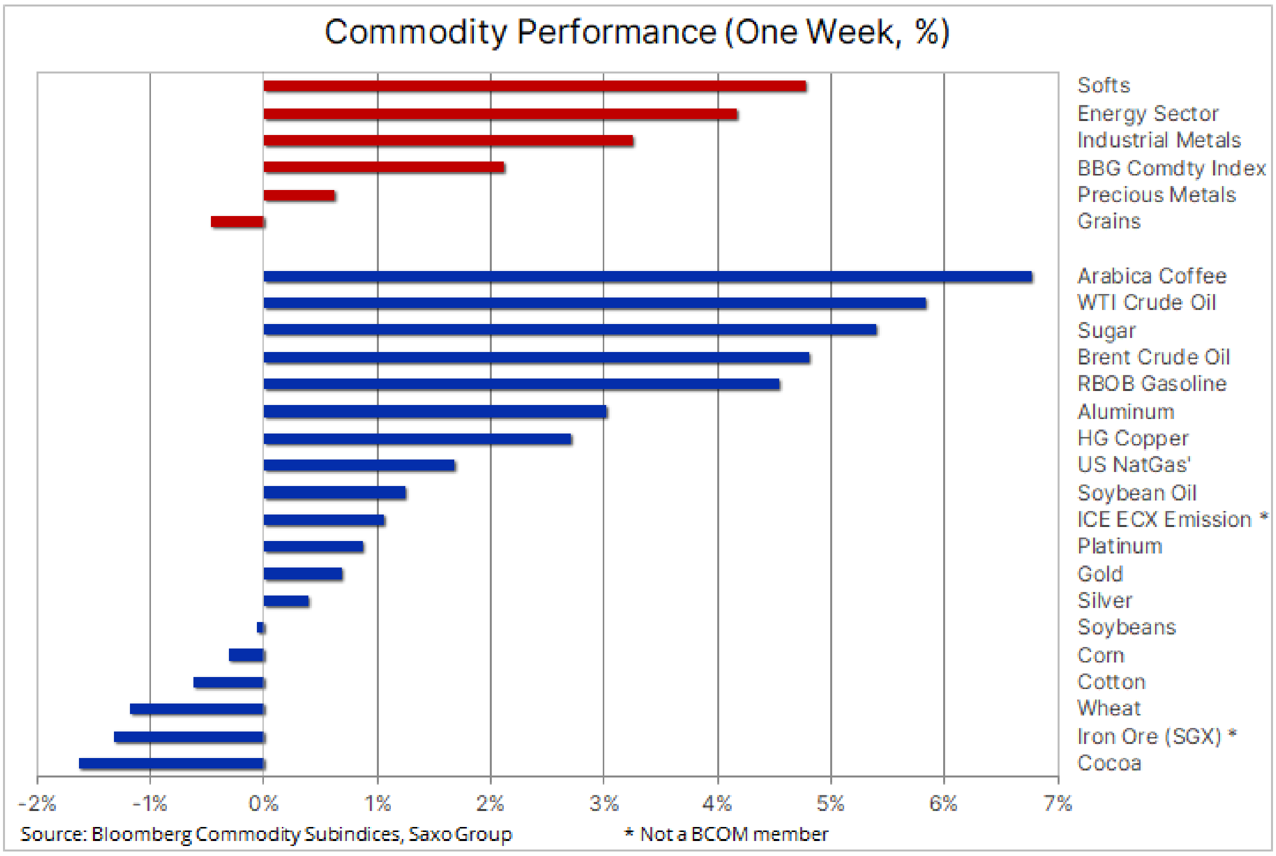
WCU: Commodity rally resumes supported by the four C's

By Ole S. Hansen // May 28, 2021

Commodities staged a broad comeback this past week with the Bloomberg Commodity Index rising 2.1%, thereby retracing more than half the mid-May correction. Gains were seen across most sectors led by growth-dependent sectors such as industrial metals and energy. Global growth optimism, increased decarbonization efforts and spending by governments received renewed attention. Not least after big-spending President Biden announced a $6 trillion budget plan to boost U.S. economy combined with a continued recovery in global mobility, apart from a few major virus hotspots in Asia.

