

Commodities Trade Recommendations – “A Dangerous New Phase...”

Commodities Research

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Short-term risk reward remains negative for industrial commodities. However, at current levels, prices likely to rally once macro stability restored (our central scenario)

As mentioned in our commodities forecast update ([Commodities Forecast: “A Dangerous New Phase...”](#)), recent pricing in commodity markets have been driven overwhelmingly by macro sentiment, with fears of an economic implosion in Europe, and to a lesser degree the US weighing heavily.

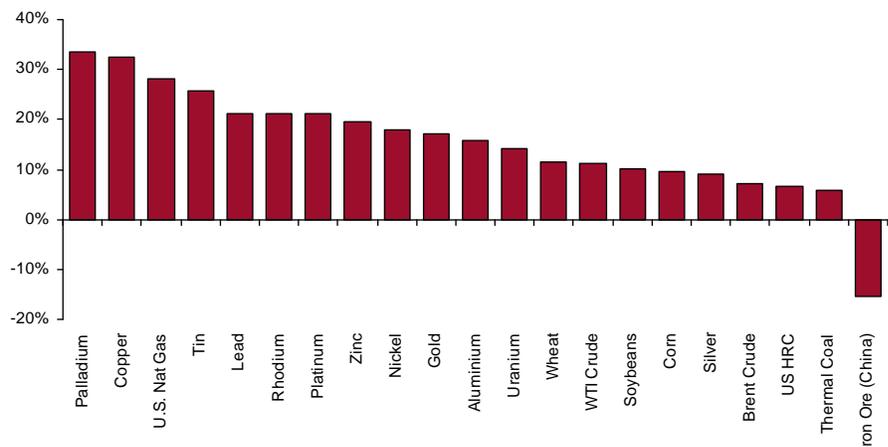
While the outlook is even murkier than normal, continued **solid Chinese demand is likely to provide “base load” support** for many commodities – the complex remains more leveraged to China than other asset classes. However, **this is unlikely to be enough to support pricing in the short term**, with marginal demand and sentiment likely to continue to be driven primarily by events in the North Atlantic.

Given the continued lack of policy direction in Europe, **the short-term risks remain firmly to the downside**, with prices likely to remain highly volatile. However, once the ‘panic’ subsides, (hopefully the G20 meeting on Nov 3-4 will provide some clarity) **the key “fundamental” consideration will be the extent to which the financial meltdown has contaminated the real economy.**

To that extent, and assuming that European policy makers eventually act to shore up the financial system, we believe that **many prices are likely to trough in Q4, before resuming their decade-long upward trend in 2012.**

Exhibit 1: One-year commodity performance expectations

Based on Q3 2012 forecasts against last day of Q3 2011 prices



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Trading Recommendations

Energy

Crude Oil (Brent)

View: We expect Brent oil fundamentals and prices to soften over the Northern Winter. Consequently we expect the current backwardation to flip into a contango. However, around the middle of next year we expect the rebound in global economic growth to flow through to the oil market, with the still tight fundamentals beginning to take centre stage.

Financials: We recommend selling March 2012 against the December 2012 (\$1.57/bbl on Sept 30) with a stop loss at \$2.10/bbl (breaking the 200-day moving average). This risks \$0.53/bbl assuming you are stopped out of the position. If you prefer a slightly longer horizon with the same idea, sell the June 2012 against December (\$0.83/bbl on Sept 30) with a stop loss at \$1.40/bbl (breaking the 200-day moving average), a position which risks \$0.57/bbl should you get stopped out of the position, likely should the economy recover stronger than expected.

Consumers: Despite the risk of softer fundamentals in the near term, we see risk to the upside for relative prices of middle distillates this winter. Inventories of diesel, heating oil and jet kerosene are relatively low, there are a string of issues with refiners and demand remains relatively robust. We recommend short term hedges against price spikes for these products this winter. This can be achieved by Jan 2012 gasoil contracts and selling April 2012 gasoil contracts (\$15/tonne on Sept 30), with a stop loss at \$5.25/tonne (breaking the 50-day moving average). This risks \$9.75/tonne should the position get stopped out, which is likely in an economic meltdown.

Producers: We recommend hedging only if very sensitive to any further downside. We think we are not far away from the low end of the near-term trading range, barring an economic meltdown.

