

Commodities caught between AI jitters and escalating energy risks

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Key Points:

- AI jitters weigh on copper: Technology sector weakness and US tariff uncertainty challenge copper's bullish outlook, despite resilient physical fundamentals.
- Energy supply risks intensify: Middle East escalation drives oil to five-month highs, while European gas remains vulnerable to winter supply disruptions.
- Gold's investor divide deepens: Speculative selling continues to outweigh persistent ETF demand, despite growing geopolitical and fiscal risks.
- Commodities retain their portfolio appeal: Supply constraints, inflation risks and positive roll returns in backwardated markets support the case for tactical exposure.

Global commodity markets are becoming increasingly divided as investors confront weakening risk appetite, renewed geopolitical tensions and the unwinding of crowded speculative positions. While concerns about AI investment are weighing on copper and industrial metals, escalating Middle East tensions have lifted crude oil to a five-month high. Meanwhile, gold continues to struggle despite persistent ETF demand, while agriculture has suffered a sharp reversal driven by harvest pressure and speculative liquidation.

AI concerns challenge copper's bullish narrative

The Nasdaq's latest tumble of more than 500 points highlights growing concerns about the sustainability of the AI investment boom, with potential implications extending well beyond technology shares.

High grade copper, down 2.4% and breaking below recent support around USD 6.50 per pound, has been caught between two sources of uncertainty. First, investors are questioning whether the US will proceed with tariffs on refined copper, potentially undermining the tariff-driven stockpiling that has helped support prices. Second, concerns about a slowdown in AI and data centre investment are challenging an increasingly important source of expected future demand.

However, there is a distinction between weakening investor sentiment and deteriorating physical fundamentals. Copper continues to benefit from electrification, grid expansion and constrained mine supply, while much of the world's visible exchange inventory remains concentrated in the US. The current weakness may therefore reflect a deflation of previously elevated expectations rather than a fundamental drop in demand.

Oil defies broader risk aversion

While growth-sensitive commodities struggle, crude oil is moving in the opposite direction. Brent has reached a five-month high above USD 112 as escalating Middle East tensions and the threat of further US military action raise concerns about renewed supply disruptions.

Despite recovering shipments from the region, the global oil market remains vulnerable. Shipping attacks, elevated freight costs and the risk of damage to critical energy infrastructure continue to threaten supply chains, while tight refined-product markets, particularly diesel, amplify the potential consequences of another disruption.

European natural gas faces similar risks, with relatively low storage levels leaving the region more dependent on continued imports throughout winter. A prolonged cold spell, combined with renewed disruptions to LNG shipments, could trigger another sharp increase in prices from the current level around EUR 90 per MWh "H USD 29.50 per MMBtu.

This creates an uncomfortable backdrop for financial markets. Higher energy prices are increasingly a source of pressure on both equities and bonds, reflecting the risk that another inflationary shock could limit central banks' ability to ease monetary policy. After several years of above-target inflation, investors can no longer assume that weaker growth expectations will automatically translate into lower borrowing costs.

In that sense, energy remains an important portfolio hedge against geopolitical and inflation risks, even as elevated prices ultimately threaten economic activity and demand.

Gold caught between speculative selling and strategic demand

Gold's inability to capitalise on the latest bout of risk aversion remains a key focus. Despite softer Treasury yields, a slightly weaker dollar and mounting geopolitical uncertainty, bullion is, for the third time this month, struggling below USD 4,100.

The explanation lies partly in the contrasting behaviour of different investor groups. Short-term macro-focused traders remain sensitive to interest-rate expectations, currency movements and technical signals, while longer-term investors continue to accumulate gold through ETFs as protection against fiscal instability, geopolitical risks and currency debasement.

The latest surge in French government borrowing costs reinforces the latter argument. France's 10-year yield has risen above 5% for the first time in 24 years, while its spread over Germany has widened towards 170 basis points, highlighting growing concerns about fiscal sustainability.

For now, speculative selling continues to more than offset strategic demand, with positioning data highlighting the divergence between the two investor groups. Since 25 August, managed money accounts, including hedge funds and CTAs, have reduced their net long exposure by 4 million ounces, while bullion-backed ETF holdings monitored by Bloomberg have risen by 2.3 million ounces. The persistence of ETF inflows despite weaker prices suggests that the underlying investment case remains intact. Once the current wave of speculative liquidation subsides, longer-term buyers may regain greater influence over price direction.

Agriculture: Positioning pressure meets weather risks

Agricultural commodities, particularly grains, have suffered a sharp reversal over the past six weeks, with the Bloomberg Grains Index falling 14% and almost fully reversing August's explosive rally. Harvest pressure and improving supply expectations have triggered a substantial unwinding of speculative positions, with the combined managed money net long across six major grain and soybean futures contracts falling from a record above one million contracts to around 750,000 in the latest reporting week.

The correction illustrates how positioning can amplify fundamental developments, with falling prices encouraging further long liquidation and adding to downward pressure. However, despite the recent weakness, the longer-term supply outlook remains exposed to several risks.

The ongoing conflicts involving Iran and Russia–Ukraine, the potential emergence of a powerful Super El Niño and the possibility of renewed food export restrictions could all disrupt agricultural production and trade. While current supply conditions have weighed on prices, the combination of geopolitical uncertainty and weather-related threats, in our opinion, leaves room for renewed volatility and potential price recoveries.

Commodities retain their role as a portfolio hedge

The divergence across commodity markets highlights an increasingly complex investment environment. Growth concerns are weighing on industrial metals and agriculture, while geopolitical tensions continue to support energy prices and strategic demand underpins gold.

Importantly, commodities can offer protection against risks that traditional portfolios may struggle to absorb. Supply-driven energy inflation can hurt both equities and bonds, while geopolitical disruptions, extreme weather and trade restrictions create upside risks across several commodity sectors.

The case for tactical commodity exposure therefore remains compelling, even if the outlook for individual sectors is becoming increasingly fragmented. We favour broad-based commodity exposure while maintaining a particular focus on markets where rising demand meets persistent supply constraints, potentially driving structural upward price pressure and attractive investment returns.

For futures-based commodity investments, total returns reflect not only changes in the underlying commodity price but also the roll return earned or lost when expiring contracts are replaced, together with interest earned on cash collateral. In markets trading in backwardation, where longer-dated futures are cheaper than nearby contracts, this rolling process can generate a positive return as futures prices converge towards spot prices, assuming the curve remains unchanged. Conversely, contango can create a negative roll return. Persistent supply tightness can therefore offer investors a double benefit: potential price appreciation and positive roll returns, even during periods when spot prices are broadly unchanged.

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