CIO | VIEW

CIO Commodity Commentary

March 24, 2020

Marketing Material

COMMODITY-MARKET TURMOIL

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IN A NUTSHELL

_ The gold price has been falling but a supportive rates environment and safe-haven demand brighten our outlook.

_ The Saudi-Russian oil-price war broke out at the worst possible time. Any further negotiations are likely to involve a new kid on the block – the United States.

_ Soft commodities were more affected than grains by the broader risk-off move, sugar suffered in particular, since it is linked to energy prices by ethanol demand.

Commodities are a very volatile asset class and they are staying true to form in this current crisis. Indeed a number of factors have coincided to make them particularly hard hit this time.

Let's start with the question of why gold, the traditionally perceived safe haven, did not gain amid all the turmoil? The stock markets have fallen by around a third year- to- date and central banks' adoption of lower interest rates ought to support the yellow metal, which does not pay interest. As the sell-off deepened, however, and liquidity became more constrained, investors were forced to tap their most liquid asset classes. Gold, whose market is highly liquid and developed, has therefore served as a source of funds for investors. But after the recent U.S. Federal Reserve (Fed) action we expect an easing of the selling pressure and some stabilization in markets to brighten the outlook. The low rate environment – reducing the opportunity cost of holding gold – and safe-haven demand are additional positive factors. The current development could be similar to the trend in gold prices during the global financial crisis: prices fell for much of 2008 but then rallied strongly in subsequent years.

While natural gas used to be our problem child, it is oil that has suffered the most across the commodities space during the past 30 days. Both demand and supply have been hit hard. On the supply side, large oil-consuming economies like India and China have already been severely affected by the coronavirus crisis, thereby weakening oil demand and prices. Saudi Arabia therefore attempted to persuade OPEC+ countries, which had agreed to cut production by 0.5 million barrels per day (b/d) in December, to cut by further 1.5 million b/d in an effort to stabilize prices. Russia's refusal to even abide by the previously agreed cut led Saudi Arabia to change its objective, targeting market share instead of a certain price level. By increasing its output, it drove prices further down. Russia's actions do not come as a surprise as it repeatedly did not adhere to previously agreed cuts exacerbating the cartel's fragility. The implications are profound. Additional stress has been brought to the credit markets. Most U.S. shale exploration and production (E&P) companies now cannot, at the greatly reduced prices, generate enough cash flow to fund their capital expenditure, so there will likely be further downgrades from the investment-grade space. Likewise, there are rising concerns over potential bankruptcies within the high-yield segment, and correspondingly yields in the U.S. energy sector have increased.

On the oil demand side the picture is also bleak as the coronavirus pandemic is essentially putting economies around the world on hold. Looking forward, we do not believe that the shift from price maintenance to a market-share-protection strategy will go on indefinitely. Lower oil prices not only force Saudi Arabia to run large budget deficits, but also hurt the income of the Royal family and force further share issuance by its large oil company to be delayed. Russia meanwhile is being put under severe strain by the price war, with its revenues down and the ruble tumbling to its weakest level in years, putting further pressure on the Russian economy. Although we do not expect the price war to continue indefinitely, it is likely to get worse before it gets better. Trust is a hard-earned commodity and will take time to rebuild. In 2015, for example, it was hard to restore OPEC and Russia's credibility with regard to the production cap.

