RBMC

THE BHAR REPORT

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The Week in the Markets

Week of 15 May 2020 – Number 18

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	2,854	2,868	0.62%	100.3	$28.0	$1,733	2,390	$5,193	$1,475	$12,006	$1,957	$1,600	**$15,030**
Change w-o-w	**-2.2%**	**-0.9%**	**0.02**	**0.5**	**19%**	**0.8%**	**-0.1%**	**-2.5%**	**-0.7%**	**-1.0%**	**-2.3%**	**-0.6%**	**-1.3%**

Macro Themes

As of 15 May, about 4.4mn Covid-19 cases have been confirmed worldwide, and the death toll has surpassed 303k, according to Johns Hopkins University data. Increasingly its apparent that reopening will be gradual with testing and contact tracing needed until a vaccine has been developed (see Chart 1). Financial markets are calmer and on a firmer footing, as shown on the next page (Dashboard). However, the **global economic outlook** is still worsening, according to the **IMF**; any recovery will be slow and gradual says the **OECD**.

Fed chairman Powell said on Wednesday that the scope and speed of this downturn are without modern precedent, significantly worse than any recession since World War II. We are seeing a severe decline in economic activity and in employment, and already the job gains of the past decade have been erased. Since the pandemic arrived in force just two months ago, more than 20mn people have lost their jobs. Among people who were working in February, almost 40% of those in households making less than $40k/p.a. had lost a job in March.

This **downturn** is different from those that came before it. Earlier in the post– World War II period, recessions were sometimes linked to a cycle of high inflation followed by Fed tightening. The lower inflation levels of recent decades have brought a series of long expansions, often accompanied by the buildup of imbalances over time - asset prices that reached unsupportable levels, for instance, or important sectors of the economy, such as housing, that boomed unsustainably. The current downturn is unique in that it is attributable to the virus and the steps taken to limit its fallout. This time, high inflation was not a problem. There was no economy-threatening bubble to pop and no unsustainable boom to bust. The virus is the cause, not the usual suspects - something worth keeping in mind as we respond.

To date, **Congress** has provided roughly $2.9tn in fiscal support for households, businesses, health-care providers, and state and local governments - about 14% of GDP. While the coronavirus economic shock appears to be the largest on record, the fiscal response has also been the fastest and largest response for any postwar downturn. At the Fed, we have also acted with unprecedented speed and force. While the economic response has been both timely and appropriately large, it may not be the final chapter, given that the path ahead is both highly uncertain and subject to significant downside risks. However, he also stated the Fed's views on **negative** interest rates has not changed, and it is not something the policy-setting committee is considering. The Fed said that economic forecasts are uncertain in the best of times, and today the virus raises a new set of questions: How quickly and sustainably will it be brought under control? Can new outbreaks be avoided as social-distancing measures lapse? How long will it take for confidence to return and normal spending to resume? And what will be the scope and timing of new therapies, testing, or a vaccine?

At the Fed, we will continue to use our tools to their fullest until the crisis has passed, and the economic recovery is well under way. Recall that the Fed has lending powers, not spending powers. A loan from a Fed facility can provide a bridge across temporary interruptions to liquidity, and those loans will help many borrowers get through the current crisis. But the recovery may take some time to gather momentum, and the passage of time can turn **liquidity** problems into **solvency** problems. Additional fiscal support could be costly, but worth it if it helps avoid long-term economic damage and leaves us with a stronger recovery.

