September 2020 Financial Markets Update:

The back to school edition: A Complete Wrap-Up Across FX, Interest Rates, and Energy Commodities

ATB listens

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Highlights

- *A weak USD and an equity rally for the ages - can it last?*
- *FX markets near a turning point, or just a pause?*
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Macro Overview

JP Dore, Markets Analyst

Recent price action across markets continues to reflect the preoccupation with Covid-19 case growth as risk assets have gained broadly over the summer as cases declined. This has largely played out in an environment where other key economic data are being ignored: Will this dynamic last is a key question as we move forward.

We saw a decline in Covid-19 case growth both in the US and globally. Daily new cases seemingly peaked in early July at +78k for the US and +345k globally. Net daily changes have now declined to +39k and +280k respectively and this has coincided with a broad recovery in commodity and equity prices along with a weaker USD which has dropped 6% since early July on a trade weighted basis.

The summer equity rally pushed the S&P 500 up almost +19% since July at one point and into positive territory on the year. This can largely been attributed to two things: 1) optimism surrounding case numbers and vaccines, and 2) record low interest rates that have made equities look very attractive relative to bonds despite the rally. The Equity Risk Premium (ERP) - the expected return investors demand to hold equities over “risk-free” government bonds - continues to oscillate near all time highs despite other metrics such as price to earnings ratios flashing red.

Essentially the theory is that 1) because bond prices can’t rise that much further as we are already at the zero-lower-bound for policy rates, and 2) because future equity dividends will be discounted using very low rates of interest (making them more valuable today), then 3) stocks remain well priced compared to other assets. That’s the theory anyways. Reality is likely to prove a bit more complex but nonetheless the market is broadly trending higher and this is a contributing factor.

And what of interest rates? Another shot in the arm for the stock market was delivered in August by the Fed’s recent monetary policy review where they shifted to targeting an average inflation rate of 2% over time - previously it had been a hard limit of 2%. This implies that the Fed will allow inflation to overshoot at times without policy rates being adjusted. And that means lower rates for longer.

That shift in policy could also hurt the US dollar and the US will need a weak currency in order to fund a growing trade deficit that reached at 12 year high in July at -US$64 billion. Despite disruptions in trade flows due to the pandemic, these trade patterns require a weak currency and thus the downward pressure on the US dollar is likely to remain for some time albeit with bouts of strength seen during risk-off periods and profit taking.

All in all, the markets fate continues to be tied to the Covid recovery. The decline in new case growth rates is welcome, but the economic data is still poor: 814k people in the US made unemployment claims last week, a declining trend from previous weeks but still very elevated. High unemployment will have to be met with more stimulus or else the optimism surrounding case growth + vaccines could be replaced by the pessimism of the underlying data.

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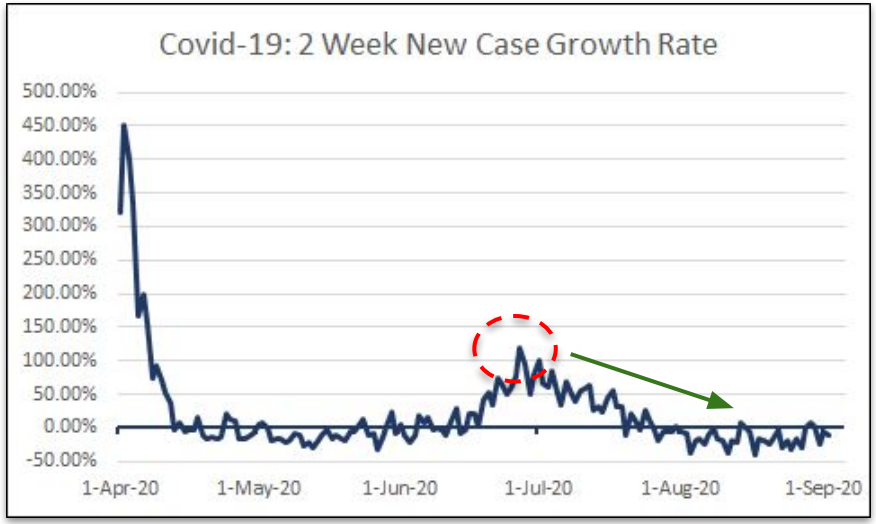
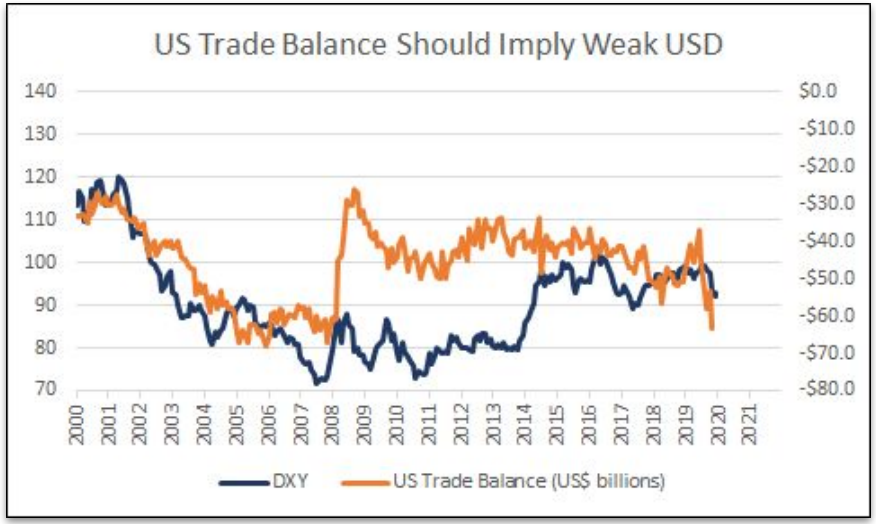




Source: Bloomberg, ATB Financial Markets

- US Covid-19 new case growth rates as measured in 2-week intervals have declined steadily from the recent peak in July
- That is a positive as the growth rate is now negative, but the case numbers are still elevated on a daily basis running ~38k per day
- Broadly speaking, buying more foreign goods than one sells to other countries (a trade deficit) should imply a weaker currency all else being equal. The US just reported a -US$64B trade deficit, a 12-yr high. This should keep downward pressure on the US dollar over the long term and it looks as though there is still room to fall despite the 6% drop in the trade weighted USD since July

FX Outlook

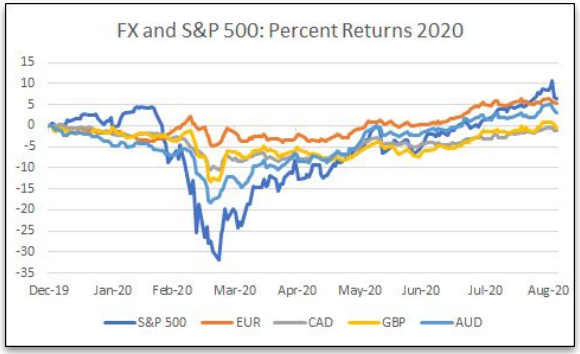
Chris Fricke MBA, Director FX Sales

Summer breaks have ended, and with it, widespread USD weakness? A newly emerging theme in the markets would suggest possibly so, that being "**moral suasion**". (Dust off your old Economics textbook, assuming you own one.) More on that in a moment.

If you listened to our rants over the past few months you will know that we needed to be nimble on what to watch for USDCAD. Pre-Covid19 we were focused on economic releases in as much as they impacted interest rate differentials between Canada and the US in the 2-year tenor, with an additional eye out for the S&P 500 (ie. risk-trade), WTI, the DXY and the VIX.

As Covid-19 hit we dropped all but the S&P 500 as our gauge for not just the CAD's fortunes, but indeed almost every major currency's fortunes vs. the USD, and arguably WTI as well. As the following chart demonstrates, the CAD followed a similar trajectory over the year to other majors over the past few months, all of which were following that same risk-trade theme ...

FX Followed the S&P 500 In Recovery Mode



Interestingly the S&P 500 itself was also being less driven by its historical norms such as earnings reports and technicals, and more on 1) Announcements of, or optimism for, fiscal and monetary stimulus to fight the economic drag of Covid-19, and 2) Daily updates on active coronavirus cases and potential treatments and/or vaccines. Without getting into the weeds on either of these items, we began to see a shift in the summer months once more, with the S&P 500 remaining the primary driver but with occasional bouts of volatility in the DXY taking over.

