RBMC

THE BHAR REPORT

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The Week in the Markets

Week of 26 June 2020 – Number 24

Weekly price change	S&P 500	Shanghai	US 10-YR	DXY	$/CNY	WTI	Gold	LMEX	LME Cu	LME Al	LME Ni	LME Zn	LME Pb	LME Sn
Last	3,087	2,981	0.68%	97.4	7.09	$39.0	$1,763	2,633	$5,873	$1,592	$12,709	$2,082	$1,768	**$16,885**
Change w-o-w	-1.5%	0.5%	-0.03	-0.1	0.3	-2.3%	1.8%	0.0%	1.2%	-0.9%	-1.0%	1.5%	-1.7%	0.0%

Macro Themes

As of 26 June, about 9.6mn **Covid-19** cases have been confirmed worldwide, and the death toll has surpassed 489k, according to Johns Hopkins University data. **US** virus data is extremely worrying, as are key parts of emerging market economies, although **China** appears to have contained the cluster in Beijing. **Europe** on the whole is still proceeding well, localized infections are contained. Nevertheless, the situation remains precarious (see **Chart 1**).

The global rally in **risk assets** has shaken off the pandemic crisis, an economic downturn and political tension. Investors are ignoring a spate of new Covid-19 cases and focusing instead on a pick-up in economic activity and central bank pledges of more stimulus. Stock markets are in the ascendancy - the FTSE All World index remains on track to complete its best quarter in over a decade, while the S&P 500 is on course for its best quarter in more than 20 years. This has been in the face of the worst global economic downturn since the Great Depression, plummeting corporate earnings and rising geopolitical tensions. **Corporate earnings** face pressure from structural shifts such as supply chain reshoring, protectionism, and higher taxation, all of which should increase costs. Many believe that at a time of massive economic and financial uncertainty stock markets are in a bubble. However, the great bubbles can go on a long time and inflict a lot of pain!

The massive **stimulus** from the **Fed** affects capital markets more than anything else. This has seen a decoupling of markets from the economy. Central banks stepped in to provide liquidity. They could see panic developing as investors made a dash for cash. It was essential that capital markets remained liquid and continued to function. The amount of money raised in equity and bond markets over the past four or five weeks has been massive. If markets had been clogged up, these companies wouldn't have been able to access that investor capital – and, ultimately, that would have just added to the public sector bill for all of this. **Rate** cuts are seen as an effort to support asset prices. The Fed, ECB and BoJ have injected a combined $5tn of liquidity into financial markets since March. Already, an estimated $10tn by governments has been pumped into the global economy to support households, stem job losses, and keep businesses afloat. The $15tn of stimulus is unprecedented. Currently, the consensus is that **deflation** is a bigger risk than **inflation**, with central banks struggling to reach targeted inflation levels. That said, there is always the risk of inflation, however.

Some **economic data** has come in better than expected, fueling hopes of a **V-shaped** recovery (where economic growth falls sharply and then rebounds) that will justify the high valuations. This is in spite of the fact that the scale of the downturn will mean it could take years to get back to the levels seen earlier this year, implying a **U-shaped** recovery (in which only a small share of lost output and employment is regained in 2020) or even a **W-shaped** double-dip (a short lived recovery followed by a severe drop in activity later this year due to a second wave of containment measures. Meanwhile, **PMIs** are improving, but they should be above 50. The **IMF** is now projecting a deeper recession in 2020 and a slower recovery in 2021. Global output is projected to decline by -4.9% in 2020, 1.9 percentage points below its April forecast, followed by a partial recovery, with growth at 5.4% in 2021. This latest assessment brings it more into line with bearish economic forecasts coming out of the World Bank and OECD in recent weeks (see **Chart 2**).

