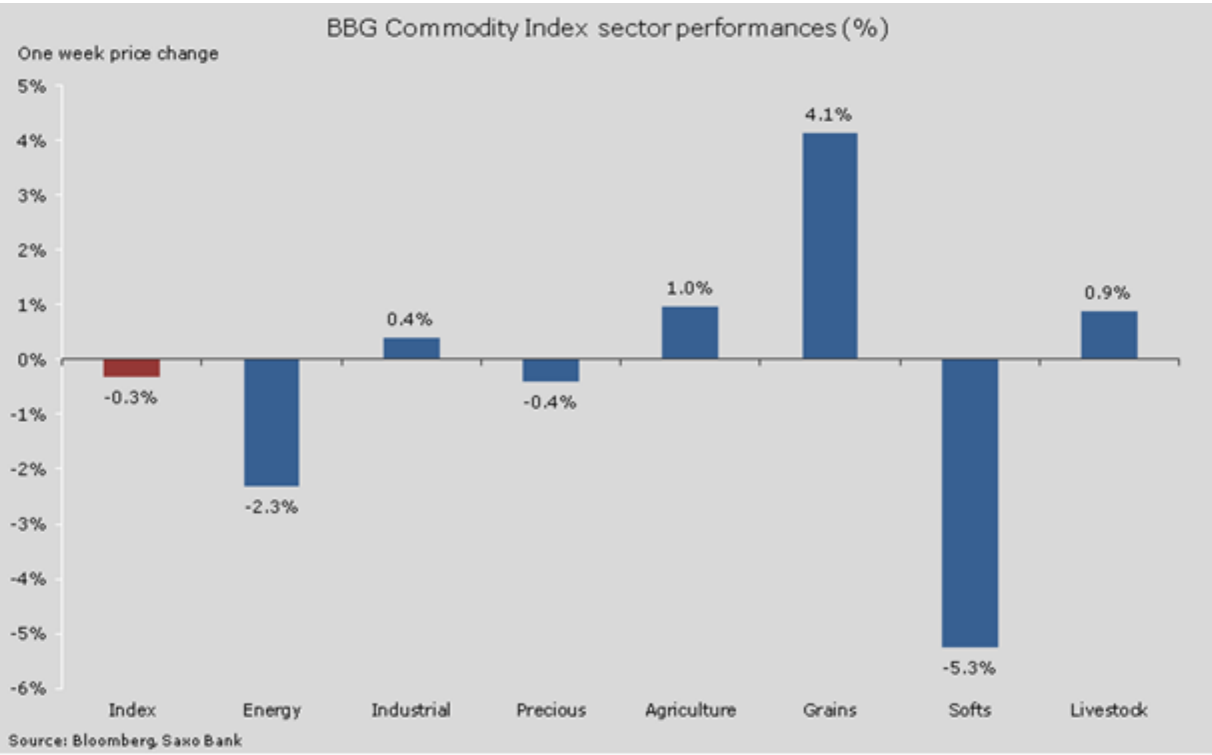
THE SPECIALIST IN TRADING AND INVESTMENT

Crude oil could fall further

Global stock markets have recovered strongly from the panic last week, while dollar buying has resumed after a couple of weeks of profit taking.

Better-than-expected manufacturing PMI data from China and Germany helped reduce worries about the extent of the current global economic slowdown. In the US, company earnings remained robust.