USD bears began to emerge more and more on a number of factors, including (but not limited to):

1. The Fed's monetary policy to keep rates lower for longer, even if inflation expectations overshoot on a temporary basis.
2. An outsized uptick in active coronavirus cases in the U.S., particularly relative to other Western countries.
3. Market sentiment that the 27-member EC was acting in a much more coordinated fashion on fiscal stimulus than had been expected/feared.

The bears particularly showed themselves on speculative long positions in EURUSD, building to its largest levels in the currency's history, but also showed on GBP, where net bears turned to net bulls for the first time in months. So being short the USD vs. most majors proved to be the trade of the summer, that is, until this week. First off, RSIs (or Relative Strength Indicators, a technical indicator that reflects if something is overbought or oversold) began to flag that the USD weakness was overdone,

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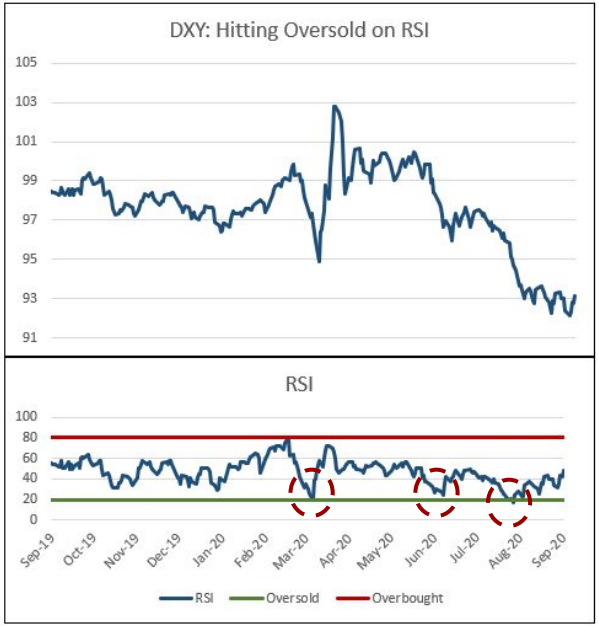
with individual currency pairs like the EURUSD, USDCAD, and GBPUSD reflecting the same.

The RSIs in and of themselves are potential indicators of a tidal shift, but where things got particularly interesting this week was the addition of **moral suasion**. In Economics 101, this is what you might consider 'jawboning' by central bank officials that in effect, and often intentionally, serve to weaken a currency. Underlying this is the possibility of a shift in monetary policy or actual currency intervention, but what makes moral suasion so interesting to traders is that the threat itself of such action often does the job. (Ie. Bark rather than needing to bite.) This past week we experienced this 'bark' on a few occasions:

Sept. 1st: Reserve Bank of Australia leaves their Cash Target Rate at 0.25% but notes that AUD vs. USD is at a 2-year high, and that "continues to consider how further monetary measures could support the economy".

Daily RSI Readings Flashing Caution



Sept. 2nd: Post EURUSD move through 1.2000, European Central Bank's Chief Economist Lane says "the Euro-dollar rate does matter" and that "If there are forces moving the euro-dollar rate around, that feeds into our global and European forecasts and that in turn does feed into our monetary policy setting.

Sept. 3rd: In case #2 didn't stick, the Financial Times posted a story quoting ECB sources that "several members of the ECB governing council" are concerned that the Euro level is restraining their economic recovery, with one member stating "it is a growing concern".

Our (still) new Bank of Canada Governor, Tiff Macklem, has not yet addressed the recent CAD strength, but you can be sure that if the BofC does not already address it at next week's Rate Announcement (Sep 9, no press conference), he will certainly be asked about it during his speech and press conference the next day.

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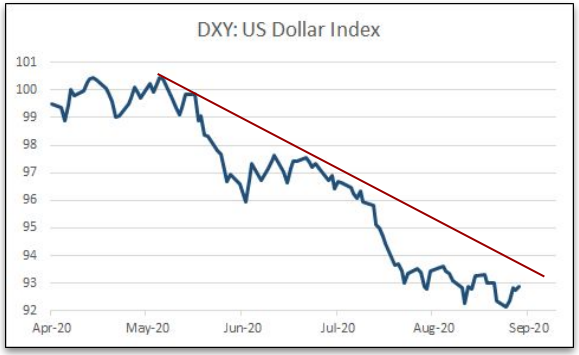
We can't predict what level in USDCAD might the BofC be concerned with, but my own sense is that sub 1.3000 things would get tricky for our export driven economy, particularly without a coincident sharp rally in commodities.

Combining the IMM positioning reports with the RSIs, with the start of what looks like a possible moral suasion campaign, and with significant event risk in the weeks ahead, I am not only pessimistic that we see further (significant) USD weakness in the weeks ahead, but I also believe that moderate strength in the USD is very much possible. For USDCAD I think that could translate into a move back to 1.33-1.35, for EURUSD 1.15-1.17, for GBPUSD back towards 1.3000, and the DXY back towards 94. Risks to this outlook include:

1. Fed keeping their foot on the economic stimulus pedal
2. S&P500 levels remaining frothy (despite Sep 3-4 setback)
3. For CAD: Spec Positions are already short, unlike EUR and GBP - covering would drive CAD higher
4. EU recovery fund bond issuance could drive EUR adoption (medium/long term)

DXY: The Trend is in, 93.80 key level



And if this thesis for USD strength does start to play out, then key levels to watch in the short term are:

DXY	93.80
USDCAD	1.3190
EURUSD	1.1710
GBPUSD	1.3150

This should be an interesting few weeks ahead of us, better grab some gravol along with that ECON 101 text.

FX Outlook

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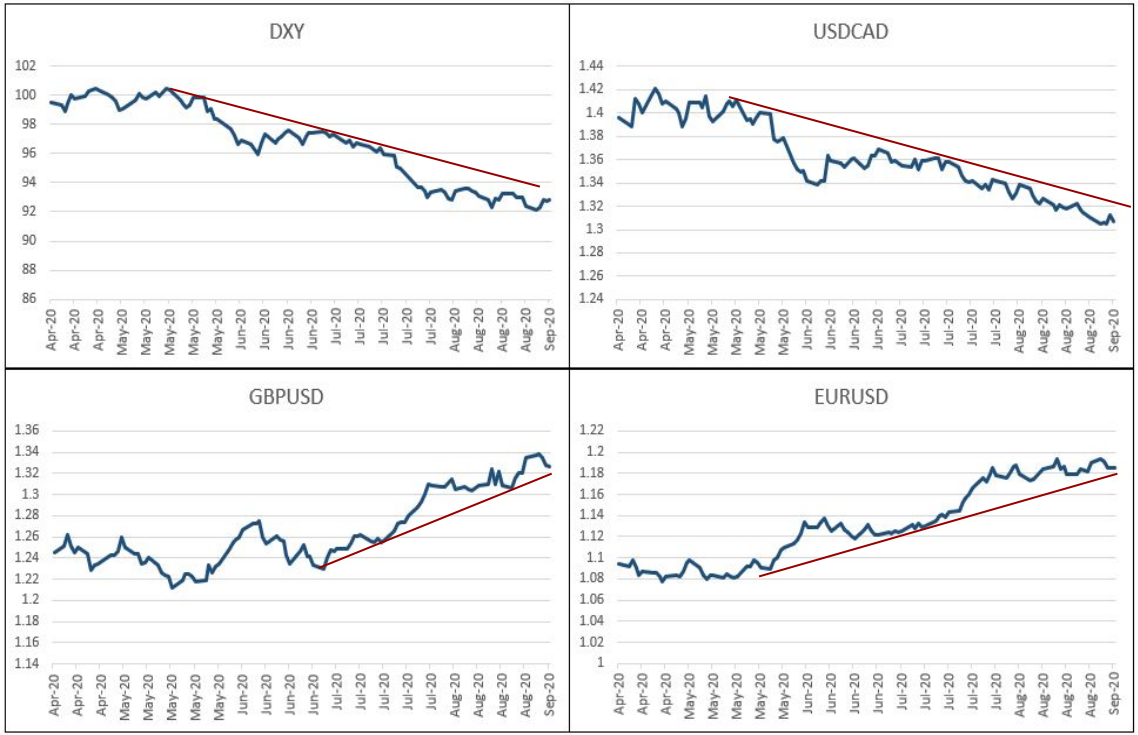
- Trends are well established across major pairs with DXY, CAD, GBP, and EUR all moving lockstep with one another
- We note that turning points can be violent and given the recent uptick in FX vol we could see a test of key technical levels in these pairs
- As mentioned, watch 93.80 on DXY, 1.3190 on USDCAD, 1.1710 EURUSD, and 1.3150 GBPUSD
- A daily or weekly close beyond those levels could mark a deeper setback for the bearish US dollar trend



