CONTACTS

Nicky Shiels
Commodity Strategist (Metals
212-225-6724
Commodities Derivatives
nicky.shiels@scotiabank.com

Follow us on Twitter @ScotiaMetals

Its been an outsized volatile week as risk / US equities finally respond to the Corona virus outbreak spreading to the ROW (previous updates here and here) with the fastest 10% SPX slide on record and 10yr yields collapsing to below 1.2%. Virus fears are growing (not yet peaked?) so below is a quick update on Golds outlook and other Precious Metals.

Equity market volatility and why Gold hasn't responded. We've argued that Gold has done what its done (repriced from $1350 previous ceiling to $1600) with only 2 out of 4 outperformance drivers "on" (Table 1).

So given the greenlight as macro fear returns with the washout in US equities, below are 5 reasons the gold "baby" got thrown out with the bath water this week:

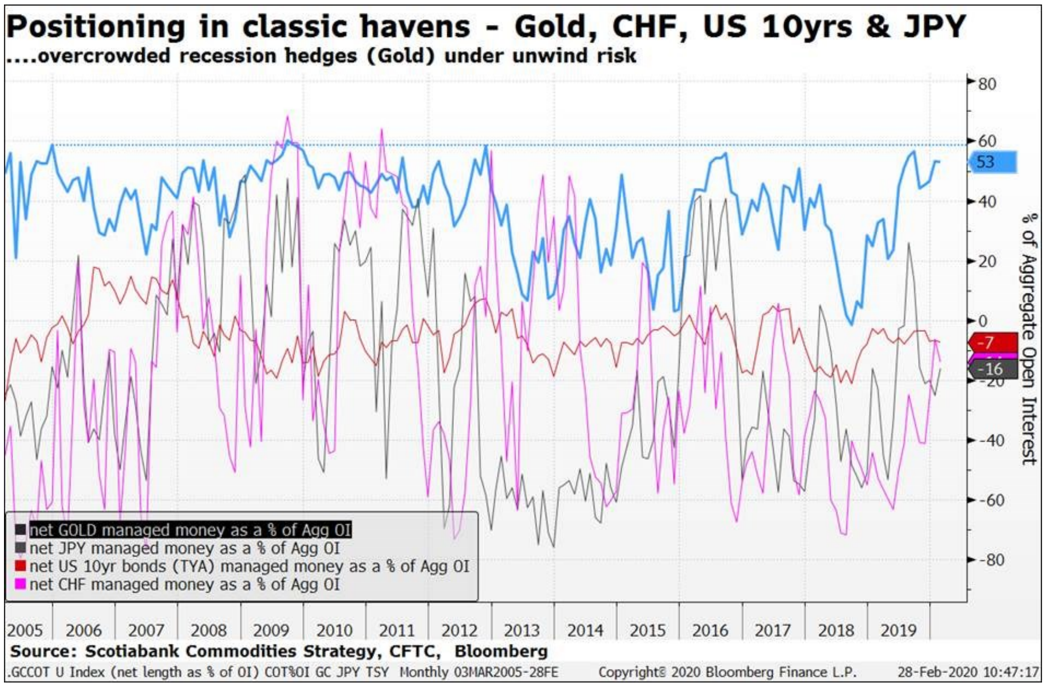
1. **Margin-related Gold derisking;** Gold was an equity inflation hedge to higher equities, so with this no longer the case, the risk of ETF or passive positioning unwind is higher and occurring;* Cash is usually always king in times of turmoil, not Gold.
2. **Opportunistic producer or CB related flows** as Gold in G-10 currencies hit all time highs (graph 1)
3. **The persistency of US$ strength** (despite the current unwind from DXY at 100, its trading at the top end of cyclical range)
4. **Deflation**: energy prices in distressed territory (crude $45, NG mid $1s) provides no favors to the 'commodity brand'. Corona is also simply a demand destruction deflationary shock, despite the fact that Gold hasn't been sensitive to inflationary trends.
5. **Paper positioning rotation amongst havens**: over positioned/weighted havens (Gold) have lost ground to underweight ones (JPY, CHF,US 10yr) today. Graph 2.

