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USDCAD in the time of COVID-19

May 2020

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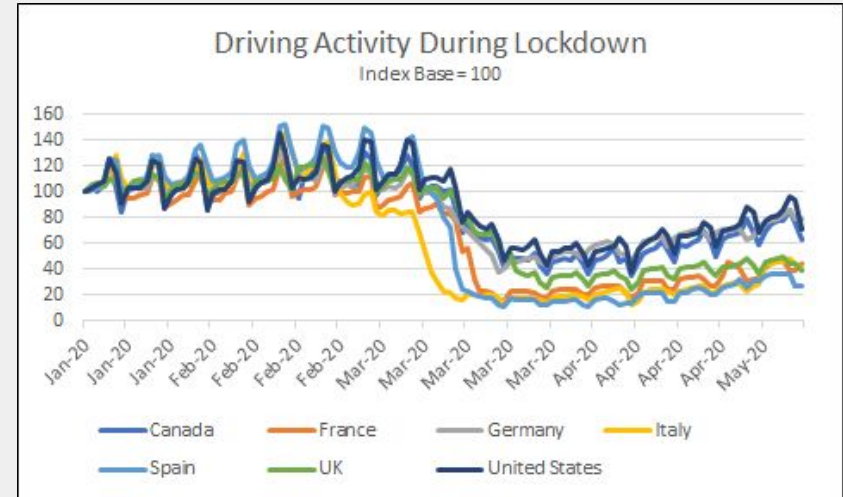
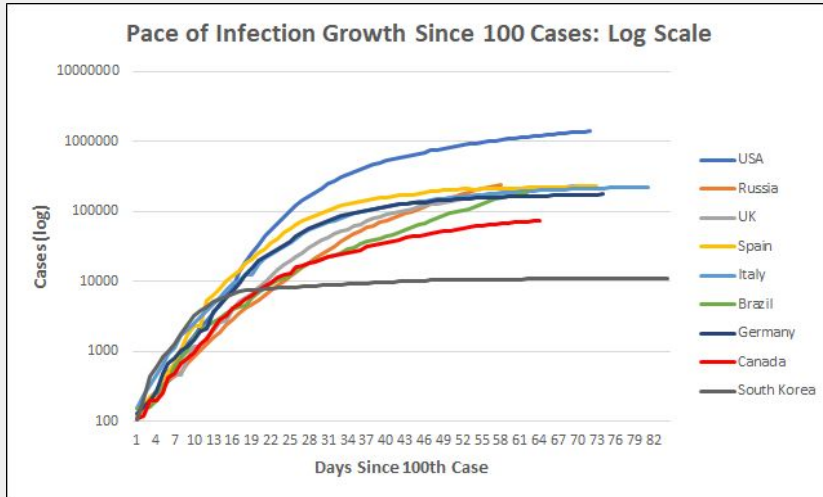
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Agenda

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COVID-19 Pandemic: From Lamb to Lion

