Metals Strategy: Macro Update & Precious Floors

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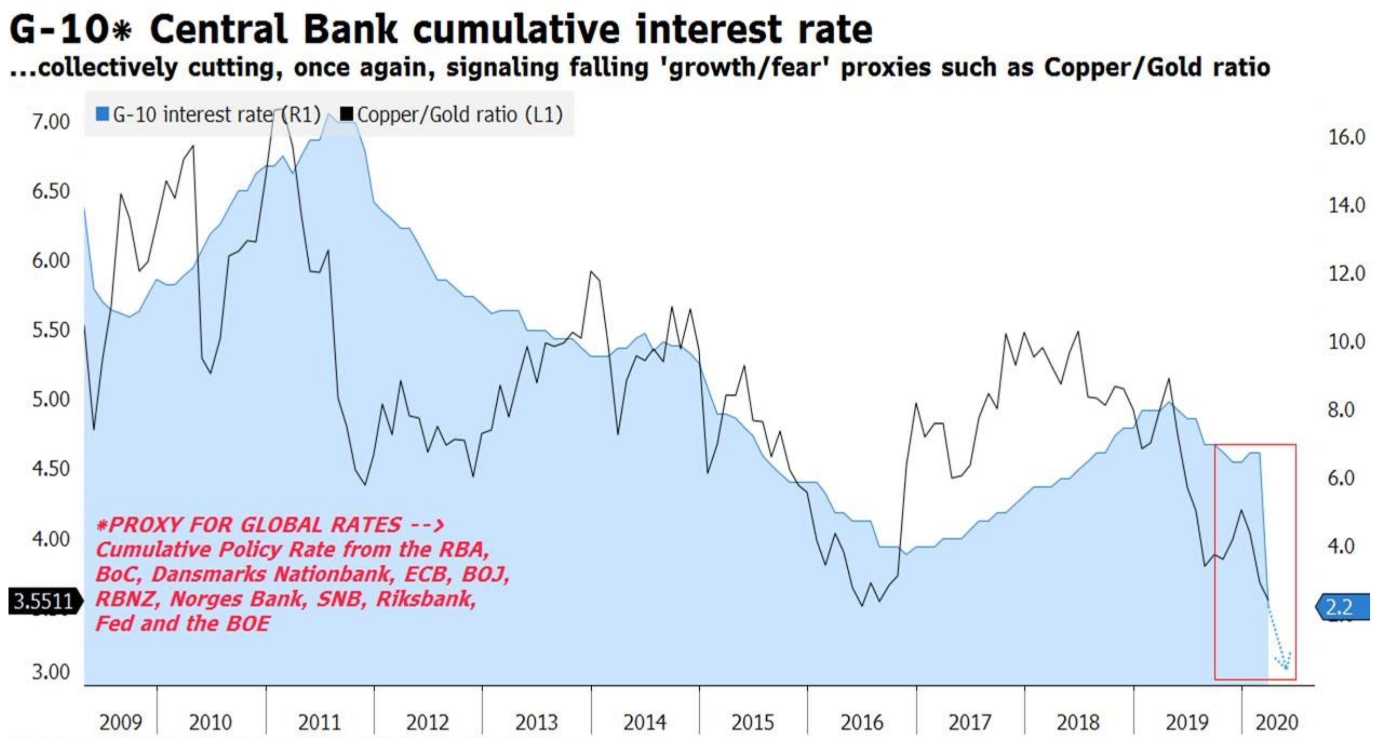
MONDAYS PRICE ACTION:
US & other Global Indices down 6-12% yesterday (SPX plunged the most since 1987)
Gold & Copper both at 1 point down 5%
Brent, Platinum & Silver down 10-11%

Some quick thoughts on the macro backdrop (part 1) because if one doesn't have a handle on this, we'll never understand the outlook for precious metals (the floors / levels which we'll explore in part 2). To be clear, the next $50 move in Gold is a coin toss, as its contingent on evolving health & economic crisis and where risk and credit markets are heading. The next $100+ in Gold is likely higher (vs lower), as we stand (aggressive stimulus measures, slower for longer growth, fiscal help) but conviction remains low; fundamentally we are even more bullish than before on its long-term prospects, but Gold is FIRST an important source of liquidity (to sell), and second a commodity under a deflationary demand destruction event – 2 key forces clearly not in its favor in the short-term.

