A Year In Review

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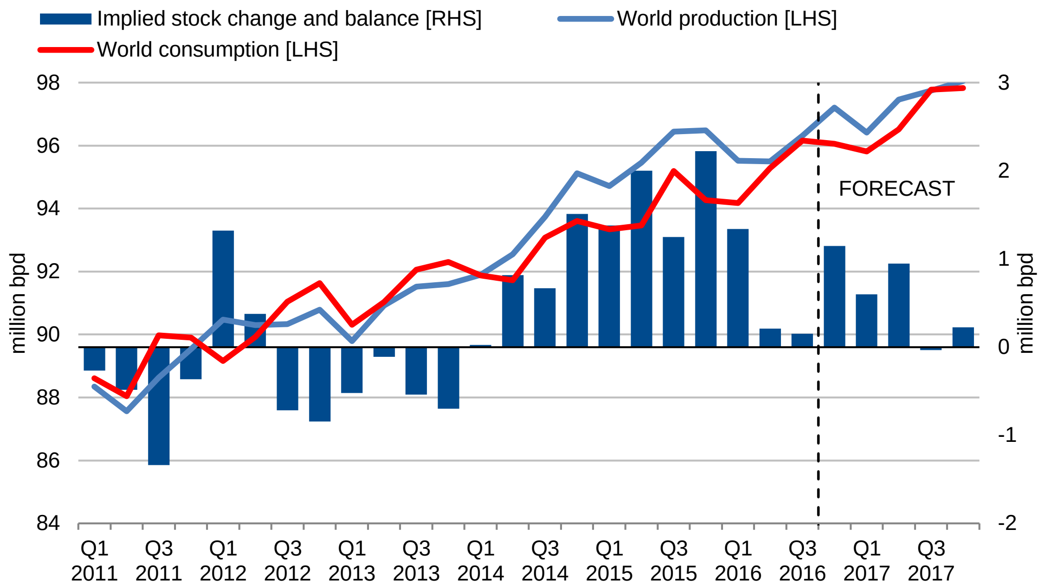
Crude Market Fundamentals: *Continued drawdowns of stocks indicate a balanced market in Q3 2017 after OPEC cuts.*



Source: EIA

In March we analysed the crude oil contango and deciphered whether or not there was scope in the storage trade whereby investors buy and hold the asset in onshore or offshore storage facilities to maximise gains from the contango in the forward curve. We calculated that in 2009 when the Baltic Exchange Dirty Tanker Index (BIDY) was at its lowest point, the 12 month contango was at $10.61/bbl. At this time the trade would have yielded approximately $21m, with relatively low risk.

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At this time, 300k DWT VLCC daily rate was $38,000 adding crew, fuel and other costs totalling $13.87m for the year we suspected this trade would have made $7.35m. In March the contango was not as steep at $6.50 and the 12-month rate is around $47,000/day or just over $17m for the year.

Applying the same metrics we calculated that the success of the floating storage trade was questionable and actually yielded a loss of $2m. While we concluded that at these price points the trade would not be profitable, we did suggest that onshore storage, if you could find it, would see decent returns.

In our September report we revisited the topic and noted that the forecasts were slightly modest as front month Brent futures were trading comfortably around $50/bbl. Unfortunately for investors, as it transpired, the timing was off and, the oversupply of tankers pushed the daily rates lower towards $31,500/day after the low for Brent near month.

In the September report we suggested how OPEC may introduce a production freeze or cut; admittedly we were dubious about the chances of such a deal but it seems that we were slightly harsh on the cartel. This, along with uninspiring global demand and enhanced efficiency from US shale producers led us to the outcome of range bound trading activity for the remainder of the year; which has largely been proved right.

As the year progressed it became apparent that we underestimated the onshore storage trade new capacity has since been built at a quickening rate a quickening pace, however our calculations for the offshore were correct but the trade didn't work.

In summary, the theory and the application behind the analysis was correct however in September's report we underestimated the markets and OPECs ability to strike a deal.

2017 Outlook

The recent OPEC decision has sent prices soaring towards $55/bbl posting a high for the year, since the announcement front month Brent contracts have bounced 18% ($8.82/bbl). This will be boosted by deals to cut production with non-OPEC members; we are sceptical about Russia actually keeping to their word.

Global stocks are predicted to continue to fall in the coming quarters with PIRA predicting the stock surplus to end in Q3 2017. This would add further support to prices; however we still expect US shale oil to be a swing factor and provide headwinds to prices, capping the upside.

