ATB Capital Markets

Financial Markets Monthly Update

December 1 2020

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What's Inside

ATB Capital Markets

Quick Take: November Rally One for the Record Books

Section I

QuickTake: A November to Remember

It's Been A Risk-On Rally All Month

Monthly Recap

- It's been a stellar month for financial markets with a risk-on rally pushing equities, commodities, and the Canadian dollar to solid gains. Optimism surrounding vaccines kick-started the move that has led to near record monthly returns across many assets (see heat map below).
- The USD dollar drifted lower as traders sold it steadily in pursuit of higher returns elsewhere. CAD, EUR, AUD, and CNY were all prime beneficiaries and currencies linked to commodities and early stage manufacturing processes look set to continue appreciating against the USD.
- In commodities, the prospect of tight physical markets across base metals and ags is exerting upward pressure on near term prices as we enter what is expected to be a strong period of global growth in 2021. Usually we would not expect to see undersupplied commodity markets this early in the growth cycle, so this is an unusual dynamic that could be very bullish for prices. Oil prices firmed as well as mobility is expected to rebound and OPEC+ should maintain its commitment to support the market via supply restrictions for another few months.
- Equities surged as low policy rates, the prospect of more fiscal stimulus, as well as vaccines pushed most indices to fresh highs – although valuations are also following suit with the S&P 500 forward P/E ratio screening in the 93rd percentile relative to the last 20 years - expensive no matter how you look at it. Can these moves last? At this point in time, 2021 global growth is essentially assumed to confirm a 'V' shaped recovery…that may be a high bar especially given the recent surge in cases that could see GDP take another dip before the benefits of immunization are realized. However, the market has paid handsome returns to those with a positive outlook since March…here's hoping that trend continues through the holidays.

Heat Map of Monthly Returns: CAD, WTI, and Equities Posted Solid Gains for the Month

	Currency				Commodities				Equities				Bonds	
	DXY	EUR	CAD	CNY	WTI	NG	Copper	Soybeans	S&P500	NDX	TSX	XEG	HYG	TLT
Nov-19	0.95%	-1.20%	-0.88%	0.08%	1.54%	-3.14%	0.86%	-4.36%	3.40%	3.96%	3.38%	6.71%	0.15%	-0.58%
Dec-19	-1.92%	1.77%	2.23%	1.00%	7.56%	1.19%	4.76%	7.56%	2.86%	3.92%	0.14%	10.74%	1.15%	-3.52%
Jan-20	1.04%	-1.07%	-1.87%	0.76%	-9.64%	-6.18%	-9.73%	-7.48%	-0.16%	2.96%	1.49%	-10.77%	-0.47%	7.69%
Feb-20	0.76%	-0.60%	-1.15%	-1.16%	-9.14%	-3.53%	0.51%	1.26%	-8.41%	-5.89%	-6.09%	-11.28%	-1.70%	6.45%
Mar-20	0.93%	0.05%	-4.79%	-1.27%	-25.76%	11.25%	-12.23%	0.28%	-12.51%	-7.66%	-17.74%	-47.90%	-10.43%	6.22%
Apr-20	-0.03%	-0.69%	0.87%	0.27%	-11.04%	13.73%	5.32%	-4.03%	12.68%	15.19%	10.48%	29.35%	4.36%	1.07%
May-20	-0.68%	1.33%	1.23%	-1.02%	22.32%	-5.14%	3.94%	-1.12%	4.53%	6.17%	2.79%	0.60%	2.47%	-1.89%
Jun-20	-0.97%	1.20%	1.47%	1.00%	7.05%	-2.44%	11.63%	5.17%	1.84%	6.29%	2.12%	-1.60%	-0.97%	0.21%
Jul-20	-4.15%	4.84%	1.22%	1.30%	4.30%	1.11%	5.45%	1.50%	5.51%	7.37%	4.22%	-2.23%	4.62%	4.31%
Aug-20	-1.29%	1.34%	2.79%	1.85%	4.92%	15.09%	5.92%	5.99%	7.01%	11.05%	2.14%	6.02%	-0.42%	-5.15%
Sep-20	1.89%	-1.80%	-2.05%	0.84%	-6.29%	-2.62%	-1.22%	7.60%	-3.92%	-5.72%	-2.38%	-18.20%	-1.33%	0.66%
Oct-20	0.16%	-0.63%	0.01%	1.48%	-11.38%	6.18%	0.44%	3.22%	-2.77%	-3.20%	-3.35%	-1.20%	-0.02%	-3.49%
Nov-20	**-2.30%**	**2.64%**	**2.64%**	**1.72%**	**24.07%**	**-16.14%**	**12.61%**	**11.00%**	**10.49%**	**10.58%**	**10.74%**	**36.56%**	**2.86%**	**1.64%**

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Interest Rates

Section II

Interest Rates and Macro Backdrop

A Run Down of What's Impacting the Cost of Money

Canada

What We Know

- BoC Governor Macklem confirmed that our central bank is concerned about the amount of bonds that it can buy via QE - given the limited supply in the market. Anything over 50% is not really viable. Hence the reduction from $5billion per week to $4billion.
- Changes in the structure of QE are more important than the reduction in the volume of bonds purchased. An increasing focus on 5-7 year part of the curve is designed to support commercial and household lending more specifically.
- The elimination of purchases of bonds under 2 years (and reduction under 3 years) will weigh on prices and keep rates at the front end underpinned.
- As these bonds are no longer "squirrelled away" by the BoC, they will be available to the street and will compete for investors with Treasury Bills and BAs. These legacy bonds have higher yields (issued before 2020). This could push BA and Bill yields higher - pushing CDOR and swap rates higher over time