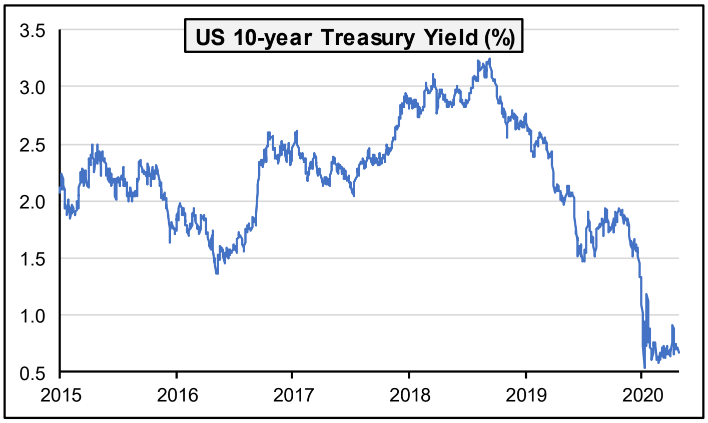
Precious Metals

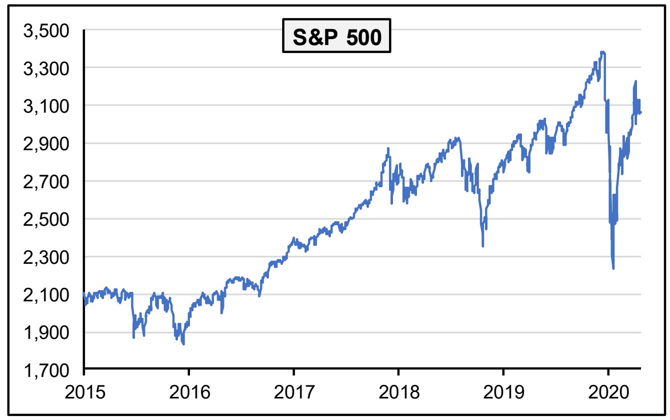
Gold prices continue to be supported by the increase in virus cases globally, raising doubts about the nature of the economic recovery in progress. Prices hit an eight-year high of $1,780/oz, on safe haven buying and the IMF's downgrade of its economic outlook. Gold's renewed attempt to challenge upside resistance towards $1,800/oz has been given some tailwind from another drop in US 10-year real yields to -0.66%, (real yields heading increasingly negative) lowest level (close basis) in 7 years (see **Chart 3**). Covid-19 worries together with the eventual inflationary impact of central bank stimulus are providing the support for gold. Demand for gold tends to grow into the early stage of the economic recovery, driven by lower real rates, additionally getting a boost from a weakening USD and worries about currency debasement. Its noteworthy that two-month gold **lease rates** keep declining into negative territory since the March Chaos, which means that borrowers of gold are being paid 1.5% to lease gold for a year. Who wants to lend gold at negative interest? Gold **ETF** holdings are at a new all-time high of 3,510t. YTD, inflows (623t, $33.7bn) now exceed the highest level of annual inflows (591t) seen in 2009. Over the past 12 months assets in gold ETFs have nearly doubled (+90%). As investors look to **hedge** the economic risks of ballooning budget deficits and high valuations for both stocks and bonds, collective holdings of gold ETFs have now surpassed Germany's official gold reserves and exceed the official gold reserves of every country except for the US (*source: World Gold Council*). This also highlights the increasing acceptance of gold ETFs among investors as a means to gain exposure to gold. **Silver** prices moved higher and if gold prices keep climbing silver could continue to outperform. Further downside in **platinum** and **palladium** is likely as both are over-supplied.