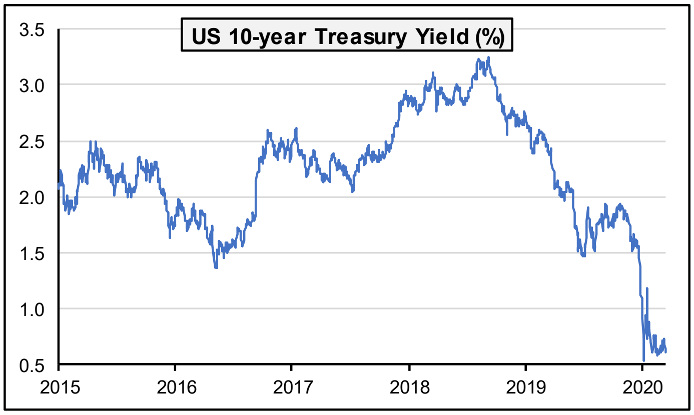
Precious Metals

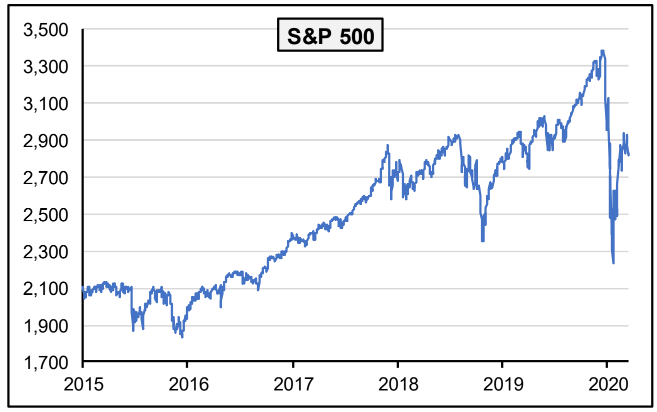
Will the Fed be under pressure to keep policy accommodative? If so, this is bullish for **gold**, as prices pushed back above $1,700/oz, as the prospect of negative interest rates remains a possibility, albeit a slim one. While the Fed is unlikely to adopt negative policy rates, and they still have plenty of other monetary tools at their disposal, buying gold to hedge this tail-risk is a distinct possibility. Fed funds futures are implying negative rates next year, signaling a protracted recession (see Chart 2). The more industrial precious metals - **silver**, **platinum**, and **palladium** - are faring worst due to the global recession and the substantial decline in manufacturing activity. Industrial demand for silver and PGMs is likely to be well down on recent years. The **gold:silver** ratio is likely to remain elevated and to remain well above its longer-term average for the foreseeable future as gold is out-performing (see Chart 3). This ratio tends to rally during periods of financial crisis, disruption and instability, and peaks generally during recessionary periods. Under the premise that both gold and silver prices should generally move with some level of correlation, extreme high or low levels of the ratio, may signal opportunities to buy one metal and short the other. Under the Covid-19 pandemic, the ratio recently traded at an all-time high of 125.

