RBMC

THE BHAR REPORT

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The Week in the Markets

Week of 28 August 2020 – Number 33

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	3,508	3,404	0.73%	92.4	6.86	$43.0	$1,964	3,017	$6,667	$1,800	$15,367	$2,515	$1,973	**$17,850**
Change w-o-w	**3.3%**	**0.7%**	**0.09**	**-0.9**	**-0.9**	**0.8%**	**1.2%**	**2.5%**	**2.4%**	**4.9%**	**2.3%**	**3.5%**	**1.2%**	**1.7%**

Macro Themes

As of 28 August, about 24.5mn **Covid-19** cases have been confirmed worldwide, and the death toll has surpassed 832k, according to Johns Hopkins University data. This week's focus is on a meeting of central bankers at the virtual Jackson Hole economic symposium where Jay Powell, the Fed chair, announced a shift in monetary policy. The **Fed** has adopted a new strategy that will be more tolerant of temporary increases in **inflation**, cementing expectations that the US central bank will keep **interest rates** at ultra-low levels for years to come. The move to an **average inflation target** will allow the measure to overshoot the Fed's 2% target to compensate for persistently low inflation. US rate traders are now requiring higher returns to offset inflation impairment - the 10-year and 30-year rates moved higher to 0.75% and 1.51%.

US stocks traded higher, as the **S&P 500** registered a new record high close, the index is now up 6.2% YTD (see **Dashboard**). Market sentiment may have been boosted by several reports suggesting progress on potential Covid-19 treatments and vaccines. The fact that stock markets reached fresh record highs indicates investors now behave as if a vaccine has arrived, which makes one wonder as to the action of the markets when a vaccine actually does arrive! Equities are rallying at a time of subdued **Treasury yields** (normally yields on US treasury bonds should be rising as bonds are sold to buy equities). Yields are low on expectations that the Fed will keep interest rates low for a long time. All things being equal, low interest rates justify higher equity valuations partly because fixed income investments become less attractive in comparison to equities and partly because big companies can access cheap financing. The historical relationship between **yields** and **growth** is important. On the one hand, the bond market is telling us the growth outlook is terrible and equities are due for a substantial correction. On the other hand, markets are now more heavily influenced by Fed policy than growth or inflation expectations. The supportive role played by suppressed government bond yields will shape the performance of equity, credit, and commodity markets for the foreseeable future (see **Chart 1**). The 10-year US treasury yield (so-called risk-free rate) of 0.6% bolsters the appeal of equity, credit, and commodity markets (via a weaker USD).

The suppression of **nominal** and **real bond yields** through **QE** has been accompanied by rising expectations of inflation, albeit from low levels. Typically, higher inflation expectations boost industrials and commodity stocks. Corporate dividends can be generally expected to match inflation over the long run. Fanning expectations of inflation by keeping a firm grip on bond yields is certainly the objective of central banks for the foreseeable future. Given huge **indebtedness** a move away from **disinflation/deflation** to inflation would be welcomed.

Economic data in the **US** is beating expectations (industrial production, housing, durable goods, retail sales) on a level that may be unprecedented. *Citigroup's* US Economic Surprise Index, which attempts to measure economic data relative to forecasts, is at its highest level ever (see **Chart 2**). And it's not just the US, the same is true on a global level.