What We're Watching For

- Vaccines. Release and availability in Canada. It appears that we shall have to be patient north of the border as we have no domestic producers. We will watch for the impact on economic sentiment and activity when this fact dawns on the public. Could this hold back the rising of market rates at the margin?
- Negative rates - or at least lower rates. Governor Macklem, when asked recently about the possibility of Canadian policy dropping to below zero, said " negative rates are in our toolkit but they would not be terribly helpful at this time." However, perhaps with one eye on the limits to QE and another on the limits of vaccine availability (and indeed the seemingly limited public willingness to receive immediate vaccination) he also added that the BoC could potentially lower the effective lower bound from 25bps without going negative.

The market remains concerned about downside risks, but the BoC has been vocal in their support of the recovery through easy policy rates and QE

Interest Rates and Macro Backdrop

A Run Down of What's Impacting the Cost of Money

US

What We Know

- Despite strong data in Q3, the Federal Reserve remains cautious on the sustainability of the bounce and the impact of a vaccine. They have no plans to change course on policy
- Indeed, they may well look to be more aggressive on QE down the road. At first, most likely in *what* they purchase - ie longer duration for more impact (like the BoC.) But should fiscal spending increase issuance, or should the economy need it, they may look at increasing *how much* they purchase too.
- Janet Yellen is the new Treasury Secretary. As a former Fed Chair, she will work more closely with Jerome Powell than Steve Mnuchin, and she knows the nature and limits of the job better than he did. No more public calls for negative rates. And a commitment to push unemployment as low as is feasibly possible with the Fed's help (via highly accommodative monetary policy).

What We're Watching For

- Georgia. A Democratic sweep in the Senate runoffs on January 5th would hand them "Blue Wave" control. With seemingly unstoppable legislative power and with the Biden/Yellen partnership at the helm, we may see some aggressive programs to boost wealth and wages. Potentially quite negative for bonds and a strong driver of a steeper yield curve. Failure to gain total control of the Senate means Gridlock - a much less powerful position for Biden and at the margin more dovish for term rates.

Election risks are back in full force in January with Senate run-offs taking place that could impact the size of any potential fiscal impulse

Major Macro Trends

Macro Charts to Consider

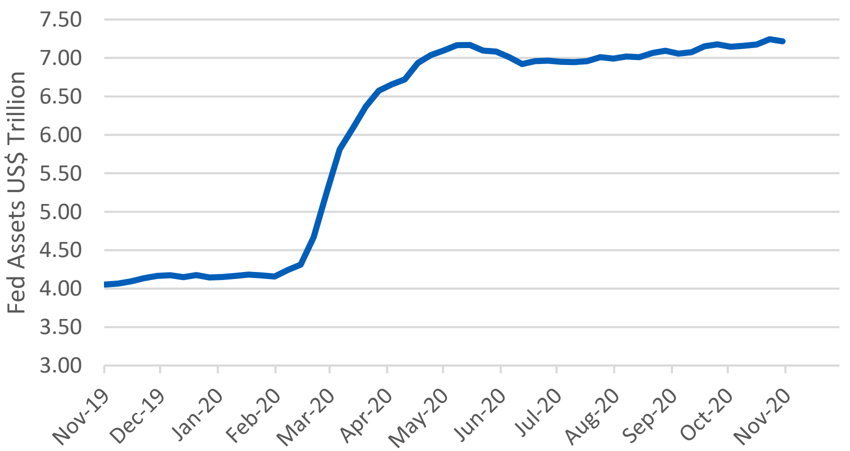
Markets are in a buoyant mood. Central banks are committed to low rates and balance sheet expansion while yield curves have taken a breather…can the party last?

- Has the backdrop changed? COVID cases are surging, vaccines are months away and yet markets are at all times highs, the USD is falling, and commodities rising
- And this is all without further clarity on the US fiscal impulse under Biden – is a large package needed if the outlook is so rosy?
- One place to look for over jubilant pricing dynamics may be stocks…the S&P 500 forward P/E ratio is screening ~21x at the moment…that's in the 93rd percentile running back to 2000…yikes
- However, what else is one to buy? Can bonds rally much further from here? Equities are anticipatory assets and thus the outlook is obviously well beyond the current maelstrom of bad news…let's hope expectations are met – we remain optimistic for a strong cyclical growth period in 2021 but the outlook is not without risks…

