Commodities bolt out of the gates to kick off 2021

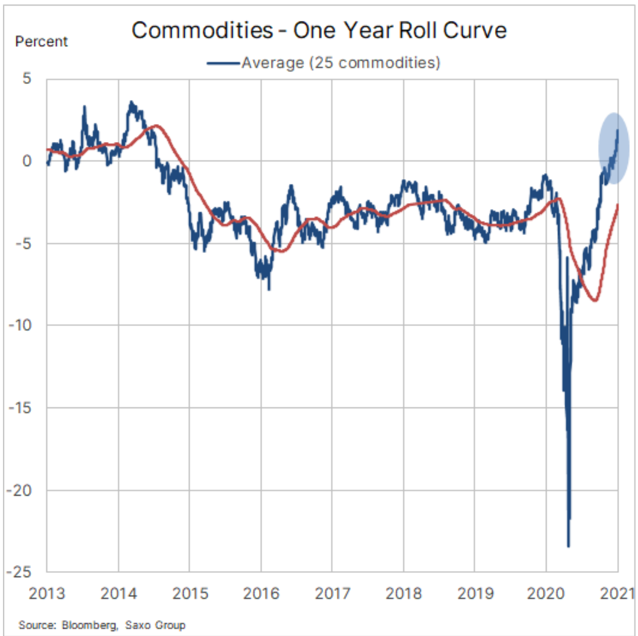
By Ole S. Hansen // January 4, 2021

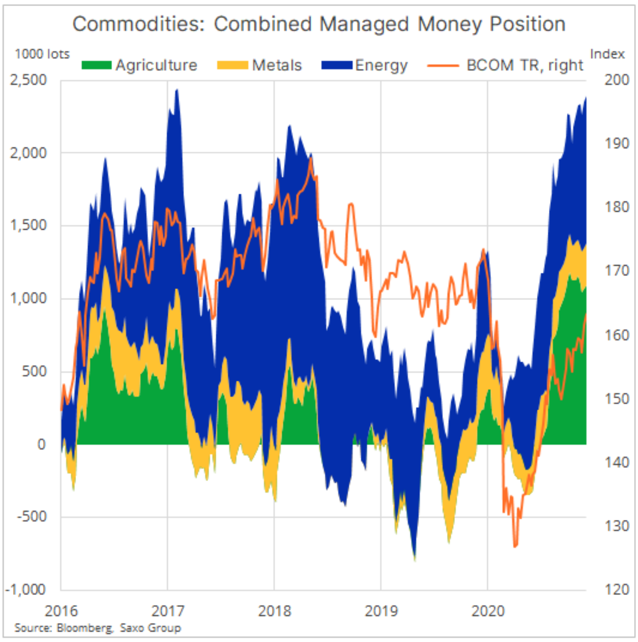
Commodities have raced out of the starting block on the first day of trading as the themes that emerged towards the end of 2020 continue to attract fresh buying. In our latest Commodity Update titled "Turbocharged commodities looking for more in 2021" we speculated whether we are at the beginning of a new super cycle last seen during the early years of this millennium.

Some of the key drivers that has and potentially will continue to support the sector:

- Emerging tightness in key commodities from copper to key crops
- A vaccine-led recovery in global growth and demand
- China's unstoppable appetite for raw materials
- A weaker dollar lifting the sector while unlocking demand from emerging economies
- Weather worries raising the cost of key food commodities
- A global market flushed with cash, driving wild speculation across markets
- Increased demand for inflation hedges given the risk of policy mistakes

Towards the end of 2020, these developments help drive a significant change in the one-year cost of holding a basket of commodities. Ample supply due to massive investments, especially in mining and energy (shale oil) and benign weather developments triggered a half decade where holding a basket of commodities would incur a negative roll yield. Something that historical have dissuaded investments in the sector as it reflected oversupply and lack of upside potential. During the past six months and led by the agriculture sector, the roll yield has flipped back to positive. A reflection of tighter market conditions with spot commodities trading at a premium to the future prices but also a pickup in speculative interest.





The second chart above shows how the speculative interest across 24 major commodities has reached a four-year high at almost 2.4 million lots representing a nominal value of 121 billion dollars. The top three in terms of net nominal exposure being crude oil ($30 bn), gold ($26 bn) and soybeans ($12 bn). The chart also shows that while the two previous peaks in speculative interest were primarily driven by energy, the recent build up has been spread across all three sectors. Not least the agriculture sector, which led by the three key crops, has seen a revival following several years of underperformance.

Crude oil reached a fresh ten-month high in early trading with U.S. versus Iran rumblings and vaccine-optimism continuing to off-set what increasingly looks like a grim period ahead with extended lockdowns seen across winter hit regions across the northern hemisphere. On the supply side, the market is also waiting for a OPEC+ decision on whether it can keep lifting output into a surging virus environment.

The immediate outlook for crude oil, especially at current levels, may be somewhat challenging as the global recovery in fuel demand continues to be pushed forward. OPEC is forecasting crude oil demand will rise to 95.9 million barrels/day this year, still well below the above 100 million barrels/day peak seen before the pandemic emerged a year ago. A recovery pace at this speed may also challenge OPEC+ which currently has more than 8 million barrels/day of spare capacity which they want to funnel back into the market at some point.