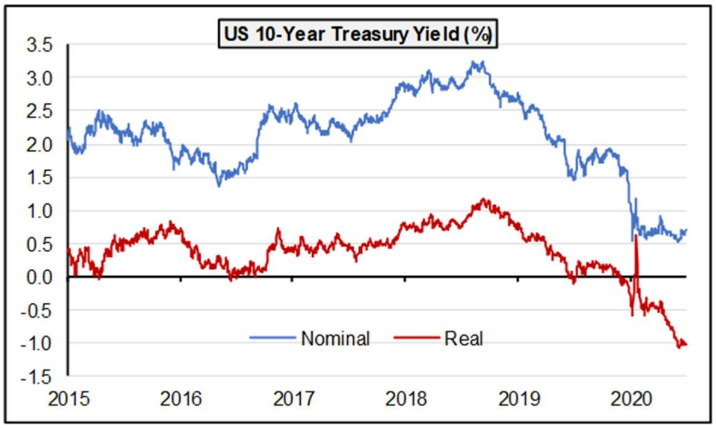
Precious Metals

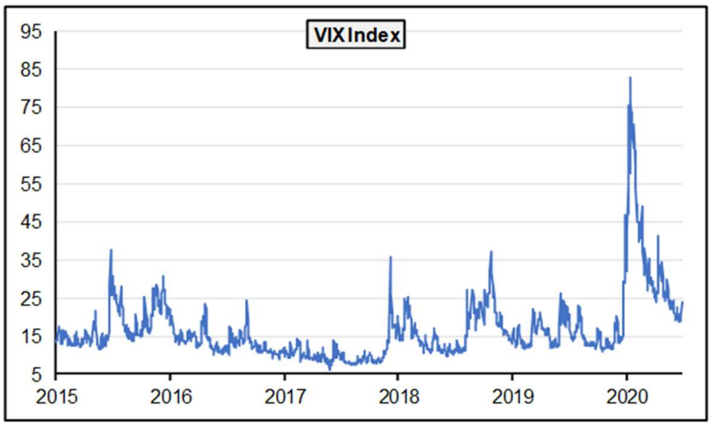
Gold prices were supported by the Fed's new policy strategy of ultra-low interest rates but sold-off as chair Powell suggested the Fed would act if inflation rose considerably above the 2% average. Since about 2006, gold has traded like an asset with nearly 30 years' real duration (meaning that a 100-basis-point move lower in US Treasury real yields has translated to a roughly 30% increase in the price of gold), according to *PIMCO*. While the spot price of gold has soared recently (as Treasury yields sank), the real-yield adjusted price of gold (the gold price discounted by the level of real yields for its empirical duration) has held quite steady. Over the last 15 years, the real-yield-adjusted price of gold has traded in a narrow range with a couple of exceptions (see **Chart 3**). Despite the recent run-up in gold prices, PIMCO believe gold remains attractively valued – one might even say cheap – in the context of historically low real interest rates. The key risk is that real interest rates rise, making gold relatively less attractive. At current valuations, however, there is some cushion against this view, with the real-yield-adjusted gold price at the lower end of its range for the last 15 years. Our base case is that rates remain relatively range-bound; this outlook, combined with our view that momentum and interest in gold causes the real-yield-adjusted gold price to move higher, points to gold still having more upside from here. Some combination of higher gold prices, a weakening USD and rising bond yields is necessary for **silver** to sustain above key resistance around $30/oz if previous trends repeat. The **PGMs** were mixed, **platinum** gained on some bargain hunting while **palladium** failed to sustain a move above $2,200/oz, as demand is expected to drop by more than supply this year. Western Europe's diesel car market share was 28.2% in July compared to 32.3% a year ago. Germany's diesel car market (excluding diesel hybrids) fell below 30% for the first time in recent years, according to *LMC Automotive*. **Platinum**-rich diesel cars have been losing out to expanding gasoline, and more recently electric vehicle markets since 2016, according to *Heraeus*. Demand for EVs, in particular, is being incentivized by the post-Covid-19 subsidy schemes on offer in some of Europe's largest car markets. Western Europe accounts for 15% of global platinum demand (ex. investment), at ~1moz**.**

