State Of The Commodity Market – February 2023

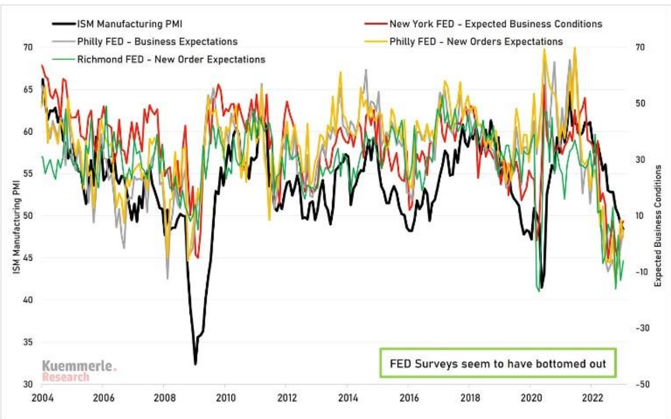
01.02.2023 – Kassel, Germany

The commodity markets are off to a mixed start in the new year. Industrial metals shine with strong price gains. Some soft commodities are also trading near all-time highs. Meanwhile, the energy sector is in free fall.

Here is our monthly macro update on economic development, the USD, interest rates and much more.

Economic Momentum

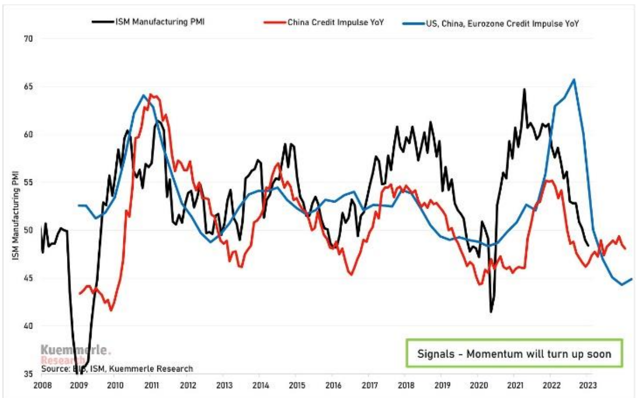
While we see from the regional Fed surveys that business expectations for the future are brightening and about half of our leading indicators continue to point to a trend reversal and a firming of economic activity in Q2, the credit impulse from the US and our Leading PMI Model don't look very promising and imply that a real economic turnaround could take a few more months and perhaps delays from Q2 to Q3 of 2023.



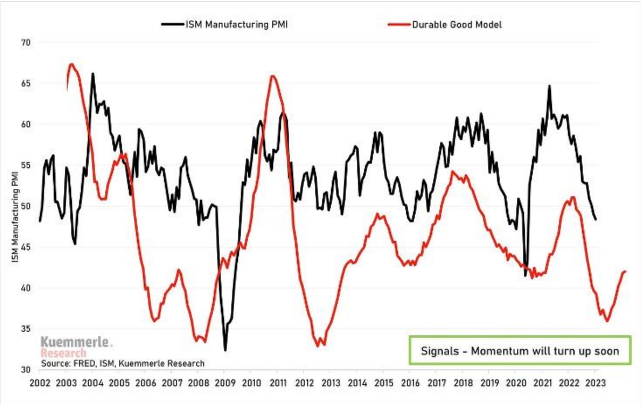
Our leading PMI model suggests something similar. We, therefore, now suspect that, after all the current euphoria, a recession could be in the offing in the second half of the year that will last a little longer than previously assumed. This is something to keep in mind also when selecting raw open trades on the long side. We, therefore, remain primarily on the short side. We, therefore, continue to find long trades in commodities with a high correlation to economic activity difficult to evaluate and do not plan to play them on the log side so far (these include copper, oil, and cotton).

As mentioned above the US and also the World Credit Impulse growth slowed not much further but usually, the time leg is about six to nine months - therefore more weakness in economic momentum seems likely on that front. Still - we expect that the component will start picking up the pace again reasonably soon, simply because of the basis effect during the next quarters.

The credit impulse from china continues to look promising and provides corresponding support for global growth. This development was noticeable last month in industrial and precious metals as well as in the oil price. Nevertheless, it seems like the index is also losing momentum again - so all in all, mixed signals on the credit impulse front.

