

# Commodity and Foreign Exchange Outlooks Q4 2015:

## Commodity supply cutbacks in focus, as central banks dictate FX moves.

### Executive Summary

**Commodity supply is being cut back** after five years of continuous negative price performance. A number of commodities from copper, platinum, corn and even sugar are likely to be in a supply deficit this year. That will help eat into inventory that has built up over the years. Oil will remain in a supply surplus until at least the middle of next year, but the wheels are turning in the right direction, with upstream capital investment being cut back severely in the wake of the drop in oil price over the past year. We identify several shocks that could move commodity prices. Beyond the macroeconomic risks, that could see interest rate increases postponed (which would be gold price positive), weather risks could shock some commodities. We are currently in the most severe El Niño since 1997. Should history be a guide for the future, we could see corn, cocoa and sugar prices rise, while coffee, soy and US natural gas prices are likely to fall.

**Low oil prices are keeping inflation measures subdued** globally and this will encourage many central banks to continue their aggressive easing stance toward year end and into 2016. Indeed, it is only the US Federal Reserve that we expect to tighten policy this year. A result of the benign inflationary environment, central bank accommodation will continue to be a feature of the currency landscape for the foreseeable future. Policy rates will remain low or negative to support economies and this will predictably exert continued downward pressure on exchange rates. Currency wars will therefore remain a consequence of such stimulatory central bank policy, whether or not it is a stated direct policy objective or not.

**The outlook for interest rates and central bank stimulus** (alongside uncertainty over the Chinese economic growth path) will continue to be the dominant driver of G10 currency pairs. Volatility has been elevated as policy uncertainty roils markets and remains a key investor concern. Currency volatility has moderated recently and we anticipate more subdued volatility levels in Q4.

## COMMODITIES

### Summary

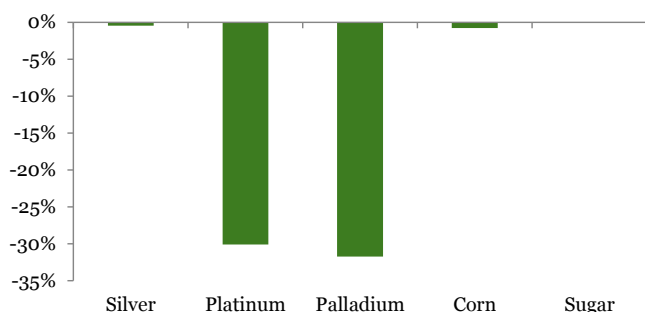
2015 has been characterised as a year of belt-tightening for miners, farmers and energy extraction companies in certain parts of the world. The notable exception has been the Organization of the Petroleum Exporting Countries (OPEC), which changed strategy last November to produce as much oil as it can to gain market share. Elsewhere in the oil space, severe cuts to upstream investment should see supply tighten in due course.

Less progress in supply cuts have been made in aluminium and certain other base metals that see their supply heavily driven

by China's production decisions. While China started the year committed to economic reform that would see markets play a more decisive role in decision making, a number of mishaps (notably the country's stalled attempts at injecting market dynamics into the equity market) has made progress in this regard disappointing.

US dollar appreciation is likely to cap commodity price gains in the final quarter of this year, although any disappointing data in the US could paradoxically be commodity price positive if rate rise expectations are pushed out further.

### A Number of Commodities Enter a Supply Deficit in 2015 Supply Deficit (% of Demand)



Source: GFMS, Johnson Matthey, USDA, ETF Securities

## PRECIOUS METALS

### Gold: 2013, take-two?

Over the past quarter it has become more apparent that gold's role as a monetary asset has out-trumped its role as a safe haven asset. Greece's near-miss with default did not drive any significant interest in the metal, yet when the Federal Reserve failed to raise rates in September, we saw US dollar depreciation and the gold price rallied.

In our view the Fed is likely to hike rates in December and there is naturally going to be a negative weight on the metal's price in US dollar terms. Although the Fed has prepared the market for eventual rate increases, we would not be surprised to see downward price movements as we saw during the "taper-tantrums" in 2013.

In euro and yen terms, the metal is faring much better. Expectations of continued policy easing by the European Central Bank and Bank of Japan are likely to favour gold as an alternative hard asset to the euro and yen.

Gold has outperformed major equity indices in both in the US and euro area euro (S&P500, Russell2000, DAX, Stoxx50) in local currency terms year to date. The underperformance of cyclical assets is likely to bring gold's defensive qualities to the fore.

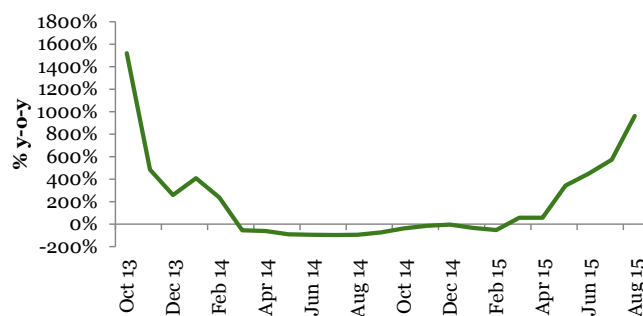
Physical demand for gold from China and India had been weak in H1 2015, but there are signs the tide is turning. Withdrawals from the Shanghai Gold Exchange hit a record high in the January to August period, indicating demand for the metal has strengthened. We observed a similar surge in gold withdrawals from the Shanghai Gold Exchange in 2013 which led to gold consumption hitting an all-time high that year. Also echoing trends in 2013, Swiss exports of the metal to Hong Kong and China have surged in recent months and China's net imports of gold from Hong Kong have doubled from a year ago in July. At the same time the gold futures curve is in backwardation. That presents a theoretical conundrum – why should a non-perishable asset trade at a lower price on spot than in the future if it can so easily be lent? Some argue that the price difference is not being arbitrated out, because the metal

remains in tight supply for immediate delivery (i.e. in appropriate LBMA or COMEX Good delivery form). Once again this echoes what we saw in 2013.

With the Chinese central bank now producing statistics on its gold holdings more frequently (monthly since June instead of one in 9 years), we can see a steady accumulation by the People's Bank of China, which is adding to demand.

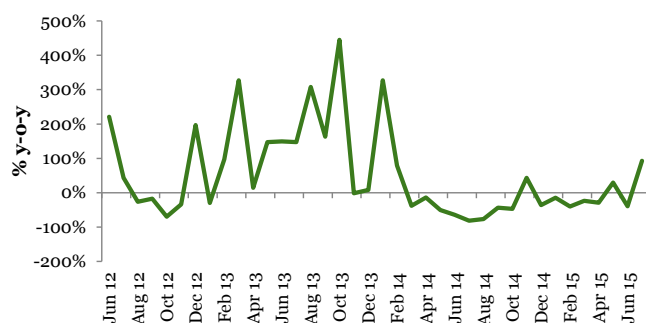
Unfortunately, China's surge in demand in 2013, did little to lift prices. This déjà vu moment could have more eerie similarities to 2013.

### Growth in Gold Exports from Switzerland to China and Hong Kong



Source: ETF Securities, Bloomberg

### Growth in Gold Exports From Hong Kong to China



Source: ETF Securities, Bloomberg

Gold demand in India usually hits a seasonal high in October. However, poor weather conditions brought on by the El Niño could curb rural spending this season. Rupee depreciation may also make the metal seem more expensive to Indians.

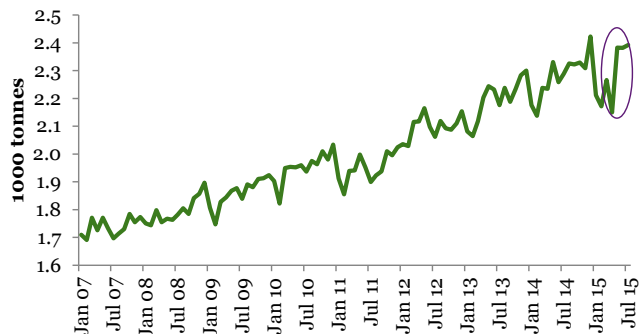
### Silver: supply deficit looms

Despite reports of coin mints running out of silver coins, there does not appear to be a general shortage of the metal. Although the US, Canadian and Australian mints seem to be facing manufacturing bottle-necks.

Only 25% of silver production comes from primary silver mines, with the remaining extracted as a by-product of gold, lead, zinc and copper. Silver supplies are therefore often difficult to control as the decision to mine is often driven by the mining decision of other metals.

With a general cutback in mining activity across many metals, silver supply looked like it was tightening at the beginning of the year. We expect that the metal will be in a supply deficit in 2015. However, recent data from the World Metals Bureau indicates that mine supply is gathering pace once again.

### Silver Mine Supply



Source: ETF Securities, Bloomberg

Supply from scrap sources, historically over 20% of global supply, declined for the third successive year in 2014. Scrap supply may remain tight due to weak prices and could account for less than 15% in 2015.

Retail investment in India looks like an area of relative strength. According to Metal Focus data, year-to-date imports of silver bullion have amounted to 4,900 tonnes, a 50% increase on the same period last year.

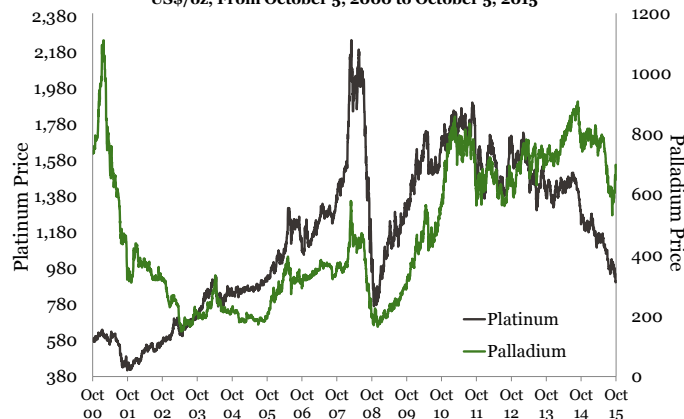
Silver maintains a tight correlation with gold. So despite the increase in demand for the metals from emerging markets like China and India for both metals, the global price may be more dictated by their role as a monetary asset.