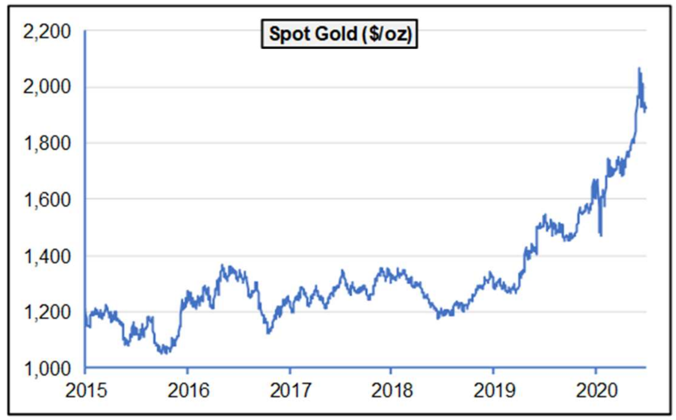
Base Metals

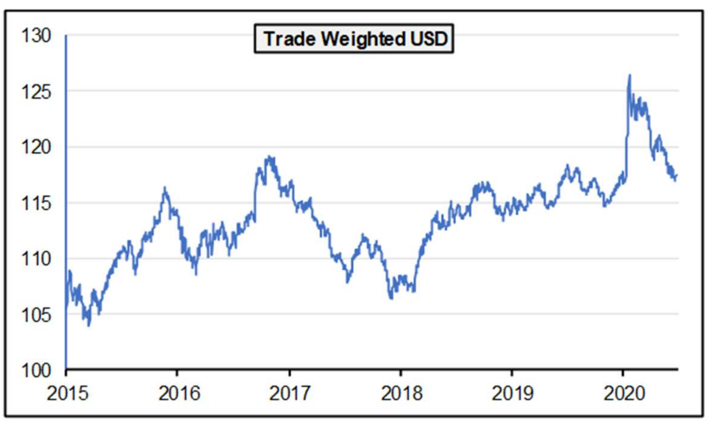
The huge stimulus provided by central banks has also helped to lift asset prices, including industrial metals. Sure, central banks are mostly buying bonds, but this provides the wind beneath the wings of almost all asset classes, including **industrial metals**. The **base** complex made gains on the week with **nickel** leading the way higher. Investors and market participants are becoming increasingly concerned about nickel supply issues just as Chinese demand is taking off. Recently nickel laterite ore prices have been continuously rising amid declining inventories at Chinese ports, which are at their lowest for two years. Stainless steel mills in China have been keen to snap up any material as stimulus measures boost demand for its products. Stainless steel margins have also improved recently, which should be supportive for nickel demand. There are three key questions for the nickel market in the longer run. The first is how fast will electric vehicles penetrate the auto fleet? The second is what mix of battery chemistries (LFP, NMC, NMA) will power those vehicles? The third is what will be the "steady state" marginal cost of converting the abundant global endowment of laterite ores (account for 80% of geological resources) to a high-grade nickel product suitable for use in battery manufacturing. The *International Copper Study Group* (*ICSG*) released preliminary data for May 2020 and Jan-May 2020 world **copper** supply and demand. In the first five months of 2020, the world refined copper balance, based on apparent Chinese usage (excluding unreported/bonded stocks), indicated a balanced market (1kt surplus) rather than a feared substantial surplus (see **Chart 4**). The world refined copper balance adjusted for changes in Chinese bonded stocks indicated a market deficit of about 30kt. Fundamentally, this robust data justifies the strong rebound in prices, as the drop in mine output and scrap flows exceed the demand impact from Covid-19. As of the end of July, copper stocks held at the major metal exchanges (LME, COMEX, SHFE) totalled 367,185t, an increase of 64,798t (21%) from stocks held at the end of December 2019. Stocks were up at SHFE (+29%) and COMEX (+138%) and down at the LME (-12%). Total visible stocks (exchanges + bonded) fell 40% to below 600kt from March to end-July (see **Chart 4**). World ex-China stocks represent one weeks consumption. Total Chinese stocks represent less than two weeks consumption. Metals markets **data** is shown on **The Backpage.**

