CIO | VIEW
CIO Commodity Commentary
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DWS

Marketing Material

OUR MONTHLY ANALYSIS AND OUTLOOK ON COMMODITIES

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IN A NUTSHELL

- While acknowledging demand concerns due to ongoing trade tensions, we believe corn and soybeans have the potential to outperform.
- Our oil outlook is darkening for the next few months. We believe that neither increased oil demand nor OPEC's production cuts will be able to absorb increased supply by North America, Brazil and Norway.
- While macroeconomic uncertainties have taken a toll on the more cyclical commodities, gold has stood out. In addition to these trade-related risks, high valuations in equities and a potential economic slowdown make gold attractive in this environment.

Slowing global growth is starting to become visible in macroeconomic data – from weaker manufacturing data, in particular in Germany to lower reported gross-domestic-product (GDP) growth across the globe. While these developments are not necessarily new, the recent escalation of the trade conflict between China and the United States highlights how quickly the world economy could lose its balance. Following the announcement of a new round of tariffs, China has suspended the purchase of U.S. agricultural products, a measure that particularly affects farmers in the Midwest of the United States [CIO Flash as of 8/6/19]. To meet domestic demand, China will probably buy soybeans from Brazil and Argentina. However, uncertainty surrounding trade talks and production will likely continue to plague key agricultural products.

As evident from the chart, the entire agricultural sector performed very weakly. The sector got off to a difficult start after a bearish United-States-Department-of-Agriculture (USDA) acreage report, as of the end of June. Positive political signals on trade following the G20 meetings failed to boost markets, even before the recent re-escalation of tensions. Nevertheless, we expect that corn and soybeans will have the potential to outperform. Of course, we acknowledge demand concerns. However, demand risks from trade talks have overshadowed the supply concerns due to bad weather conditions earlier in the year. For now, the impact of reduced planting acreage is still absent from World-Agricultural-Supply-and-Demand-Estimates (WASDE) published by the USDA. Once it starts showing up in the reports, we believe that the attention of market participants – currently very nervous about the rekindling trade war – could rapidly shift from weak demand to even weaker supply. Either way, we would expect to see increased volatility in the market.

Speaking about volatility, oil has exhibited very sharp movements recently. During July, geopolitical crises provided support for the oil price. However, on August 1, it had the largest one-day decline since 2015 after President Trump announced the imposition of 10% of tariffs on another $300 billion worth of Chinese imports. Given this decline, we believe that the oil price currently reflects fair value. We believe that slightly weaker year-over-year demand, coupled with the manifestation of continuing supply-side risks should balance the market in the short term. Toward the end of the year, however, we expect production in North America, Brazil and Norway to pick up, providing a headwind for oil prices. At the same time, we expect oil demand to pick up, partially due to seasonality. We believe, however, that neither increased demand nor OPEC's production cuts will be able to absorb in-

