Iran tension postponed – oil lower

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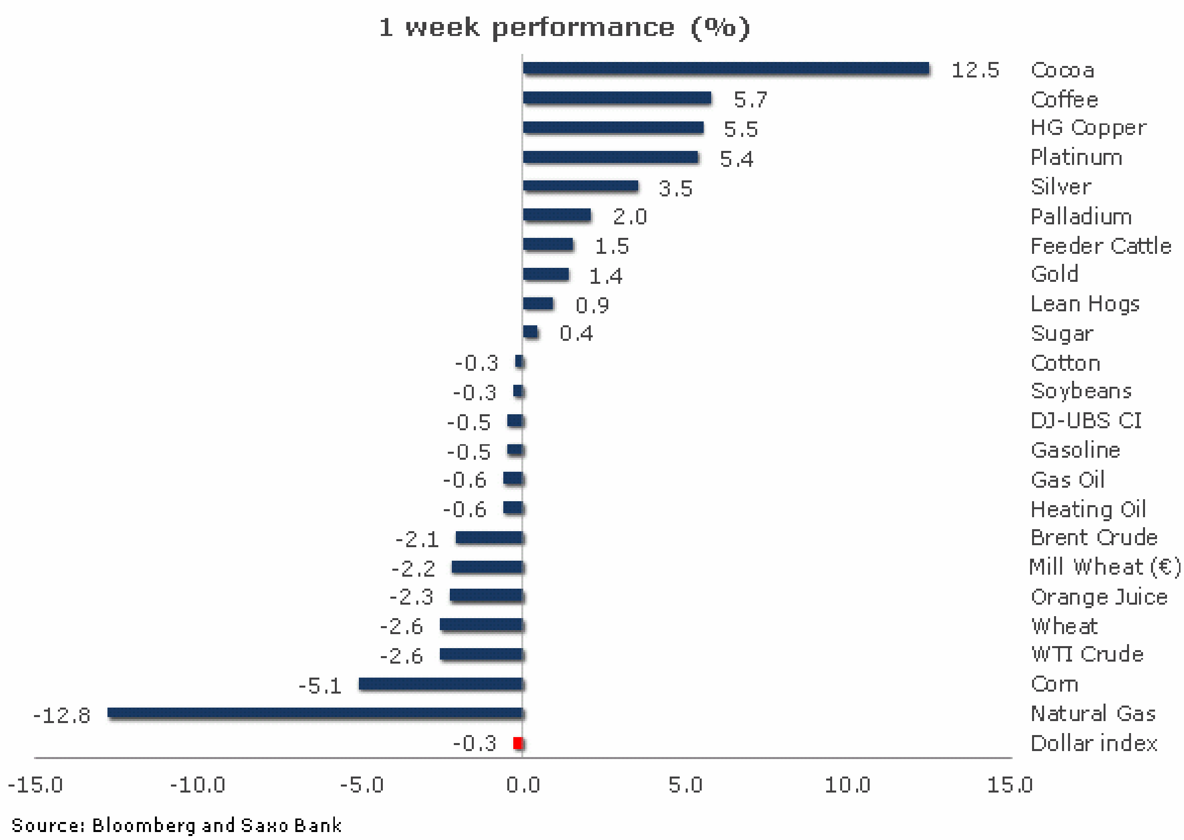
Investors spent the first full trading week of 2012 focusing primarily on the metal sector with both industrial and precious metals showing decent gains. The US Department of Agriculture wrong-footed the market once again by projecting higher than expected production and the recent rally in energy prices faded on news that the European embargo on Iranian crude will be delayed.

The DJ-UBS index showed a small loss on the week as strong gains in the two metal sectors were off-set by losses in energy and agriculture. The index rebalancing mentioned last week has so far had a limited impact on markets as all the changes were publicised well in advance.

