Gold: The June breakout was a statement about a macro regime shift. The combination of the dovish commitments by global Central Banks against a backdrop of increasingly more unpredictable and complex trade & geopolitics and softer growth (especially in the manufacturing sector), has ensured $1350 is the new floor in the near-term; further upside (i.e.: through $1440 ceiling) is now increasingly dependent on US politics/geopolitics and trade, in addition to data, especially if the larger underweight generalist investor subscribes. Gold is simply not fighting the (forces) behind the Fed. (Pages 3-5)

Silver attracted the strongest monthly investor inflows (+300m oz) in 5 years, yet prices couldn’t keep pace with Gold and reclaim $16, indicative of the structurally oversupplied backdrop; Gold/Silver ratio to remain >85 but its perhaps overshot in the near-term. (Page 6)

Palladium: despite the lack of further curve tightening, Palladium showcased typical bull market characteristics in June (rallying on micro & macro tailwinds); the path of least resistance - so long as the ‘expansion is sustained’ - is north, given underweight investor positioning, tighter emission regulations & S.A supply-side risks. (Page 7)

Platinum: extreme paper shorts, a manufacturing slowdown amidst the structural lack of Chinese jewelry & European demand demotes Platinum to an industrial metal in June as it fails to piggyback Gold; substitution has never been this attractive given relative pricing. (Page 7)

Copper: micro supply-risks overlooked due to trade and demand-side pressures & fears. That’s despite a tightening refined outlook. Macro forces destabilized copper to $6000; it will take macro to inject a repricing higher. (Pages 9-10)

Ali: trade policy, slower Chinese growth and ex-China production ramp-ups due to shrink expected deficits, and ensures a slow grind into physical support; ~$1700-1900 is the comfort zone barring a convincing story/catalyst. (Page 11)

Zinc: Loosening zinc time spreads are indicative that the wall of supply is beginning to impact the refined market, highlighting a missed opportunity (thanks to trade uncertainty) for 3m prices to capitalize on acute & chronic tightness. (Page 12)

Nickel: The markets respect of the ability for quicker supply responses (amongst other factors) ensured Nickel prices didn’t capitalize on recently strong Chinese stainless steel demand. (Page 12)
Chart of the month:

US risk had a very strong performance in 1H’19, with SPX posting its best first half performance since 1997. This has created an even larger divergence between financial assets (S&P) and Commodities & US Treasuries; how long does the liquidity pledged policy response continue to mask the lack of true fundamental growth?
Gold:

Golds sharp repricing in June, in both US$ terms and versus other fiat currencies, was a statement breakout; it highlighted a macro regime shift and proved that it has adapted to be a geopolitical hedge, a trade policy hedge, a rate cut hedge, and a currency war hedge. The combination of the dovish commitments by global Central Banks against a backdrop of increasingly more unpredictable and complex trade & geopolitics and softer growth (especially in the manufacturing sector), has ensured $1350 is the new hard floor; further upside (i.e.: through the $1440 ceiling) is now increasingly dependent on US politics/geopolitics and trade, in addition to data, especially if the larger underweight generalist investor subscribes to the structural long Gold story.

3 out of 4 macro-economic factors* we highlighted, required for Gold outperformance, came together over May & June, and created the necessary framework for a cyclical repricing. New geopolitical risks* (fresh Iranian and ME tensions) AND collectively dovish Central Banks (led by the Fed and the ECB) then provided the spark. The factor not contributing to Golds outperformance is US equity volatility (SPX and Gold rallied together in June 2019), and remains the ‘free play’ for Gold bulls as risk assets continue their stark divergence vs others pricing in slower & lower growth. Overall, Gold is finally internalizing an ongoing (cold) economic/trade war between two superpowers, that is further complicated by a potential (hot) war vs foreign nations. The $150 Gold premium built in due to escalating trade/geopolitics (& dovish CB responses) saw around a 1/3rd ($50) of it unwound on the G-20 trade truce between US and China; however, the agreement to negotiate was/is not a large enough development for the new floor ($1350) to be revisited—so what makes this time different (vs the several previous attempts at breaking the 6 year bear cycle)? :