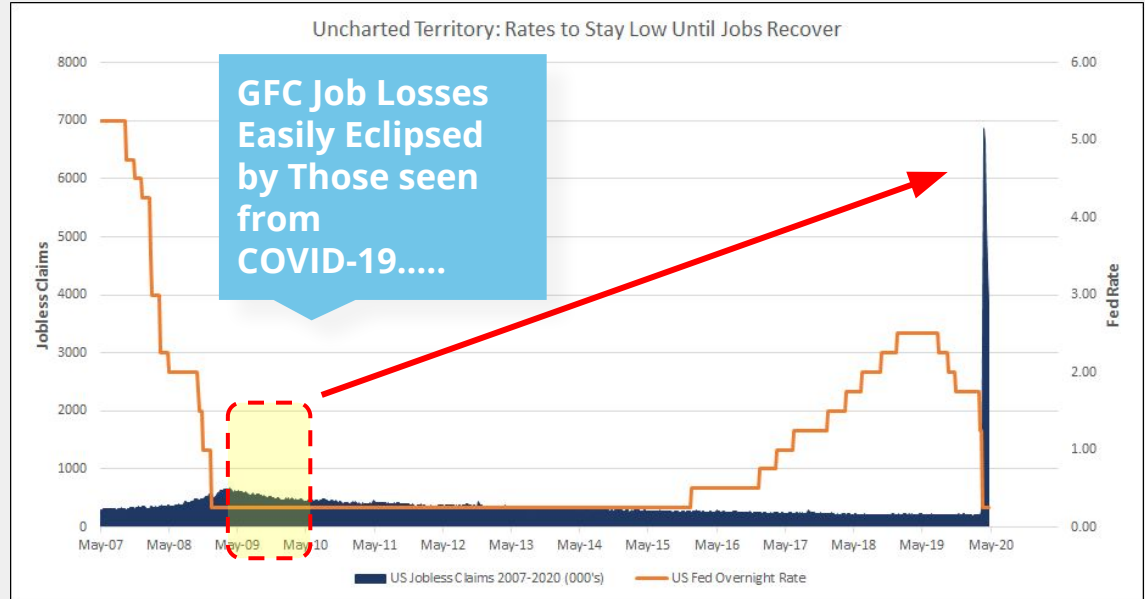


Source: Bloomberg, Apple Mobility, ATB Financial Markets.

- 2020 started off like a like a lamb with a fresh US/China trade deal, relatively strong oil markets, and overall low levels of volatility and stress across the financial system...
- ..That backdrop quickly morphed from Lamb to Lion as the Covid pandemic led to the effective shutdown of the global economy
- The chart on the right displays driving activity across key Western countries...this remains a crisis like we have never seen before with drastic implications across financial markets...

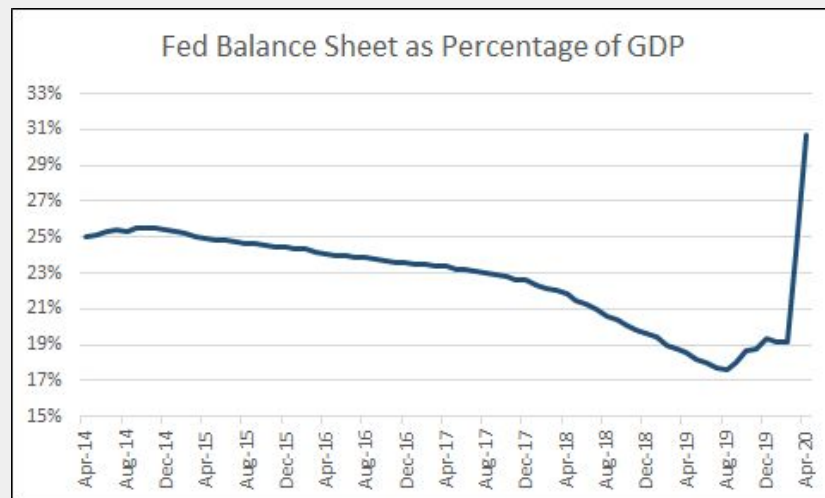
No Ordinary Crisis...

- Already we have seen depression-like job losses sweep across the US and Canada
- Easily eclipsing those seen from the Global Financial Crisis...these are not ordinary times, and thus monetary and fiscal support will be with us for a long time



Source: Bloomberg, ATB Financial Markets.

Result: Monetary + Fiscal Policy, Accelerator Pressed



Source: Bloomberg, ATB Financial Markets.

- The BoC and the Fed took similar responses to the crisis - slashing rates to a near Zero-Lower-Bound
- The Fed is also buying up record amounts of securities in an effort to boost liquidity and ensure the proper functioning of markets, but also in order to keep the front end of the yield curve low
- Canada also weighed into the QE universe for the first time with asset purchases across provincial and corporate issues
- Both the U.S. and Canadian federal governments have attempted to boost their economies via fiscal measures that measure approximately 12% (and counting) of their respective GDPs.