## PGM

### Platinum: Plummets after emission scandal

The Volkswagen emissions scandal revealed on 18 September caused a sharp divergence in sentiment resulting in platinum's premium over palladium trading at its lowest level in 13 years. Despite an improvement in the demand outlook for platinum from jewellery and investment, negative sentiment for Platinum continues to weigh on prices. While fears of a consumer shift in preference for gasoline cars, buoyed by robust US auto sales have helped palladium reverse its downward trend.

### Platinum's premium vs Palladium trades at a 13 year low



Source: Bloomberg, ETF Securities

The software defeat device used in Volkswagen's diesel engines cheated on the results of NOx (nitrogen oxides) testing, violating the US clean air act. Versions of the Volkswagen's diesel engines fitted with the Lean NOx trap (LNT) and urea based selective catalytic reduction (SCR) system emitted up to 35 and 20 times the EPA's required limit, respectively.

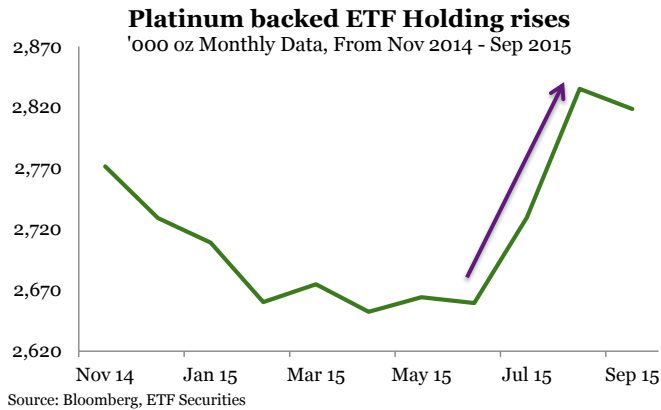
Models fitted with the SCR system require a top off of a urea solution on gases exiting the diesel oxidation catalyst. The software on Volkswagen cars sensed when the test mode was active and released urea into the emission gas to neutralize harmful nitrogen dioxide emissions. Despite having no role to play in the after treatment of NOx emissions platinum suffered the brunt of the scandal. It's worth noting that a recall of cars by Volkswagen will also have no direct bearing on the demand for platinum, since the NOx after-treatment is not impacted by the PGM based oxidation catalyst. Exacerbated fears of a consumer shift in preference for gasoline vs diesel cars have weighed on the demand outlook for platinum known to derive 44% of its use in pollution abatement technology in both diesel and gasoline cars. While the case for fuel efficiency remains strong for diesel engines it's hard to determine how long Volkswagen's deception will curtail demand. The trend of rising European auto sales is diverging from the downward trajectory of platinum prices.

### Gold:Platinum ratio



Source: Bloomberg, ETF Securities

Plunging platinum prices have led a sharp rally in the gold to platinum ratio and could help switch investor preference for cheaper platinum jewellery. The onset of the festival season in India coupled with rising platinum imports from China (up 16% year on year) bodes well for Q4 demand outlook. Platinum backed exchange traded funds continue to add to their holdings expanding 4% this year.



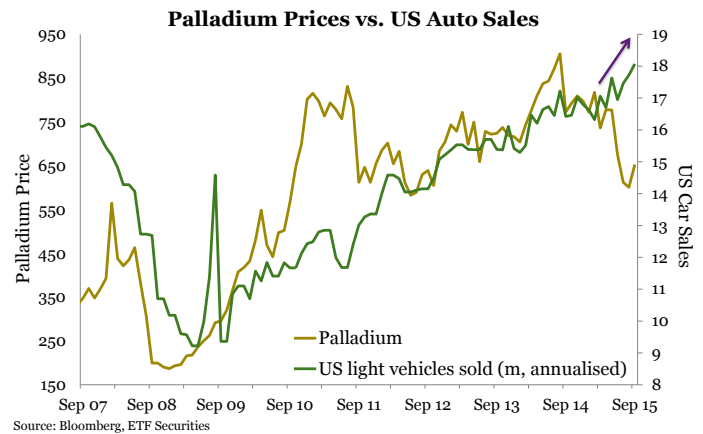
On the supply side, improvement in operational and safety performance helped South African platinum mine production rise 21% since the first quarter as reported by the World Platinum Investment Council (WPIC). Scrap supply declined in the second quarter by 5% as falling prices reduced the auto catalyst collection rates. Despite a 9% rise predicted in total supply, WPIC have revised the 2015 forecast for the platinum market deficit to 445koz from 190koz on the back of higher investment demand.

Rising costs of production amidst falling prices have forced the world's largest miners of platinum to slash jobs and idle mines in an attempt to reduce capex. Lonmin, the world's third largest platinum producer will cut annual platinum production by 100,000 ounces putting 6000 jobs at risk. While Anglo American platinum sold its three platinum mines in Rustenburg to Sibanye Gold. And its parent Anglo American plans to cut a third of the global workforce over the next few years.

We believe platinum prices have been unduly impacted by the emissions scandal and weakness in platinum prices will continue in the short term as negative sentiment pervades fundamentals. However rising auto sales in US and Europe, the onset of the festival season in India and China and moderate speculative investment appetite bode well for platinum's long term demand outlook.

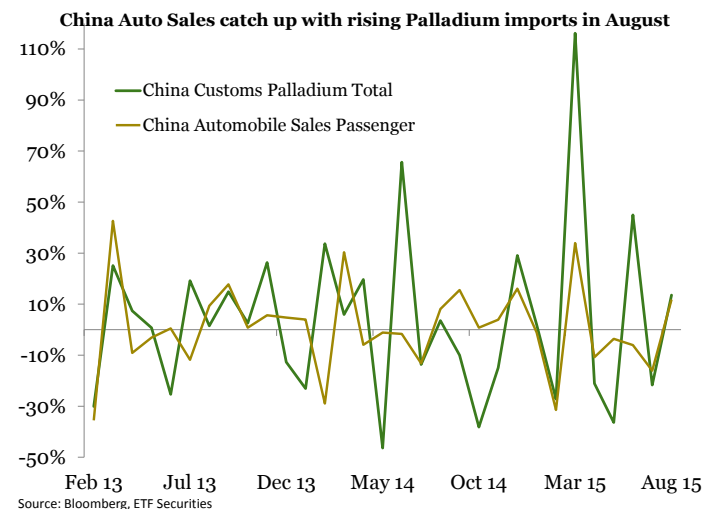
## Palladium: Fuelling up on diesel woes

Palladium known for generating 70% of its use in gasoline auto catalysts, that have a high penetration in US and Chinese auto markets, surged to a 3month high \$709. Fears of a shift in investor preference to gasoline powered engines coupled with the best US auto sales in more than a decade helped improve the demand outlook for palladium.



In addition President Li Keqiang's announcement on 22 September to accelerate construction of electric-car charging facilities in China boosted palladium prices. While in reality Palladium has no role to play in electric cars, the government's commitment to clean energy was bolstered, aiding the pollution abating metal.

The rise in Chinese imports of 14% in August closely tracked by rising auto sales of 12% created a favorable environment for palladium's demand.

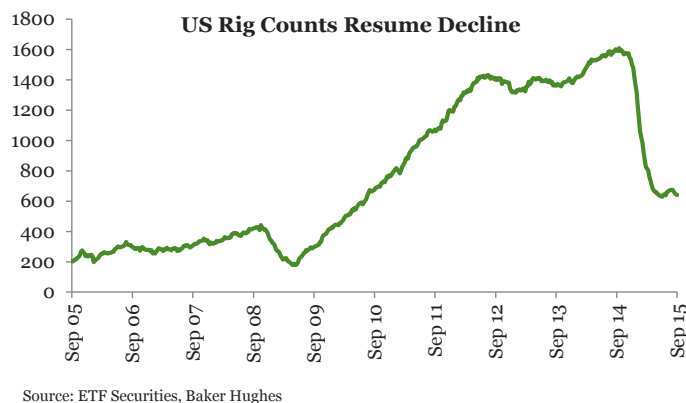
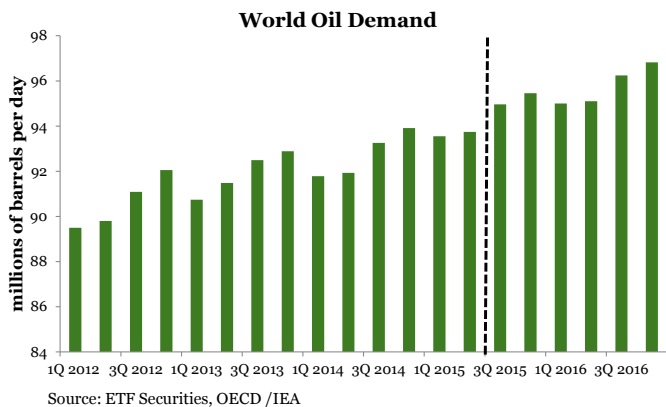


## ENERGY

### Oil: in pursuit of balance

Oil prices have resumed their decline after brief rallies between March and June and between August and September. The oil supply glut warrants further price weakness to help the market gain balance.