• The Fed is still likely to cut at the July FOMC, unless there's both a formal trade agreement (now very unlikely before July ) AND inflation metrics improves dramatically (also unlikely). G-20 simply was not enough to defer Fed policy reaction, but it was enough to cut down expectations of a 50bp cut, with a 25bp cut now the base case for July; todays strong NFP essentially removes all odds of a 50bps cut, but with inflation posing no real threat, there's little ‘cost’ for them to follow through with a 25bp insurance cut. $1350-$1400 prices in 25bp; $1400-$1450 prices in 50bp, with outlook dependent on their messaging.

• Global CBs have changed the rules of the game by talking about “insurance cuts” (now) and confirming that “crosscurrents” (trade risks, geopolitics) need to be counteracted. That depletes the no. of cuts available in their arsenal (later) when/if a recession does hit, which essentially, also promotes the use of alternative monetary tools earlier

• Trade: The US & China are still far apart on core structural issues (from tariffs on goods, to National Security to IP) where China wants concessions (the removal of current tariffs is the first ‘requirement’) if any durable deal is probable. The (multilateral) global order of trade is being redesigned into a series of several bilateral trade agreements as the threat of populism expands its reach, which makes collective action (in the face of a global recession) unlikely.

• Politics: with Gold positively responding to the mere nomination of Judy Shelton (a Trump loyalist who’s views on rates are aligned), its becoming increasingly obvious that Gold is sensitive to the risk that the independence of Global CBs from populist governments is under threat.

• Respectable technical ($1350 is the new $1500?): there’s similarities to when Gold sharply shattered $1500 in 2013 (also a key & well-cited psychological inflection point), as inflationary bets hadn’t played out (on extensive QE measures) then; Gold remained in a bear market for 6 years as the Fed edged toward a tightening cycle back then. $1350 perhaps marks the turn towards a global rate cutting regime.

• The $ and yields: The positive feedback loop of structurally lower yields and potentially lower fiat currencies (including the $) on pro-active CB responses where currencies are being openly weaponized, are 2 key ingredients that support bull markets.

• Positioning switch: For 4 years, paper/COT shorts were the dominating driver of gold price action, with gross longs sidelined and tentatively participating, ensuring a structural sell-rally market. The switch to gross COT longs dominating flow the past 2months is an early sign indicative of a dip-buying mentality.

Golds chief risk for a reversal back below $1350: a Goldilocks macroeconomic backdrop (i.e.: US data outperforms the ROW, there’s a credible US/China trade deal marking the turning point and the de-escalation of geopolitics, even as global CBs provide further liquidity, keeping the $ resiliently strong and risk assets buoyed).
**Gold:**

Golds consistently evolving “cheat sheet” - table of key bullish and bearish drivers as its reprices into and tests a different cyclical range

