

U.S. Commodities Markets

Top Five Key Risks to Commodity Prices

During the first third of calendar year 2023, performance of listed commodity futures was mixed. Commodities that had a bullish supply story like ICE sugar, CME feeder cattle or serve as protection from macroeconomic uncertainty like gold enjoyed sharp price appreciation. Commodities with a negative supply story like U.S. wheat, or with structural exposure to domestic and global macroeconomic health like crude oil, diesel, cotton, and nickel experienced acute negative price pressures.

During the next three/four months we see multiple risks that can continue to influence the price behavior of listed commodity futures.

Risk #1: U.S. Debt Ceiling Showdown

The current political theatre and brinkmanship over raising the federal debt limit that the President and Congress are engaged in is shaking confidence in risk assets. The U.S. government is scheduled to run out of cash around June 1, 2023. Since 1776, the U.S. has never outright defaulted on its debt. There have been technical defaults and government shutdowns as Congress and the President haggled over the debt ceiling. These government shutdowns occurred in 1995, 1996, 2011 and 2013. In 2023 we view an outright default as an extreme tail risk and a technical default as a higher, but still a low probability event. Overall, the ideological resolve and partisan composition of the left, U.S. Senate and the President, and the right, U.S. House of Representatives, has resulted in a political standoff and has started to inject a dose of nervousness in futures markets.

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HTS Commodities' Views: A clean resolution of the debt ceiling could represent a **bearish** input for treasuries, along with gold and silver. An expedient resolution can provide temporary **bullish** support to crude oil, crude products (RBOB, ULSD), and cotton. Soybean oil and corn could also experience short term price support. A dirty and prolonged negotiation would create acute left tail price risks for the above commodities.

Risk #2: U.S. Recession

A U.S. recession in 2023 could be the most well publicized and highly anticipated economic event in recent times. The probability of either a technical or an absolute recession is high, but the probability estimates vary. A Bloomberg survey of economists estimates a 65% probability of the U.S. entering a recession in 2023 and/or in 2024. The Cleveland Fed's model that uses the yield curve to estimate the odds of a U.S. recession stands at 76%. While the depth and length of the economic slump will be subject to interpretation, the impact on commodity demand has not gone ignored.

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HTS Commodities' Views: The prospect and growing probability of a domestic economic slowdown and negative economic growth is **bearish** aggregate commodity demand and prices. We feel that this sentiment is already in the process of being priced in the crude, crude products, natural gas, soybean oil, cotton, and base metals (aluminum, copper, nickel, zinc) commodity curves.

Risk #3: Weather – El Nino

The global climate pattern has moved from La Nina and is transforming from an ENSO neutral to El Nino. NOAA's Climate Prediction Center (CPC) predicts a 68% probability of El Nino developing during May-July 2023 in the northern hemisphere. As El Nino emerges, heat and precipitation risks will arise. Over a 40-year history, the El Nino climate pattern can generally be attributed to above-trend precipitation in the southern and eastern region of the U.S. Storm activity tends to be more vigorous in the Gulf of Mexico. Drier weather conditions in northern Brazil, Australia and Indonesia are also typical characteristics of the pattern while India tends to experience reduced monsoon rainfall.

HTS Commodities' Views: We believe that the El Nino weather pattern can create **bullish** price risks for natural gas, coffee, cocoa, sugar, and feeder cattle. We see El Nino as a **bearish** price input for wheat, corn, soybeans as higher likelihood of moisture increase can support yields.

Risk #4: Ukraine

Continued military activity in Ukraine preserves a myriad of commodity related risks. We see the Ukraine generated commodity price risk as dynamic and diverse that contain simultaneous right and left tail risks. These tail and normalized risks, normalized because the regional political instability has been intact for 16 months, are proven to impact aggregate commodity prices. A cease fire, peace agreement or escalating military activities in Ukraine can create both right and left tail commodity price outbursts.

HTS Commodities' Views: A ceasefire in Ukraine can generate **bearish** price sentiment for U.S. corn, wheat, and soybean oil. An end of the military conflict could be **bullish** for crude oil and base metals (copper, aluminum, nickel, and zinc) as construction efforts could stimulate demand. Escalating military activities by Russia or physical engagement by NATO countries could be **bearish** for energy and base metals. If broadened military actions slow Ukraine and/or Russian exports of corn, wheat, and sunflower oil this could be **bullish** catalyst for U.S. and Matiff wheat, corn, and oilseeds (canola, rape, and soybeans) prices.

The normalized commodity price risks focus on events inside Ukraine's current political paradigm and include:

- Ukraine agricultural commodity production has been a looming global question since Russia invaded the country in late February 2022. In 2023, favorable rains, and lower fertilizer prices can help offset the declining acres. However broad estimates see the country's agricultural production falling below MY 22/23 levels.
- Capricious Russian behavior towards the country's participation in the Black Sea Grain Initiative is another source of volatility for regional cereal and feed grain exports.
- Ad hoc military events. Over the last 16 months these include focused bombings, drone attacks, attempted seizures.

Each of these adds both right and left tail price risks for U.S. corn, U.S./Matiff wheat, and soybean oil.

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Risk #5: China

The commodity price risks that can originate in China are broad, unique, and far reaching. These risks range from slowing economic growth to escalating trade disputes between the country and the U.S. along with a low probability event like China invading Taiwan. Because China represents a large portion of the demand and supply equation for practically all commodities, we see a dynamic buffet of political and economic variables that can represent both bullish and bearish price inputs for listed commodity futures.

HTS Commodities' Views: Over the next three to four months, we see slowing post-COVID Chinese economic growth relative to estimates as potential **bearish** inputs for crude oil, hogs, and base metal futures prices. We also view the El Nino ENSO pattern as creating **bullish** risks to wheat and corn prices.

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YTD 2023 Returns		2/1/2022 - Current Returns	
LME Aluminum	-2.2%	LME Aluminum	-25.9%
Canola	-15.6%	Canola	-28.8%
Coffee	14.5%	Coffee	-22.0%
LME Copper	-2.4%	LME Copper	-17.4%
Corn	-13.3%	Corn	-5.8%
Cotton	0.3%	Cotton	-34.7%
Crude: Brent	-8.8%	Crude: Brent	-17.8%
Crude: WTI	-7.9%	Crude: WTI	-21.5%
Feeder Cattle	12.6%	Feeder Cattle	23.4%
Gold	8.0%	Gold	10.5%
Live Cattle	4.5%	Live Cattle	15.7%
Lean Hogs	2.5%	Lean Hogs	0.9%
Natural Gas	-40.4%	Natural Gas	-51.4%
LME Nickel	-32.1%	LME Nickel	-7.6%
Palm Oil	-12.1%	Palm Oil	-34.4%
RBOB	5.0%	RBOB	-6.2%
Rough Rice	-3.7%	Rough Rice	13.2%
Silver	-2.1%	Silver	6.1%
Soybean Meal	-10.5%	Soybean Meal	-2.3%
Soybean Oil	-24.9%	Soybean Oil	-27.8%
Soybeans	-8.3%	Soybeans	-11.7%
ICE Sugar	32.3%	ICE Sugar	44.9%
ULSD	-23.4%	ULSD	-16.7%
Wheat: Chicago	-16.5%	Wheat: Chicago	-13.9%
Wheat: KC	3.0%	Wheat: KC	16.4%
Wheat: Matiff	-22.6%	Wheat: Matiff	-10.2%
Wheat: MGEX	-4.4%	Wheat: MGEX	-2.4%
LME Zinc	-17.0%	LME Zinc	-30.7%

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