RBMC

THE BHAR REPORT

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The Week in the Markets

Week of 5 June 2020 – Number 21

Weekly price change	S&P 500	Shanghai	US 10-YR	DXY	WTI	Gold	LMEX	LME Cu	LME Al	LME Ni	LME Zn	LME Pb	LME Sn
Last	3,134	2,931	0.86%	96.8	$38.3	$1,706	2,537	$5,574	$1,571	$12,704	$2,033	$1,724	**$16,070**
Change w-o-w	**3.3%**	**4.4%**	**0.19**	**-1.2**	**17%**	**-1.3%**	**3.7%**	**4.5%**	**2.2%**	**4.3%**	**5.1%**	**6.8%**	**3.6%**

Macro Themes

As of 5 June, about 6.5mn **Covid-19** cases have been confirmed worldwide, and the death toll has surpassed 386k, according to Johns Hopkins University data. Increasingly its apparent that re-opening will be gradual with testing and contact tracing needed until a vaccine has been developed (see **Chart 1**). On the whole, **Europe's** reopening is proceeding well

Manufacturing PMIs released this week showed a recovery in manufacturing activity (China) or for most other economies a slowing in their growth contraction (see **Chart 2**). **China's** official Purchasing Managers' Index (PMI) and the Caixin/Markit index both stayed in positive territory in May, at 50.6 and 50.7, respectively. New orders were particularly strong, rising to the highest since January. However, both surveys showed export orders shrank. **US** factory activity showed signs of recovery, with the ISM manufacturing index rising for the first time in four months. The May PMI registered 43.1%, up 1.6% from the April reading of 41.5%. The **eurozone** manufacturing PMI posted an increase in May to 39.4 from 33.4 in April. In contrast, **Japan's** PMI shrank at the fastest pace since 2009 to 38.4 in May from 41.9 in April, while **South Korea's** fell to 41.3 from 41.6. Economies that have been more successful in containing Covid-19 and witnessed a quicker recovery in mobility, still have to contend with a very weak external environment.

Beyond the initial bounce that stems from the reopening of economic activity, what are the chances of a **sustained** and **robust** recovery? Is that possible while businesses operate at below full strength in an effort to maintain public health? The evidence from **China**, which is a month or so ahead of the US and Europe on this front, provides some reasons to be sceptical on the pace of recovery: while manufacturing production has rebounded, retail sales have been much slower to recover. This partly reflects a jump in unemployment, but it also partly reflects the fact that those workers with a job remain reluctant to spend. It seems that the initial response to Covid-19 has been to increase **precautionary savings**. Evidence suggests that the **savings ratio** in the US has increased sharply.

The **Dollar Index** (**DXY**) now at 96.82, is the lowest level since 16 March and is set to decline for three reasons. Firstly, the expectation that the Fed's **balance sheet** could grow to $10-12tn by the end of 2021 amid very accommodative monetary policy - "lower for longer." Secondly, the recent surge in US **unemployment** has taken a structural and therefore permanent shift higher that may not be repaired in the short term. Thirdly, protests and violence have erupted in many US states as they are trying to reopen, throwing some doubts on the speed of the US **recovery**. US infection rates are stubbornly high - will it reaccelerate / affect breadth of reopening in light of these protests? The DXY peaked in early March on safe-haven inflows (the "dash for cash" to pay debts and to seek refuge in the world's reserve currency) and started to decline as the Fed slashed interest rates to near zero and flooded markets with dollars through international swap lines. Investors are long dollars and therefore prone to liquidation which will fuel downside momentum as potential growth of the US economy is lower than in emerging markets. In addition, the recovery of stock markets and easing financial stress has seen demand for dollars on the wane.