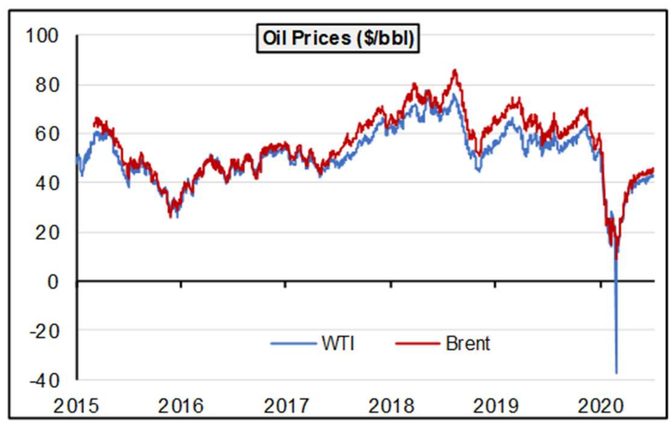
Dashboard – What You Need to Know

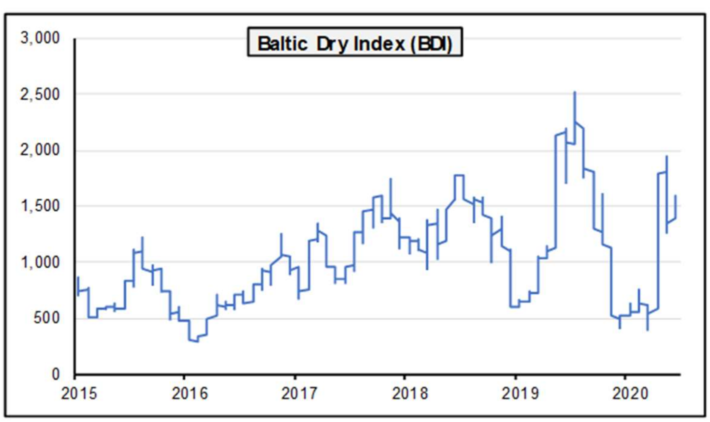


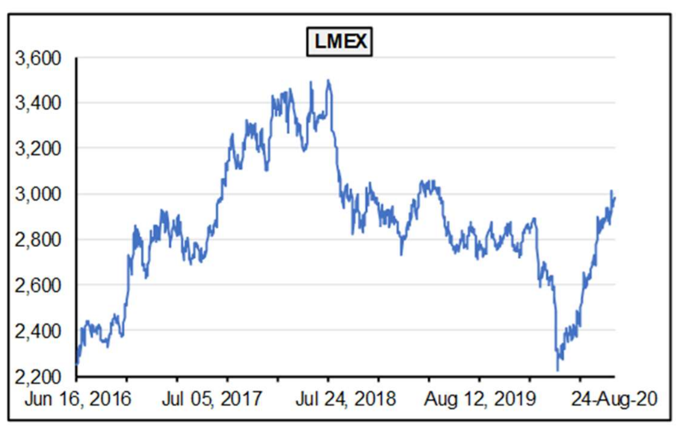








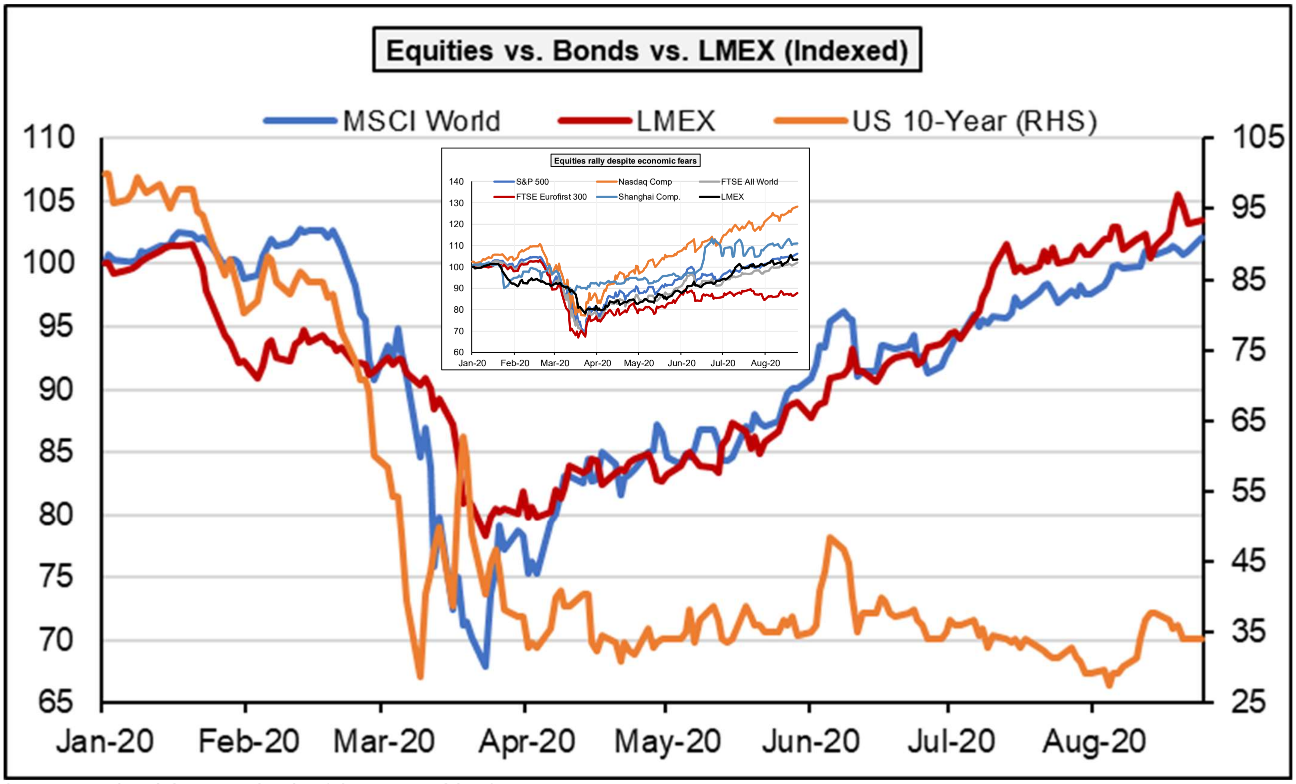




Source: Federal Reserve Bank of St. Louis, Trading Economics