Source: Bloomberg, ATB Financial Markets

FX Outlook: Key Dates

Chris Fricke MBA, Director FX Sales

September 8	U.S. Congress returns from recess - Stimulus deal/no-deal?
September 9	Bank of Canada Rate Announcement
September 10	BofC Governor Macklem Speech; ECB Rate Announcement
Mid-September	Possible results from AstraZeneca PLC on hopeful coronavirus vaccine
September 17	Bank of England Rate Announcement
September 23	Canada Throne Speech (and with it, risk of another Canadian federal election being called)
September 26	FOMC
October 5	Reserve Bank of Australia Rate Announcement
October 7	Minutes from Sep 26 FOMC
Mid-October	Possible results from Moderna, and separately Pfizer/BioNTech on their hopeful coronavirus vaccine
October 28	Bank of Canada Rate Announcement and MPR Update
October 29	ECB Rate Announcement
November 2	Reserve Bank of Australia Rate Announcement
November 3	U.S. election - note debates are scheduled for Sep 29, Oct 15 and Oct 22; VP debate falls on Oct

Oil Markets

JP Dore, Markets Analyst

Crude markets steadily improved throughout the summer as price volatility continued to normalize alongside steady declines in inventories and even some positive greenshoots on the demand front. Below we layout bull, bear, and base cases for crude prices over the medium term.

Oil markets have been characterized by two substantial shifts since Covid hit: 1) A testing of the physical limitations of energy infrastructure as supplies swelled forcing prices to plunge so the market could re-balance, and 2) A recovery from that price plunge that may see both lower demand growth as a result of Covid, and/or lower near term supply availability due to lost reserves from the necessary shut-ins.

The bullish thesis is that forced/unplanned shut-ins during the price crash, along with a lack of access to capital markets to fund expensive drilling programs, may keep the easiest to tap supplies in the ground: Shale oil. In a situation where demand starts to recover faster than expected, shale supply would theoretically be the first to be brought back on line to cover supply deficits as they are the easiest assets to restart. However, a lack of access to capital markets due to a myriad of reasons (of which depressed WTI prices are just one) means shale assets may not be available to the same extent as before the crash. And this could then lead to an inflationary pricing environment for oil as the market bids up spot prices in an effort to bring more expensive barrels back to the market. Overcorrection in one direction, leads to an overcorrection in the other direction.

The bearish thesis is that oil demand takes another hit as we are forced to curtail mobility in light of renewed Covid outbreaks come this flu season. Given that inventories have normalized somewhat, current storage infrastructure is capable of handling an increase in stockpiles better than it could have a few months ago. But storage levels are still running well above seasonal averages so there isn't a lot of room for error. Inventories at Cushing (the physical delivery point for WTI futures) have normalized faster than other PADD's and thus a return to negative prices could prove unlikely, but a demand drop due to increased mobility restrictions could easily see prices dip to the low 30's or high 20's.

The base case is that we continue to muddle on through with demand slowly recovering to pre-Covid levels, though remaining depressed from a demand *growth* perspective. This should lead to sustainable WTI prices above US$40 and perhaps even into the mid to upper US$40's. However, at that point we could run into a potential problem: Excess capacity from OPEC producers. Some OPEC members will be itching to take advantage of better pricing in order to fund growing government budget deficits and they could crank up supply leading to a cap on any rally past US$50.

The outlook for oil is thus a very interesting one with many competing narratives all having their own unique implications. This is reflected in pricing dynamics with volatility steadily above 30% which is elevated on a historical basis, and the curve exhibiting steeper contango in the near term relative to further down the road. Expect some wild swings as we head into late 3Q/4Q20.

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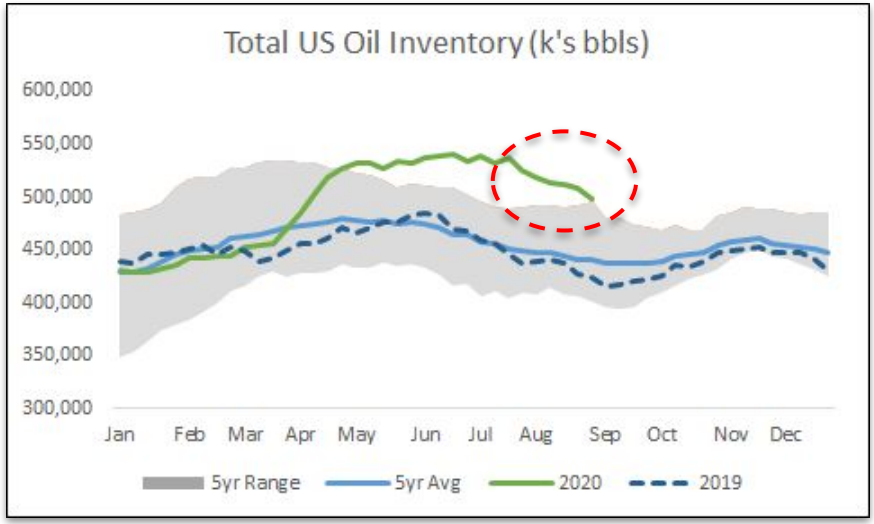

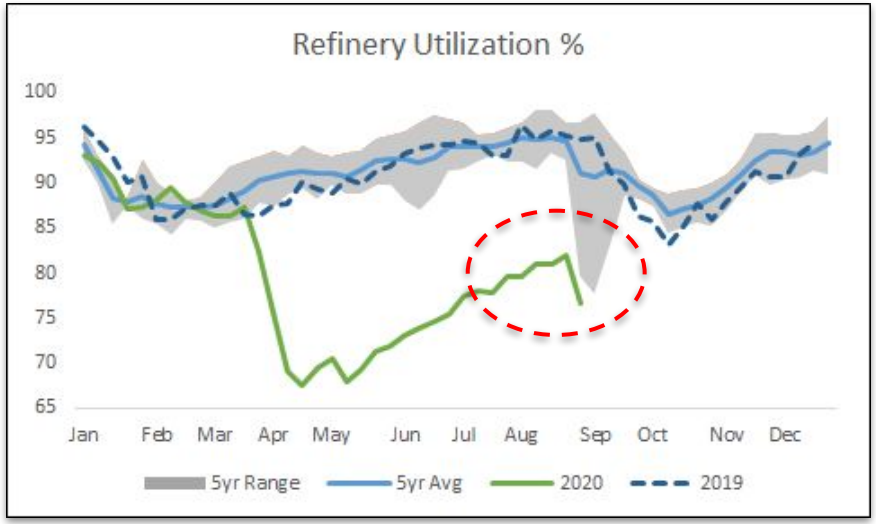

Source: Bloomberg, ATB Financial Markets

- US commercial crude inventories have normalized from extremes but are still very elevated on a seasonal basis running above 5-yr range highs
- Demand remains the big question mark - as a proxy refinery utilization is still very suppressed with activity unable to sustainably break past the 80% level (recent caveat being Hurricane Laura having an impact)

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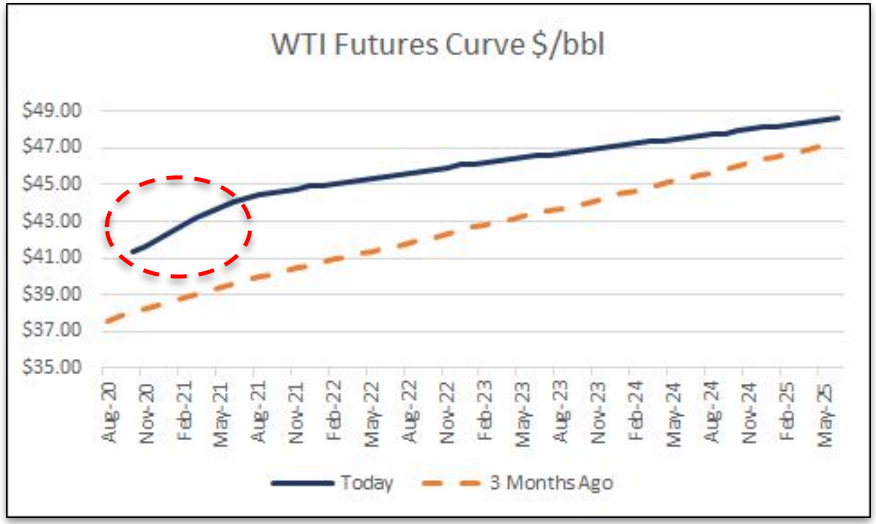