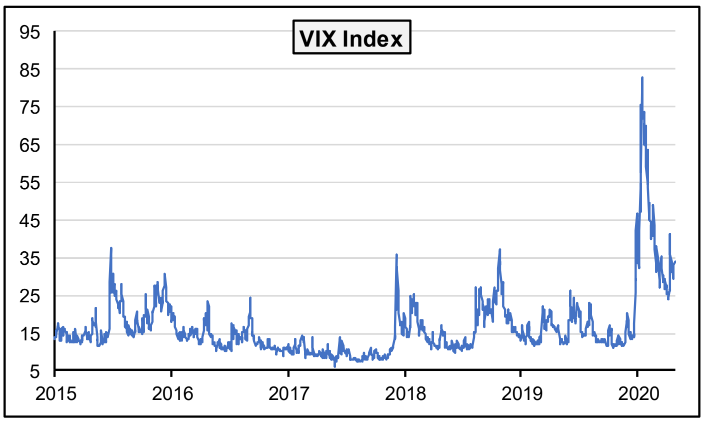
Base Metals

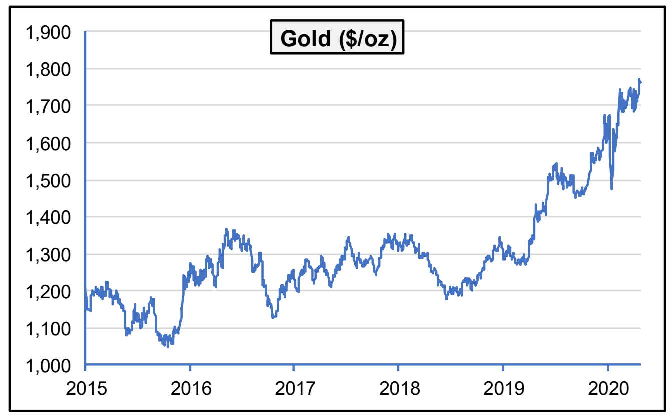
In the short-term it's all about the **macro** and nothing else. Trying to tie the evolving fundamentals to price action in **industrial** metals is futile and **chart analysis** might be more rewarding. The Covid-19 pandemic is still playing out. Metals have rallied sharply - the **LMEX** is up 18% from the March lows - in response to massive stimulus packages and rebounding economic activity in China. Forget the micro fundamentals (supply, demand, and inventories) and instead focus on the macro fundamentals (stimulus/liquidity, risk appetite, capital markets, bubbles. etc.). Supply/demand fundamentals don't mean much for now, as the macro is supporting prices amid an influx of huge liquidity, but longer-term the fundamentals must matter, and rising inventory levels should cap the rally. The exception is **copper**, which is underpinned by strong Chinese demand and ongoing supply disruptions at mines. Chile's *Codelco* is halting work on all construction projects in the country's north. The company has been operating at reduced capacity, with staff trimmed by 30% since May. The *World Bureau of Metals Statistics* (*WBMS*) published preliminary data for Jan-Apr 2020 on demand, supply, stocks, and market balances (see **Chart 4**). Only copper, lead and tin were in deficit in this period. *WBMS* noted that demand for most countries is calculated on an apparent basis. Metal shipments are in transit for some weeks and stock levels are under reported and so it is likely that the demand for all metals will be overstated for the next few months. The copper market recorded a deficit of 2.4kt in this period which follows a deficit of 268kt in 2019. In April 2020, refined copper production was 1,952kt and demand was 2,116.2kt. The market balance for primary **aluminium** was a surplus of 1.1Mt which follows a surplus of 749kt recorded for 2019. In April 2020, primary aluminium production was 5,394.1kt and demand was 5,262.5kt. Charts with moving averages are shown on **The Backpage**.