Table 1:

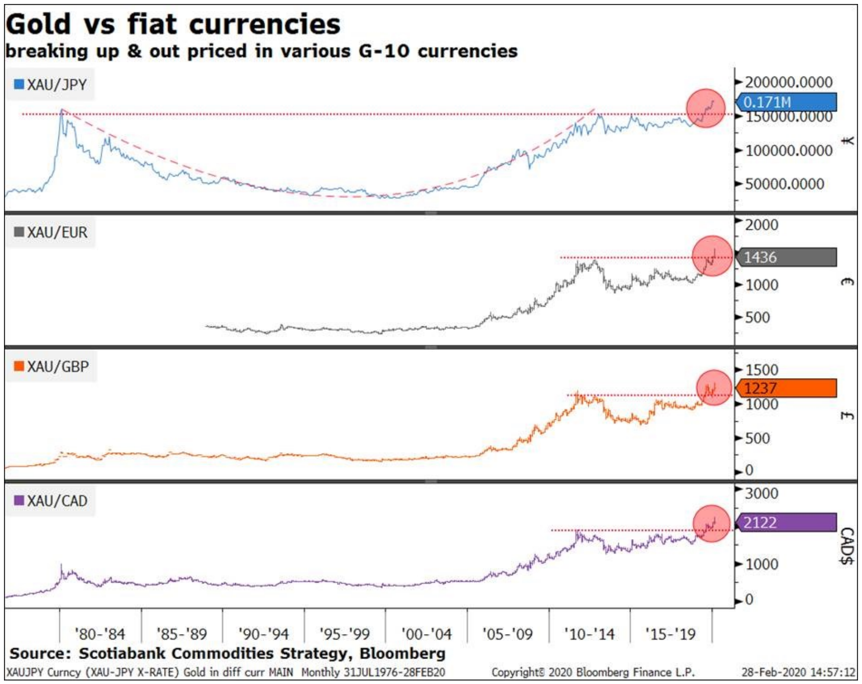
Gold Outperformance Requirements: 2 out of 4 Drivers "on" in 2019	
1. Sustained equity market volatility (✖)	3. Lower yields for longer (✓)
2. A negative USD catalyst (✖)	4. A dovish leaning fed (✓)
(✓) Achieved. (-) Undecided; TBD. (✖) Not achieved	

** Massive paper volumes have printed in Gold / precious on the screen all week ("Asia buys / NY sells") as investors de-risk ALL assets, including havens*

Graph 1:



Graph 2:



The parallels with 2008 are growing and reasonable; policy intervention risk rising. Back then equity market volatility drove gold down >20% in the lead up to Lehman (summer 2008), before prices stabilized and reversed quickly up once there was a policy response (QE). While a March Fed cut is almost fully priced in, talk of an "emergency" Fed rate cut or some similar policy response is rising. Intermeeting cuts in response to major derisking episodes have happened (last one was 2008 GFC, 2007 discount rate cut, and 9/11 & dotcom bubble cuts), but are unlikely (not impossible!) ahead of the March 18th FOMC. **The markets will drive a policy response, and even if the Fed doesn't do an intermeeting cut they can *signal* accommodation.**

Table 2 shows metals historical response during largescale derisking episodes in SPX (-down 1-0% in 5days). *On average,* since 2007, Gold should hold steady during this 5-day -10% derisking onslaught (it has not); 60days on, Gold actually falls on average~7% (which it has largely achieved from the recent highs), and 100days Gold is on average 11% higher (graph 3). IE: **that puts Gold at $1750 by Memorial day, if history is any indication.**

The historical profile of the white precious metals & copper prices outlines a decently bearish outcome – on average, they are down between 30-40%, 60 days on following a 10% SPX washout in 5days.

