COMMODITIES ESSENTIAL
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Main Article, p2thru5

Post Fed: Looking at corn, crude oil, gold and iron ore.
So far risk assets have been driven sharply higher. I expect this could be a blow-off move and expectations will come down to earth in the next month or so.

After that, however, it might be tough denying the trickle up effect that unlimited monetary accommodation will have on commodities.

So, seeing that markets may be ripe for a correction as they surge to overstretched levels, here are some developments that may factor into price action for certain commodities: corn, crude oil, gold and iron ore.

Trade Essentials, p5

No new recommendations or adjustments at this time.

Positioning, p5

No open positions: stopped out of **DTO** today.

14 September 2012
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WWGD: What Will Gold Do?

I'll spare you a long-winded reaction to yesterday's Federal Reserve announcement. But if you somehow missed the news, they:

- Pledged to by $40 billion worth of mortgaged-backed securities each month
- And they put no end-date on the program

The effectively open-ended program is the difference maker – it was not expected and seeks to avoid any market disappointment. So far risk assets have been driven sharply higher. I expect this could be a blow-off move and expectations will come down to earth in the next month or so.

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So, seeing that markets may be ripe for a correction as they surge to overstretched levels, here are some developments that may factor into price action for certain commodities:

Corn

The summer heat and drought in the US caused grain prices to surge. Expectations for horrible weather seemed to eventually catch up and validate extreme price action. But despite lingering pessimism over grain supplies, prices have consolidated sideways. While the supply threats seem to be covered sufficiently by analysts, the analysis on demand seems less specific and very much assumed. This might disappoint the bulls who believe we are on the verge of a global food crisis.

Prices could still go up if commodities continue to be driven by promised liquidity from central banks. And that certainly could create inflation pressures. But it seems to me that any revisions to demand will be to the downside. Higher prices are the cure for high prices. I'll let Reuters and China provide the case in point:

> China's corn imports in 2013 may plunge more than 80 percent from this year's estimated purchases due to surging global prices, government think tank China National Grain and Oils Information Center said on Thursday.'

Crude Oil

The crude oil market currently does not face a supply shortage. Commodity permabulls will reiterate the point that the world has run out of cheap oil. But that doesn't matter right now. Beyond some regional maintenance and production issue that influence supplies of Brent crude, supply should not be the utmost concern ... even though there are plenty who note the recent tension across the geopolitical hot-bed that is the Middle East.

Barring a preemptive attack on Iran with Israel targeting Iranian nuclear facilities, I would imagine the regional tension will not influence the price of crude oil to any great degree at these levels (we're just shy of $100 per barrel on the WTI contract.)

But for amusement purposes, let's discuss Iran ...

Reuters reports "US economic sanctions against Iran have slashed the countries crude oil exports and oil revenue." Take that, you potential nuclear weapon seekers. Reuters also said the US Treasury has vowed to keep the pressure on Iran so they don't get no stinkin' nukes.

> U.S. efforts have paid off with Iranian crude exports down to about 1 million barrels of oil per day from the approximately 2.4 million barrels last year, the U.S. Treasury said. This hit to exports is costing Iran about $5 billion a month, "forcing the Iranian government to cut its budget because of a lack of revenue," Treasury Undersecretary David Cohen said at the New York University School of Law.

Are you sure about that, Mr. Cohen?

Let's go back to Reuters – a different article:

> Iran is using a little-known port off the East Malaysia coast to hide millions of barrels of oil from Western sanctions, according to shipping data, industry sources and officials.
>
> A Reuters examination of shipping movements and interviews shows how Iranian crude is shipped to the area and loaded on to empty vessels at night to await potential Asian buyers. Storing the oil on hired tankers operating under the Panamanian flag in the calm waters off the tax-haven port of Labuan - an offshore financial centre about the size of Manhattan - means Iran can keep its own fleet active and ensure the flow of oil money into its struggling economy.

What does this mean? Not a whole lot, necessarily, except it might suggest the US is more concerned about appearing firm on this issue rather than actually expecting these sanctions to prove effective. What might be more important is the destination of Iran's phantom crude supplies. Many such vessel are reported to be heading to Asia, namely China.

A recent EIA report suggests there is some global oil supply unaccounted for, i.e. either there is more demand than reported or there is hidden supply somewhere. That somewhere could very well be in China's strategic petroleum reserves. You might recall they are in the second phase of filling up these reserves. Should they be closer to capacity than expected, the bullish outlook for oil may take a hit.

Gold

As I discussed in some detail last week, gold should do well if the international monetary system is unstable and central banks continue to provide liquidity. Well, that's pretty much where we are and several commentators have made that clear.