<table>
<thead>
<tr>
<th>Current outlook</th>
<th>Revisiting drivers for Gold above $1350</th>
<th>Drivers when Gold was below $1350</th>
<th>Revisiting drivers for Gold above $1350</th>
<th>Current outlook</th>
</tr>
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<tbody>
<tr>
<td>Up</td>
<td>Fed (and ECB!) pre-emptively due to cut rates sooner rather than later due to trade/geopolitical risks</td>
<td>Tailwinds</td>
<td>Headwinds</td>
<td>Gold Producer consolidation / M&amp;A driving “peak gold” supply calls</td>
</tr>
<tr>
<td></td>
<td>Risk of CB demand slowing due to significantly higher prices vs 1H19</td>
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<tr>
<td></td>
<td>Geopolitics escalated with major turning pt. in trade risk (May) and war risk (June). Outlook uncertain; formal trade deal unlikely</td>
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<tr>
<td></td>
<td>Lower for longer yields; talk of threat of negative rates in the US in medium term</td>
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<tr>
<td></td>
<td>Alternative CB tools (MMT, QE+, negative interest rates globally) increasingly more relevant as rate cuts arrive earlier</td>
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<td></td>
<td>Structural theme, and one which has taken a backseat to trade/politics (for now)</td>
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<td></td>
<td>Democratic debates mark the real start to the 2020 campaign</td>
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<td></td>
<td>Sentiment theme in the short-term</td>
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<td>Down</td>
<td></td>
<td>Expanding pool of negative yielding debt securities &amp; lower global bond yields</td>
<td>Muted physical support from India &amp; China as higher prices in local terms defer purchases</td>
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<tr>
<td></td>
<td></td>
<td>Growing talk around alternative Fed tools (eg: Modern Monetary Theory)</td>
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<td></td>
<td></td>
<td>Unsustainable US debt/fiscal path</td>
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<td></td>
<td></td>
<td>A pickup in socialist rhetoric &amp; polarizing politics</td>
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<tr>
<td>Flat</td>
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</tbody>
</table>

**Tailwinds**

- A late cycle Fed pause, rate cut increasingly likely soon
- Higher pace of Central Bank gold buying, diversifying against flat and US$
- Geopolitics: a new & unpredictable multi-front trade/cold war
- Expanding pool of negative yielding debt securities & lower global bond yields
- Growing talk around alternative Fed tools (eg: Modern Monetary Theory)

**Headwinds**

- A stubbornly perky US$
- Lack of sustained macro fear; the inbred resilience of US equities and other higher yielding Gold ‘detractors’
- Lack of momentum & technical follow-through as the marginal investor has a fear of buying breakouts
- Muted physical support from India & China as higher prices in local terms defer purchases
- Unsustainable US debt/fiscal path
- A pickup in socialist rhetoric & polarizing politics

**Key**

- **Bullish**
- **Neutral**
- **Bearish**
Gold is firstly a currency (strongest correlation with JPY, then EUR), secondly a rates hedge or source of liquidity (correlation with real 2yr yields), and lastly a commodity (almost no correlation with broader complex).

Golds technical milestone its cleared ($1350), its perceived ceiling ($1500) and near-term support ($1380) & resistance ($1440).

* Mexican tariffs threatened marking the turn in US trade policy (more unpredictable) and start of the cited $150+ Gold rally.

Source: Scotiabank Commodities Strategy; Bloomberg

* Real 2 year yields = 2 Treasury yields - 2yr Breakevens

Source: MacroBond, Scotiabank Commodities Strategy
Silver: attracted the strongest monthly investor inflows (+300m oz) in 5 years, yet prices couldn’t keep up with Gold and reclaim $16, indicative of the structurally oversupplied backdrop; Gold/Silver ratio to remain >85 but its perhaps overshot in the near-term.

The Gold/Silver ratio continues to make new highs in June, through the top end of a long-term range, hitting 93 (last seen in 1990). In the current macro-economic regime where there’s an overreach for safe havens like Gold and Treasuries, there are a few headwinds impacting Silver’s prospects, which include:

- Silver is no longer poor man’s gold (with nominal Gold prices well below record highs in US$ terms)
- It fails to attract the steady Central Bank inflows seen in Gold
- The rollover in manufacturing PMIs in June ensured Silver traded as a base metal aligned with Copper
- Alternative investments, such as cryptocurrencies, have detracted would-be investment and retail flows, away from high beta Gold proxies such as Silver and Platinum
- Known exchange inventories are sitting at record highs, creating a persistent overhang leaving spreads in contango and physical premiums suppressed, further curtail the impact of any investment inflows

Through June, net investors (ETF + COT) added almost 300m of Silver to holdings, which is the highest month of investor inflows in 5 years; the next largest month of inflows was +200m oz (Oct 2015). YET, Silver prices could not put in any convincing attempt to retake $16 and piggyback the Gold rally, which simply confirms the structurally oversupplied backdrop.