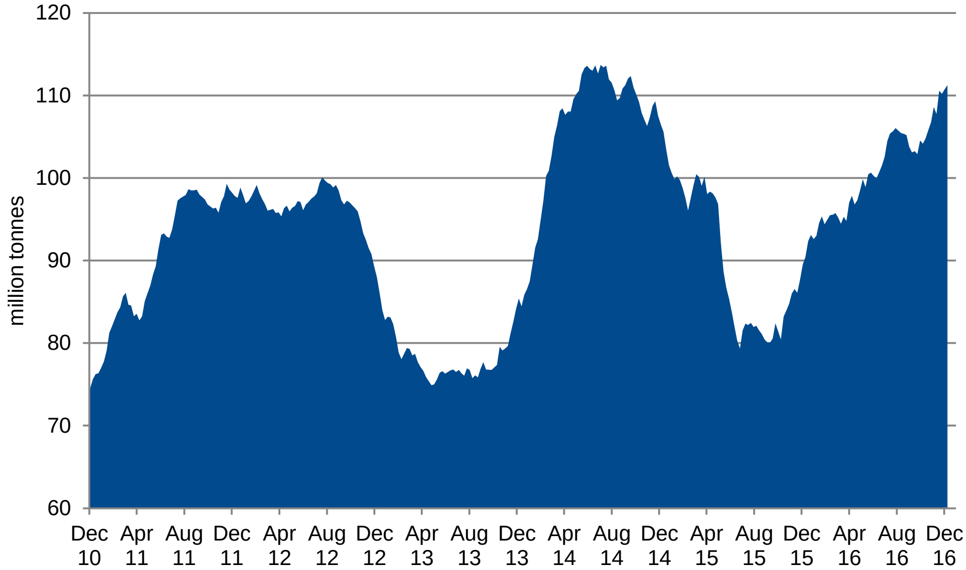
"We suspect prices to trade between $50-60/bbl in 2017 with prices nudging towards $65bbl if stocks are drawn-down in a material way…
"

We suspect prices to trade between $50-60/bbl in 2017 with prices nudging towards $65bbl if stocks are drawn-down in a material way, seasonal averages would be the benchmark level but even then given the steady pace of demand growth, any dip towards these levels could in fact signal a tighter market outlook than top line figures would suggest.

Iron Ore Stronger for Longer

Given the fundamental outlook and the dependence on China construction & manufacturing sectors to boost the economy, we felt that there was a case for iron ore to stay well supported throughout 2016. We still hold the view that the Chinese economy is overweight industrial and manufacturing capacity, excess capacity which will in time need to be shuttered as the economy transitions towards services. However, for the medium term we anticipate continued support and stimulus measures to smooth this transition and avoid a hard landing.

SteelHome Iron Ore Port Stocks: *Inventories have risen steadily in 2016.*



Source: Bloomberg

“Spot prices followed SHFE futures higher with front month rebar contracts gaining 50% throughout H2…”

As a result, prices have overshot our previous target of $70/tonne, finding bids above $80/tonne in recent weeks as encouraging PMI and industrial production data coming out of China illustrated the desired impact of stimulus measures by the NDRC. Spot prices followed SHFE futures higher with front month rebar contracts gaining 50% throughout H2, picking up considerable pace since the US election as uncertainty began to subside and event risk diminished.

Given the widespread risk on appetite permeating global markets spot cargoes have remained well supported above $80/tonne in recent sessions in defiance of the underlying fundamentals. Steel production growth is expected to remain broadly unchanged next year, with only a modest 1-2% y/y increase anticipated and while infrastructure spending will remain supporting into the coming year the outlook suggests that ample supply and lower per capita consumption could act as headwinds and cap any further upside potential.

Adding to the headwinds will be softer coking coal prices as marginal capacity responds to the recent surge, bringing down the recent cost inflation for steel producers.

For now, seaborne iron ore prices seem well supported towards $70/tonne on speculative appetite alone, but with stocks at Chinese ports high, above 110m tonnes and back towards 2014 levels, we could see some tempering of spot prices in early 2017 as we approach Chinese New Year and a potential return back towards 460/tonne towards the end of Q1.

Gold Silver Ratio

Historically when the gold silver ratio has hit 80 there has been a sharp fall mean reversion with targets towards 65 where we see expect consolidation before extending the move. In February, the ratio hit 83 and we decided to investigate the trade to see if outlook differed this time around. Since writing, the ratio has traded within a range of 65 and 74 with the current ratio standing around 71.

