A MOMENT IN MARKETS – FED'S POLICY SHIFT PUTS A SHINE ON METALS

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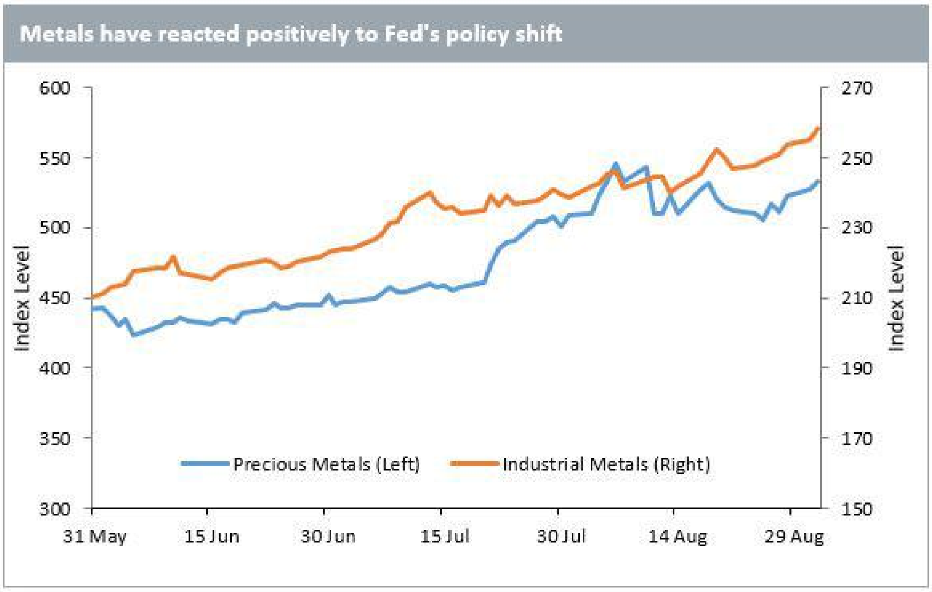
In his August 27 speech from the annual Jackson Hole Economic Symposium, Jay Powell – Chairman of the US Federal Reserve (Fed) – announced a major policy shift for the central bank. The Fed's monetary policy framework normally aims to maximise employment and target long-term inflation at 2%. Going forward, the central bank will aim for average inflation around that level – a policy that will be especially important following economic crises and long periods of low inflation.

The direct result of this policy shift

This deviation in policy from the Fed is neither surprising nor unreasonable. US inflation has been below the Fed's target more often than not since the global financial crisis. The Fed's quandary of what to do about it has been exacerbated this year by the pandemic – with inflation falling to nearly 0% in the US. Chairman Powell's speech has solidified the expectation – or 'hope' even – from markets for monetary policy to remain accommodative for a protracted period. Allowing inflation to rise above 2% without tightening policy means that the Fed will keep rates lower for longer.

Treasury yields have fallen to historic lows and the US dollar has been extremely weak this year – a direct result of economic uncertainty and highly accommodative monetary policy. Fed's formal announcement of a 'lower for longer' policy is expected to keep yields low, and the dollar, weak.



Source: Bloomberg. Data from 31 May 2020 to 01 September 2020. 'Precious metals' refers to the BCOM Precious Metals Total Return Subindex. 'Industrial metals' refers to the BCOM Industrial Metals Total Return Subindex.

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Metals stand to benefit

Both precious and industrial metals have received a boost since Jay Powell's speech (see figure above), and are expected to gain strength from Fed's policy shift going forward for three key reasons:

1. **Safe-haven demand:** The US dollar normally serves as a safe-haven asset during times of economic distress. With continued weakness in the greenback, investors will remain interested in alternative assets as better 'stores of wealth'. Precious metals will remain at the forefront to fulfill this need for investors.

2. **Physical demand:** When the dollar is weak, physical demand for commodities from holders of other currencies can be expected to rise as it makes it cheaper for those buyers to purchase dollar-denominated assets. This could further fuel the recovery and rally in industrial metals.

3. **Hedging demand:** As inflation picks up (and rises beyond 2% in the US), the need to hold effective hedges against inflation eroding portfolio value will become all-the-more important. Precious metals – especially gold, and broader baskets of commodities – especially including cyclical sectors such as industrial metals, will serve investors well as part of their strategic asset allocation.

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