Natural Gas (Henry Hub)

View: We expect the North American natural gas oversupply situation to dominate market in the near term, leaving annual average prices at sub-\$5 levels through 2013. Looking further along the curve, we expect pending EPA regulations to gradually tighten this market, potentially increasing gas power generation to 5 Bcfd by 2015. As the market begins to balance, prices may move up to \$5.50 per MMBtu by 2014 with risks toward the upside further along the curve.

Financials: Given our view that US storage will end the winter season at 1.96 Tcf (new historical record), we see downside risk to the March 2012 contract and would recommend buying puts or selling the March/April 2012 spread at current levels, risking losses should the spread widen.

Consumers: Consumers should lock in low gas prices along the curve, in our view, given price risks appear to remain to the upside, particularly for Cal14 and Cal15 strips.

Producers: While current pricing creates a difficult hedging situation for producers, we recommend longer-term production hedging by selling favorable pricing spikes in the \$5-\$5.50 range. This limits downside risk should prices reverse lower, but also limits upside should prices rise higher than forecasted.

Base Metals

While under our central scenario, we expect most base metal prices to bottom out in Q4, and to move higher over 2012, given the recent violent moves, and the still ever present risk of a policy failure in Europe, we recommend caution when trading the LME.

Copper (LME)

View: We remain bullish on copper's fundamentals over the medium term. However in the near term the price still looks vulnerable to a further bout of futures liquidation.

Financials: We don't see a compelling trade at the present time, but would look for a more opportune entry point over coming weeks.

Producers: Given the large macro risks to the outlook for global growth, those producers particularly sensitive to volatility could look to lock in the current price through purchasing puts or selling forwards. Note that selling forwards limit participation in upward movement in prices, and buying puts may result to loss of premium should prices rise above the option's strike price.

Consumers: End users with the credit and flexibility to buy forward into 2013 should already be doing so, in our opinion, and should use further weakness in spot (currently around \$7000) to add to those forward positions.

Aluminium (LME)

View: We believe aluminium offers the best cost support and one of the strongest demand profiles of any industrial metal, and represents a relatively safe trade compared to other industrial metals. This outlook matches our macro view that markets will remain volatile in the short term, with sharp downside potential for risky assets (notably copper among base metals). As market sentiment improves, we anticipate recommending a shift out of aluminium as a holding pattern, and into copper at that time.

Financials: We would look to go long Dec 12 futures on dips below \$2100 (currently trading at \$2238). This risks losses should prices continue to fall lower.

For investors currently long aluminium, we recommend maintaining positions, with an eye to shifting to copper once market conditions improve.

Producers: Given the large macro risks to the outlook for global growth, those producers particularly sensitive to volatility could look to lock in the current price through purchasing puts or selling forwards. Note that selling forwards limit participation in upward movement in prices, and buying puts may result to loss of premium should prices rise above the option's strike price.

Consumers: We advise consumers to add to hedging positions on dips, as we view further downside as limited, especially compared to potential appreciation on improving macro sentiment.

Tin (LME)

View: Tin has a unique profile amongst base metals: so as long as the coalition of Indonesian smelters stands fast in their halt on exports, we believe they will be successful in pushing tin prices back up to \$25,000.

Financials: We recommend going long Jun-12 Tin, with a target of \$25,000. The risk to be monitored is the stability of the export freeze, with a breakdown representing a clear signal to liquidate the position.

Producers: Given the current level of macro uncertainty, reducing risk by purchasing some downside support makes sense. However, we do not advise more comprehensive hedging given our expectation of coming price increases.

Consumers: Current depressed levels represent a good opportunity to increase hedging positions, as we view risks skewed heavily to the upwards.

Precious Metals

Gold

View: We believe that the recent correction in gold has provided an opportunity for those with a one-month-plus investment horizon to get long. The metal bounced very strongly off technical support and robust physical buying has since added to the upward momentum. However, we think that CTAs and parts of the hedge fund community are now underinvested in gold and will probably not participate in size until the metal breaks up through \$1,700.