“The fundamental outlook remains bullish for silver, as unprecedented demand from jewellery and industry, specifically solar power, driving gains.”

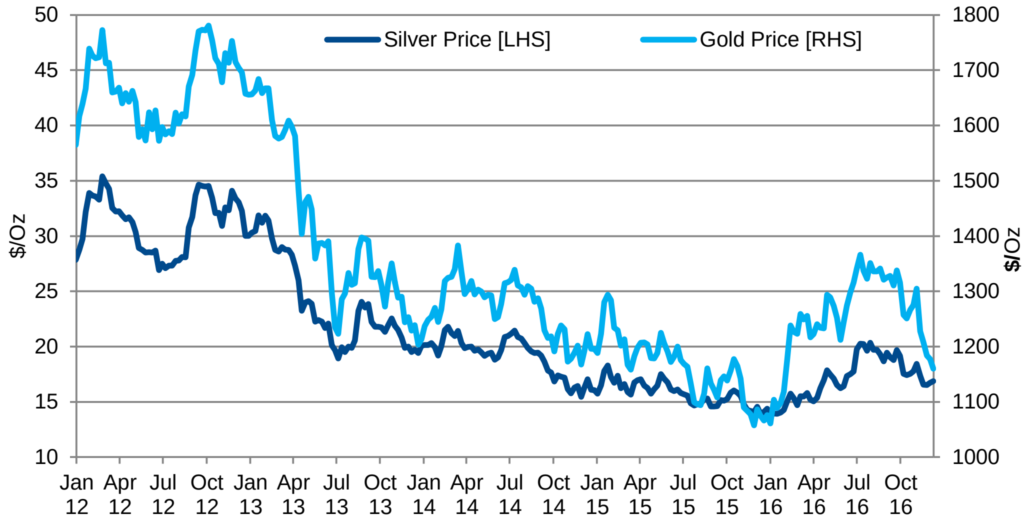
The fundamental outlook remains bullish for silver, as unprecedented demand from jewellery and industry, specifically solar power, driving gains. The supply side however was weaker, principally as a result of the majority of silver is produced as by-product of base metals mining such as copper, zinc and lead.

The downward trend of these commodities in recent years has caused the big miners to rack up considerable debt and cut loss making mines; these closures worsened the silver deficit as supply was further limited. With these factors considered we suspected that the silver market would fail to see much improvement on the previous year’s 112.5m ounce deficit.

We suspected that the gold/silver ratio would fall towards 60 citing that gold prices, at the time, remained supported above $1,250/oz by risk aversion and macro concerns and silver would outperform gold. Our view was that the silver spot price could post gains towards $20/oz. In July the spot price recorded a high for the year at $21.13 per troy ounce. We believe this was largely due to events increasing global uncertainty and appetite for safe haven assets.

We revisited the topic of gold in October in an attempt to provide a path in which investors could navigate the potential market turbulence ahead. We felt that in the near term market forces could see gold prices trade towards $1,300/oz due to uncertainty in the global economy especially the US election. However, the looming prospect of rising rates in the US along with lacklustre physical demand for gold in Asia, led us to believe that as these events past the market could fall towards support at $1,200/oz with potential for $1,170/oz, currently the spot price is trading at $1,160/oz.

Spot Gold vs. Spot Silver: *Both metals have fallen on improving risk appetite.*



Source:Bloomberg

Further headwinds to prices can be seen in investor sentiment as the total known ETF holdings, after hitting a yearly high in mid-October of 64.33m troy ounces, have seen sharp decline since the US election to 59m troy ounces as of December.

2017 Outlook

The recent silver price fixing case is likely to lead to some downside pressure in the short term as the investigation deepens, however the fundamentals remain bullish and we expect contracts to be supported by this. In last few weeks the money managed net length has fallen below the year-to-date (YTD) average of 58,000 contracts with the ETF holdings having also fallen to 657m troy ounces from 675m.

Silver has a stronger fundamental outlook which may see the commodity strengthen towards the 200 day moving average at $17.76/oz. Physical demand remains strong and as only a quarter of silver is produced from dedicated silver mines, supply prospects remain weak. Despite a strong fundamental outlook, we may see silver soften in the first few months of 2017 as the commodity suffers from a strong dollar and a rate increase from the US Federal Reserve.