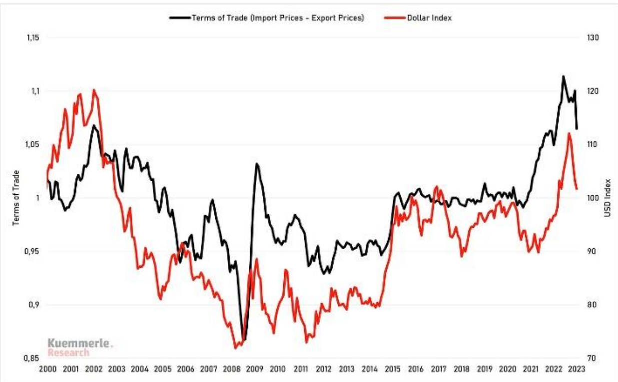


Our Durable Good Model still suggests that a turning point in economic momentum is near.

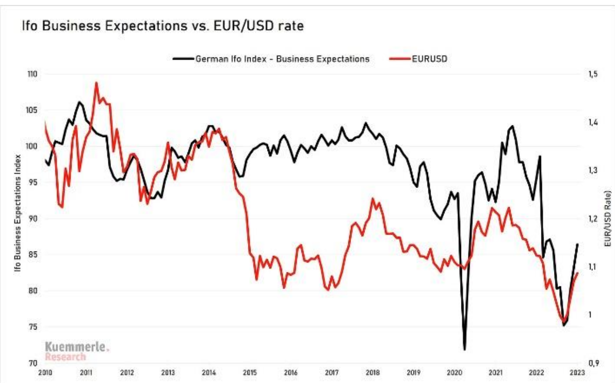


The US Dollar

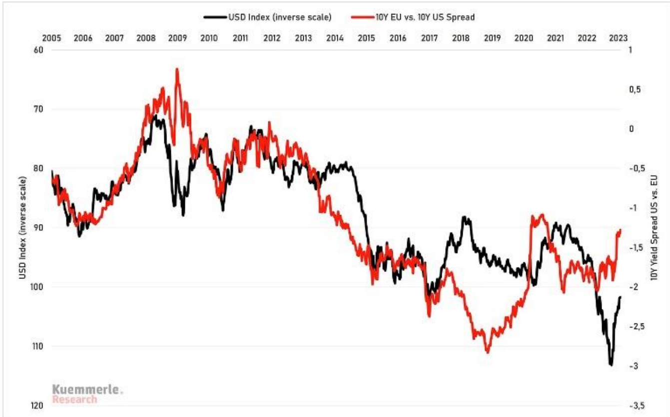
We are expecting a pullback move or correction to the upside soon. However, we will use temporary dollar strength to sell off the greenback. Our Terms of Trade Model already signaled last year that the US dollar peaked from a fundamental perspective. In 2023, a steady depreciation of the dollar should continue to prevail.



We like the Euro vs. the USD - also because the ECB is not as far with its hiking cycle as the FED.



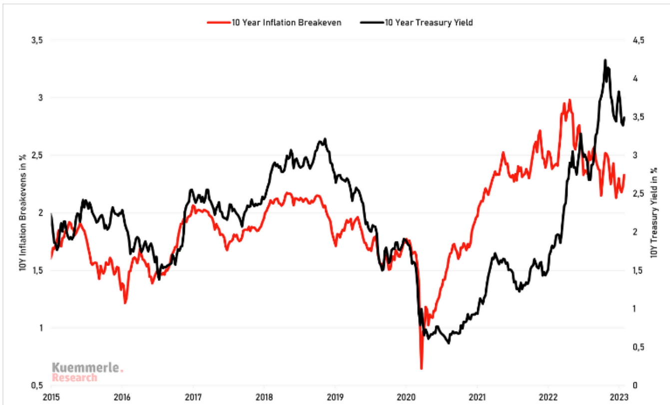
The spread between 10Y treasuries from the EU and the US confirms that there is actually more upside for the Euro.



Yields

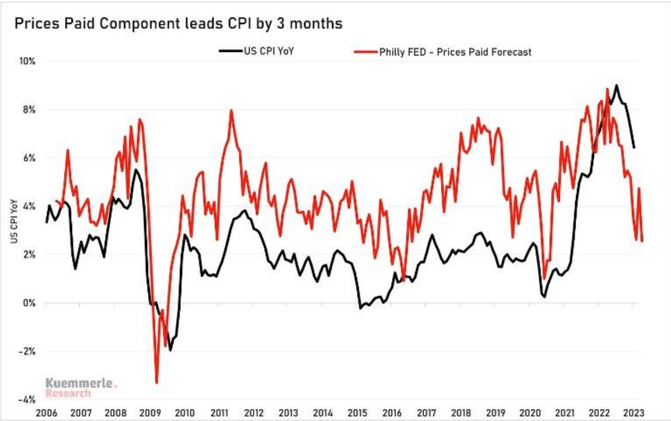
The bet on lower yields will in our opinion still be a great trade in 2023. Since this is already evident in all annual outlooks and sentiment is very euphoric, we think bond yields will test the highs again first to flush the consensus out of the market. After that, we will increasingly buy US Treasuries, as we expect 10Y yields to decline again to a median level of 2.50 to 2.75% and 2Y yields below 3% towards the end of the year.

