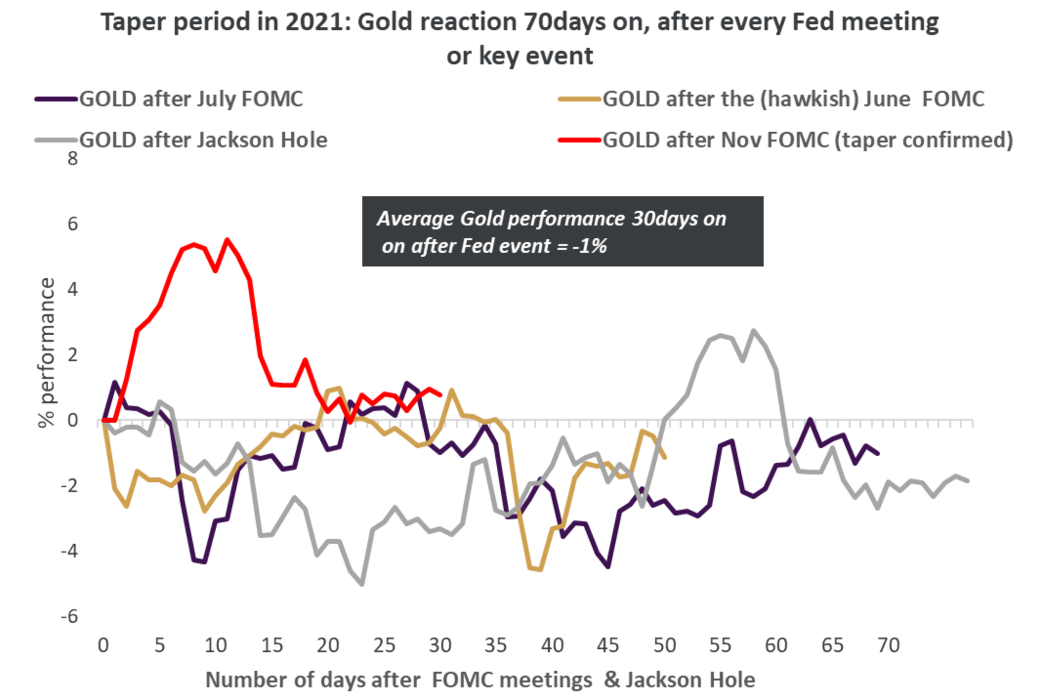
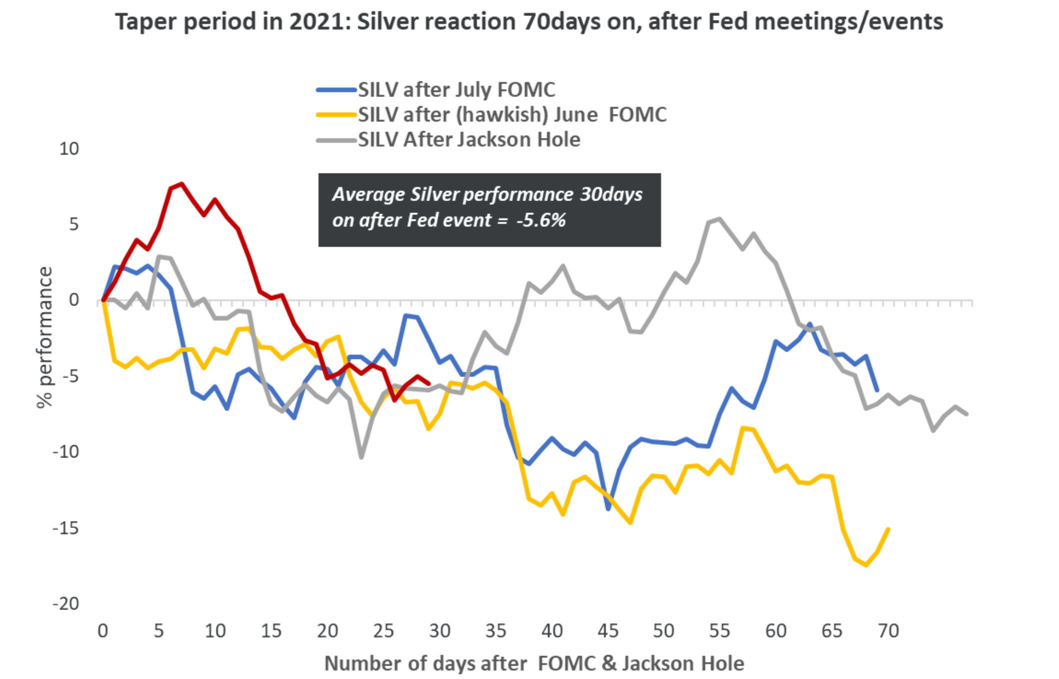
