

The Fed & Gold: preparing for another cut, but the devil is in the details

The Fed is preparing for its 3rd rate cut tomorrow, which some expect could mark the end of this 75bp rate cutting cycle. Gold & silver have remained under pressure (albeit rather jittery) into the FOMC, which is standard given strong expectations of a 25bp cut but which has been muddled by both 1) uncertainty of whether its another hawkish cut or not (by altering their guidance toward future rate cuts and suggesting a '3rd-and-done' cut) and 2) macro risk-on/complacency stemming from positive US/China trade developments (there's a 'mini-deal' between China and US due in mid November) & Brexit (UK is set for a December election set to become a proxy referendum on EU membership)

The FOMC also comes at an important technical inflection point in asset pricing: Gold, which recently tends to trade in \$50-\$100 bands, is near the bottom of its comfortable 2 month range. US Stocks are at all time highs, taking VIX back into the sub-15 trough. And the US yield curve has jumped out of the over-hyped "recession signal" territory, with 10yr yields also creeping toward the the pivotal 2% handle (a level not revisited since the July 31st FOMC marking the 1st rate cut in this cycle). Thus, running with the thinking in our FX strategy note** (a hawkish, dovish or neutral rate cut), the expectation and our thinking around Gold & precious is as follows:

Summary:

1. Downside Gold risks = (another) hawkish cut. Gold \$1450-1500 (page 1)

- Gold would simply revert to a less bullish trajectory (not back to bear-market status as 1) Trade/geopolitics - the Feds reaction function - has not been fully resolved, 2) Any large Fed disappointment will inject macro fear /equity volatility (with stocks at ATHs) & thus fresh Gold inflows, 3) A hawkish cut is *not* a cyclical shift in Fed policy and thus doesn't substantiate a new lower range below \$1450, 4) US data has deteriorated (manufacturing softened joining the ROW and GDP tomorrow is set to show growth cooled sharply in Q3 to +1.6% down from 2% in Q2)

2. Neutral Gold = neutral rate cut. Gold \$1480- \$1520/40 (page2)

- This is the more likely scenario, where they keep the window open for another cut (at the end of December or early 2020) given subdued inflation, unresolved trade issues and the recent deceleration in US data. So with soft physical Gold demand putting the onus even more so on investor flows, a neutral Fed cut merely solidifies the floor at \$1480, with any upside then dependent on: Data, Technicals, Geopolitical and/or trade updates: Q4 macro risks

3. Upside Gold & Precious risks = A dovish cut. Gold \$1500 - \$1550+; Silver \$20+; overextension in Palladium (page 3)

- A dovish cocktail/cut supports a structurally bullish Gold (and precious) story. However, given that the preferred 'home' for any additional Fed liquidity is risk assets/the stock market (whether its scheduled QE in 2012-2015 or due to emergency REPOs the past month), there's thus more upside potential in high beta/ industrial/reflation metals (white metals and base), vs Gold. Especially if trade optimism remains and manufacturing data bottoms in Q4'19—Q1'20

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Golds risks around:

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- * A dovish cut (\$1500-1550+): Page 3
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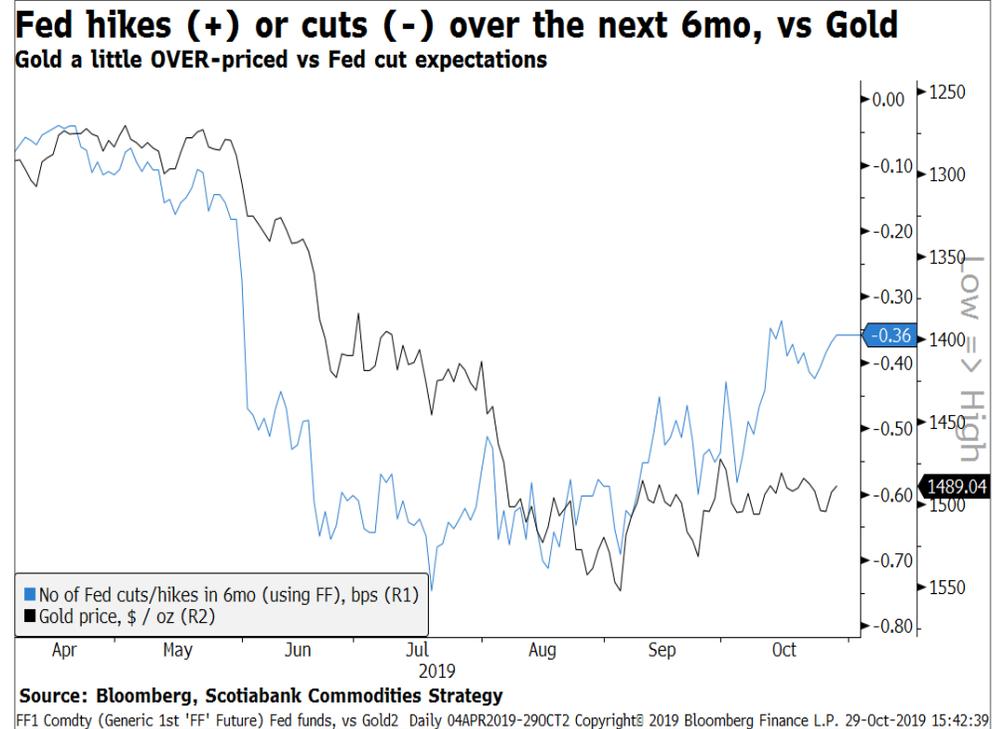
Please review the notes for full details on Scotias thoughts on the FOMC:

*Scotia Economics: [Fed Preview: A Hawkish Cut?](#)

**Scotia FX Strategy: [What to Expect When You're Expecting a Fed Cut: USDCAD in Three Fed Scenarios](#)

1. Downside Gold risks = (another) hawkish cut. Gold \$1450-1500

- ⇒ There's little hint of further 2019 cuts, Powell's presser suggests the end of the easing cycle is near, with trade/geopolitical risks downplayed while remaining upbeat on the resilience of the US economy (i.e.: growth/manufacturing slowdown perhaps transient). It's likely Powell leans *slightly* hawkish, but he's unlikely to change the script drastically (and point to *no* future cuts) into yearend, when there is some hope behind a US/China trade deal that's required to drag global manufacturing out of the hole. Powell has attempted to be hawkish the last two FOMCs, and succeeded, but that has still managed to keep Gold above \$1450.
- ⇒ Gold momentum has stalled so a hawkish cut could inject a quick kneejerk purge toward the important \$1450 inflection point. Gold investor positioning (ETF + COT) has swelled by 6.4m oz since the July 31st FOMC (driven by relatively stickier ETF inflows, not COT) and poses and drives this risk, together with rather sidelined/inactive COT shorts. Overall, current Gold prices are somewhat overweight vs Fed rate cut expectations (graph 1)
- ⇒ Recall, the previous 2 hawkish Fed cuts were either met with actionable political pushback (Trump upped tariffs post July 31st FOMC) or arguably unintended consequences (repo stresses ahead of the September FOMC)
- ⇒ **Gold would simply revert to a less bullish trajectory (not back to bear-market status as 1) Trade/geopolitics - the Fed's reaction function - has not been *fully* resolved, 2) Any large Fed disappointment will inject macro fear / equity volatility (with stocks at ATHs) & thus fresh Gold inflows, 3) A hawkish cut is not a cyclical shift in Fed policy and thus doesn't substantiate a new lower range below \$1450, 4) US data has deteriorated (manufacturing softened joining the ROW and GDP tomorrow is set to show growth cooled sharply in Q3 to +1.6% down from 2% in Q2)**



