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CPM's Jeffrey Christian reflects on 2019, forecasts what lies ahead in 2020

INTERVIEW | CPM Group sees precious metal prices rising in 2020

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Jeffrey Christian is the managing partner of CPM Group, a commodities research and management, consulting and financial advisory firm in New York. He founded the company in 1986, spinning off the Commodities Research Group from Goldman Sachs & Co., and its commodities trading arm, J. Aron & Company. Christian is an expert on precious metal markets and took time to speak with *The Northern Miner* about his views on the key trends in 2019 and his outlook for gold, silver and platinum group metals (PGMs) in 2020.

The Northern Miner: *It has been a crazy year with the U.S.–China trade war, impeachment hearings, worries about economic growth in the U.S., and Europe. And in the precious metals space, we've seen a wave of mergers and acquisitions that show no signs of diminishing. Let's start with some of the macro-economic issues that have dominated the headlines this year. How do you see the U.S.–China trade war playing out next year?*

Jeffrey Christian: I have taken a somewhat contrarian view about the trade war and that's actually a great place to start. We can talk about the trade war and pivot to all of the other political issues that are going to be much more important.

I keep telling my clients and colleagues to pay less attention to the trade war. It's interesting because I was in China in May right when U.S. President Donald Trump escalated things. I got off the plane on Sunday evening here and Monday morning there, and all these people were watching all of these nasty tweets from Trump. I said the trade war was a bogus thing. There have been trade imbalances for years that have gone unattended. Trump started the trade war not because of the long-standing trade imbalance, but as a distraction from his domestic legal and political issues. The problem for the Chinese government is that there's nothing they can offer for him to say the trade war is resolved, because it has got nothing to do with the U.S.–China trade war. Chinese Premier Xi Jinping said the exact same thing that Thursday. He said there's nothing China can offer the U.S., because it's based on Trump's domestic political and legal problems, and said he doesn't see any need to meet him at the next G20 meeting. That was in May and now it's December and it's the same story. But markets have been obsessed with this straw man.

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Market participants get optimistic that the trade war is going to be resolved, and then it's not going to be resolved and they turn bleak. It's like the guy sitting on his front porch with a shotgun on his lap waiting for the Feds to come down the lane, and meanwhile, the Feds came in his backdoor and cleaned out his house. There are all these big issues that are being ignored and we aren't dealing with the big issues.

CPM's view is that our clients should stop paying attention to the trade war. The key is to work around it because if you're looking to wait for it to resolve, well, that's not an effective business plan. An effective business plan is: How do you play your hand given the cards you have been dealt, and those include the U.S. wild card trade wars against China and any number of other countries.

It's important to realize that we are seeing a slowdown in the economy of the U.S. and in other countries, but we're not seeing a recession. The difference between a recession and a slowdown is that the economy is still growing in a slowdown. China has seen a contraction in auto production, but every other country has seen continued expansion of auto production, but at a slower pace. So yes, they are still making cars and using platinum and palladium in their catalytic converters.

The trade war will go back and forth in 2020 and we will continue to see a slowdown in economic expansion. We may avoid a recession in 2020 and 2021, but A) you've still got a lot of political troubles; B) fiscal, monetary, and financial issues are going to be problematic in nature, and C), there's no capacity it seems intellectually or morally to deal with the deficits and problems facing the United States. Then you've got the U.K. and an upcoming election that won't resolve anything; you may have a referendum in Scotland; you have issues within the EU; problems in Russia; increased nationalism in Eastern Europe; a range of economic and political issues in China; a number of countries in Africa that are experiencing protests, revolutions, and worse; problems in South America in countries like Ecuador, Chile, Venezuela and Brazil. So there are a lot of economic and political issues that the world is going to be struggling to deal with in 2020 and the trade war is sort of a distraction.

TNM: *Where do you see interest rates going next year?*

JC: They'll probably stay relatively flat in the U.S. You'll probably see an increase in the spread between U.S. Treasury rates and commercial rates for corporate borrowing. On the one hand the Fed will continue to be accommodative because the economic environment won't be overheated, and they have this enormous deficit to underwrite.

More important than the levels of benchmark rates could be issues arising from structural changes in the debt market.

While rates may remain relatively flat this year, you have this shift away from LIBOR to something new. There are various new overnight benchmarks that people are looking at. All have issues to be resolved and are not as liquid as the well-established, albeit flawed, LIBOR system. What the banks are warning regulators about is that these things aren't as stable or balanced as LIBOR, so you could have disruptions in the lending market next year. Even though the economy is puttering along and central banks are being accommodative, you could have problems in the lending and debt markets because of changes in the mechanics of banking. Obviously central banks are extremely worried about that, but they know they have to find a replacement for LIBOR, so the risk of something happening that might upset the apple cart in terms of mechanical changes is probably greater than what some of the people outside the banking sector realize.

TNM: *There has been a flood of mergers and acquisitions this year, starting with Barrick and Randgold, then Newmont Mining and Goldcorp, and more recently Kirkland Lake Gold's proposed takeover of Detour Gold and Endeavour Mining's bid for Centamin. Do you see this wave continuing and what's driving it?*

JC: What's driving it is somewhat higher prices in gold and silver and some of the base metals, and a lack of organic growth opportunities on the part of these large companies. As a result, it will continue, and, it might accelerate, but it's really about the failure to develop their own companies. It's easier for these guys to merge and acquire than to find their own mines.

