17/04/2020

Q2 COMMODITIES REPORT

The first quarter of 2020 was an extremely volatile period for commodities. While the year started with optimism after the US and China signed a 'phase one' trade deal in mid-January, defusing the trade war, the outlook for the asset class deteriorated as the coronavirus began to spread. With economic activity grinding to a halt throughout the quarter, commodity demand - which is linked to global economic growth in many cases – declined significantly, leading to sharp falls in the prices of most commodities. Overall, the S&P GSCI Index, a widely-recognised commodities benchmark, fell 42% for the quarter.

Oil, which is the most-actively traded commodity, was hit particularly hard during Q1. With countries around the world taking unprecedented steps to contain the coronavirus, demand for oil plummeted. Making matters worse, an oil price war erupted between Saudi Arabia – the leader of the Organization of the Petroleum Exporting Countries (OPEC) – and Russia during the quarter after Russia refused to comply with Saudi Arabia's request to cut oil production. This price war resulted in the price of crude oil falling from around $60 per barrel at the start of the year to around $22 per barrel at the end of the quarter – the lowest level in nearly 20 years.

Base metal prices also fell a long way over the quarter as a result of the deteriorating demand fundamentals. Copper, which is often seen as a global economic bellwether, fell 20% for the quarter. Nickel, which is used to produce stainless steel and batteries, posted a 20% loss. Meanwhile, Aluminum, another widely-used industrial metal, declined 17%.

Precious metals had a mixed quarter. Gold, which is seen as a 'safe-haven' asset and tends to rise during periods of economic uncertainty, rose from $1,520 per ounce to $1,583 per ounce over the three-month period, registering a gain of 4%. However, silver, which has more industrial applications than gold, fell 21% over the period. Platinum, which also has many industrial applications, declined 25%, falling to its lowest level in almost two decades.

Throughout Q2, it's likely that commodity price volatility will remain elevated. While an economic slowdown is bearish for many commodity prices, the combination of central bank stimulus measures and production cuts could result in substantial two-way price volatility, particularly within the industrial sector of the commodity market.

Ultimately, there could be many opportunities for traders and investors in the months ahead. With that in mind, we highlight five commodities that could be worth a closer look right now.

TRADE COMMODITIES ON ETORO

1. OIL

Source: eToro

The oil price tanked in Q1 as the coronavirus pandemic weighed on demand and an oil price war erupted between Saudi Arabia and Russia. Is it set for a rebound?

- This is not the first time that oil prices have crashed spectacularly. During the Global Financial Crisis of 2008/2009, the price of crude oil dropped from $145 per barrel to around $30 per barrel – a decline of roughly 80%. Similarly, between mid-2014 and early 2016, a period which is often referred to as the 'Great Oil Bust', the oil price fell from $110 per barrel to under $30 per barrel – a decline of more than 70%.
- On both occasions, oil prices rebounded relatively quickly. After the Global Financial Crisis, for example, the oil price rose back to $110 per barrel by the first half of 2011.
- Saudi Arabia, Russia, and the US are the three largest oil producers in the world. With oil prices at such low levels, economic growth in these countries is likely to be negatively impacted. This means that it is in the best interests of all three countries to boost oil prices back to a level that increases oil revenues yet keeps inflation under control.
- On 13 April, major oil-producing countries agreed to a historic oil deal that will see oil production cut by 9.7 million barrels per day in the near term. The deal – which will reduce oil supply by about 10% – represents the largest cut in production to have ever been agreed.
- However, so far, the deal has not stabilised the price of oil in the way it was supposed to. With demand at its lowest level in decades, oil firms have been forced to rent tankers to store surplus supply. As a result, oil prices have fallen into negative territory for the first time in history.