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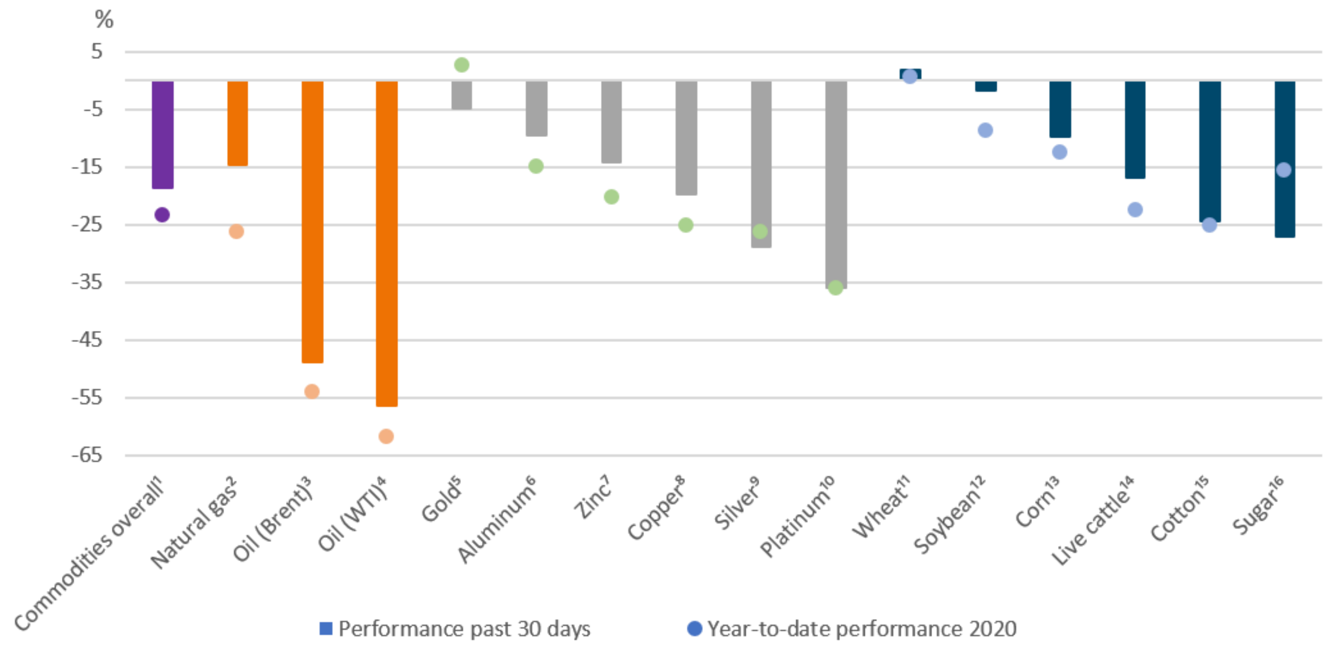
The price war could hardly have been unleashed at a worse time. But further developments may involve a new kid on the block – the United States. Concerned about the struggling U.S. shale-oil producers, President Trump has said that he has ordered the Energy Department to fill the strategic petroleum reserve "to the top."[1] He has also said he would get involved "at the appropriate time" in the dispute between Saudi Arabia and Russia. These comments have helped to put a floor under oil prices. For now, we believe that it is unlikely that all three parties will come to the table directly. Future agreements will probably involve only a subset of them at first.

The latest U.S. Department of Agriculture World Aggregate Supply and Demand Estimate (WASDE) report was relatively uneventful. As expected, estimates of South American production were increased following an excellent growing season. Soft commodities were more affected by the broader risk-off sentiment, particularly sugar, whose price is linked to energy prices through ethanol demand, has fallen by about 15% this year. Assuming energy volatility persists, agriculture is likely to continue to trade in sympathy. Sugar and corn (ethanol), soybean oil and palm oil (biodiesel) and cotton (synthetics) will be most affected in our view. In the absence of a downward pull from energy prices, we are generally constructive on agriculture as food demand is relatively macro agnostic and is likely to suffer less than other commodities in the coronavirus crisis.

PAST 30-DAY AND YEAR-TO-DATE PERFORMANCE OF MAJOR COMMODITY CLASSES



Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P., DWS Investment Management Americas Inc. as of 3/23/20

[1] Bloomberg Commodity Index, [2] Bloomberg Natural Gas Subindex, [3] Bloomberg Brent Crude Subindex, [4] Bloomberg WTI Crude Oil Subindex, [5] Bloomberg Gold Subindex, [6] Bloomberg Aluminum Subindex, [7] Bloomberg Zinc Subindex, [8] Bloomberg Copper Subindex, [9] Bloomberg Silver Subindex, [10] Bloomberg Platinum Subindex, [11] Bloomberg Wheat Subindex, [12] Bloomberg Soybeans Subindex, [13] Bloomberg Corn Subindex, [14] Bloomberg Live Cattle Subindex, [15] Bloomberg Cotton Subindex, [16] Bloomberg Sugar Subindex

GLOSSARY

Bloomberg Aluminum Subindex (BCOMAL) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Aluminum.