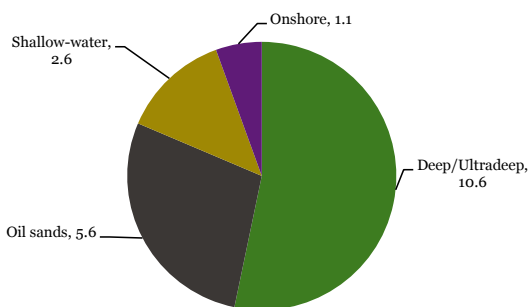
The process appears to be working. Demand for crude is set to increase according to the International Energy Agency, which edged up its demand forecasts once again last month, bringing 2015 demand to a five-year high.



Low oil prices are driving project deferrals and will cut investment across the industry. A recent study by Wood Mackenzie shows that 20 billion barrel oil equivalent (boe) of final investment decisions in upstream energy will be deferred as a result of the rout in prices this year. That equates to a US\$200bn hole in the industry’s investment pipeline. Over 50% of those cuts come from deep water projects and nearly 30% from Canadian oil sands. The lead-times for these projects are long. Once deferred these projects will not come back on-stream quickly.

Russian and North Sea oil production is also likely to decline, taking non-OPEC supply down to 57.7m b/d at the end of 2016 from 58.1 m b/d at the end of 2015 according to the IEA.

**Deferred Project Reserves by Resource Theme (bn boe)**



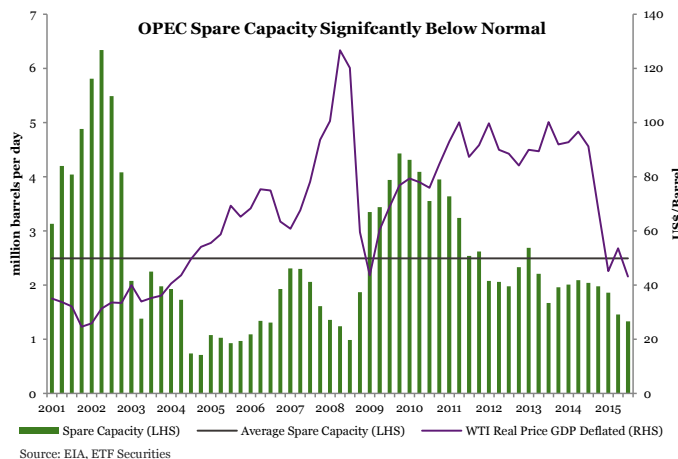
OPEC crude supply actually fell in August, led by losses in Saudi Arabia, Iraq and Angola. We don’t think that OPEC is going to change course on its strategy to rebuild market share and therefore the group’s production is unlikely to fall significantly, but the last month’s data highlights that it is difficult even for OPEC to continue to produce at such volumes.

We believe that it will take some time for strengthening demand and slowing supply to bring the market into balance. A lot rests on whether OPEC continues to increase production. However, as the process gathers pace, we could see Brent crude reach US\$60/bbl in the second half of 2016.

We believe that the era of US\$100/bbl oil is well and truly over. Oil may reach US\$80/bbl when the markets regain balance in 2017.

US oil rigs in operation have also started to fall again, helping to tighten supplies from the US. According to the IEA, US tight oil supply could fall by 400k b/d next year (from 4.3 m b/d to 3.9m b/d), factoring in rig closures and depletion rates. A key feature of the US tight oil market is the continued need for investment to maintain the current pace of production. Output per US tight oil well has historically fallen by more than 70% in the first year of operation, highlighting the need for rigs to be moved frequently.

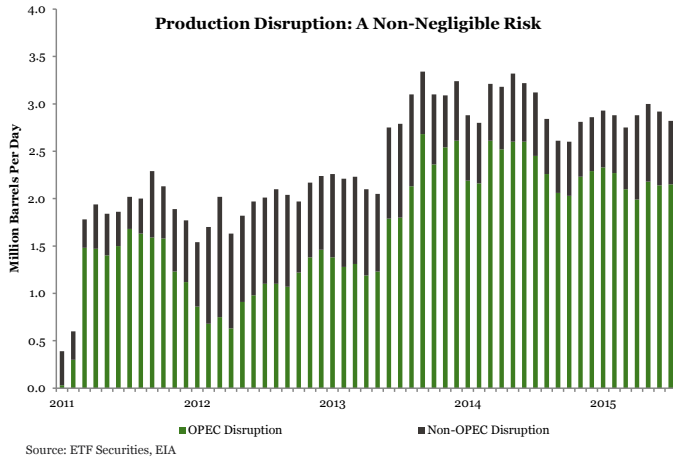
However, there are risks of temporary spikes. As non-OPEC production continues to decline, the “call” on OPEC will increase. OPEC spare capacity remains low by historic standards. The ability of the group to respond to production shocks is likely to be compromised and so shocks could more easily translate into price increases, as they have done in historic periods of low capacity.



Shocks by their definition are not predictable, but we do note



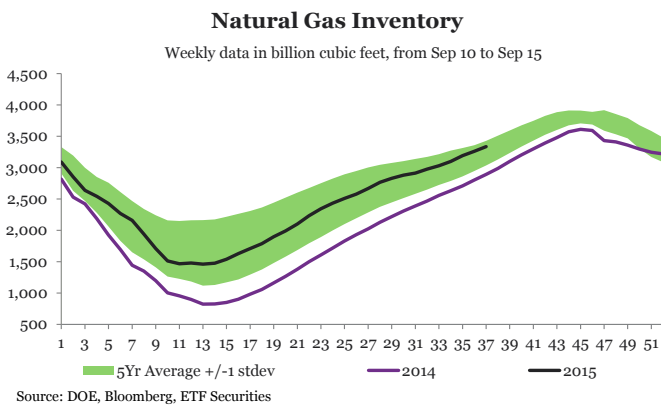
that supply disruption risks are non-negligible. Disruptions are currently significantly higher than they were in 2011-2012, with long-standing outages in Libya and Iran (OPEC) and Syria and Yemen (non-OPEC). In 2015, outages in the Neutral Zone at the Khafji and Wafra fields between Saudi Arabia and Kuwait have also detracted from supply. Further disruptions could put strain on a system that is operating at close to capacity.



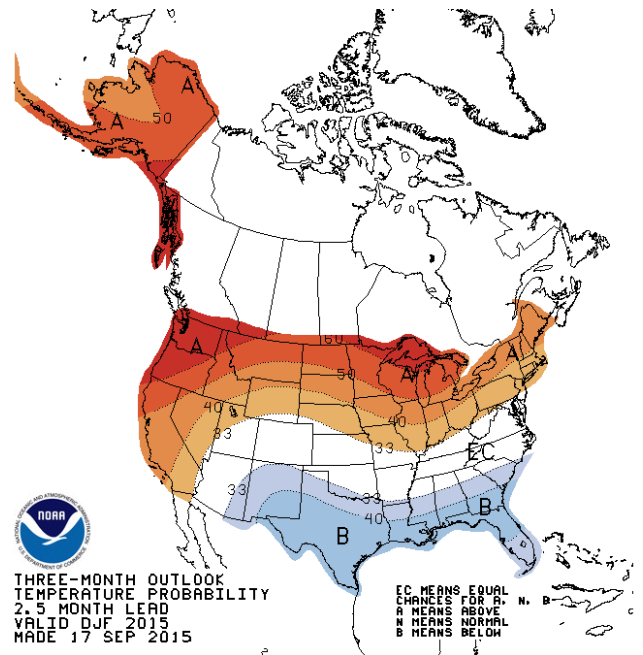
The impact of shocks are likely to be short-lived because US tight oil can be very responsive to price changes. It can take as little as a month to switch on horizontal rigs in tight oil formations in the US and many lie idle at the moment.

### Natural Gas: warm winter woes

Natural gas inventories rose by 10% last month as the end of the seasonally high demand period gave way to the fuel injection season. By the end of October the EIA expects inventories to increase to the third highest October-end levels on record.



Meteorologists expect the El Niño to provide a warmer winter in northern parts of the US, which will likely reduce heating degree days. Although southern parts of the US are likely to be colder than normal, the impact on heating demand is likely to be more pronounced in the north. Natural gas prices are likely to fall.

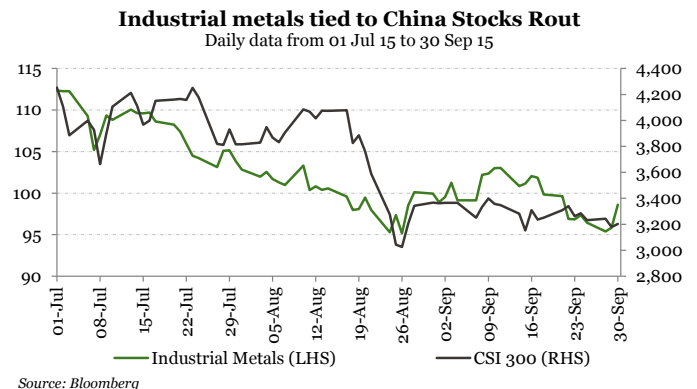


## INDUSTRIAL METALS

### Have prices reached their bottom?

Industrial metals over the past quarter have been mainly driven by concern over China economic slowdown and rising volatility on the global stock market. Following the rout on China stock exchanges in late August, a Chinese hard landing scenario has become much more real in investors' mind. However, positive signs have lately emerged from a technical viewpoint which, if confirmed, could brighten the outlook for Q4.

With the exception of tin, industrial metals recorded negative returns of 10% on average over the past quarter, as global manufacturing data disappointed. China Manufacturing PMI came out weaker than expected for July and fell below the 50 mark for August and September, indicating that the sector has been contracting. The US ISM, although above the 50 mark, also disappointed, adding to the general pessimism that has been affecting the industrial metals market for months.