However, yields are a tricky game and **we will stay flexible**. If inflation for example, shows to be more sticky towards the second half of the year, inflation expectations could surge and drag yields higher again.

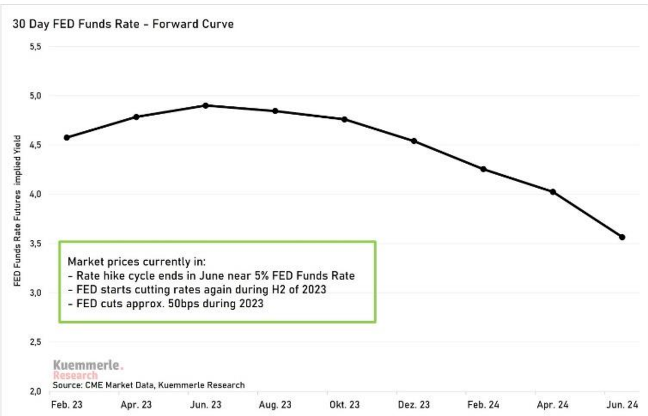


When will the FED actually cut again?

We doubt that the Fed will start cutting rates with core inflation above the 2% target. Due to the basis effect, inflation will weaken sharply in the first half of the year.

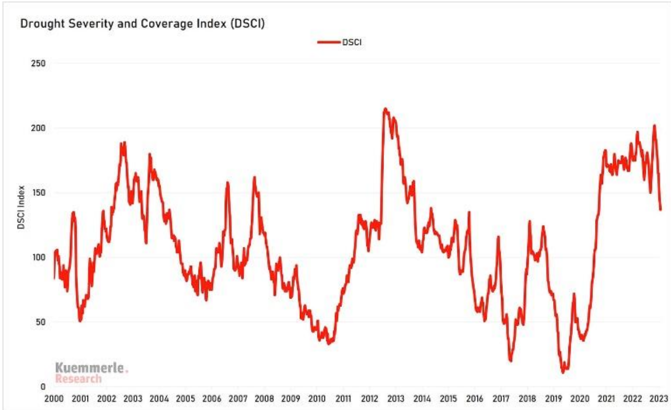


The futures curve is currently pricing in that the Fed will cut rates for the first time between August and October. This may be a little premature. The consensus is, therefore, already very euphoric. **There is the potential for a surprise if inflation data in the next few months turns out to be higher than the already very euphoric consensus.**



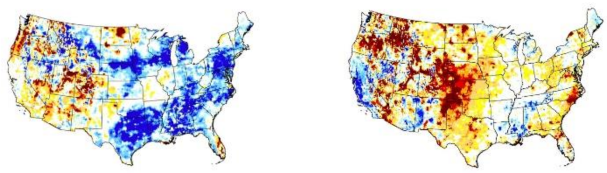
Weather & Drought Conditions

The US remains enormously dry - but it gets better. Groundwater levels in the US have recovered in recent months (see DSCI index). However, conditions are still just not good compared to January 2019, when conditions were almost perfect and set the stage for an excellent harvest.



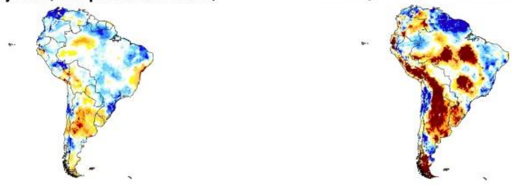
By the way, with U.S. wheat selling for a record-high average, growers say they will sow the largest amount of land to wheat in seven years, enough to bump up production by 17%. *Farm Futures magazine* said its annual winter survey of farmers found that they intend to plant 48.8 million acres of wheat, the largest seedings since 2016 and enough land, with a modest recovery in yields per acre from drought, to grow a crop of 1.92 billion bushels, a 276-million-bushel increase from last year. **Market prices are high for wheat at the same time that profit margins for corn and soybeans are squeezed by rising input costs.**

January 2019 (near perfect conditions) **January 2023 (current conditions)**

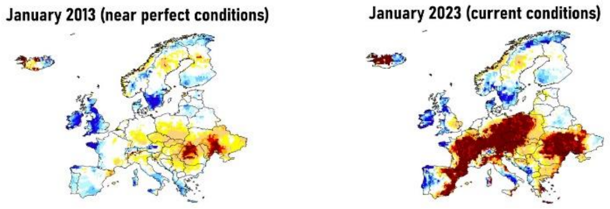


South America also remains dry in some places - but it is essential to distinguish between the two, as this has become a "normal" phenomenon. South America has experienced more extreme weather and drought in the past than the US.