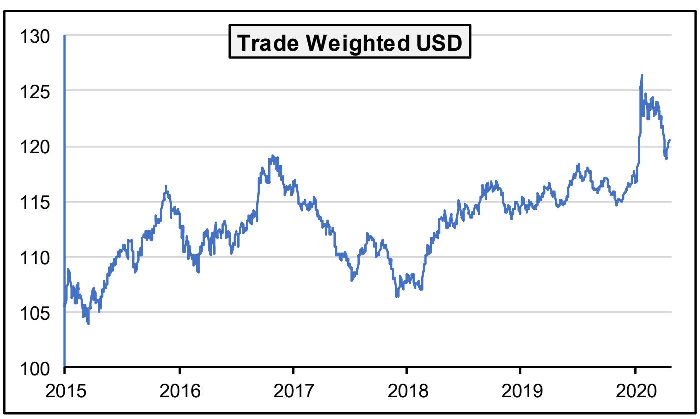
Dashboard - What You Need to Know

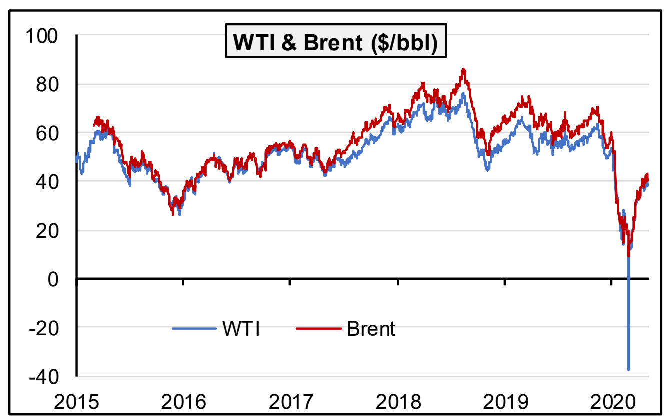


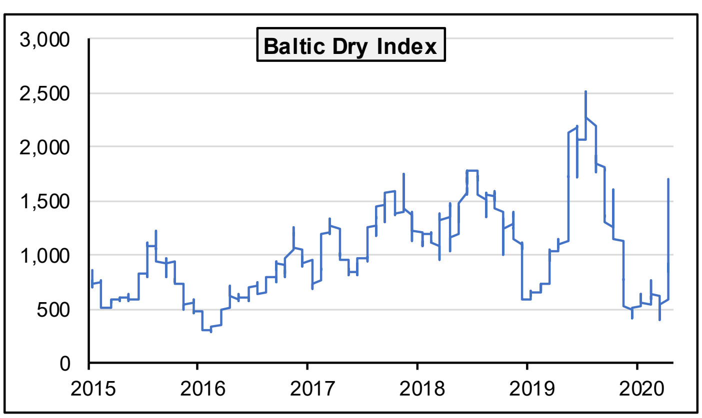


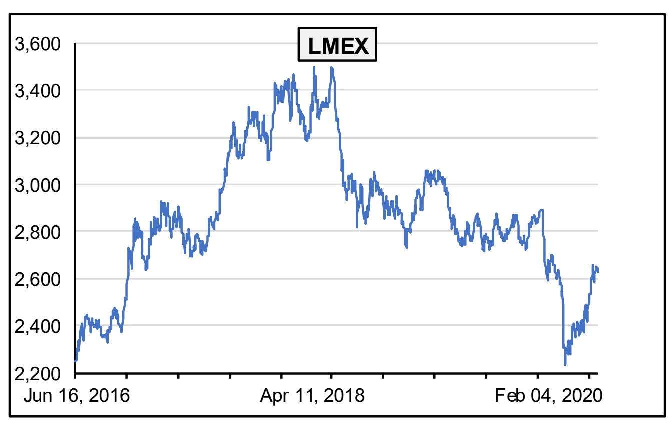












Source: Federal Reserve Bank of St. Louis, Trading Economics

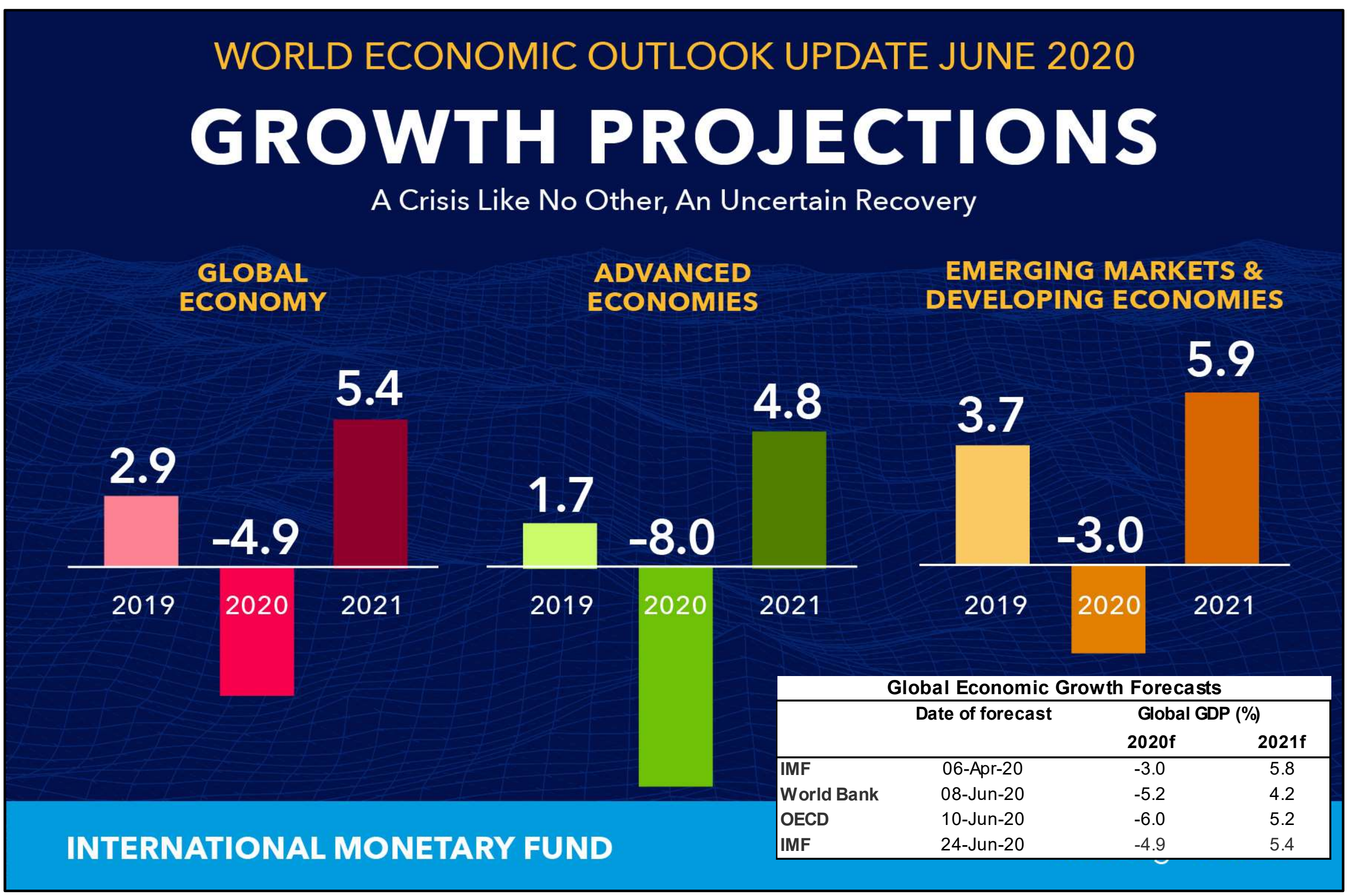
Charts of the Week

Chart 1. A precarious situation

Factors needed for quick and robust recovery	Recent news	Looking ahead
Infection contained (travel restrictions can be eased)	US virus data extremely worrying, as are key parts of EM China appears to have contained the cluster in Beijing Europe on the whole still proceeding well, localised infection contained	How will US reopening be affected by infection rates? How does EM gain control given inability to shutdown and do governments absorb costs? How do ongoing clusters affect ability to open service economy?
Policy response - Fiscal stimulus of sufficient size and nature - Central bank backstop - Absence of 'nationalism' and political scapegoating	BoE slowing pace of asset purchases, QE unwind stage one of exit strategy Early signs of Brexit compromise	US and China tensions/ US political risk
Economic resilience - proof of 'suspended animation'	PMIs improving, but they should be above 50?	2nd quarter earnings season (less about Q2, more guidance)