Fig. 2: US 5s-30s Curve has Levelled Off After Steepening Sharply

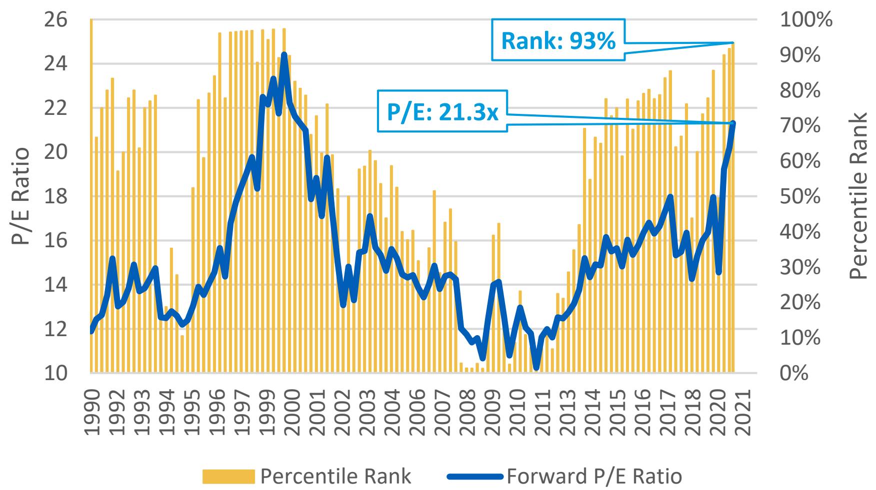
Sources: Bloomberg

Fig. 1: Fed Assets Have Sky Rocketed Above US$7 trillion…



Sources: Bloomberg

Fig. 3: Stocks Getting Pricey? SPX P/E in the 93rd Percentile



Sources Bloomberg, ATB FMG

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Canadian Dollar and G10 FX

Section III

Canadian Dollar Outlook

The Loonie Could be a Prime Beneficiary of the Growth Story in 2021

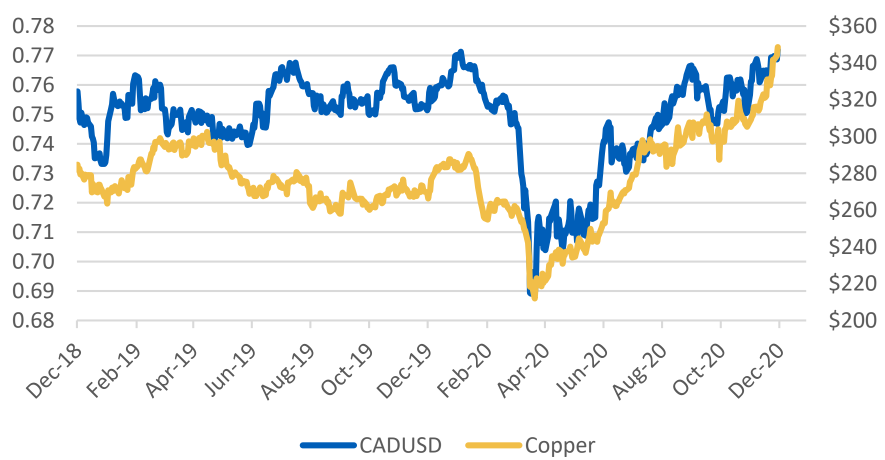
The Loonie had a strong month as commodity prices and growth prospects continue to drive appreciation against the US dollar

- With copper, oil, and equities all surging in November it was easy for CAD bulls to go along for the ride as the Loonie gained over 2.5% on the month
- CAD's high beta status means it will be riding shot-gun if the engine of global growth starts to rev in 2021
- Raw materials, agriculture, and energy prices all could be on the cusp of cyclical bull markets in 2021 as persistent under-investment in the last decade has created the conditions for tight physical markets to appear very early in the growth cycle – commodities are typically in deficit only in the late stages of the growth cycle, not the beginning
- That could be a boon for the Loonie in 2021…but risks remain
- COVID cases continue to threaten activity into 1Q21 and Canada is also lagging many G10 countries for delivery of vaccines, which could hamper domestic growth