Table 2a:

2007 - Today: Response in Metals When S&P500 is Down More Than 10% in 5 Days

	Gold	Silver	Platinum	Palladium	Copper
Max	9.30%	8.62%	7.12%	5.77%	2.05%
Min	-7.81%	-10.29%	-11.86%	-17.97%	-20.35%
Average	0.92%	-3.16%	-3.37%	-6.31%	-8.63%
Median	0.58%	-4.34%	-3.71%	-5.72%	-9.29%
Stan Dev	5.07%	6.23%	5.94%	7.50%	6.08%

Note: 11 Observations since 2007
Scotiabank Commodity (Metals) Strategy

Table 2b:

2007 - Today: 60 Day Forward Response in Metals When S&P500 is Down More Than 10% in 5 Days

	Gold	Silver	Platinum	Palladium	Copper
Max	15.66%	14.88%	-2.90%	-0.64%	-0.19%
Min	-17.89%	-45.40%	-49.97%	-54.09%	-54.48%
Average	-7.36%	-30.59%	-39.05%	-42.42%	-36.74%
Median	-8.88%	-35.39%	-46.62%	-50.98%	-39.34%
Stan Dev	9.42%	18.82%	17.00%	16.90%	17.61%

Note: 10 Observations since 2007
Scotiabank Commodity (Metals) Strategy

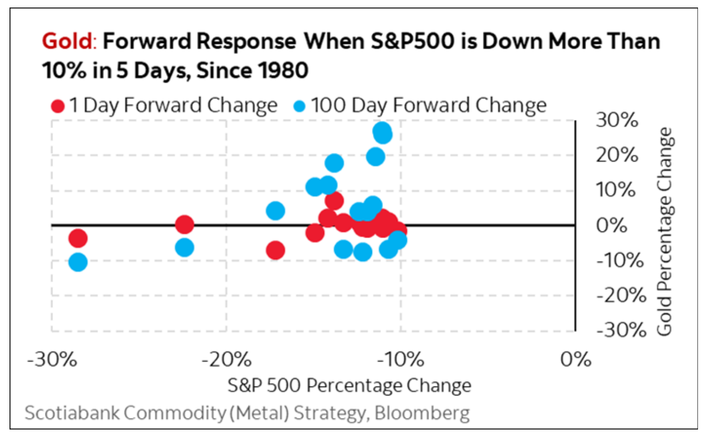
Table 2c:

2007 - Today: 100 Day Forward Response in Metals When S&P500 is Down More Than 10% in 5 Days

	Gold	Silver	Platinum	Palladium	Copper
Max	27.22%	45.81%	51.70%	31.18%	27.09%
Min	-6.55%	-25.38%	-16.98%	-10.94%	-44.26%
Average	11.42%	20.95%	14.73%	6.76%	-14.17%
Median	11.52%	27.75%	6.13%	2.14%	-13.50%
Stan Dev	11.66%	22.02%	23.68%	13.78%	24.49%

Note: 10 Observations since 2007
Scotiabank Commodity (Metals) Strategy

Graph 3:



Fear the restrictions not the deaths: to clarify, the economic impact does NOT stem from the deaths (or the parallels to numbers being less than the common flu), but from the largescale quarantining & restrictive measures.

