Unprecedented, Unexpected and Unprepared: Analyzing The Covid-19 Impact on Metal Markets

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April 2020

Todays Agenda

Macro Backdrop:

- Unprecedented health crisis quickly morphed into an economic one

Outlook for Gold:

- More bullish trajectory than the 2009-2012 Cycle

Outlook for Silver:

- The ‘tagalong’ awaiting a growth inflection point and/or catalyst

Outlook for PGMs:

- Longer term is clearer than the short term - a new cycle, an era of higher (PGM) prices

Outlook for Copper:

- A 2nd frustrating year for bulls -- new surplus with a U-Shaped recovery; upside bias on macro factors in s/t, fundamentally stronger in l/t

Outlook for Aluminum

- Hard-hit by demand destruction to transportation and now awaiting supply response

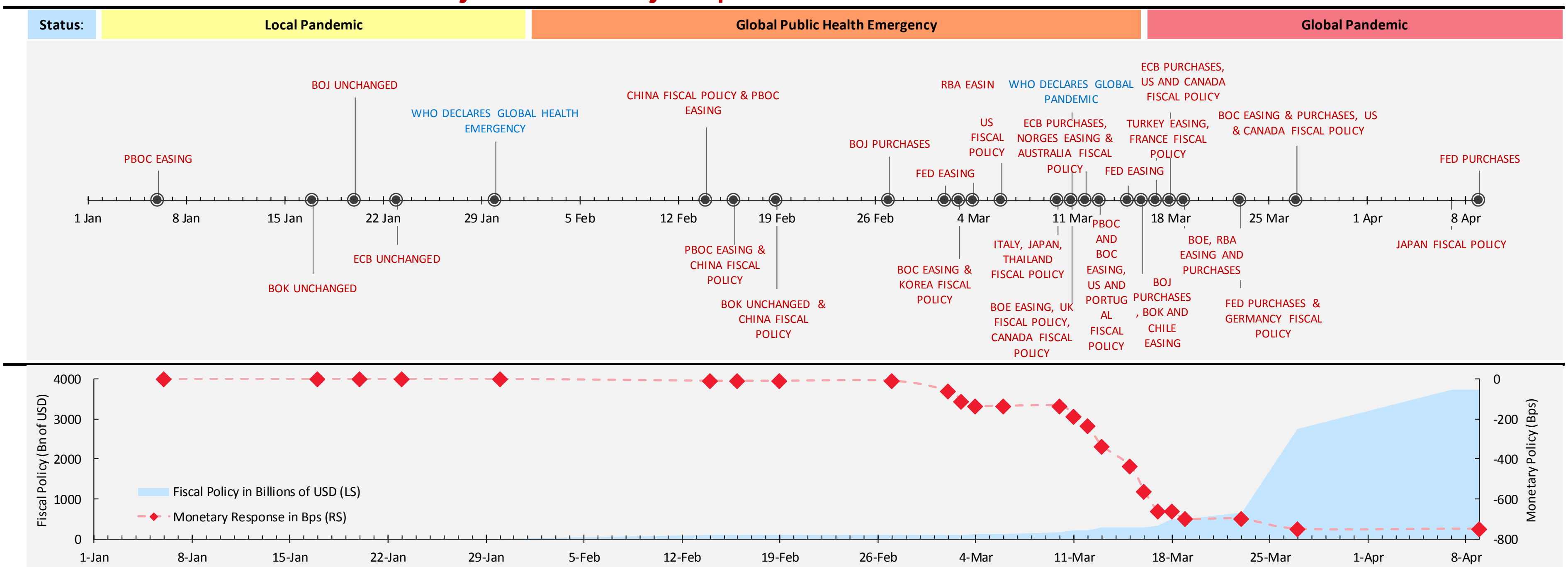
Macro Summary: Navigating Various Crises in a Ever-Faster News, Data & Policy Cycle

- A deflationary demand crisis, a supply chain crisis, a labor market crisis and an energy price crisis.
- From Trade to COVID-19: similar phenomenon (borders-up protectionism)
- Policy action: ‘too much’ (cascading and extended lockdowns) because ‘too late’
- Larger tail risks: “V-U-or L”, but also “↓” or “Nike Swoosh” recoveries?

Macro Summary: Unprecedented monetary & fiscal policy

- Both have started earlier and ramped up faster than anytime in history.
- Swift pre-emptive totalitarian action by governments, creates an ugly precedent for permanently bigger government, surveillance states.
- Correlated but not coordinated policy response; 750bps of global rate cuts (620 bps driven by G-10 CBs) and almost $4 tn has been pledged by COVID-19 affected countries!