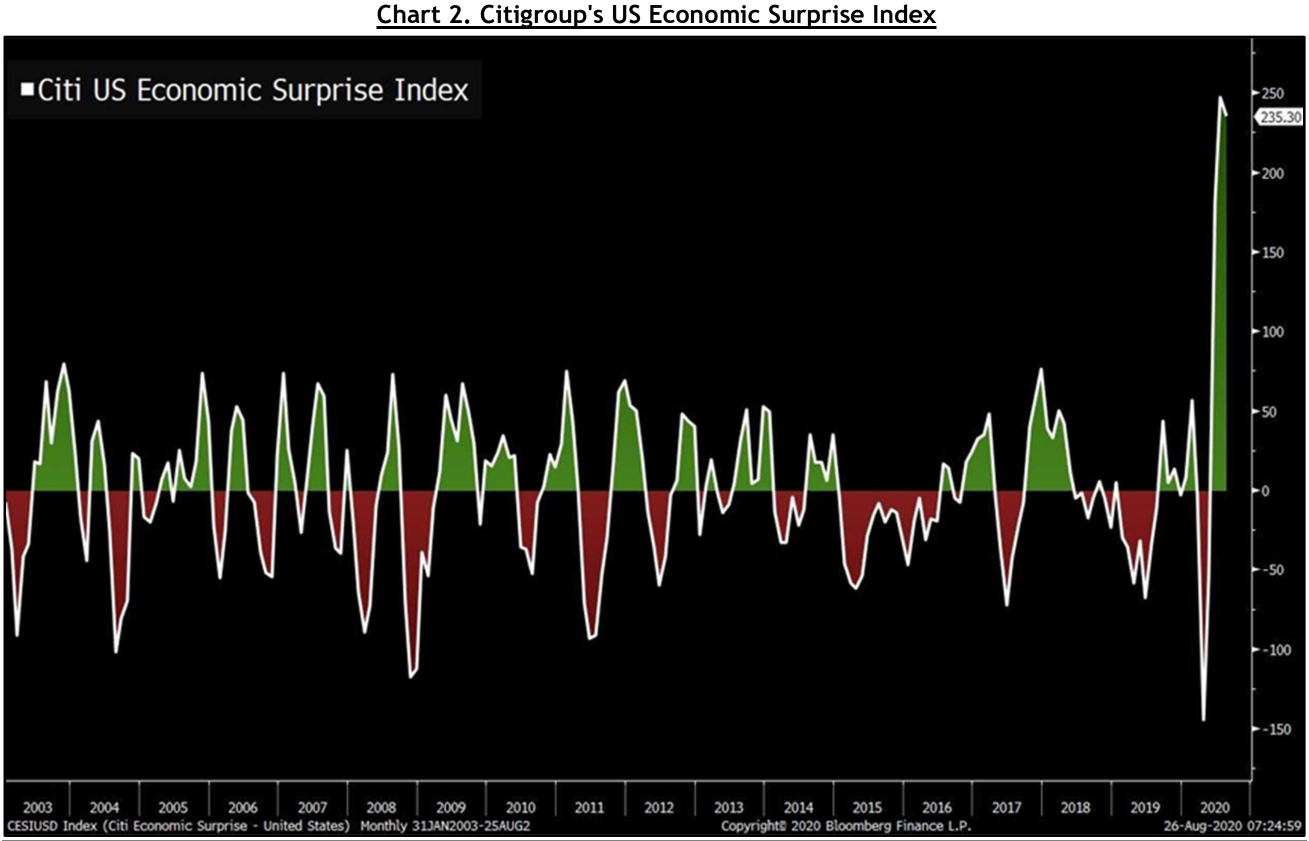
Charts of the Week

Chart 1. Suppressed bond yields bullish for equities and metals



Source: Federal Reserve Bank of St. Louis, RBMC

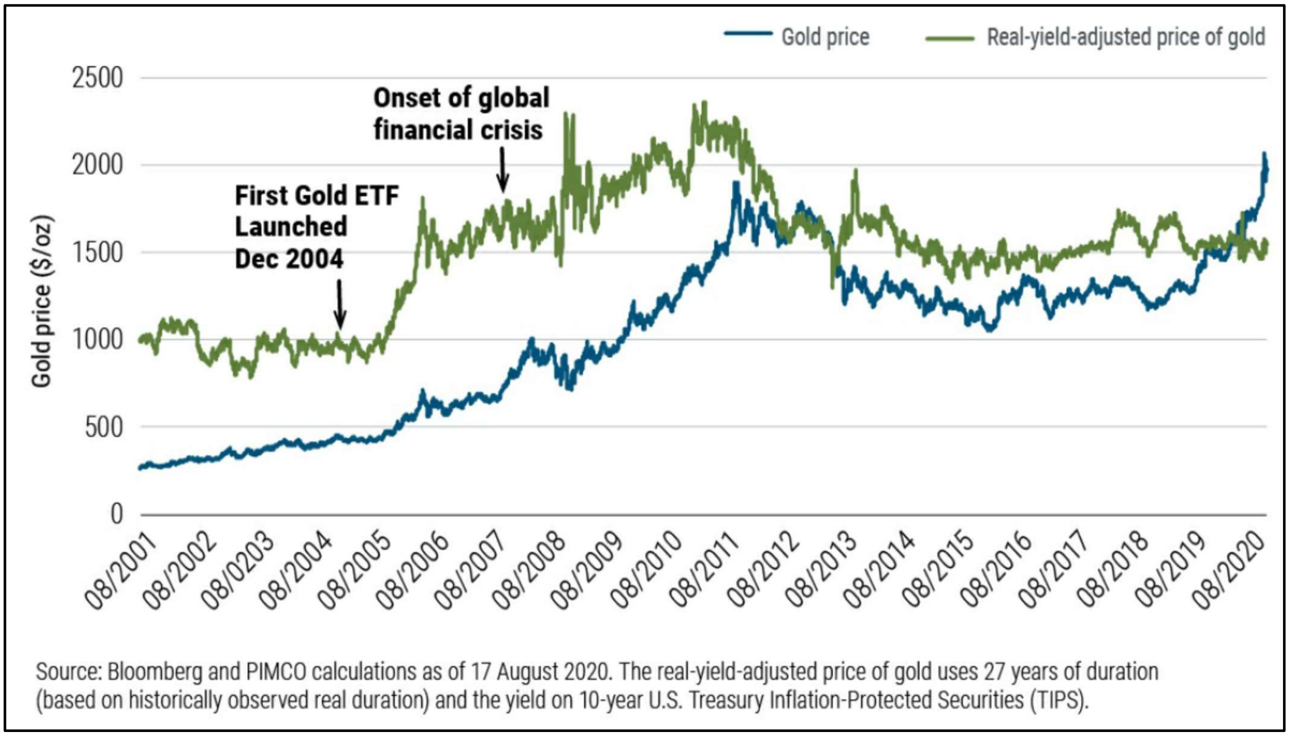
Chart 2. Citigroup's US Economic Surprise Index