FX Returns: YTD, Peak of Crisis, Since S&P 500 Nadir

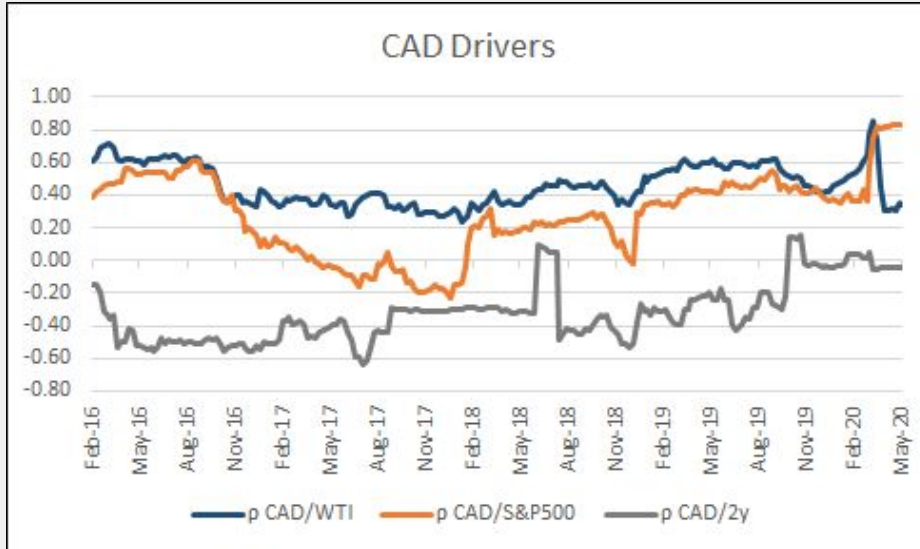
| FX Returns: Year-to-Date | |
|--------------------------|---------|
| Japanese Yen | 1.33% |
| Swiss Franc | 0.21% |
| Danish Krone | -2.71% |
| Euro | -2.90% |
| Swedish Krona | -4.26% |
| British Pound | -6.73% |
| Australian Dollar | -7.46% |
| Canadian Dollar | -7.79% |
| New Zealand Dollar | -9.31% |
| Norwegian Krone | -13.56% |
| Mexican Peso | -22.71% |
| Brazilian Real | -31.64% |

| FX Returns: S&P 500 Peak to Trough | |
|------------------------------------|---------|
| Japanese Yen | 0.13% |
| Swiss Franc | -0.07% |
| Euro | -0.73% |
| Danish Krone | -0.74% |
| Swedish Krona | -5.44% |
| Canadian Dollar | -8.78% |
| New Zealand Dollar | -10.43% |
| British Pound | -10.67% |
| Australian Dollar | -12.54% |
| Brazilian Real | -15.20% |
| Norwegian Krone | -19.95% |
| Mexican Peso | -26.80% |

| FX Returns: Recovery Since S&P 500 Trough | |
|---|---------|
| Norwegian Krone | 13.82% |
| Australian Dollar | 10.84% |
| New Zealand Dollar | 6.26% |
| British Pound | 6.22% |
| Swedish Krona | 5.82% |
| Mexican Peso | 4.05% |
| Japanese Yen | 3.82% |
| Canadian Dollar | 2.95% |
| Swiss Franc | 1.58% |
| Danish Krone | 1.29% |
| Euro | 1.14% |
| Brazilian Real | -12.58% |

Source: Bloomberg, ATB Financial Markets

- Emerging markets and Commodity Currencies bore the brunt of the sell-off
- Traditional Safe Havens like the Japanese Yen and Swiss Franc shone relatively brightly
- The Canadian Dollar has been a mid-performer thus far

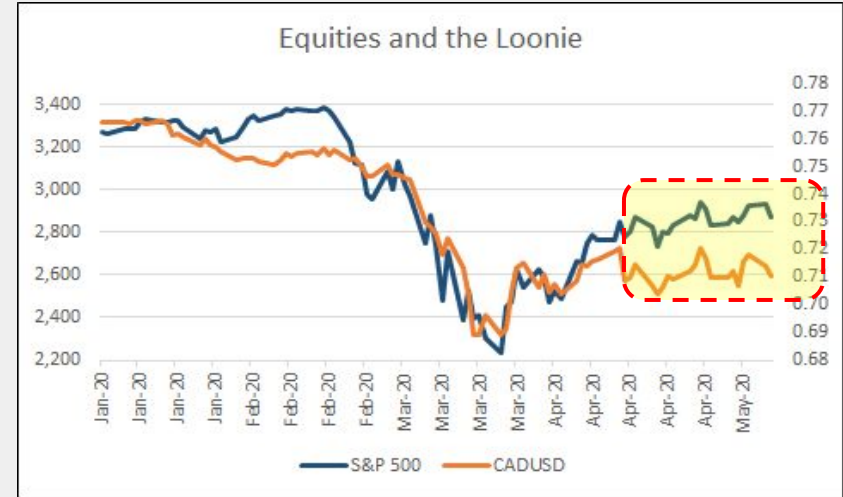


Source: Bloomberg, ATB Financial Markets.

What's Driving the Loonie? WTI, S&P500, or Rates?

