CIO | VIEW
CIO Commodity Commentary
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DWS

# COMMODITIES SHOW A STRONG REBOUND YEAR TO DATE WITH OIL CONTINUING TO RUN AHEAD

Darwei Kung
Head of Commodities

IN A NUTSHELL

- In spite of a challenging macroeconomic backdrop, commodities performed well during the first quarter.
- The metals space has found some support from news on progress in the trade dispute and additional stimulus in China by VAT cuts. We believe that risks can emerge from macro headwinds, negative headlines out of China and, in particular, from U.S. dollar strength in light of our tactically positive outlook on the U.S. dollar against the euro.
- In contrast to energy and metals, agriculture was a laggard the past month. The U.S.-China trade negotiations are a critical factor for the entire agriculture space, but also for commodities overall as any potential resolution of the trade war should improve macro sentiment and provide a tailwind to commodities.

Brexit twists, trade negotiations, weaker economic data, dovish central banks and our belief of peak growth last year along with elevated levels of volatility, creates a challenging market environment. This in turn makes the positive momentum of commodities all the more attractive. Whether that momentum can be maintained depends largely on how economic activity evolves making a correction likely in case of lacking improvement in macroeconomic data.

In spite of this macroeconomic backdrop, commodities performed well during the first quarter.

Stricken by a tough fourth quarter in 2018, investors can finally breathe a sigh of relief as most asset classes have rebounded year to date. Month-end performance data were almost unchanged, which is in contrast to the roughly 8% year-to-date gain of the Bloomberg Commodity Index. A large part of this increase can be traced to the developments in the energy space. Ambitions by OPEC and Russia to curb supply under the OPEC+ agreement finally translated into higher prices. Compliance, however, with the oil production cuts was unequally distributed. Whereas Saudi Arabia has been the largest contributor to achieving the agreed targets – which is in stark contrast to its non-compliance in 2018 – Russia, another grand player in the oil industry, only gradually moved towards the target. This development is, however, critical for the oil price in light of the United States' high production volumes. OPEC+ agreed that, going forward, they will cancel the April 2019 meeting to review production quotas given rising inventories, upcoming Iran waiver[1] renewals and the expected jump in U.S. shale production. Consequently, they announced to resume meeting later in the year, namely at the end of June. In our view, ample spare production capacity and a heavy dependence on supply cuts in order to support higher prices should limit any major upside potential for crude oil. OPEC members' compliance and a slowdown in global demand remain two key downside risks to prices this year, with major supply disruptions due to geopolitics serving as the only major upside risk.

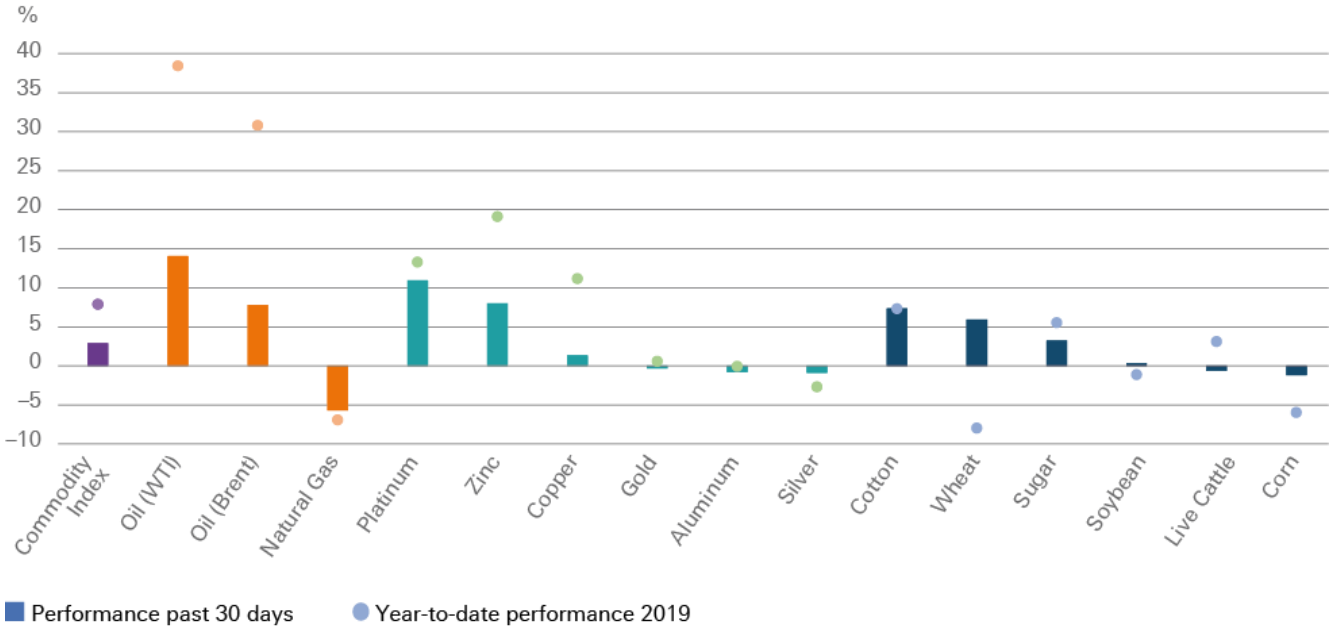
The metals space has found some support from news on progress in the trade dispute and further stimulus in China by value-added-tax (VAT) cuts in manufacturing, transport and construction. Of the base metals, zinc has been an outperformer over the past month, benefitting from low inventory levels. Similarly, copper recovered well year-to-date and should be further supported by the latest Chinese Purchasing Manager Index (PMI) data lowering inventory levels; however, an economic slowdown for the remainder of the year, as forecasted by DWS, could be a drag on copper prices. Additionally, we believe that risks can emerge from arising macro headwinds, negative headlines out of China and, in particular, from U.S. dollar strength in light of our tactically positive outlook on the U.S. dollar against the euro. Meanwhile, on the precious-metal front, gold's performance has been almost unchanged in March, it surprised by sticking to its usual anti-cyclical behavior. This is in con-