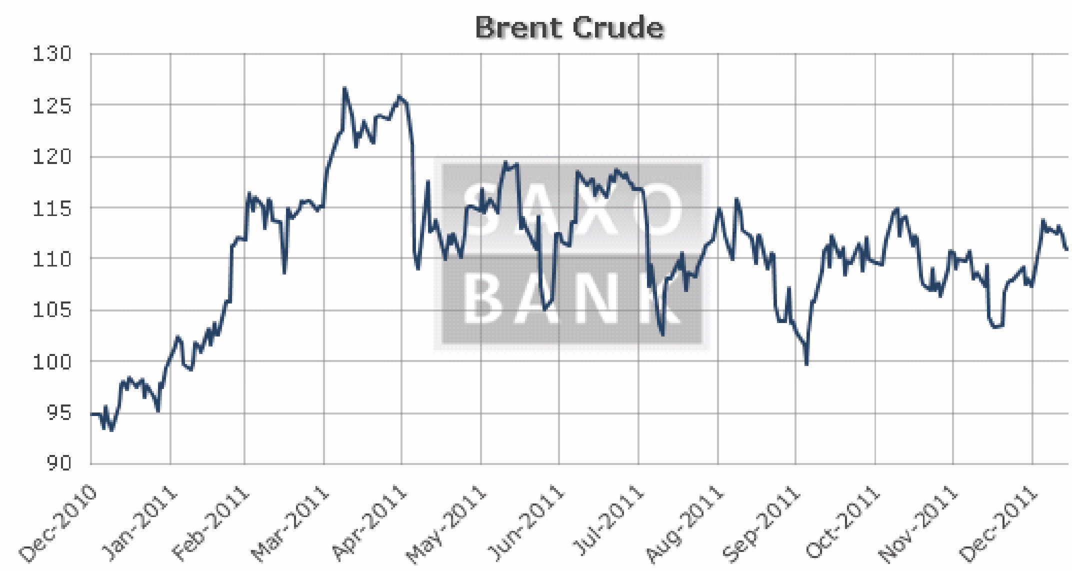


Oil lower as embargo may be delayed

Crude oil continues to be torn between worries of slowing demand and the risk of supply disruptions stemming from concerns over a possible embargo on Iranian oil and a major strike in Nigeria. News that Europe may delay the enforcement of the embargo to allow some countries time to find alternative supplies helped trigger the biggest weekly decline in a month.

Europe and the US continue to place pressure on Iran about its nuclear intentions. The potential response from Iran, should an embargo be implemented, has so far been the main focus for oil markets. The removal of Iranian oil at a time where spare capacity is only slowly being rebuilt after Libya's recovery and where safe passage through the Strait of Hormuz be threatening has triggered strong buying over the last month.

Another supply worry is the threat of strikes among the oil union in Nigeria, Africa's largest oil producer. This is part of nationwide protest, which has paralysed the country, after the government announced the removal of fuel subsidies. Domestic fuel prices have doubled after the removal of the subsidies which last year cost the government USD 8 billion.



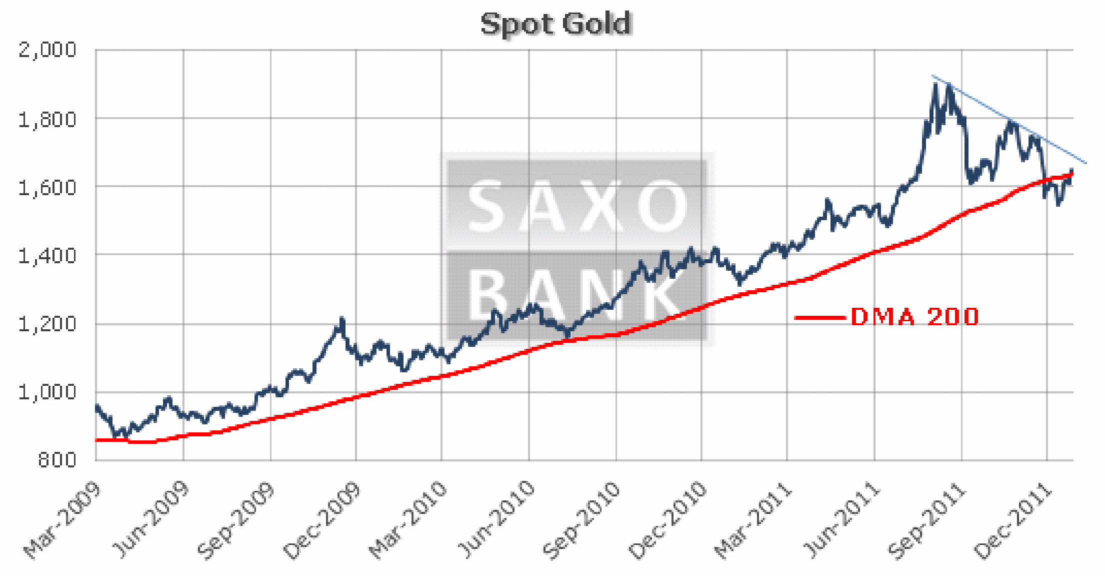
Source: Bloomberg and Saxo Bank Strategy & Research

Against this backdrop, where traders still fear a sudden spike in prices, sellers of oil have been in minority during recent weeks. So while maintaining a relatively large speculative long futures position they have instead turned to the options market where they now pay more to protect themselves against a fall in prices than a gain. This could also be a signal that they do not really believe that the current rhetoric will be transformed into actual action from Iran in terms of blocking the Strait of Hormuz but for now they play it safe and remain long oil.

