RESEARCH NOTE

February 14, 2024

Tactically Sell Copper And Buy Gold

Key Highlights

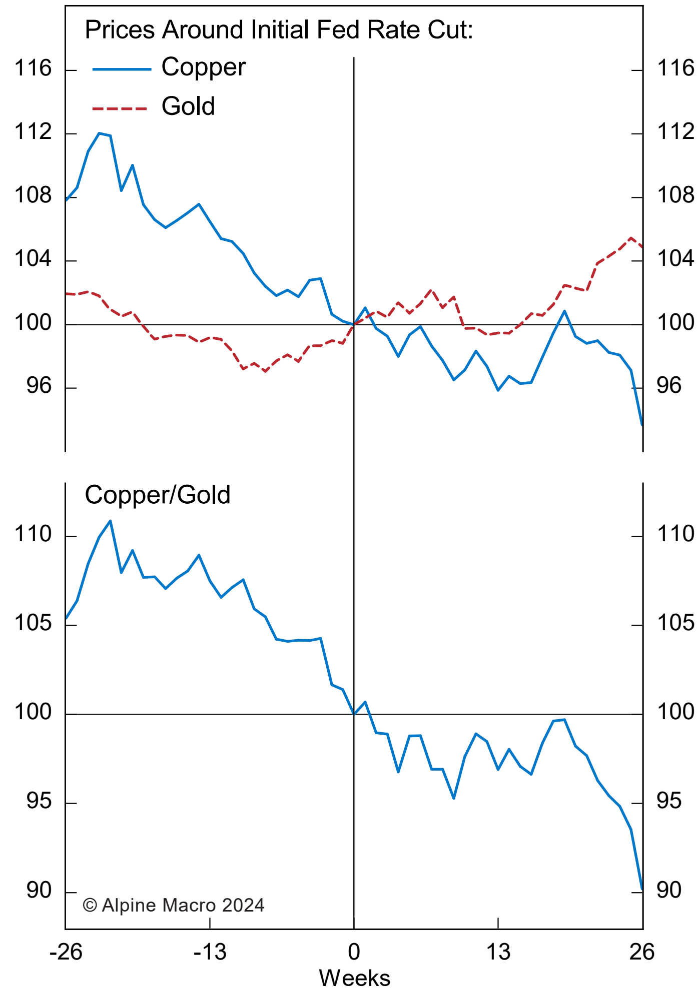
- A tactical window is open to short copper and go long gold.
- Copper underperforms gold during Fed easing cycles, regardless of whether the economic outcome is recession or soft landing.
- Copper prices should be hampered by an uninspiring cyclical growth outlook, particularly in light of the ongoing credit downturn in China.
- In contrast, gold is poised for an upside breakout based on recent price action and prospects for global monetary reflation.

Everything is correlated to the Fed right now, so it is not surprising that both copper and gold sold off on the stronger-than-expected U.S. CPI print that removed 25 bps of expected easing for 2024. But looking beyond the noise, the main message is that the central bank will steadily cut rates later this year.

In anticipation of this, investors should sell copper and buy gold. This recommendation is not sensitive to whether previous tightening results in a soft landing or a deeper downturn.