Covid-19 Affected Countries Monetary & Fiscal Policy Response Timeline



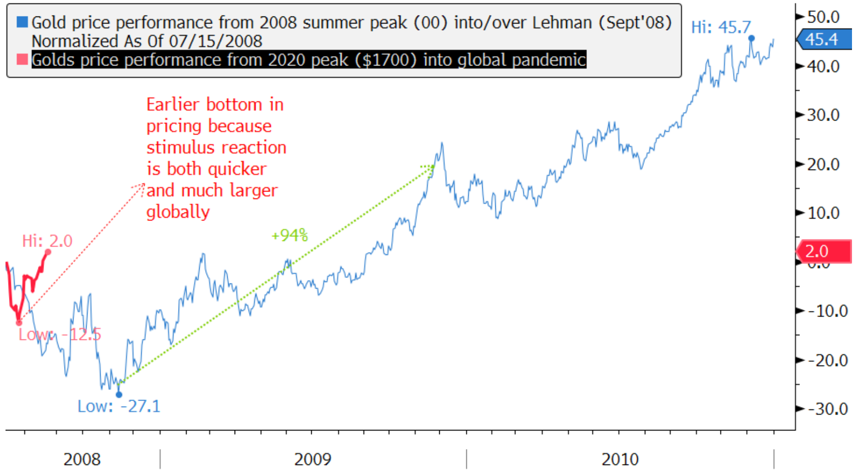
Note: Fiscal policy numbers are converted using exchnage rates on the day of announced policy. Easing equates to traditional rate cuts and not repo operations.

Source: Scotiabank Commodity (Metals) Strategy

Gold: Navigating the Deflationary-Inflationary Signals

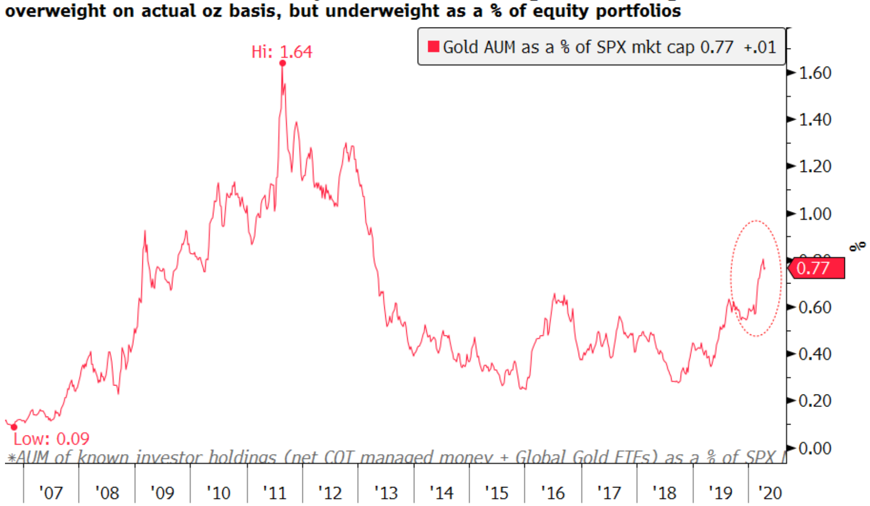
- Gold has found it post crisis floor.
- Large dislocations between paper/physical after some hefty margin related selling.
- Fast money positioning is a lot cleaner.
- Max macro fear has dialed back from extreme levels.
- New super bullish structural themes have emerged faster than anticipated (bigger gov, unlimited QE, negative interest rates, unlimited deficits, Fed buying junk bonds, MMT-like policies).

Golds response into a crisis: into Lehman (2008) vs into COVID-19 (2020)
Most havens (ex cash/USD) are dumped during EXTREME market volatility, then rally



Source: Scotiabank Commodities Strategy, Bloomberg
GOLDS Comdty (GOLD SPOT $/OZ) COVID vs 2008 Daily 15JUL2008-31DEC2010 Copyright© 2020 Bloomberg Finance L.P. 13-Apr-2020 12:54:36

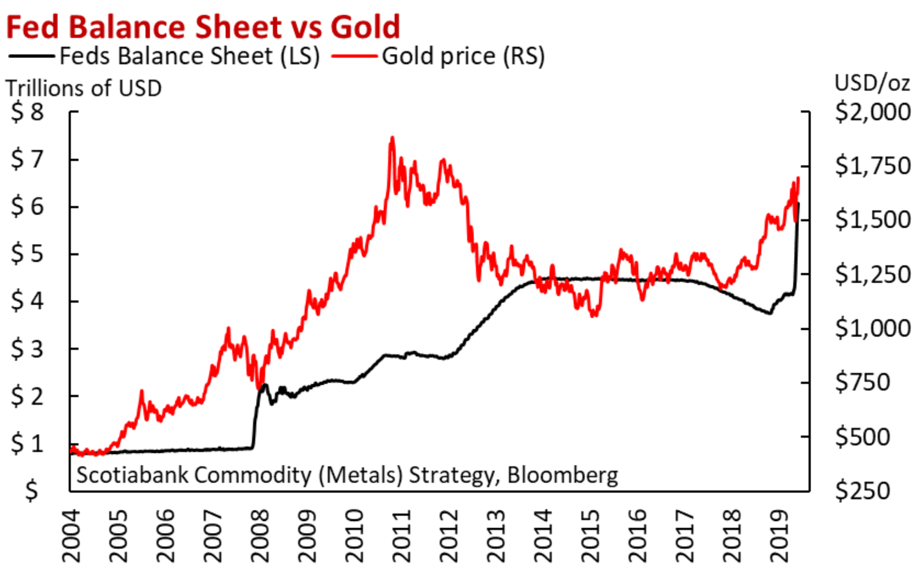
Investors: share of Gold in portfolios underweight but rising
overweight on actual oz basis, but underweight as a % of equity portfolios