Source: J.P. Morgan Asset Management

Chart 2. IMF downgrades its economic outlook



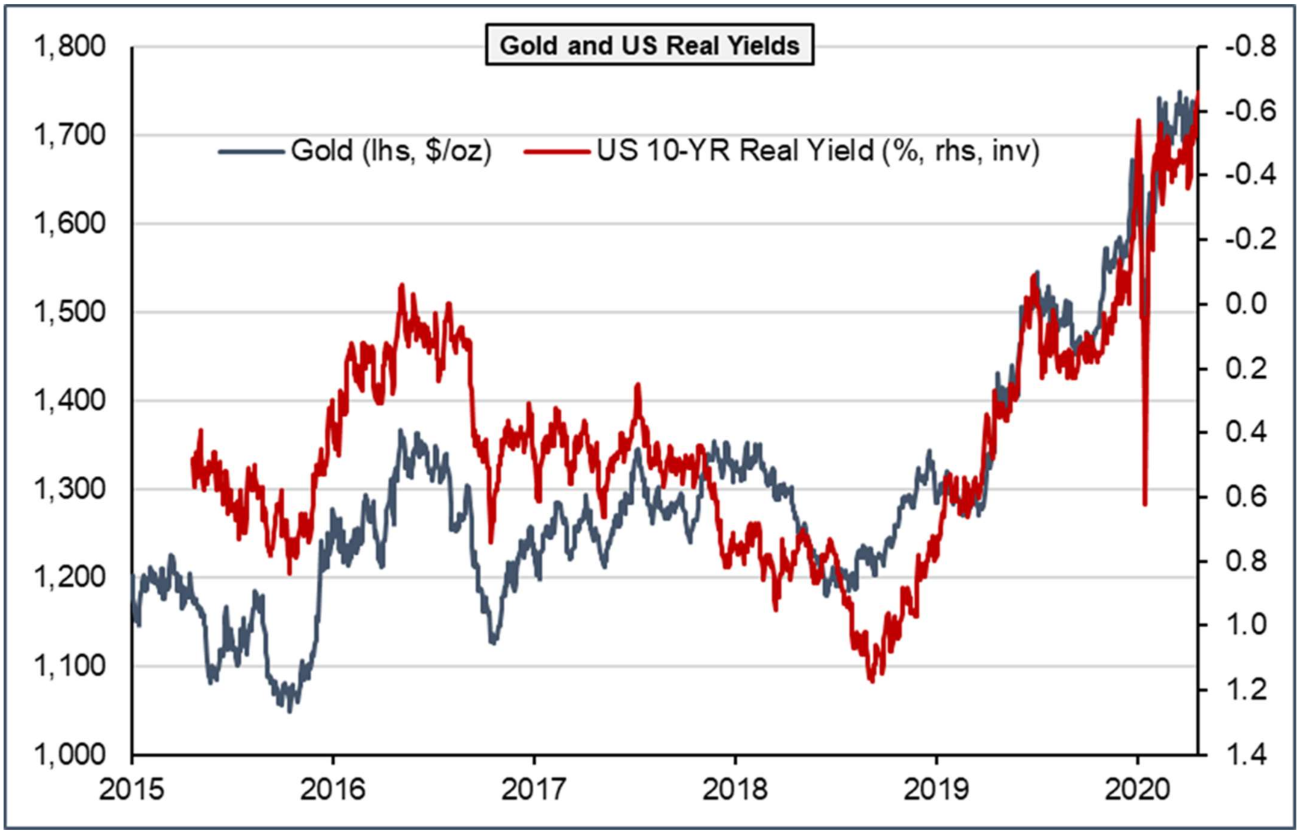
Global Economic Growth Forecasts

	Date of forecast	Global GDP (%) 2020f	2021f
IMF	06-Apr-20	-3.0	5.8
World Bank	08-Jun-20	-5.2	4.2
OECD	10-Jun-20	-6.0	5.2
IMF	24-Jun-20	-4.9	5.4