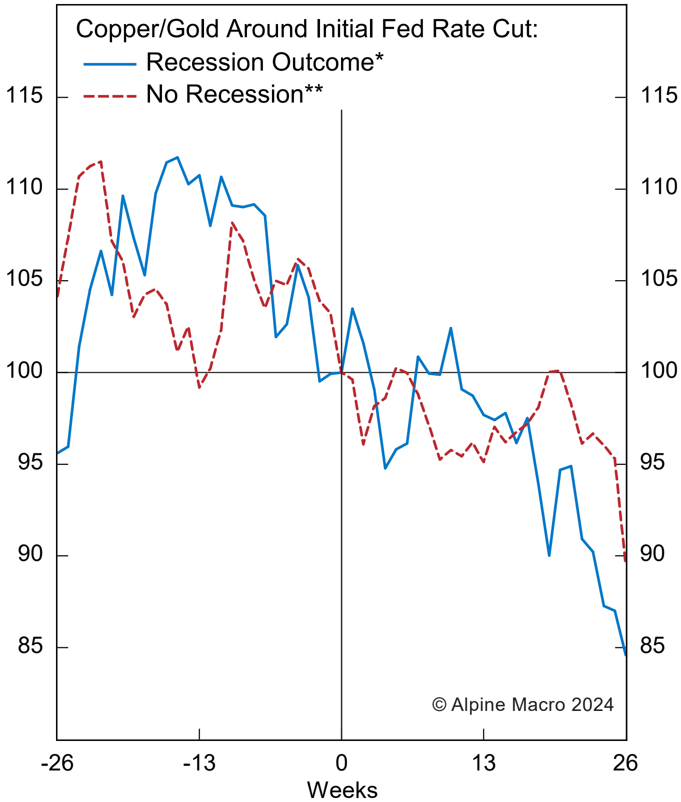
An analysis of seven previous easing cycles over the past 40 years reveals that the copper-to-gold ratio (CGR) typically decreases by nearly 20% during the 12-month period surrounding the initial rate reduction (**Chart 1**). While gold prices tend to experience mild increases during this timeframe, it is the significant and sustained underperformance of copper that primarily contributes to the decline in the CGR.

Chart 1 Short Copper/Gold In Lead Up To Fed Rate Cuts



Note: Based on average of 7 Fed easing cycles since 1984; series are rebased to 100 at start of Fed easing

Chart 2 An Agnostic Trade To Landing Scenario



*Median of 3 Fed easing cycles since 1984
**Median of 4 Fed easing cycles since 1984, including the initial rate cut of July 2019
Note: Series are rebased to 100 at start of Fed easing

It is important to highlight that the falling CGR during easing cycles encompasses both recessionary and non-recessionary outcomes (**Chart 2**). In fact, the ratio ended lower in 6 out of the 7 cases observed.

The sole exception occurred in 1984, an episode that shares few similarities with today. Back then, the Fed reduced rates mid-cycle for fine-tuning purposes rather than because of plunging inflation or a material growth slowdown. This monetary easing into a booming economy stimulated risk assets such as copper but undermined safe havens such as gold.

Monetary Policy And Business Cycle Imply Lower CGR

The CGR tends to weaken because copper is sensitive to soft global growth, while gold benefits from policy reflation. Both conditions will be in place for much of 2024.

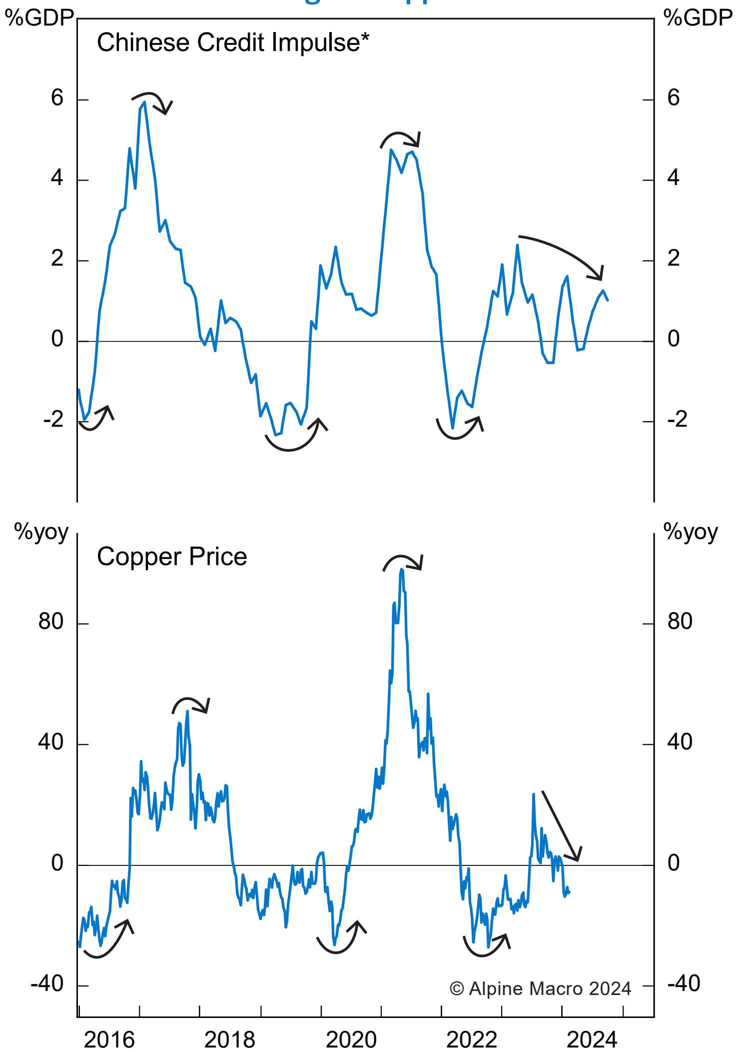
From the cyclical growth perspective, the backdrop is set to remain soggy for a while longer. Europe is grappling with a mild recession, and the delayed impact from policy tightening should result in U.S. growth dipping below trend in the coming quarters.