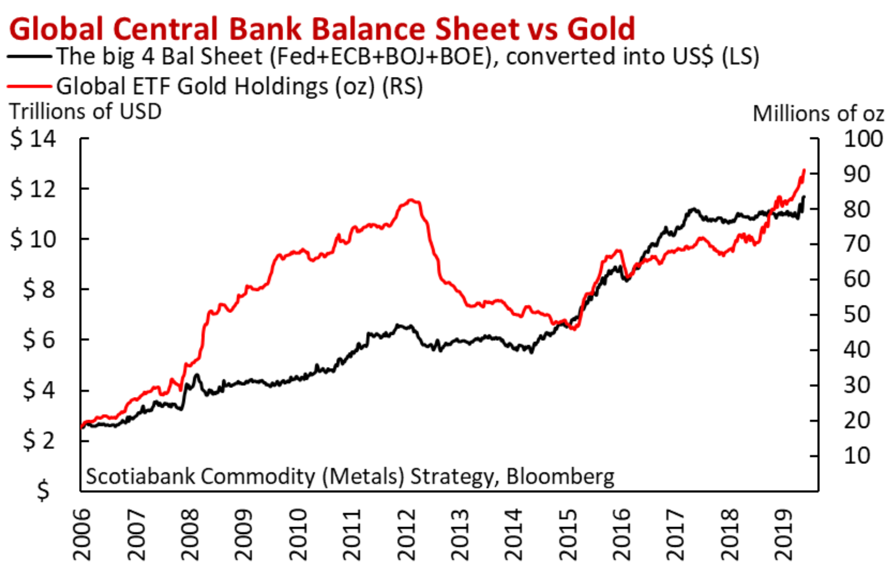


Source: Bloomberg, Scotiabank Commodities Strategy
.GC/SPX2 U Index (gold AUM as a % of SPX mkt cap) Gold AUM as % of SPX Weekly 2 Copyright© 2020 Bloomberg Finance L.P. 13-Apr-2020 12:56:05

Gold: More Bullish Trajectory Than The 2009-2012 Cycle

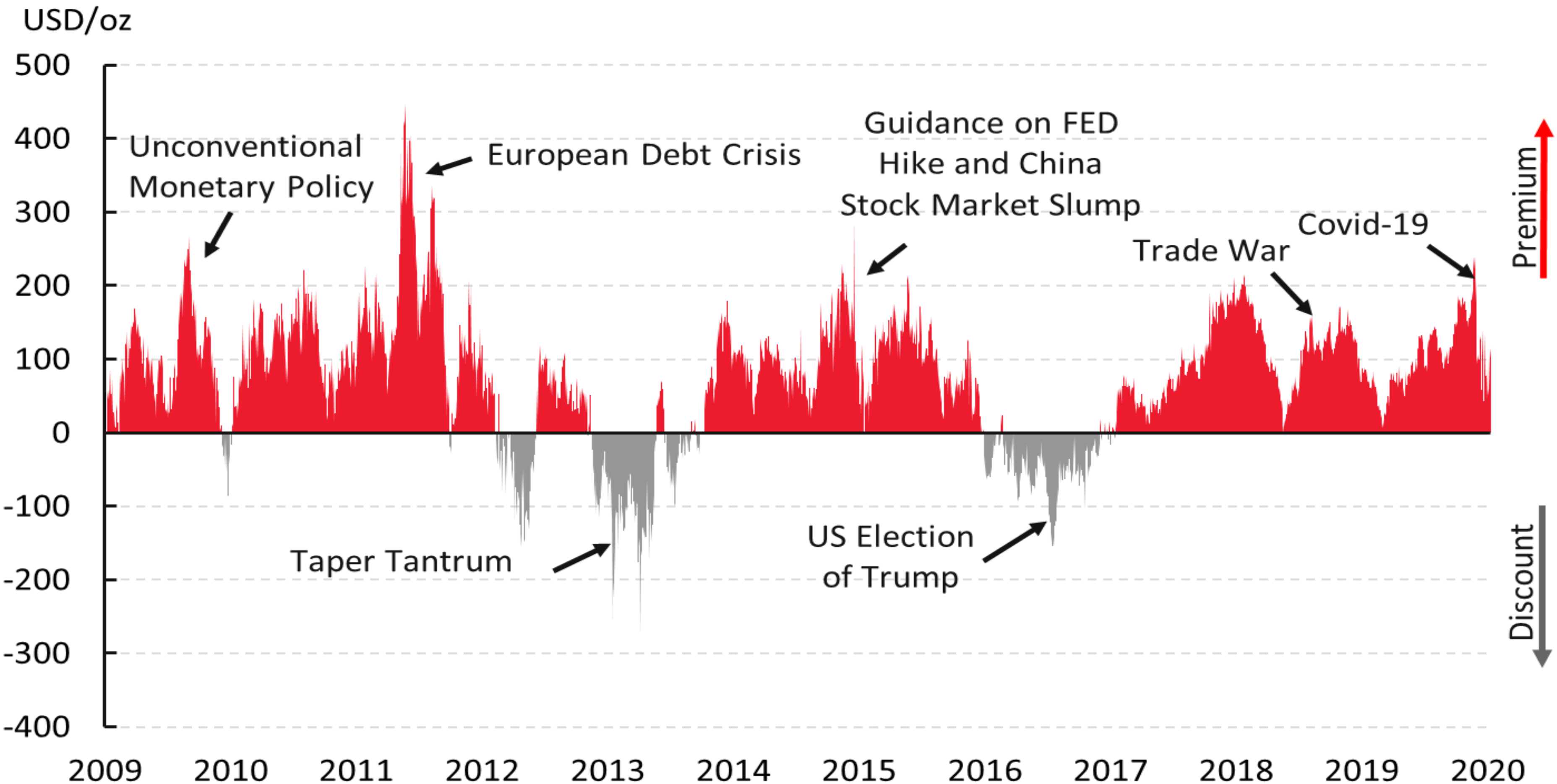
- Macroeconomic backdrop of lower & slower growth profile and unprecedented stimulus, never been better.
- BUT some short-term headwinds (liquidity, subdued Asian physical demand, inactive bullish CB activity).
- Largescale inflow from Western retail & institutional should offset weaker physical demand and the short-term headwinds.