Speculative interest for crude oil, from a growth and reflation prospect, however, are likely to support the price through these first few demand challenging months of the year. During this time we see the upside for Brent crude oil limited to $55/b with support at $49/b followed by $46.6/b.

Source: Saxo Group

Gold (XAUUSD) surged above $1900/oz in early trading with the next level of resistance being the November high at $1965/oz. The reflation element combined with a weaker dollar and lower real yields all points to further short-term gains. While ten-year US breakeven yields – an expression of future inflation expectations – have reached 2%, real yields, a key driver for gold, has slumped to -1.09% and near the lowest for this cycle.

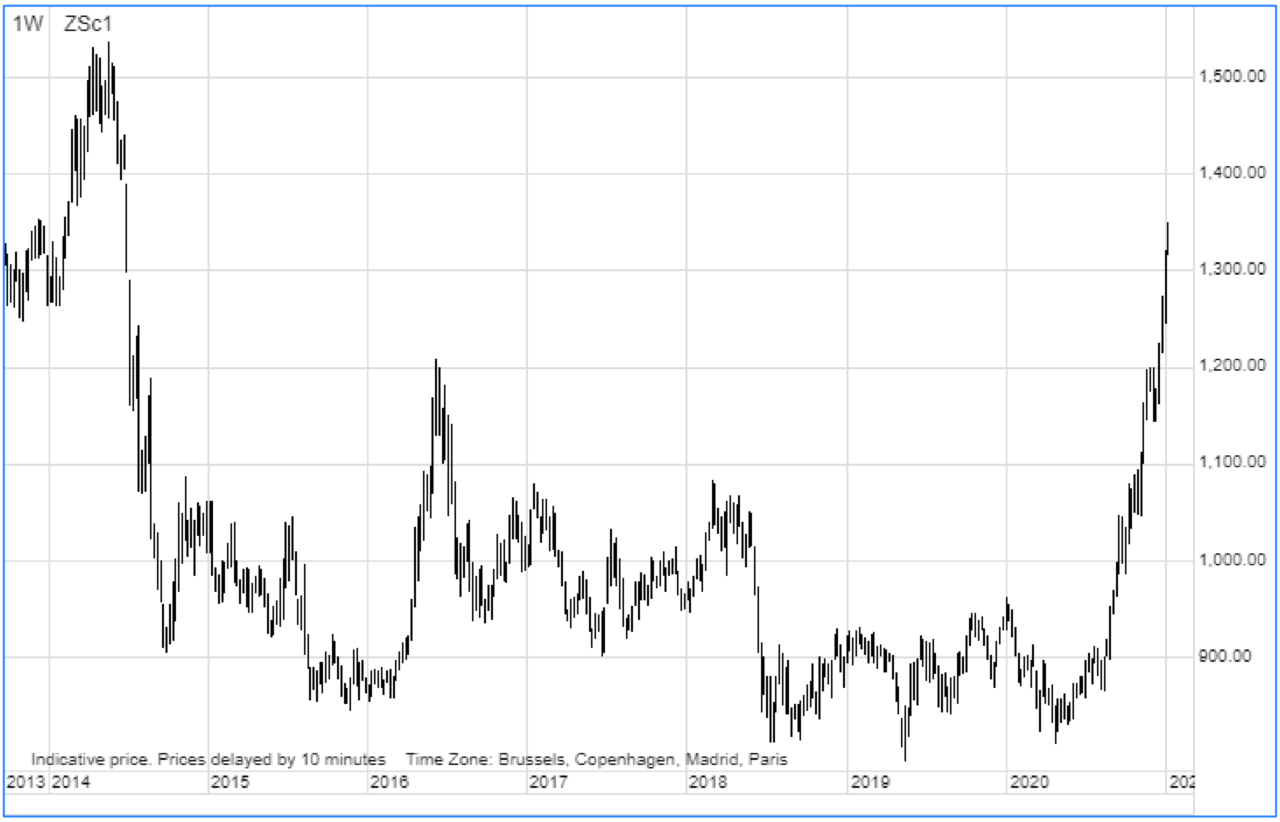
In the US, the Georgia Senate run-off elections on Tuesday may further strengthen the reflation sentiment and gold if polling projections are correct in handing victory to both Democrats and with that the Senate majority. This on expectations that a Joe Biden administration will easier be able to boost stimulus and increase spending.

Source: Saxo Group

Silver (XAGUSD) jumped more than the three percent with support from gold, copper and a weaker dollar. The XAUXAG ratio is once again approaching 70 (ounces of silver to one ounce of gold) while the spot price is facing resistance towards $27.50/oz.

HG Copper also jumped on the first day of trading, supported by a weaker dollar, not least against the Chinese Yuan which surprisingly was allowed by the PBoC to strengthen by more than 1% overnight. Chinese manufacturing PMI expanded for an eight consecutive month which suggests continued strong demand for metals from the world's by far largest consumer.

Soybean (SOYBEANSMAR21), corn (CORNMAR21) and wheat (WHEATMAR21) all trading higher supported by a weaker dollar, bright demand outlook led by China and dry weather threatening production in South America. Especially in Argentina, the world's biggest exporter of soy products with dry conditions also building in Brazil. Soybeans has surged past $13/bu for the first time in 6-1/2 years while corn has recorded its longest run of gains in six decades.



Source: Saxo Group

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