Particularly crucial for global growth prospects, and therefore copper, is the state of the Chinese economy. Policymakers there have fallen well behind the curve in their attempts to revive household sentiment and boost aggregate demand. With the credit impulse still grinding lower, the odds of a near-term rally in copper are severely diminished (**Chart 3**).

Turning to policy, signs are increasingly pointing towards an end to the global monetary squeeze. U.S. inflation is already on track to reach 2%, and a further fall would increase pressure on the Fed to step up rate cuts (**Chart 4**, top panel). At the same time, China is exerting strong disinflationary pressures on the global economy, with export prices recently falling to the lowest on record (**Chart 4**, middle panel).

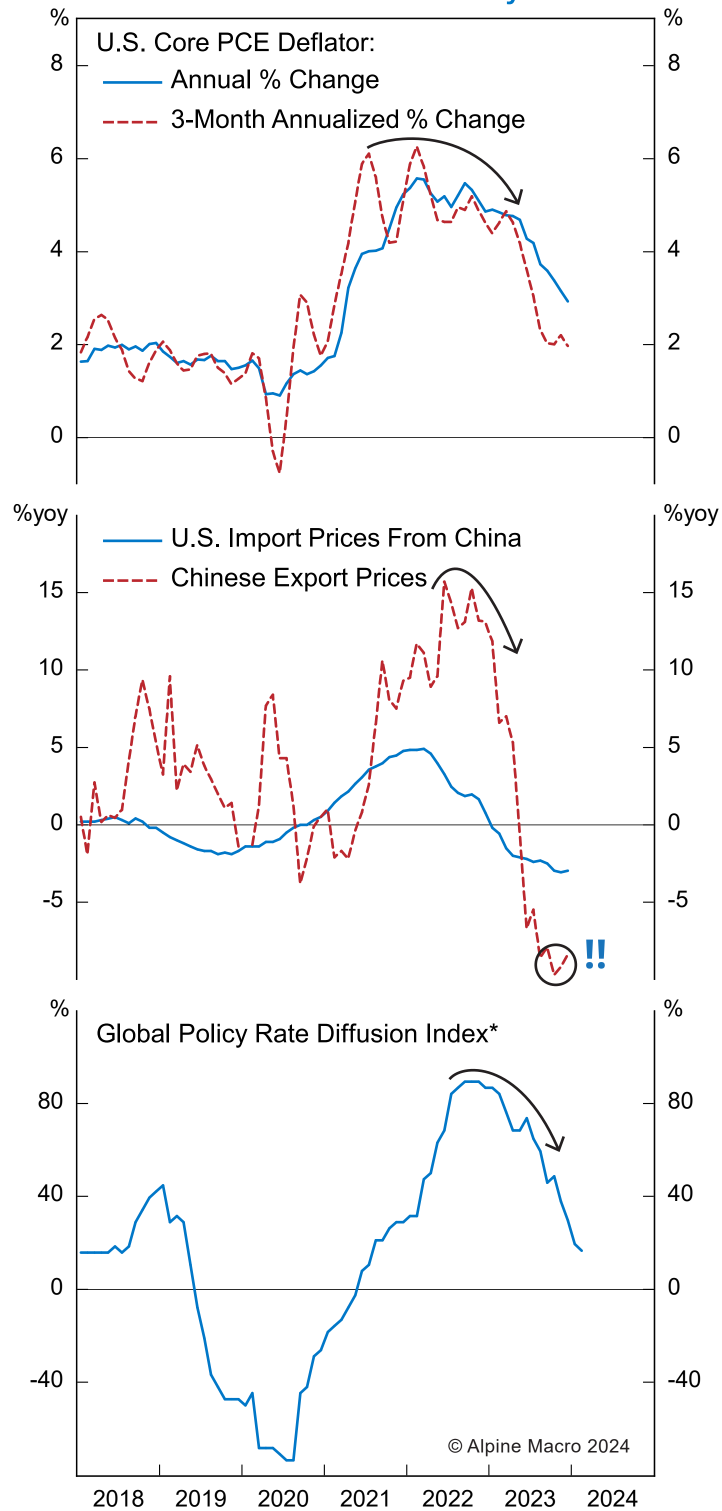
Cooling price trends should mean that the global policy rate diffusion index, which has already fallen sharply, is bound to enter "easing" territory soon (**Chart 4**, bottom panel). Gold almost always benefits in an environment of rate cuts and declining yields.