Fig. 2: USDCAD Strong Support ~1.30 Being Tested Once Again

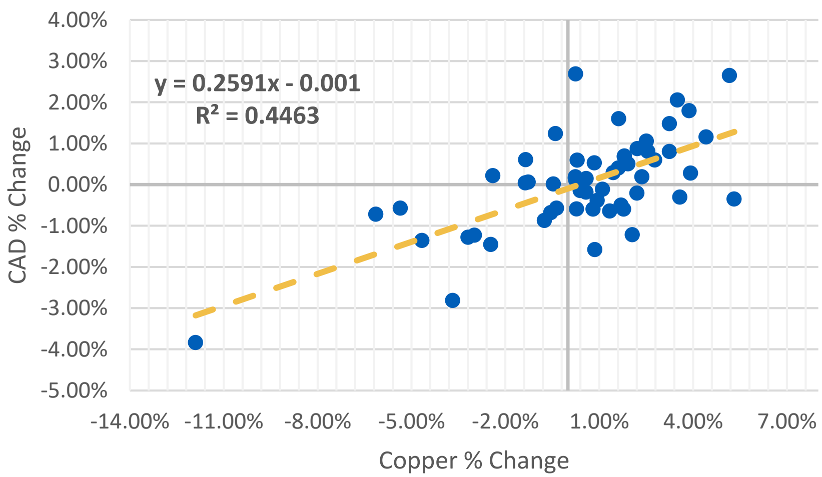
Sources: Bloomberg, ATB FMG

Fig. 1: CAD vs Copper: Loonie Tracking Dr. Copper Closely



Sources: Bloomberg, ATB FMG

Fig. 3: CADUSD vs Copper, Weekly 2% Change in Copper = 0.5% in CAD



Sources Bloomberg, ATB FMG

USD Index and G10 FX

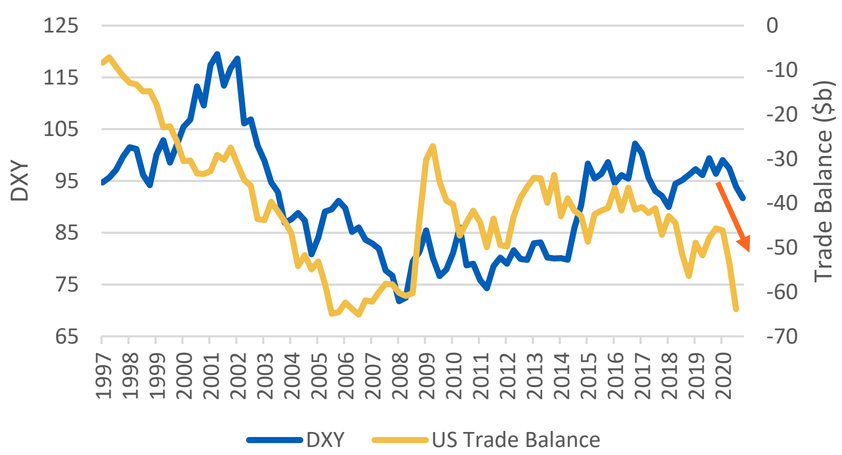
The Greenback On the Precipice

The USD has been on the back foot since the spring with the DXY down -10% since March and -4% year to date. The market is now testing key technical levels, and given the weak fundamental backdrop it could be 'make-it-or-break-it' time in the next few months

- The USD is facing three major threats: 1) A record trade deficit, 2) Ultra loose monetary policy + more fiscal stimulus, and 3) An increasing chance of a multi-year period of global cyclical growth
- The USD remains the world's reserve currency and in times of upheaval it will catch a bid in the flight to safety…but the weak fundamental backdrop means that the USD is swimming against the tide over the medium term
- Periods of strong global growth are generally not great for the USD as commodity exporting/manufacturing currencies reap the most reward
- Incoming Treasury Secretary Yellen has also noted in the past how a strong USD held the domestic recovery back in 2014+2016

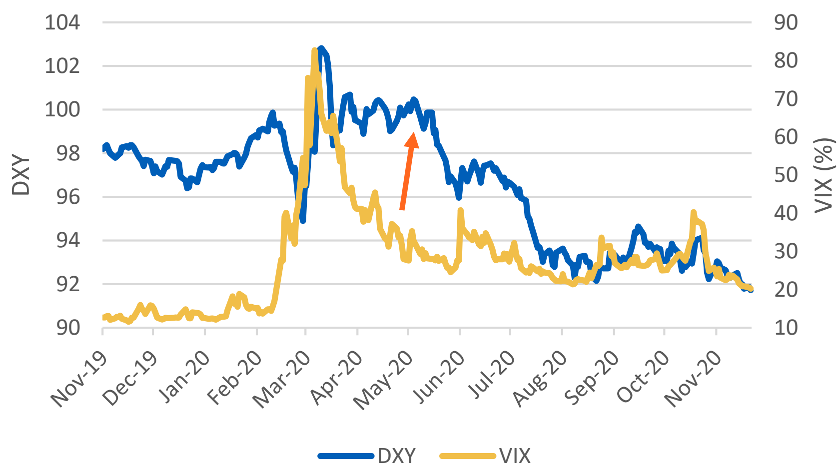
Fig. 2: DXY Near Crucial Support with Momentum Against it

Fig. 1: US Trade Deficit Should Exert Downward Pressure on the USD



Sources: Bloomberg, ATB FMG

Fig. 3: When Vol Spikes (Yellow), So Does the DXY (Blue)



Sources Bloomberg, ATB FMG

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WTI + Canadian Crude Outlook

Section IV

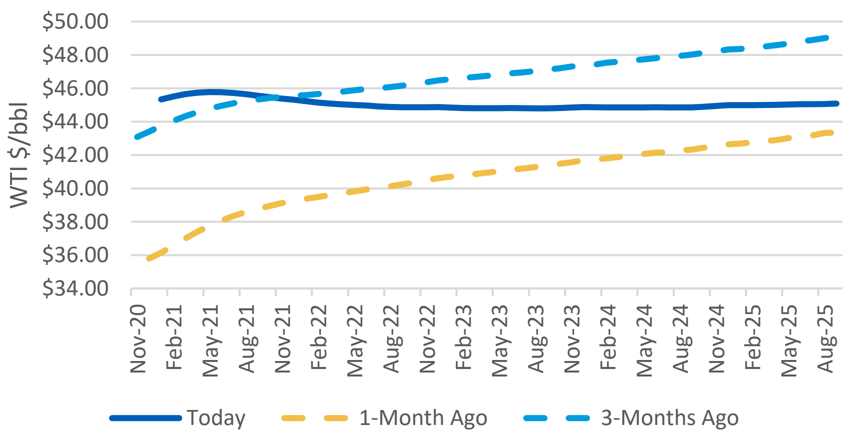
Crude Oil Outlook

OPEC, Lockdowns Key to Near Term Outlook

Oil prices surged as vaccine news drove the hope that we finally have a path towards normal mobility levels. However, that optimism must be tempered amid key near term risks: OPEC and a COVID Winter Wave