TRADE OIL

2. GOLD

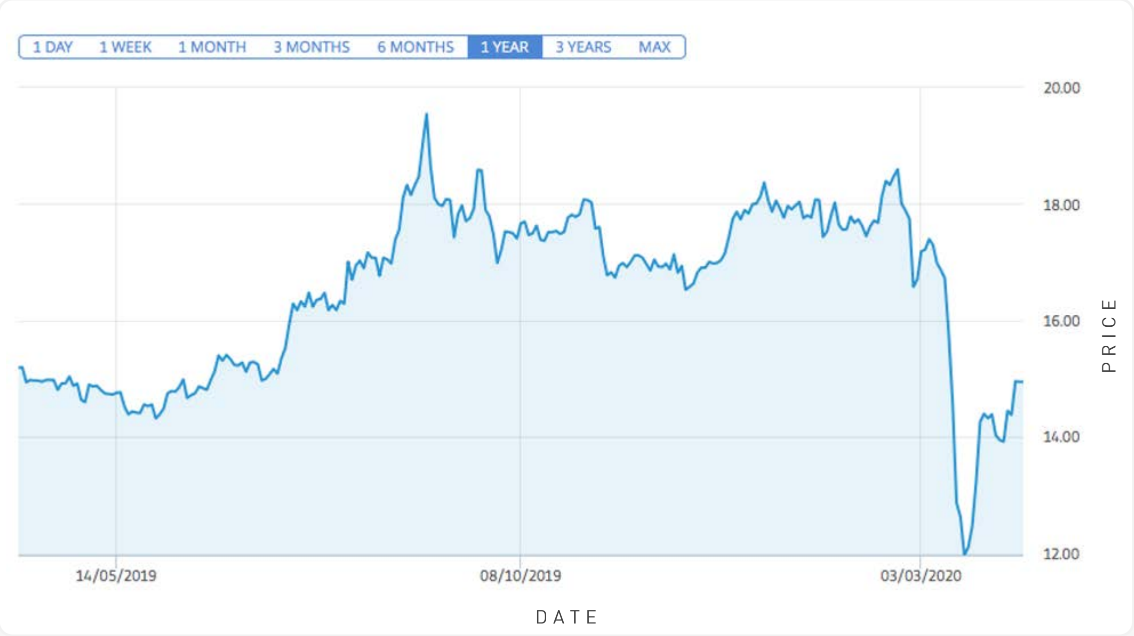
Source: eToro

The price of gold rose in the first quarter of 2020 as economic uncertainty drove investors towards safe-haven assets. Can the precious metal keep rising?

- Gold is viewed as a defensive, safe-haven asset. This means that economic shocks that send equity prices lower can often drive the price of the precious metal higher as traders and investors rush to buy it.
- Gold is also viewed as a hedge against inflation as it has historically performed well during periods of higher inflation. With central banks recently announcing an unprecedented amount of stimulus in an effort to bolster the global economy, there could be implications for inflation and gold.
- The price of gold can be influenced by interest rates. Generally speaking, the gold price and interest rates have an inverse relationship, meaning that gold often rises when interest rates are falling. Recently, central banks around the world have cut interest rates to rock-bottom levels, which could have implications for gold.
- Gold's price initially fell in early March as investors rushed to cash in the wake of the coronavirus outbreak. However, it has rebounded significantly since mid-March after the US Federal Reserve cut interest rates to zero, devaluing the US dollar.

TRADE GOLD

3. SILVER



Source: eToro

Silver prices fell to 11-year lows throughout the quarter on the back of lower industrial demand. Will the precious metal continue to fall or will it bounce back?

- Whereas the majority of gold's demand is linked to jewellery and investment, around 60% of silver's demand comes from industrial uses. This is because the metal is used in many industrial applications including electrical contacts, batteries, and jet engines.
- With economic activity across the world grinding to a halt due to the coronavirus, there could be implications for silver demand.
- On the other hand, the current gold-to-silver ratio, which represents the number of ounces of silver it takes to buy a single ounce of gold, suggests there could be upside for silver. Over the last 20 years, this ratio has averaged roughly 65. However, after silver's recent price fall, the gold-to-silver ratio has risen to around 110. For the ratio to revert to its 20-year average, the silver price would have to increase significantly, assuming the gold price stays constant.
- Traders and investors should note that silver's price is far more volatile than gold's price, both on the upside and the downside. Compared to gold, its price movements are more magnified. This means that silver can be a very profitable commodity if the correct trend is identified early. However, it also means that losses can be magnified if the trade goes wrong.

[TRADE SILVER]

4. PLATINUM

Source: eToro

Falling 25%, platinum was the worst-performing precious metal in the first quarter of 2020. Will it fall further or will it rebound?

- Like silver, platinum is used in a wide range of industrial applications. Specifically, around 40% of platinum is used in the catalytic converters of vehicles to remove harmful emissions.
- Demand associated with vehicle production could potentially limit platinum's upside in the near term, as every major car manufacturer – including Daimler, Volkswagen, and Ford – has suspended manufacturing in Europe recently, due to the spread of the coronavirus.
- Analysts at J.P. Morgan believe that car production across Europe, the Americas and China could decrease 19% this year, while analysts at Citi believe global auto sales could fall 10% for the year.
- However, platinum could find support from gold, as the two precious metals often tend to move together. If gold continues to rise, it could potentially drag platinum higher.
- From a historical perspective, platinum appears to offer value as the commodity recently fell to its lowest level since 2002.

TRADE PLATINUM

5. COPPER

Source: eToro

Copper, which is often seen as a global economic bellwether, fell 20% in the first quarter as economic activity ground to a halt. Does it have further to fall?

- The price of copper can fall sharply when investors are in 'risk-off' mode. For example, during the Global Financial Crisis, copper fell from around $4.20 to around $1.25 – a decline of approximately 70%. Since its 2020 highs in mid-January, it has only fallen around 20% so far.
- With economic uncertainty remaining elevated as we begin Q2, copper's price is likely to continue to reflect the halt in business activity around the world.
- A significant indicator of the short-term price direction of copper is the level of London Metal Exchange (LME) inventory. This is worth monitoring closely.
- At the end of March, LME copper inventories stood at 222,225 tons, an increase of 76,525 tons, or 52.5%, on the previous quarter. The rising level of inventory could weigh on the price of the commodity in the near term as it indicates that there is significantly lower demand.
- Traders should note that in the commodities crash of early 2016, copper fell as low as $1.94. This could be a key level of support in the near term.

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