Financials: We recently recommended call spreads in XAUEUR ([Trade Idea: Long Gold/Short EUR](#)) – that trade has started to perform well but we now see better value in going long gold in USD. Implied volatility has eased back a touch off the recent highs but is still around 6 vols above the average of the last three years. Consequently, simply buying calls is not that attractive and we would look instead at 3- to 6-month OTM calls with strikes between \$1,700 and \$1,900, risking the option premium should prices remain stable, or continue to move lower.

Consumers: Should probably be looking to buy forward for the next six to nine months, credit lines permitting.

Producers: With spot currently trading around 14% below its early September peak, we do not believe now is an ideal time for producers to be hedging. However, we would recommend buying zero cost collars (allowing some additional upside participation) if and when spot gets close to \$1,900 again. However, note that a zero cost collar would limit gains should prices move higher than expected.

Silver

View: While we expect silver to move higher from current levels (\$30.80 at the time of writing), we think the two sharp corrections of May and September mean a re-test of the previous high (49.79) is increasingly unlikely and we would not be surprised to see a further sizeable move lower in spot either.

Financials: For those willing to be short volatility we would suggest selling three-month \$40/\$44 call spreads, risking losses should prices move above \$40.

Consumers: We recommend leaving resting orders below the market to buy silver forward on dips.

Producers: We recommend that miners with significant exposure to the silver price should sell calls above \$36 and use the premium received to buy downside protection at \$25. This would minimize gains should prices recover higher, but also limits downside risks to future prices.

Platinum Group Metals

Platinum

View: We remain bullish on platinum's fundamentals over the medium term. However, in the near term, the price still looks vulnerable to a further bout of futures and ETF liquidation.

Financials: We don't see a compelling trade at the present time, other than to be short platinum/long palladium – see below.

Consumers: End users with the credit and flexibility to buy forward into 2013 should already be doing so, in our opinion, and should use further weakness in spot (currently ~\$1,495) to add to those forward positions.

Producers: Other than for new project financing we would not recommend hedging in USD given our view on price.

Palladium

View: As with platinum, we are bullish over the medium term and believe palladium is likely to start to outperform its sister metal from this point forward. That view is based both on fundamentals (a structurally tighter market, we think) and positioning (much less speculative length remaining in palladium).

Financials: With the platinum: palladium ratio trading around 2.53: 1 and platinum looking more vulnerable to further liquidation we think that a short platinum/long palladium trade makes sense. However, limited liquidity in futures beyond three months and wide volatility spreads between the two metals makes it a hard trade to effect – we would consider OTC forwards or swaps. Alternatively, we would also recommend going outright long palladium via 6-month call spreads with suggested strikes of \$700 and \$850, risking the call premium should price remain stable or move lower.

Consumers: Palladium below \$600 is a good opportunity for end users to add to existing hedges we think.

Producers: Other than for new project financing we would not recommend hedging in USD given our view on price.

Bulk Commodities

Iron Ore

View: Until increased supply arrives in the market, high cost Chinese production is likely to support prices in the \$150-\$160 range.

Financials: We recommend buying the Q2 contract on dips to \$135 (currently around \$140).

Consumers: As our forecasts sit considerably higher than the current forward curve we recommend consumers buy protection from rising prices through the Cal12 swap contract.

Producers: Given the large macro risks to the outlook for global growth, those producers particularly sensitive to volatility could look to lock in the current price through purchasing Cal 12 swaps (currently prices at around \$138).

Thermal Coal (Newcastle)

View: With Indian and Chinese imports likely to remain strong, and Chinese production costs continuing to move higher, partly because of RMB appreciation, the risk reward for thermal coal looks attractive relative to other industrial commodities which appear more exposed to macro risk.

Financials: We recommend buying Cal13 swaps on dips below \$120 for Newcastle FOB.

Consumers: Given our forecast of rising prices, consumers should look to lock in prices through the Cal12 and Cal13 contracts.

Producers: Again producers may not wish to offset their fundamental long position but macro concerns do present downside. With vol at relatively low levels we recommend buying Cal12 and Cal13 Asian put options to hedge this risk. The risk to this trade though is rising prices, which could cause the option to expire out of the money with investors losing the option premium.

Grains

View: Our central scenario is for prices to move sideways to downward over the next 18 months. However, given the underlying tightness of markets, small movements in supply are likely to result in large movements in price.

Financials: We do not recommend a grains trade at this time given the high degree of uncertainty and likely continued high volatility.