2. Neutral Gold = neutral rate cut. Gold \$1480- \$1520/40

- ⇒ Powell reiterates they will ‘act appropriately to maintain the expansion’, taking a meeting-to-meeting approach dependent on data and trade/geopolitical developments. This is the more likely scenario, where they keep the window open for another cut (at the end of December or early 2020) given subdued inflation, unresolved trade issues and the recent deceleration in US data.
- ⇒ Physical Gold demand has been very light (e.g.: despite Diwali, Indian Gold sales tumbled this year due to high XAUINR prices and concerns about an economic slowdown), putting the onus even more so on investor flows. Those flows are driven by 1) the macro backdrop, 2) the Fed, and 3) trade/geopolitics. Golds recent comfortable range has been \$1480—\$1520, so a neutral Fed cut merely solidifies the floor at \$1480, with any upside outlook then dependent on:
- Data:** manufacturing data, into Q4 and over this US/China ‘mini-deal’, will be critical in assessing whether the “risk-on/trade hope” trade has legs and whether the ‘mini-deal’ was too little, too late. The fickle nature of trade policy—at the drop of a tweet, the unexpected U-turn in rhetoric and tariffs—hints that perhaps investment may not return as quickly as some hope.
 - Technicals:** there has been determined heavy resistance at \$1520 (3 large failures the past month), that coincides with Gold keeping within a short-term downtrend channel, marked at \$1520, then \$1540. In addition, Golds preferred driver (since its statement repricing above \$1350), has been US rates (less so the US\$), thus whether 10yrs remain sub 2% (a pivotal handle) is key.
 - Geopolitical and/or trade updates:** China-US trade risks have eased quite some since July 31st (the general stance then was ‘trade escalation’) with this mini-deal’ already being priced into risk assets and injecting short covering in most base metals. However the trade conflict is still unresolved given it has broadened beyond just trade (to incorporate IP protection, national security, human rights and free speech issues etc), with a mismatch in time horizon goals, suggesting that some stalemate (no escalation, but no respite either) is likely.
 - Q4 macro risks;** its not been unusual for some unexplained volatile macro asset repricings to occur, and with markets unusually complacent and risk underpriced, that’s becoming a larger threat.