Source: Citi

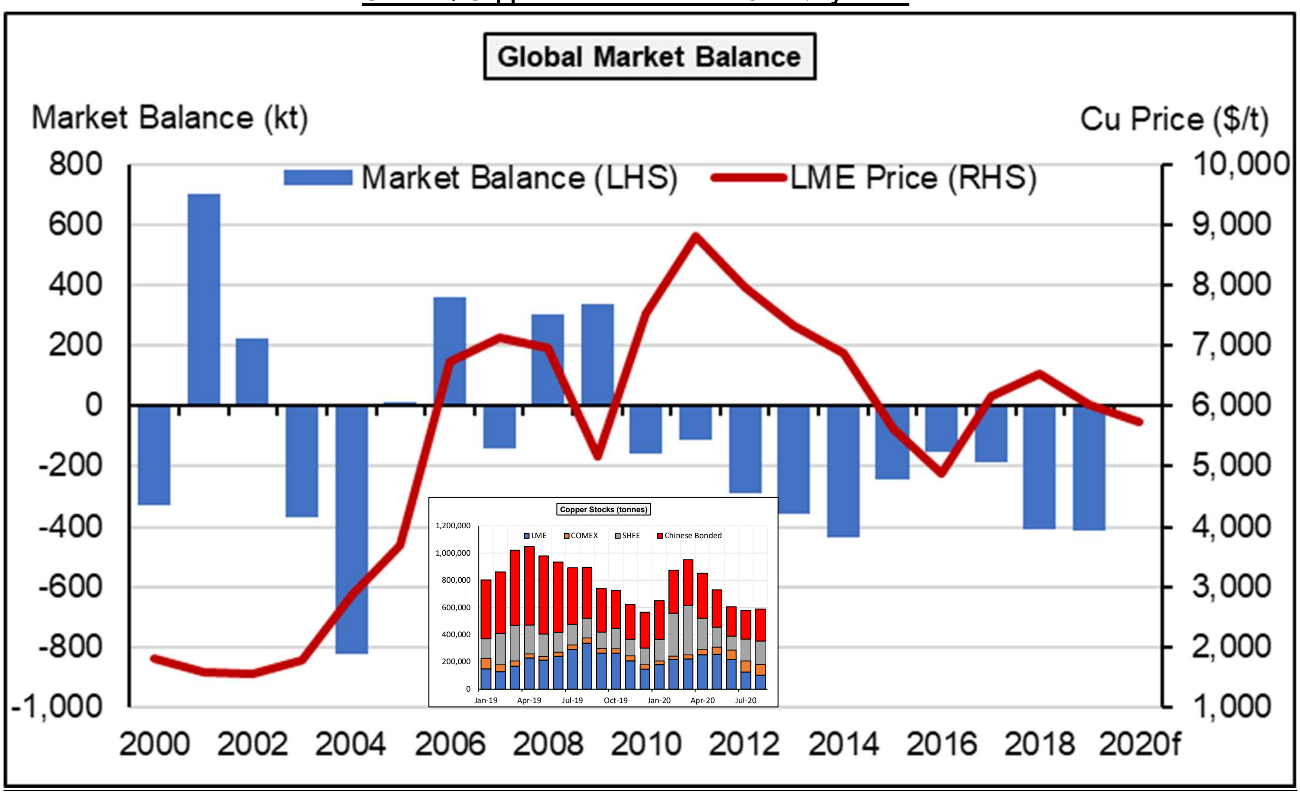
Charts of the Week

Chart 3. Gold is trading near the lower end of its multi-year real-yield-adjusted price range