Consumers: Given the likelihood that any further supply disruptions would see prices move materially higher, we recommend consumers look at opportunistically fixing forward prices.

Producers: Given the likelihood that any improvement in supply conditions would see prices fall materially, we recommend producers look to at opportunities to fix forward prices.

Exhibit 2: Trade recommendations scorecard

Based on end of day prices or latest available price, recommendations in blue are being (have been) closed out, recommendations in green are initiated today

Returns column: green means positive returns, and red means negative returns, black when zero.

Commodity	Position	Publication	Date Initiated (Closed)	Opening Price	Current or Close Price	Profit/(loss)	Return
Brent crude	Sell March 2012 future, buy Dec 2012 future	A Dangerous New Phase	3 Oct 2011	\$1.57			
Nat Gas (US)	Sell March 2012, buy April 2012 future	A Dangerous New Phase	3 Oct 2011	\$0.066			
Aluminium	Buy Dec 12 futures on dips below \$2,100	A Dangerous New Phase	3 Oct 2011	n/a			
Tin	Buy June 12 futures targeting \$25,000	A Dangerous New Phase	3 Oct 2011	\$20,389.0 0			
Gold	Buy March 12 call spread with strikes at \$,700/\$1,900	A Dangerous New Phase	3 Oct 2011	\$50.0037			
Silver	Sell Jan 12 call spread with strikes at \$40/\$44	A Dangerous New Phase	3 Oct 2011	\$0.3095			
Palladium	Buy March 12 call spread with strikes at \$700/850	A Dangerous New Phase	3 Oct 2011	\$16.0947			
Iron ore	Buy Q2 2012 futures on dips to \$135	A Dangerous New Phase	3 Oct 2011	n/a			
Thermal Coal	Buy CAL13 swaps on dips below \$120 for Newcastle coal	A Dangerous New Phase	3 Oct 2011	n/a			
Gold	Buy gold in Euros (Buy gold/short Euro)	Mind Those Hedges	28 Sept 2011	€1,195.97	€1,242.03	€46.06	3.85%
Gold	Buy Dec 11 futures on dips under \$1800	Autumn Resolutions	30 Aug 2011	\$1,800.00	\$1,649.00	(\$151.00)	(8.39%)
Copper	Buy Dec 11 call spread with strikes at \$9,500/10,000	This Mess We're In	10 Aug 2011 (18 Aug 2011)	\$108.9271	\$112.3902	\$3.4631	3.18%
Palladium	Buy Dec 11 call spread with strikes at \$810/850	This Mess We're In	10 Aug 2011 (18 Aug 2011)	\$7.9632	\$11.8955	\$3.9323	49.38%
Brent crude	Buy Sept 11 Brent crude puts	Bewitched, Bothered and Bewildered	02 Aug 2011 (05 Aug 2011)	\$1.0143	\$5.4014	\$4.3871	432.52%
Copper	Buy Sept 11 puts at \$9,500 strike	Bewitched, Bothered and Bewildered	02 Aug 2011 (15 Aug 2011)	\$184.2395	\$697.5897	\$513.3502	278.63%
Aluminium	Long Oct 11 aluminium futures	Aluminium: Buy the Dip	19 Jul 2011 (02 Aug 2011)	\$2,513.00	\$2,579.75	\$66.75	2.66%
Nickel	Long Dec 11 nickel futures	Nickel: Short-term bounce	28 Jun 2011 (02 Aug 2011)	\$22,600.0 0	\$24,813.00	\$2,213.00	9.79%
Gold	Buy Oct 11 call spreads with strikes at \$1600/\$1750	The Song Remains the Same	23 Jun 2011 (19 Aug 2011)	\$16.9179	\$125.1100	\$108.1921	639.51%
Platinum	Buy Dec 11 call with strike at \$1700	The Song Remains the Same	23 Jun 2011 (19 Aug 2011)	\$89.5570	\$172.5000	\$82.9430	92.61%
Iron Ore	Long CAL-12 futures	The Song Remains the Same	23 Jun 2011 (19 Aug 2011)	\$156.50	\$162.50	\$6.00	3.83%
Nat Gas (US)	Short Oct-11 futures	The Song Remains the Same	23 Jun 2011 (17 Aug 2011)	\$4.287	\$3.943	\$0.344	8.02%
Copper	Long Dec 11 copper futures	The Song Remains the Same	23 Jun 2011 (02 Aug 2011)	\$8,980.00	\$9,692.50	712.50	7.93%

Source: Credit Suisse Locus

Technical Analysis

Energy

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Brent Crude Oil (ICE continuation) – weekly



Source: Uputa, the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

The energy group remains under pressure in the range. Brent Crude Oil and WTI Crude Oil continue to roll back toward the August lows at \$98.74 and \$75.71/00, respectively.

