What does the Fed know... (that we don't)?

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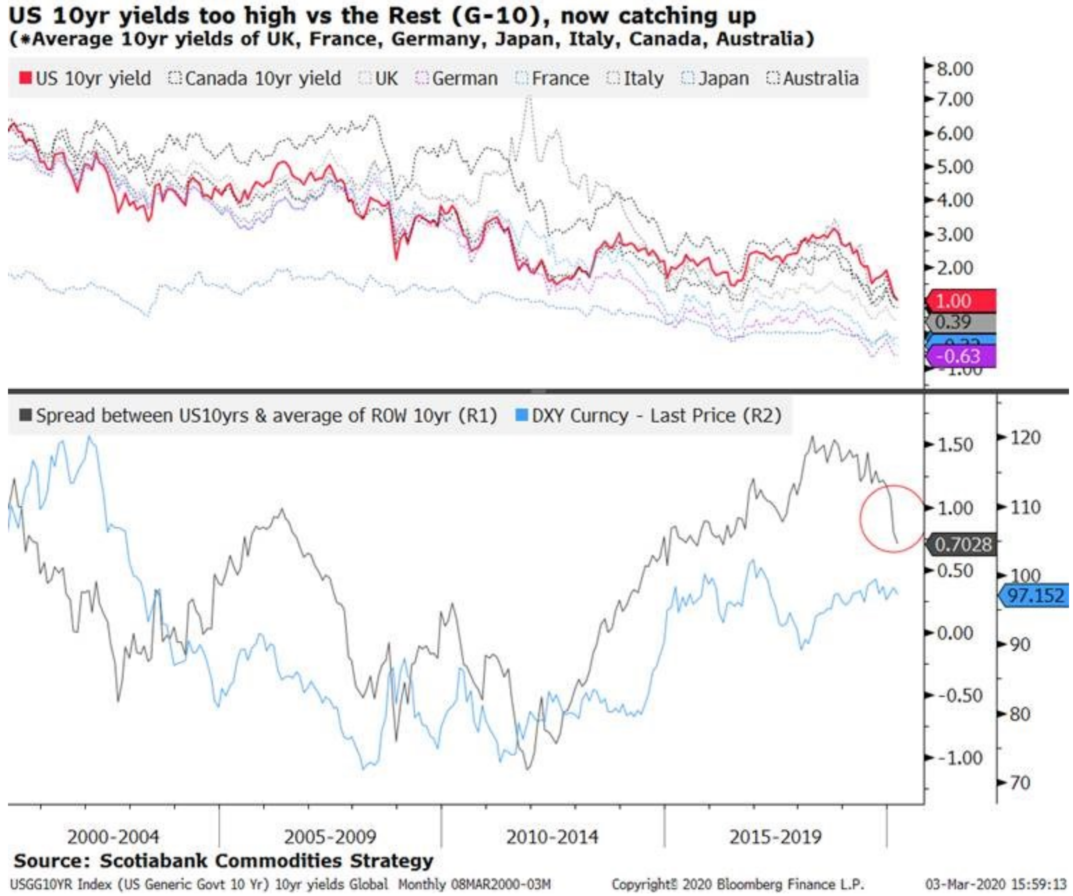
Well todays surprise intermeeting Fed cut of 50bps and subsequent market volatility, tells us a few things:

The theme du jour has been 'intervention'. That began a while back with economic stimulus packages in Asia (China, HK, Singapore, South Korea) & Italy over the weekend, and transcended to CBs (the BoJs unscheduled JGB purchases, RBAs rate cut) to the Fed slashing 50bps just hours after a G-7 "stand-ready-to-act" meeting today. That's followed by the BoC tomorrow, rising risk of OPEC 'intervention' (Thursday) amidst a potentially large-scale Chinese stimulus package targeting infrastructure after their outlier PMI print over the weekend.

Theres two camps: 1) *"What does the Fed know" (that we don't)* and 2) *"Too much too soon"* (which calls into question their credibility and independence, given their off timing – immediately after G-7 meeting, just before Super Tuesday, when US stocks had only corrected, not in steep bear market territory). Either scenario, is arguably bullish-supportive Gold, but it matters how other asset classes, especially equities (in which extreme volatility has been the thorn in Golds side), behaves.