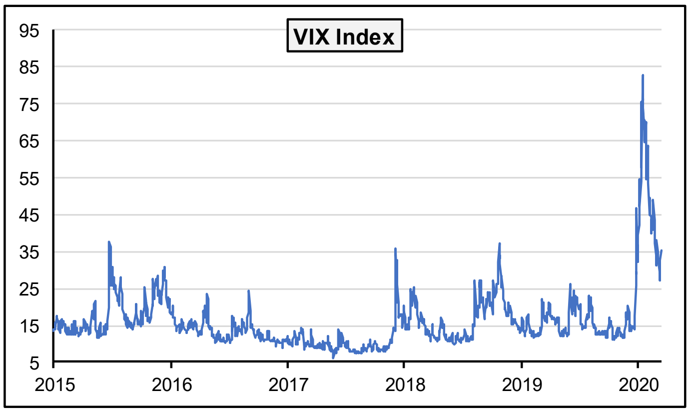
Base Metals

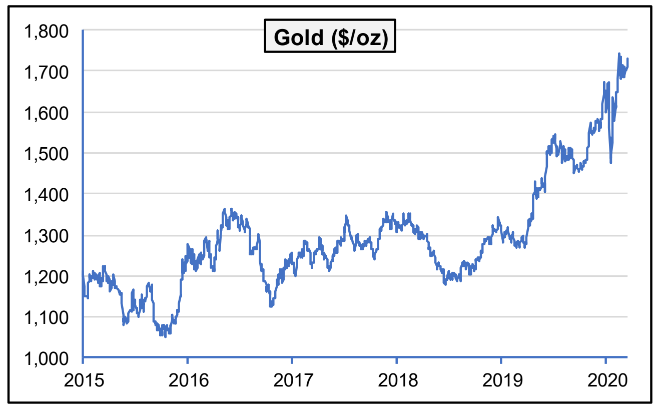
Sentiment in **base metals** continues to improve, with strong import demand from China fueling (China *Customs* data showed imports of refined copper +12.2% YoY in April to 460kt) hope that the worst is behind us. Tighter scrap regulations in China, mine supply disruptions and a revival in business activities kept refined **copper** imports strong. Realistically though, rallies are not really going to get established until we have a much clearer picture, and that is not going to happen in the next few days or weeks – so, **sell in May and go away!** YTD price performance shows aluminium is lagging behind the other base metals, having fallen by 19% since the start of 2020. **Aluminium** prices are largely tracking sideways and just off earlier lows in contrast to the others which have trended higher since their lows registered in late-March (see Chart 4). **Hard rock** metals (**Cu**, **Ni**, **Pb**, **Zn** and **Sn**) have experienced significant disruptions and temporary closures to mines due to Covid-19 restrictions and lockdowns. This factor has boosted sentiment and prices for these metals. Something like 265 mines have been affected by Covid-19 related shutdowns (mainly in Canada, Mexico, Peru, Chile, South Africa, and the US), according to *S&P Global Market Intelligence*. Aluminium has seen very few smelter closures as production costs have fallen on lower input costs (energy/power, alumina, carbon, coke) and depreciated local currencies. The lack of cuts is somewhat surprising given that a significant number of smelters on a global basis are cash negative amid prevailing prices. Given the substantial fall in consumption - up to 10% YoY - from key end-use sectors such as transportation (autos and aerospace), building & construction, and packaging, supply reductions have been minimal by comparison. This means that a global market surplus this year of 4Mt is equivalent to 6.6% of world consumption, compared to about 2-3% of world consumption for the other metals. Investors and speculative players continue to trade from the short side - aluminium is the most heavily shorted of the base metals - and this does not look to be changing anytime soon. Aluminium prices are still trading fairly close to their lows of the year. Charts with moving averages are shown on The Backpage.

