

OUR MONTHLY ANALYSIS AND OUTLOOK ON COMMODITIES



Darwei Kung
Head of Commodities and
Portfolio Manager

IN A NUTSHELL

- Tactically, it is likely that short-term supply-side risks will continue to support oil prices. Strategically, however, we stick to our forecast of \$60 per barrel for WTI by June 2020.
- Within the base-metals space, idiosyncratic stories are dominating. We have revised our strategic gold forecast upwards to \$1,400 per ounce.
- On the agricultural front, bad weather conditions earlier in the year continue to have repercussions today.

As the first half of the year has elapsed, it is time to take stock of the developments within the commodities space. Some key price drivers changed quite dramatically; notably the move of central banks towards dovish monetary policies has had a sizeable impact across the board. By contrast, others remained broadly the same, including the lingering U.S.-China trade conflict. While broad commodity indices exhibited a solid performance year-to-date, this was mainly due to oil, gold and corn.

Let's have a closer look at the underlying causes of performance so far and how they might keep us busy in the second half of the year. In the energy space, many of the drivers from the first half of the year carry over. The supply-side risks in the oil market, which we outlined in our last commentary, have now started to materialize [[CIO Commodity Commentary as of 6/13/19](#)]. Several countries, including India, have actively been shifting their oil sourcing away from Iran, typically increasing imports from the United States instead. Unsurprisingly, these shifts away from Iranian crude are already showing up in the numbers. Iranian exports are 80% lower than last year and there are fears that the latest round of sanctions could escalate the conflict with Tehran even further. The seizure of a British tanker at the Strait of Hormuz is just another act of despair that increases the possibility of a supply

disruption, potentially impacting production in the wider region. The oil price, however, has not only been grinding higher because of geopolitical risks materializing, but to a lesser extent because OPEC+ (including non-OPEC members, such as Russia) extended their production cuts until 2020. While Saudi Arabia is willing to shoulder most of the cartel's cuts, sticking together in these turbulent times sends a very positive signal in our view. In addition, the latest data of the U.S. Energy Information Administration (EIA) showed a decrease in the counter-seasonal crude-oil inventory builds – further supporting the oil price.¹

Instances like the complete destruction of an alkylation unit at a Philadelphia oil refinery during the past month pushed prices higher. Tactically, it is likely that short-term supply concerns prop up oil prices further – e.g. the hurricane season. Strategically, however, we stick to our forecast of \$60 per barrel for West Texas Intermediate (WTI) by June 2020. Lacking progress in the U.S.-China trade talks would continue to weigh negatively on oil demand and additionally, heavy non-OPEC supply growth contributes to weaker oil prices. Continued U.S. shale-output growth will likely reduce OPEC's market share further, potentially changing the market permanently. Technological cost savings coupled with an abundance of the raw material would allow for a continuous downward trend in prices –

¹Source: <https://www.eia.gov/petroleum/weekly/crude.php> as of 7/11/19

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making it harder for OPEC to regain market share. This is in sharp contrast to traditional mining exploration where the costs of the next exploration project are usually higher than the previous one, so that prices naturally trend upward.

Unlike crude oil, prices for its close cousin natural gas went down year-to-date. Excess supply from the output surge last summer and a mild winter did not really contribute to a depletion of inventories. Hence we do not expect Storm Barry and the consequential shut-down of wells and ports in the Gulf of Mexico to yield much support for natural gas prices. Not least because the boom in shale contributed to a lower dependence on offshore gas. While prices are strategically driven by a structural oversupply, markets are tactically driven by weather conditions. The summer heat during the past weeks contributed to the positive performance lately. In the coming weeks, warm temperatures may well provide further upside for the price.

While natural-gas prices are relatively unaffected by the trade conflict, industrial metals are very sensitive to the state of the Chinese economy as it is a primary demand generator. The unresolved trade conflict between the United States and China still hangs like a Sword of Damocles over base-metal prices. The mere absence of negative headlines after the G20 summit contributed to a short-lived rally at least in copper prices. Also, labor strikes at one of the world's largest copper mine supported prices. As evident from the graph, however, there is no clear trend among the various base metals. Idiosyncratic stories dominate the space. In the coming weeks, we believe that copper will fail to find a strong bullish catalyst and lower gross-domestic-product (GDP) growth in China could dampen its tactical outlook. Our tactical outlook on zinc is equally gloomy as trade-related uncertainties translate into lower demand numbers. Coupled with capital expenditures increasing supply efficiency, the zinc market is oversupplied. Iron ore on the other hand should benefit from higher demand due to credit easing and increased infrastructure spending in China.