- Here we track correlations between CADUSD, WTI, S&P 500, and US-CA 2yr Yields
- Calculated as a percentage change on a 40wk rolling basis going back to 2016
- Three Themes to Take Away:
 1. You can see that Yield Differentials are not driving price action at all...(grey)
 2. While WTI has had less of an effect recently (blue)
 3. And the S&P 500 has jumped to multi-year highs as a key driving factor for CAD price action (orange)

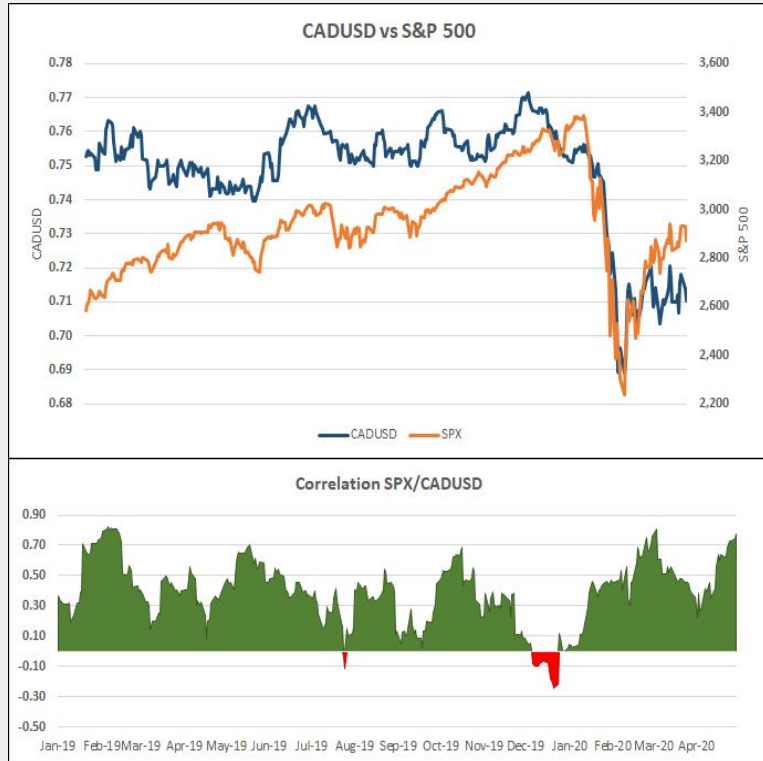
Some Key USDCAD Drivers shifted...



Source: Bloomberg, ATB Financial Markets.

- The coronavirus outbreak prompted an approximate 35% sell-off in the S&P 500 from early February to mid-March before monetary & fiscal policy measures worldwide, coupled with hopes of treatments/vaccines, created a slow (but still volatile) bounce. Its correlation with USDCAD has pushed higher such that it has become the best overall predictor for day-to-day movement.
- On the Right we have shown USDCAD inverted (CADUSD) to illustrate how closely the two mimic each other's movements, despite "occasional" decoupling.

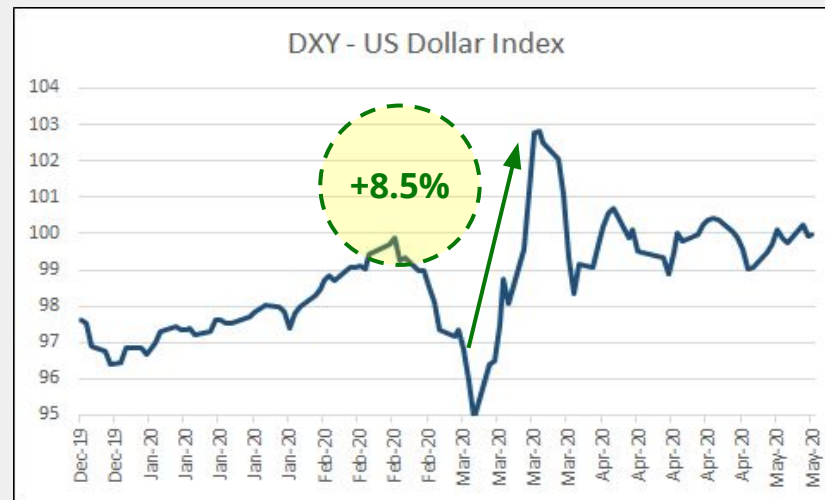
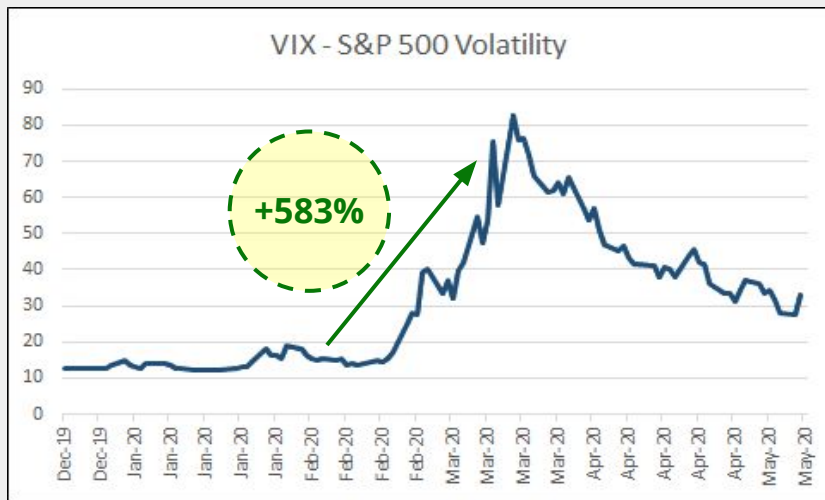
Loonie and S&P 500: Close Relationship