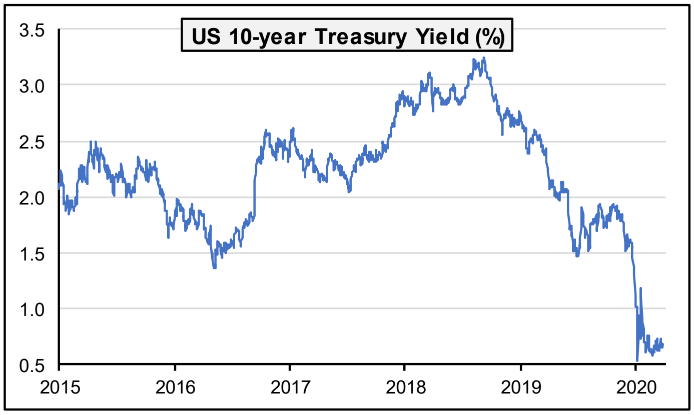
Precious Metals

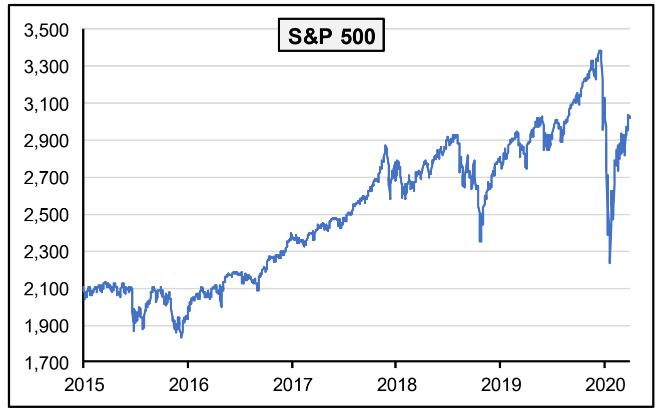
Gold remained steady amid rising geopolitical tensions and social unrest in the US, but gains were capped by the risk-on tone across markets. Nevertheless, the weak economic backdrop continues to provide some support, with investors continuing to pile into gold-backed ETFs, holdings are headed for their sixth straight monthly gain - inflows YTD now exceed the highest level of annual inflows seen in any calendar year. On the charts, support is still an upward sloping trend line that comes in near $1,699, with further support near the 50-day moving average at $1,693. On the upside, resistance is seen near the May highs at 1,754. With **palladium** trading at a widening premium to **platinum** since 2018, there has been renewed research into the use of platinum in gasoline catalyst applications (see **Chart 3**). However, there has been limited **substitution** to date as it had entailed high conversion costs and technical barriers. The high price, sustained demand growth and limited supply growth of palladium is making material platinum demand growth due to substitution of some palladium in gasoline cars extremely likely, according to the **World Platinum Investment Council** (**WPIC**). The WPIC report two developments, reinforcing the view that platinum can be used in place of palladium in today's emissions-control environment: **BASF**, the German chemicals giant, announced recently that it has successfully developed and tested new autocatalyst technology that enables the partial substitution of high-priced palladium with the relatively lower-priced platinum in light duty gasoline vehicles, without compromising emissions standards. This follows confirmation earlier this year from **Johnson Matthey**, which produces a third of all car autocatalysts globally, that platinum could be replacing palladium in 'underfloor' catalyst units in gasoline cars by February 2021.