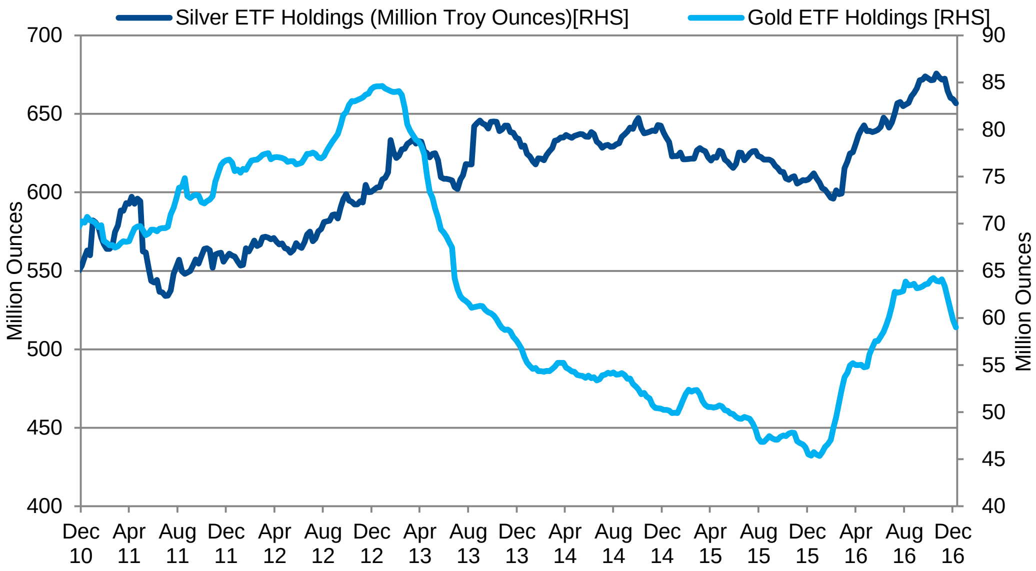
"We anticipate gold will face strong headwinds in 2017…"

We anticipate gold will face strong headwinds in 2017 as a result of similar factors, the strong dollar has exercised considerable influence on gold and we expect the Greenback to remain strong in 2017.

Furthermore higher bond yields and US interest rates may see bullion continue to lose its allure in the first months on 2017. The extent of the yellow metal decline is reliant on the route the Fed takes. Chair Janet Yellen in her most recent meeting has indicated the she may increase rates three times next year, we expect bullion will continue its downtrend however after this year we remain wary of Fed promises to increase interest rates.

One bright spot could be Europe as prolonged uncertainty keeps investors on the lookout for safe haven assets. Political instability in many of the continent's major countries looks set to continue next year with the French, Dutch and German Presidential elections…dare we mention the UK's invoking of Article 50 as well?

Gold & Silver ETF Holdings: *Both have seen a drawdown in holdings this quarter.*



Source: Bloomberg

Further event risk including but not exclusively Middle East uncertainty and the inauguration of President Trump could provide some short term upside potential. As a result the gold/silver ratio, which currently trades at 71, could soften towards the 65 on gold weakness, however demand for silver remains strong suggesting we could remain range bound trading either side of 70 with potential for spikes lower.

Blue Skies Ahead for Soybeans

Back in June the Soybean active contract was up 34.55% year-to-date, this move was largely driven by a weak supply outlook. Disruption to the Argentinian harvest due to flooding culminated in 2016 total production of 56.8m tonnes, down from 61.4m tonnes. Prices soared to a high of $11.82/bushel. When the report was written, the US harvest was starting and although there were signs of a strong yield, we did not expect for total production to reach 107m tonnes, equalling last year's record crop.

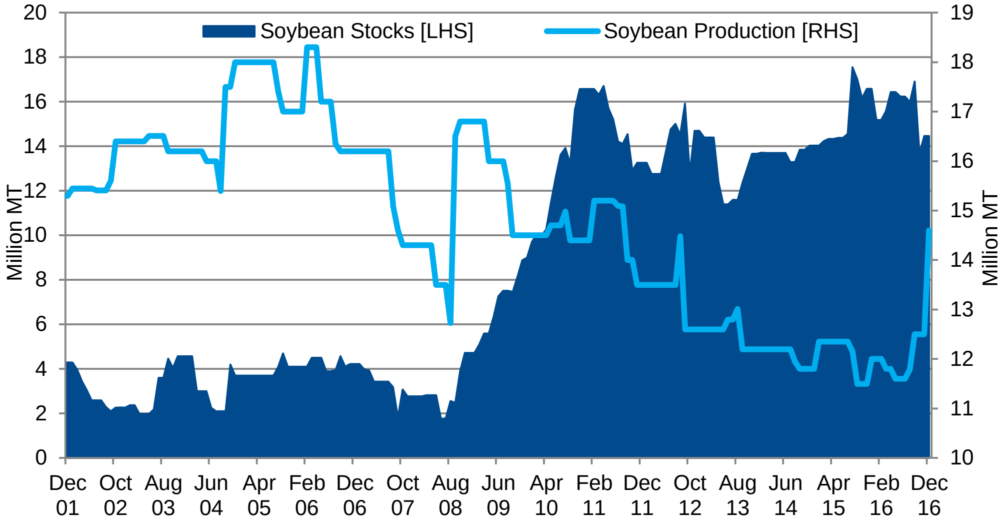
As the market realised the magnitude of a strong US crop we saw prices soften. Prices remained well supported at around $9.50/bu despite the strong production number. In recent weeks we have seen the active futures contract advance back towards $10.50/bu, these moves once again are built on bullish demand figures.