Overall, Silver’s longer-term thesis has not changed — the longer prices remains near its cyclical floor around $15, AND the longer price volatility remains contained (3m ATMs have averaged <16% YTD vs >25% in 2012-2016 period), the better chance it has of attracting and inducing new technologies and end-use demand. We continue to believe the Gold/Silver ratio will remain lofty but its perhaps recently overshot, creating tactical opportunities if there’s a sustained relief rally in EM, base metals and risk into 2H’19.

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Source: Scotiabank Commodities Strategy
Palladium: despite the lack of further curve tightening, Palladium showcased typical bull market characteristics in June (rallying on micro & macro tailwinds); the path of least resistance—so long as the ‘expansion is sustained’—is north, given underweight investor positioning, tighter emission regulations & SA supply-side risks. Platinum: extreme paper shorts and lack of Chinese jewelry & European demand demotes Platinum to an industrial metal in June as it fails to piggyback Gold; substitution has never been this attractive given relative pricing.

Palladium was the star performer across all metals in June, managing double digit (+16%) gains, versus the 5% gains for Platinum. Despite the fact that palladium forwards did not tighten up dramatically in June (1mo lease rates remain structurally tight and comfortable in the 0-5% range, but not near the 30-35% levels seen in Dec’18-Jan ‘19), and NYMEX warehouse saw inflows (usually a sign of metal availability), Palladium still managed a $250 rally. It simply managed to piggy-back the best of both worlds—the micro backdrop (Rhodium—a good proxy for true auto demand—rallied toward $3500, +18% MoM) and risk appetite which extended on dovish CBs (the S&P logged its best month since January and its best first half since 1997); that’s not atypical of any asset in a bull market.

The auto-related bid (as China shifts to stricter emission regulations in 2H’19), unconfirmed reports of refining issues and some investor participation mostly drove Palladium’s price action; the re-emergence of concerns over rare earths (or by extension, the availability of any “strategic metal”, whether it’s a rare earth or environmentally important metals like PGMs) is a story that could induce some front-loading by consumers. While Chinese auto sales continue their sharp weakening streak, with US auto sales largely plateauing, European auto sales turned the corner in June to post their first increase in nine months. That should, in theory, benefit Platinum (more so than the others) given Europe’s reliance on diesel. However, details highlight that Germany led EUs auto sales because they benefited from offering generous trade-in incentives to swap older diesel cars for cleaner, newer hybrid models (which usually lean gasoline) or electric vehicles consumers are being incentivized to opt for perceivably “cleaner” gasoline hybrids cars over diesel.

The re-commitment of investors to Palladium was the final strong driver in June, with ~155K oz of net length (ETF + COT) being accumulated; this was enough firepower for the recent $1300-1450 range to convincingly give way. Palladium spot prices are now $50 away from all-time highs (made in March), while all investors own 40% of their recent peak holdings... So while there are constraints to entry in the Palladium market (exchange limits, lack of liquidity & wide spreads, extreme and unexplained intraday price action), which arguably deters some investors, the path of least resistance—so long as the ‘expansion is sustained’—is north.

Platinum remains the metal with the preferred risk-reward profile, given that its discount to both Palladium and Gold fell to new lows in June. Short positioning is extreme (mirrorring trends seen in industrial metals/Copper) as it continues to come under both investor and producer-related pressure into the half-year turn. The threat is that potential supply-side disruptions (as SA wage negotiations kick off) may also be overlooked due to the macro overhang indicated in spread and physical indicators (akin to what occurred in Copper, see pages 9-10). The upside risk is that these (relative) prices make substitution even more incredibly attractive.
Base metals chart of the week: all base metals have put in seasonally strong gains in Q3, if historical performances the past 10 years (2009-2018) are any indication.