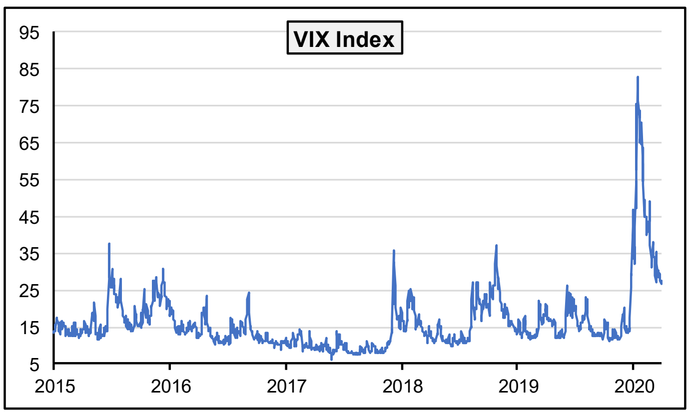
Base Metals

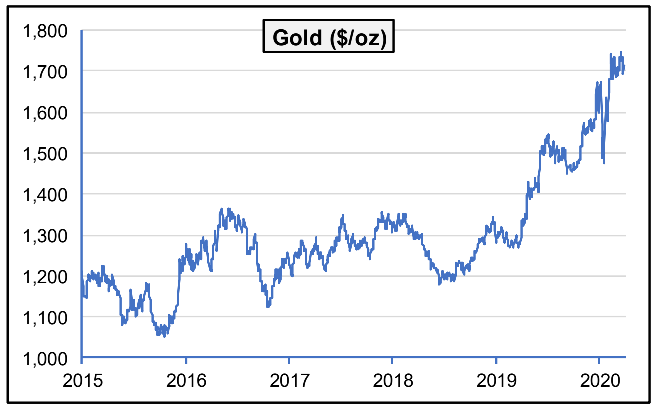
The **base complex** is rallying, which is attributed to easing of the lockdowns, albeit very slowly, and improving economic activity after the sudden stop in March and April. Economic activity is rebounding in China, as evidenced by the manufacturing PMI above 50 (see **Chart 2**), which is seeing domestic demand for metals improving. At the same time, ongoing supply disruptions overseas - Peru's copper output fell 33% to 125.2kt in April as companies struggled to run operations at full capacity due to Covid-19 and at large copper mines in Chile - and tighter scrap markets are underpinning the positive trend. That said, in times of past crises, such as 2008-09 and 2016, Beijing has come to the economy's rescue with massive metals-friendly infrastructure stimulus packages. This time, however, things are panning out slightly differently. Yes, government spending is ramping up, but China's leadership is wary of repeating mistakes of the past. A weaker USD for the reasons mentioned above has been supportive too. The **USD** has been in a bull market over the past two years and has been a headwind to industrial metals. If **DXY** has indeed peaked and set to decline further, then this will act as a tailwind to industrial metals. The RMB dropped to 7.18 against the USD, its weakest level since last September but has since rebounded. There is a negative correlation between the **CNY** and **LMEX**. Can rallies be sustained? If Covid-19-related restrictions can be lifted without sparking fresh waves of outbreaks, the optimistic view is likely to prevail. On the other hand, the pessimistic view is that the end of 2021 could be the earliest at which economies return to their 2019 levels. The net **money manager** short position on **Comex copper** has been contracting steadily from an early 2020 peak of 58,557 contracts to only 5,300 contracts last Tuesday (May 26). Just about all the action, however, has been short-covering. Outright bear positions have been cut to 41,215 from almost 101,000 contracts in February. Outright long positions have increased only marginally to 35,915, from 28,991 in early April (see **Chart 4**). Charts with moving averages are shown on **The Backpage**.

