NESVICK TRADING GROUP, LLC

Thursday, May 21, 2020
NTG Morning Comments
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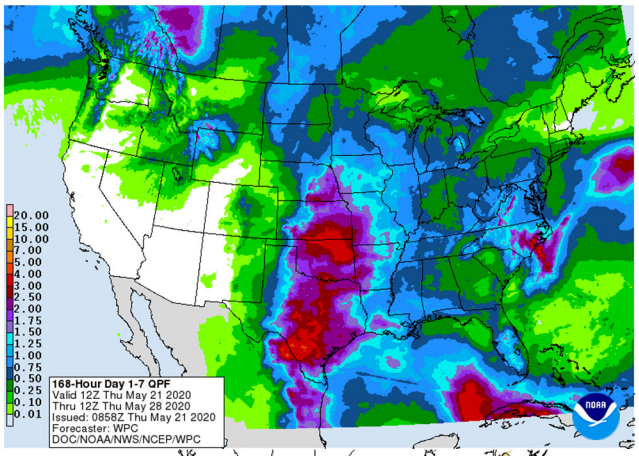
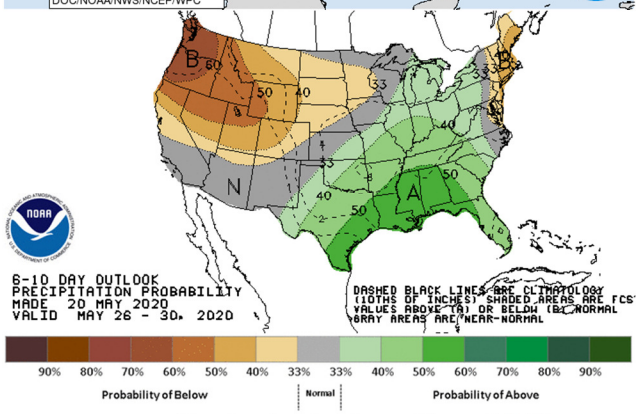
Weather

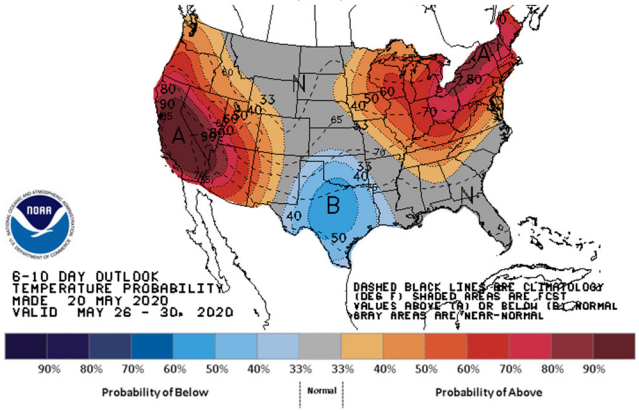
No major changes to the forecast this morning. Not a lot of precipitation today but showers should start in the Plains and WCB later tonight and tomorrow and we should see near daily chances for rain over the next several days after that. The biggest rainfall totals should probably been seen on Sun/Mon favoring the Southern Plains and portions of the southwestern Corn Belt. Rainfall totals are never very big in the ECB, but there will be near daily chances for persistent rains which will keep the area damp. That area should also expect to see AN precipitation chances during the 6-10 day period. No changes on the temperature outlook with a mix of mostly near to above normal temps expected through the country over the next two weeks.