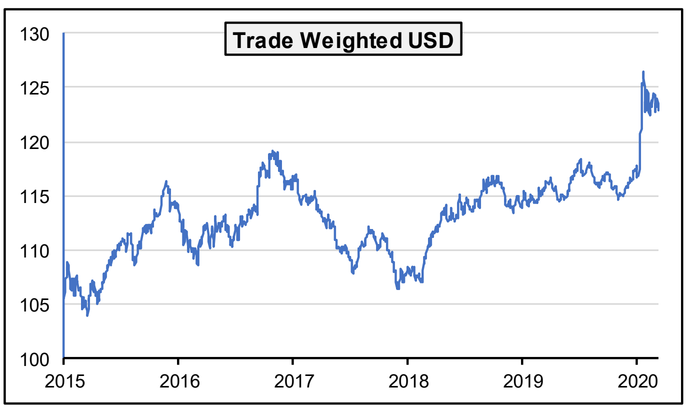
Dashboard – What You Need to Know

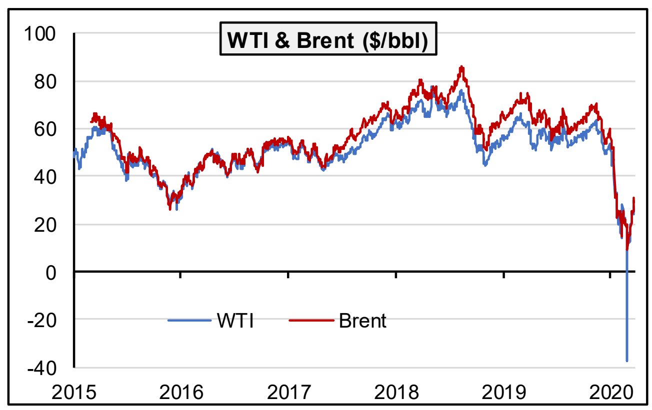


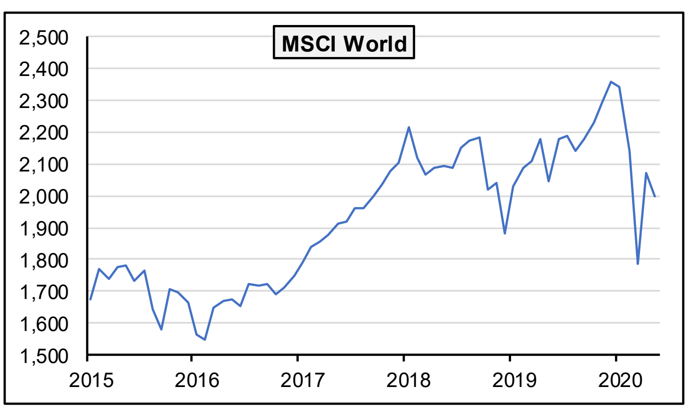


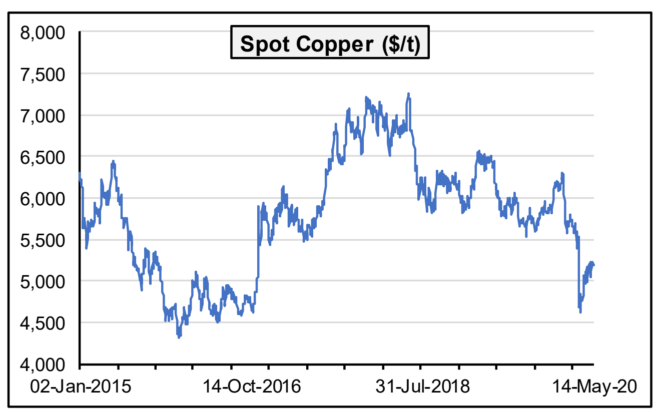












Source: Federal Reserve Bank of St. Louis, Trading Economics

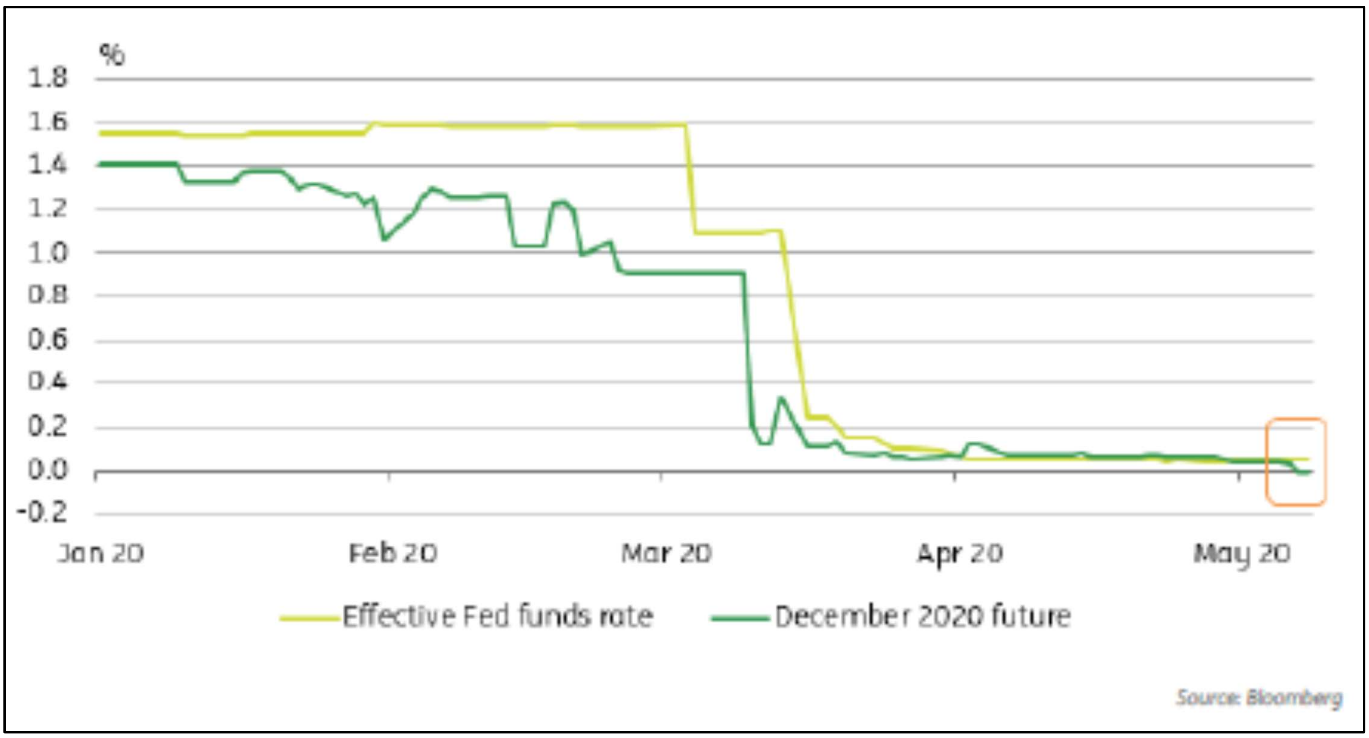
Charts of the Week

Chart 1. Increasingly apparent that reopening will be gradual

Factors needed for quick and robust recovery	Progress	Further progress needed