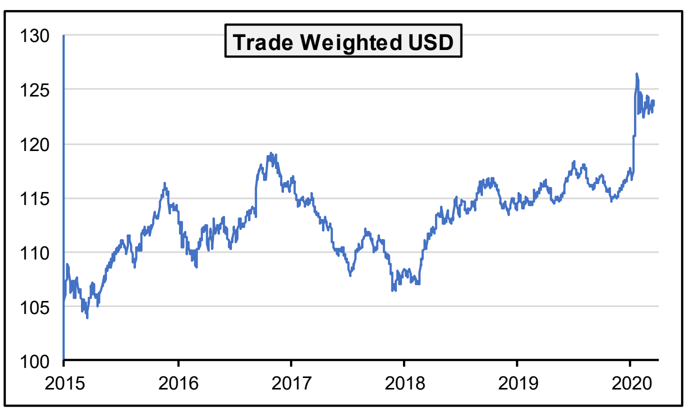
Dashboard – What You Need to Know

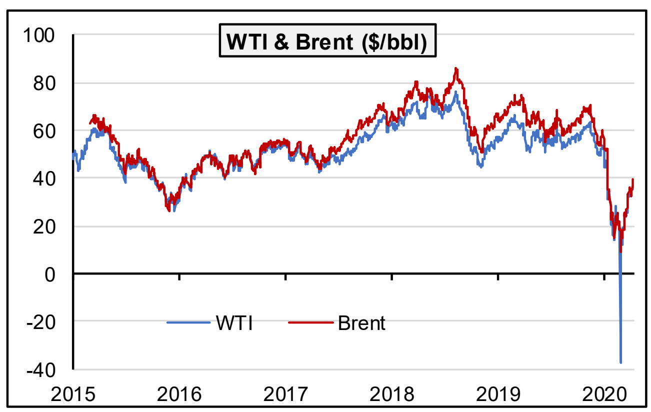


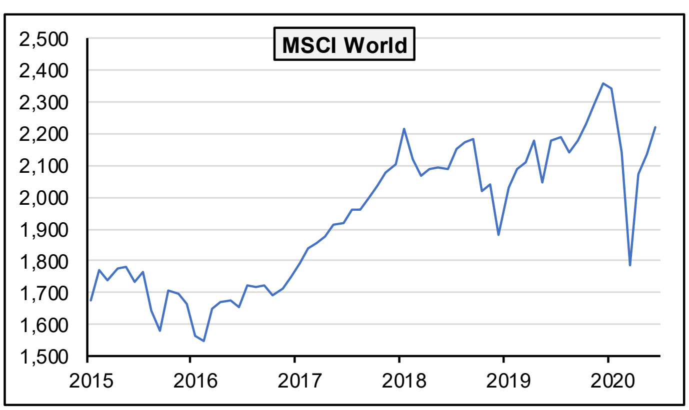


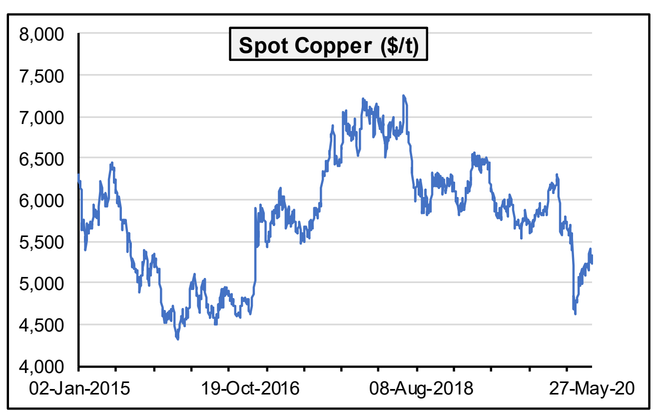












Source: Federal Reserve Bank of St. Louis, Trading Economics

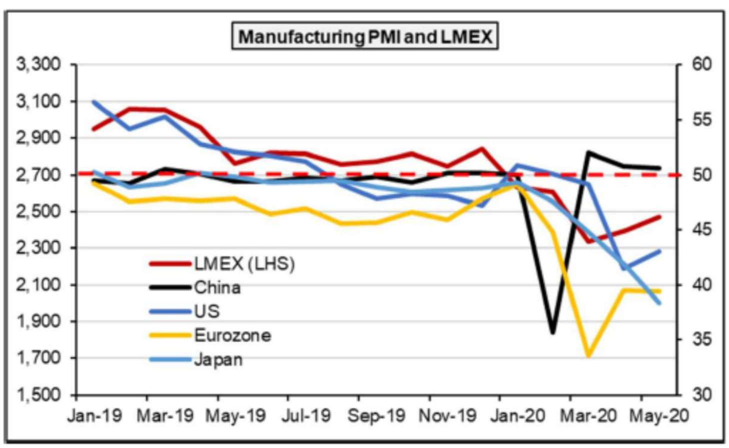
Charts of the Week

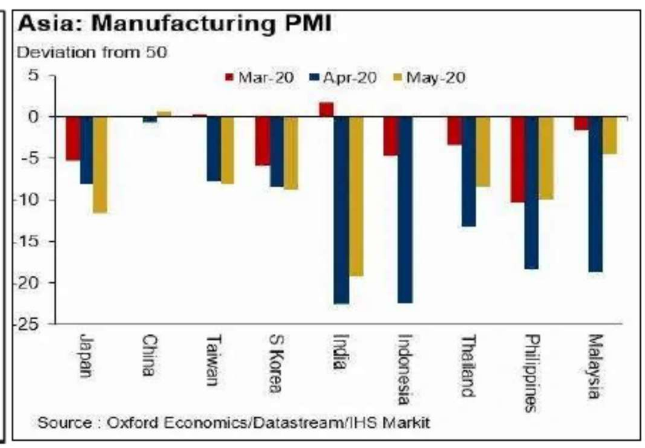
Chart 1. So far so good, but early days on reopening

