

Precious Update:

This note will cover

- **The Saudi oil disruption, the Fed (pages 1,2) and implications for havens like Gold (page 3)**
- **Platinum Week thoughts (page 4)**

The drone attack on Saudi Arabia's Aramco oil facilities, should take the focus this week; it certainly risks spoiling the risk-on / reflation party we've seen the past two weeks that saw US yields rebound and investors rotate out of havens into cyclical high beta trades such as base metals. Without fear mongering (or citing the conspiracies surrounding the weekends events), a few thoughts as they pertain to macro, geopolitical and the gold/precious outlook:

- Its not *only* about the actual supply-side numbers and whether softer demand, trade, global stocks, US production and/or SPR release can plug the outage (~5% of global supply cut—see full report from Equity Research [here](#)); its also about geopolitics and perception given that macro markets were abnormally nervy/skittish this summer, theres an upcoming Fed meeting, the investigation is ongoing as to the source of the attack (Yemeni Houthi rebels have claimed responsibility yet US and Saudi have pointed at Iran), at a time when US foreign policy is now increasingly unpredictable and/or unfocused (after Boltons exit) and the markets are late cycle seemingly awaiting some shock to derail high valuations.
- This is a **major geopolitical development** indicated by the ~20% repricing overnight in Brent—prices usually always overshoot, but not to this extent—the largest 1day repricing since 1991— with the kneejerk reaction that held most intraday gains into the NYMEX close. The Saudi attack marks a turning point in 1) the recent macro thinking (out of safehavens and into reflation and cyclicals), which should now reverse, and 2) the focus within oil circles from slowing growth and/or trade on demand, to supply risk and the incremental premium the market may demand. It confirms geopolitical risk is back on (since it ups the risk of military retaliation), increases the uncertainty over how both the US and Saudi may respond politically, and brings forward the question of retaliation in the region for finger pointing (e.g.: the Strait of Hormuz, a critical chokepoint for 1/3rd of global oil supply is effectively controlled by Iran)
- While the usual bombastic Tweet (the US is “locked and loaded”) has perhaps been overlooked by most havens for now, the attack and subsequent response in oil prices is enough to renew attacks on **Powell** (“Will Fed ever get into the game? Dollar strongest EVER! The oil hit. Big Interest Rate Drop, Stimulus!”); any major oil disruption simply makes it easier for Powell to reduce opposition to any cut. A 25bp **Fed cut** is fully priced in and locked, with a special focus on Powells press statement. After a somewhat dovish ECB decision last week (restarting open-ended QE, and cutting rates further negative), the idea of monetary easing reaching their limits at many DM CBs (excluding the Fed) gaining traction AND this weekend's fresh geopolitical developments, there's less risk of “mid-cycle cut” outlook; Powell more likely leans pre-emptively dovish (citing international trade tensions & geopolitics which have clearly risen) feeding into the largely dovish positioning/market expectations, which is a potential catalyst for the next leg higher in Gold (sustained move lower in DXY). There are also other CB decisions (BOE, BOJ, SNB) which can impact the US\$.
- The market was looking forward to some positive **trade updates** or momentum (given that the US was considering an interim trade agreement with China with Beijing signaling ag purchases) and an extension in the recent reflation trade, but after this Saudi oil attack, trade rhetoric should takes a backseat as the US administration refocuses attention to Middle East and the Feds response. If fear and subsequent demand for havens can subside in the short-term, with oil refocusing on finding a fairer higher range (as it prices in the risk of further supply risks/geopolitics), the implications for **longer-term inflation** is notable; most CBs are either sidelined or easing, keeping (nominal) rates low but with a pickup in both US wages and core CPI and thus inflation expectations, real yields risk falling (which would be an additional booster to Gold). The counter-argument is if oversized positioning in rates unwinds faster (higher nominal rates) than the pickup in inflation expectations (via stronger wages/CPI. IE: Inflation Breakevens) - that would pose a large threat to Gold.