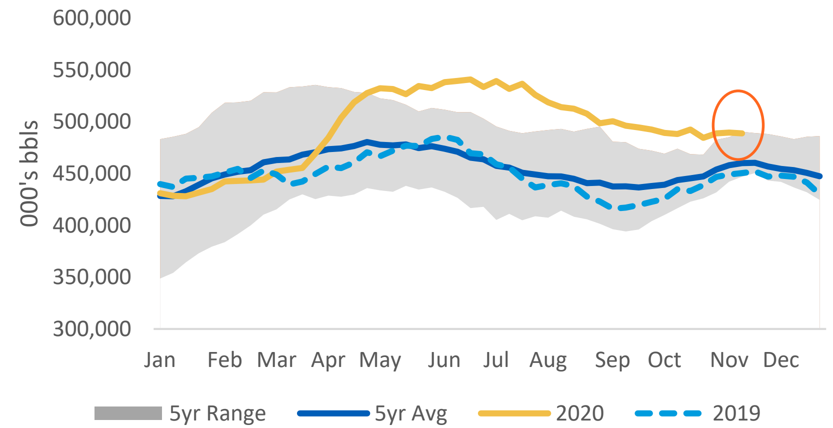
- WTI prices had a historic month with a +25% rally in the prompt contract that pushed the curve flatter (Fig. 1) with mild backwardation creeping into the picture
- However, we are still observing overall high levels of inventory despite the progress made to date with US commercial stockpiles running right at their 5-yr range top (Fig. 2)
- The outlook is also pressured by OPEC indecision on whether to maintain the current supply cuts: The market is convinced another 3-months is needed, but Gulf states are now wary about supporting the return of US shale and are dealing with large domestic budget deficits
- All of this and we may face yet more lockdowns as COVID cases surge...oil price volatility remains high and with good reason (Fig. 3)

Fig. 1: WTI Curve Backwardated Near the Front, Backs Stay Flat



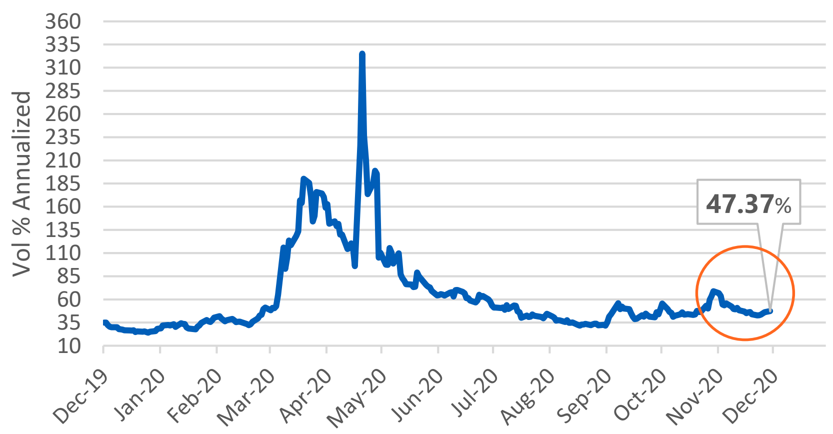
Sources: Bloomberg, ATB Financial Markets

Fig. 2: US Oil Inventories Normalization Has Slowed



Sources: Bloomberg, EIA

Fig. 3: Volatility Remains Elevated at 47%



Sources Bloomberg

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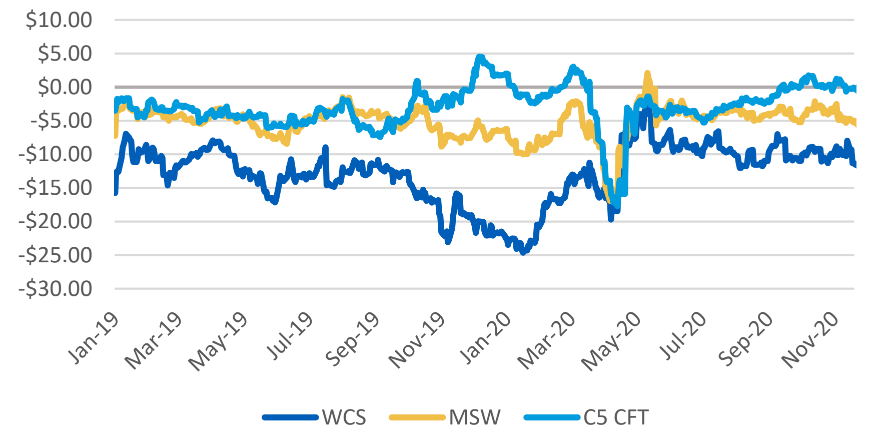
Canadian Crude Outlook

Differentials Remain Strong

Canadian Crude differentials continue to see stable pricing environment as US imports recover.