Source: Bloomberg, ATB Financial Markets.

- USDCAD correlation to the S&P 500 remains elevated. Since its nadir in mid March, the S&P 500 has managed to claw back 60% of its losses, and in that same period the CAD retraced 55% of its losses.
- Equities, normally driven by earnings and economic indicators, are now more a study of the severity of the coronavirus and possible developments on vaccinations and/or treatments.
- If optimistic on a return to the “old normal” then expect both Equities & CAD to strengthen.
- If pessimistic on the how quickly we move to a post-Covid world, then expect the CAD to remain under pressure.
- One model of a potential recovery that some of us subscribe to is the theory of a "swoosh" type recovery where the uptick is at a low angle, non-smooth line.
- **As a result, we expect USDCAD to gravitate in the low 1.40s in the days to weeks ahead before a slow grind lower in H2 2020, closing the year near 1.36.**

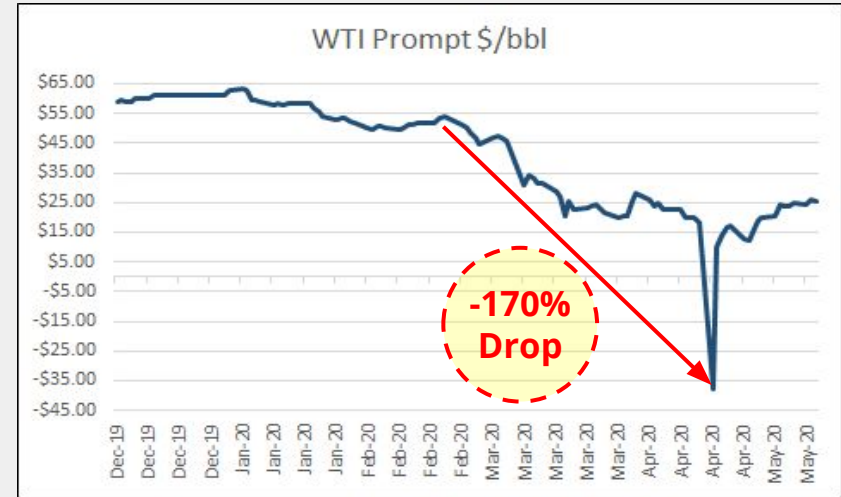
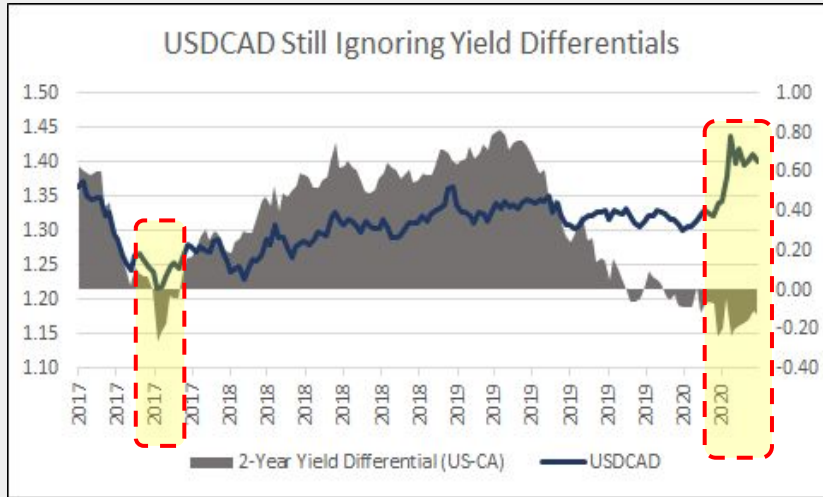
...While Others Re-Emerged: VIX & DXY



Source: Bloomberg, ATB Financial Markets.