Chart 3 Weak Chinese Credit Impulse A Drag On Copper



*Advanced by 9 months; Alpine Macro proprietary indicator

Chart 4 Dissipating Inflationary Pressures Portend Further Policy Reflation



*Percentage of 38 DM & EM countries with policy rates higher than 6 months ago minus those lower

Gold's recent price action bolsters our conviction level, as it continues to trade within an "ascending triangle" (Chart 5). This bullish technical formation usually portends upside breakouts.[1]

The bottom line is that there is an excellent tactical opportunity to sell the CGR.

1 Alpine Macro *Global Fixed Income* & *FX Strategy* "Gold: How Does The Deadlock Break?" (November 24, 2023).

Avoid Going Short Oil/Long Gold

On a final note, we strongly prefer selling the CGR to selling oil versus gold. The latter ratio does not exhibit a consistent relationship with the global cycle, despite being grounded in the same principle of pairing a growth-sensitive asset with gold.

This can be attributed to two factors:

- Copper is intricately linked to the higher-beta sectors of the economy such as construction, infrastructure, and other industrial activities. In contrast, the demand for oil, primarily used in transportation, is more inelastic and less sensitive to inflections in growth.

- Second, oil could benefit from geopolitical tensions,[2] supply disruptions, and changes in OPEC policy.

These factors introduce significant noise into the oil-to-gold ratio, making it less directly aligned with the broader economic cycle.

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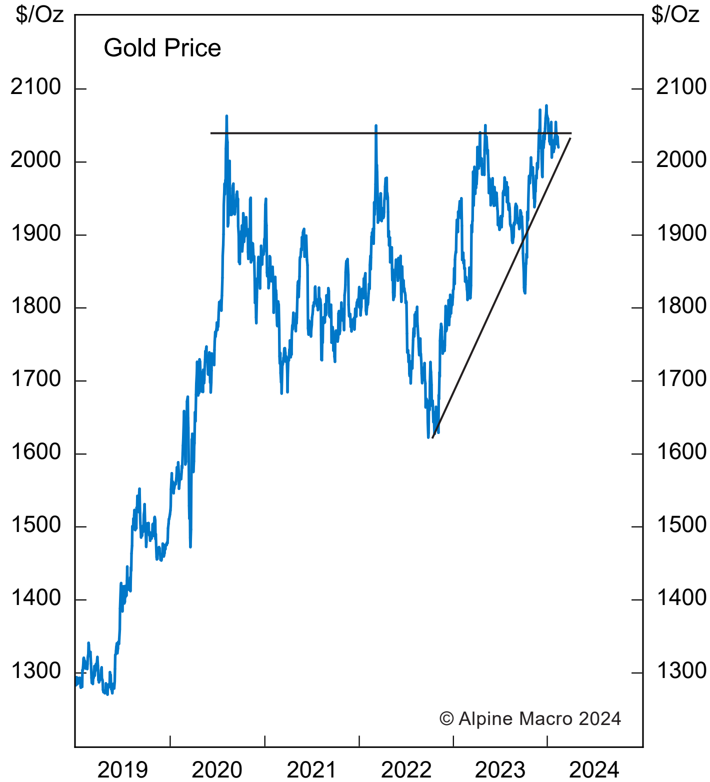
Consulting Strategist