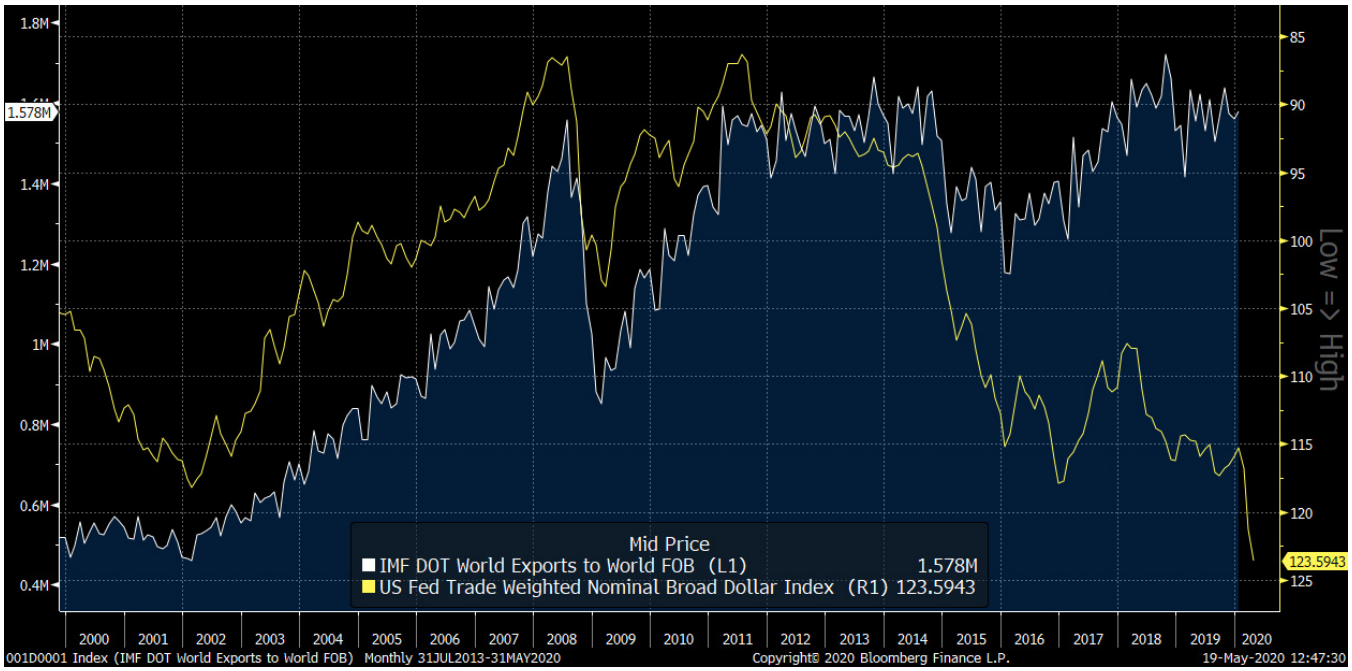
Crops

We're looking this week at bringing grains and oilseeds "back" and what that might require. We noted yesterday that strength in the dollar is encouraging Brazil's farmers (and other countries) to continue to expand production as prices in local currency terms are at record levels. So today we'll start to look at the outlook on the dollar. Unfortunately, there are just too many moving pieces to cover here. I'm going to narrow down the focus to "international" and "domestic" factors. Obviously within those sub-groups, there are lots of moving pieces, and within them I'm only going to focus on one issue for each. We just don't have the time to go too far in the weeds. Even if we did, I'm not sure how much it would help. Even narrowing it down to those two factors…I have a hard time making up my mind on what to expect from the dollar here. That said, I hope this at least frames the conversation and that, with these ideas in mind, we can see the shifts in market action in real-time more effectively.



Most of the hyper-bullish USD traders and analysts I see mainly point towards a "collapse" in global trade as a key catalyst to propel the dollar higher. They point out the US-China trade war, increasing protectionism globally, and now Covid-19 are all reasons to expect global trade flows to contract going forward. They correctly point out that the US-China trade "deal" doesn't really solve much and obviously global economic numbers are a wasteland in the wake of Covid-19. In the past, global trade flows did indeed post a strong correlation with the dollar index. The chart below shows this relationship. The white line represents the IMF's estimates of total

global exports on a monthly basis. The yellow line shows the Fed's trade-weighted broad dollar index, with the axis inverted. As you can see here, in the past when global trade volumes increased, the dollar weakened. In 08/09, when global trade volumes contracted sharply, the dollar strengthened. The reasoning goes that, as the world's reserve currency, when global trade is expanding there are lots of dollars floating around in the global financial system. Many countries issue dollar-denominated debt, and when trade is active there are plenty of dollars available for them to use in payment of that debt. When global trade contracts, however, those countries are "short" the dollars and the dollar rallies in response.