- **VIX**, sometimes referred to as a "fear index", is the market estimate of the expected volatility of the S&P 500 index; it's calculated by using the midpoint of real-time S&P 500 option bid/ask quotes. It is highly negatively correlated with the performance of the S&P 500, and of late, positively correlated with Covid-19 incidences
- **DXY** - an index measure of the value of the U.S. dollar relative to a basket of currencies with the following weightings, EUR 57.6%, JPY 13.6%, GBP 11.9%, CAD 9.1%, SEK 4.2% and CHF 3.6%. When the S&P 500 decouples with USDCAD, it is often owing to movements in the DXY.

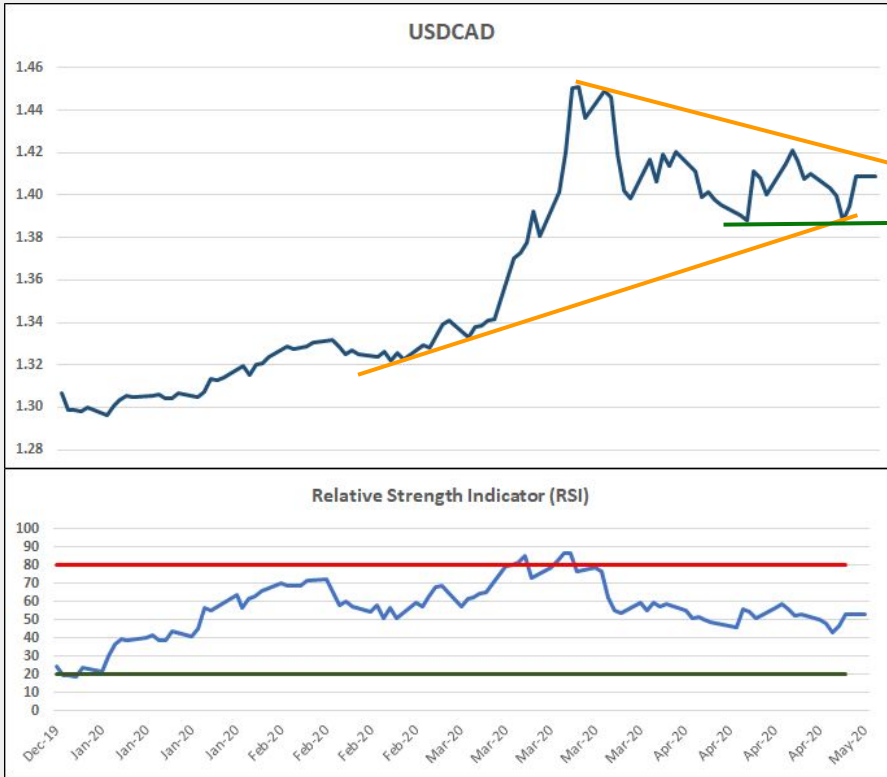
And Yet Another Got Thrown Out



Source: Bloomberg, ATB Financial Markets.

- Together with the "risk trade" as represented by the S&P 500, 2-year yield differentials helped explain USDCAD movements in the "non-crisis" past
- For example, note the spike in September 2017 corresponded perfectly with the move in USDCAD that year from the 1.37s to the 1.20s. This year's spike however to near +30 occurred on the same day that USDCAD traded up near 1.42
- A significant drop in global demand coupled with price wars pushed WTI into negative territory for the first time ever, however, USDCAD has not responded in kind. When WTI trades sub \$30 per barrel or north of \$80 per barrel (ie at extremes) the correlation falters.