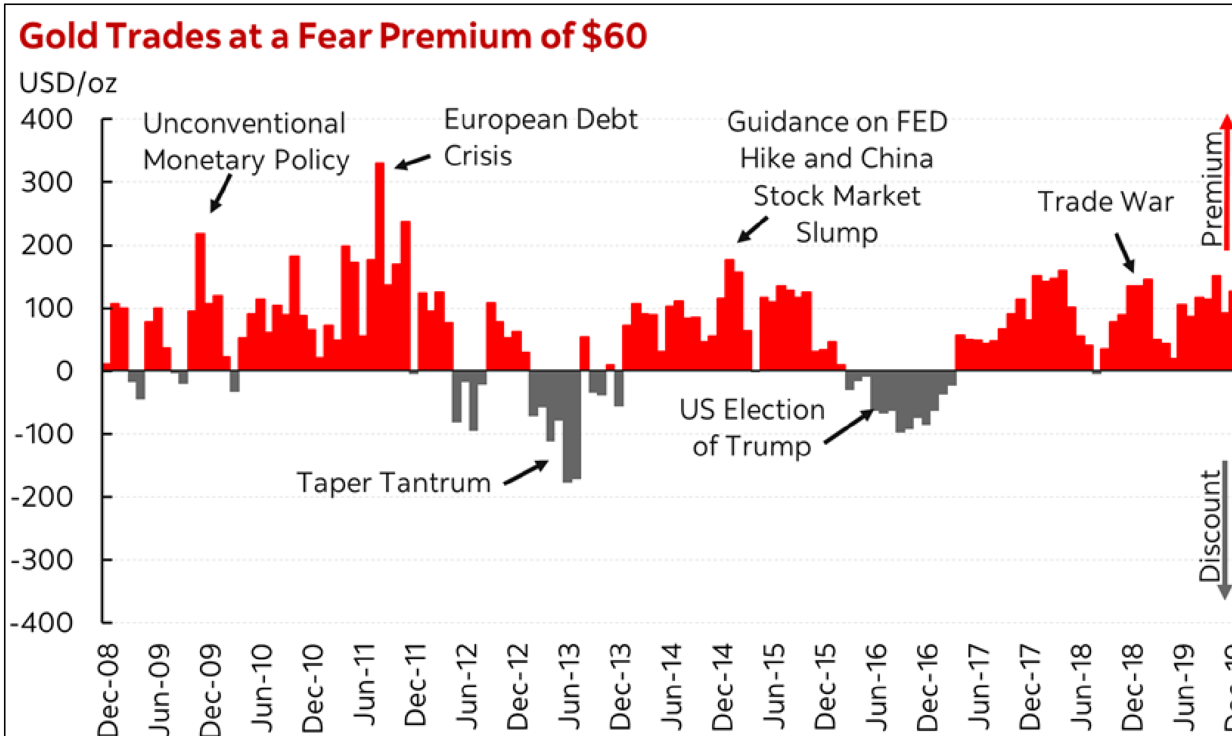
Revisiting V, U or L shaped recovery? We argued that the risk a U-shaped (or the uglier L-shaped) recovery for 2020 is growing, albeit from a low level. That's clearly accelerated this week. While US data remains relatively solid (Economic Surprise Index remains bid), it's the threat of the spread of the virus (given how interconnected the world is) AND the restrictive measures could have on the global crutch (the US consumer) that's largely dislocating financial markets. **Even when the spread is globally contained, the disruption to global supply chains will take months to reset.**

Headline risk remains high: markets are not pricing in containment and its attempting to pre-emptively price in tape bombs (e.g.: NYC stats, Olympics, pre-emptive restrictive measures/quarantines) just ahead of a US election. It still remains very (politically) inconvenient for the global economy to rollover now, so expect efforts from Trump to either talk down the US$ (especially given the 'cheap' EUR is) and/or pressure the Fed to cut short-term rates in light of this weeks market reaction.

Corona, not Bernie shielding all the blame: if there was a global pandemic, why hasn't healthcare stock or biotech rallied? **Theres a growing consensus that the political polarization and polling of Sanders is starting to be (smartly) priced into risk.** Our core belief for Gold is that US election risk remains under-priced with little premium being factored in on a pro-gressive/socialist Democratic nominee.