Seasonal Q3 commodities performances since 2008 *

*aggregate monthly performances for July, August, September for years 2009 - 2018

Source: Bloomberg, Scotiabank Commodities Strategy
Copper: micro supply-risks overlooked due to trade and demand-side pressures & fears. That’s despite a tightening refined outlook. Macro forces destabilized copper to $6000; it will take macro to inject a repricing higher.

After taking a stab through the key $5800 handle in the beginning of June, largely in response to the threat of US tariffs on Mexico and escalating political tensions in the Middle East, prices managed to find physical support, stabilize and launch a small (3%) gain in June. Prices simply can’t convincingly escape $6000/mt, reflecting the top-down macro view of further deterioration in global manufacturing PMIs (which the Fed has acknowledged) and is proxied by gross short paper positioning hitting a new peak in June.

The mix of micro developments in June, failed to inject a sustainable bid to Copper, frustratingly for fundamental copper bulls who have patiently waited for the market to return to a deficit. They include:

- A ~two week strike at Codelco’s Chuquicamata copper mine, which would marginally impact balances but wasn’t prolonged enough to inject a fear premium; recall buying Copper on strike-risk has been a hard lesson learnt (e.g. the move up through $7000/mt in the summer of 2018 on the fear of BHP/Escondida going on strike, which was abruptly unwound as the strike didn’t materialize).

- Nationalization fears over copper mines/projects in Zambia alongside plans of several producers to reduce output due to tax reforms impacting the marginal tonne.

- Smelter shutdowns or maintenance: a mix of smelter maintenance in China led to lower refined output in Q2 (and thus a drawdown in local stocks), but this is due restart in 2H’19. Outside of China, KCM’s Nchanga and Glencore’s Mufulira have been shut down due to a dispute between the government and KCM, and to repair a damaged furnace (Mufulira)

- The mine collapse in the DRC (where 43 illegal miners died from a mine collapse) is likely to have a short-term impact on production while there’s an ongoing investigation.

- Ramped up restrictions on Chinese imports of copper scrap (beginning July 1 2019 on Category 6 copper) have forced buyers to source alternative forms & sources of Copper, as China continues with its campaign against shipping in foreign waste. This creates bottlenecks, and while its expected that final import quotas for 2019 for Cat 6 scrap will be similar to 2H’18, there’s a net loss on imports due to the ban on Cat 7 scrap which’ll increase refined demand (not aggregate demand).
Copper: micro supply-risks overlooked due to trade and demand-side pressures & fears. That’s despite a tightening refined outlook. Macro forces destabilized copper to $6000; it will take macro to inject a repricing higher.

Thus overall, there’s an incremental buildup in supportive micro stories, but ones which are being overlooked despite the fact that deficits are set to grow slightly in 2019 due to:

- **1H’19 supply disruptions** (YTD there’s already been >400k mt of Copper disruptions due to strikes & weather in Latam and smelter stoppages)
- Structurally lower stocks: CME, SHFE & LME stocks are hovering around 400k mt (25% below the 10 year average) with a drawdown in both blister and concentrate stocks also noted.
- Demand optimism for a pickup in 2H’19 Chinese demand (where the Q1’19 stimulus efforts from the PBOC targeting the old economy of infrastructure & property have yet to play out due to lagged effects*)

Thus despite a relatively tighter fundamental market for refined copper, prices continue to internalize the macro and trade risks indicative in top-down demand indicators (PMIs, stabilized albeit low stocks, contango market). Macro destabilized copper; it will take macro to force a repricing higher, making prices contingent on US/China relations, the Fed and $ outlook and EM assets.
Ali: trade policy, slower Chinese growth and ex-China production ramp-ups due to shrink expected deficits, and ensures a slow grind into physical support; ~$1750-$1850 barring a convincing story/catalyst.

Aluminum prices continue to remain extremely contained and suppressed at the lower end of a cyclical range, finishing June barely unchanged. Despite low known inventories falling below 1m mt (on the LME), Woodmac estimates that both known and unknown stocks are worth around 70 days of consumption (highs closer to 90 days), and thus together with supply growth (stemming from US restarts, the Boguchansky ramp-up & Bahrain), any rally toward $1850 is short-lived.