Regardless, negative interest rates - for those who believed its a farfetched phenomenon – will be in the US sooner than later? Chart 1. An emergency 50bp rate cut (when policy room is already limited) & shorter holding periods (this cut arrived only 4 months after the last Fed cut; before that the Fed flipped from a hiking cycle to an easing cycle in just 7 months in response to trade wars) simply indicates these macro wobbles – whether geopolitical, trade, or off-calendar event risks - are more frequent. **A faster news cycle but also a faster "renewed risks-CB response" cycle**

Chart 1:

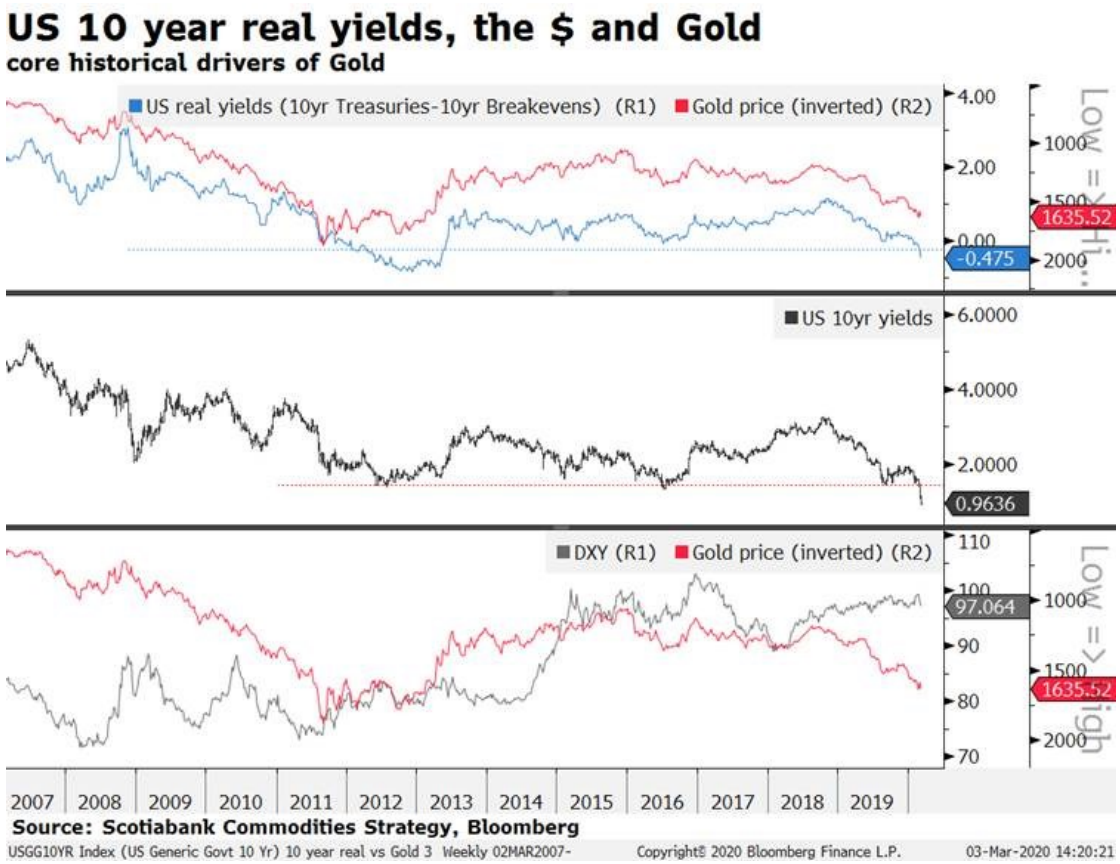


The deflationary demand destructing event due to the virus is being fought by some informally 'coordinated' inflationary CB and government stimulus. Global Central Banks - well the Fed – is pricing in an "U or L" shaped growth recovery, and yields (10yrs through 1% and collapsing) & rates markets are pricing in ADDITIONAL cuts next week as the Global/ex-China spread of the virus triggers more economic sudden stops.