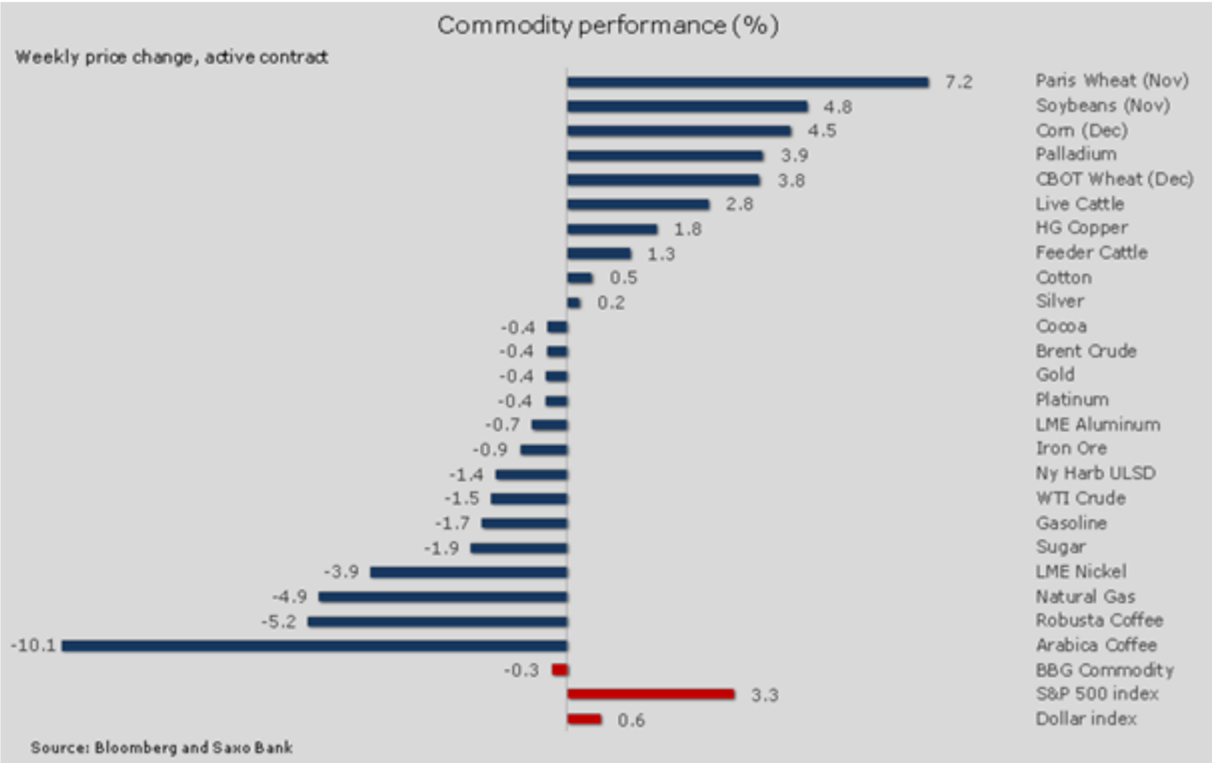
However, the continued spread of Ebola outside West Africa could cause renewed risk-off moves in markets.



The improved economic data helped give industrial metals a boost, while precious metals ran into profit taking.

The energy sector was lower for a fourth week in row, with natural gas and gasoline the biggest losers. The crude oil markets have stabilised following the major price slump in recent weeks.

The agriculture sector was higher for a fourth week, but a strong performance among the key crops was offset by losses in the soft sector.



Oil markets still concerned about rising supply

Crude oil finally managed to stabilise after its pounding in previous weeks. But not before WTI crude oil once again tested the 80 USD/barrel level after another strong weekly inventory report from the US. The strong rise in inventories currently seen in the US is due to the seasonal slowdown in refinery activity combined with production levels – currently running at levels last seen in the 80s.

News that Saudi Arabia may have unilaterally cut oil supply to the market in September helped the price to recover. Doubts, however, quickly emerged: was this a deliberate decision to cut production to support prices? Or did Saudi Arabia simply not find enough demand from its buyers? The potential for a rise in demand going forward also helped stabilise the price after the better-than-expected news on industrial activity in the eurozone and China.

Near term, the upside remains limited as we still need to see a sizeable pick-up in US demand following maintenance – something that is still weeks away – or a reduction in supply from OPEC.

China, the world's biggest importer of crude oil, has stepped in to take advantage of the current low prices. Its imports and consumption figures in September are at the second highest levels ever.