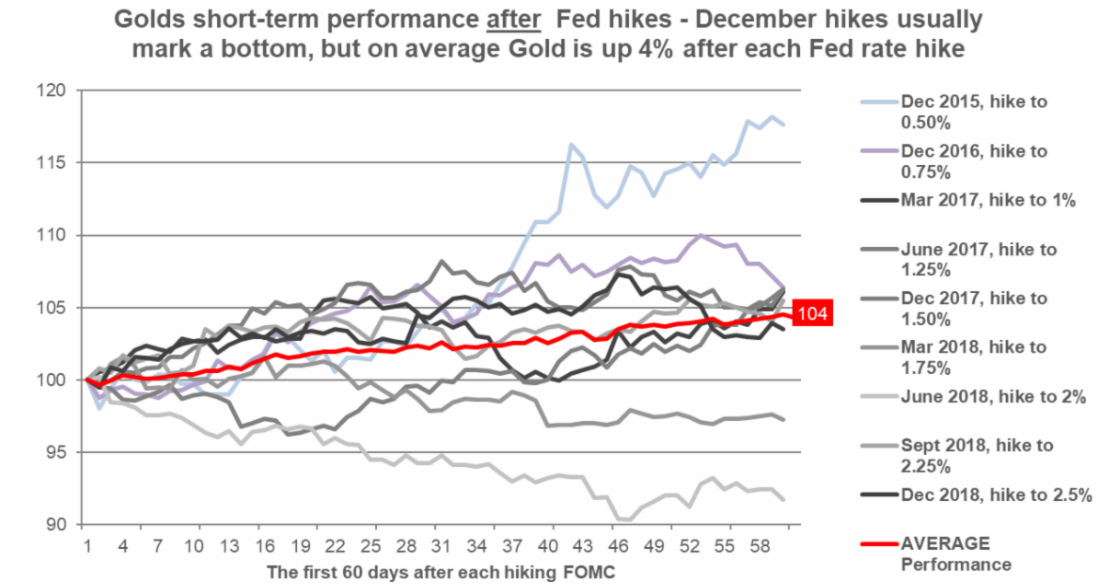
European Daily Wrap