Infection contained (travel restrictions can be eased)	Infections slowing in Continental Europe Infections plateauing in the US, UK	Vaccine ready for mass production Test and trace technologies to facilitate sustainable reopening
Policy response - Fiscal stimulus of sufficient size and nature - Central bank backstop - Absence of 'nationalism' and political scapegoating	Furlough schemes extended (but pressure growing for private sector contribution) Negative rates back in discussion	ESM terms in Europe attractive, need to overcome stigma German Court ruling implications Brexit negotiation extension Conciliatory communications between US and China
Economic resilience - proof of 'suspended animation'	US unemployment (18m of 23m reported as temporary) Furlough schemes being well utilised in Europe	Increased discussion of conditional loan forgiveness

Source: J.P. Morgan Asset Management

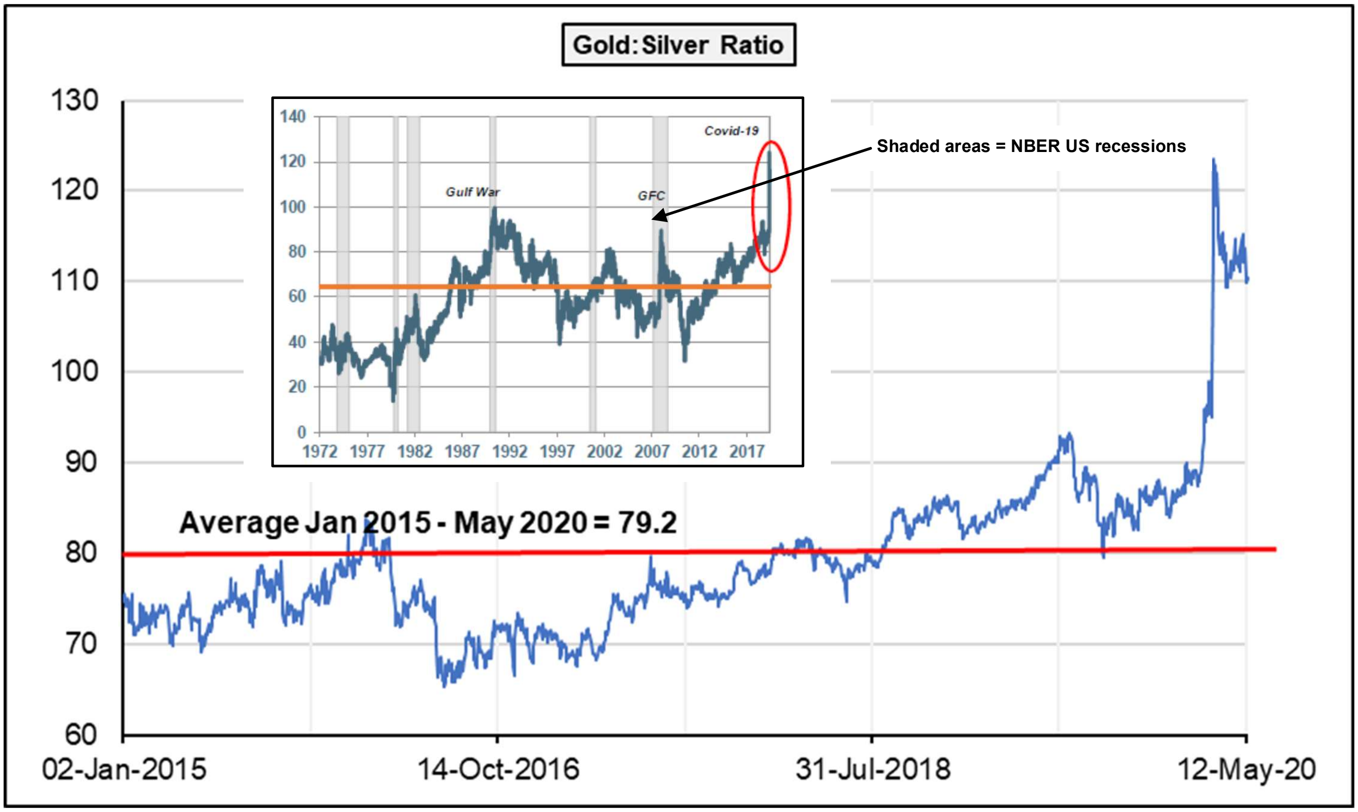
Chart 2. Effective funds rates versus the December 2020 futures discount