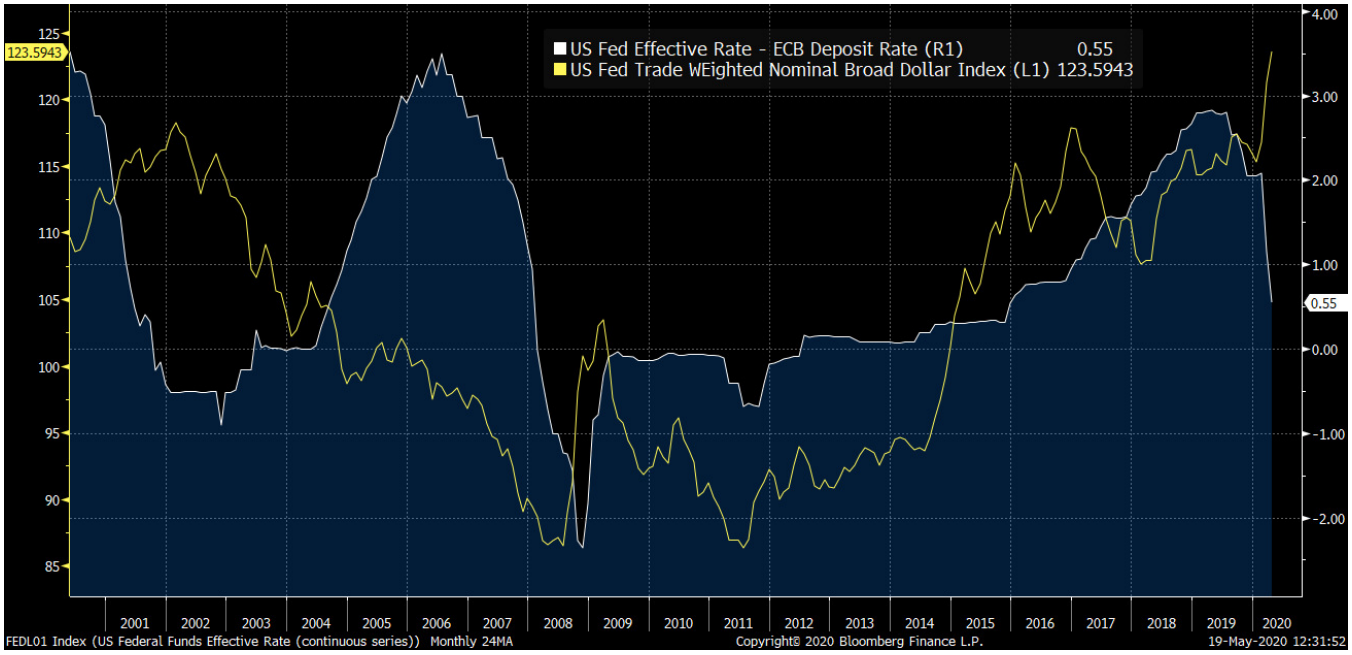


So the relationship as shown above has been strong over the past 20 years and the thought-process makes sense. I don't think many of you would argue that we're not moving towards more protectionism globally. That said, it bugs me that the relationship above breaks down starting in 2016. From 2016 through 2019, global trade volumes were expanding but the dollar simply maintained a trading range. Obviously here in 2020 the dollar has broken out to new highs, and I suspect the IMF's trade data will show a sharp contraction when it is updated (the chart above is only current through January). Still, the question remains – what changed in 2016 that prevented the dollar from weakening when global trade volumes were increasing?

As it turns out, the answer wasn't too difficult to figure out. Starting in late 2015, the Fed began raising rates. While the rest of the world's major central banks, and specifically the ECB and BOJ, were maintaining zero or sub-zero interest rates, the US Fed began a rate hiking cycle that started in December 2015 and stretched through mid-2019. Essentially, the Fed was the lone hawk in a sea of doves, allowing the dollar to continue to strengthen even as global trade volumes increased.

But the Fed's stance on monetary policy is no longer a massive outlier. The Fed has aggressively cut rates this year to zero. Again, with the BOJ and ECB both negative that still leaves the Fed as one of the higher rates within the developed world. However, I think it is important to note that the gap has narrowed significantly.