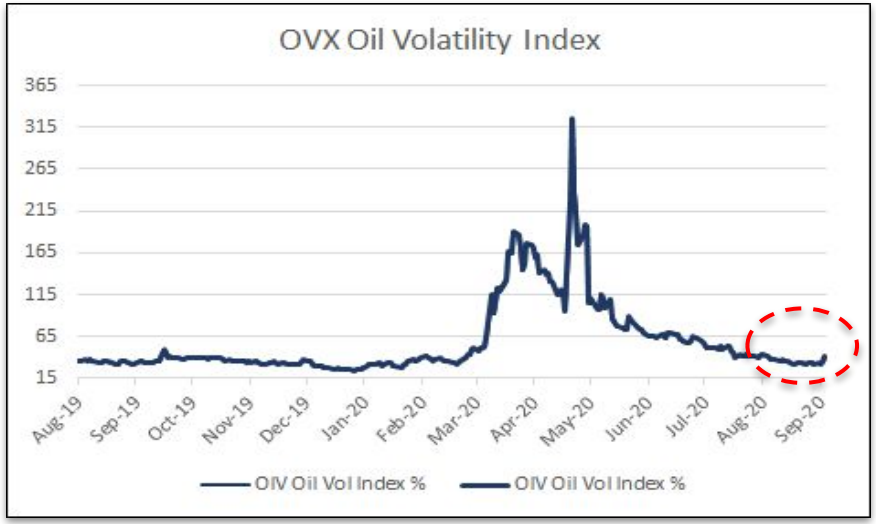

Source: Bloomberg, ATB Financial Markets

- The futures curve has recovered over the summer but notice that contango (near term prices lower than far dated prices) has increased in the front of the curve which could indicate oversupply concerns are creeping back into the market

- Volatility has remained above 30% since normalizing from extremes - however that is still elevated on a historical basis indicating a heightened concern and thus a wider range of possible price outcomes

Natural Gas

CJ Hilling MBA, Associate Director Energy and FX Sales

The rally continues! Unlike a prorogued parliament, AECO nat gas prices continue to function and run higher. Driven by the ongoing depressed E&P activity in the Western Canadian Sedimentary Basin (WCSB) that have resulted in declining supply, the bullish outlook for AECO fixed price is unchanged. The strength in AECO natural gas prices has yet to spur on any drilling activity in the WCSB, and gas rig counts are down 1 to 35 on the week and sitting at an historical low level for this period of the year.

Since last week, AECO day prices have increased further and averaged $C2.56, up 0.03/gj from the prior week, September front month closed on Friday at $C2.46, up 0.10/gj from the prior week, and $C0.01/gj above October near month. AECO Winter 20/21 is up $C0.10 to $C3.01/gj, and summer 2021 is up $C0.04 to 2.56/gj, a new high for these 2 strips, and the 2021–2023 calendar strip has also set a new high at $C2.47/gj. For comparison, the Cal21 strip started August around C$2.50, and at the time of writing, that same strip is C$2.74/gj.

AECO storage inventory is 88% full versus 62% last year same period and storage is expected to fill by mid October.

On 24 August 2020, the Canada Energy Regulator (CER) set the following process regarding the Application from the Explorers and Producers Association of Canada EPAC (C07585) to extend the NGTL Temporary Service Protocol (TSP) tariff provision. Stay tuned for more discussion.

Much like Aeco, the Nymex Henry Hub active contract jumped from ~US$1.80 from the beginning of the month, to over US$2.50/mmbtu by months end. Driven by the return of some commercial demand and storm activity in the Gulf of Mexico (Hurricane Laura). Moreover, the juxtaposition of Canada and the US continues, separated by more than just the 49th parallel.

U.S. rigs activity is up 3 to 72, its highest level since early July and activity will increase driven by the higher natural gas prices although the impact on supply is probably months away. The outlook remains bullish for 2021 and forward; and the strength will likely be driven by power demand, LNG exports, and exports to Mexico. The strength at the front of the curve has yet to have an impact on the back-end as Cal22 pricing was down $0.005/mmbtu on the week and the strip for 2023 – 2026 was up a mere US$0.01/mmbtu over the same period.

Regarding USGC LNG exports to Asia, the outlook is more favorable, as variable costs are now covered for part of Winter 20/21, and for Winter 21/22 forward. At this point, both Europe and Asia forward prices would have to increase by $US 1.50 – 2.00/mmbtu to cover the fixed costs and trigger FID's for LNG projects in the USGC.

Natural Gas

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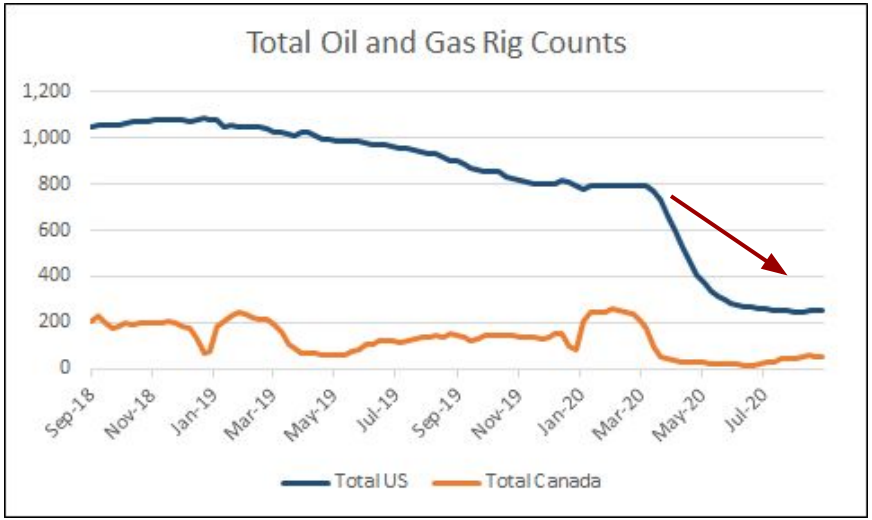

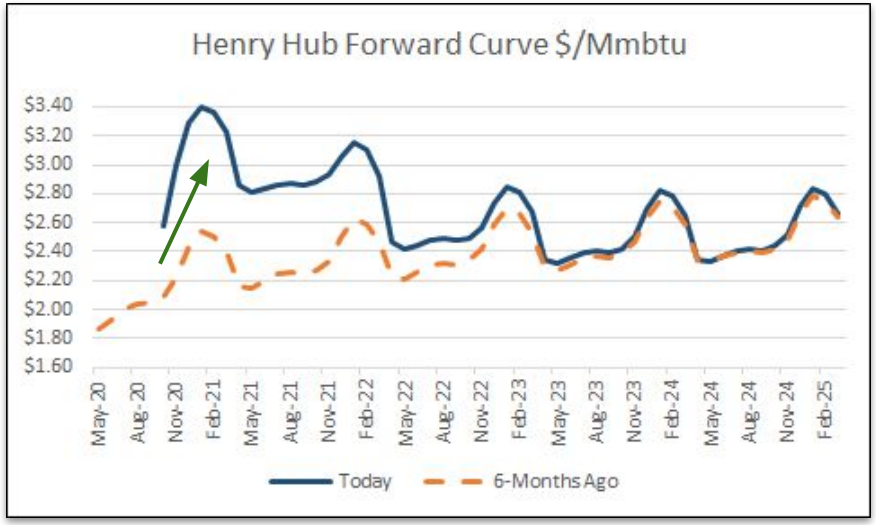

Source: Baker Hughes, Bloomberg, ATB Financial Markets

- Drilling activity has been significantly curtailed with rig counts across all basins near record lows, however the US has seen a slight uptick relative to Canada
- Lack of access to capital is contributing to the dearth of drilling activity - at some point projects will become economic and financing will be available which should act as a 'cap' on price as supply rises - but we don't seem to be there just yet..
- In the meantime, the Henry Hub curve has rocketed higher with the 2020-2022 strips materially higher than they were just a few months ago