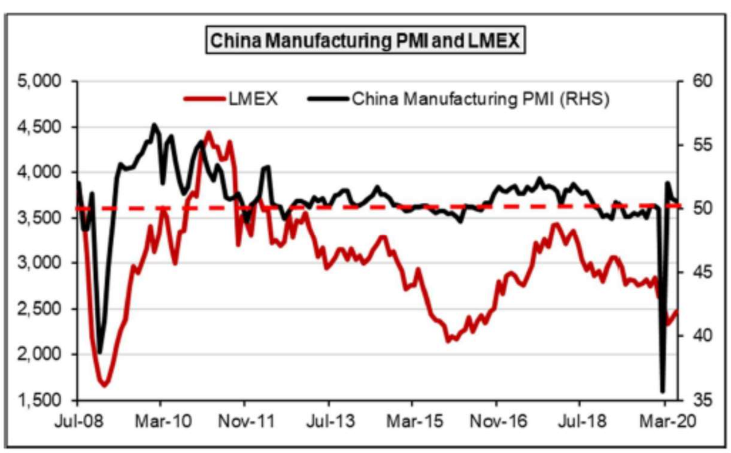
Factors needed for quick and robust recovery	Recent news	Looking ahead
Infection contained (travel restrictions can be eased)	On the whole, Europe's reopening proceeding well	US infection rate stubbornly high – will it reaccelerate/ affect breadth of reopening in light of protests Will Europe's reopening broaden successfully?
Policy response - Fiscal stimulus of sufficient size and nature - Central bank backstop - Absence of 'nationalism' and political scapegoating	Additional German fiscal package struggling to pass	ECB this week, Fed next week Brexit US and China tensions US protests
Economic resilience - proof of 'suspended animation'	UK furlough scheme unwind is gradual EZ unemployment increase is modest Stimulus clear in US income report	Monitoring unemployment US payrolls on Friday