Markets are shifting from internalizing some Asia containment ('de-escalation' of virus, rebuild efforts imminent) **vs Europe/Americas spread** ('escalation' of virus, impact on consumer/growth & Fed response efforts). That's clear in the longer Copper keeps its head above recent cyclical floors (~$5500) and the growing chatter on infrastructure led stimulus from China (see Global Times with article calling for a 2009-like stimulus boost, which seems unlikely, given over-capacity constraints and structural deleveraging goals, but not impossible)

Stocks & Yields vs Gold diverging price action: after the emergency meet, SPX was down over 4% at one point with Gold up $50, and is notable in that it clearly indicates the Fed (or G-7) easing bias was almost fully priced into risk assets (from the dip below 2900 on Friday), but not so much into Gold. The downside risk for Gold is any EXTREME equity market (as was the case on Friday, see note here) will induce margin-related paper deleveraging in all havens, excluding the US$. Together, with physical floors providing much less support on any paper/investor turn (SGE premium is flat or negative as Asian consumers are buying essentials & not gold jewelry), that's one of the main reasons why Gold hasn't repriced to 2012-2013 levels ($1700-1800) as many have expected, given the freefall in US interest rates (Chart 2).

Chart 2:

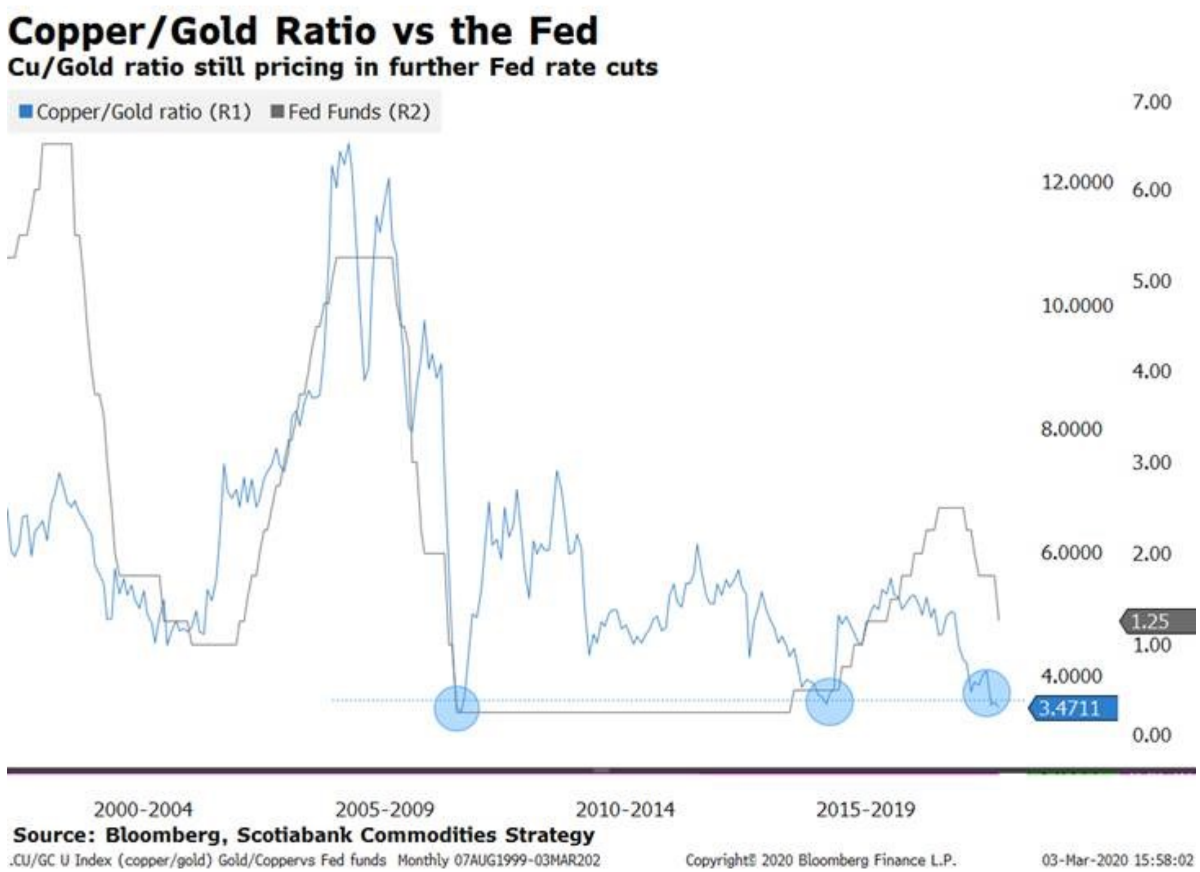


The Fed bungled an operation & communication while policy tools remain ineffective in addressing actual impact of Corona? FX strategy duly noting that "CBs have lost the element of surprise to an extent with the oddly timed Powell statement (Friday) and raised market expectations for concerted G7-action with the publicized conference call earlier today which produced little of consequence on the face of it. **We are perhaps seeing the consequences of the breakdown in international cooperation in the past few years, forcing the Fed to go it alone today. [It] Has to be very disquieting price action for the authorities this afternoon"** as the S&P closed down almost 2.8% today. We have policy correlation (CBs largely following the Feds lead), but given a geopolitical protectionist backdrop, there is no proper policy coordination at the global level to address the impact of the virus

Risk remains fragile head of Super Tuesday: With Democrats now mostly flocking around the business/markets-friendly Biden (dubbed the "comeback grandfather"), a strong Sanders showing poses large downside risk to US equities / upside risk to Gold. The path toward the election is likely to get messy and more complicated especially after growth fears have re-emerged and equity market volatility (long a bellwether for Trumps approval rating) is under pressure. Man-made political disasters (a shift far left) have far greater implications to the global economy and risk, than a 'natural' disaster that needs to play out the destruction-reconstruction cycle.