The dual (yet related) demand risks remain trade policy (and its impact on global growth) as well as China’s automotive sector which continues to put in double digit monthly sales declines which will impact auto production in 2019. The deficits, closer to 2m mt, expected from the industry earlier this year have thus been consistently revised lower toward 1m mt (e.g.: CRU expects a 1.2m mt deficit in 2019 down from 1.5m previously forecasted). In addition, alumina is not providing any tailwinds in the short-term, with prices falling toward $320/mt in June (lowest since August 2018) on additional availability, where stocks are expected to rise.

Aluminum tends to have problems self-balancing efficiently and quickly (recall the markets belief in production cuts when prices fell beneath the ‘perceived’ cost of production floor of $2000/mt, which simply did not materialize). Ex-China producers then resort to ramp-ups in order to lower unit costs given the low-price environment. That fact hasn’t gone unnoticed by investors who tend to be either sidelined or short (participation on both SHFE + LME is sitting at <20m mt, the low end of a 5-year range).

Overall, while the short-term outlook remains rather bleak barring any supply-side catalyst, key investment decisions and projects need to be made now to prevent structural shortages in the medium term (if the assumption that growth can hold above ~3%, holds...); the lower aluminum can remain relative to copper, the more there is substitution opportunity to switch to Aluminum in applications ranging from renewables to electric grid; this is perhaps incrementally occurring giving the Copper/Al ratio is >3. That’s a positive development and one which would increase this supply-gap risk; by some estimates, aluminum prices need to reach incentivization levels (well above $2000) to induce new required capacity of ~6m mt of by 2022; for now that’s being overlooked as prices continue the slow contained grind.
Zinc/Lead: Loosening zinc time spreads are indicative that the wall of supply is beginning to impact the refined market, highlighting a missed opportunity (thanks to trade uncertainty) for 3m prices to capitalize on acute & chronic tightness.

Zinc continued to bleed lower throughout June, falling from almost $2700 to key support at $2500. Despite the positive outcome from the G-20 as China and the US agreed on a trade truce, the fresh paper short selling, probably contingent on inflows into both the LME and SHFE warehouse and the collapses in spreads, ensured any macro induced rally was short-lived.

Cash-3m spreads narrowed from 2 decade highs (seen in March) to its lowest level since March (in June from $150 back to under $50b), in a statement indicating that the ramp up in (concentrate) supply is finally hitting the refined market. And while its still unclear on the ability of China’s zinc smelters to collectively increase utilization rates, other production ramp-ups ensures the supply story this year is in tact; production at the Penasquito mine in Mexico has restarted after it was suspended in late-April due to a blockade of the mine site, ensuring a rise in in higher grade zinc ores.

The outrage at the end of May at Nyrstar’s Port Prairie lead smelter in Australia had a (limited) impact on spot, but more so on spreads which contracted to their tightest in 2years. 3m Lead managed a quick $150 rally in June, toward $1950, but that was shortlived and has the characteristics of a dead-cat bounce; support seen at $1800.

Nickel: The markets respect of the ability for quicker supply responses (amongst other factors) ensured Nickel prices didn’t capitalize on recently strong Chinese stainless steel demand.

With Nickel prices well supported around $11,600, the drawdown in LME inventories in the latter half of June, positive expectations of a G-20 trade outcome and the announced closure of Onça-Puma all helped drive a short-lived rally to $12,700. However, sentiment sits firmly on additional supply from Indonesia and Chinese ramp-ups, which seems enough to have offset the strong tailwinds from the stainless steel sector (Chinese stainless steel production sustained high rates since March through June). Additional reasons for the lack of nickel price appreciation to strong SS demand are: talk of high stocks, the expectation of falling SS demand, the need for production cuts and the fact that Chinese SS mills are said to be de-stocking their own Nickel inventories and increasing scrap usage, which decreases nickel uptake.
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