Metals Strategy: Macro Update

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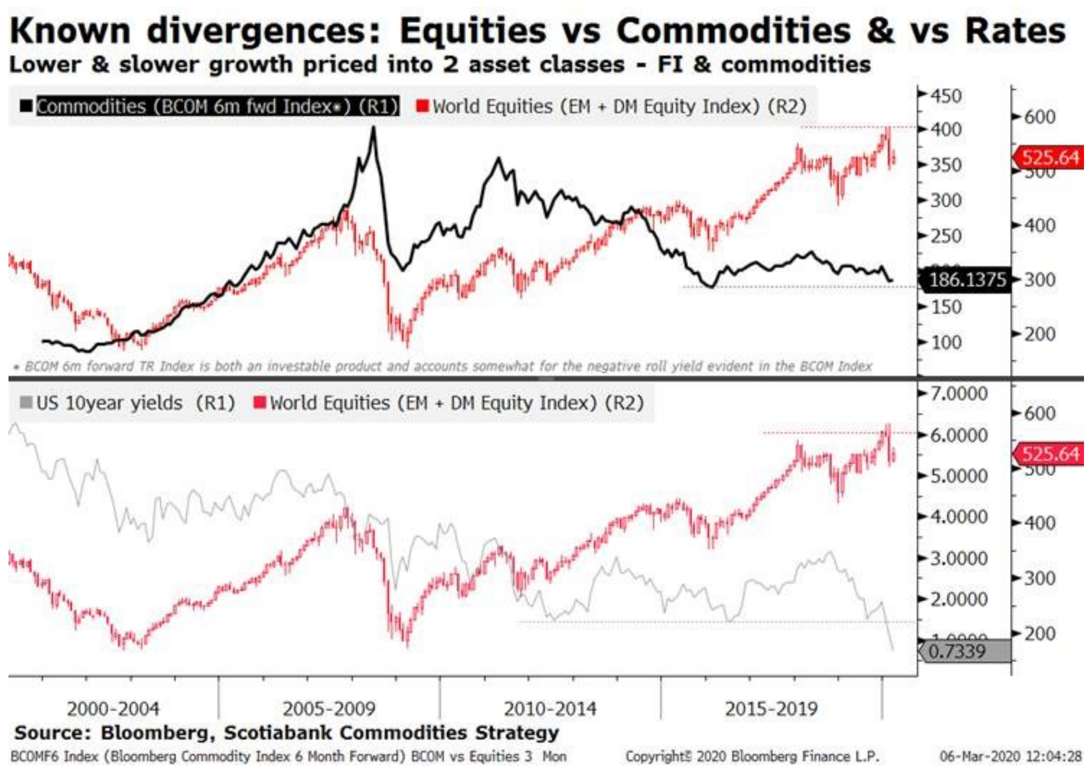
Another rollercoaster week with macro markets in unprecedented territory – max virus panic is here, that's arguably been accentuated by policy missteps (surprise too-soon-too-much Fed cut, no OPEC deal), and led to major dislocations and a return to recessionary-like asset prices in many. Its been a lesson in understanding economic "sudden-stops", the impact of fear & irrationality and pricing in the faith (or lack therefor) of CBs.

There are a lot of worrying signals which include:

- **Unprecedented plunge in US yields.** US 10yr yields has repriced 125bp already this year and touched an ATL of 0.65%, perhaps triggering a run for duration (US 30yr fell toward 1.2% the end of this week). These are supposedly safe (liquid) assets but price action is indicative of something broken. Chart 1.
- **Spillover into funding and credit markets**, with extreme widening of dollar FRA/OIS, through levels last seen during last September Repo stress.
- **Commodities complex through 2016 & 2008 lows**, simply pricing in a worst case L-shaped recovery & escalating disinflationary environment, led by energy*, ags and industrial metals sub sectors. Energy credit is now at distressed levels
- **Aggressive acceleration in Fed rate cut expectations** ('demanding' more than 50bps of cuts at the March FOMC, expecting Fed funds at 0.25% by year-end)
- **Extreme volatility in US Equities**

Chart 1:



*See recent piece on OPEC from our Energy Strategist here

Hence Gold repriced to $1690 (once again) today, as it gets swept up in the flight to safety panic buying.** The core question we're addressing is, ***why is Gold not much higher***, given the extraordinary shift lower in US yields, that is *now* paired with US$ weakness (largely as EUR continues to be squeezed higher as the market prices in limited scope for ECB to fully jump onboard and cut/ease)…

Graphs 2 & 3 below attempts to quantify Golds "Fear Premium" vs the current price of some of its historical core drivers (some FX pairs, and US real rates).