Copper/Gold ratio is unsurprising back down and hovering near 2008 lows, perhaps pre-emptively pricing in further rate cuts (Chart 3). It however also highlights that the Fed is, through this lens, still too tight; the relative 'growth/fear' commodities proxy below 4 has been associated with Fed funds rate at 0- 0.50%.

Chart 3:



Outlook: stimulus provides some reprieve to Copper, solidifies the Gold bull case

US risk stocks have arguably switching to sell-rally mode until global growth trajectory is upgraded and ROW (ex China) virus is contained.

Remain tilted bullish in Gold as markets price in U or L shaped growth recovery that's fought with aggressive CB action. We will likely see physical Gold demand actually lost (Asian consumers unlikely to overcompensate and buy more jewelry in Q2) and extreme equity market volatility poses a risk. However, core tailwinds (lower growth profile, US election/Sanders, absurdly lower rates for longer, unsustainable US debt/fiscal path and US$ losing its haven status) is driving Western/investment & CB inflows which should overcompensate for the risks & [physical void. Continue to buy dips below $1600 (rallies are short-lived!)

Copper: some demand will be lost, but most should delayed until 2H and 'triggered' on any major Chinese stimulative efforts. Its tightening path was very short-lived given the impact of Corona on Chinese growth, with our predicted deficits for 2020 now pushed out. As we stand now, **a soft floor around cyclical lows is $5500, but its low conviction as the virus situation remains fluid & headline risk remains high.** Factories are only operating at ~60% capacity, inventories continue to grow, and risk sentiment remains fragile. On the contrary, upside price risk includes a weaker US$, flat-lower supply, risk of short covering on any major stimulative efforts by China targeting infrastructure; that is a growing risk given their awful manufacturing PMIs over the weekend and 'greenlight' from the Fed. The firms forecast ($2.80 / $6170) in 2020 will be revised end of March.

KEY tables & graphs showing different historical responses in Gold, Silver & Copper both to 1) COORDINATED CB policy action, and 2) Emergency Fed rat cuts

Table 1 shows the very short to longer-term responses in these 3 metals, and other macro assets (Oil, SPX) to COORDINATED CB policy action (not what the Fed taking action alone today). These are aggregate of responses to coordinated CB action to 9/11 in 2011, 2007 credit crunch, 2008 Lehman & 2011 Eurozone crisis. **Overall, its not as a bullish an outcome as one would expect in the liquidity responsive metals; Gold is on average essentially unchanged after 7days (but still outperforms risk, in which both Oil & SPX are both down ~3%). The DXY & Copper are the overall winners in the medium-term (30days on), both up on average 2%.** And while the current knock to global economy and pre-emptive Fed move some argue arguably not akin to these blackswan events (SPX arguably has still held its uptrend line?!), its some useful data to chew through.