CONTACTS

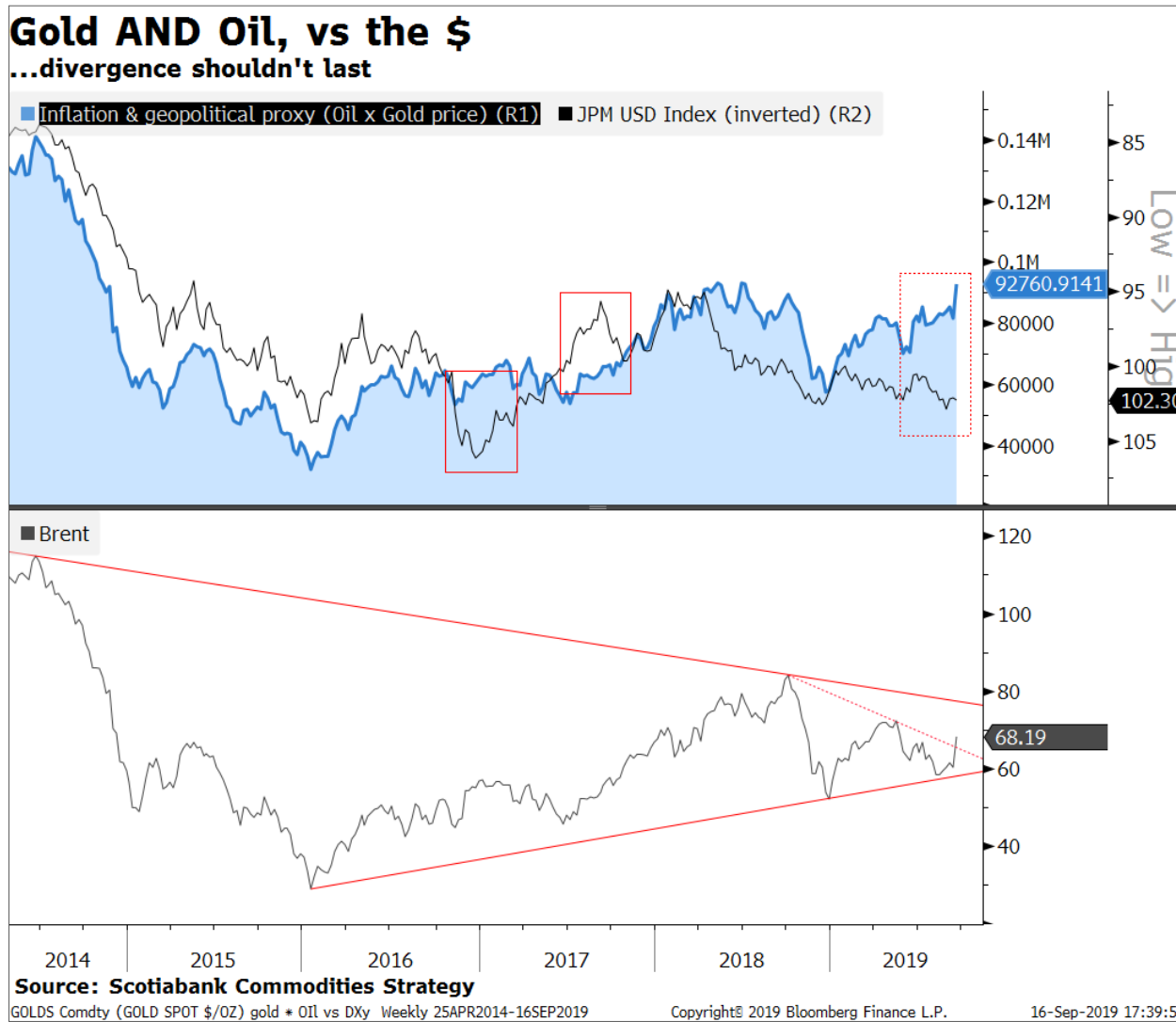
Nicky Shiels
Commodity Strategist (Metals)
212-225-6724
Commodities Derivatives

 Follow us on Twitter @ScotiaMetals

CHART:

The US\$ is unfairly strong vs two core commodities (gold & oil as a geopolitical and inflation proxies).

Oil has convincingly broken short-term range; floors in the review mirror.