Bloomberg Brent Crude Subindex (BCOMCO) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Brent Crude.

The Bloomberg Commodity Index (BCOM) traces 23 commodities and reflects commodity futures price movements.

Bloomberg Copper Subindex (BCOMHG) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Copper.

Bloomberg Corn Subindex (BCOMCN) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Corn.

Bloomberg Cotton Subindex (BCOMCT) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Cotton.

[1] https://www.sacbee.com/news/article241340686.html

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Bloomberg Gold Subindex (BCOMGC) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Gold.

Bloomberg Live Cattle Subindex (BCOMLC) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Live Cattle.

Bloomberg Natural Gas Subindex (BCOMNG) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Natural Gas.

Bloomberg Platinum Subindex (BCOMPL) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Platinum.

Bloomberg Silver Subindex (BCOMSI) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Silver.

Bloomberg Soybeans Subindex (BCOMSY) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Soybeans.

Bloomberg Sugar Subindex (BCOMSB) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Sugar.

Bloomberg Wheat Subindex (BCOMWH) is a commodity group subindex of the Bloomberg CI (BCOM) composed of futures contracts on Wheat.

Bloomberg WTI Crude Oil Subindex (BCOMCL) is a subindex of the Bloomberg CI (BCOM) composed of futures contracts on WTI crude oil.

Bloomberg Zinc Subindex (BCOMZS) is a subindex of the Bloomberg CI (BCOM) composed of futures contracts on Zinc.

Capital expenditure (Capex) are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

The financial crisis refers to the period of market turmoil that started in 2007 and worsened sharply in 2008 with the collapse of Lehman Brothers.

High-yield bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

Investment grade (IG) refers to a credit rating from a rating agency that indicates that a bond has a relatively low risk of default.

Liquidity refers to the degree to which an asset or security can be bought or sold in the market without affecting the asset's price and to the ability to convert an asset to cash quickly.

OPEC+ is an informal alliance of OPEC members and other oil-producing countries, led by Russia, aiming to coordinate their production strategies.

The Russian ruble (RUB) is the official currency of the Russian Federation.

The U.S. Federal Reserve, often referred to as "the Fed", is the central bank of the United States.

Volatility is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

APPENDIX: PERFORMANCE OVER THE PAST 5 YEARS (12-MONTH PERIODS)

	02/15 - 02/16	02/16 - 02/17	02/17 - 02/18	02/18 - 02/19	02/19 - 02/20
Bloomberg Commodity Index	-26.6%	15.5%	0.5%	-7.7%	-12.8%
Bloomberg WTI Crude Oil Sub-	-51.1%	27.2%	9.3%	-5.8%	-22.2%
Bloomberg Brent Crude Subin-	-51.7%	32.8%	13.6%	4.2%	-16.7%
Bloomberg Natural Gas Subin-	-53.6%	13.6%	-22.6%	3.8%	-51.7%
Bloomberg Gold Subindex	1.3%	0.2%	3.2%	-2.9%	15.8%
Bloomberg Silver Subindex	-11.1%	21.2%	-13.3%	-7.5%	1.9%
Bloomberg Platinum Subindex	-21.6%	9.3%	-5.6%	-13.3%	-3.7%
Bloomberg Copper Subindex	-21.7%	24.6%	12.0%	-8.5%	-14.9%
Bloomberg Aluminum Subindex	-18.2%	19.3%	7.4%	-10.4%	-15.1%
Bloomberg Zinc Subindex	-16.8%	57.5%	21.9%	-16.1%	-24.2%
Bloomberg Corn Subindex	-18.3%	-4.7%	-10.7%	-15.1%	-10.1%
Bloomberg Wheat Subindex	-14.6%	-16.2%	-7.5%	-18.3%	10.7%
Bloomberg Soybeans Subindex	-15.7%	17.9%	-3.2%	-20.2%	-10.4%
Bloomberg Sugar Subindex	-5.1%	27.5%	-33.6%	-12.3%	0.6%
Bloomberg Cotton Subindex	-15.1%	32.4%	9.1%	-13.4%	-18.4%
Bloomberg Live Cattle Subindex	-9.0%	-5.0%	5.4%	4.7%	-19.0%

Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P., DWS Investment Management Americas Inc. as of 3/23/20

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