Table 1:

Summary Statistics of Asset Performances to the 4 coordinated CB action events (tables 2-4)							
	SPX	DXY	Gold	Silver	Copper	WTI	US 10Y
7D Average	**-3.3%**	**0.3%**	**-0.3%**	**-3.3%**	**0.2%**	**-2.7%**	**18**
7D Median	-4.9%	0.3%	1.0%	-4.9%	0.3%	-7.3%	11
7D Max	5.5%	1.8%	1.5%	5.5%	1.8%	29.0%	44
7D Min	-8.9%	-1.2%	-4.5%	-8.9%	-1.6%	-25.4%	4
30D Average	**-2.0%**	**1.9%**	**-3.6%**	**-2.0%**	**1.7%**	**-11.2%**	**0**
30D Median	-3.3%	0.8%	-4.9%	-3.3%	0.6%	-11.6%	-5
30D Max	5.2%	6.1%	12.3%	5.2%	6.1%	4.5%	29
30D Min	-6.5%	-0.3%	-17.0%	-6.5%	-0.3%	-26.1%	-19
180D Average	**-1.7%**	**1.7%**	**0.8%**	**-1.7%**	**1.6%**	**-17.9%**	**-1**
180D Median	-0.6%	3.5%	-0.2%	-0.6%	3.2%	-20.4%	-11
180D Max	10.3%	4.4%	12.0%	10.3%	4.4%	-2.0%	77
180D Min	-16.1%	-4.4%	-8.3%	-16.1%	-4.4%	-29.0%	-58

NOTE: % changes for most. BP changes for 10YR US Yields.

Source: Scotiabank Commodity Strategy, Scotiabank FX Options Trading, Bloomberg

Table 2:

Table 2 - 5: Individual Statistics of Asset Performances to the 4 coordinated CB action events

9/11 Attacks (Coordinated Cuts on Sep 17 & 18)							
Date	SPX	DXY	Gold	Silver	Copper	WTI	US 10Y
Intervention Day	-4.92%	-1.73%	1.37%	-4.92%	-2.17%	-2.44%	7
Intervention + 7D	-8.15%	-1.20%	1.30%	-8.15%	-1.64%	-25.45%	16
Intervention + 30D	-1.41%	0.17%	-1.09%	-1.41%	-0.28%	-26.14%	1
Intervention + 180D	6.74%	2.65%	1.58%	6.74%	2.20%	-17.00%	77

2007 Credit Crunch (USD Term Facilities on Dec 12th)							
Date	SPX	DXY	Gold	Silver	Copper	WTI	US 10Y
Intervention Day	0.61%	-0.10%	2.07%	0.61%	-0.10%	-4.75%	12
Intervention + 7D	-1.67%	1.79%	0.65%	-1.67%	1.79%	-8.10%	6
Intervention + 30D	-5.19%	-0.32%	12.33%	-5.19%	-0.32%	0.38%	-19
Intervention + 180D	-7.84%	-4.42%	12.02%	-7.84%	-4.42%	-1.99%	3

2008 Post-Lehman Bankruptcy Fallout (Coordinated Cuts on Oct 8)							
Date	SPX	DXY	Gold	Silver	Copper	WTI	US 10Y
Intervention Day	-1.13%	-0.07%	2.31%	-1.13%	-0.07%	7.17%	14
Intervention + 7D	-8.87%	1.33%	-4.49%	-8.87%	1.33%	29.01%	44
Intervention + 30D	-6.55%	6.09%	-16.96%	-6.55%	6.09%	4.51%	29
Intervention + 180D	-16.14%	4.44%	-2.05%	-16.14%	4.44%	-23.75%	-58