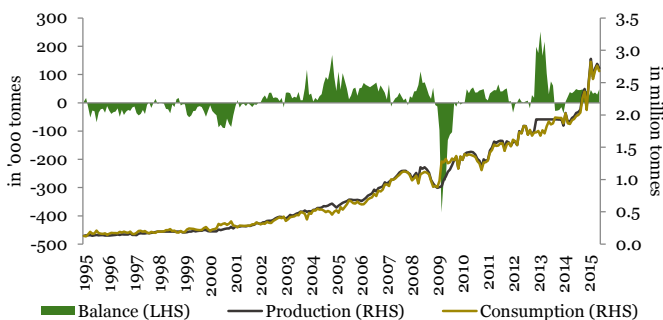


As global stock markets were recovering from the Chinese turmoil late August, metal prices rebounded from their multi-year lows as well, ending the quarter in a positive note. Although signs of fundamental support have yet to materialise for most metals, market sentiment has recently started to reverse for aluminium, copper and tin, suggesting that prices could have reached their bottoms in Q3. We believe that prices will recover in Q4 as global production cuts across industrial metals accelerate.

## Aluminium: Surging output weighs on price

Aluminium declined by 5% in Q3 as concerns over elevated Chinese output kept prices low. After surging 35% in Q1, output from China has stabilised in Q2/Q3 according to the World Bureau of Metal Statistics (WBMS). However, China production rise was in response to a leap in domestic consumption which rose to an all-time high in March 2015. Although China is a net exporter of the metal, exports dropped 23% in H1 2015 and 27% compared to June 2014, suggesting that concern regarding oversupply was somewhat overblown. The global aluminium market is in deficit, confirming that the market is tightening.

**China Aluminium Balance**  
Monthly data to July 2015



Source: World Bureau of Metal Statistics

At the London Metal Exchange, net non-commercial positions in aluminium futures have shown signs of recovery in Q3 as money managers reduced their short positions for the metal, suggesting that sentiment may continue to experience a favourable shift in Q4. Tighter market conditions combined with positive sentiment could lift aluminium prices.

## Copper: weak prices lead to supply cut

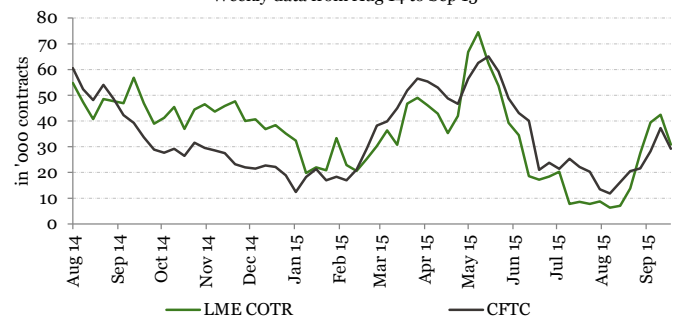
An uncertain global economic outlook has prompted volatile copper trading, initially dragging the price of copper down to its six-year low at the end August. The metal subsequently rebounded 9%, crossing US\$5,400/MT on the back of supply concerns after a severe earthquake in Chile. Copper closed the quarter at US\$5176/MT, down 10%.

Weak copper prices have however started to affect global supply as two of the largest commodity producers announced revised figures for 2015 and 2016. Glencore revised down its output target for 2015 by 500k tonnes while Freeport said it will reduce capital spending to US\$4bn in 2016 compared with

US\$5.6bn initially planned. Chile, the world's second largest producer of refined metal after China, saw its production down 6.4% y-o-y to July according to the WBMS. Codelco, the world's largest copper miner, also expects output from Chilean mines to fall 33% in the next 25 years as ore grade is declining in Chile.

Meanwhile, sentiment towards the metal is also reversing. Net long positions into copper futures listed on the LME and COMEX recently surged as money managers dropped their short positions. Although net positions remain more than 40% below their peak in May, this shift in sentiment should eventually lend support to copper price in the near term.

**Net Positions into Copper Futures**  
Weekly data from Aug 14 to Sep 15



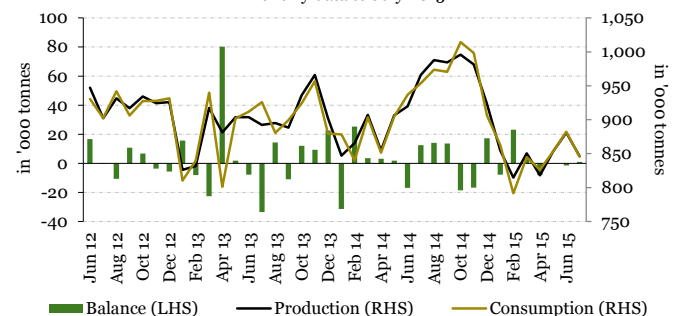
Source: ETF Securities, LME, CFTC

Of the 364k tonnes of surplus forecast by the International Copper Study Group (ICSG) for 2015 in April, only 19k tonnes (5.2%) have materialised so far. China copper net imports surged 11% y-o-y to July as domestic consumption jumped 7.1%, indicating that China demand for the metal has been strong. We maintain our view that copper will end this year in a deficit on strong global demand and further production cuts. We expect the price of copper to lead industrial metals recovery in Q4.

## Lead: Waiting for a catalyst

Down by 5% in Q3, the global lead market appears to be relatively balanced this year according to the latest numbers from the International Lead and Zinc Study Group (ILZSG). The metal posted a small 1,000 tons surplus in July 2015.

**World Lead Balance**  
Monthly data to July 2015



Source: International Lead and Zinc Study Group

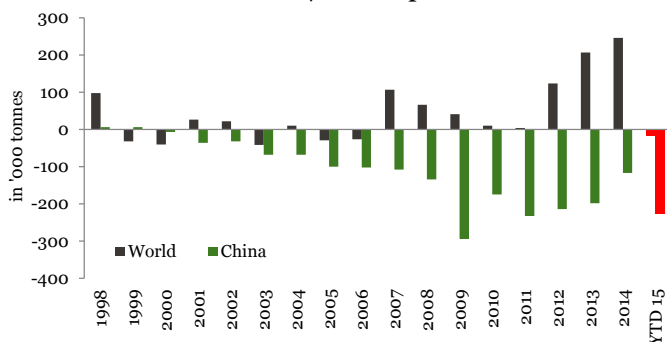
China is the world's largest producer and consumer of refined

lead, followed by the US. While manufacturing weakness has weighed on prices across the industrial metals complex, we expect negative sentiment to be overdone. Accordingly a turnaround in sentiment could help support prices.

## Nickel: Elevated stockpiles keep prices low

According to data from the WBMS, the global market in H1 2015 recorded a deficit for the first time since 2006 while the Chinese market has been in deficit since 2000. China accounts for 36% of the world production and 60% of the world consumption and is on track for its largest deficit in 2015. As a result, China has been importing nickel during H1 2015, getting close to its record in July 2009.

### Nickel Production/Consumption Balance

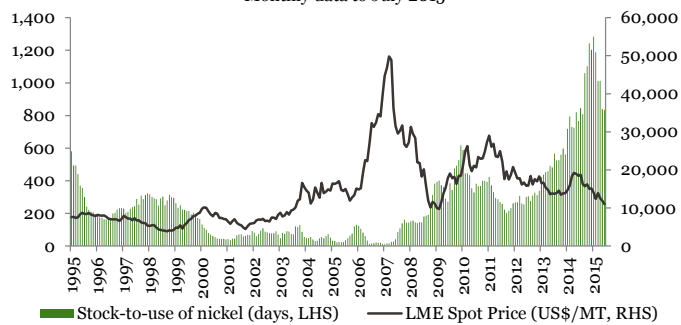


Source: ETF Securities, World Bureau of Metal Statistics

However, large stockpiles kept the price of nickel low in Q3. While inventories at the LME have declined by 4% since the peak at 470k tonnes in June, stock-to-use for July still stands at around 800, indicating that any shortfall of supply can be covered by inventories for at least 2 years.

### Nickel Stock-to-Use vs. Price Level

Monthly data to July 2015



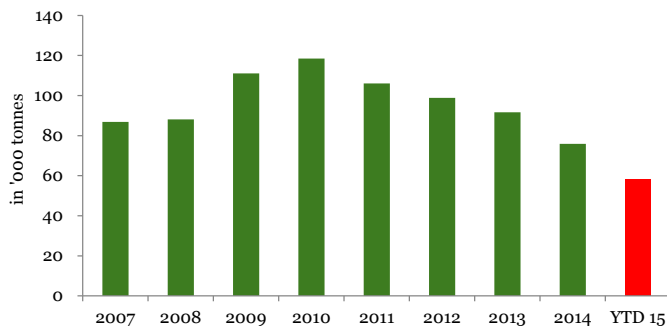
Source: ETF Securities, LME, World Bureau of Metals Statistics

We however believe that global demand for nickel will continue to ramp up, above all from China, trimming inventories further. We maintain our bullish view on nickel and expect the metal to be one of the best performers of the complex in Q4.

## Tin: Price gains on low Indonesian exports

Tin was the best performer among industrial metals in Q3, gaining 13% as Indonesia, the largest exporters of tin, is on track for its lowest annual exports on record.

### Indonesia Exports of Tin



Source: Ministry of Trade of the Republic of Indonesia

The decision of Indonesia to introduce new rules for shipments of tin in May has caused delays in delivering export approvals under the new rules sending tin exports for July to 6.3mn tonnes, down 24% compared to previous month and 17% y-o-y. The news came shortly after the metal reached its historical low early July, providing a boost to the price of tin.

At the Indonesia Tin Conference and Exhibition (ICDX) in mid-September, the Association of Indonesian Tin Exporters (AETI) stressed the importance to support the price of the metal as between 50% and 70% of Indonesian tin resources are not minable at prices around US\$15,000/MT according to the president of the association. After reaching US\$14,000/MT in late August, tin rose 12% since. We believe global supply will continue to tighten and lend support to the metal in Q4.