The energy group of commodities remains under pressure, which has seen **Brent Crude Oil** continue to be capped at channel resistance now at \$116.35. The reversal from here leaves the bias lower to the August low at \$98.74, where we would look for buying to emerge. Capitulation through here and follow through the 50% retracement of the 2010/2011 rally and channel support at \$97.44/\$96.45 would signal a more protracted bear phase and target solid support at \$90.28/\$89.58, which we would look to provide floor. A break above \$116.22/60 is required to see the trend turn higher but through \$120.97/\$121.50 to re-open a test of the 2011 peak at \$127.00.

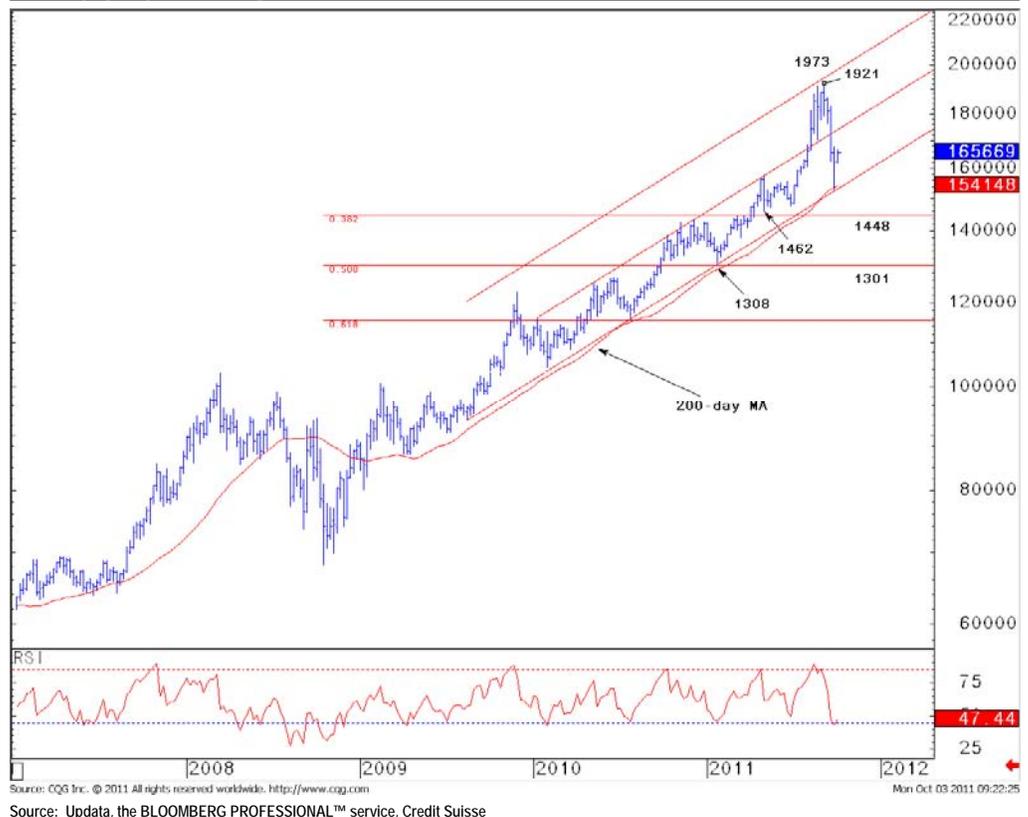
WTI Crude Oil's August recovery failure at the \$90.00 region and subsequent reversal confirmed a bearish "wedge" pattern and leaves the risks skewed for a retest the August low and the 78.6% retracement support at \$75.71/00. We would look for a fresh attempt to find a floor here. However, a break below here would signal a more bearish turn for price support at \$70.76. Above the \$90.00 region is required to put in a base for \$95.27/\$96.00. Only through \$99.89/\$100.62 would the trend turn higher again.