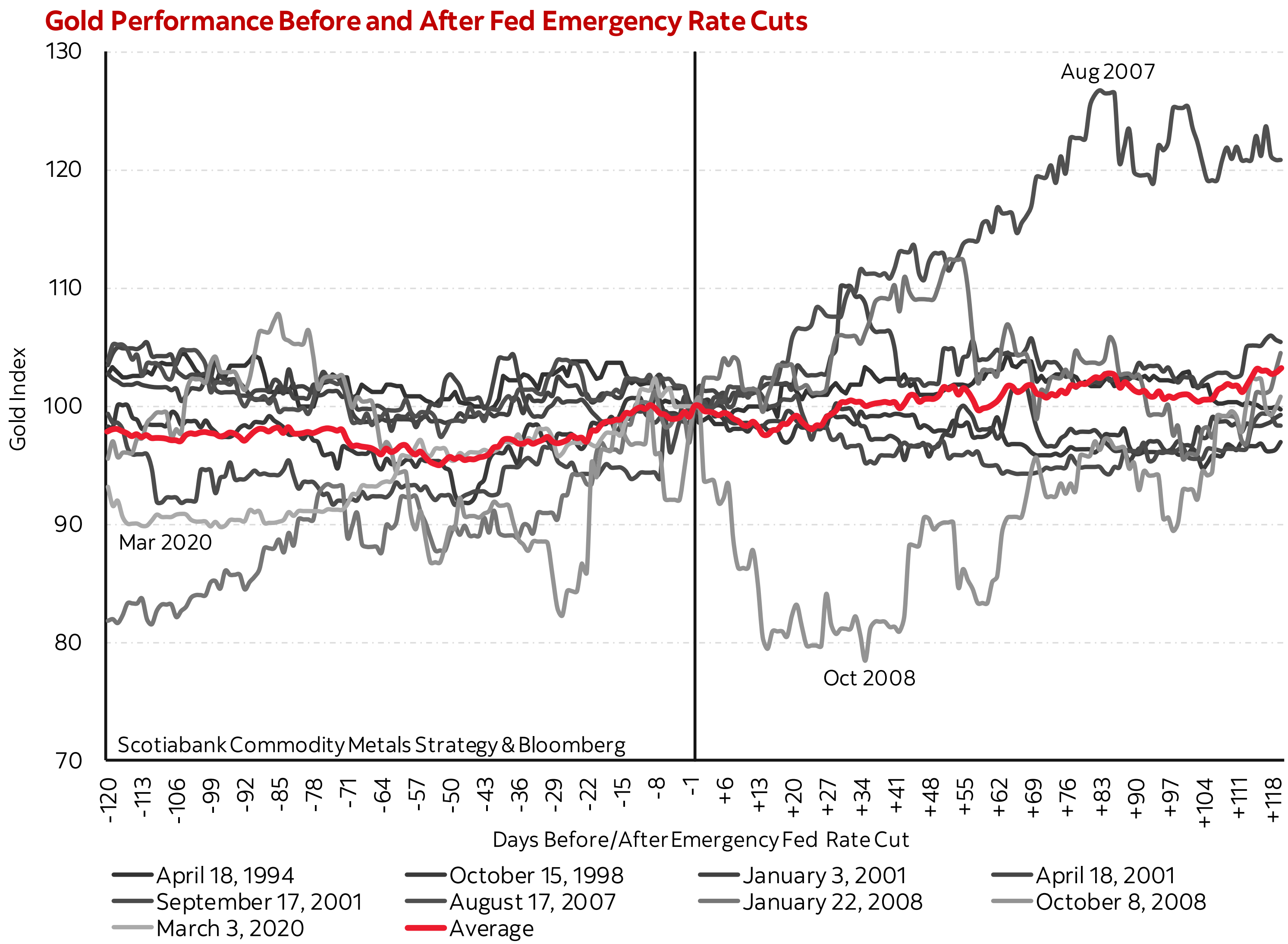
2011 Eurozone Crisis (Rate Cuts on USD Swap Arrangements)							
Date	SPX	DXY	Gold	Silver	Copper	WTI	US 10Y
Intervention Day	4.33%	-0.79%	1.79%	4.33%	-0.79%	-9.27%	8
Intervention + 7D	5.51%	-0.66%	1.53%	5.51%	-0.66%	-6.43%	4
Intervention + 30D	5.22%	1.48%	-8.79%	5.22%	1.48%	-23.63%	-12
Intervention + 180D	10.26%	4.30%	-8.30%	10.26%	4.30%	-28.98%	-25

NOTE: % changes for most. BP changes for 10YR US Yields.

Source: Scotiabank Commodity Strategy, Scotiabank FX Options Trading, Bloomberg

Chart 4 shows Golds response in the 120 days following an emergency Fed cut; theres been 9 instances since 1990. **Over average, Gold is up 2.8% in the 3months following an emergency Fed cut, and +3.2% in 4months after.** The ranges are quite volatile depending on the macroeconomic backdrop (Gold will NOT perform in a dash for cash/US$ scenario like Q3-Q4 2008, but will in the lead up to a recession/bust as in 2007).

Chart 4:



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