Gold: More Bullish Trajectory Than The 2009-2012 Cycle

Gold Trades at a Fear Premium of $120

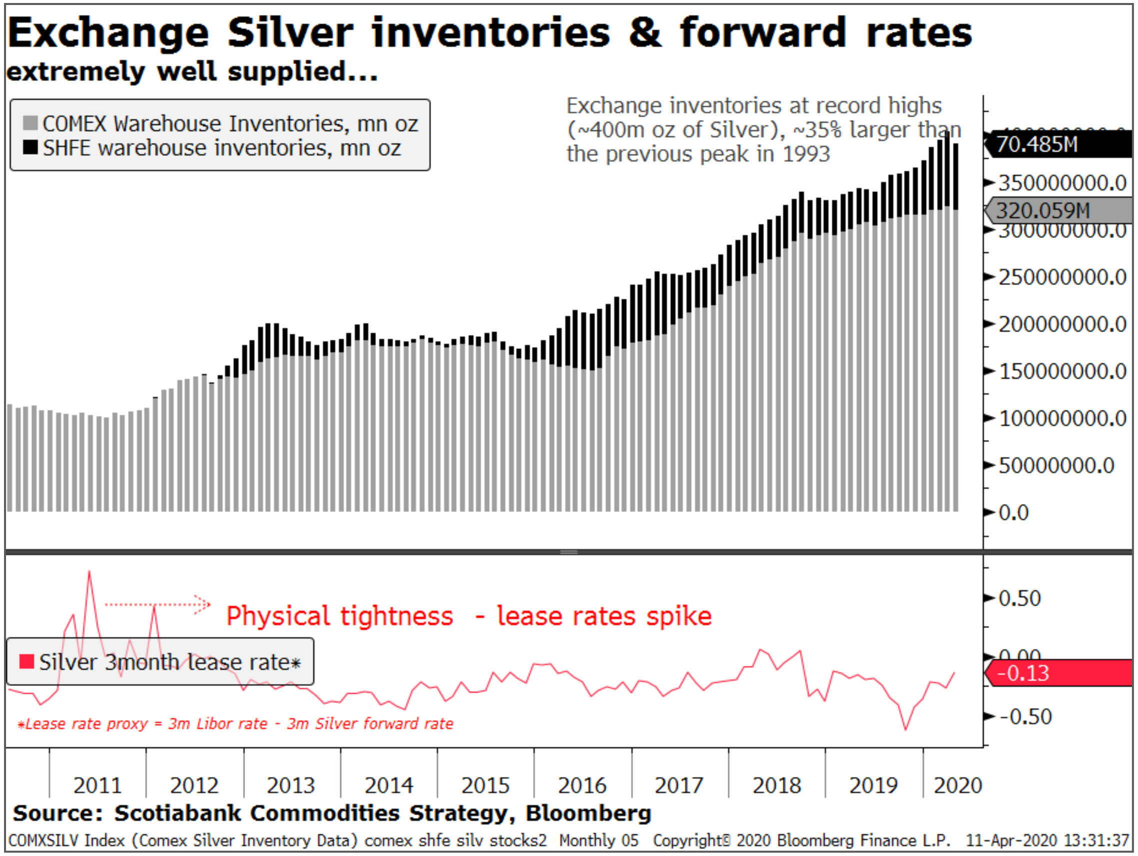


Source: Scotiabank Commodity Strategy (Metals) Calculations, Bloomberg
Note: Note: Premium/discount is estimated using a multi variate OLS robust regression model with a 10-year rolling window approach. Our features include the DXY, USDJPY, USDEUR, USDGBP, and the US 10-year real yield derived off the 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.