Natural Gas

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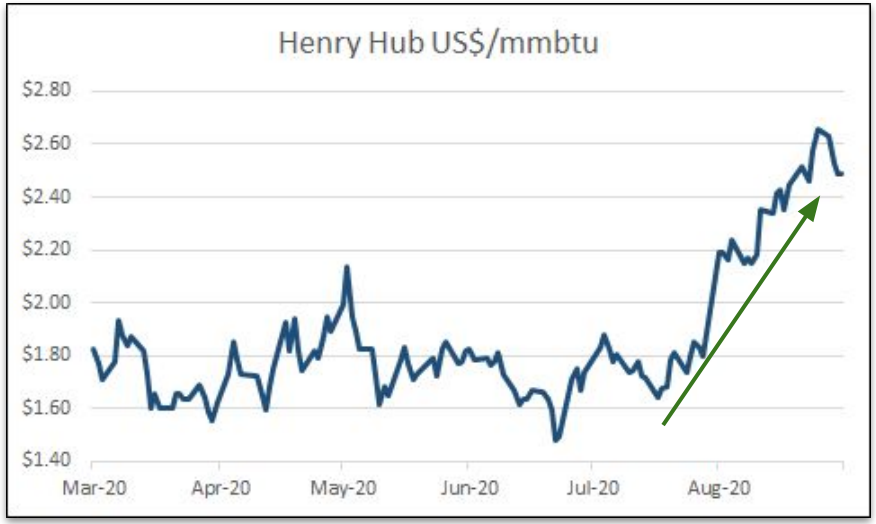


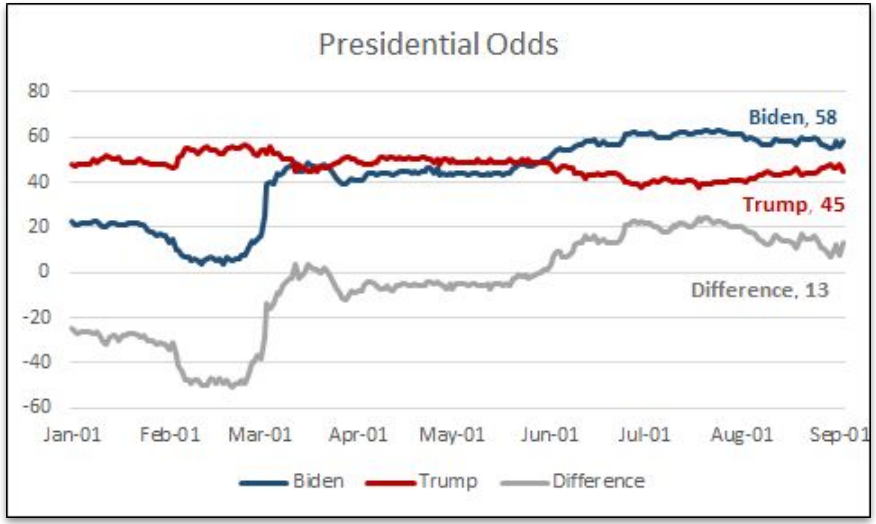
Source: Bloomberg, ATB Financial Markets

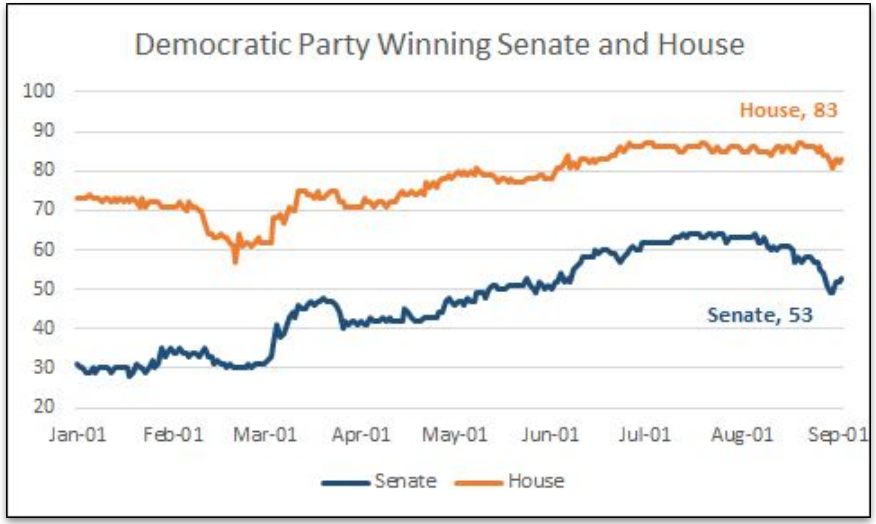
- Natural gas prices have rallied significantly as low rig counts across oil and gas fields alike have meant less supply - the warmer weather hasn't hurt either with res-comm demand perking up as HDD's increased in the late summer

CHARTPACK

ATB listens

US Presidential Odds and Outlook





Source: PredictIT, ATB Financial Markets

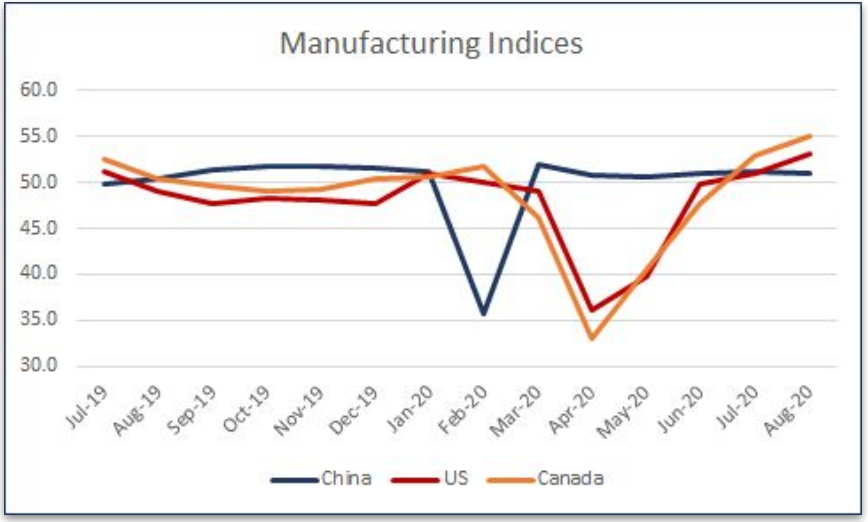
- The upcoming election is garnering increasing public and market scrutiny with the odds favouring a Biden administration, and a 50/50 chance of a 'Blue-Wave' Democratic controlled Senate and House
- A Biden win would see larger scale stimulus + deficits, increased taxes, and expedited climate policies
- A Trump win would see lower taxes, less stimulus, enhanced focus on domestic energy security, and a renewal of contentious trade negotiations with China and the EU

Global PMI Data

PMI Heat Map	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20
China	50.6	50.0	50.1	50.2	49.7	48.3	49.9	50.8	50.2	50.2	49.4	49.9	50.4	51.4	51.7	51.8	51.5	51.1	35.7	52.0	50.8	50.6	50.9	51.1	***51.0***
US	60.8	59.5	57.5	58.8	54.3	56.6	54.2	55.3	52.8	52.1	51.7	51.2	49.1	47.8	48.3	48.1	47.8	50.9	50.1	49.1	36.1	39.8	49.8	50.9	***53.1***
Canada	55.7	55.5	56.2	57.1	56.9	56.8	54.8	53.9	54.9	53.6	53.0	52.6	50.5	49.7	49.1	49.2	50.4	50.6	51.8	46.1	33.0	40.6	47.8	52.9	***55.1***