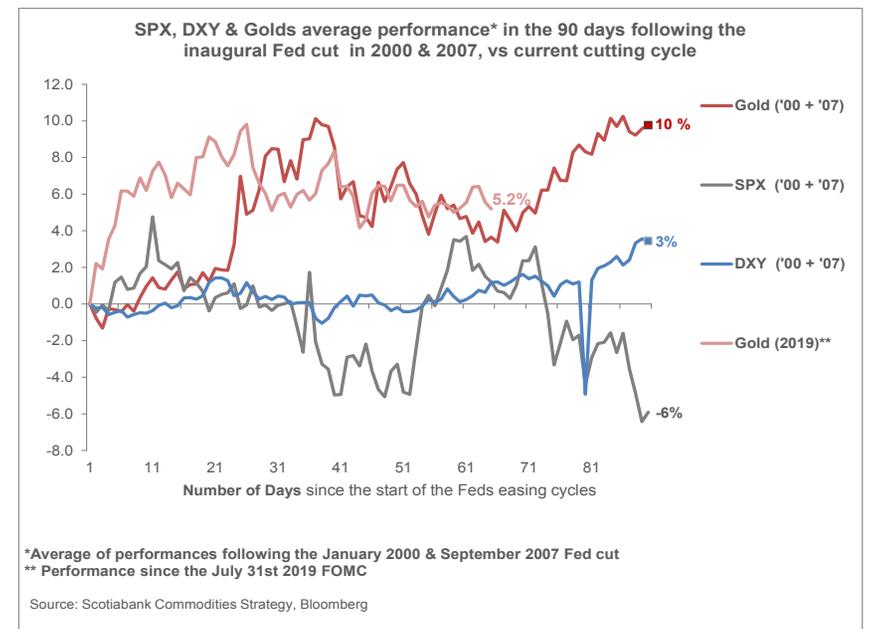
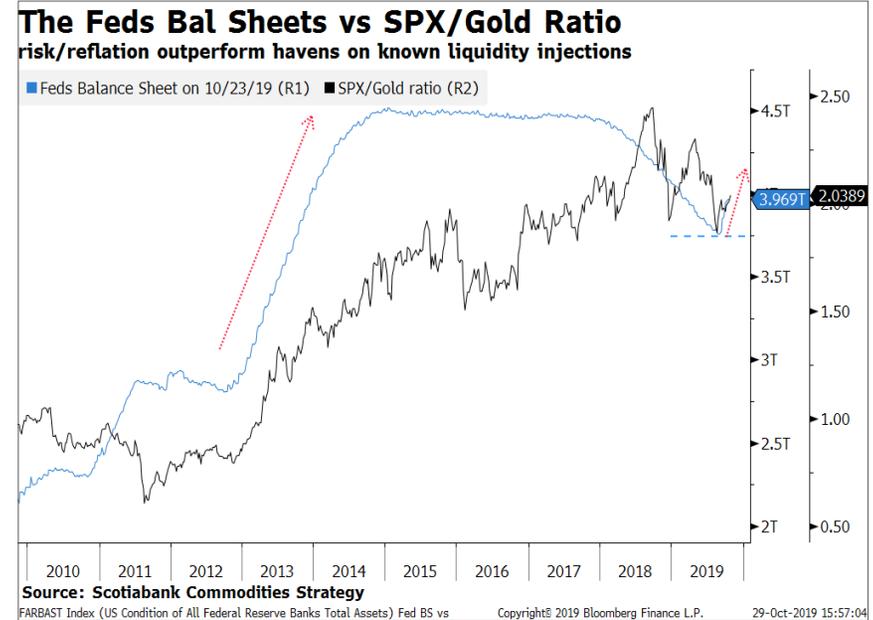


3. Upside Gold & Precious risks = A dovish cut. Gold \$1500 - \$1550+; Silver \$20+; overextension in Palladium

- ⇒ Powell talks up both the potential impact of trade uncertainty (and its drag on manufacturing) and unresponsiveness in inflation, which drives rate cut expectations further out the curve.
- Recall, the Fed is already injecting liquidity and expanding its balance sheet (which wasn't the case in September where the BS runoff was counterintuitive to a rate cut). A dovish cocktail/cut supports a structurally bullish Gold (and precious) story. However, given that the preferred 'home' for any additional Fed liquidity is risk assets/the stock market (whether its scheduled QE in 2012-2015 or due to emergency REPOs the past month), there's thus more upside potential in high beta/industrial/reflation metals (white metals and base), vs Gold. Especially if trade optimism remains and manufacturing data bottoms in Q4'19—Q1'20

Revisiting past easing cycles: what happened to risk assets & Gold in 2000 & 2007

- Comparisons are tough given there are more macro-economic, geopolitical/political and market structure *differences* than *similarities* now vs previous cycles (outside of the simple fact that the Fed is entering an easing cycle). Nevertheless, it has not gone unnoticed that the previous 2 times the Fed embarked on an easing cycle (2000, 2007), risk markets weren't happy. This time is different in that the Fed is not patient, awaiting an equity meltdown before acting; whether equities retain their bull market self preferring to find any reason to extend gains ("sustain the expansion"), or concede to their historical performances (by piggy-backing rates to the zero bound) will be interesting; the former is more likely if US data remains relatively robust, but cracks have started to appear as noted.
- Nevertheless, Graph 3 outlines the average performances of Gold, SPX & the \$ in the 90 days following the 2 previous Fed cuts that marked the start of an easing cycle. On average (and while its only 2 data points), Gold is up 10%, SPX is down 6% and the \$ puts in mild gains (+3.4%). Golds current gains of 5.2% since the July 31st FOMC and trend since then, is decently aligned with its historical performance, and also hints that there is some upside potential.



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