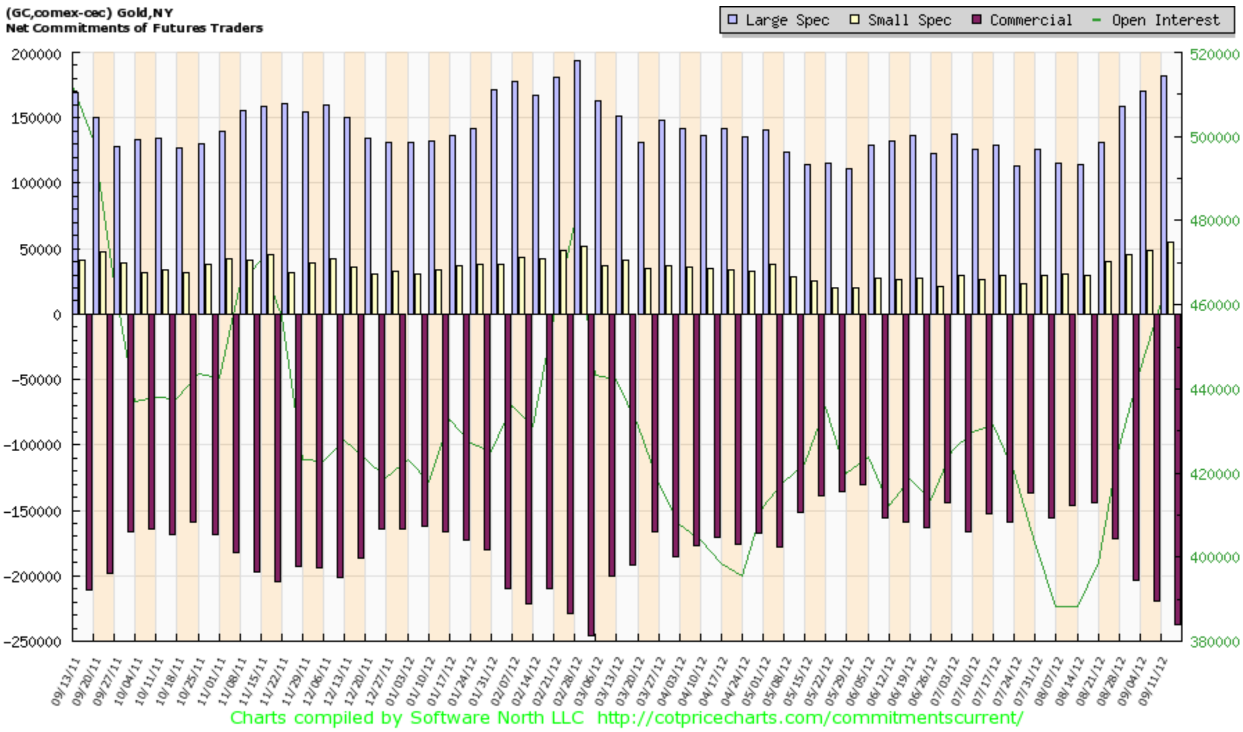
But that worries me.

One guy basically said gold is **100% back in bull-market mode.** Another guy is fairly certain **gold will hit $5000** (no timeline given). And another guy said **this is the 'best climate' he has ever seen for gold price increases.**

When the dollar is beaten up as badly as it's been the last few weeks, it's a pretty good environment for gold. But I think these guys might be getting a bit ahead of themselves. Consider the psychology of the popular market idiom "buy the rumor, sell the news."

After the announcement yesterday we may have seen panic buying in the market, as new believers become fearful of missing the bus. And we may also be seeing a shift from skepticism to confidence, as the Fed verdict and subsequent price action validate the long-time believers.

Thus, from a contrarian perspective, it may now be time to sell the news and go against the near-term trend in gold. To that same point, the large and small speculators in gold futures are extremely bullish:



Iron ore

I read a good article in the Financial Times recently discussing a concept called "price majeure." It's a play on force majeure and reveals how a self-feeding cycle of price declines are forcing iron ore and steel producers out of business and pressuring prices even lower.

The main point of the article was to suggest that, eventually, price declines will become overextended/unwarranted.

I'll agree. But ...

This assumes demand remains steady at current levels. Unfortunately, there are some indications it won't. The hurt on Chinese companies has been widely covered amidst their ongoing slowdown. But Australia is just as tied in to the commodity industry. Price majeure is currently pressuring an Australian company, Foretescue.

And miners in the country are pulling back from projects and new investments in a big way. Reuters:

> A $246 billion pipeline of planned mining investments in Australia is on increasingly shaky ground, with **nearly half already frozen or likely to be delayed, as miners and lenders wrestle with high costs and sliding revenue.**
>
> A sharp fall in iron ore and coal prices, driven by a drop-off in demand from China, has caught many by surprise and forced miners -- from the world's largest, BHP Billiton, down to the smallest -- to review their investment plans.

Reuters again:

> Employment in Australia's mining industry has fallen for the first time in three years, in what could be an early sign that a major engine of jobs growth is losing steam.
>
> Government data out on Thursday that covers the three months to August showed jobs in the mining sector fell by a net 4,600, following an increase of 25,500 in the three months to May.

Perhaps not a huge adjustment just yet, but it's enough to trigger caution. Especially since Australia's economy has become relatively unbalanced, leaning significantly on the mining industry to maintain growth.

Trade Essentials.

No new recommendations or adjustments at this time.

Positioning

No open positions at this time. STOPPED OUT of **DTO** today with a small loss. It was a relatively tight stop-loss level to avoid getting stuck in a blow-off move. If crude oil cannot maintain recent Fed-induced momentum, then I think it will make sense to reposition in DTO.

Click on the hyperlink to view the audio/visual chart analysis. **Bold** denotes change.

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