Golds Fear premium: Gold responds to global monetary policy *and* fear drivers such as trade/virus, geopolitical and growth risks re-emerging. That's a known. Attempting to measure this fear premium is highlighted in the graph 4. **Golds current 'fear premium' of~$60 (vs $165 yesterday) after today is rather under-weight vs its historical peak-trough fear ranges from +/- $200** (attributed to the European debt crisis in 2011 and Taper Tantrum in 2013)

Graph 4:



Source: Scotiabank Commodity Strategy (Metals) Calculations, Bloomberg

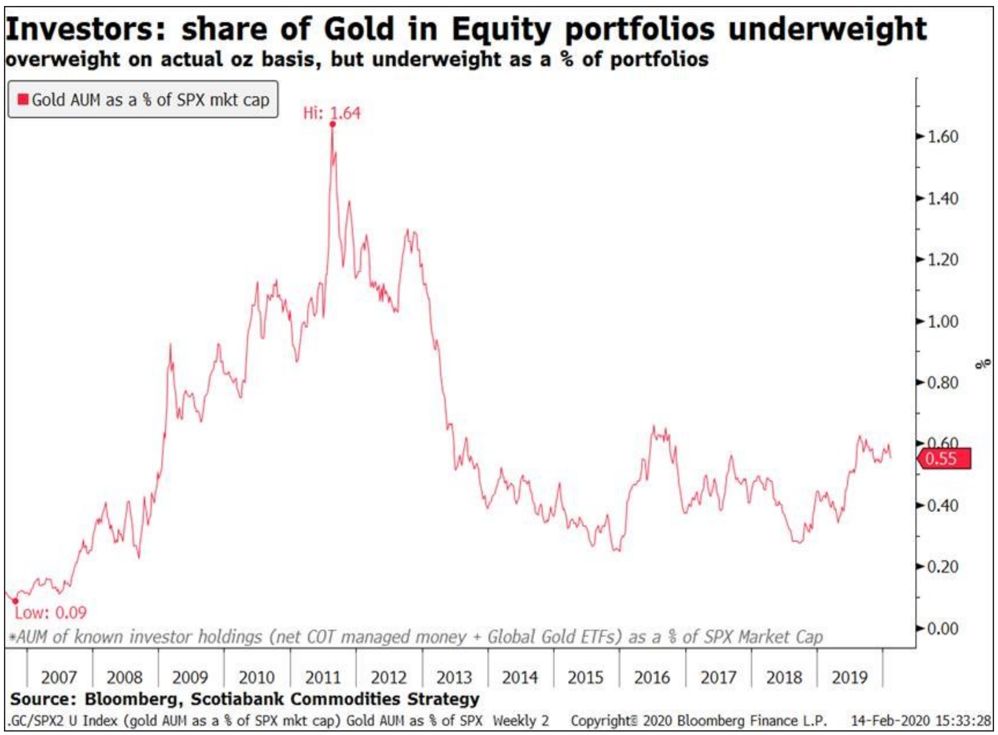
Note: Premium/discount is estimated using a multi variate OLS robust regression using a 10 year rolling window approach. Endogenous features include safe haven currencies and real interests. Our model is able to explain 95% of the variation in gold since 1999. A positive number indicates gold is trading at a premium due to safe haven inflows. A negative number illustrates gold is trading at a discount.

GOLD Outlook Update:

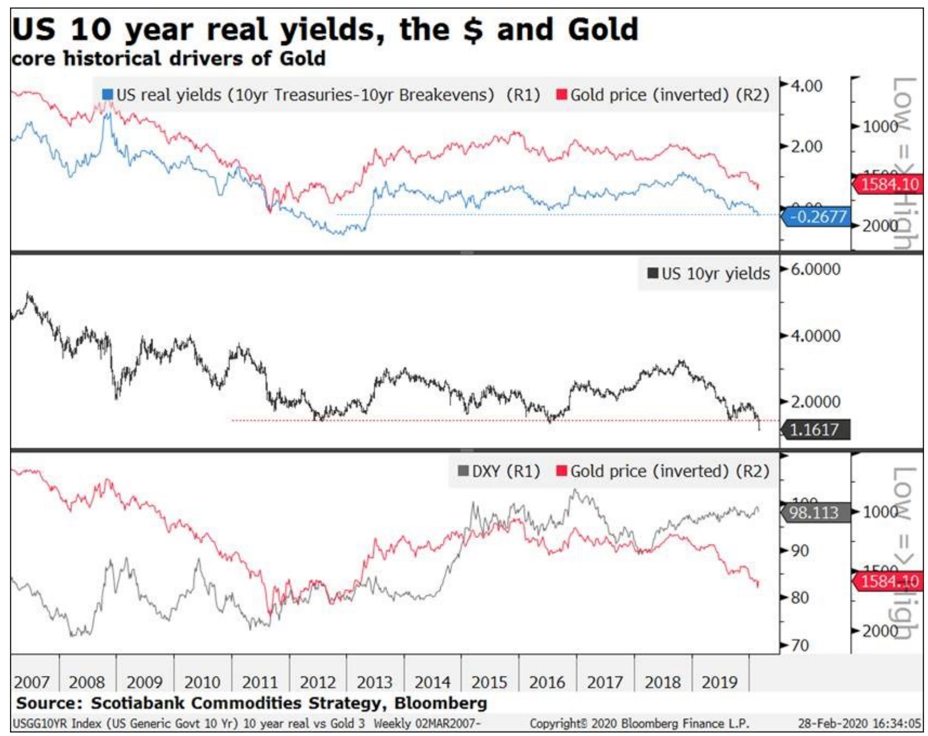
While investors own a record ~110m oz of Gold (ETF & COT), without equity market volatility and an unwind of the bull run, the larger equity / generalist investor remains underweight Gold (graph 5). Gold remains an investment *(story driven by Western flows)* not a commodity story *(driven by Eastern flows).* **This weeks "shoot-first-ask-questions-later" selloff is surprising to many and unwarranted but an opportunity to capitalize on structural tailwinds ("U" or "L" shaped growth recovery, US election/Sanders, absurdly lower rates for longer, unsustainable US debt/fiscal path) which will be "remembered", once risk stabilizes**. $1625 is the new comfort handle this year

SILVER Outlook Update: The Gold/Silver ratio (which was expected to remain in a structural uptrend as macro markets navigate a delicate late cycle era) is likely to steepen given the impact of Corona virus on growth. The large physical overhang (with exchange inventories at record highs), the steady emergence of supply (due to higher gold prices), opportunistic hedging, and growing surpluses due to weakening global demand in short-term, should cap Silvers upside.

Graph 5:



Graph 6:



PGMs Outlook Update:

Platinum circled the drain this week, down over 10% (from a low base!) and was the worst precious performer. Clearly there is limited *sustained* substitution given extremely short-lived rallies, global growth uncertainty will hit already thin jewellery & auto demand and EM / ZAR weakness (well through 15 vs the $) with by-product strength incentivizes production, swelling the surplus and was a key driver of capitalization. Sub $800 is at risk if ETFs inflows – which are in danger of being disappointed, once again - begin to unwind.

Palladium is a rock, BUT deficits can't persist in at major economic slowdown. The path of least resistance was higher as the collective markets expectations/ forecasts weren't bullish enough. Palladium established a double top at $2850 which induced an unwind of longs; prices have diverged from risk/SPX and even forwards (which have loosened), as it continued to factor in supply fears (threat of supply disruptions/Eskom, current lack of availability) AND technical changes (emission regulations that won't alter on demand slowdown) vs demand fears (reduced or temporary demand stall because of the auto closures).

Commodities Strategists are not research analysts, and this report was not reviewed by the Research Departments of Scotiabank, nor prepared in accordance with legal requirements designed to promote the independence of investment research. Commodities Strategist publications are not research reports and should be considered for regulatory purposes as marketing communications. The views expressed by Commodities Strategists in this and other reports may differ from the views expressed by other departments, including the Research Department, of Scotiabank.