Source: J.P. Morgan Asset Management

Chart 2. Manufacturing PMIs show growth only in China



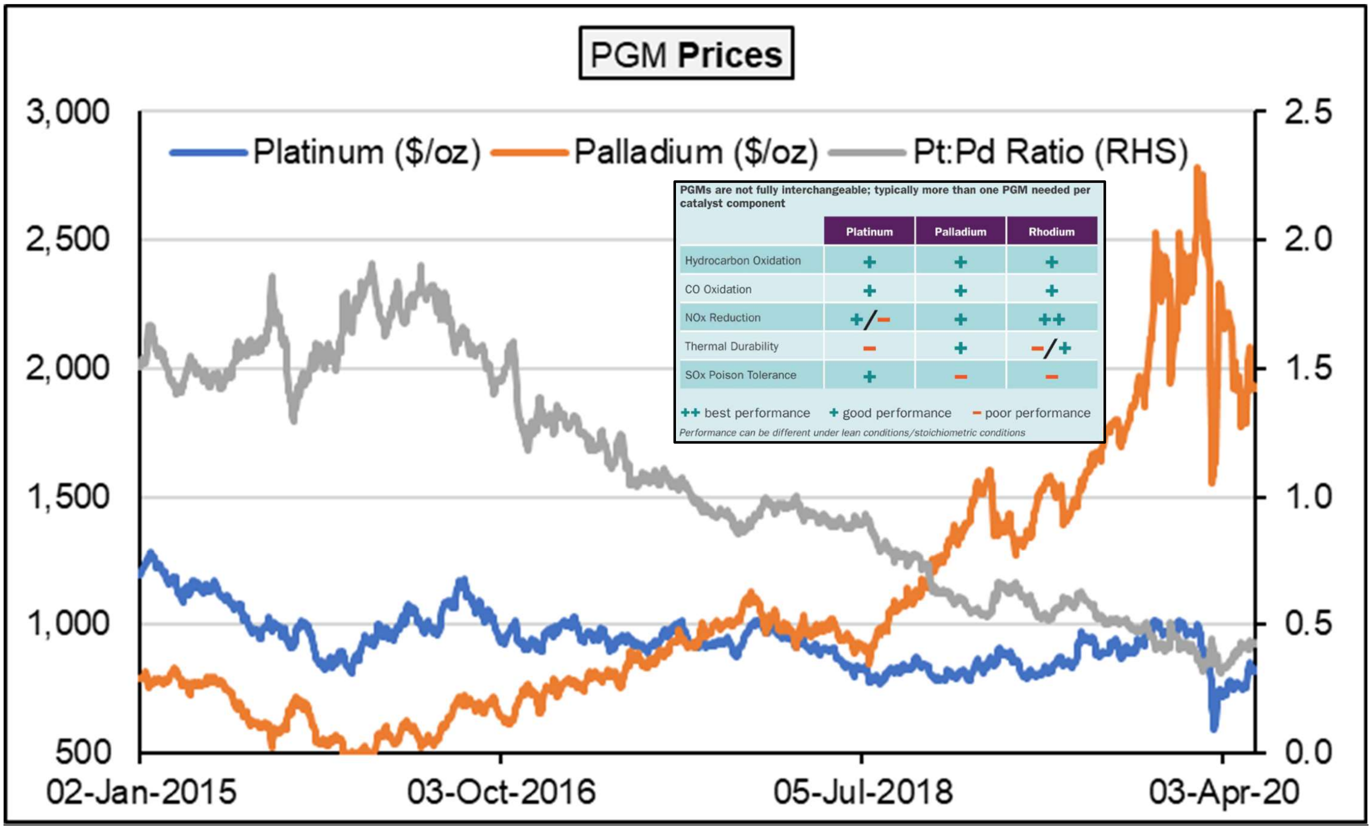




Source: IHS Markit, China National Bureau of Statistics, LME

Charts of the Week

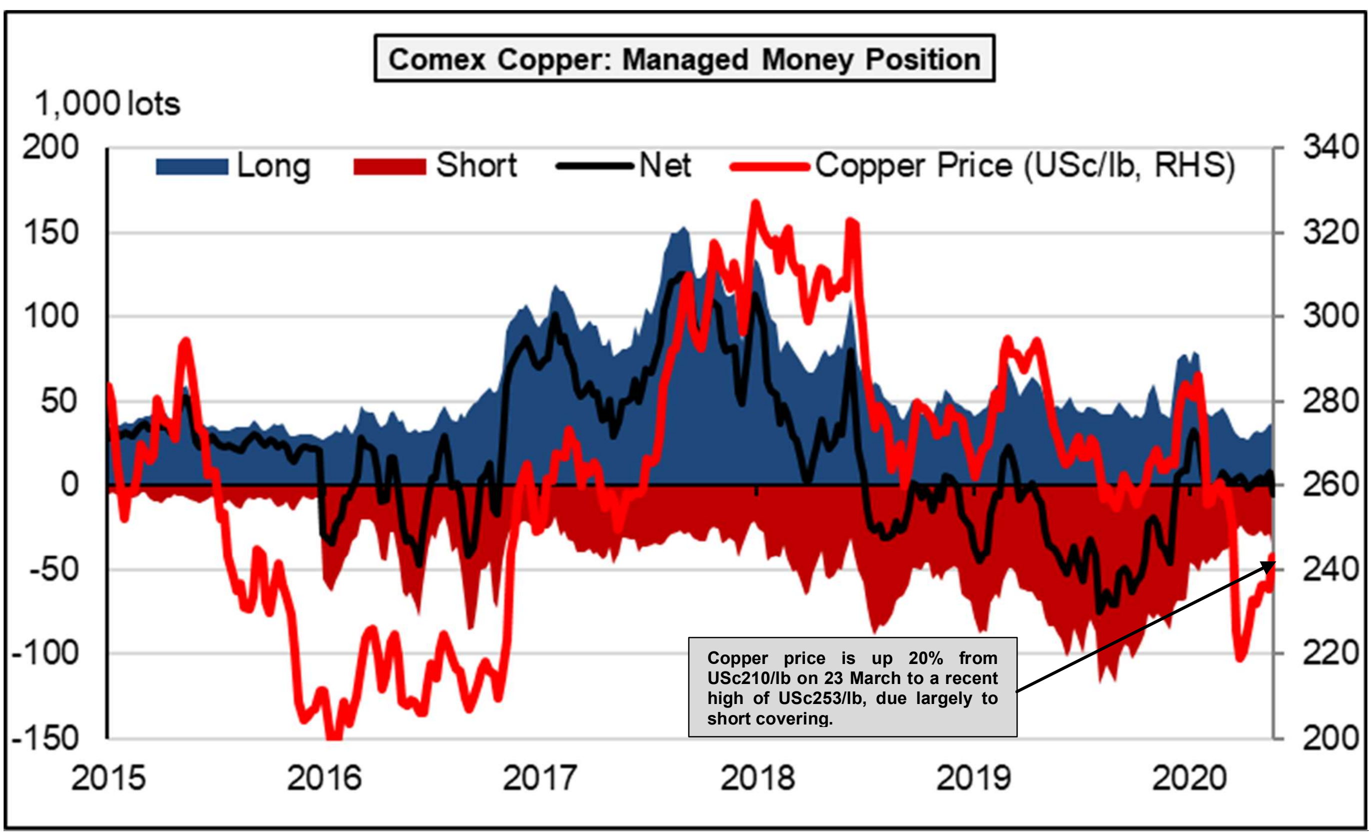
Chart 3. Platinum and Palladium Prices