The mentioned correction has to a large extend been driven by Chinese authorities attempting to reduce the involvement of speculators in some key markets. The action taken to curb speculation and hoarding has so far, and despite a strong bounce ahead of the weekend, seen a reasonable amount of success when it comes to China-centric commodities such as steel and iron ore. Overall, however, the action is unlikely to create a lasting impact on most other commodities, not least due to the continued focus on a DM-led recovery in demand which could see western consumers become the marginal buyer, a role reserved by China throughout the past couple of decades.

Rising physical demand into a period of inelastic supply, especially in industrial metals where new mining projects can take years to bring online, combined with a certain amount of investment demand from speculation and inflation hedging, remains some of the key reasons why the market talks about a commodity super-cycle continue.



The recovery in demand combined with scarcity of supply continue to see commodities receiving attention, not only from the physical world but also from investors seeking a hedge against a prolonged period of inflation. The combination of free-spending governments and central banks keeping their feet off the brakes to maintain loose monetary conditions remains a potent cocktail that could see inflation ending up being anything but transitory.

The Invesco DB Commodity Index, up 27% year to date, with ticker DBC is a $2.5 billion market cap Exchange-traded fund. It tracks the performance of the DBIQ Optimum Yield Diversified Commodity Index with exposure in 14 different commodity futures split across energy (60%), metals (19%) and agriculture (21%).

Gold reached a four-month high before entering what looks like an overdue consolidation phase. It traded softer towards the end of the week after having almost reached the next key level of resistance at $1923, the 61.8% retracement of the August to March correction and a level, if breached, that could signal a renewed push towards the August record high at $2074.

The chief theme across markets which has boosted risk sentiment has been the Fed's ongoing tsunami of liquidity provisions. These actions have supported the recent dollar weakness while keeping bonds in demand despite continued inflation worries. However, in the short term, the precious metal markets need to consolidate recent strong gains and an early warning of that potentially starting was signaled this past week through the relative underperformance of silver and platinum against gold. The XAUXAG ratio rose to a one-month high while platinum's discount widened to $710 from a recent $500 low.

From a technical perspective, a break below $1890 could target $1870 followed by the 200-day moving average, currently at $1843. Key drivers, as per usual, will be developments in the dollar and yields which have both strengthened this week, as well as how much long-term trend-following funds still need to calibrate their positions to reflect the recent improvement in the technical outlook.

Renewed rally supported by the four C's: copper, crude oil, coffee and corn

Copper rallied to retrace more than half of its recent 9% correction on supply concerns, and after the market concluded Chinese measures to curb speculation and hoarding would primarily be focusing on the highly polluting steel industry. The threat of strike actions by individual groups at BHP in Chile, who operates the world's biggest copper mine, helped further improve sentiment. Not least given the prospect of strong and rising demand over the coming years for so-called green metals such as nickel, aluminum, nickel, platinum and all-important copper. Following its shallow correction to a one-month low at $4.44 per pound, high-grade copper has recovered, with a break above $4.72 potentially signaling a return to the May 10 peak at $4.88 and above.

Crude oil futures found a fresh bid with surging U.S.-led demand offsetting concerns about the prospect of rising Iranian supplies. The rally was led by WTI which on a closing basis reached a two-year high while Brent once again has been taking a closer look at $70, the top of the recent range. Focus turning to next week's OPEC+ meeting where the group, despite uncertainties about future Iranian output, is expected to confirm an already agreed 0.8 million barrels per day increase for July. Until the market receives more clarity about the outcome of the U.S.-Iran negotiations, and the global recovery in fuel demand becomes more synchronized, the upside potential beyond the March high at $71.40 seems limited.

Arabica coffee prices jumped 7% on the week to reach a 4-1/2 year high above $1.6 per pound. Prices have soared recently amid concerns about supplies from top growers Brazil where drought continues to see output projections slip, and Columbia where political protests have held up shipments since the end of April. Key to the short-term direction remains these two developments but with the prospect for colder weather in Brazil adding the risk of frost on higher grounds, the outlook points to further support.

Corn surged the most in two years, further recovering from the recent rout which resulted in a top to bottom correction of 18%. This after weekly export data showed the second largest ever sale since 1990. After hitting a one-month low on Wednesday at $6.03, the July contract rose by the exchange allowed limit to $6.6450, thereby pulling both wheat and especially soybeans higher with it. The sale primarily driven by another bumper order from China a reminder that the country, despite attempts to clamp down on speculation and hoarding, will continue to drain global supplies in order to feed the expansion of the world's biggest hog herd.

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