Chart 1:



Source: Scotiabank Commodities Strategy, Bloomberg

.G10 S 91511857 Index (BBG CIX OF G-10) G10 CB easing vs Cu/Gol Monthly 27JAN20 Copyright© 2020 Bloomberg Finance L.P. 17-Mar-2020 07:56:30

- **Risk markets don't like emergency cuts because it spells panic** *(what does the Fed know that they couldn't wait for Wednesday?)*. The Fed has rolled over enough for markets to lose the little confidence they had in monetary policy, and for risk assets to seize up once again triggering circuit breakers; ultimately a fiscal bazooka, rather, to counter a consumer slowdown and stave off a recession is being demanded. The Fed is being 'blamed' more so than the (unknown) but mounting "bad news" (economic/growth/earnings). **Its likely to get challenging to keep markets open, at the very least fully functioning, as the Fed can counter liquidity issues, but clearly has a harder time countering or controlling equity market risks and credit.**

- **The once unthinkable is very quickly becoming a reality:** protectionist measures implemented (Europe on lockdown, Canada & others shutting borders, SF ordered a 'shelter in place'), with wide-ranging shut-ins of economic activity (bars, restaurants, gyms, theatres etc closing in LA & NYC). Retail traffic goes to zero, overnight. A "health crisis" has evolved into an "economic crisis", but it is NOT (yet?) a "financial crisis". Financial markets are attempting to price in the concept of "rolling recessions" (the expectation of a Q1'20 recession in China/Asia, Q2 recession in Europe and US), and are looking to the full economic impact that is slowly emerging with data from China*. **Base metals** (and Chinese equity markets which have yet to fall into bear market territory) have been relatively supported by the belief that PBOC stimulus measures would be enough to support as the East "V"-recovers"; **however that is being undermined as investors realize China's reliance on trade with the ROW at a time when Europe and the US look increasingly fragile.** The large difference is that the impact in each economy is different - with the US a services based economy (in contrast to manufacturing driven China which is more elastic to monetary easing/ infrastructure fiscal plans etc), the impact on the consumer here is mostly lost (not delayed) and the recovery could be relatively slower.

- **Large scale unprecedented stimulus**: Global Central banks are taking global rates closer to zero, faster than expected, and led by the Fed. Following Sundays emergency rate cut, the RBNZ cut 75bps, RBA injected $3.6bn of liquidity, the BOJ upped the purchases of ETFs/JGBS/ Corporate Bonds & CP, the BoK cut 50bp, Chile delivered its largest cut since 2009, and Egypt & Czech Republic also cut. And this week we still have decisions (or earlier..) from the Central Banks of Indonesia, Phillipines, Taiwan, Russia, Brazil and South Africa while the PBOC is expected to cut its LPR on Thursday. It's a known known that conventional monetary policy has run its course (the Fed will stick close to zero, unlikely below it, through the end of 2021 per swap pricing). However, whats surprising is the lack of a narrative of unconventional monetary policy (the return of MMT) or fiscal tools (Green New Deal) etc. Kevin Warsh put it well → "Old weapons must be paired with new ones fit for the 2020 pandemic"; even Bernankes 2020 paper outlines alternative tools which could "add policy space" (including a combination of asset purchases, forward guidance, raising the inflation target, etc). Overall, a helicopter drop (via issuing zero interest rate short-term loans to those affected or simply Universal Basic Income / cash handouts?) is a growing real possibility & gaining traction, especially once you tie in the political swing (to the left/socialism) over the years, and insatiable risk markets looking for 'more'. Ultimately, **a larger wealth gap (aggressive global monetary policy) and a need to hedge out massive inflationary response with real assets are the perhaps the obvious longer-term winners to such drastic measures.**

- **Trump U-turn on Coronavirus; fiscal policy in 2nd inning**: its tough to exactly know where the uncertainty lies (around health/stats, US policy response or economic impact), but with the combination of all three risks rising in tandem recently, clearly really knocked equity markets. However, after Trumps Friday afternoon presser, subsequent (respected) WH news conferences and a coordinated fiscal 'pledge' by G-7 to "do whatever it takes", a relatively more believable action plan is in place (vs the outright denial by US authorities only week ago!) – **that removes a lot of policy uncertainty but doesn't remove much of the economic uncertainty.**

* much larger than drops in industrial output (-13.%), retail sales (-20.5%), and investment (-24.5%).

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