Real Assets: Commodities

- Volatility within the oil market continues. Last week, crude oil bounced off of its lowest level ($28.35/barrel) since 2003 and moved above the key psychological $30/barrel barrier. A report that Russia was ready to negotiate with OPEC to cut production helped support prices.
- However, as optimism on Russia's actions faded, crude oil posted its worst two-day decline (-11.1%) since March 2009 (Monday & Tuesday).
- With NYMEX crude oil shorts remaining near a record high, financial positioning will continue to foster volatility in the oil markets in the near term as any news may drive sharp price moves.
- However, as prices remain depressed, we do not believe that the current output level of U.S. producers is sustainable over the long term. As of January 29, U.S. production has fallen only 4% since its record high in June 2015 while rig counts have fallen over 60% since their peak.
- Given unsustainable production levels, we believe that oil production will begin to come offline. As it does, we believe that crude prices will rise to $50/barrel by year-end 2016.

Figure 3: NYMEX Crude Oil Shorts
Source: FactSet, Deutsche Bank Wealth Management.
Data as of January 29, 2016.

Focus of the week

Commodities: As crude oil shorts remain near record highs, volatility in the oil market will continue.

Global FX: Diverging monetary policy will continue to be a tailwind for USD strength in 2016.

Global FX

- As U.S. economic data has been weaker than expected and the Citigroup Economic Surprise Index has fallen to an eight month low, the futures market has shifted and is not pricing in an additional Fed rate hike until 2017 at the earliest. As a result, the Dollar Index is on pace to post its worst week since May 2009.
- We believe that this move in the USD is overdone and given the strong labor market and expectation for a moderate rise in growth and inflation, there is still justification for the Fed to continue raising rates this year (our estimate is two rate hikes).
- In addition, the BoJ's decision to adopt a negative interest rate policy and the likelihood of additional policy measures by the ECB in the coming months should support the USD as the policy divergence continues.
- We expect the USD to strength to .95 against the EUR and 125 against the JPY by year-end 2016.

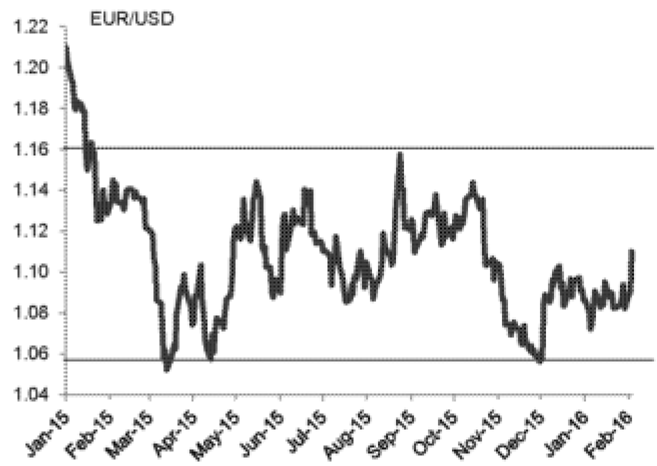

Figure 4: EUR/USD Trading Range
Source: FactSet, Deutsche Bank Wealth Management.
Data as of February 3, 2016.