Elsewhere, **Gasoil** remains under pressure in the range and continues to slide to key support at the August low at \$851.75, where we would look for an attempt to form a base. Should this be removed, weakness could extend to \$825.50. Above \$976.50 is required to turn the trend higher again for \$1000.00. **RBOB Gasoline** remains under pressure toward \$2.5150, then better support at the 61.8% retracement level at \$2.4580.

US Natural Gas continues to roll lower in the broader range, and we continue to target 78.6% retracement support at \$3.590, where we look for a better recovery attempt. Below here would aim at \$3.410, with better support at the 2010 low at \$3.212. Above \$4.143 is required to put in a base.

Precious Metals

Gold (Spot) – weekly



Gold has collapsed to test key long-term support at \$1535/30, which we look to try and hold.

Gold has succumbed to broader macro pressures, and the removal of the \$1704/00 level completed a top. The collapse from here has seen price action test key long-term support at \$1535/30 – the 200-day moving average and trend support. We look for the metal to hold here and try to form a base. Only a break of \$1530 would warn of a more bearish turn and aim at price supports at \$1478/62, with better retracement support (38.2% of the 2008/2011 rally) at \$1448. A break through \$1700/04 is required to put in a base, but through \$1773 – the 61.8% retracement of the 2011 plunge – to turn the trend higher again, for the \$1921 record peak.

Elsewhere in the precious metals group, **Silver's** break of the \$32.31 price lows has put in place a larger top, and while below here, the risks remain lower to the 61.8% retracement of the 2008/2011 rally at \$24.25. Solid support is at \$21.40/23 – the March 2008 high and the 61.8% retracement of the 1993/2011 rally. A break above \$36.33/\$37.00 is required to put in a base and turn the trend higher again. **Platinum** has held good support at \$1469. However, only a move back through \$1677 would ease broader downside risks. Capitulation through \$1469 would see further weakness to \$1378/30. **Palladium** has also reverted to good support at \$605.25, but while below the \$697.00 retracement hurdle, downside risks remain in place.

Industrial Metals

Copper (LME 3-month) – weekly



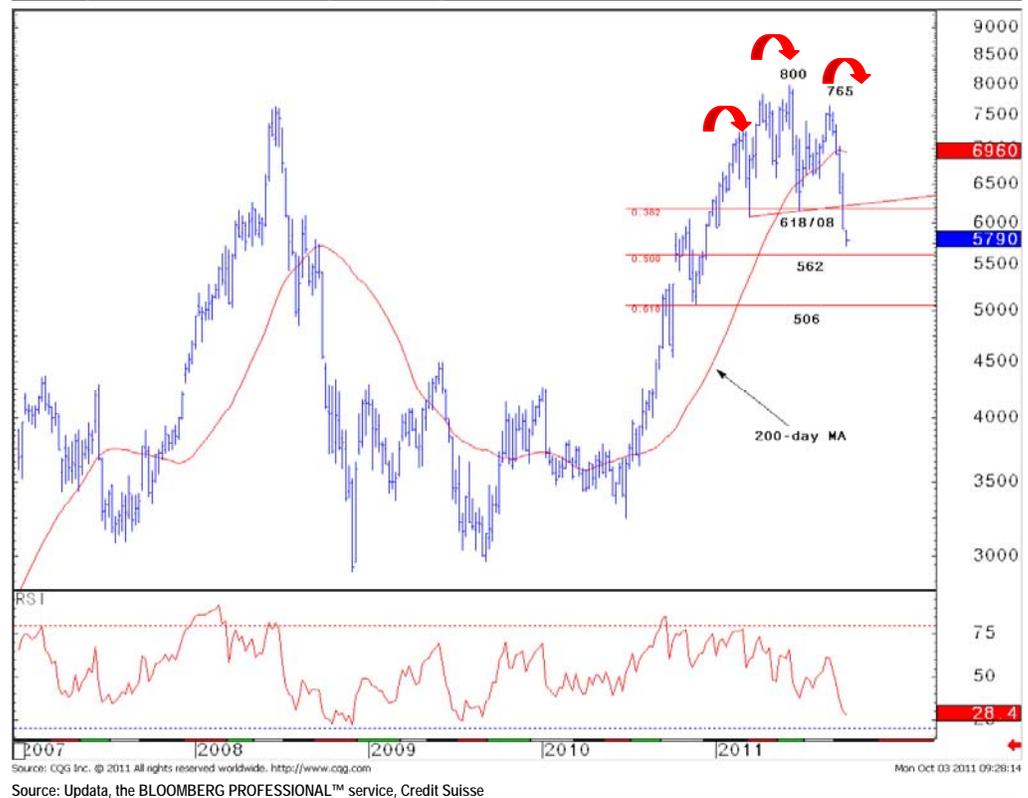
Industrial metals remain under pressure to bigger supports