The chart below shows the spread between the Fed Fund effective rate vs. the ECB's main deposit rate with the white line. Again, note how the Fed effective rate was running almost 300 bps higher than the ECB's in 2019. That made the US the destination for capital within the world and accounts for the dollar's strength relative to global trade volumes at that time. Note that after the Fed's rate cuts this year, the spread between the Fed and the ECB has become more normalized. I've overlaid the dollar index again on this chart just for illustrative purposes. You can see there can be some similarities here, though hardly a great correlation.



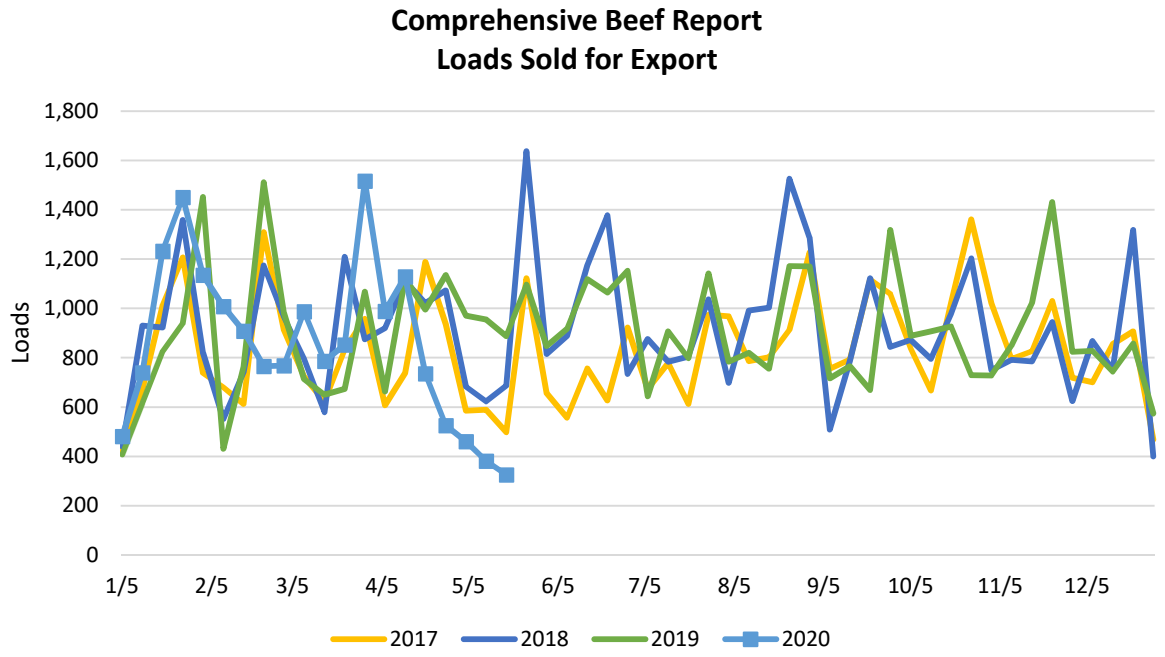
So…we are likely looking at a big reduction in global trade volumes following the Covid-19 outbreak. We'll see what happens with the US-China relationship but obviously that doesn't look too rosy for the moment. All of that argues for strength in the US dollar as trade volumes contract. However, for how long will trade volumes suffer? We're already hearing reports of normalization in Chinese oil imports, for example. IF IF IF global trade volumes were to start to recover following the post-Covid crash, the normalization of the interest rate differentials would potentially provide the opportunity for weakness in the USD.