January 2011 (near perfect conditions) **January 2023 (current conditions)**

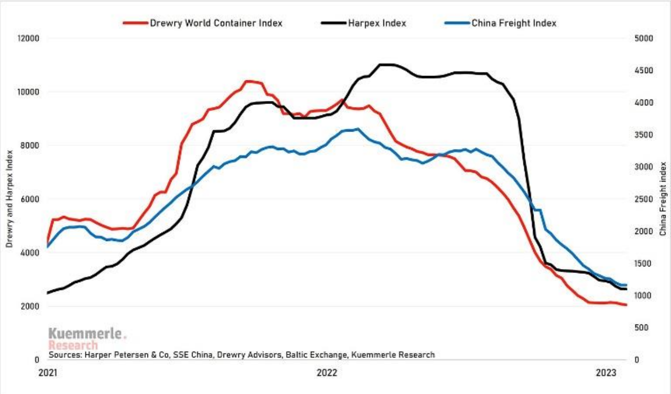


Conditions in Europe remain challenging as well.

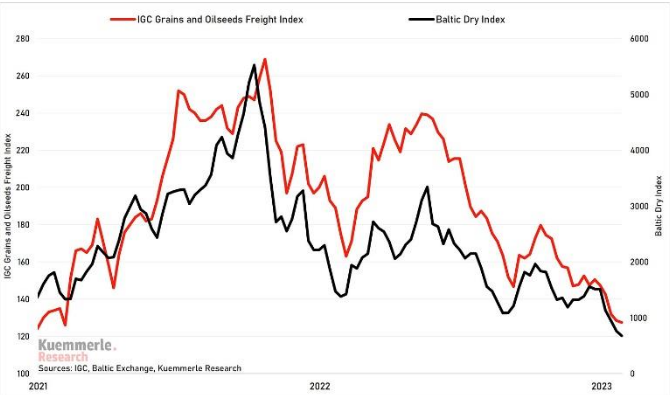


Shipping Conditions

Shipping conditions worldwide continue to improve - with freight rates for containers and ships falling. Nevertheless, as stated in last month's report, it seems like container rates are trying to find a bottom at these levels.



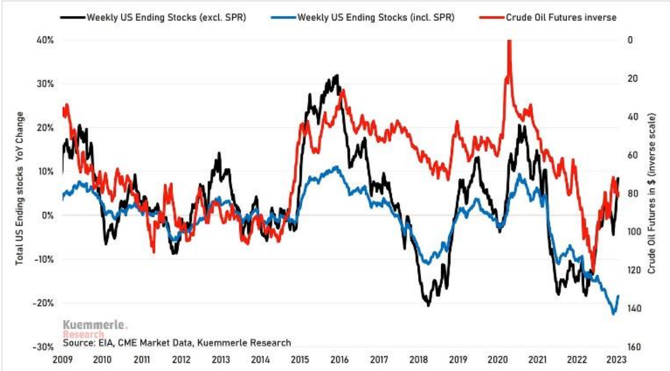
On the Bulk Dry front, it also seems like the rates for shipping grains and other bulk dry freight around the world continue their downtrend direction.



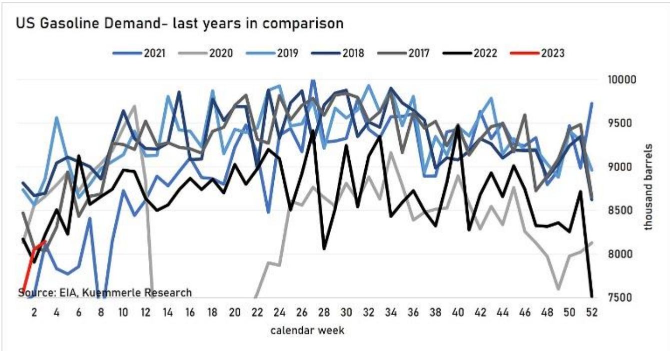
Important: Both shipping rate segments are usually lagging indicators as they move after the commodities have - with a delay of between 3 to 4 months.