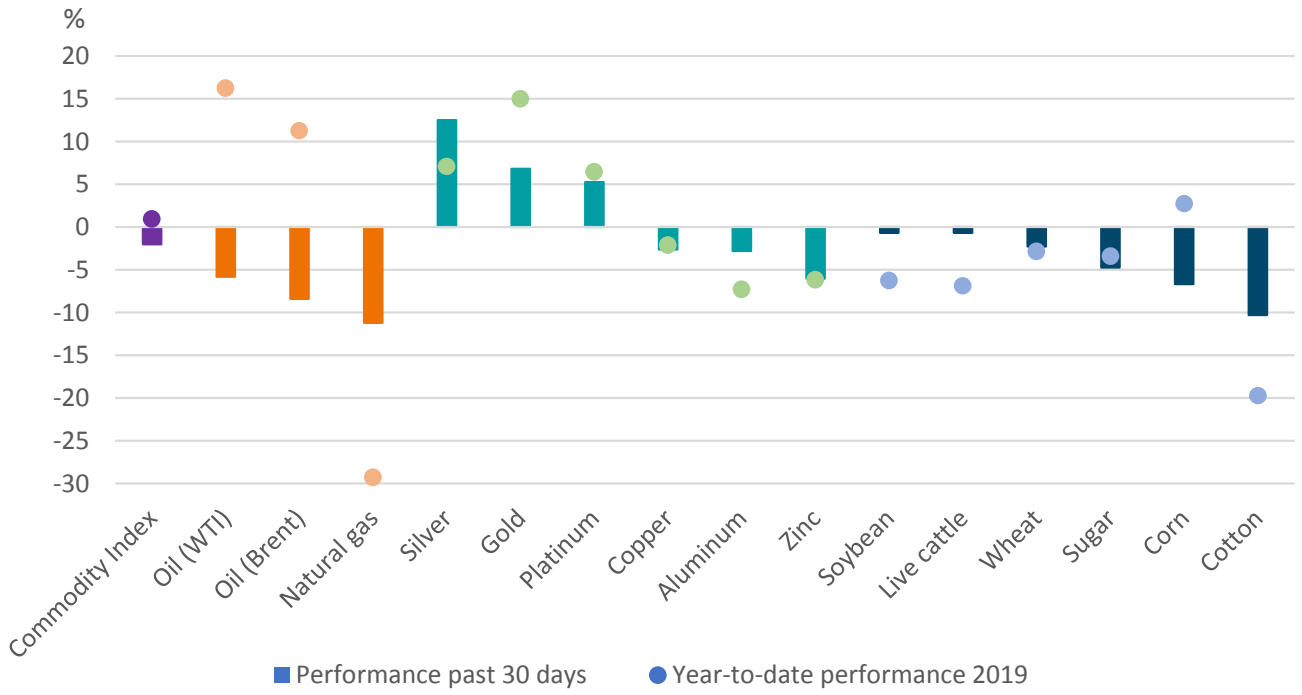
creased supply to keep the market in balance. Consequently, we have switched our strategically positive view on the oil price to neutral with a slightly negative outlook.

Amidst these developments, China's currency devaluation has further shaken things up for a wide range of commodities. It also brought the trade conflict close to a fully-fledged currency war. This is critical as a weaker yuan will make oil more expensive for Chinese consumers, which could, in turn, weaken demand further. The Middle Kingdom's attempt to limit the yuan weakness should, however, dampen such fears. Nonetheless, China will likely attempt to avoid U.S. crude, given ongoing trade tensions.

And while macroeconomic uncertainties have taken a toll on the more cyclical commodities, gold stood out during the past 30 days. Silver did even better, while the gold/silver ratio flirted with all-time highs previously. Despite the recent positive performance however, we remain tactically neutral. The main reason is that while the cut of the federal funds rate by 25 basis points (bps) weakened the U.S. dollar slightly, the U.S. currency is again trading at pre-interest-rate-cut levels. One reason for continuing dollar strength might be the July Federal-Open-Market-Committee (FOMC) meeting comments which were interpreted by the market as hawkish. Such dollar strength looks set to limit the upside of gold in the short term. In the longer term, we believe that a slowdown in global trade is likely to persist and emerging-market (EM) central banks will likely continue to diversify their reserves into gold. High valuations in equities, the metal's relative attractiveness to U.S. Treasuries and a potential global economic slowdown may also make gold a relatively attractive asset class to consider.

As long as macro headwinds persist, we keep our cautious outlook on base metals. Once these clouds move aside, we expect attention to shift to the fundamentals, which already look quite supportive in many instances like copper. For now, however, trade-related volatility looks set to continue to overshadow even relatively healthy fundamentals.

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



Sources: Bloomberg Finance L.P., DWS Investment Management Americas Inc. as of 8/9/19

GLOSSARY

Basis point
One **basis point e**quals 1/100 of a percentage point.

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

Chinese yuan (CNY)
The **Chinese yuan (CNY)** is legal tender on the Chinese mainland and the unit of account of the currency, Renminbi (RMB).

Devaluation
Devaluation is the forced reduction of the value of a currency against other currencies.

Emerging markets (EM)
Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

Federal funds rate
The **federal funds rate** is the interest rate, set by the Fed, at which banks lend money to each other, usually on an overnight basis.

Federal Open Market Committee (FOMC)
The **Federal Open Market Committee (FOMC)** is the committee that oversees the open-market operations (purchases and sales of securities that are intended to steer interest rates and market liquidity) of the U.S. Federal Reserve.

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.

United States Department of Agriculture (EN only)
The **United States Department of Agriculture** is the U.S. federal executive department responsible for developing and executing federal laws related to farming, forestry and food.

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.

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