

## Industry Commentary May 2011

### Dow Jones-UBS Commodity Indexes in May: Down As Inflation Trade Loses Popularity; Dollar Strengthens

By Christine Marie Nielsen

The [Dow Jones-UBS Commodity Index](#) was down 8.36% for the month of May as commodities saw some reversal of the so-called "inflation trade," where market participants bought commodities in anticipation of inflation. A strengthening U.S. dollar was viewed as non-inflationary, and the rise in the dollar made commodities more expensive to those holding other key currencies.

Silver, tin and nickel were the three biggest laggards during the month, with down performances of 28.18%, 16.68%, and 16.63%, respectively.

Precious metals rose strongly during the month of April, with gold prices up 8.9%, while silver prices increased by 28.8%. However, gold saw weakness and silver experienced a dramatic reversal in May amid extreme volatility as investors decided to take profits. "The price of silver has settled around \$35 a troy ounce after the sharp correction at the start of May," Commerzbank analysts said in a research report distributed May 20. "Continued outflows from silver ETFs indicate, though, that the actual 'strong' hands are still exiting the silver market and the slump is not over yet.... We believe that the speculative overheating in the case of silver has not been fully reduced yet. Prices are likely to find a long-term base between \$25 and \$30 (a troy ounce) in the summer."

Base metals also lost ground in May after surveys indicated growth in the euro zone's dominant service sector had slowed at a quicker rate than expected. There was also concern that demand from China was down due to a cooling economy.

The top performing Dow Jones-UBS Single Commodity Indexes were orange juice and wheat, with month-to-date returns of 7.20% and 0.22%, respectively. The Dow Jones-UBS Corn Sub-Index posted the narrowest performance drop of 0.33%.

The approach of hurricane season buoyed prices in orange juice as market participants considered whether severe weather could exacerbate supply issues. The price of the July contract gained 26% in the 12-month period ending in May.

Weather concerns – including dry spells in parts of the U.S. and Europe, and excessive rain in other areas including Canada -- underpinned the strength in grains prices. On May 11, Goldman Sachs raised its three-month wheat forecast to \$8 a bushel, from \$7.75 a bushel, citing "persistent adverse weather" in many growing areas. The U.S. government said that, as of May 15, U.S. winter wheat was in its worst condition since 1996, with 44% of fields rated poor or very poor.

Adding support to the corn market was that the U.S. Department of Agriculture reported a rise of U.S. corn exports to 843.2 thousand tons for the week ending May 12, making exports twice as high as the average for the previous four weeks. Corn inventories have been near historically low levels after a series of natural disasters in 2010 decreased output.

So far in 2011, the Dow Jones-UBS Corn Sub-Index has posted the highest gain among the Dow Jones-UBS single commodity indexes, with a gain of 17.12%. The Dow Jones-UBS Sugar Sub-Index posted the biggest drop, 25.62%, as sugar prices fell to levels not seen since fall 2010. Specialists forecast that sugar exports from Thailand – the world's second -largest shipper of the product - would increase, while there were signs of slowing demand in China, the world's largest sugar consumer.

Year to date, the Dow Jones-UBS Commodity Index is down 1.01%.

*Christine Marie Nielsen has worked for more than 14 years as a financial journalist, covering the fixed income market and Chicago exchanges for Dow Jones Newswires for eight years. She has worked as an equity analyst and has been quoted as an expert on the markets by WSJ.com and Agence France Presse. She's also hosted a syndicated radio show on the stock and futures markets from the floor of the Chicago Board of Trade. She is currently working as an editor on MarketsWiki.com, an online open source knowledge project for current and historical information about the global exchange-traded capital, derivatives, environmental and related OTC markets.*