

COMMODITIES OUTLOOK

From strength to strength

Over the past year, prices for commodities and commodity-related assets have risen sharply, recovering much of the ground lost during the 2008 financial crisis. In this report, UOB Asset Management's **ROBERT ADAIR** shares his outlook on commodities for 2010.

LAST year, the Reuters Jefferies Commodity Index increased by 21 per cent, while the HSBC Global Mining Index rose by 98 per cent, in Singapore dollar terms. Improving economic indicators mean investors are anticipating similar performances this year.

The positive outlook stems largely from global economic recovery. But despite improving economic data in emerging markets and OECD countries, policy-makers remain haunted by Japan's "double dip" recession in the '90s. Many see a repeat in the early withdrawal of stimulus measures by several governments today.

Investors are viewing commodities as an important asset class. Barclays Capital estimates total commodity assets under financial management were almost US\$250 billion (\$350 billion) at end-December 2009, having increased a record US\$60 billion during the year. Continued financial inflows are likely to be positive for commodity prices and share prices of commodity-producing companies.

Some are talking about a "commodity supercycle". This implies a prolonged period of commodity price strength as China, India and other developing countries become urbanised and industrialised. While such talk may be premature, a recovery should produce a positive outlook for commodity prices. The main driver may be stronger OECD demand. Even if China prevents economic overheating, restocking in the US, Europe and Japan may offset the loss of Chinese demand.

In terms of which part of the commodity complex offers the best returns this year, here is our assessment of the four main areas:

Expectations should be positive for commodity prices, especially gold. We believe any return to financial market instability will see gold benefit from its "safe haven" status. Silver and platinum prices look inexpensive compared to their historic trading range against gold.

BASE METALS AND BULK COMMODITIES: Base metals have seen strong price gains despite rising inventory levels. An increase in real demand is needed before prices strengthen. The outlook for bulk commodities is more favourable, given higher steel production from China. Chinese producers have a preference for the higher quality of imported iron ore.

ENERGY: Crude oil prices are expected to consolidate below US\$90 per barrel this year, with current Opec spare capacity still sufficient to meet a growing recovery in global demand. US natural gas prices remain relatively inexpensive and may offer trading opportunities during the year. Listed exploration and production companies look attractive, combining the potential for pricing and production volume gains.

AGRICULTURAL COMMODITIES: Agricultural commodities can be volatile, and are often influenced by short-term weather factors. There has been a general price recovery in recent months, especially by sugar. One way to avoid potential volatility in crop prices is to invest in fertiliser companies, which produce a key input for improving yields.

A generally low application of fertilisers last year means increased fertiliser usage is required this year. This should result in higher fertiliser prices and volumes over the year.

Robert Adair is Director at UOB Asset Management.

PRECIOUS METALS: A rise in inflation ex-

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