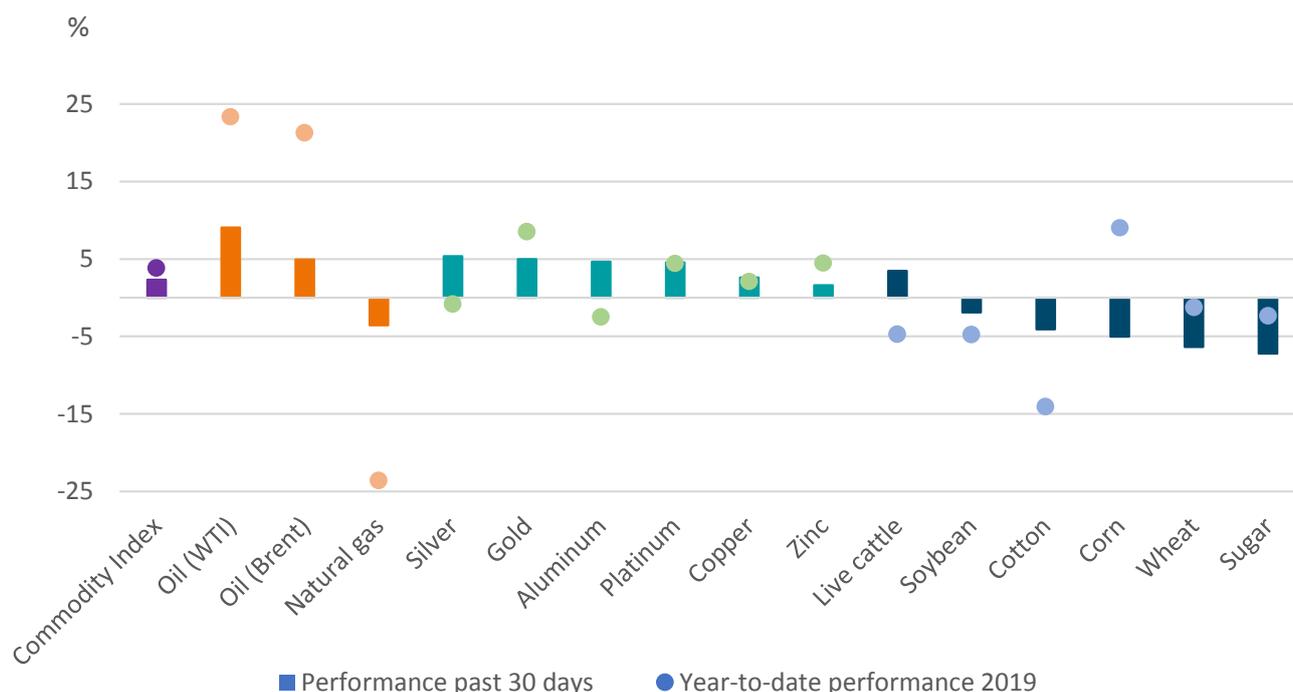
Due to the shift in the central bank's reaction to market sentiment, we have recently updated our thinking on the U.S. Federal Reserve (Fed) interest-rate policy. We now expect two Fed interest-rate cuts of 25 basis points (bps) each [[CIO Flash: Adjusting our 12-month targets as of 6/25/19](#)]. As a result, we revised our strategic gold forecast upwards to \$1,400 per ounce. Lower interest rates not only make a U.S. dollar (USD) appreciation less likely, but also decreases the opportunity cost of holding gold relative to lower yielding U.S. Treasuries. Likewise, safe-haven flows into the asset class in light of geopolitical risks and unresolved trade tensions continue to support the gold price. We stick to our strategically positive outlook, despite a significant climb in non-farm payrolls by 224,000 in June and the resulting decline in the gold price.² Tactically, we continue to be cautious as the gold market currently prices in a 50 bps cut and any change in sentiment could see a sharp reversal to the downside.

On the agricultural front, bad weather conditions earlier in the year continue to have repercussions today. In our view, July's acreage report was widely misunderstood and should be taken with a grain of salt. The farm survey, conducted in early June, indicated 91.7 and 80.0 million planted acres of corn and soybeans, suggesting little to no prevented planting in the United States. However, the United States Department of Agriculture (USDA) later clarified that 17% and 41% of those "planted" acres, respectively, were in fact "intended" to be planted at the time of the survey. In most years, there is typically only a very small percentage of intended acres and thus these planted estimates are highly suspect. Accordingly, the USDA will conduct another survey in July and correct the figures in August. We expect this August report to show significantly lower planted acres and thus see further upside to grains, particularly corn and soybeans. We will closely monitor the evolution of the weather conditions as they remain the primary driver in the agricultural market.

²Source: <https://www.bls.gov/news.release/pdf/empst.pdf> as of 7/5/19

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



Sources: Bloomberg Finance L.P., DWS Investment Management Americas Inc. as of 7/15/19

GLOSSARY

Appreciation

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

Basis point

One **basis point** equals 1/100 of a percentage point.

Central bank

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

Dove

Doves are in favor of an expansive monetary policy.

G20

The **Group of 20** are the largest industrialized and emerging economies in the world.

Gross domestic product (GDP)

The **gross domestic product (GDP)** is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

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.

Treasuries

Treasuries are fixed-interest U.S. government debt securities with different maturities: Treasury bills (1 year maximum), Treasury notes (2 to 10 years), Treasury bonds (20 to 30 years) and Treasury Inflation Protected Securities (TIPS) (5, 10 and 30 years).

U.S. dollar (USD)

The **U.S. dollar (USD)** is the official currency of the United States and its overseas territories.

U.S. Energy Information Administration (EIA)

The **U.S. Energy Information Administration (EIA)** is a principal agency of the U.S. Federal Statistical System responsible for collecting, analyzing, and disseminating energy information.

U.S. Federal Reserve (Fed)

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

West Texas Intermediate (WTI)

West Texas Intermediate (WTI) is a grade of crude oil used as a benchmark in oil pricing.

Yield

Yield is the income return on an investment referring to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

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