Source: ING

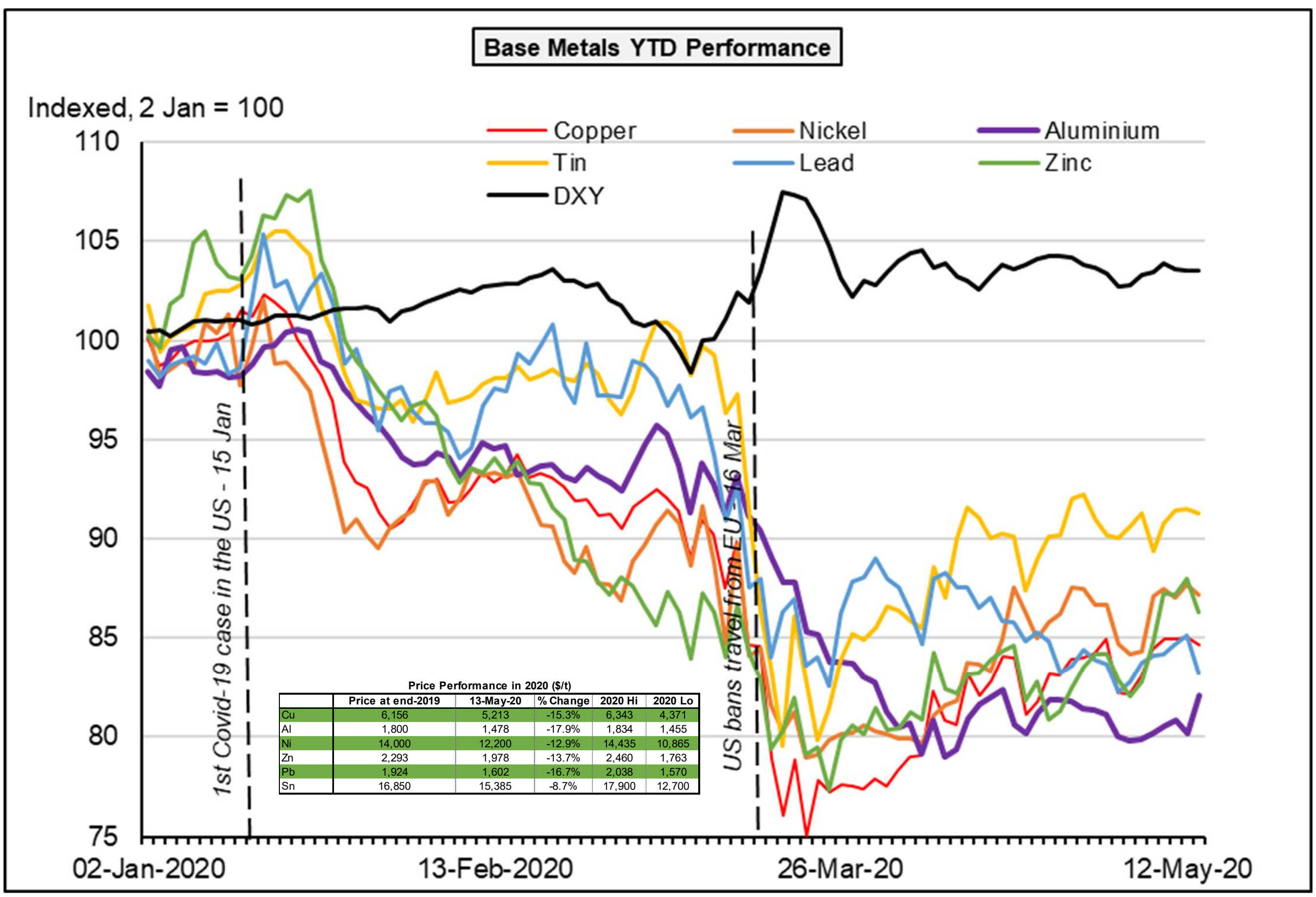
Charts of the Week

Chart 3. Gold:Silver ratio at an all-time high



Source: LBMA, World Gold Council, Murenbeeld

Chart 4. Base metals YTD performance

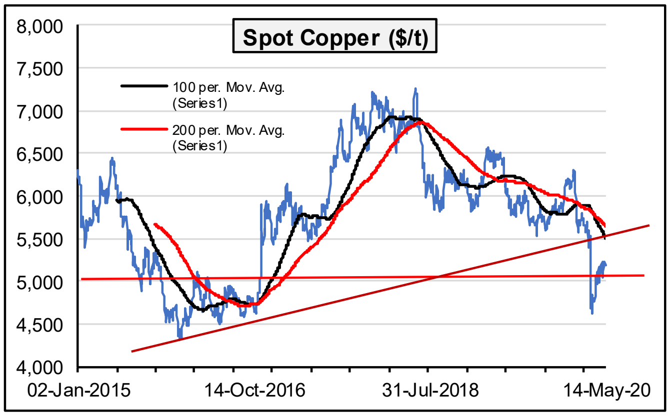


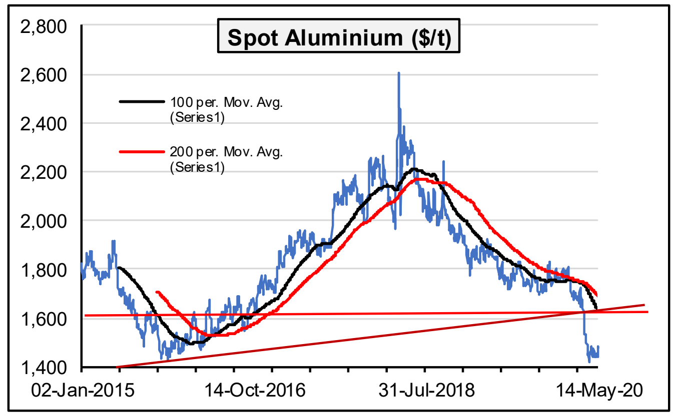
Price Performance in 2020 ($/t)

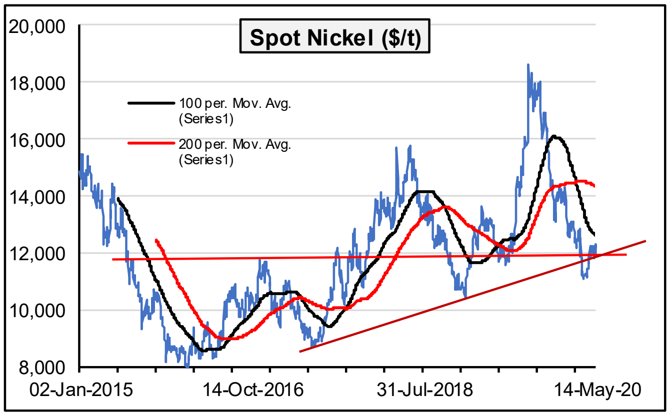
	Price at end-2019	13-May-20	% Change	2020 Hi	2020 Lo
Cu	6,156	5,213	-15.3%	6,343	4,371
Al	1,800	1,478	-17.9%	1,834	1,455
Ni	14,000	12,200	-12.9%	14,435	10,865
Zn	2,293	1,978	-13.7%	2,460	1,763
Pb	1,924	1,602	-16.7%	2,038	1,570
Sn	16,850	15,385	-8.7%	17,900	12,700