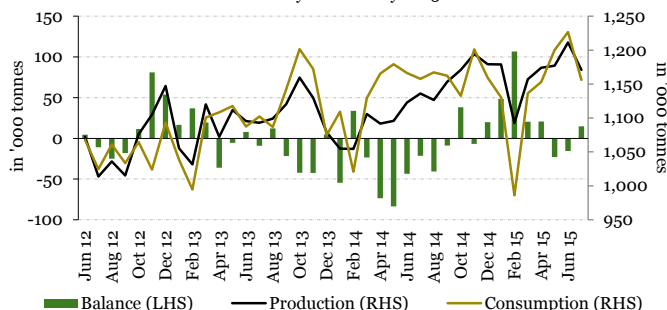
## Zinc: Inventories build-up weighs on price

Zinc is the worst performer of the quarter, down 16%, as inventories at the LME warehouses saw 38% rise since mid-August, underscoring the abundant supply situation market.

According to the ILZSG latest numbers, the world zinc market recorded a surplus of 172k tonnes during H1 2015, following two years of deficit, with the largest monthly surplus being in February.

### World Zinc Balance

Monthly data to July 2015



Source: International Lead and Zinc Study Group

A recovery of other industrial metals would lift the price of zinc. However continued rising inventories are likely to cap upside gain in the near term.



## AGRICULTURE

### Extreme El Niño

The 2015 El Niño is already the strongest since 1997-98 by some measures, and could become the most severe since records began in 1950. In our last quarterly outlook, we described some of the implications of an intensifying El Niño event (see [Outlook Q3 2015, “What Happens When Fundamentals Reassert Over Sentiment?”](#)). Meteorologists can confirm that we are in a strong event, lifting some of our conditional statements on its implications. However, El Niños rarely occur in isolation, with several other weather patterns competing, complicating actual outcomes. Extreme El Niños are also very rare, with only three others on record (1972-73, 1982-83, 1997-98), limiting our empirical knowledge on the topic. Notwithstanding these limitations, we believe that the weather event will be positive for corn, cocoa and sugar prices and negative for soy and coffee.

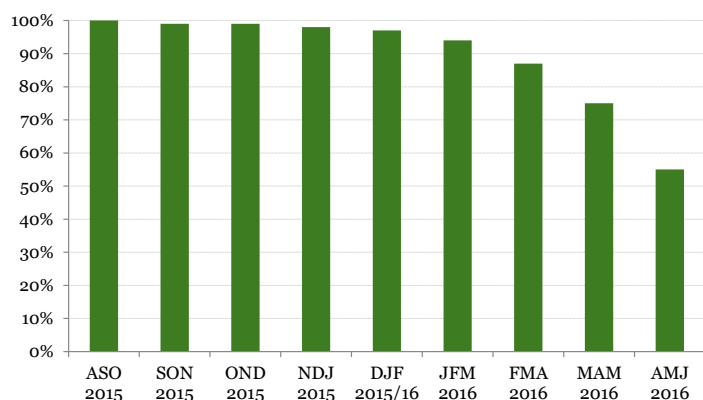
#### Summary of price expectations

Price Projection	Overall
Arabica Coffee	↓
Sugar	↑
Cocoa	↑
Wheat	↔
Soybean	↓
Corn	↑

Source: ETF Securities

The El Niño is likely to last into 2016, peaking in winter 2015 and therefore will affect a number of global crops in production.

**El Niño Likely to Last into 2016**  
(Probabilistic Based ENSO Forecasts)

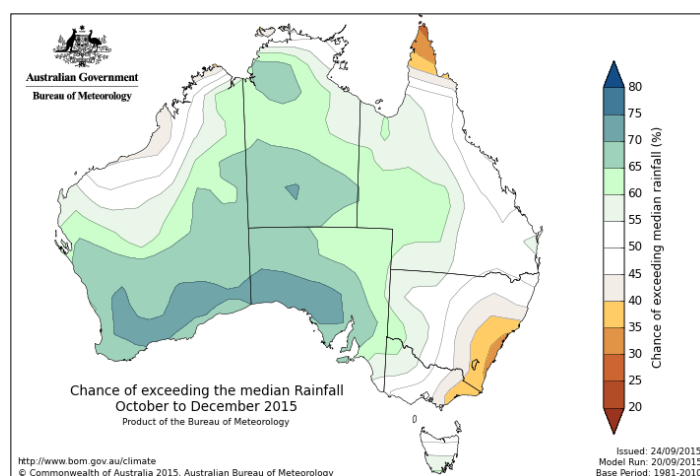


Source: International Research Institute for Climate and Society (Columbia University), ETF Securities

### Wheat

The El Niño had arrived too late to affect the US winter wheat harvest that has just completed. The US crop remained strong, but fell short of the 2012/13 high. Larger crops in the European Union, Russia and Ukraine have helped boost global production to a record high for 2015/16.

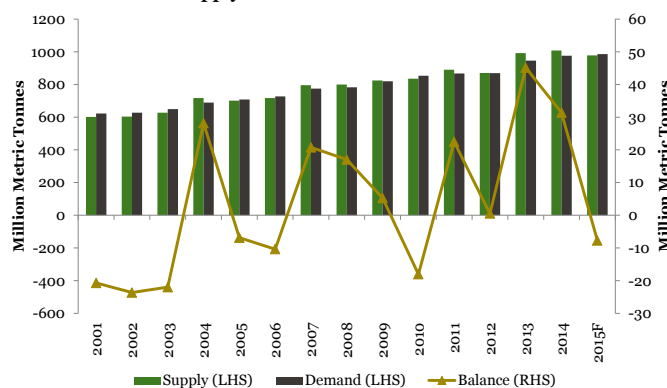
Australian climate is highly influenced by temperature patterns in the Indian Ocean. Sea surface temperatures in the southern Indian Ocean had hit the highest on record for the southern hemisphere winter. El Niño is usually associated with below-average southern hemisphere winter-spring rainfall over eastern Australia, and a warm Indian Ocean typically reinforces this pattern over central and southeast Australia. However, this pattern has been offset in central and some southern areas by the record warm Indian Ocean. Warmth in the Indian Ocean is likely to continue. Wheat growing in eastern parts of Australia is likely to suffer, while wheat growth in Western Australia will likely prosper, with both effects broadly offsetting each other on price. El Niño intensification could out-trump the Indian Ocean effects in due course, but with a significant portion of the reproductive growth period over, there is likely to be little upside to prices in this season.



### Corn

Corn is likely to be in its first supply deficit since 2010, with reduced planting driving the tightness. The El Niño is likely to exacerbate the situation as unfavorable weather conditions in the US could hurt the crop. European Union corn growing has been adversely affected by hot dry weather, with the USDA reducing its estimate for the size of the EU crop for this season by close to 7% last month.

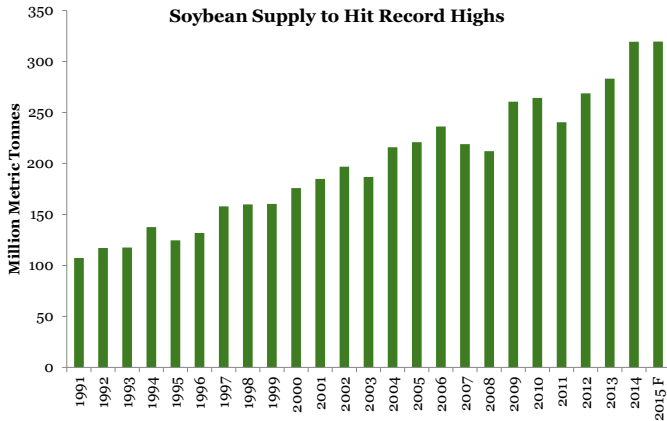
**Corn Supply Heads for First Deficit Since 2010**



Source: ETF Securities, Bloomberg, USDA

## Soybean

With the Brazilian and Argentine harvests over, focus is now on the US where the harvest will begin. US production typically increases in El Niño years with a combination of increased precipitation and warmth aiding yields. With that boost to yields we are likely to see record global production, after a very strong output from Brazil earlier this year. While demand is also expected to increase, it will not keep pace with supply, likely leading to the fourth consecutive year of supply surplus.

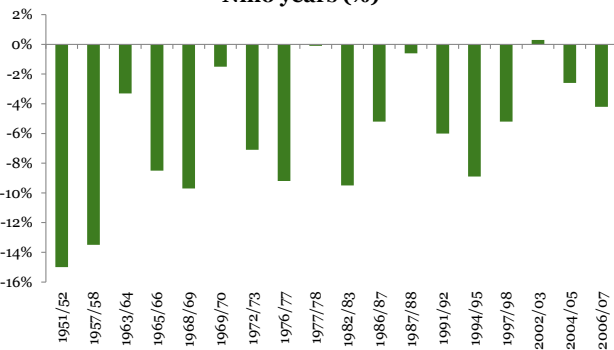


Source: ETF Securities, Bloomberg, USDA

## Cocoa

The El Niño is likely to exacerbate the dryness in West Africa and hamper the cocoa crop this year. Ghanaian yields have been poor this year. The Ivory Coast paradoxically has suffered from too much rain during its flowering process in July, and now excess dryness brought on by the El Niño will be ill-timed as the crop enters its main harvest period. Although cocoa prices have already rallied this year, we could see the further upside to price.