[1]The United States granted Iraq again a 90-day waiver allowing it to source energy from Iran and thereby exempting it from U.S. sanctions.

trast to mid last year until January, where it exhibited a continuous upward trend while the S&P 500 showed a V-shaped performance. In March, however, U.S. dollar strength had lent some headwinds to gold prices, whereas gold rallied late in the month on weaker U.S. macroeconomic data and increasing uncertainty over Brexit and an inverted yield curve. Our gold-price forecast implies a continued moderate appreciation as several of the risk factors supporting our bullish view on gold remain in place. Comments from the U.S. Federal Reserve (the Fed) officials indicate the tightening cycle may be more uncertain and a shift in the Fed's rhetoric now leads to a slower implementation of future interest-rate hikes while inflation does not seem to be increasing. These developments have driven down rate-hike expectations, which should also benefit gold.

In contrast to energy and metals, agriculture was a laggard the past month. Grains were initially weaker on continued news of the spread of the African Swine Fever (ASF) throughout China. This is particularly critical as China is a leading pork-consuming country which usually requires large quantities of grains to feed its hog herds. The bounce back towards the end of the month was caused by increased demand ahead of the planting season. Additionally, severe weather conditions in the Midwest increase the chances of a delay in crop planting in the United States overshadowing the reported planting intentions by the United States Department of Agriculture for key crops. It is therefore critical to observe the development of the ASF, potentially causing further demand destructions for feed grains as well as the potential delay of plantings in the Northern Hemisphere due to the wet spring. Finally, the U.S.-China trade negotiations are a critical factor for the entire agriculture space, but also for commodities overall as any potential resolution of the trade war should improve macro sentiment and provide a tailwind to commodities.

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




Sources: Bloomberg Finance L.P., DWS Investment Management Americas Inc. as of 4/8/19

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

| | 03/14 - 03/15 | 03/15 - 03/16 | 03/16 - 03/17 | 03/17 - 03/18 | 03/18 - 03/19 |
|---|---|---|---|---|---|
| Commodity Index | -27.1% | -19.7% | 8.3% | 2.5% | -7.3% |
| Oil (WTI) | -52.4% | -42.2% | 9.7% | 24.2% | -6.9% |
| Oil (Brent) | -51.7% | -40.3% | 15.7% | 28.9% | -1.1% |
| Natural Gas | -45.0% | -47.3% | 16.5% | -29.4% | -3.5% |
| Gold | -8.2% | 3.9% | -0.3% | 4.0% | -4.9% |
| Silver | -17.1% | -8.1% | 15.5% | -13.0% | -9.9% |
| Platinum | -19.9% | -14.9% | -3.7% | -3.7% | -10.5% |
| Copper | -9.3% | -21.2% | 19.0% | 10.7% | -5.6% |
| Aluminum | -4.1% | -19.8% | 26.3% | -1.2% | -4.6% |
| Zinc | 2.8% | -15.0% | 49.9% | 18.3% | -6.4% |
| Corn | -31.5% | -15.9% | -5.6% | -7.0% | -19.6% |
| Wheat | -31.8% | -10.6% | -22.9% | -12.3% | -10.7% |
| Soybean | -21.9% | -5.4% | 1.8% | 4.9% | -21.6% |
| Sugar | -46.4% | 17.1% | 4.0% | -29.7% | -6.8% |
| Cotton | -25.2% | -9.6% | 29.6% | 5.8% | -6.1% |
| Live Cattle | 13.1% | -15.9% | -0.6% | -8.1% | 14.7% |

Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P., DWS Investment Management Americas Inc. as of April 2019

## GLOSSARY

### Appreciation
In relation to currencies, **appreciation** refers to a gain of value against another currency over time.

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

### Brexit
**Brexit** is a combination of the words "Britain" and "Exit" and describes the exit of the United Kingdom of the European Union.

### Bull market
A **bull market** is a financial market where prices are rising - usually used in the context of equities markets.

### Central bank
A **central bank** manages a state's currency, money supply and interest rates.

### Inflation
**Inflation** is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

### Organization of the Petroleum Exporting Countries (OPEC)
The **Organization of the Petroleum Exporting Countries (OPEC)** is an international organization with the mandate to ”coordinate and unify the petroleum policies“ of its meanwhile 12 members.

### Purchasing Managers Index (PMI)
The **Purchasing Managers Index (PMI)** is an indicator of the economic health of the manufacturing sector in a specific country or region.

### S&P 500
The **S&P 500** is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

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

### Value-added tax (VAT)
A **value-added tax (VAT)** is a consumption tax that is collected based on the incremental value added in each stage of production (as opposed to a sales tax where only the final consumer is taxed).

### Volatility
**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.

### Yield curve
A **yield curve** shows the annualized yields of fixed-income securities across different contract periods as a curve. When it is inverted, bonds with longer maturities have lower yields than those with shorter maturities.

### Yield-curve inversion
A **yield-curve inversion** is when the yields on bonds with shorter duration are higher than the yields on bonds that have a longer duration.

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