"Demand for soybeans in China was forecast to grow by 3.8m tonnes…"

Demand for soybeans in China was forecast to grow by 3.8m tonnes by USDA this year, with the majority being used for animal feed. This strong consumption data led us to believe that soybean futures would remain well supported going into Q1 2017.

Although we did not put a price target on soybeans, we feel due to the strong demand outlook futures could remain above $10.00/bu in the short term with potential for spike higher. As we move into 2017 and harvests start once more we suspect that prices may retreat back towards $9.50/bu on the record crop.

China Soybean Stocks vs. Production: *Domestic production looks to get back to previous highs despite high stock levels.*



Source: Bloomberg

2017 Outlook

Persistent Chinese demand look set to support the market going into 2017. The USDA forecasts that Chinese consumption will be around 100m tonnes as imports increase to 86m tonnes as well as growth in domestic production growing also to 14.1m tonnes, up from an estimated 12.5m.

These figures seem to be at the top end of the spectrum; however the Asian economy's GDP per capita is still growing at faster rate than its population. The uncertainties of Chinese imports lie with the domestic harvest as well as the price and timing the government auctions off reserve stocks.

Incentives for production in China to rise further are likely to be affected by the government's decision on stocks. These ending soybean stocks according to USDA data stands at 14.46m tonnes which are considerably higher stocks above the 10 year average of 10.73m tonnes.

Despite our reaffirmation that Chinese demand for soybeans will remain high, there are certainly factors that could impact prices, prompting a retreat to the downside. The strong dollar is likely to add downward pressure along with any indication of an increase in acreage from US farmers.

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Speculators drive commodity gains

Low economic growth and inflation coupled with zero to negatively yielding bonds remained the story when we embarked on our July piece about speculators driving commodity gains. Central banks around the world continued to embark on what was seemingly ineffective monetary policy, failing to influence the markets.

Going into July, the S&P 500 was up 3% year-to-date, with the FTSE trading up 3.40% year-to-date with major sovereign bonds also yielding low to negative returns, investors were on the hunt for alpha with the commodity market the willing acceptant after years of lacklustre performance.

High levels of volatility prompted investment flows of $54bn into the commodities industry, which is an all-time high for the first 8 months of the year. This was especially evident in the metals space where we saw the 3 month rolling copper contract trade in a range of $1000 in a day, moving $500 up and down in the same session. We suspect the rise of the algorithmic trader may have had an impact on these moves, which backs up our proposition of speculators driving commodity gains.

However, our view also suggested that currency volatility could take its toll on the commodity market. Commodities have an inverse relationship with the dollar .A strong Greenback, whilst helping those exporting goods, increases costs for producers and growers. Consumers not paying in dollars will witness goods becoming more expensive. The agriculture complex has seen suffered from the strengthening dollar, this is also due to the initial weakening of LATAM currencies after the US election.

The closing quarters of 2016, until now, have been supportive for the majority of the commodities complex, with copper, zinc and nickel in particular recording impressive gains, thus bucking the traditional trend of weakening as the dollar strengthens.

"…however moves have been exaggerated by speculators causing the market to overheat"

Brent and WTI have kick on in recent sessions since the OPEC meeting. It is worth noting that moves in these commodities have been off the back of fundamental news. A bullish fundamental picture has led to a promising price outlook; however moves have been exaggerated by speculators causing the market to overheat.

BCOM Sub-Indices: YTD total returns have been promising, especially for industrial metals.