	Platinum	Palladium	Rhodium
Hydrocarbon Oxidation	+	+	+
CO Oxidation	+	+	+
NOx Reduction	+/–	+	++
Thermal Durability	–	+	–/+
SOx Poison Tolerance	+	–	–

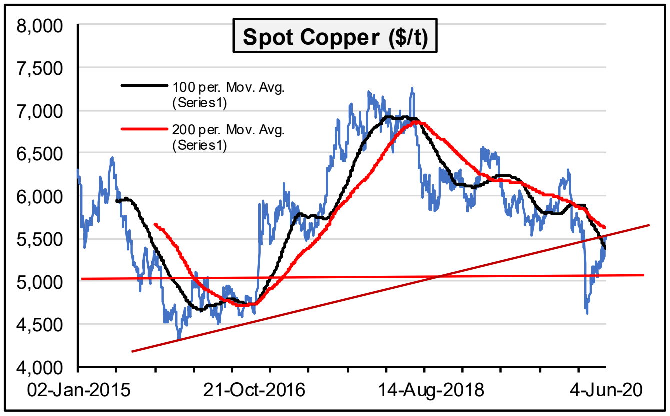
Source: Trading Economics, Fastmarkets

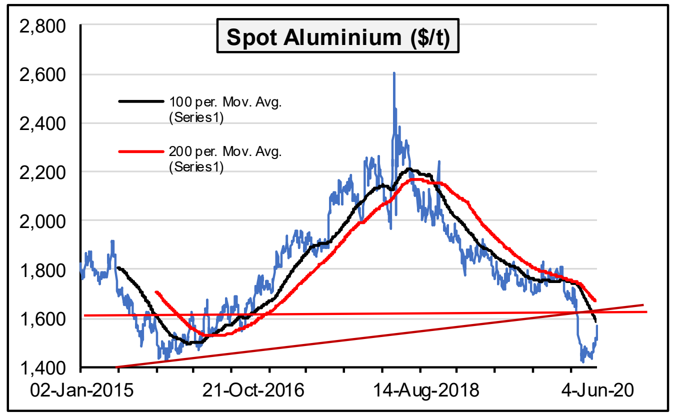
Chart 4. Net Speculative Positioning in Copper