Implications for GOLD & SILVER:

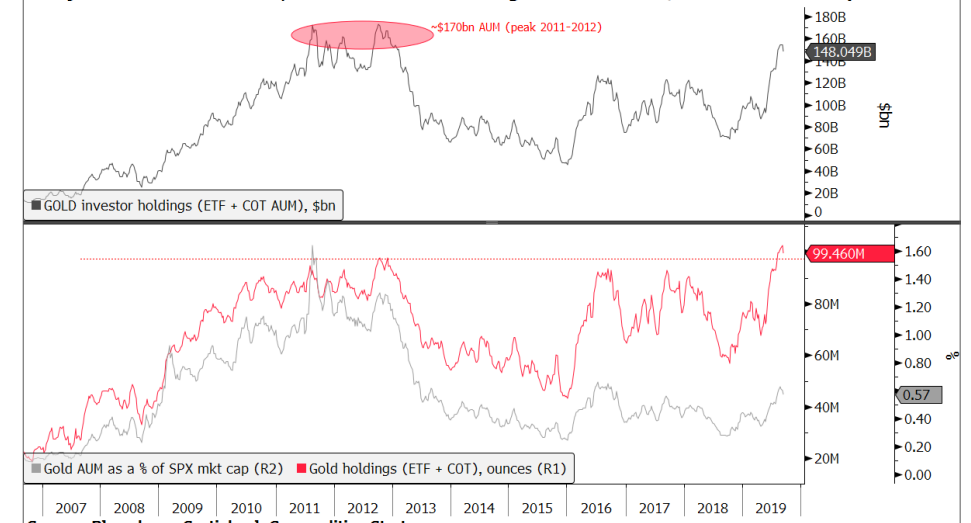
- The recent decision to perhaps explore an interim trade deal with China, was not a game-changer in overall US-China dispute, but helped prompt a relief rally in risk assets and triggered a Gold unwind through \$1490 (down ~5% from 'peak fear' seen the end of August) and Silver through \$17.40 (down 11% from recent peak).
- Gold has been surprisingly very well bid the end of last week despite stronger yields, its core promoter/driver recently. US real yields and Gold have enjoyed a strong -0.97 correlation the past 6 months, arguably when markets began their insatiable hunt for recession hedges or havens. Thus with real 10yr yields rallying above 0.20% last week (up from a bottom of -0.1% in August), a simple regression indicates gold should've been closer to \$1450. This ~\$50 "premium" vs yields and in light of Silver weakness, can be explained away by a mildly softer US\$, some steady inflows below \$1500, but the ability (or stubbornness) to fade risk-positive developments.
- The lack of a sustained reaction in typical havens today—gold, silver, the JPY—with markets adding an additional geopolitical layer (potential threat of a proxy war) over the existing framework (trade war, rate cuts and/or currency war on slower global growth and limits to monetary easing), is surprising. Outsized positioning across most "trade hedge" havens (Bonds, Gold, Silver etc) and a stronger US\$ (for a range of reasons that requires further explanation) explains part of the inability to capitalize and reprice back toward recent highs, but that should be short-lived on an incrementally dovish Fed. Gold saturation certainly poses some short-term downside risk, but a structural driver (geopolitical escalation) has been renewed which puts the target back on \$1600 Gold (> \$20 Silver)

US 10 year real yields and Gold
reflation bounce which had limited impact on Gold



Source: Scotiabank Commodities Strategy, Bloomberg
USGG10YR Index (US Generic Govt 10 Year Yield) 10 year real vs Gold 4 Daily 31D Copyright© 2019 Bloomberg Finance L.P. 16-Sep-2019 12:56:07

Gold positioning
..lofty on actual ounce-basis, but somewhat underweight on historical \$-basis and as % of portfolios



Source: Bloomberg, Scotiabank Commodities Strategy
.GCHOLDIN U Index (ETF + netspec) ETF COT AUM SI GC2 Weekly 25AUG2006-13SEP2019 Copyright© 2019 Bloomberg Finance L.P. 16-Sep-2019 15:36:17

PLATINUM/ CME WEEK TAKEAWAYS: Precious metals industry participants gathered in NYC last week for Platinum/NYMEX/CME week and while we wont recap each event, below are a few thoughts around conversations and presentations attended:

- Sentiment from many players remain quite upbeat given the largely sustained strong metals pricing.
- PGMs: there was an acceptance that between most information sessions, there were no real structural changes to the story and drivers in Platinum and Palladium:
 - Palladium remains in a sustained deficit, albeit one that is shrinking in 2019 due to supply growth, flat demand and increased recycling. The price action, in face of a sustained auto-recession in key markets, is well cited 'proof' of stricter emission standards taking hold (RDE in Europe, China 6a/b being accelerated etc). There's known risk for a pullback as tightness has eased (fed by ETFs, NN Palladium Fund and previously bottlenecked WIP inventory), but historical lack of liquidity and fickle/unexplained nature of price action has deterred many discretionary players. Persistent disagreement on both the topic of substitution and extent of it occurring (if at all) amongst participants, while there was a lack of focus of the impact of the trade war and/or threat of auto tariffs on supply chains and specific PGM needs by end-users.
 - Platinum continues to battle through a supply overhang (but one in which above ground stocks are its lowest in 45 years, if taking into account ETF demand. *WPIC*). Given that the fundamental picture hasn't improved much, the market remains in surplus but one in which auto declines (Europe) shouldn't shoulder all the blame; acceptance that jewelry (particularly China) is at a critical inflection point to halt structural demand declines. Strong investor (ETF, COT) inflows, hasn't been enough to soak up excess metal - Ex-ETF/investment demand, the (*WPIC*) surplus is 1.2moz (15% of supply) or 1.3m oz (SFA). Downside risks: high PA/Rh prices encourages previously mothballed mines to restart while core demand areas (auto, jewelry) remain weak. Platinum positive drivers include: substitution (from PD), higher PGM loadings from China 6 standards, FC demand growth, & supply risks in SA from ongoing wage negotiations & power outages. Growing debate amongst participants whether ETFs are an important depository for excess supply (given lack of sustained price action) or whether its true and structural longer-term investor demand
- There was a lot of focus, questions and concerns around Rhodium. While many agree parabolic pricing isn't sustainable (due to tightening emission regulations and a scramble to secure Nox-fighting Rhodium with WIP stocks still 'tied' up in SA but due to return to market in 2H), there was an apprehension to talk about 1) the fact there is no substitute (no presentations focused on the substituting way from Rhodium with prices sitting at historical >5x peak vs platinum), 2) the role Chinese participants (both investors and industrial end-users) have played, 3) the impact of the trade war and uncertainty on fabricator buying trends. There is another driver outside of stricter Chinese emission regulations that is occurring— China has imported all of their 2018 needs in the first half of 2019 (why), that comes at a high costs (elevated lease rates) while the market is expected to largely be in a surplus (in near-term)...
- Gold: speculation and interest is mounting, that with rising prices, it'll drive further acquisitions after years of underinvestment, creating a sellers market for smaller gold producers available for M&A. The WGC hosted an Investment Summit with a respected range of speakers covering wide ranging Gold topics: 3 noteworthy takeaways include: 1) Real assets (not just Gold) is becoming increasingly more attractive due to the purposeful debasement of currencies, 2) The Fed would not be easing if there was no trade dispute, upping inflationary risks, 3) Two aspects of Chinas economy is underestimated by global economy/markets (#1 the sheer size with 300m people shifting to middleclass over the next decade, #2 the *tolerance* of the Chinese to overcome obstacles) . A handful of presentations Q&A focused on cryptos and the potential threat of to both Gold and precious markets—most answers aimed to separating the benefits of blockchain vs the risks and "work" cryptocurrencies/bitcoin etc need to do. The topic is certainly no longer fringe.
- There is still no consensus over the weeks label/name; most large financial institutions (most of whom attended the ~350 person CME dinner) refer to the week as "NYMEX/CME week", while the traditional corporate players (largely attending specific one-one-one dinners) refer to it as "Platinum Week"...

[WPIC Q2 Platinum report here](#)

[World Gold Councils report on "Gold: the most effective commodity investment" September 11 2019 here](#)

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