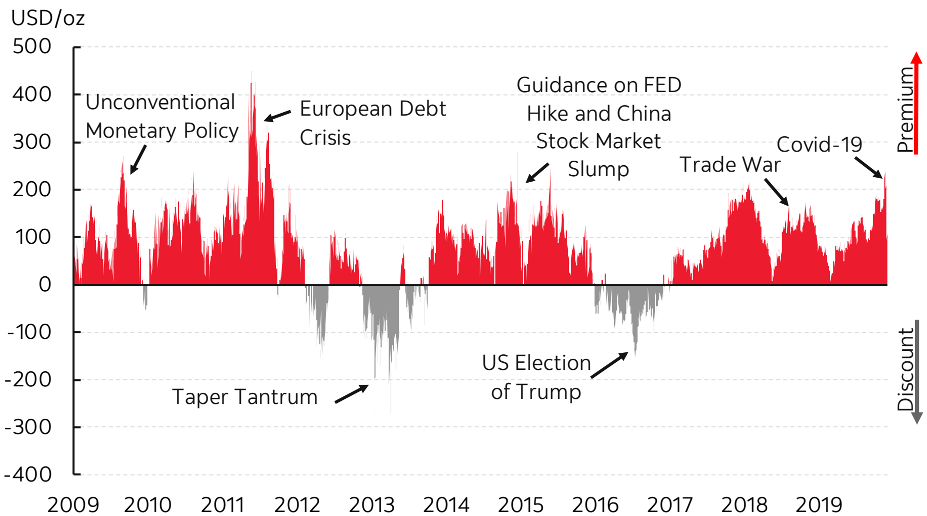
- Golds Fear premium vs US real yields alone, is at $92, vs its historical range of -$300 (Taper Tantrum) to +$300 (QE, European financial crisis).
- Gold Fear premium vs a range of currency & interest rate inputs, is currently $90, vs a -/+$200 range

⇒ I.e.: Golds fear premium is relatively underpriced vs historically peak fear levels confirming investor suspicions that's its underpriced vs yields.US$ trends. Haven flows are finding alternative homes (where they're being treated better – technical trending Treasuries, equity subsectors like utilities/staples) AND there's been intermittent (and unexplained) largescale investor selling deterring interest (see range of reasons here). Essentially, we chalk it up to margin related selling, and perhaps CB and/or producer related flows, and when that selling occurs, there is very minimal physical support (as XAUINR & XAUCNH are at ATHs; Asian demand is purchasing food, masks & medicine, not gold jewelry). Thus the drawdowns re sharp

We continue to lean bullish, but with little visibility (and little explanation on the timing behind some of its sharp collapses near tops), the market needs to learn to shift from buying momentum/chasing rallies to buying dips. Golds fear premium (and thus Gold) should continue to increase to the point at which we get ROW containment or credible fiscal stimulus

Chart 2:

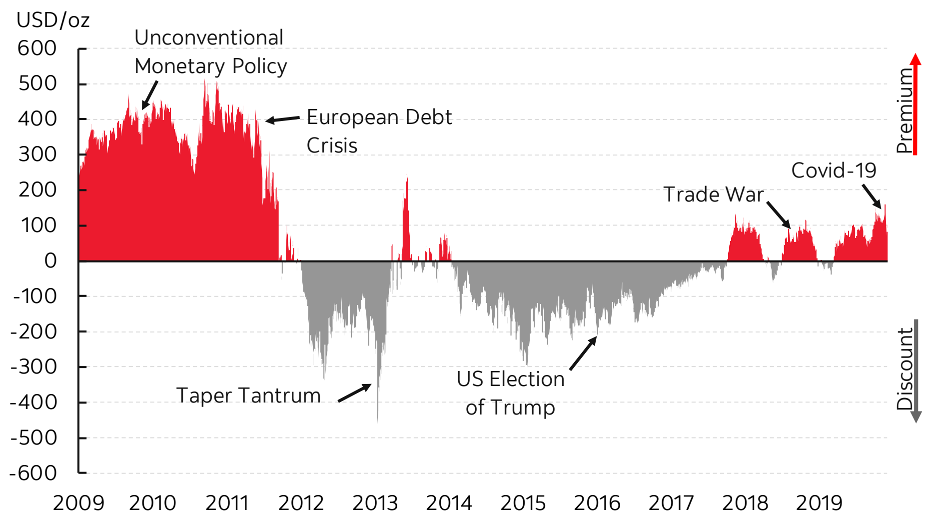
Gold Trades at a Fear Premium of $90



Source: Scotiabank Commodity Strategy (Metals) Calculations, Bloomberg
Note: Premium/discount is estimated using a multi variate OLS robust regression model with a 10-year rolling window approach. Our features include the DXY, USDJPY, USDEUR, USDGBP, and the US 10-year real yield derived off the US 10-year treasury and 10-year breakeven. Our model explains 95% of the variation in gold since 1999. A positive (negative) number indicates Gold is trading at premium (discount) versus where our current endogenous variables are indicating.

Chart 3:

Gold Trades at a Fear Premium of $92 Versus Current Real US 10 Year Yields



Source: Scotiabank Commodity Strategy (Metals) Calculations, Bloomberg
Note: Premium/discount is estimated using a single variate OLS robust regression model with a 10-year rolling window approach. The endogenous feature is the US 10-year real yield derived off the US 10-year treasury and 10-year breakeven. Our model can explain 82% of the variation in gold since 1999. A positive (negative) number indicates Gold is trading at premium (discount) versus where current real US 10-year yields are indicating.

**Todays moves mimics last Fridays largescale selling

Chart 4:

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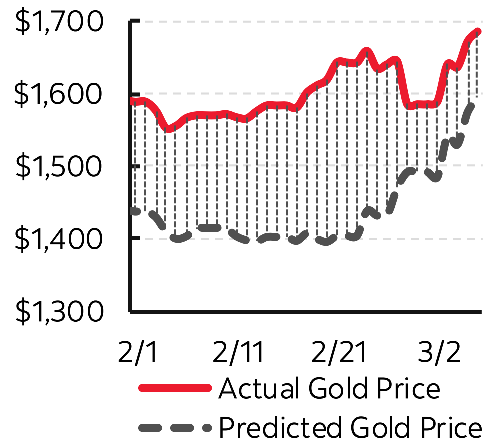
Commodity (Metals) Strategy

Gold Fear Premium Daily Report

Friday, March 6, 2020

Regression Results			Current Prices		
Intercept	$	2,213	Gold Price	$	1,686.20
US10Real	$	(227)	US10Real	$	(0.58)
DXY	$	49	DXY	$	95.85
USDJPY	$	(14)	USDJPY	$	105.10
USDEUR	$	(4,194)	USDEUR	$	0.88
USDGBP	$	(340)	USDGBP	$	0.77
R Squared		83.71%			

Actual vs Predicted Gold Price

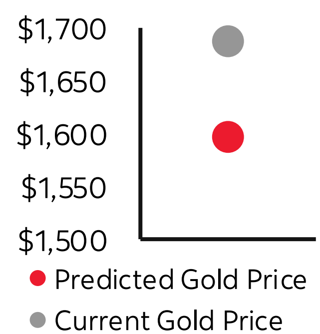


Source: Scotiabank Commodity Strategy (Metals), Bloomberg

Predicted Prices & Premium			Prediction Share Of Estimate	
Gold Price	$	1,596.36	Intercept	138.60%
Fear Premium	$	89.84	US10Real	8.33%
			DXY	294.45%
			USDJPY	-93.11%
			USDEUR	-231.89%
			USDGBP	-16.38%
			Total	100.00%

Scotiabank Commodity (Metals) Strategy
Prices as of 06-03-2020

Fear Premium



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