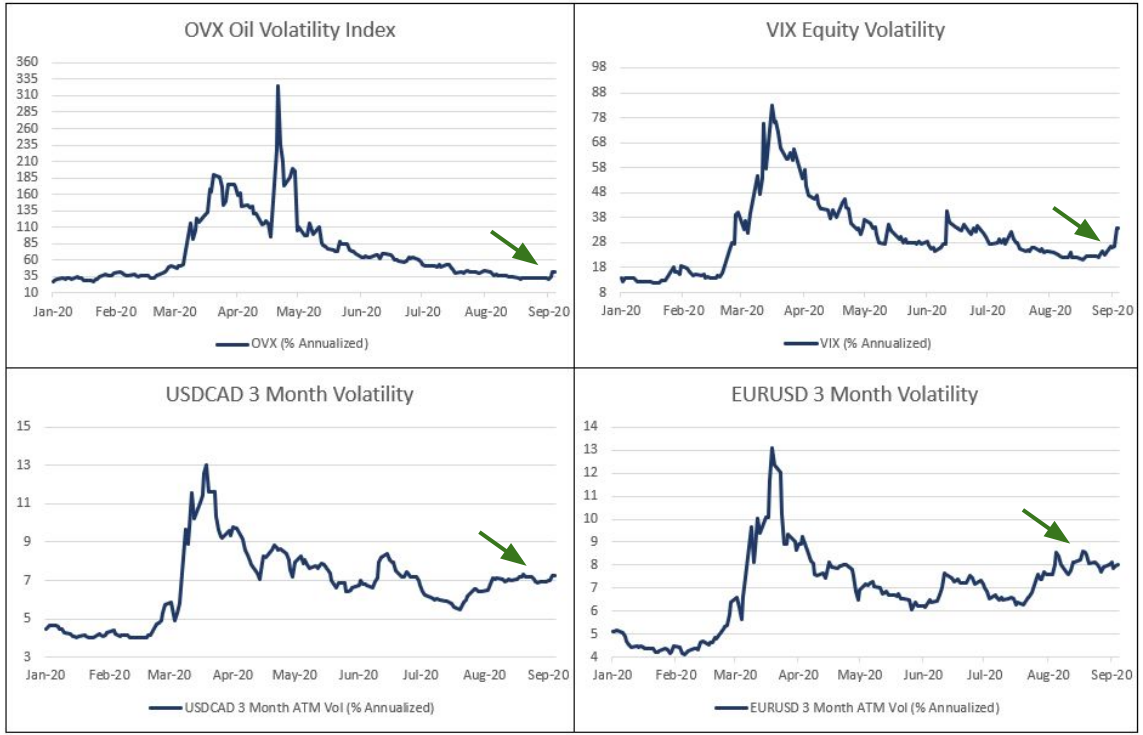
Source: Bloomberg, ATB Financial Markets

- Readings of global economic activity are represented here by Purchasing Managers Indices (PMI) from China, the US, and Canada
- Readings above 50 indicate an overall expansion of activity, below 50 would indicate an outright contraction
- Data from all three countries has improved significantly since the crash earlier this year and Canada is actually outperforming the US and China over the last two months which has contributed to the recent bout of CAD strength



Volatility Remains 'Elevated'

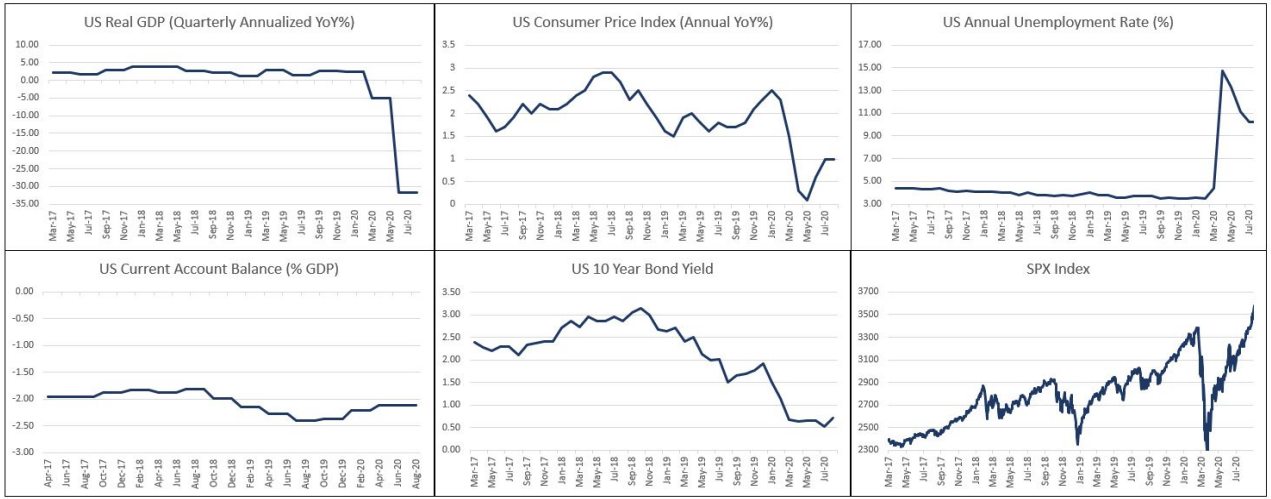
- As we head into what is going to be a busy autumn, we are noticing that volatility readings are starting to rise once again across assets
- Oil, equity, and FX implied vol readings have all increased after falling steadily throughout the summer months
- The market is also seeing vols increase as the terms extend over the presidential election as varying outcomes of White House/Senate/House control are modelled
- With increased scrutiny over the coming weeks I would expect vol to remain high and thus the distribution of potential outcomes for asset returns to increase as well



Source: Bloomberg, ATB Financial Markets

US Country Snapshot

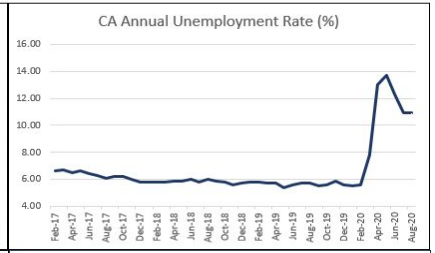
Indicator	Last
Real GDP (Annual YoY%)	-31.70
Consumer Price Index (Annual YoY%)	1.00
Annual Unemployment Rate (%)	10.20
Current Account Balance (% GDP)	-2.12
10 Year Bond Yield %	0.71

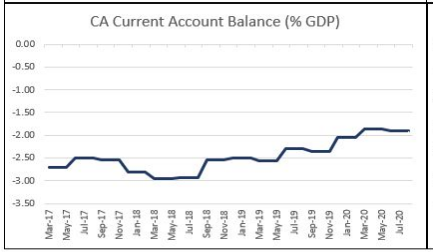


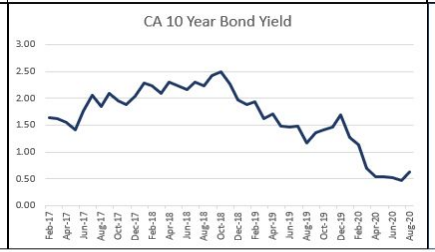
Source: Bloomberg, ATB Financial Markets

Canada Country Snapshot

Indicator	Last
Real GDP (Annual YoY%)	-38.68
Consumer Price Index (Annual YoY%)	0.10
Annual Unemployment Rate (%)	10.90
Current Account Balance (% GDP)	-1.92
10 Year Bond Yield %	0.62