The nuclear negotiations between Iran and six nations – US, France, Germany, China, Russia and the UK – could still reach a positive conclusion before the November 24 deadline. If successful, Iran would increase its production back to pre-sanction levels – one million barrels per day more than current production.

Global supply currently exceeds demand by nearly one million barrels per day, and as long as this imbalance remains, a meaningful recovery seems out of reach. The overriding risk, therefore, remains that we have yet to see the bottom in this current sell off.

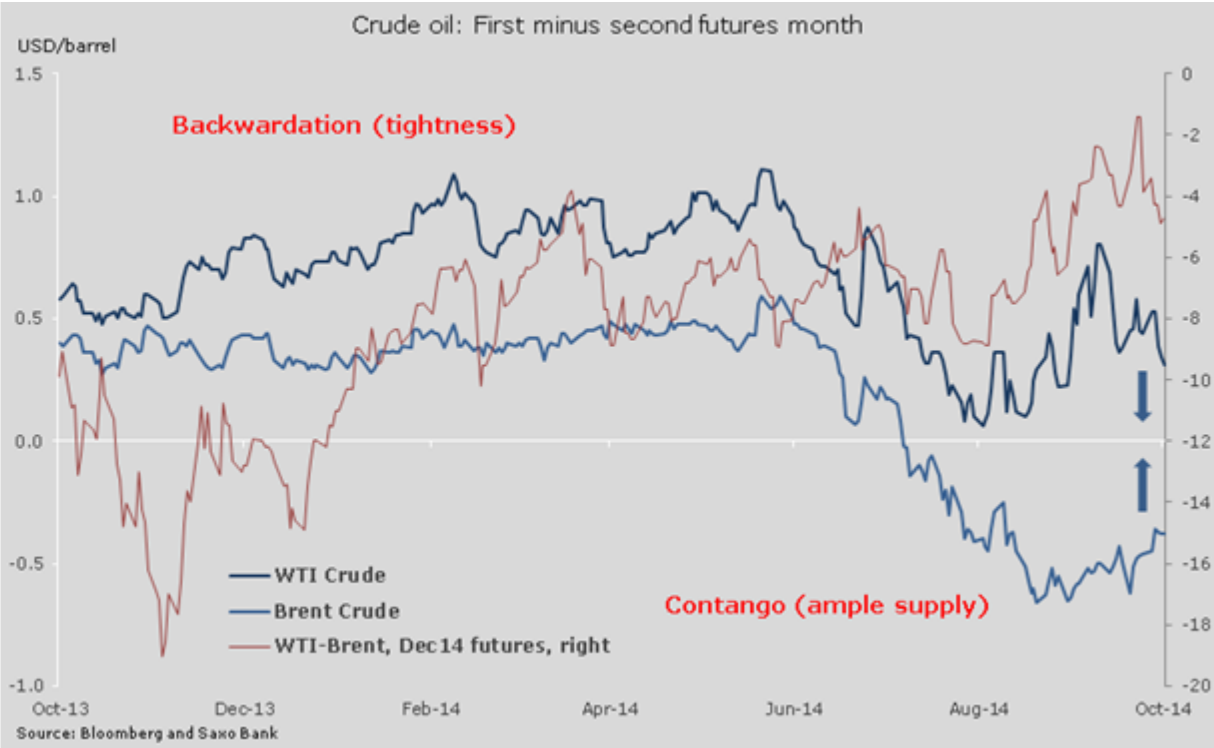
Oil supply at Cushing, Oklahoma, the delivery point for WTI futures, could rise from current levels of over 20 million barrels. Photo: Tom Pennington \ Thinkstock.com

Changing WTI crude fundamentals

Another feature of the oil market is the renewed widening of the spread between WTI crude and Brent crude. The delivery hub for WTI crude at Cushing, Oklahoma could see stocks rise over the coming weeks from its current holdings of more than 20 million barrels.