USDCAD Technical Outlook

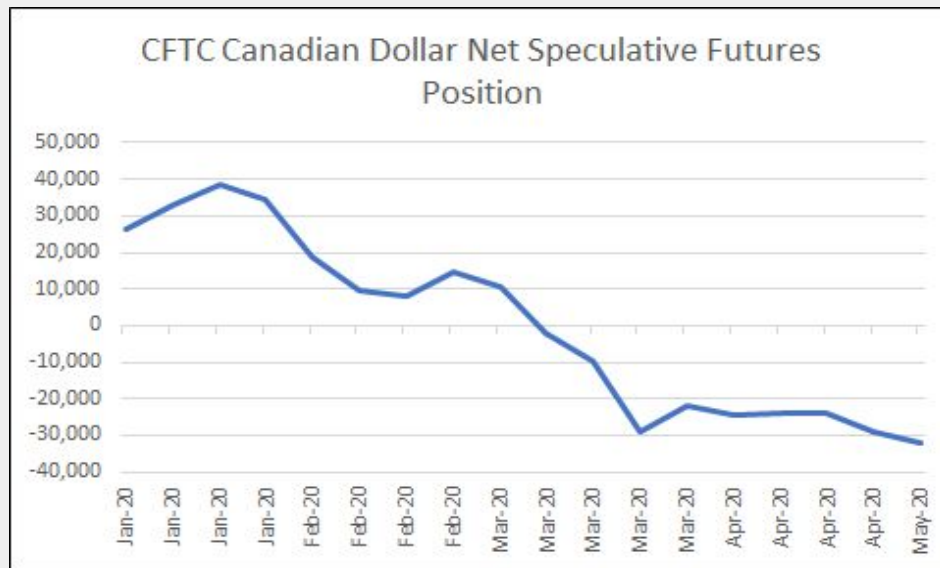


Source: Bloomberg, ATB Financial Markets.

- USDCAD peaked in mid-March near 1.4660, just shy of early 2016 highs near 1.4690
- RSI pulled back to neutral from overbought
- Trend of late has largely been consolidation within a 1.3850 - 1.4300 band. Recent wedge formation brings this in even further, to an approximate 1.3925 - 1.4125 range.

Net CFTC Positioning for the Loonie

- CFTC net speculative community continues to hold on to CAD shorts...
- ...but they are not adding to them anymore after a steady flow out of the Loonie



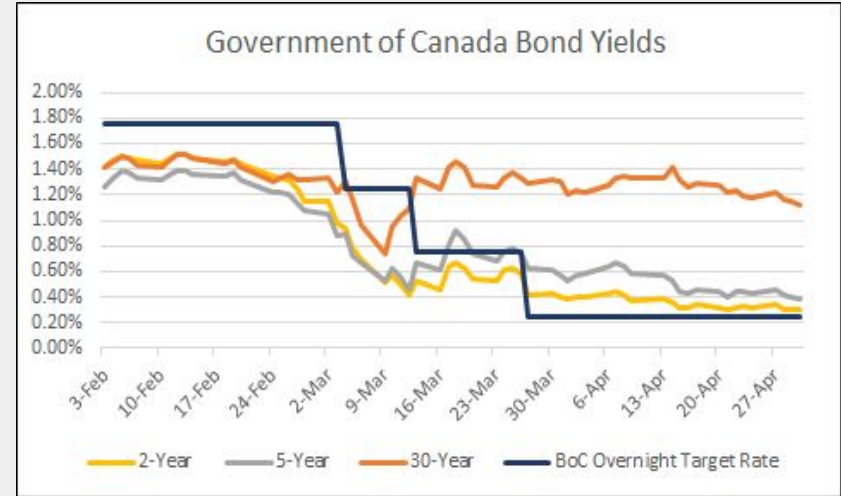
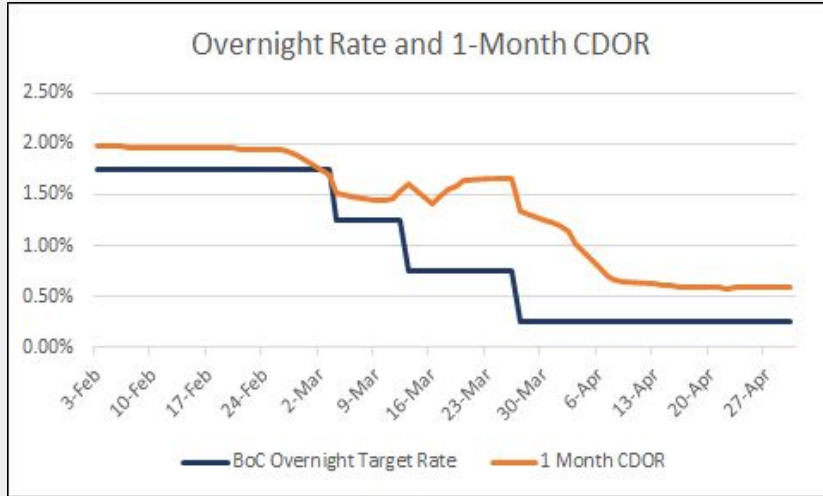
Source: Bloomberg, ATB Financial Markets.