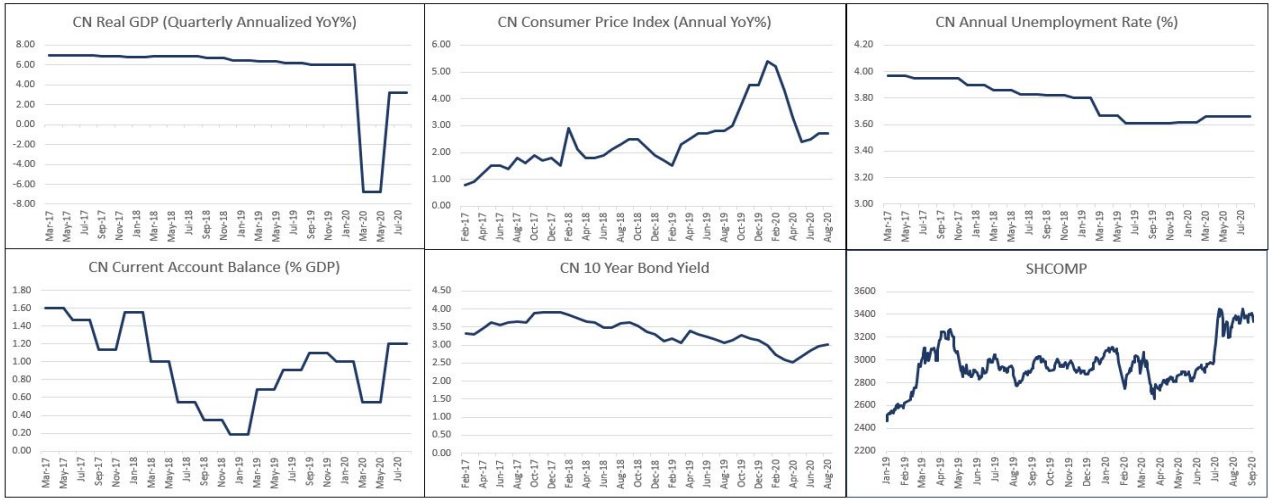




Source: Bloomberg, ATB Financial Markets

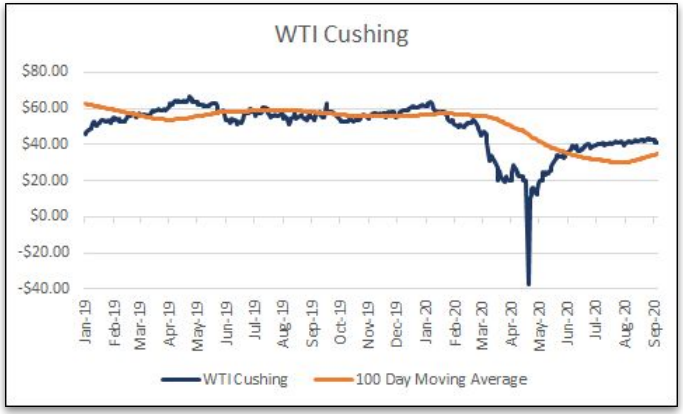
China Country Snapshot

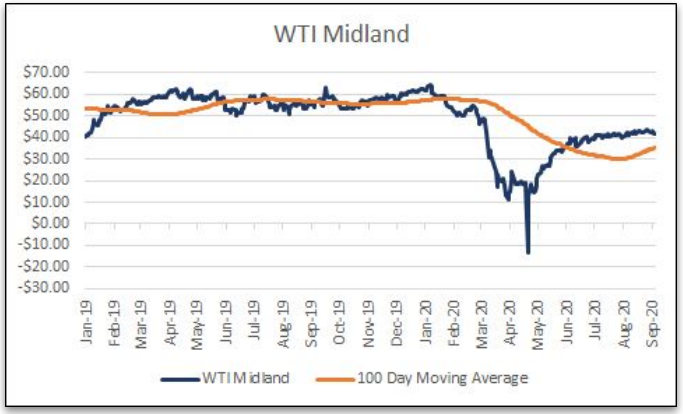
Indicator	Last
Real GDP (Annual YoY%)	3.20
Consumer Price Index (Annual YoY%)	2.70
Annual Unemployment Rate (%)	3.60
Current Account Balance (% GDP)	1.20
10 Year Bond Yield %	3.02

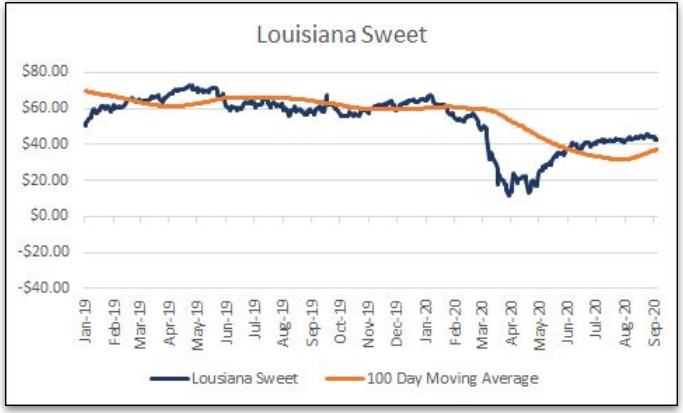


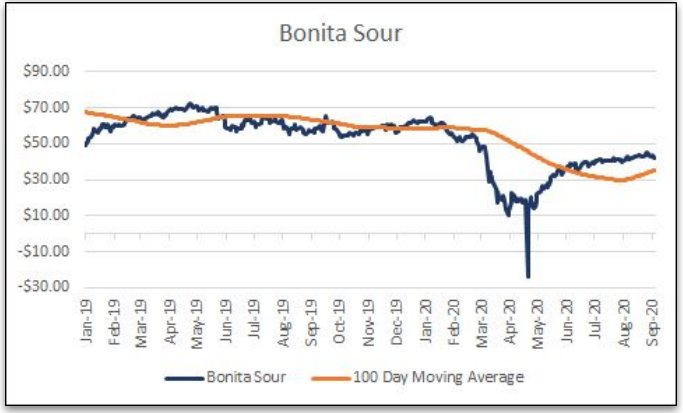
Source: Bloomberg, ATB Financial Markets

US Crude Prices ($/bbl)



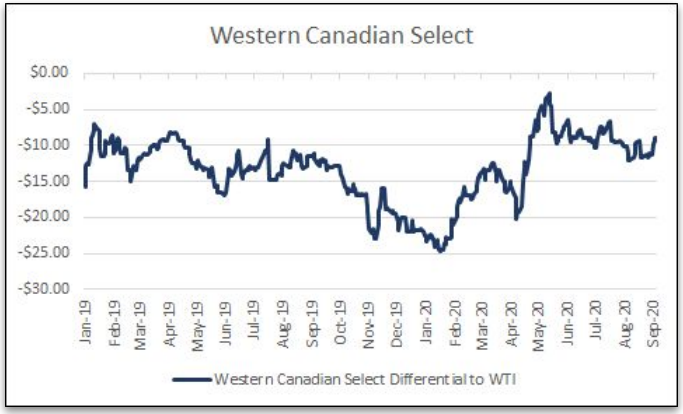


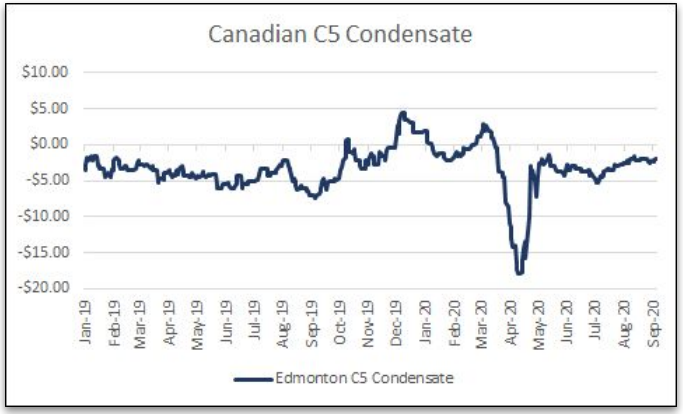


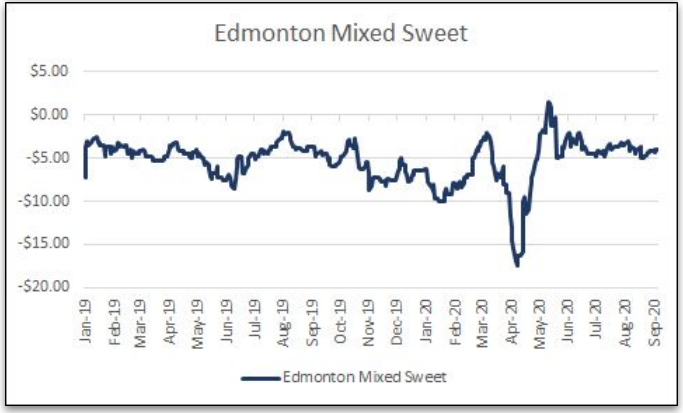


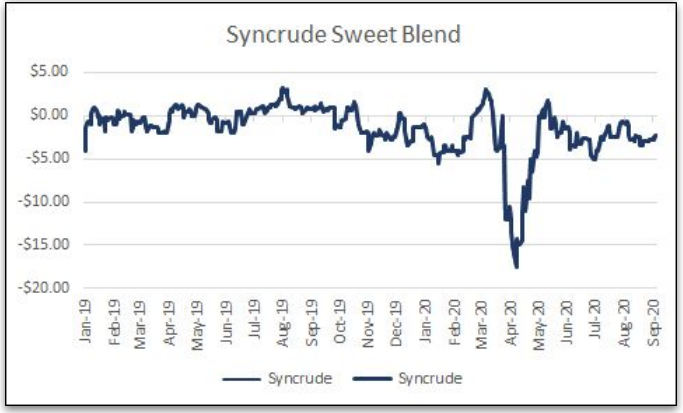
Source: Bloomberg, ATB Financial Markets

Canadian Crude Differentials ($/bbl)