US Energy Report - Oil & Gas

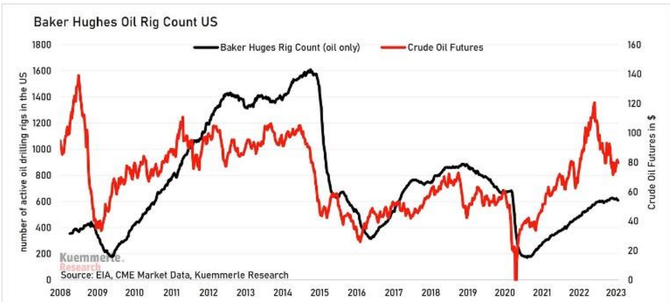
There remains a significant mismatch between inventory data and the price of crude oil. This gap seems to close again (slowly) due to the fact that oil demand slowed and a stock build of oil inventories became visible again over the last four weeks.



Demand for oil products in the US remains weak - especially for gasoline.



It will also be important to keep an eye on the oil rig count. Notice that oil usually rallies when rigs are added - we're now at a turning point and rigs seem to become less again as demand fades.

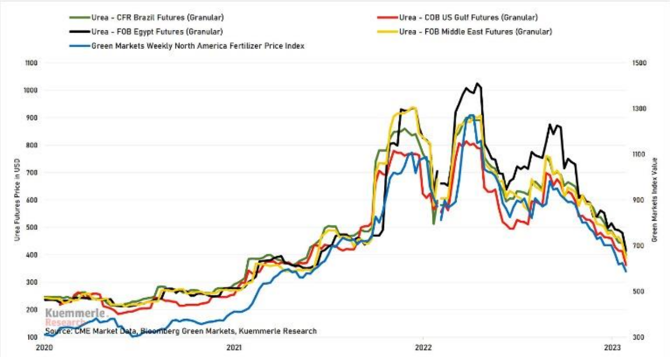


The natural gas picture looks more in order and in line with the previous year's trend. On the other hand, Henry Hub futures are currently being sold off mercilessly and hedge funds have very high short positions.

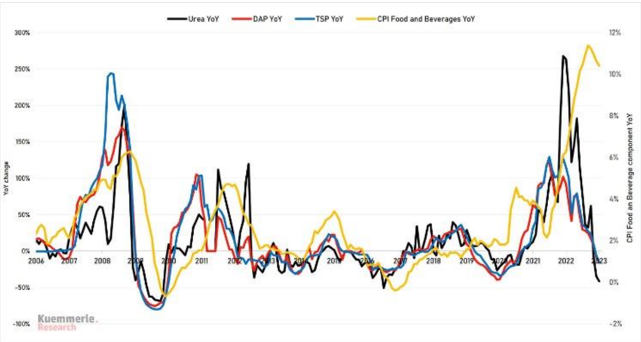
Opportunities could arise again soon, which we will highlight in the Kuememrle report.

Fertilizer Prices

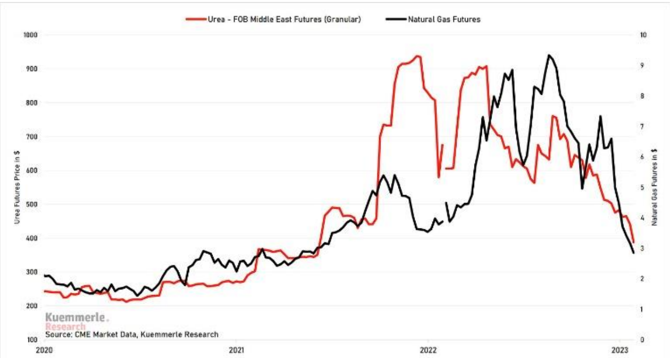
Fertilizer prices continue to trade way above pre-covid levels and are currently in a sideways market.



Because of the basis effect this sideways market should help to bring down the Food and Beverage component of the CPI quickly.



The natural gas market remains primarily driven by temperature changes in the US and Europe. Significant changes in the price action of Henry Hub Natural Gas will therefore remain the primary driver of prices going forward.



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All external data sources are named directly in the charts.

Sources used in the report:

CME Market Data, ICE Market Data, Tradingview Charts & Market Data, NASA Weather Service, World Ag Weather, USDA, EIA, CFTC Data, Nasdaq Data-Link,

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