United States President Donald Trump and President of the People's Republic of China Xi Jinping, in June 2019 at a G20 Summit in Osaka, Japan. WHITE HOUSE PHOTO BY SHEALAH CRAIGHEAD

TNM: *Let's move to your precious metals forecasts for 2020.*

JC: We expect gold and silver prices to rise modestly on an annual average basis — about a 10% increase, which would put gold close to US$1,600 per oz. by the end of 2020, and perhaps a 17% increase in silver on an average annual basis, which would put it at US$18 per oz. by the end of 2020.

These are relatively modest increases, far less bullish than the "true believers" or promoters espouse. One of the things that we have seen, and it's very interesting, is that when we talk about real economic and political issues facing the world, and the chimera ones like trade wars, it's a real problem, but the reality is that it has gotten far too much attention and it's very superficial. It's just listening to the tweets as opposed to looking at the underlying trade negotiations. But as that has happened in 2018 and 2019, we have seen investors buying less physical gold and silver. It's kind of interesting that while economic and political problems seem to be getting worse and should drive prices higher, people are buying fewer ounces of physical gold and silver. There's a lot of activity in the futures and options market. In other words, mainstream investors are buying exposure to gold and silver prices, while long-term insurance seekers are buying less physical metal, seemingly less concerned about economic catastrophes disrupting their access to money in the bank. We're seeing that investors are getting a good accurate read that no, we're not in a recession, the stock market has shown a lot of volatility and capacity to decline, but it's still rising and reaching record levels. Investors are not ready to pivot into physical precious metals yet, and some of these are short-term, opportunistic investors, rather than investors holding long-term positions. We have seen enormous futures and options positions established by mainstream investment management companies that are not interested in owning gold or silver, but want hedges against their stocks and debt asset holdings.

We're seeing relatively tight physical markets, meanwhile, that could play into higher prices later, when physical investors return as buyers. However, in 2018 and 2019, we have really been seeing some of the lowest demand from precious metal investors in almost two decades. If and when investors decide to come in and buy even small amounts of physical gold and silver — if they step up their gold and silver purchases in small amounts — compared to 2019 — the buying of physical metals could have a very powerful effect on pushing prices up. By extension, if CPM does not think prices are going to skyrocket next year, it reflects our view that we don't think investors are going to come racing back into the market, either.

In a "normal" world, if the U.S. president were up for impeachment for something other than oral sex, you'd expect that to be seen as a destabilizing event that would push gold and silver prices higher. I refer to former U.S. president Bill Clinton as the exception. That was, to be nice, a joke impeachment proceeding, although the joke led to the creation of the hostile political environment that has grown since that event. If you go back to Nixon's times, and think in general theoretical terms, the impeachment of a president or investigation of criminality and treason of a president ought to destabilize the markets, but in this crazy world right now, if Trump was removed from office, it would be a selling opportunity for gold and silver because it would be a reduction of uncertainty. It's kind of weird but that's the way it is.

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A haul truck at Detour Gold's Detour Lake gold mine in Ontario. DETOUR GOLD

TNM: *The Dow and S&P continue to reach new records. What's going on there?*

JC: It's all about the flood of money. If you look at private equity, there's US$1 trillion in cash in private equity funds and another US$3 trillion in bonds waiting to be allocated to investments. Bond rates are very low, in some cases they're paying the government to own the bonds, so there's a tremendous amount of cash looking for investments. Much of the money stacked up in bank deposits by banks and institutions is being used as collateral for higher-yielding collateralized debt offerings, many tied to U.S. equity market indexes. On top of this enormous pile of investible cash, you continue to have decapitalization in the U.S. market, where companies are buying their own shares and dividending out profit rather than investing in their businesses. They're not particularly aggressively hiring, they're not building new factories or buying new equipment, so you've got this decapitalization that shrinks the pool of shares and so pushes up stock market prices.

TNM: *What about PGMs?*

JC: The palladium price is more than double the platinum price and that's going to be the case for a long time. You're starting to find investors that want to believe platinum prices will rise, but the reality is they really struggle around the US$900 per oz. mark. We don't think it will rise dramatically over the next year or several years, because part of the bearishness about platinum is that diesel is going away and internal combustion engines are going away much more rapidly than they really are.

If you look at the auto industry and what they expect of growth in the electric vehicle market and compare it to what the metal industry and others are saying, the auto industry is much more cautious about the growth rate and market share-taking of EVs, because they say there's not enough electricity, the grids can't support the distribution of the electricity that's needed, and the infrastructure that's required to build the components and controllers isn't there. EVs will probably grow in terms of market share, but it's going to be very slow growth. And even if you use the most bullish forecasts about EVs, you have only 30% of the market being EVs by 2040, so that means 65% or more of the cars will still have internal combustion engines (ICEs), and will need platinum and palladium in their catalysts to clean up their emissions. ICEs and platinum and palladium are going to be used for a long time. This is being missed in the market, and as a result, we think the platinum market is underappreciated. We see platinum prices struggling towards US$1,000 per oz. and palladium pretty much plateauing at US$1,800 to US$1,900 per ounce. TNM

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