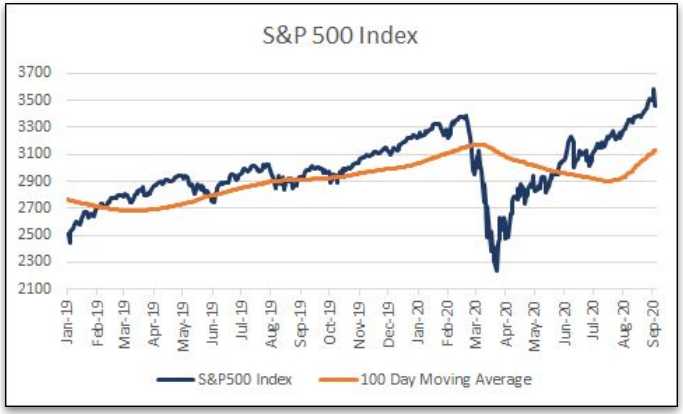


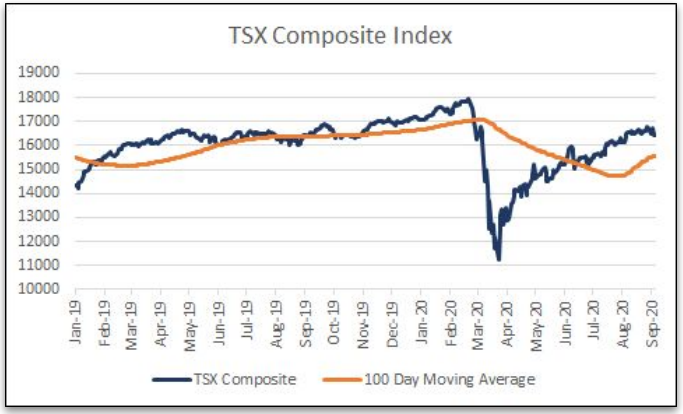


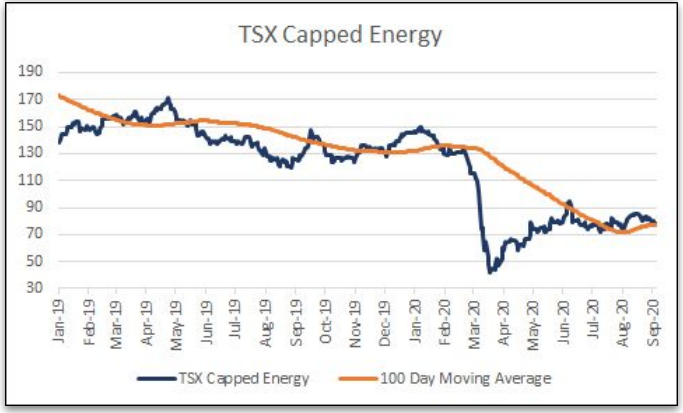


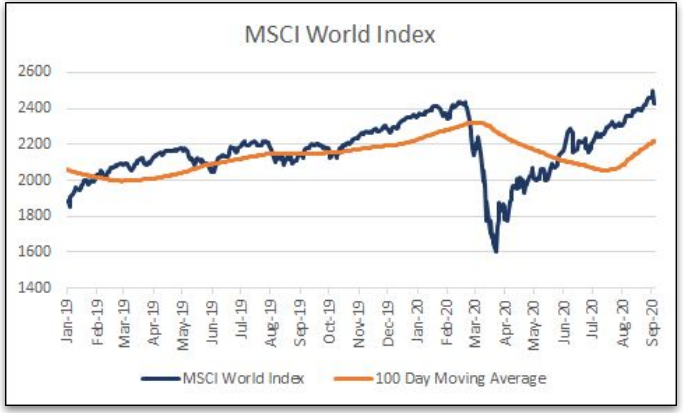
Source: Bloomberg, ATB Financial Markets

Equity: S&P 500, TSX, MSCI



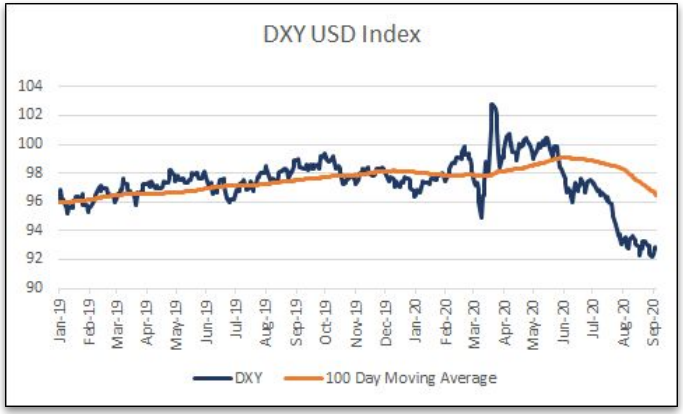


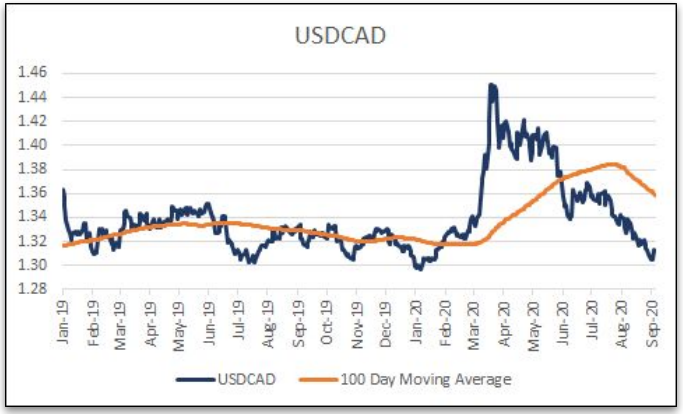


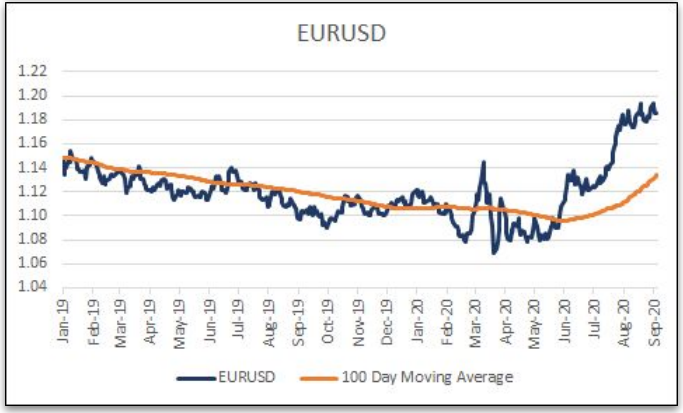


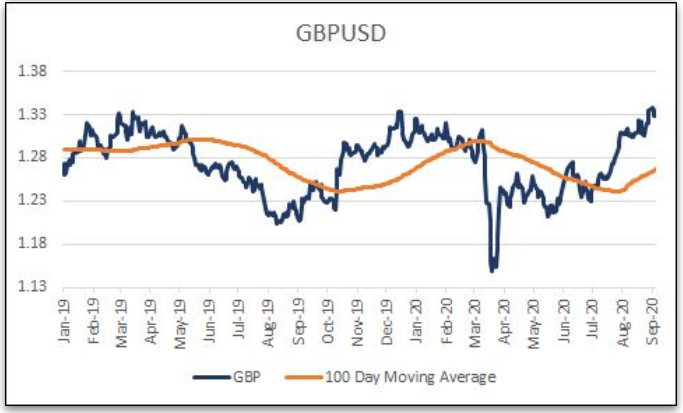
Source: Bloomberg, ATB Financial Markets

Global FX - DXY, CAD, EUR, GBP









Source: Bloomberg, ATB Financial Markets

Looking to hedge your risk?

Talk to us…we're here to listen.

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ATB listens

We can *transform banking*
Reimagine it MAKE BANKING
WORK FOR PEOPLE
Because we carry the *outrageous*
belief that banking can change
PEOPLE'S LIVES FOR THE BETTER
Make their time richer
their aspirations closer
THEIR HAPPINESS DEEPER
HOW WILL WE DO THIS? By doing things other banks wouldn't do
By being ever loyal *relentlessly*
to our customers *inventive*
and steadfastly genuine in our pursuit
of Albertans' greater good
BY USING BANKING TO CREATE HAPPINESS
WHY HAPPINESS?
Because good things happen when happiness becomes your purpose
that's why ATB
will always
BE MORE
than a bank