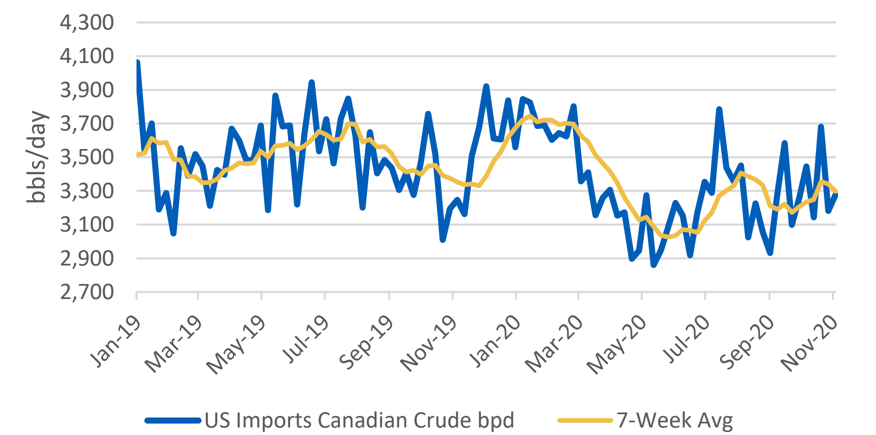
- The demand for Canadian heavy oil from US refiners remains strong and shipments into the US have improved slowly but surely since the market bottomed in May
- The 7-week average of US imports is sitting just below 3.3 million barrels per day, which is isn't too far from the levels seen prior to the market crash earlier this year
- Egress out of the WCSB continues to be favourable given the increased capacity on the Mainline due to lower overall volumes…the call on crude by rail has plummeted as a result (Fig. 3)
- Rail shipments were running less than 100k bpd during September, the last month for which data is available – this compares to over 400k bpd pre-COVID…
- At the current run rate, Canadian differentials should remain strong over the near term despite demand headwinds

Fig. 2: Canadian Crude Differentials to WTI (US/bbl)



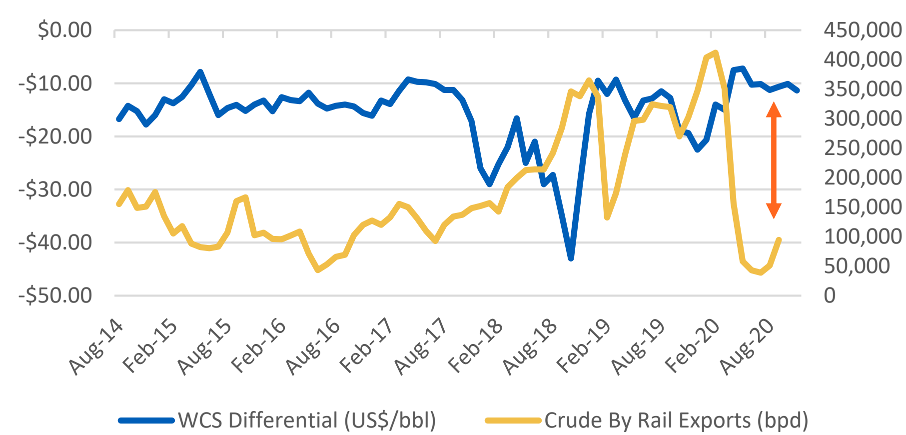
Sources: Bloomberg, ATB FMG

Fig. 1: US Imports of Canadian Crude Improving, Not Fully Recovered



Sources: Bloomberg, DOE, ATB FMG

Fig. 3: Crude by Rail Volumes Plunged, Supporting WCS Diffs



Sources: Baker Hughes, ATB FMG

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Natural Gas

Section V

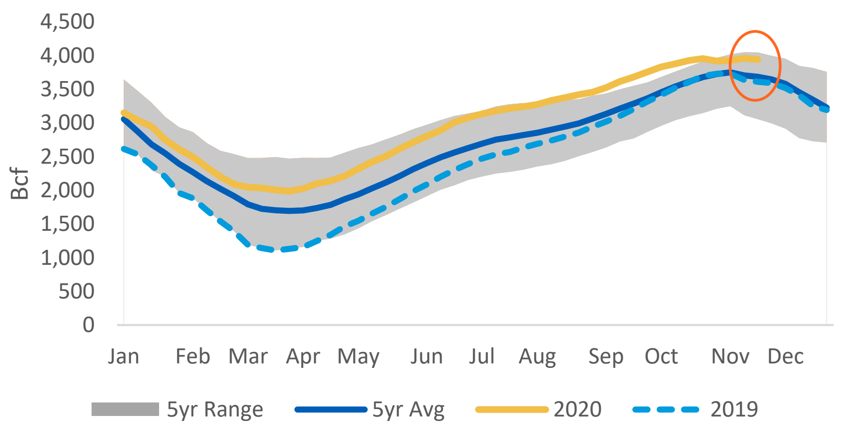
Natural Gas Outlook

Inventories Elevated, Winter Weather Missing

Natural gas prices plunged in November as warmer weather kept demand on the backfoot

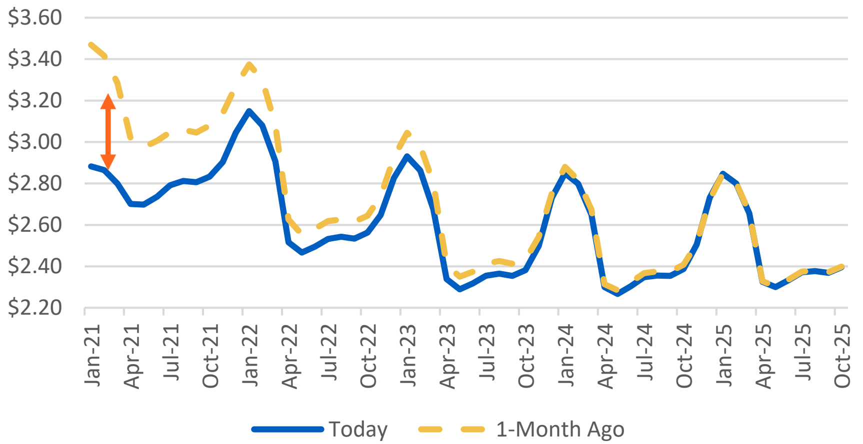
- The outlook for natural gas prices remains fundamentally strong as low capex/drilling + lower associated gas out of the Permian has shifted inventories across North America and created conditions where we could see significant price appreciation in the medium term
- But for now we are missing one key ingredient…winter weather
- Above seasonal temperatures were not on the radar this year as La Nina was expected to usher in a cooler than average winter
- Thus far we are seeing heating demand *below* average for November (Fig. 3) which has pushed the curve much lower in the fronts over the last month (Fig. 1)
- US inventories are still ~7% above the 5-yr average (Fig. 2)…so we need something to break soon or else the downward pressure on prices will remain