Looking Ahead: Reasons for Optimism

- Daily S&P 500 ranges are narrowing & VIX is well off of its mid-March peak - volatility and the CAD do not get along
- DXY is well off of its mid-March peak and seems to be consolidating sub 100.00
- Multiple Covid-19 treatments and possible vaccinations currently being tested
- Yes, Canada's GDP is expected on average to contract by approximately 5% this year, but that's close to the expectations for the U.S. as well. Remember, it's all relative!!
- The Bank of Canada Governor position is filled, and in Tiff Macklem we have a veteran central bank official with significant experience. He was the Senior Deputy Governor of the BoC from 2010-2014, and was a senior member of the Ministry of Finance during the Global Financial Crisis. No significant surprises are expected at the helm.
- The Bank of Canada's newly announced Open Market Operation to purchase BAs (BAPF) helped bring down CDOR/BA rates to near normal spreads

BoC Action Helping the Corporate Market



Source: Bloomberg, ATB Financial Markets.

- The BoC rate cuts starting to filter through to corporate market with CDOR spread to O/N rate tightening up
- BoC Q/E measures are helping to keep 2 and 5 year rates much lower relative to the long term 30y

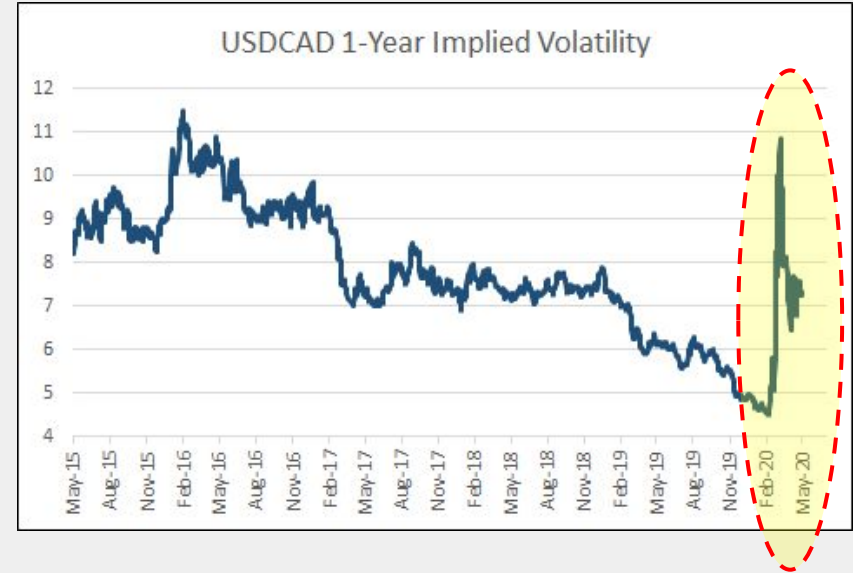
Looking Ahead: Reasons for Pessimism

- While the coronavirus induced 13% rally in USDCAD this year appears remarkably sharp, it pales in comparison to the near 26% rally in USDCAD during the GFC in late 2008: The severity of this move should not be misinterpreted as being without precedent nor overdone.
- We have not experienced such a bio-crisis in generations, thus making the path forward very cloudy, not conducive to "going long" CAD
- There is evidence that Covid-19 is impacting the way consumers act moving forward; eg. in Germany, retail sales are nearly 10% pre-Covid-19 sales levels
- At near 175%, Canadian Consumer Household Debt remains amongst the worst in the world, suggesting that the recovery here likely slower
- WTI is settling down at historically low levels as global crude demand plummets 30%
- Geopolitics: Increased rhetoric from the U.S. on China's culpability on Covid-19 in addition to accusations that China is attempting to disrupt the upcoming U.S. Federal election; Coronavirus reaches White House; Minority Government in Canada; North Korea.
- Most foreign interest in currency markets flows through to local fixed income markets; the total float of Canada's fixed income markets is less than 5% of that the U.S., thereby making liquidity a legitimate concern.



Recommendations: Use Volatility to Your Advantage

- We quickly moved from record low implied volatility levels in early 2020 to overly-elevated levels in mid-March and then back to our near average over the past 5 years.
- In keeping with our aforementioned assessment that in the short-term the future remains very cloudy, we would encourage USDCAD sellers to look at structures that allow for partial participation for CAD weakness ahead, including structures that embed a small amount of net volatility sales.
- For USDCAD buyers we are more inclined to act on any moves sub 1.40 and pin some short-term needs. Further out, in as much as your budget levels allow for some upside pain, we favour vanilla option structures that allow for partial participation for CAD strength, in the (hopeful) case we receive positive developments on Covid-19 and thereby positive signals for the global economy.
- Please call into our desk for further details



Source: Bloomberg, ATB Financial Markets.

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