Silver: The ‘tagalong’ awaiting a growth inflection point or catalyst

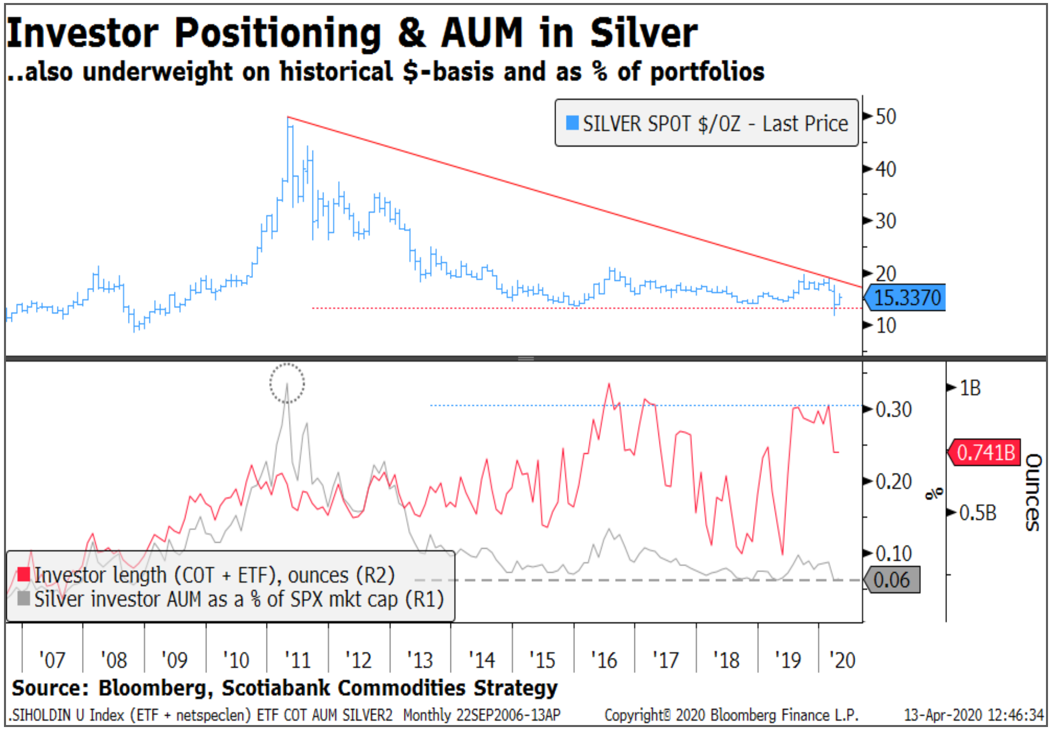
- Will begrudgingly tag behind any Gold rise and should continue to underperform in the near-term until the growth inflection point.

- Fresh catalyst emerging with 1/3rd of global supply down, but fundamentally requires years of deficits to substantially draw down inventories.



Silver: The 'tagalong' awaiting a growth inflection point or catalyst

- Fundamentally oversupplied but still attractive as a cheap high beta gold proxy.
- Gold/Silver ratio to remain in a less bullish uptrend as macro markets navigate from late cycle era to recovery period.
- Upside (>$20) dependent on: Gold outperformance, inflation and reflation risks AND fresh real demand drivers in medium term, potentially stemming from known (PVs) and nascent (auto) industries.



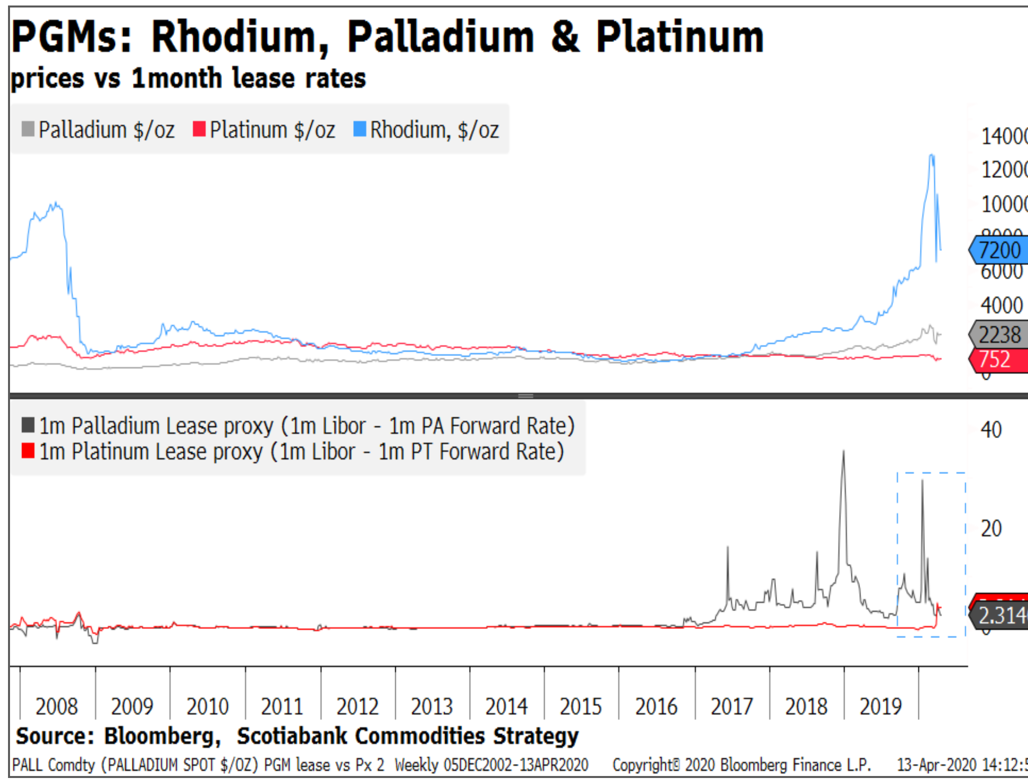
PGMs: A New Era of Higher Prices vs The Previous Decade

- (Bullish) longer-term is clearer than the (low conviction) shorter-term.

- With major supply disruptions in S.A due to national 5-week lockdown and ongoing logistical and transportation issues more than offsetting the negative demand impact auto plant closures in US, India & Europe.

