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GOLD ANALYSIS

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Precious metals likely to outperform for commodity investors.

Global financial and economic meltdown has hammered commodities, but investors still see rich pickings in agricultural staples.

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LONDON (REUTERS) -

Global financial and economic meltdown has hammered commodities, but investors still see rich pickings in agricultural staples such as grains and rice -- essentials the world cannot do without.

The strong outlook for the agricultural sector this year is likely to be closely followed by prospects for oil where output cuts by OPEC countries are expected to accelerate over the next few months, leaving the market short.

Gold's role as a hedge against inflation and financial uncertainty is expected to boost its appeal, while the losers will include commodities like copper and natural gas, which are highly attuned to the deepening global economic crisis.

"Oil, agriculture and precious metals are likely to outperform in the commodity space," said Adam Robinson, director of commodities at U.S.-based fund manager Armored Wolf.

"Natural gas and industrial metals are likely to underperform, with the latter most exposed to the weakening economy. Agriculture demand is least exposed to the economy; people always need to eat."

Benchmark U.S. wheat futures are down by more than half since hitting a record high above $13 a bushel in February last year, while oil at around $37 a barrel has plunged about 75 percent since July's record high above $147 a barrel.

Crude hit $32.40 a barrel last month, the lowest since 2004, but has recovered slightly on an OPEC oil producers decision to cut output by more than 4 million barrels a day.

Fund managers expect OPEC to make further drastic cuts to shore up prices and revenues.

"We have already seen oil production being cut. It is likely that more cuts will follow," said Ashok Shah, chief investment officer at fund manager London & Capital.

SOVEREIGN JUNK

Also on the buy list for investors is gold as they ready for a period of rampant inflation because of the large amounts of cash being pumped into the global financial system.

Expectations that the dollar will resume its downtrend because of a ballooning U.S. government deficit will also boost gold's status as an alternative currency.

Spot gold is up nearly 20 percent at around $810 an ounce since October when the financial market crisis took a turn for the worse after U.S. bank Lehman Brothers collapsed.

Mounting concerns about governments' ability to repay debt have resulted in debt downgrades for Spain and Greece. Expectations that others will follow are also likely to fuel an aversion to sovereign bonds and other paper assets.

"We like precious metals because we have ongoing concerns about paper assets and inflation further out," said Andrew Cole, director of asset allocation at Baring Asset Management.

"We are keen on agriculture. People still need to eat ... there hasn't been enough investment in the sector."

Fund managers say the cost of producing grains is now above the prices they command and that underinvestment will mean the sector will follow a familiar pattern of feast to famine.

"If the price you can sell at is less than the production cost, you have no incentive to plant," said Kimberly Tara, chief executive at FourWinds Capital Management.

NO END IN SIGHT

With no end in sight to the financial crisis and the global economy deteriorating by the day, prices of industrial commodities such as copper and natural gas are expected to come under further selling pressure.

Copper used widely in power and construction is hovering around $3,300 a tonne, down more than 60 percent since July's record high of $8,940 a tonne. Natural gas has also fallen by a similar amount to below $5 a million British thermal units (mmbtu) since July.

"Factories that are shut down and homes that are left vacant are not going to consume natural gas no matter how cold the winter gets," Armored Wolf's Robinson said.

The lead indicator of demand for these commodities is industrial production, which is plummeting around the world. Markets are particularly focussed on China, responsible for much new commodities demand over the last few years, where November industrial production fell 5.4 percent year-on-year from levels above 15 percent at the beginning of 2008.

But fund managers say things could change if government plans to plough money into infrastructure help boost prospects.

"Large fiscal measures all around the world include big spending plans for infrastructure," London & Capital's Shah said. "The outlook for hard commodities could be interesting."

(Additional reporting by Jane Merriman and Nigel Hunt; editing by David Evans)