Cocoa Production Departure from Trend in El Nino years (%)



Source: United States Department of Commerce, National Oceanic and Atmospheric Administration (NOAA), International Cocoa Organization (ICCO)

## Sugar

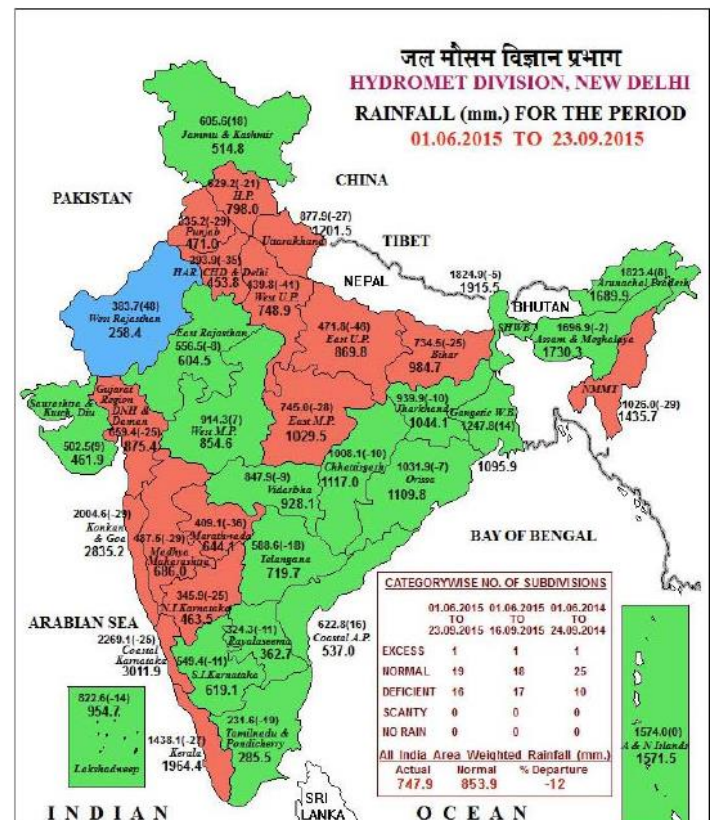
The El Niño has suppressed the Indian monsoon, driving rainfall 12% below normal levels. India, the second largest producer of sugar, relies on monsoon rainfall for 70% of its annual precipitation. Some of the key sugar-producing regions of India have seen their rainfall fall 20 to 59% below normal. The Indian Sugar Mills Association has revised its production

estimate for this year down to 27 million tonnes (-3.6% from its July forecast).

Brazil, the largest producer of sugar, is experiencing excess rain which is slowing its harvest. São Paulo has harvested 8% less cane so far this year (harvest should end in November) and sugar production in the region is currently 14% below last year's levels. Should the rain not abate, cane in the ground could start to spoil, hurting this year's crop.

China has been reducing its own planting of cane amid weak prices in recent years and will need to import a record 5.5 million tonnes in the 2015/16 marketing year which has just started (up 70,000 from last year). The USDA has already upgraded the 2014/15 import estimate by a million tonnes to 4.8 million tonnes. China is now the largest importer of sugar and the USDA's forecast of Chinese consumption growth of 1.7% this year will see its share of global consumption grow.

Although there is no danger of running out of physical sugar, with five prior years of surplus global production to work through, a smaller crop this year is likely to lead to a supply deficit. The International Sugar Organization raised its deficit forecast to 2.487 million tonnes in August from 2.3 million in May.



LEGEND: ■ EXCESS (+20% OR MORE) ■ NORMAL (+19% TO -19%) ■ DEFICIENT (-20% TO -59%)  
■ SCANTY (-60% TO -99%) ■ NO RAIN (-100%)  NO DATA

NOTES:  
 (a) Rainfall figures are based on operational data.  
 (b) Small figures indicate actual rainfall (mm.), while bold figures indicate Normal rainfall (mm.)  
 Percentage Departures of Rainfall are shown in Brackets.

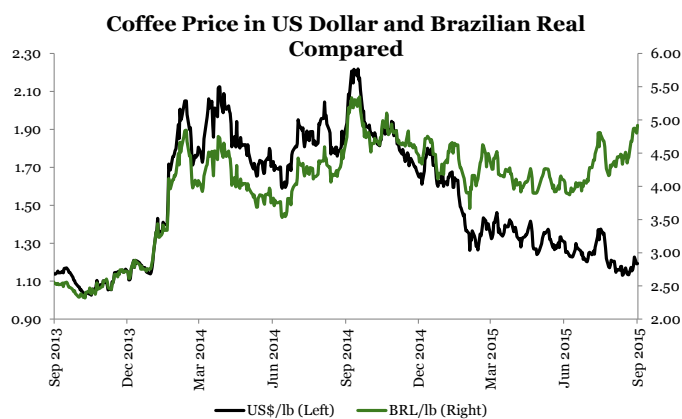
## Coffee

Arabica coffee has seen significant volatility this year amid

speculation about the size of this year's Brazilian harvest and volatility in the Brazilian Real. Brazil accounts for 45% of global arabica production and last year's drought threatened to damage this year's crop. While rain has been unseasonal this year, it has been plentiful, helping to reverse some of the damage to coffee bushes last year. Speculation ceased at the end of September with Conab (State Agricultural Department) announcing that the arabica harvest was only 3.1% below last year's, significantly better than many had expected.

Still weighing on coffee prices is the depreciating Brazilian Real. Economic woes and corruption scandals have depreciated the currency by 40% against the US Dollar in the past year. As coffee is traded in US Dollars, Brazilian farmers have been keen to sell into the international markets as they have been able to maintain a stable income in Brazilian Real terms despite the falling price of coffee.

The El Niño is helping to provide precipitation in key growing areas in Brazil during its flowering process, which should aid recovery of the crop yield in 2016. El Niño may reduce rainfall in Central America and Mexico (25% of global Arabica production). That could help suppress the rust fungus that has been damaging the crop in the region for the past few years. As long as the dryness is not excessive, we could see crop production in the region improve. El Niño is also likely to increase dryness in Colombia (10% of global production) and hurt the crop there. According to the Federacion Nacional de Cafeteros de Colombia, 18% of the national crop is likely to be exposed to areas of reduced precipitation. However, on balance we believe El Niño is likely to benefit than damage more growing regions. And Colombian production has had a running start to the year, with January to August production up 13% compared to the same period last year.



Source: ETF Securities, Bloomberg

## CURRENCIES

### Summary

The debate over the outlook for rates and central bank stimulus (alongside uncertainty over the Chinese economic growth path) continues to be the dominant driver of G10 currency pairs. As a result, volatility remains a key fear for investors across asset markets and currencies have not been overlooked.

Nonetheless, currency volatility has moderated and we anticipate more subdued volatility levels in Q4. We expect underlying growth and policy fundamentals to sway market sentiment as investors focus on the underlying economic outlook for the global recovery in the coming months.

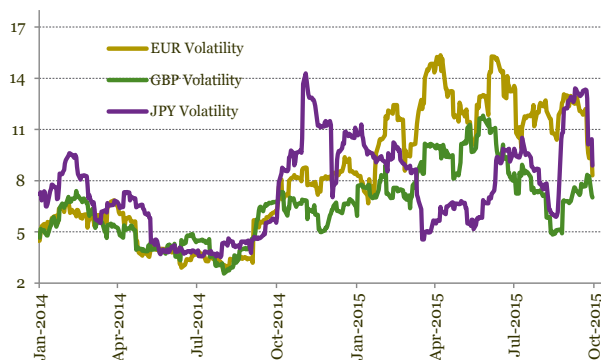
Low oil prices are keeping inflation measures subdued globally and this will encourage many central banks to continue their aggressive easing stance toward year end and into 2016. Indeed, it is only the US Federal Reserve that we expect to tighten policy this year.

A result of the benign inflationary environment, central bank accommodation will continue to be a feature of the currency landscape for the foreseeable future. Policy rates will remain low or negative to support economies and this will predictably exert continued downward pressure on exchange rates. Currency wars will therefore remain a consequence of such stimulatory central bank policy, whether or not it is a stated direct policy objective or not.

Currency adjustments will help improve international competitiveness for countries significantly exposed to global trade and encourage import competition. We remain structurally bullish on the US Dollar in the medium term, expecting tighter policy by year-end.

The Euro, Yen and Norwegian Krone are likely to be the underperformers as growth outlook remains subdued and central banks firmly in stimulus mode. Low rates and the flood of liquidity is likely to keep these currencies under pressure and 2016 could see further easing of policy to support growth and lift inflationary expectations. Any tightening of policy is not expected ahead of 2017 at the earliest.

#### Currency volatility moderates



Source: Bloomberg, ETF Securities

### USD: Rates to (finally) move higher

FOMC members seem torn as to when to hike rates, with several members appearing comfortable with 2015 as the appropriate time to tighten policy, while others feel that this year would be too early.

See-sawing market expectations of when the US central bank will raise benchmark rates has kept the US dollar largely rangebound against major currencies. But it has been a wide range and while currency volatility has declined, USD trading has been choppy.

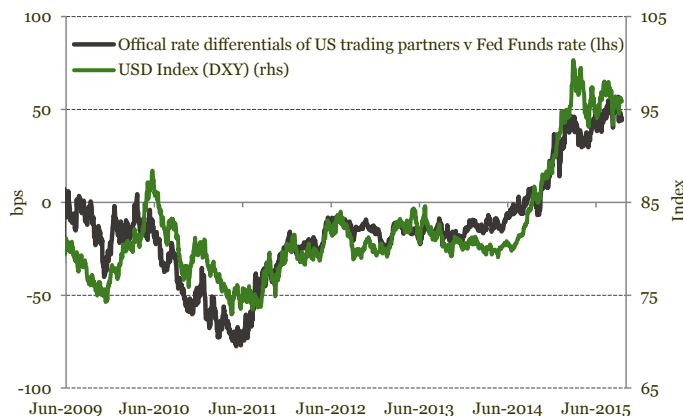
After some expected consolidation, the US Dollar looks primed for further gains in the Q4 of 2015 as the US Federal Reserve embarks on its long anticipated tightening cycle.

We expect the next leg of the USD's rally will be driven by the continuation of the US economic recovery and investor expectations for tighter policy from the Fed, in stark contrast with those for other major central banks. Currently the market is almost pricing in a rate hike for early 2016. Economist estimates are slightly more hawkish.