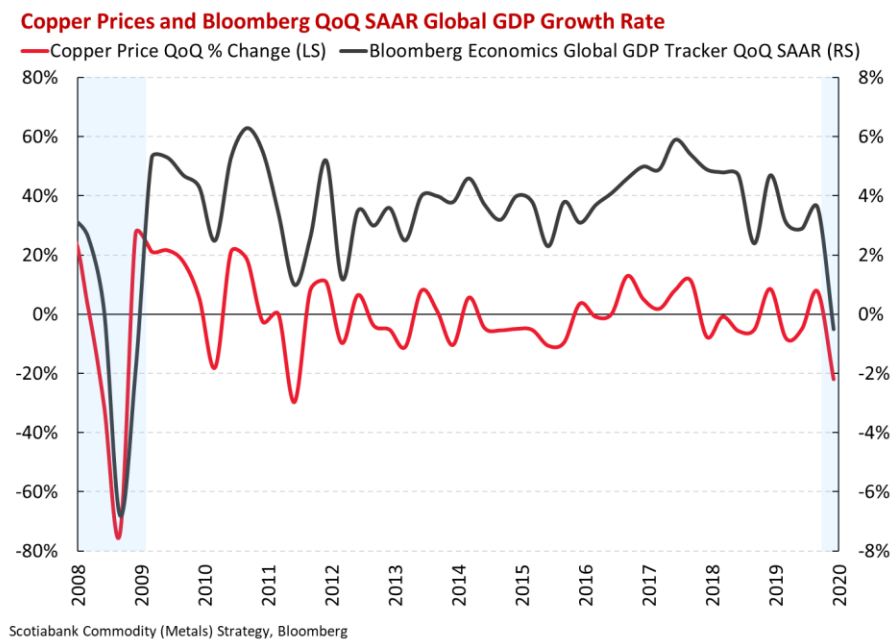
- Historically and relatively tighter metals (Palladium & Rhodium) are to remain super volatile with availability sporadic and tight, while Platinum's surplus is due to narrow.

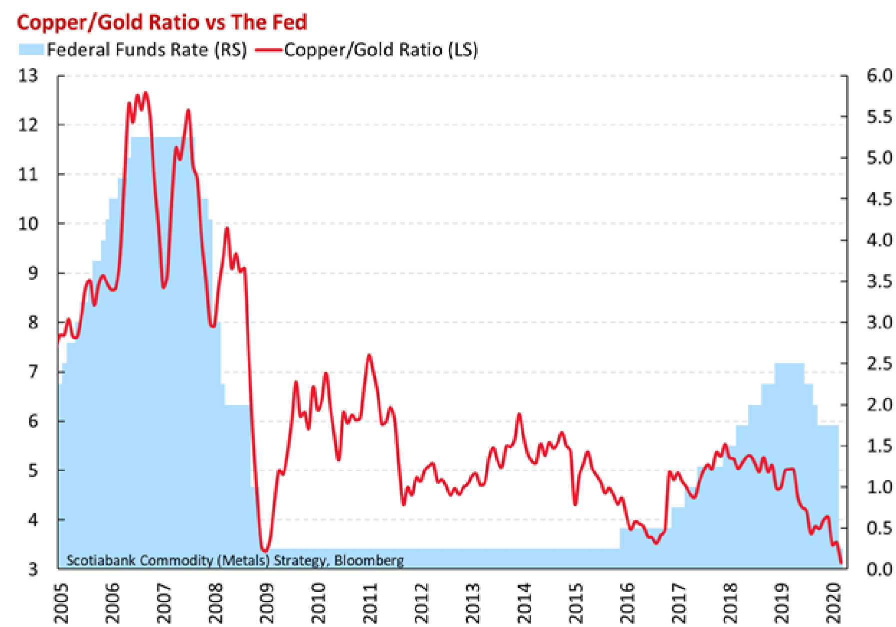
- Platinum should reset higher above $1000; palladium to average $2300+ in 2020.



Copper: A 2nd Frustrating Year for Bulls; New Surplus with a U-shaped recovery

- Demand destruction: falling 5.7% YoY in 2020; surplus of ~540k mt, but incremental & subsequent supply cuts ensure a ‘runaway surplus’ is thwarted, not reversed.
- Downstream indicators in China of copper demand is improving as factories re-open (fabricators are reportedly operating ~80% of usual utilization rates
- BUT major export headwinds loom large as the ROW has joined the cascading economic and social shutdowns. Some economic numbers confirm a soft ‘v-shaped’