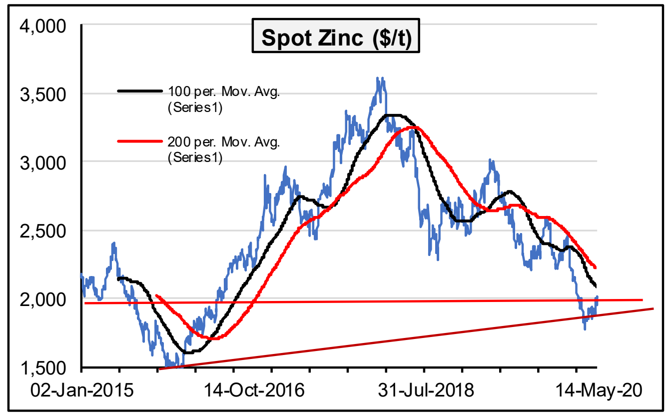
Source: LME

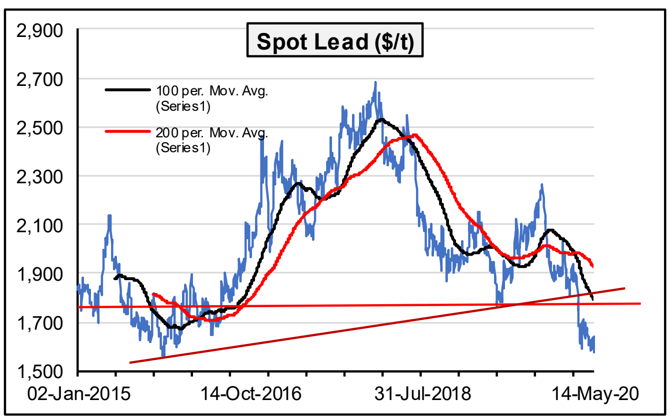
The Backpage – Industrial Metals

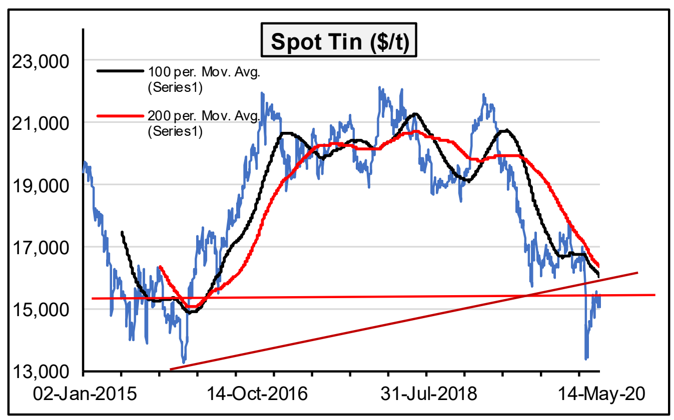


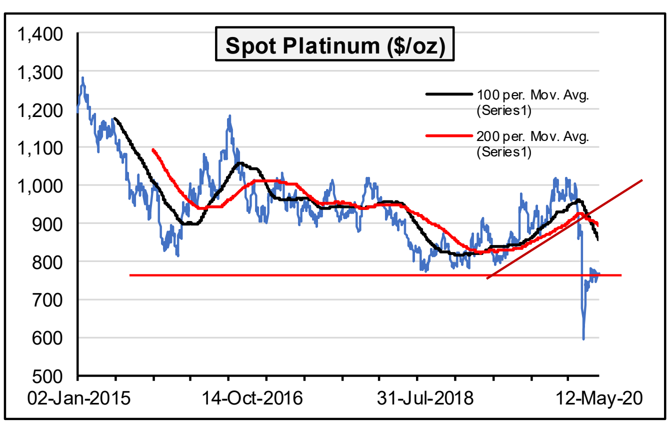


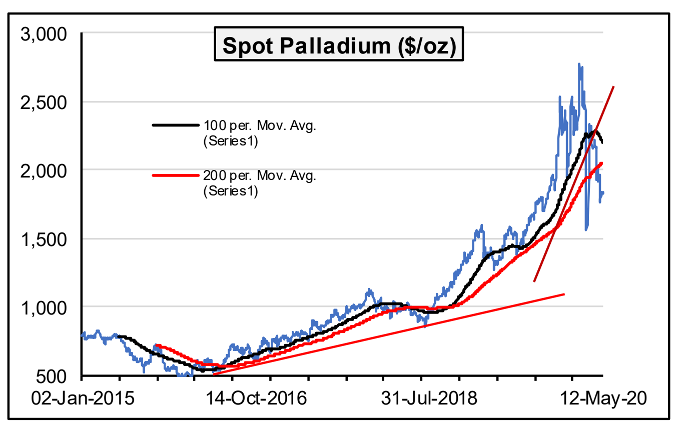












Source: LME, LBMA, LPPM

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