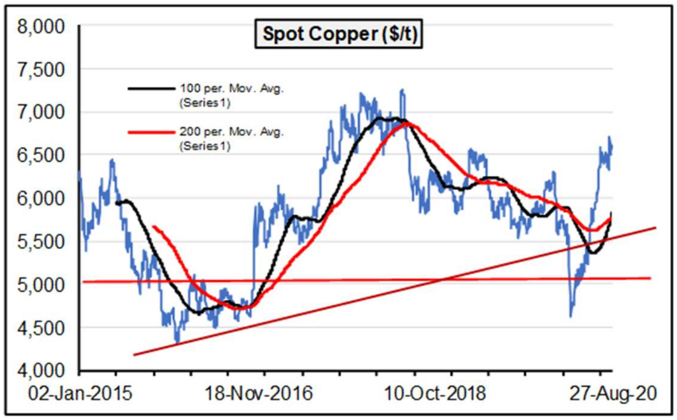
Source: PIMCO

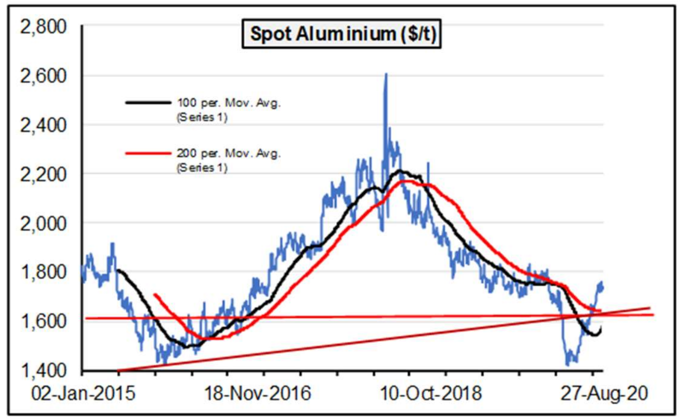
Chart 4. Copper market balance Jan-May 2020