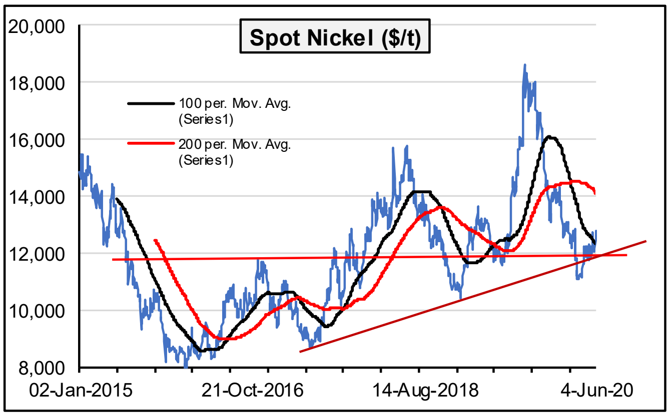


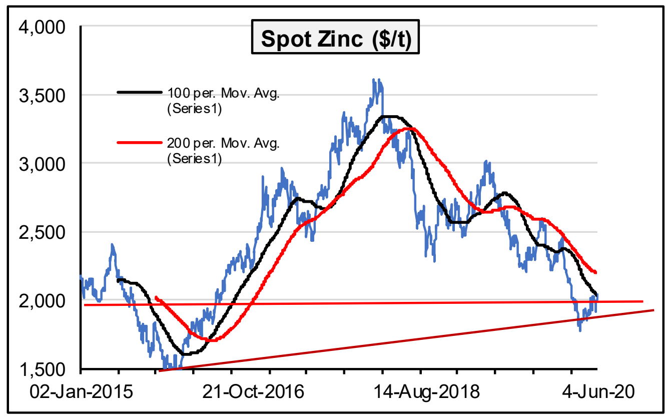
Source: CFTC COT, NYMEX

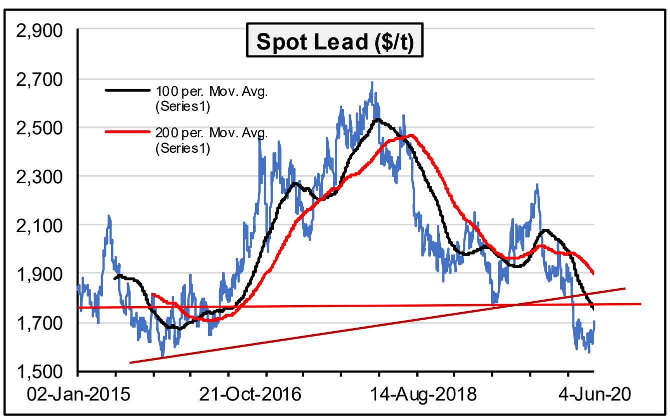
The Backpage – Industrial Metals

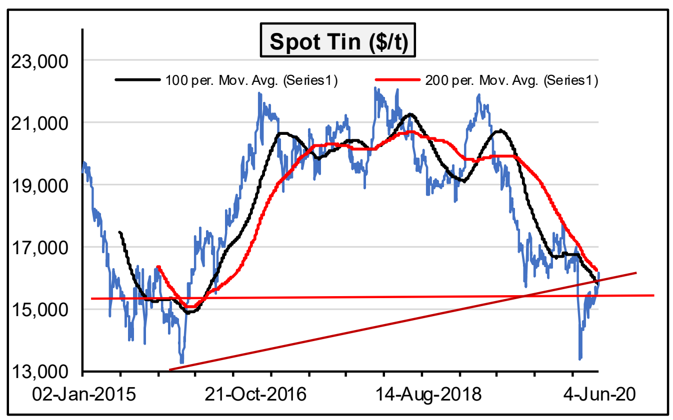


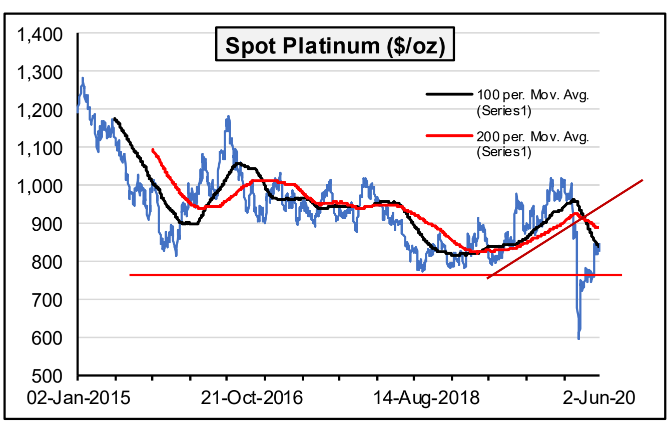


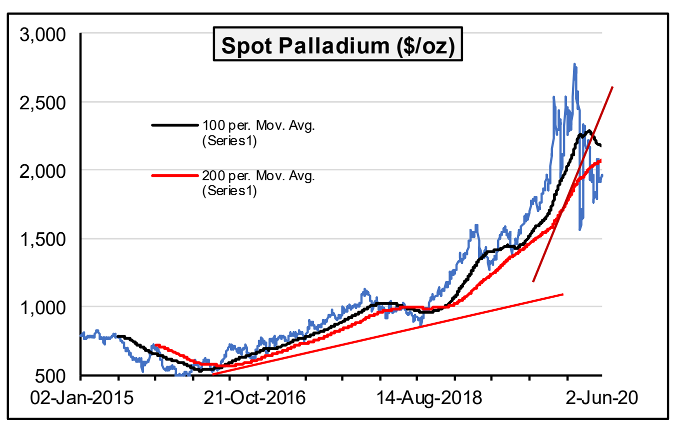












Source: LME, LBMA, LPPM

For more commentary see my blog on www.rbmc.world
Comments, suggestions, and feedback is welcomed