The Fed has been balanced in its communication with investors, noting that the economic recovery remains solid enough to justify the beginning of policy tightening this year. There is stronger evidence of wage growth alongside rising household spending. In turn, the strengthening economic environment has seen inflation indicators begin to improve. A gradual and well communicated tightening cycle combined with the Fed maintaining a healthy balance sheet is unlikely to derail the US recovery, but it should keep the USD well supported.

The USD Index has consolidated and has moved broadly back in line with interest rate differentials in recent months. Accordingly, we feel that any weakness is an opportunity to again establish long positions.

#### USD Consolidates in Choppy Range





## Euro: Election risks

Although the Euro has traded a broad 1.10-1.15 range against the US Dollar in recent months, we remain bearish for the currency. Continued instability on the political front for Europe remains a considerable risk for the Euro. Coupled with the rising chance of an extension to the central bank stimulus program the future direction for the Euro remains firmly skewed to the downside against major currencies.

Elections in Spain will come into focus going into year-end, with anti-establishment parties likely to gain ground and dent already fragile sentiment. After the Greek example gave an example of what can occur, issues like unemployment and migrants could surface and increase currency volatility in late December, when liquidity is already low.

While volatility has moderated to more normal levels for Euro crosses in recent months, the Euro could still trade lower as fundamentals suggest a weaker currency in coming months. We expect the ECB is likely to expand and/or extend its current QE policy and coupled with wider rate differentials put downward pressure on the Euro.

While economic activity is likely to benefit from ECB stimulus measures and low/negative rates, the recovery is going to be gradual. The employment environment remains subdued and as a result consumption remains sluggish. We expect the Euro to grind lower in coming months and retain our year-end target of 1.05 against the USD as the threat that rate hikes in the US becomes a reality.

Central Bank	Official Rate
Swiss National Bank	-0.75
Riksbank	-0.35
European Central Bank	0.05
Bank of Japan	0.10
US Federal Reserve	0.14
Bank of England	0.50
Bank of Canada	0.50
Norges Bank	0.75
Reserve Bank of Australia	2.00
Reserve Bank of New Zealand	2.75

## CHF: Still overvalued

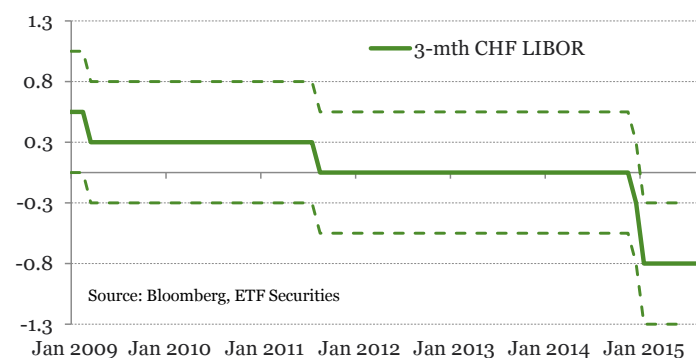
The Swiss Franc (CHF) performance has assisted the local economy in recent months, with a moderate decline. However, this is not expected to last, according to market pricing, with a modest appreciation against currencies of its major trading partners, particularly the Euro.

The modest improvement in the Swiss economy has largely been driven by externally improving demand, despite the

exchange rate environment providing headwinds. Nonetheless, the Swiss Franc has depreciated over the quarter and is close to our initial Q3 target of 1.10 against the Euro. We continue to foresee further weakness, but the Swiss National Bank may need to engage in further intervention to offset any policy driven weakness of other European currencies, with currency wars being firmly in play.

Risks for the Swiss economic growth have moderated but the Swiss Franc remains 'significantly overvalued' from the Swiss National Bank's (SNB) perspective. As a result, and with the SNB remaining active in currency markets, we feel that he recent decline in the Franc should continue.

### Negative rate environment



The SNB has kept policy settings unchanged but remains willing to continue its intervention in fx markets to counteract what it sees as an overvalued currency. With inflation staying in negative territory, monetary policy settings are likely to be made looser if anything, especially with other central banks in the region firmly in stimulus mode. Indeed we perceive the aggressiveness of the SNB's policy to eclipse that of the ECB and should thus be a key focus for investors in Q4, with inflation well below zero.

The SNB expects short-end interbank rates to be significantly negative until inflation becomes positive in 2017. Capital outflows are likely to assist the decline of the CHF, as investors look to other higher yielding markets for returns. We anticipate EUR/CHF will likely to breach 1.10 level to the upside over Q4 2015, moving toward 1.12 by year end.

## CAD: Commodity currency outperformer

The Canadian Dollar (CAD) continues to be one of the strongest performing 'commodity currency' thus far in 2015, aided by the rebound in crude oil prices in recent months.

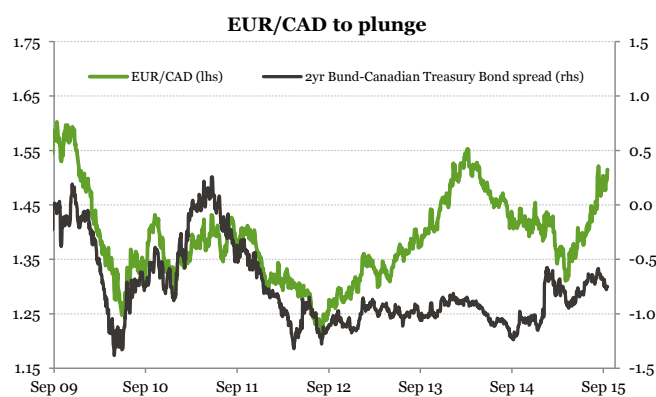
The Bank of Canada (BOC) appears comfortable, not only with its policy stance, but also with how the response of the economy to policy is progressing and the depreciation of the Canadian Dollar. The positive feedback from the central banks rate cuts in 2015 are beginning to be experienced and the inflation profile has stabilised.

Lower oil prices are restraining the business sector but this



negative impact should begin to fade going into 2016. The weakness in the Canadian dollar is also providing a buffer for economic activity. Trade is gaining momentum, assisted by both the CAD weakness and the strengthening US economy, a market which accounts for over 75% of Canadian exports. In addition, the household sector is also experiencing positive momentum, with spending. To the extent that the oil price delays any strength in CAD, Canadian exports will remain competitive, and domestic substitution for imports will also help lift activity.

We expect that CAD will begin to rebound against the USD, as oil prices stabilise and begin to rise into year end. Against the EUR, we expect a return to strength as the Canadian recovery outpaces that of Europe and the ECB retains a more aggressive and accommodative policy stance. The recent stronger EUR/CAD has moved out of line with fundamentals and as the oil shock impact on the CAD fades, we expect the currency pair to move back toward 1.35.



## GBP: 2016 rate lift-off

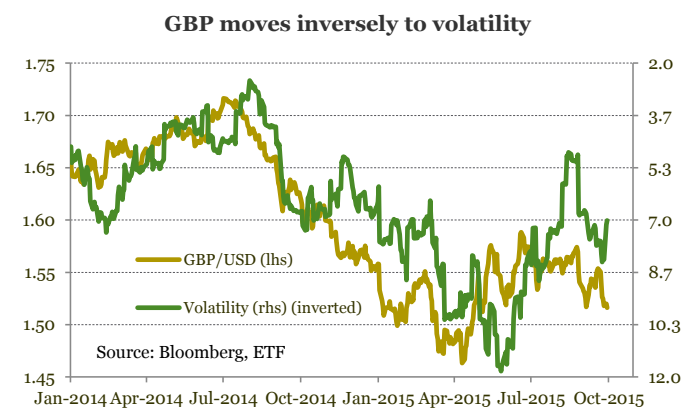
We expect there is upside potential for the pound as currency (and other asset market) volatility eases. Volatility has historically had an adverse influence on the value of the British Pound.

We expect GBP to find strong support, on the back of rising rate expectations and declining volatility. Bank of England Governor Carney has indicated that even the recent volatility, stemming from China concerns, would not derail its plans to raise rates. Voting on the MPC Board has turned more hawkish in recent months with one policy member voting for a rate hike at both the August and September MPC meetings.

The domestic environment in the UK has improved. Business investment has surprised to the upside and retail sales remain strong. We expect the uptick in UK economic momentum to continue with consumer confidence remaining at decade highs.

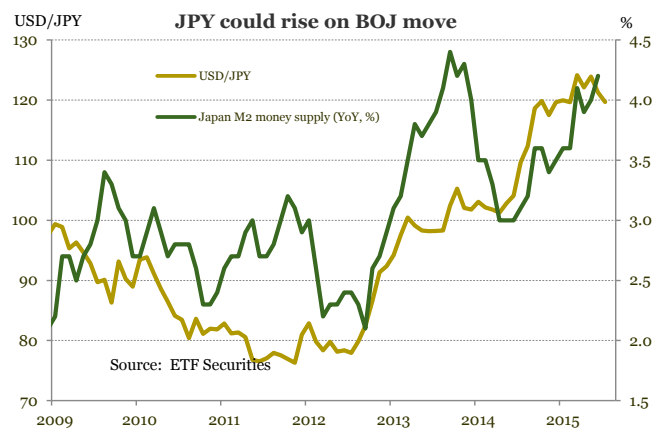
We expect the GBP will slowly grind lower against the USD as

rate hike expectations in the US again take hold going into year-end. Against the Euro the outlook is more favourable and we expect further appreciation in the medium term. However, after the beginning of tighter US policy, GBP could pare losses as the policy focus switches to the UK toward the end of the year. EUR/GBP is trading near the top of the 0.70-0.74 range for 2015 and we expect that upward momentum to fade. We feel the pair could move toward 0.72 in coming months, as the market increasingly sees rate hikes likely in the first half of 2016.