Gold higher but platinum shines

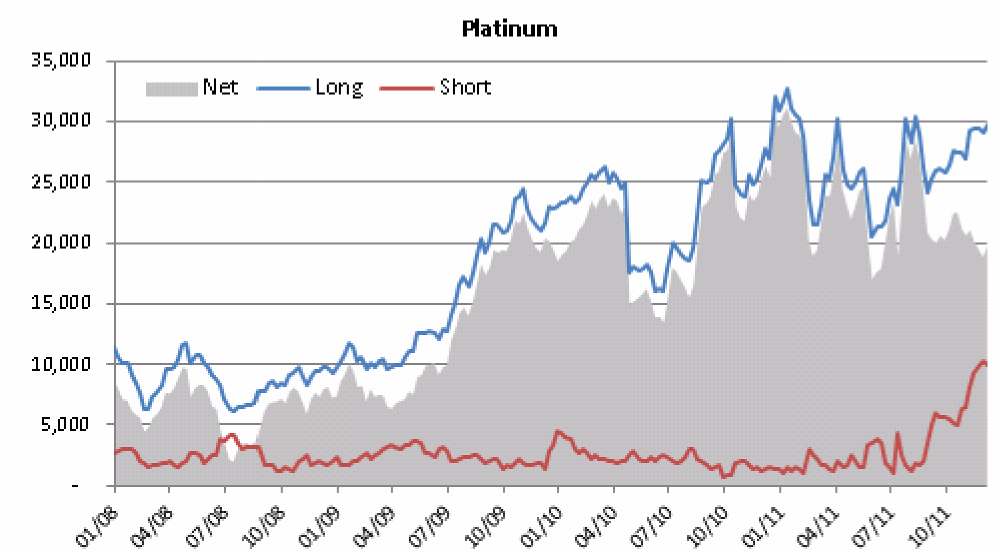
Gold finally regained its foothold above its 200-day moving average with investors still convinced that the yellow metal will produce a twelfth year of positive performance. The move was not least helped by news that China imported a record 102.2 tonnes during November. China overtook India in the third quarter as the largest gold jewellery market and the sharp rise in imports indicates that the People's Bank of China is adding to its reserves. What is so significant about Chinese buying is that the metal can't leave the country as it is not permissible to export gold.

Further consolidation can be expected, especially with the debt crisis in Europe having eased somewhat this past week, but investors seem to have regained some of the confidence that was lost during the past few months. Technically we are looking for a potential near-term trading range of 1,605 to 1,680.



Source: Bloomberg and Saxo Bank Strategy & Research

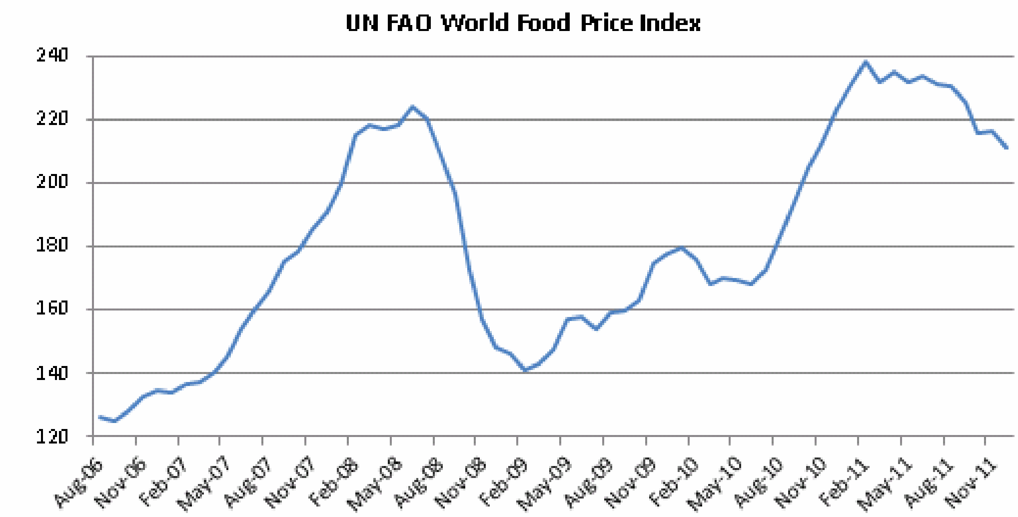
Platinum also had a strong week rallying on a combination of relative cheapness to gold, a very large short position and worries about the ability of South Africa, the world's biggest producer, to maintain production at current levels. What particularly helped platinum to outperform gold over the last week can be explained by looking at the composition of speculative long and short positions on the COMEX future contract. During the last few weeks of 2011 the number of short positions continued to rise in line with longs leaving the net position almost unchanged. With the price beginning to move higher the possibility of short-covering cannot be ignored given the elevated short position that currently exists.



Source: Saxo Bank, CFTC, Bloomberg

Food price inflation continues to fall

The fear of higher food prices which has been a major concern over the last couple of years seems to be receding further. The UN Food and Agriculture Organization's food index fell in December to the lowest level in more than a year, driven by sharp falls in cereals, sugar and vegetable oils. This has helped drive down inflation, especially among emerging economies, like China, where food prices take up a relatively high proportion when calculating consumer prices.



Source: Saxo Bank, UN FAO, Bloomberg

USDA wrong-foots the market – again!

Meanwhile the US department of Agriculture once again managed to wrong-foot the market in a spectacular way. Corn and wheat prices plunged the most in three months after they forecast an increase in stockpiles against expectations of a drop. Traders were caught long and wrong after expectations had risen that a drought in South America would trigger a reduction in projected inventory levels which would support the recent strong rally in prices. Corn prices especially took a tumble after ending stocks was left unchanged at 846 million bushels against expectations of 758 million and a smaller Argentinian corn crop due to drought was offset by larger supplies in China and the Ukraine.

Wheat futures fell on both sides of the Atlantic as global supplies may total 210 million tonnes, the most since 2000 as producers from Australia to Russia ramped up production.

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