The information contained in this presentation is being provided for information and discussion purposes only. An investment decision should not be made solely on the basis of the contents of this presentation. This presentation is being provided upon the express understanding that no representation or warranty, express or implied, is made, or responsibility of any kind accepted, by The Bank of Nova Scotia, Scotiabank Europe plc, or any of their respective affiliates ("**Scotiabank**"™), their directors, agents or employees with respect to the completeness or accuracy of the information, conclusions and opinions provided herein, or as to the achievement or reasonableness of any projections, targets, estimates, or forecasts and nothing in this presentation should be relied upon as a promise or representation as to the future. Past performance or simulated past performance is not a reliable indicator of future results. Forecasts are not a reliable indicator of future performance.. This presentation has not been prepared (i) by a member of the research department of Scotiabank, or (ii) in accordance with the legal requirements designed to promote the independence of investment research. It is considered a marketing communication for regulatory purposes and is solely for the use of sophisticated institutional investors. This presentation does not constitute investment advice or any personal recommendation to invest in a financial instrument or "investment research" as defined by the UK Prudential Regulation Authority and the UK Financial Conduct Authority, and its content is not subject to any prohibition on dealing ahead of the dissemination of investment research.

The information contained in this presentation reflects prevailing conditions and our judgment as of the date of the presentation, all of which are subject to change or amendment without notice, and the delivery of any such amended information at any time does not imply that the information (whether amended or not) contained in this presentation is correct as of any time subsequent to its date. Scotiabank undertakes no obligation to update or correct any information contained herein or otherwise to advise as to any future change to it. Scotiabank does not provide any applicable tax, accounting or legal advice and in all cases independent professional advice should be sought in those areas.

This presentation incorporates information which is either non-public, confidential or proprietary in nature, and is being furnished on the express basis that this information will not be used in a manner inconsistent with its confidential nature or be disclosed to anyone other than as may be required by law or to those who have been informed of the confidential and proprietary nature of this presentation. This presentation and its contents are strictly confidential to the person to whom it is delivered and may not be copied or distributed in whole or in part or disclosed by such persons to any other person without the prior written consent of Scotiabank. This presentation and the information contained herein remain the property of Scotiabank.

This presentation is not and shall not be construed as an offer, invitation, recommendation or solicitation to sell, issue, purchase or subscribe any securities or bank debt in any jurisdiction or to enter into any transaction. Nothing in this document contains a commitment by Scotiabank to sell, issue, purchase or subscribe for financial instruments, or securities, to provide debt or to invest in any way in any transaction described herein, or otherwise provide monies to any party. Any participation by Scotiabank in any transaction would only be provided in writing after satisfactory legal, financial, tax, accounting and commercial due diligence, as well as being subject to internal approval processes. Any transaction implementing any proposal discussed in this document shall be exclusively upon the terms and subject to the conditions set out in the definitive agreement related thereto.

This presentation is not directed to or intended for use by any person resident or located in any country where the distribution of such information is contrary to the laws of such country. Scotiabank, its directors, officers, employees or clients may currently or from time to time own or hold interests in long or short positions in any securities referred to herein, and may at any time make purchases or sales of these securities as principal or agent. Scotiabank may also have provided or may provide investment banking, capital markets or other services to the companies referred to in this presentation.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable. Scotiabank, together with "Global Banking and Markets", is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including Scotia Capital Inc., Scotia Capital (USA) Inc., Scotiabanc Inc.; Citadel Hill Advisors L.L.C.; The Bank of Nova Scotia Trust Company of New York; Scotiabank Europe plc; Scotiabank (Ireland) Designated Activity Company; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Scotia Inverlat Casa de Bolsa S.A. de C.V., Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank Group and authorized users of the mark. The Bank of Nova Scotia is incorporated in Canada with limited liability. Scotia Capital Inc. is a member of CIPF. Scotia Capital (USA) Inc. is a registered broker-dealer with the SEC and is a member of the NASD and SIPC. The Bank of Nova Scotia is authorised and regulated by the Office of the Superintendent of Financial Institutions of Canada. Scotia Capital Inc. is authorised and regulated by the Investment Industry Regulatory Organization of Canada. The Bank of Nova Scotia and Scotiabank Europe plc. are authorised by the UK Prudential Regulation Authority. The Bank of Nova Scotia is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Scotiabank Europe plc is regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia 's regulation by the UK Prudential Regulation Authority are available upon request. Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., and Scotia Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.