Source: IMF, World Economic Outlook, World Bank, OECD

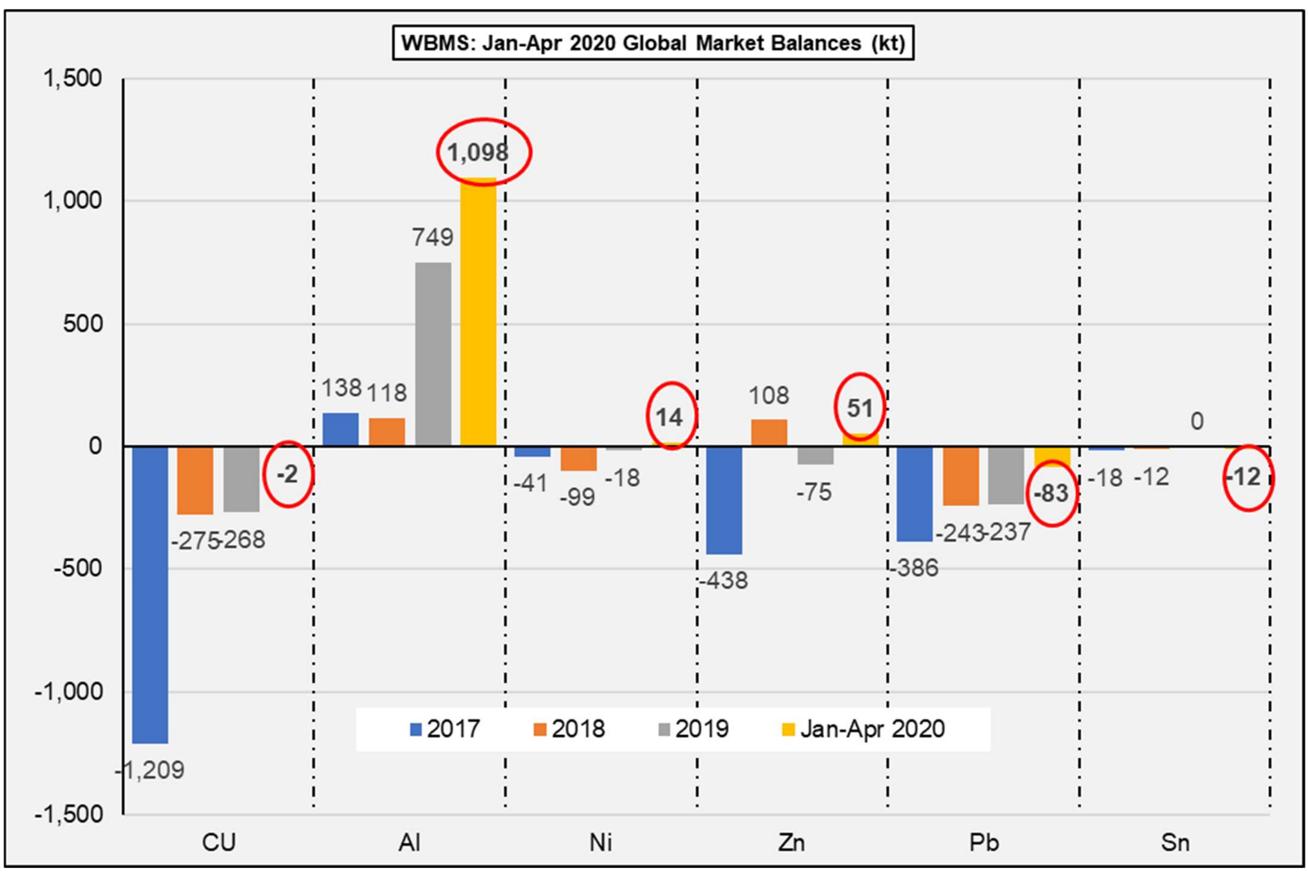
Charts of the Week

Chart 3. Gold tracking negative real yields



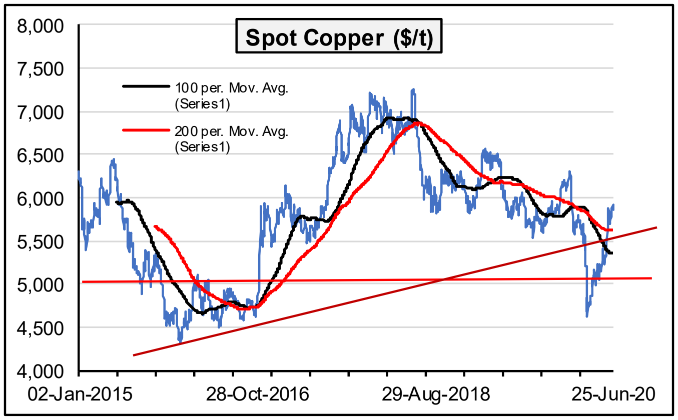
Source: Federal Reserve Bank of St. Louis, LBMA, RBMC

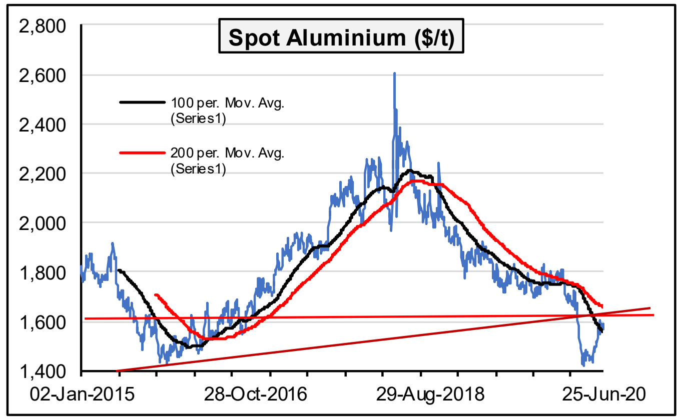
Chart 4. WBMS Market Balances, Jan-Apr 2020