## JPY: Downside potential

The economic landscape in Japan continues to pickup and this has supported the Yen against major currencies. The recovery is being assisted by the Bank of Japan's accommodating stance and the central bank continues to add to the monetary base via its Quantitative and Qualitative Easing (QQE) policy. The BOJ is likely to continue this policy for some time as inflation remains depressed, balancing the fine line between inflation and deflation. We expect that against the USD, JPY could weaken substantially and potentially break our 125 year-end target to the upside if the BOJ are forced to widen its accommodative policy stance, if the recovery falters.



Wage growth has been positive for two years, supported by improving corporate balance sheets and helping buttress solid private domestic demand. The improving wage environment is being assisted by a stronger jobs environment, and the

unemployment rate is at the lowest level in nearly 20 years.

Positive signs are emerging on the corporate side as well. Corporate profits are at record levels – sustained rise in corporate profits are a critical element of a sustainable recovery in Japan, which will foster business investment. Currently business investment expectations for large manufacturers are at the highest level since 2004, and capital expenditure plans are rising.

Strengthening job environment is helping support a robust retail environment. But while household balance sheets are becoming more healthy, there are ongoing signs that the BOJ's QQE strategy is helping the long anticipated recovery, we feel most of the good news has been priced in.

We expect that USD/JPY will grind higher toward 125 by year end, with upside risks if the BOJ loosens policy further and rate differentials widen.

## SEK: Stimulus bearing fruit

The Swedish central bank, the Riksbank, continues to push the boundaries of monetary policy and remains one of the most aggressive central banks in the G10 currency space. The Riksbank's commitment appears to be beginning to pay off.

The inflation trajectory is showing signs of a modest upward trend, thanks to negative interest rates and a committed quantitative easing plan. However, the Riksbank doesn't want to rest on its laurels: after cutting rates three times in 2015, it has also extended its QE program till end 2015 in order to ensure the economic and price momentum can gain traction.

The improving economic backdrop has been cause for optimism, with economic growth surprising to the upside and expected to remain above average in coming years. Consumer confidence is near longer-term average levels, while optimism from businesses over the economic outlook is approaching multi-year highs, rebounding strongly this year. Growth and jobs are expected to continue their gradual improvement in 2016.

Rates are not expected to get back into positive territory until Q3 2017, a significant change from the end-2016 expectations earlier in the year. Such a depressed rate environment is likely to remain a significant drag on currency performance. The Riksbank has continued to indicate its willingness to add to the current stimulus measures, in case the recovery begins to stumble. We expect that the Swedish Krona will remain soft against major crosses until there is clear evidence of a sustainable rise in price pressures, and a material improvement in external demand that will allow the central bank to begin to scale back its support toward the end of 2016. We expect that SEK could make gains against the Euro in the medium term as a more sustainable recovery is witnessed, however, the near-term outlook remains more muted. We feel that EURSEK will trade a range between 9.30 and 9.40 in Q4.

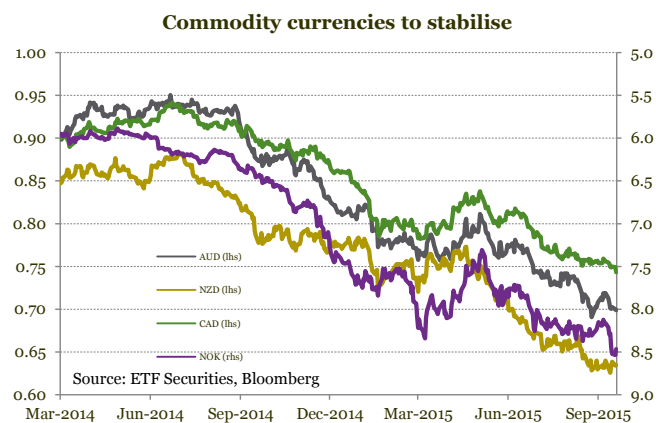
## NOK: Norges Bank ready to do more

The Norges bank has begun to take its cue from its Scandinavian counterpart – cutting rates unexpectedly in June, and likely to follow up with more policy easing if Norwegian economic growth remains sluggish. With the highest official rates outside of Australia and New Zealand, there is room to do more, and Krone weakness should be seen in this light.

In contrast to the Swedish economy, the Norwegian economy is struggling. Additional cuts in business investment, tied to depressed oil prices and the petroleum industry, are likely to remain a weight on growth dynamics.

Despite a worsening jobs environment, household consumption remains a bright spot, supported by low (and likely lower) interest rates. Wage growth has been supportive, and the housing sector is being buoyed by rising household debt levels. However, this could unravel if business investment remains soft in 2016/17, in turn further depressing the jobs market.

While we expect that the stronger commodity market fundamentals to give greater buoyancy for energy linked currencies going into year-end and early 2016, NOK could be the laggard if the economic backdrop fails to be quickly revived and Norges Bank further loosens policy settings.



## AUD: Soft domestic activity and China fears

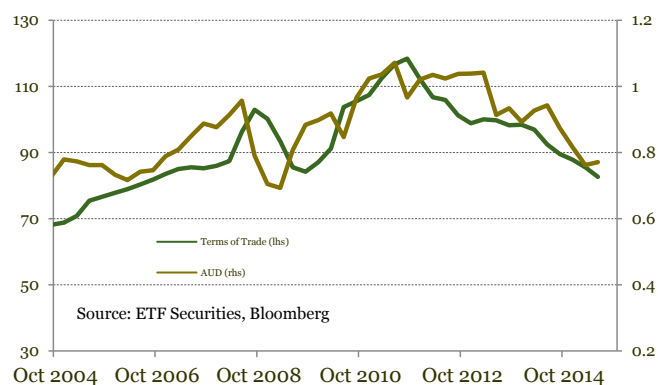
The Australian dollar breached our downside targets over the past quarter and we expect this downside risk to remain elevated as pessimistic sentiment surrounding the outlook for the Chinese economy is pronounced. Indeed, the AUD was the worst performing G10 currency over the past three months. Meagre economic growth, narrowing interest rate differentials and the softening terms of trade remain the key drivers for the Aussie Dollar and are unlikely to provide a catalyst for an AUD rebound in Q4 2015.

The Reserve Bank of Australia (RBA) remains determined to provide economic support with accommodative policy. While we expect that the RBA's policy stance will remain broadly neutral after May's rate cut (the second for 2015), central bank rhetoric will likely remain a weight for the currency.

Despite a stronger employment environment, wage growth remains modest. Lower oil prices and lower interest rates have been providing a tailwind for consumer spending. Lower rates are expected to continue to feed through to the real economy and assist business investment in the medium term, but evidence is lacking at this point and better signs from non-mining investment earlier in the year are beginning to fade.

The AUD susceptibility to the external environment remains high and market volatility surrounding China and the potential for tighter US policy remain key risk factors. AUD remains exposed to fragile sentiment surrounding the uncertainty Chinese growth path.

**Terms of trade dictates AUD**



The Australian Dollar's strong link to the external environment via its terms of trade, could add an additional layer of downward pressure as long as concern over Chinese growth lingers. Australia's terms of trade forecasts have declined in recent months as the economic outlook for its major trading partners has become less certain. In an environment of uncertainty over the Chinese growth path, commodity price growth could remain depressed. If commodity fundamentals improve, it will provide AUD support. However, this is likely to be tempered by expectations of further rate cuts in the year ahead. Accordingly, we expect that AUD will hover in a tight band around 0.70USD over the next quarter, but with downside bias. Market expectations indicate that AUD should be the worst performing G10 currency going into year-end.

## Kiwi: RBNZ talks NZD down

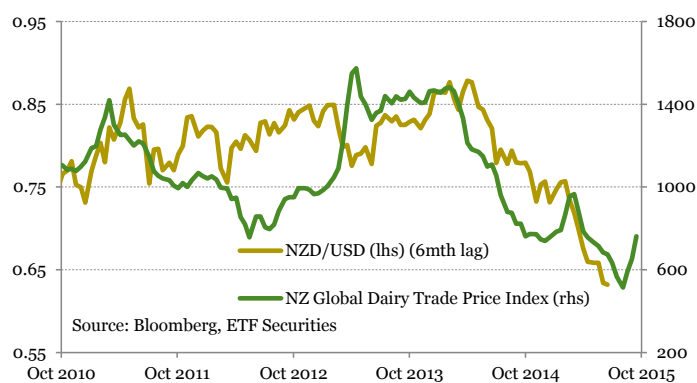
The Reserve Bank of New Zealand (RBNZ) is being equally active in cutting rates in 2015 as it was in hiking rates in 2014. The central bank has now cut rates three times in four months, with the propensity to do more. Nonetheless, the NZ Dollar was the best performing commodity currency over the past three months, something that hasn't bypassed the RBNZ's attention.

Falling dairy and oil prices have been a persistent weight on inflationary pressures, with inflation expectations in a downtrend, but hovering in the middle of the target range. CPI remains well below the central bank's target 1-3% range. NZD remains closely linked with dairy prices, as New Zealand is the world's largest exporter of dairy products and a recovery to more historical levels is not expected to occur in the foreseeable future.

Dairy prices have bounced in recent months but remain depressed, near six-year lows. Abundant supply, similar to other commodities, remains the problem, and inventory levels are elevated. While household spending is being supported by lower oil prices and low interest rates, there are continued fears surrounding farm incomes as a result of falling dairy prices. Employment has begun to tail off and both business and consumer sentiment has declined in recent months.

We expect further weakness in the NZD, as the potential for further rate cuts weigh on the currency. At the end of August, two rate cuts were fully priced in over the coming year. Although this has since been pared back and we expect further downside risk of the NZD, in line with RBNZ rhetoric.

**Dairy downside for NZD**



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