Fig. 2: US Inventories Still Elevated at +6.8% to the 5yr avg



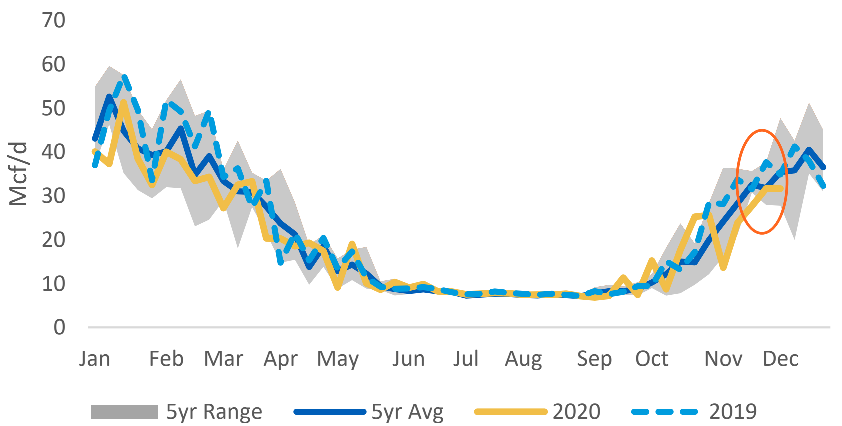
Sources: Bloomberg, EIA

Fig. 1: Nymex Pricing Took a Hit in the Front



Sources: Bloomberg, Baker Hughes

Fig. 3: Res-Comm Demand Below Seasonal Averages for November



Sources Bloomberg, ATB FMG

Natural Gas Outlook (cont'd)

Inventories Elevated, Winter Weather Missing

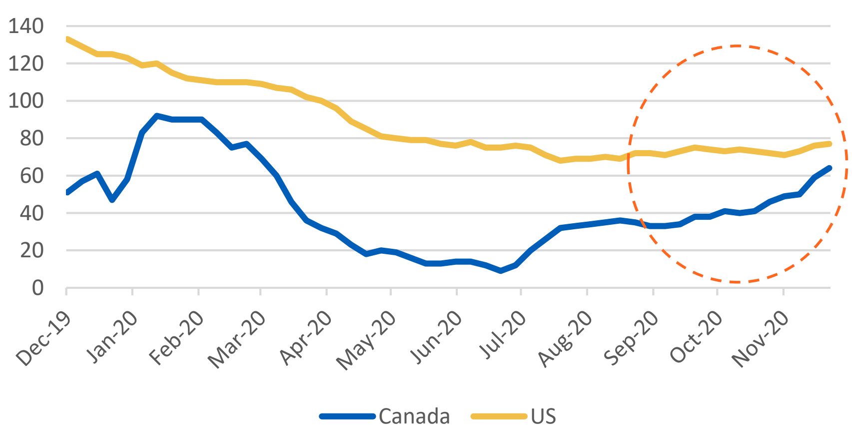
A bright spot for prices recently has been US LNG exports, which have surged to a new record this month at +11Bcf/d – quite the recovery from a meagre 2bcf/d back in the summer

- Strong TTF and Asia pricing has helped drive demand and the arbitrage for US producers remains favourable
- This is a bright spot given the weak domestic res-com demand profile highlighted on the 1st page – if we do get seasonal winter weather and continued LNG demand in the 9-11bcf/d range then the conditions are ripe for a sustained rally until spring injection season
- Drilling activity in the US remains low, with Canadian rig counts rebounding much faster as AECO surged past C$3.00/Gj
- That dynamic may help Nymex outperform AECO this winter in addition to recent lower than contracted flows at Eastern gate
- However, the AECO basis has proven resilient thus far and is still stronger than it was in October running at -US$0.75/mmBtu for January

Fig. 2: US LNG Exports Have Surged to Record Highs (Bcf/day)