The combination of a seasonal slowdown in refinery demand, coupled with new pipelines supplying oil to this major hub have helped reduce the premium between spot and deferred crude – so much that the spread between the December and January futures contracts have contracted from a backwardation of 80 cents/barrel at the beginning of the month to just 27cents currently.

This drop in the time spread or backwardation has reduced the relative appeal of WTI crude over Brent crude, which has been in contango for months now. As a result, we could see Brent crude oils premium rise further over the coming weeks from the current level of 4.7 USD/barrel.



Precious metals lower as market sentiment recover

Gold, and to a lesser extend silver, ran into profit taking following a couple of weeks of buying. The bounce in stock markets, coupled with a somewhat stronger dollar, attracted some renewed selling, not least after the failure to breach resistance at 1,255 USD/oz.

With the market sentiment turning from bearish to neutral during the past few weeks, tactical traders, such as hedge funds, have reduced their bearish bets in the market – but investments in exchange-traded products backed by physical gold continue to see reductions.

These reductions in ETP holdings are pointing towards a degree of hesitancy in reaching bullishness at this stage. The overriding sense in the market is still that the dollar will resume its ascent and thereby create some headwind for precious metals.

Alternatively, traders could take a look at XAUXAG, which reached a five-year high earlier in the week before some relative strength in favour of silver emerged. Others may want to isolate the dollar considering the current belief that it will strengthen by taking a look at XAUEUR. This gold cross is currently up 12% year-to-date and a break above 985 EUR/oz could signal further upside.

"Give us our gold back" referendum just a few weeks away

The Swiss Gold Referendum on November 30 continues to attract some attention given that we saw the first, albeit unofficial, poll this week, which indicated that 45% of voters support the proposal, which stipulates that the Swiss National Bank should:

- hold at least 20% of its assets in gold compared with 8% currently
- be prohibited from selling gold reserves in the future
- repatriate all gold holdings back to Switzerland

The first official poll should become available during the next few days. If the percentage in favour remains high, we could be in for a month of raised volatility both in gold and the Swiss franc.

A yes vote would mean the SNB would have five years to reach a 20% allocation of gold in its reserves, something that would require the purchase of more than 1,500 tonnes during this time.

Alternatively, it could reduce the amount of gold it needs to acquire by reducing its total reserves by selling out of its foreign currencies such as euros and dollars. This, however, would raise doubts about the SNB's ability to defend the 1.20 floor in EUR/CHF, and as a result could cause a rise in speculative bets in the currency markets in order to test the resolve of the central bank.

Other commodities in brief:

- **Wheat** prices in Paris and Chicago both reached a six-week high as they received support from forecasts that Russia may see a lower crop next season owing to dry weather. Australia's harvest may also fail to live up to expectations after frost and hail damaged crops.

- **Soybeans** traded back up to $10 dollars per bushel on a combination of strong export demand from China and a continued delay of what is believed to be a record US harvest owing to wet conditions.

- **Copper** was the best performer of the industrial metals as better-than-expected Chinese data triggered short covering. This took the price back to relative safety above $3 per pound. **Nickel**, meanwhile, lost more than 4%, and the price has now almost retraced all of its strong gains from earlier this year. In fact, the current weekly losing streak has been the longest in 13 years as rising stockpiles, especially in Asia, saps support.

- The price of both Robusta, and especially Arabica **coffee** came under some heavy selling pressure as rain has finally reached key growing areas in Brazil and alleviated some of the heightened fears about a shortfall in supplies next year. Arabica coffee remains by the best performing commodity in 2014 with a current gain of 74%.

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Ole Sloth Hansen is a specialist in all traded Futures, with over 20 years' experience both on the buy and sell side. Hansen joined Saxo Bank in 2008 and is today Head of Commodity Strategy focusing on a diversified range of products from fixed income to commodities. He previously worked for 15 years in London, most recently for a multi-asset Futures and Forex Hedge fund, where he was in charge of the trade execution team. He is available for comments on most commodities, especially energies and precious metals.