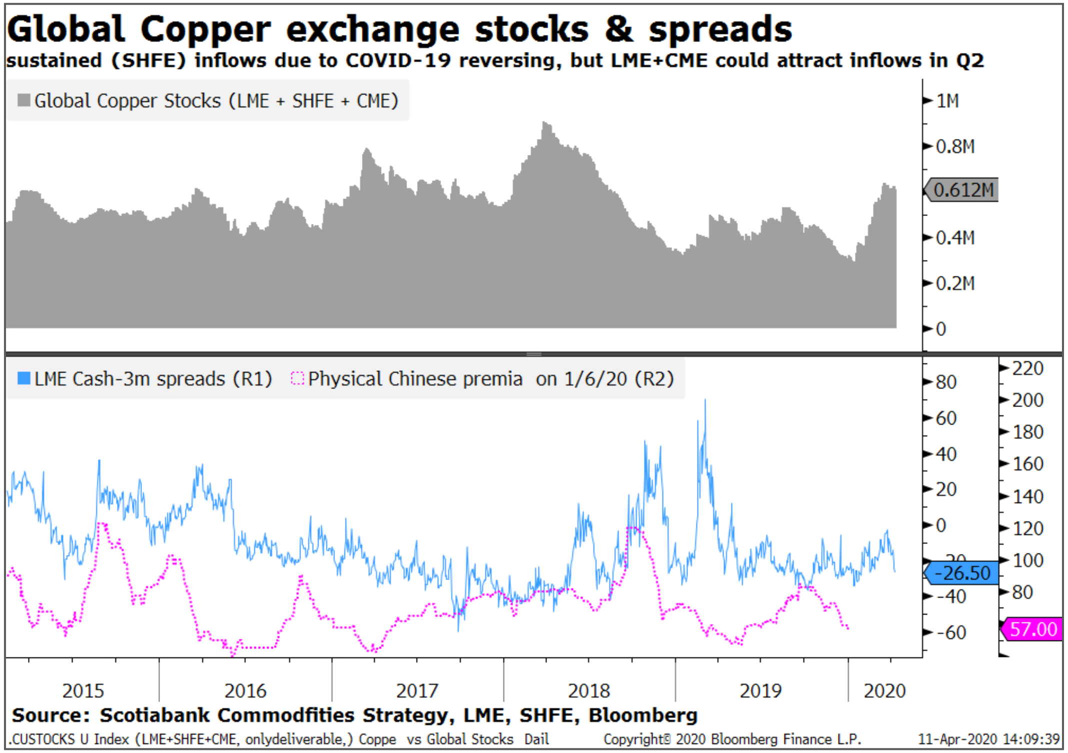
Copper: A 2nd Frustrating Year for Bulls; New Surplus with a U-shaped recovery

- Floors are in after macro uncertainty unwound and risk assets boosted with a possible infrastructure bill(s). Extremely under-positioned.

- The asymmetric response to the *fear* of demand, over the fear of supply will persist, limiting rallies in s/t

- Some demand will be lost, but most should be delayed until 2H and 'triggered' on any major stimulative efforts

  - Further announced supply cuts (<2% of global supply) 'fit the bullish narrative' but not the dominant driver.



Copper: A 2nd Frustrating Year for Bulls; New Surplus with a U-shaped recovery

- Conviction in short-term remains low as the virus containment remains fluid & headline risk high

- A new surplus but with "U-Shaped" recovery, $4500 - $5100 ($2.05-$2.30/lbs) comfort range with upside bias on macro factors.

- But underpriced below $5000 if outlook is 'v-shaped'.

- Upside risks include: Weaker USD, Flat-to-lower medium-term supply (grade declines & depletions), structurally higher energy prices, reflation, Chinese or US infrastructure spend

Ali: Hard-hit by Destruction to Transportation; Awaiting Supply Response

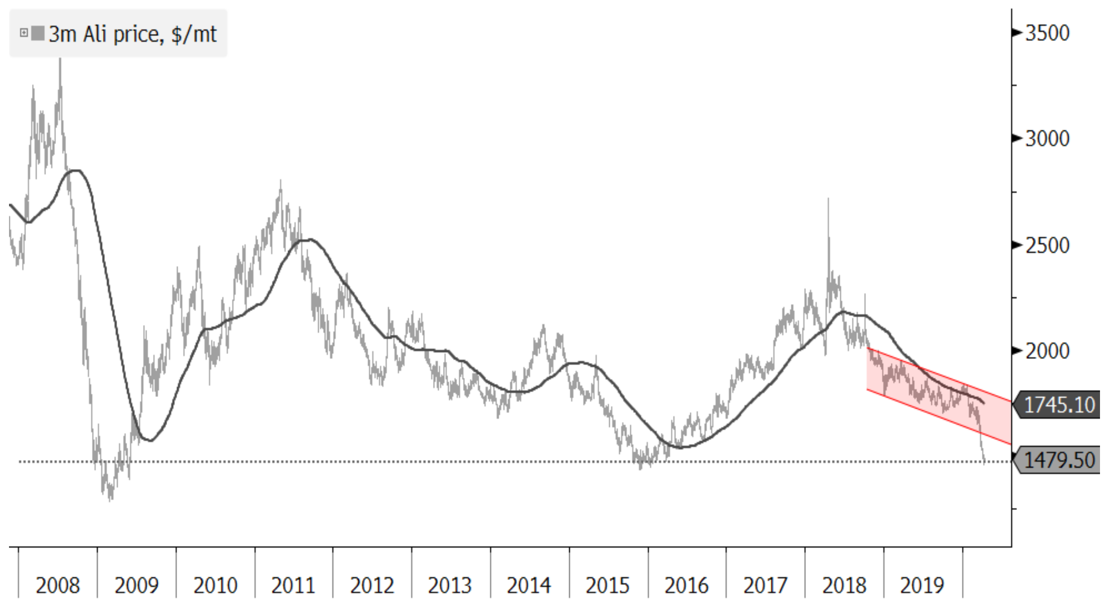
- The old slow grind lower accelerated with global national lockdowns and escalating auto closures; demand to drastically reduce by almost 10%.

- Outright prices are falling faster than falling cost of production costs (due to the oil/energy & alumina price collapse).