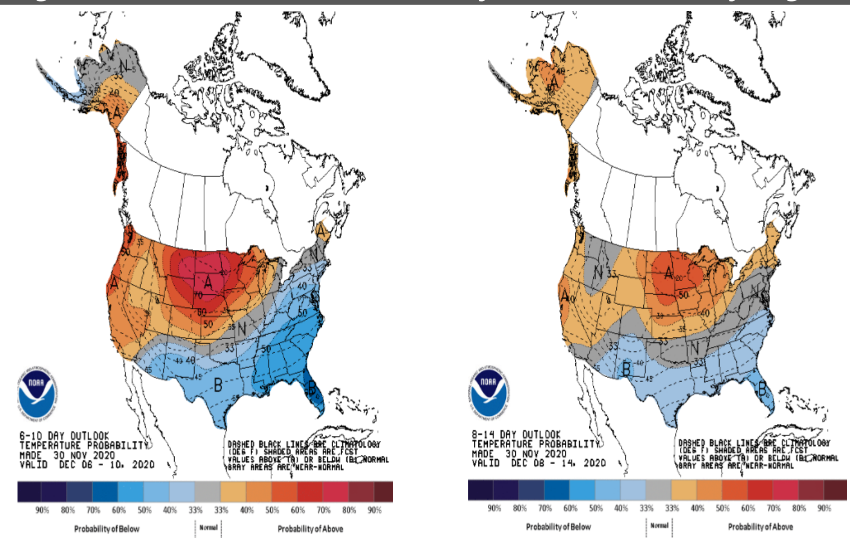
Sources: Bloomberg, EIA

Fig. 1: Canadian Gas Rig Counts Have Rebounded Faster than the US



Sources: Bloomberg, Baker Hughes

Fig. 3: US Weather Outlooks: 6-10 Day (Left) and 8-14 Day (Right)



Sources Bloomberg, ATB FMG

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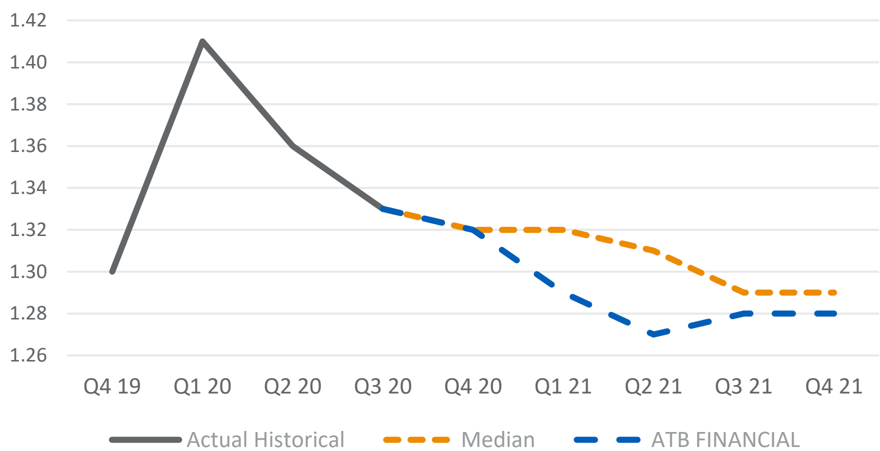
ATB FMG Forecasts

Section VI

ATB Capital Markets Pricing Outlooks

USDCAD Outlook and Energy Price Deck

ATB FMG USDCAD Forecast



ATB USDCAD Forecast	
Q4 20	1.32
Q1 21	1.29
Q2 21	1.27
Q3 21	1.28
Q4 21	1.28

As of October 2020

ATB Capital Markets Energy Price Deck

	2020			2021			Long-Term		
Oil	**New**	**Old**	**Change**	**New**	**Old**	**Change**	**New**	**Old**	**Change**
WTI (US$/bbl)	$38.75	$38.75	*$0.00*	$42.50	$42.50	*$0.00*	$55.00	$55.00	*$0.00*
Cdn Par (C$/bbl)	$45.00	$44.75	*$0.25*	$47.25	$47.25	*$0.00*	$63.25	$63.25	*$0.00*
WCS (C$/bbl)	$36.25	$36.25	*$0.00*	$36.25	$36.25	*$0.00*	$49.25	$49.25	*$0.00*
Brent (US$/bbl)	$41.50	$41.75	*($0.25)*	$47.00	$47.00	*$0.00*	$60.00	$60.00	*$0.00*
FX (US$/C$)	$0.74	$0.74	*$0.00*	$0.75	$0.75	*$0.00*	$0.75	$0.75	*$0.00*

	2020			2021			Long-Term		
Natural Gas	**New**	**Old**	**Change**	**New**	**Old**	**Change**	**New**	**Old**	**Change**
NYMEX (US$/mcf)	$2.10	$2.15	*($0.05)*	$2.85	$2.85	*$0.00*	$2.75	$2.75	*$0.00*
AECO (C$/mcf)	$2.30	$2.25	*$0.05*	$2.70	$2.70	*$0.00*	$2.50	$2.50	*$0.00*

Sources: Bloomberg, ATB Capital Markets

As of September 2020

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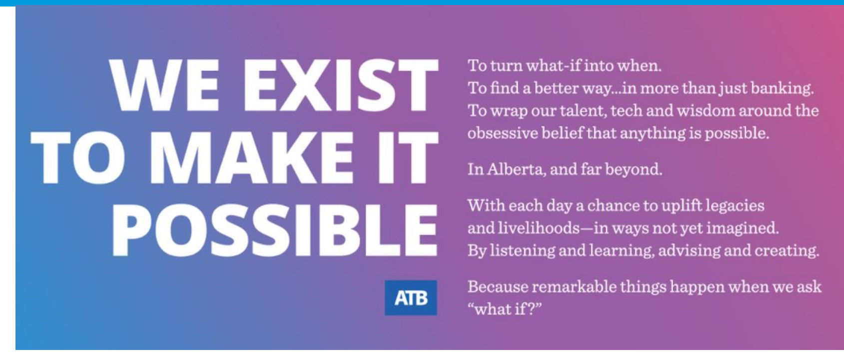

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