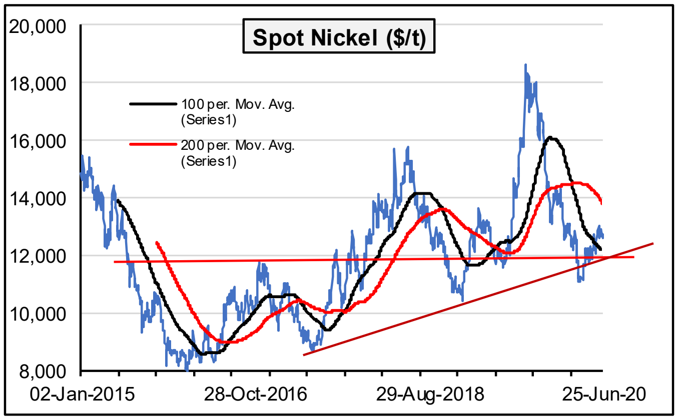


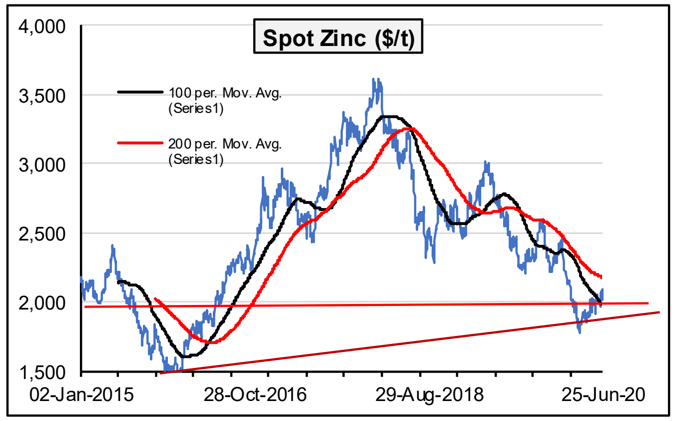
Source: WBMS, RBMC

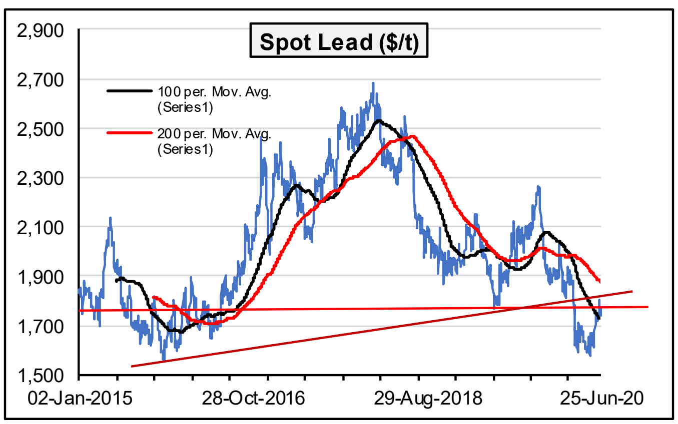
The Backpage – Industrial Metals

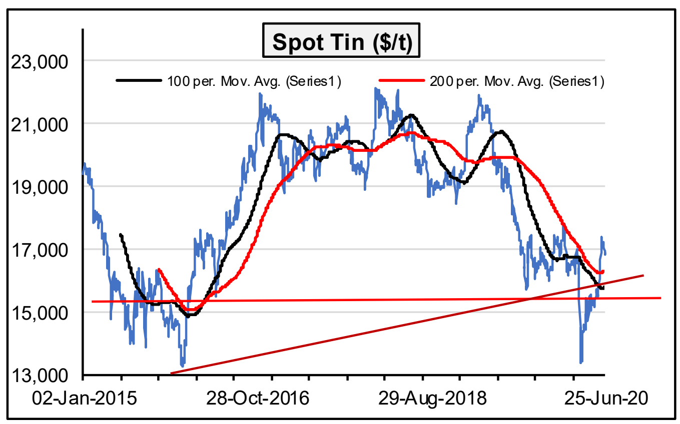


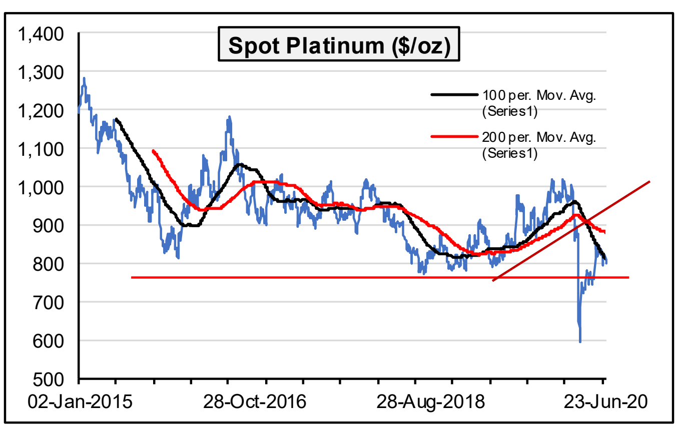


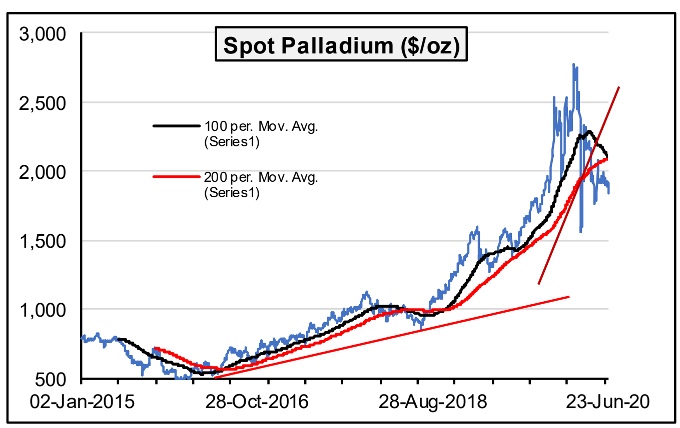












Source: LME, LBMA, LPPM, RBMC

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