A View from the Trenches Toronto, Wednesday, September 9th, 2009

Good morning,

Gold has finally passed the $1,000/oz mark. I was a bit nervous on Tuesday morning, but by noon, I had the feeling that the day would end according to our main trend forecast. Let's see…

The 3-mo Libor-OIS spread made a newer low, at 12.89bps as Libor is now at 30.19bps. Thus, going forward I don't think liquidity will have the power to fuel the rally to new highs, as the law of marginal returns kicks in, but at least forms a formidable wall against any "rebellion".

Do I think yesterday's action was about risk seeking, away from the USD, as it so smelled in early trading? Not really. Here's why: If you look at the chart below (Source: Bloomberg. For regular readers, this is now a classic chart at "A View from the Trenches") the spread between 30-yr Treasury and S&P500 was erratic. It was only after 1pm, after the uneventful $5BN of Treasuries purchases by the Fed took place that the random movements began to fade, with an inverse relationship between equities and sovereign risk taking the driver's seat. The Fed bought Treasuries maturing between May/16 and Aug/19 (total purchases so far are at $281BN = only $19BN left to complete the $300BN program!!!). After 3pm, with the announcement of the record drop (by $21.6BN) in U.S. consumer credit, equities corrected but managed to close higher (S&P500 up 0.88%, at 1025.39). Corporate credit gives us another flag: The IG and HY indexes have been in range-bound trading since mid August, and yesterday's action only confirmed this characteristic. Therefore, am I surprised that gold broke the $1,000/oz? No. Do I think it is the start of a new phase for gold? I will answer this from the other side of the coin. I read yesterday two asset allocation reports based on macro outlook reports. They were both bullish on equities. Regardless of the side they take, I think the approach is mistaken. Macro stats should support nothing these days.
It is all about deleveraging/leveraging forces, which tells me that central banks still hold too much power and makes me fear being a gold bug. For example, with yesterday morning's move in gold, the Canadian dollar had made it to 1.0674 CAD/USD, only to go back to the 1.08+ CAD/USD. Why? The Bank of Canada intervened the market again, buying C$1BN of securities in a 272-day repurchase agreement, announced at 10:30am.
In conclusion, I don't see the rally in gold as a reflection of risk appetite (asset inflation) and I don't see gold strong enough to withstand a potential killing move by central banks.

Last but not least, I noticed that after the announcement of the fall in U.S. consumer credit, the CAD regained strength. A few days ago, such news would have triggered a flight-to-safety and USD-supportive trade. Yesterday, the market reacted different, confining the bad news to the US market. This was news to me…

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