BCOM Subindex TR	Q4 % Change	YTD % Change	2Yr % Change
Gold	-12.54	8.69	-3.32
Silver	-12.85	17.31	5.12
Aluminium	9.5	13.4	-11.62
Nickel	13.55	28.12	-24.9
Zinc	13.85	65.9	17.97
Copper	26.98	22.26	-8.2

Source: Bloomberg

2017 Outlook

The increase in speculative activity has been seen in the commodity space in the form of volatility. Exaggerated positions detailed in the commitment of trader's reports have led to longer tails. We suspect this will extend into 2017 as commodity prices continue to rise and investors' hedge against inflation.

"…the use of algorithms has led to exaggerated price moves and inflated volumes…"

Recent data suggests that in china there are 5000 hedge funds trading commodities with a few managing assets of 10bn yuan ($1.4bn). The inflows however have not just been from hedge funds; retail investors who have less knowledge of the space and trade on headlines are increasingly having an impact. Likewise, the use of algorithms has led to exaggerated price moves and inflated volumes in the commodity space as investors look for greater returns.

With improving sentiment in the commodity space we anticipate investors may continue to use the asset class as an inflation hedge as well as hunting for greater returns. Donald Trump is expected to target high levels of growth through infrastructure investment which also may boost commodity prices. We suspect and are hopeful that those commodities that boast a strong fundamental outlook will continue to attract interest from the non-commercial investors.

“If we see some stability around 140cents/.lb we could see futures push back towards 150-160cents/lb”

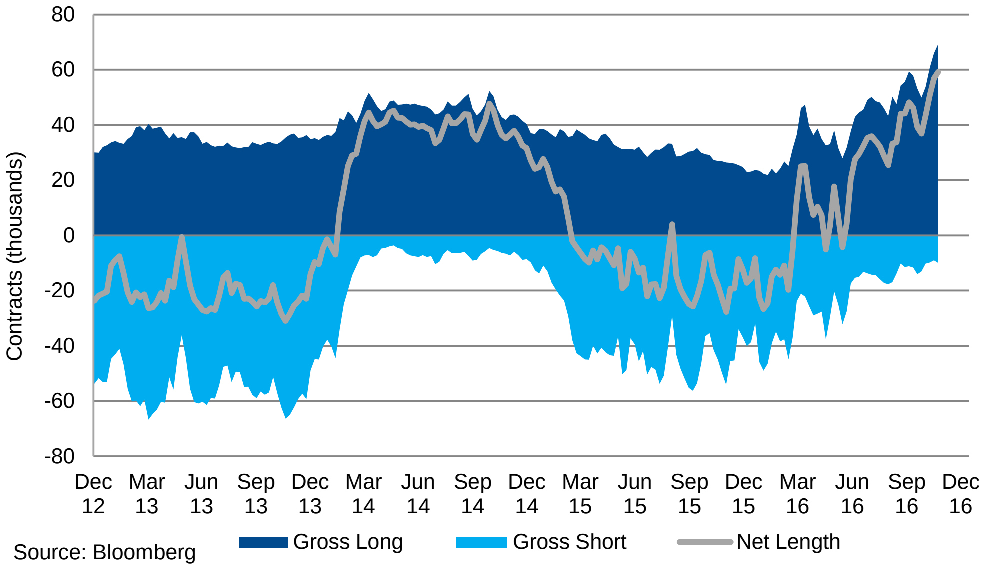
Coffee given a kick

An impressive bull run in both Arabica and Robusta contracts saw coffee become one of the Bloomberg commodity index’s top performers. The London contract posted a 3-year high in October when the price hit $2188/tonne. We cited changing demand trends as one of the reasons for this with millennials consuming a larger variety of coffee and drinking more cups. The demand side of the equation continued to look strong whilst the supply side continued to be disrupted by supply side shocks leading the market into a long term upward trend.

In the report we mentioned that the record net long position was an ominous sign and since writing, the New York market has sold off sharply, taking back most of the gains since the 20th of August as prices have tumbled to 140cents/lb from 180cents/lb.

Although it is too soon to fully analyse the performance of our report however we anticipated a retracement in the near term, however the recent move has surprised us, surpassing our target off 155cents/lb. We suspect that a combination of long liquidations along with algorithmic traders may have exaggerated moves. If we see some stability around 140cents/lb we could see futures push back towards 150-160cents/lb

CFTC Money Manager Net Position: *Net length continues to rise despite this month’s sell off.*



Source: Bloomberg

The fundamental outlook remains unchanged since November as strong demand which supported the market throughout 2016 is set to continue into the coming year. From a supply side, we suspect a rise in production will loosen the tension on the market and as we move through 2017 see prices soften towards H2 2017.

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