- Ali balance to post a larger surplus in 2020 closer to 4m mt; prices to average $1500/mt

- With prices through cash costs, ex-Chinese smelter closures and a slower ramp up of Chinese smelter expansions will lower surplus in 2H’2020 and particularly in 2021

Ali - the persistent grind lower
breaks below downtrend channel



Source: Bloomberg, Scotiabank Commodities Strategy
LMAHDS03 Comdty (LME ALUMINUM 3MO ($)) Ali tech 2 Daily 15NOV2007-13APR2020 Copyright© 2020 Bloomberg Finance L.P. 13-Apr-2020 14:57:32

Other Base Metals

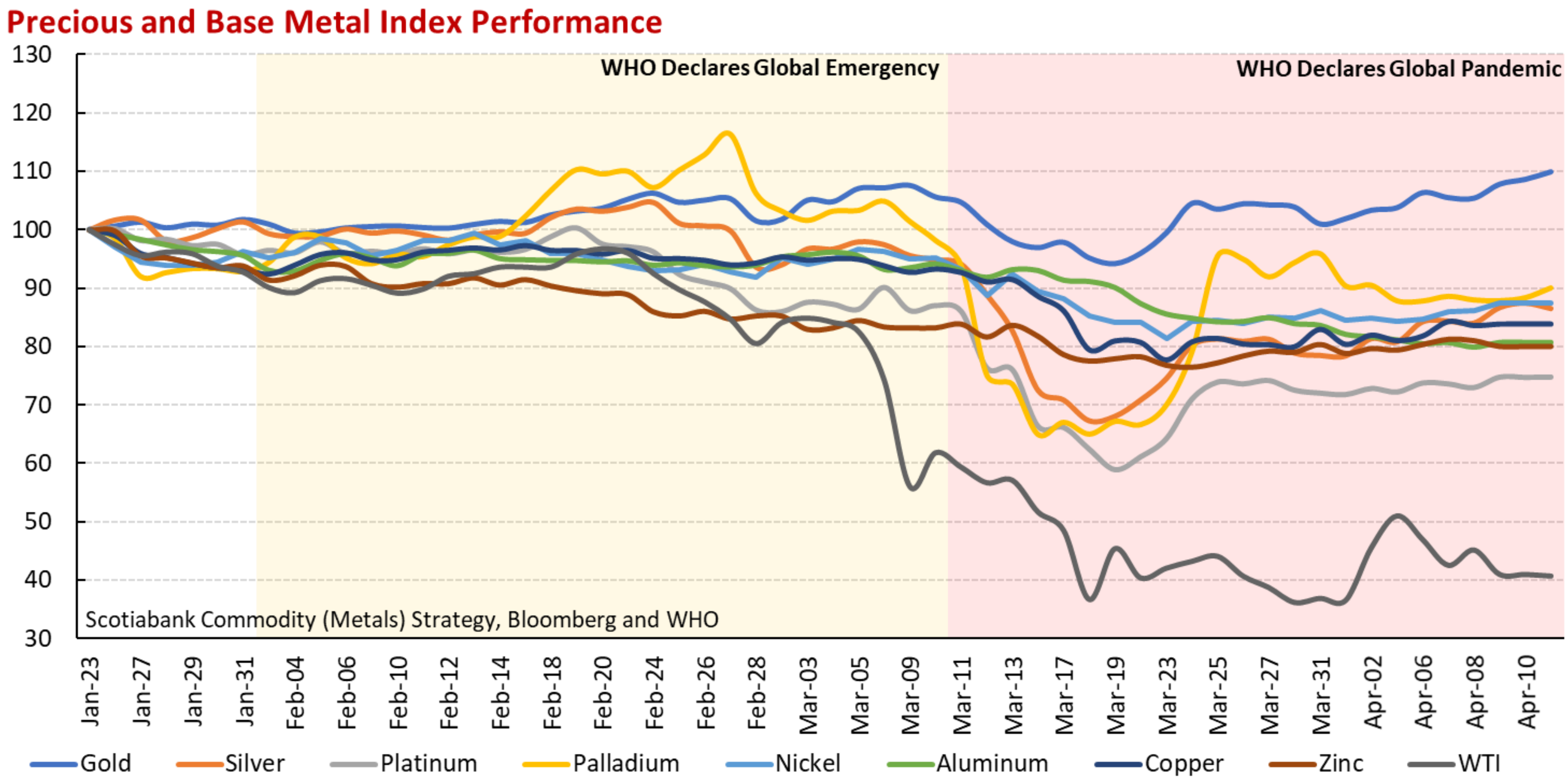
ZINC:

- Bull market period is in the past
- Demand destruction in 2020 and a structural (concentrate) surplus expected to lift exchange stocks over the next few years as it enters renewed & deeper surpluses.
- That's unless there's a convincing response via the closure of mines (due to inability to sell concentrate at economic terms)

NICKEL:

- The multi-year destocking cycle seems to have now convincingly reversed with the impact of COVID-19 on demand and balances, despite the Indonesian export ban.

Q&A & Summary



Precious and Base Metal Index Performance
130
120
110
100
90
80
70
60
50
40
30
WHO Declares Global Emergency
WHO Declares Global Pandemic
Scotiabank Commodity (Metals) Strategy, Bloomberg and WHO
Jan-23
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Apr-02
Apr-06
Apr-08
Apr-10
Gold
Silver
Platinum
Palladium
Nickel
Aluminum
Copper
Zinc
WTI

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