Copper has plunged through the former 2011 range low at \$8446, which completed a large top and leaves copper skewed for further downside to better support at \$6505/00. This level marks not only half the 2008/2011 rally but also trend support projected from the September 2009 low. We look for it to try to hold and see an attempt to form a fresh base here. However, should this be removed, this would aim at the June 2010 low at \$6038. Only through here would signal a more protected bear phase and aim at \$5634. Above \$7730 would ease the immediate downside risk, but only through the "neckline" to the top and price resistance at \$8410/\$8446 would a base be signaled.

Elsewhere in the group, a large top remains in place for **Aluminum**, which leaves the risk lower to \$2094, then better retracement support at \$2041/37, where we would look for better support to emerge. A move back through the \$2323 is required to ease downside pressure but through \$2345/53 to turn the trend higher again. **Nickel** is similarly under pressure while minimally below \$20200, and should \$16800 be removed, this would see weakness extend to \$16490, with key props placed at the \$15720 level. **Lead** and **Zinc** have both resolved the broader range lower, and while capped by \$2102 and \$2122, downside risk remains in place.

Grains & Softs

Corn (CBoT continuation) – weekly



The Grains and Softs group of commodities have all put in tops, and all remain under downside pressure

Corn's break of support at 618/08¢ – the 38.2% retracement of the 2010/2011 rally and the March and June 2011 range lows – completed a large “head & shoulders” top. This clears the way for further weakness to the 50% retracement level at 562¢. Should this be removed, this would aim at better support at 506¢ – the 61.8% retracement level and the November 2010 low. Above 666¢ is required to ease the immediate downside pressure. Elsewhere, **Soybeans** have broken the 1270¢ range low, which puts in place an intermediate top and has seen an extension of weakness through the 50% retracement support at 1178¢. The aim is now to better support at the 61.8% retracement level at 1112¢. Above 1286/1300¢ is required to ease downside pressure. **Wheat's** break of 643¢ August low keeps the focus on major support at 585/65¢ – the 2009/2011 major high/low.

In the **Softs** group, a top remains in place for **Sugar No.11**, and the risks are still seen lower to 24.77/59¢. Through here would aim at the 78.6% retracement of the 2011 rally at 22.85¢, where we would look for better support. Above 28.14¢ is required to ease the immediate downside pressures. **Cotton No.2** remains biased lower to the July 93.50¢ low. Capitulation here would aim at 85.10/84.94¢. **Coffee** has extended weakness through the 38.2% retracement of the 2008/11 rally at 228.07¢ and now targets the 50% retracement level at 203.92¢ next.

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Disclosure Appendix

Analyst Certification

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Buy: Indicates a recommended buy on our expectation that the issue will deliver a return higher than the risk-free rate.

Sell: Indicates a recommended sell on our expectation that the issue will deliver a return lower than the risk-free rate.

Corporate Bond Fundamental Recommendation Definitions

Buy: Indicates a recommended buy on our expectation that the issue will be a top performer in its sector.

Outperform: Indicates an above-average total return performer within its sector. Bonds in this category have stable or improving credit profiles and are undervalued, or they may be weaker credits that, we believe, are cheap relative to the sector and are expected to outperform on a total-return basis. These bonds may possess price risk in a volatile environment.

Market Perform: Indicates a bond that is expected to return average performance in its sector.

Underperform: Indicates a below-average total-return performer within its sector. Bonds in this category have weak or worsening credit trends, or they may be stable credits that, we believe, are overvalued or rich relative to the sector.

Sell: Indicates a recommended sell on the expectation that the issue will be among the poor performers in its sector.

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