* Hawkish FOMC defined as first mention of tapering bond purchases (Jan 22 2013 FOMC and June 16 2021 FOMC)
Source: Bloomberg, MKS PAMP Group



* Hawkish FOMC defined as first mention of tapering bond purchases (Jan 22 2013 FOMC and June 16 2021 FOMC)
Source: Bloomberg, MKS PAMP Group



*Prices indexed at 100 at the start of every hiking FOMC

Source: MKS PAMP Group, Bloomberg

- **Another day and another upside US inflation surprise with the PPI beating expectations** both on headline (+9.6% YoY) and core (+7.7% YoY). There is simply no indication from data that inflation metrics are going to rollover alone, which only adds pressure to the Fed with this 2day FOMC meeting starting today. **The almost $20 Gold and 40c kneejerk fall in Gold & Silver to the PPI print just highlights the dominant market thinking --> "Inflation is bad for gold (bc of an assumed hawkish Fed)"**

- The dominant consensus is that the Fed will double the pace of tapering tomorrow (i.e.: to reduce bond purchases by $30bn vs the current $15bn/mo), which would end the purchases by mid March 2022. They are also expected to pencil in more rate hikes over the next three years. Remember, inflation has been rising for over a year and they've done little to deal with it (until it hit 6% and "transitory" was retired); d**oing 'too much too late' is always any policy risk - its been that way for 2+ decades since the Fed as largely been reactive (vs being proactive in early 1990s). So, don't rule out a hawkish taper** (a taper done in 2 meetings, mabe even one!).

- However, that's certainly been priced in... The streets expectations for rate liftoff is around summer (June through September); only a very few sell side analysts have a call for a hike in Q1. B**ut the moves in Fed Funds and other rate-sensitive metrics has been huge in Q3'21 alongside the run in CPI prints; arguably Gold still overpriced/expensive vs the move in Fed Funds, as its essentially unchanged QoQ.** We've noted that Gold is stuck– its stuck between pricing in 2 vasty different Fed policy mistakes

- **Fed policy errors – will the Fed move too quickly (inducing an early recession) or too slowly (inflation escape)?** That's has HUGE implications for Gold. The former is depressionary/disinflationary (with rising real rates), the other is inflationary (with falling negative real rates), and **hence forecasts for next year should incorporate a wide bull/bull case given the tricky corner the Fed is being pushed into.**

- We will also get the first glimpse of Powell after this recent hawkish Congressional testimony in which "transitory" was retired. He's now been fully confirmed for another 4 years and the markets will get further clarity around the the **two schools of thinking --> 1. The Feds center of gravity is shifting dovish; they will be behind the inflation curve, VS 2). Powell has a reputation to the uphold and will manage a soft landing of inflation expectations.**

- Gold didn't go up when inflation has been peaking while the Fed was holding steady; is the opposite true? IE: Will Gold go up when inflation peaks as the Fed moves away from the zerobound? Gold cares whether, on aggregate, the Fed is behind (negative real rates rates) or ahead (positive real rates) of the inflation curve**. For now, the "COVID-supplychain-higher-inflation" cycle will continue, ensuring negative real rates keep precious in play, albeit not super bullish. That thinking changes if they really surprise the market (read: ending taper in**

1 meet, surprise hikes, 50bp hikes etc) which will stop the run in inflation expectations in their tracks. Put another way, when Kashkari votes for a rate hike (the "ultimate" dove), they are ahead of the inflation curve (=sell gold).

- P**olitical pressure will ramp up o the Fed to combat inflation because of 1) midterms next year, 2) higher gas prices, 3) fiscally, nothing is being done to combat inflation – the administration actually believes "Build Back Better" plan reduces inflation. So unfortunately, the Fed will have to pull out all of the inflation fighting tools.**

- Graphs 1 and 2 simply show the reaction in Gold and Silver after every FOMC meeting in 2021, in which the Fed threatened taper (June, JH, Sept 2021) and finally announced tapering (Nov 2021). **The takeaway is that Gold/Silver is faded with rallies sold after each meeting in which hawkish rhetoric presides; the meeting to buy is once any action is finally announced (a little "buy the fact") which was seen after the Nov '21 FOMC**, with Gold/Silver rallying 6 / 7% respectively in the very short-term. The quicker the Fed tapers and gets to a hiking cycle, the more tit will pressure precious metals. However a slower hiking cycle (vs expectations) will be constructive for Gold; graph 3 shows Golds on average up 4% 60days on after each of the recent Fed hikes; t**he traditional thinking that Gold can't rally during hikes is incorrect, especially if structural bullish drivers (negative real rates, debt, inflation fears) remain.**

**approved for all external purposes*