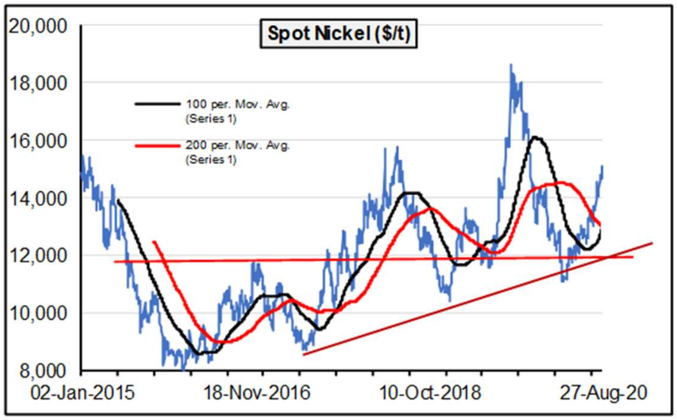


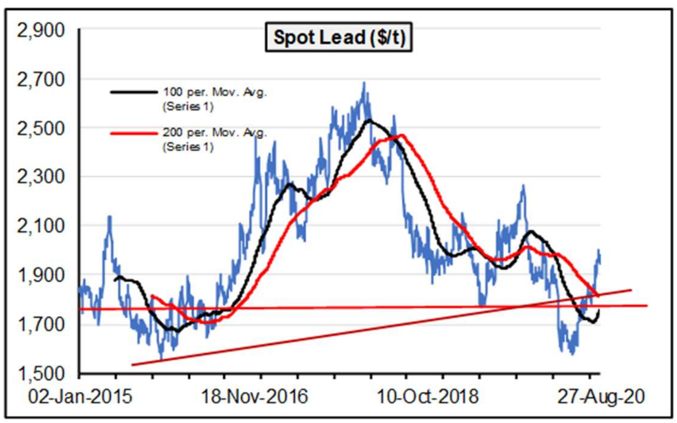
Source: ICSG, RBMC

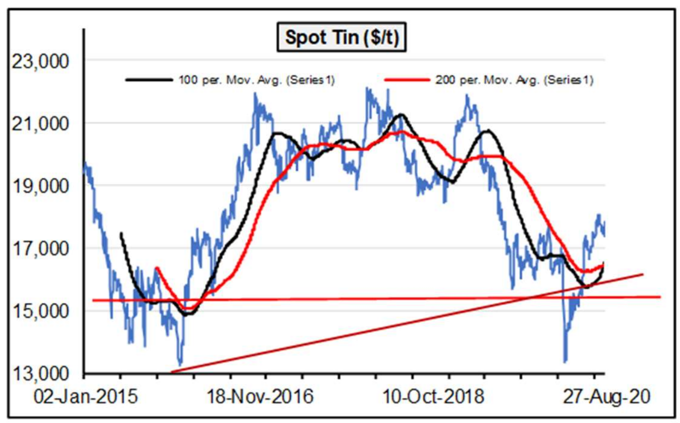
Charts: Industrial Metals

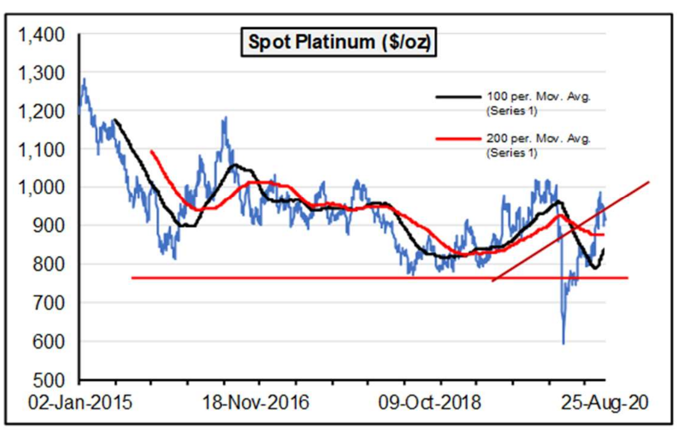


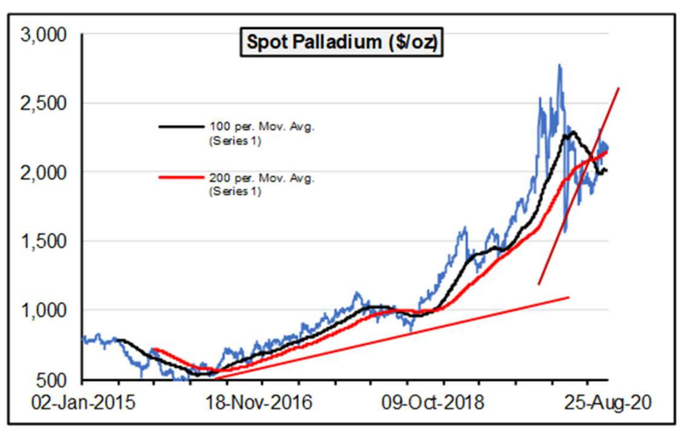












Source: LME, LBMA, LPPM, RBMC

The Backpage - Metals Markets Data

Base Metals Inventories (tonnes)					
Copper	**28-Aug-20**	**Week-Ago**	**Month-Ago**	**3m-Ago**	**Year-Ago**
LME	89,350	103,475	134,025	218,175	334,700
LME Cancelled Warrants	48,025	50,550	89,175	75,725	59,025
SHFE	170,086	172,266	159,513	310,760	143,876
COMEX	77,457	79,284	80,263	26,049	38,909
GLOBAL	336,893	355,025	373,801	554,984	517,485
Aluminium	**28-Aug-20**	**Week-Ago**	**Month-Ago**	**3m-Ago**	**Year-Ago**
LME	1,554,375	1,355,900	1,658,175	1,082,150	936,225
LME Cancelled Warrants	231,350	218,200	274,150	218,850	276,825
SHFE	251,037	246,900	221,819	439,087	361,977
COMEX	42,365	46,687	32,895	17,987	6,572
GLOBAL	1,847,777	1,649,487	1,912,889	1,539,224	1,304,774
Nickel	**28-Aug-20**	**Week-Ago**	**Month-Ago**	**3m-Ago**	**Year-Ago**
LME	238,974	238,950	234,852	235,428	150,510
LME Cancelled Warrants	60,054	59,718	56,382	55,098	37,716
SHFE	33,374	34,160	34,215	34,900	25,262
GLOBAL	272,348	273,110	269,067	270,328	175,772
Zinc	**28-Aug-20**	**Week-Ago**	**Month-Ago**	**3m-Ago**	**Year-Ago**
LME	219,950	226,300	173,000	75,275	68,625
LME Cancelled Warrants	9,625	11,225	18,250	20,500	24,925
SHFE	75,010	77,629	88,347	160,011	72,062
GLOBAL	294,960	303,929	261,347	235,286	140,687
Lead	**28-Aug-20**	**Week-Ago**	**Month-Ago**	**3m-Ago**	**Year-Ago**
LME	125,425	125,575	117,600	67,800	78,325
LME Cancelled Warrants	12,075	11,200	15,425	17,000	4,675
SHFE	27,580	32,403	32,938	38,011	31,079
GLOBAL	153,005	157,978	150,538	105,811	109,404
Tin	**28-Aug-20**	**Week-Ago**	**Month-Ago**	**3m-Ago**	**Year-Ago**
LME	5,265	5,240	4,015	2,455	6,755
LME Cancelled Warrants	335	220	180	1,025	470
SHFE	3,628	3,584	3,283	3,491	5,076
GLOBAL	8,893	8,824	7,298	5,946	11,831

Open Interest (lots)					
	28-Aug-20	**Week-Ago**	**Month-Ago**	**3m-Ago**	**Year-Ago**
Copper	317,328	331,061	307,043	286,964	310,473
Aluminium	758,321	789,906	765,119	790,983	667,276
Nickel	113,219	212,086	108,035	105,662	108,520
Zinc	220,485	221,301	208,924	191,756	229,431
Lead	212,028	113,918	198,220	201,811	277,215
Tin	16,584	16,405	16,304	16,173	16,093

Moving Averages					
	Cash	**10-DMA**	**40-DMA**	**100-DMA**	**200-DMA**
Copper	6,667	6,557	6,443	5,827	5,776
Aluminium	1,800	1,735	1,690	1,580	1,644
Nickel	15,367	1,961	1,876	1,760	1,812
Zinc	2,515	2,437	2,293	2,103	2,140
Lead	1,973	14,751	13,950	12,975	13,045
Tin	17,850	17,532	17,579	16,560	16,468

Support, Resistance and RSI					
	S1	**S2**	**R1**	**R2**	**RSI**
Copper	6,465	6,252	6,709	7,027	63
Aluminium	1,740	1,704	1,806	1,813	63
Nickel	1,956	1,931	2,025	2,038	64
Zinc	2,363	2,321	2,598	2,620	72
Lead	14,530	14,000	15,500	15,750	79
Tin	16,795	16,405	18,000	18,250	60

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