Chart 5 Gold Is Already In A Bullish Technical Formation



2 Alpine Macro *Research Note* "Middle East Tensions Bubble, But Oil Sleeps?" (February 1, 2024).

Alpine Macro, founded in 2017, is an independent global investment research firm based in Montreal, Canada. We focus on the analysis of major macro economic forces and specialize in forecasting the direction of global financial markets, while providing actionable recommendations on investment strategy and asset allocation.

Our Leadership

Chen Zhao, Chief Global Strategist From 2015 to 2016, Chen was Co-Director of Macro Research at Brandywine Global Investment Management. Prior to Brandywine Global, Chen spent 23 years at BCA Research. As a Partner, Managing Editor and Chief Global Strategist, Chen created and wrote BCA's China and Emerging Markets publications in the 1990s, and was the author of BCA's flagship publication, Global Investment Strategy, from 2005 to 2015.

J. Anthony Boeckh, PhD, Executive Chairman & Editor-In-Chief Tony was previously Founder, Chairman, Chief Executive and Editor-In-Chief of Montreal-based BCA Research for 34 years. He authored The Great Reflation (Wiley) in 2010 and was publisher of, among others, the Bank Credit Analyst, a monthly big-picture analysis of the U.S. and global economies and financial markets.

David Abramson, Chief U.S. Strategist & Director of Research Prior to joining Alpine Macro, David was a Macro Strategist holding a variety of senior roles at BCA Research. Most recently, he was Chief U.S. Strategist and also Director of Research for the firm. During his 28 years at BCA Research, David launched the European Strategy and Commodity & Energy Strategy services.

Yan Wang, Chief Emerging Markets & China Strategist Prior to Alpine Macro, Yan spent 15 years at BCA Research, as Managing Editor and Chief Strategist for BCA's China Investment Strategy service, and played a major role in formulating BCA's view on the Greater China region and emerging Asia. Prior to BCA, he spent six years as an equity analyst in China and Hong Kong.

Harvinder Kalirai, Chief Fixed Income & Currency Strategist Before joining Alpine Macro, Harvinder spent a decade with BCA Research, where he headed the firm's Foreign Exchange Strategy and Daily Insights services. Previously, Harvinder was Head of Currency Management at CIBC GAM. He also held various positions at State Street and he began his career at the Bank of Canada.

Mark McClellan, Chief U.S. Bond Strategist Prior to joining Alpine Macro, Mark was a Senior VP and held numerous key positions during his 23-year career at BCA Research, including Chief Global Fixed Income Strategist. He was instrumental in developing several fixed income publications, including the BCA Global Fixed Income Strategy and the U.S. Bond Strategy services.

Caroline Miller, Chief Asset Allocation Strategist Previously, Caroline spent 8 years at BCA Research as a global strategist and the chief advocate for the firm's research worldwide. Before that, Caroline spent 20 years in various global fixed income portfolio management roles, including positions at UBS, the Caisse de dépôt et placement du Québec, J.P. Morgan, and GMO where she began her career in 1992.

Dan Alamariu, Chief Geopolitical Strategist Prior to joining Alpine Macro, Dan spent eight years with UBS, as an Executive Director, responsible for country sovereign risk analysis for the Americas. Prior to UBS, Dan was a Director at Eurasia Group in various roles, including in global comparative analysis, and ran product development. Dan has also worked at the Bank of Tokyo-Mitsubishi UFJ, and at Deloitte Consulting.

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