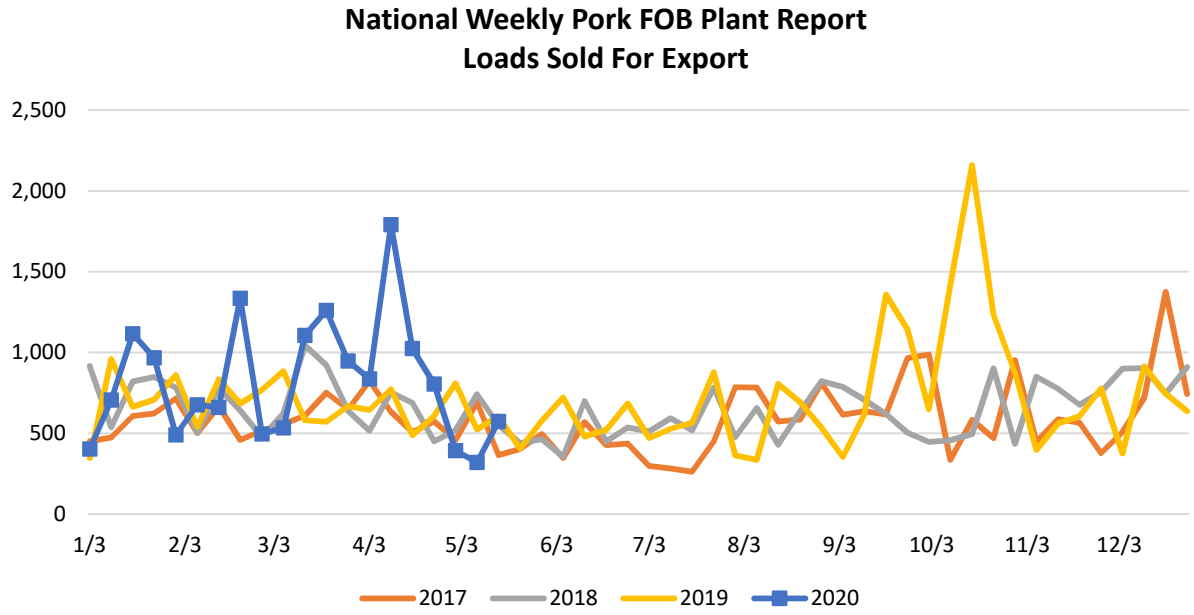
A big IF, for sure. Thoughts appreciated. More on the dollar tomorrow…

Livestock

More fairly active cash cattle trade yesterday with most of the volume near 120. I noted yesterday I didn't think packers would keep paying 120 if beef broke hard, but beef prices are hanging in there a bit better than feared… for now.

Export sales data out this morning. If the weekly comprehensive beef report is to be believed, and I suspect it should be, I would not be optimistic for a big beef sale number this morning. The pork plant FOB report showed a decent uptick in pork loads for export, so maybe that translates into a slightly better number this morning.





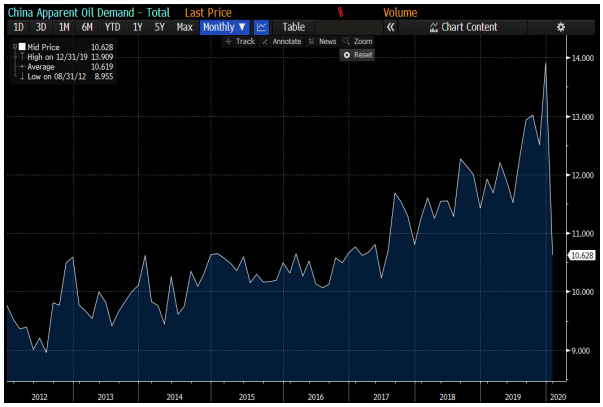
Financials

A negative tone to equity markets to start the morning. A lot of this is being blamed on the war of tweets between President Trump and various Chinese interest about the spread of Covid-19. Additionally, the White House released a report critiquing Chinese policy across a wide range of subjects. China' annual parliamentary session begins tomorrow, so it might be interesting to see if there is any "official" response from those at the

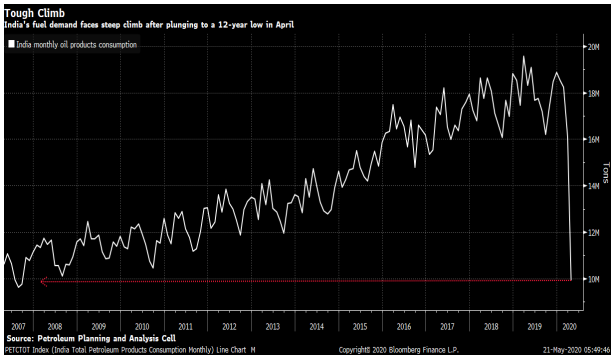
top of the government. While the US-China relationship is reason for the risk-off tone, economic data released overnight actually should generate a modest degree of optimism. PMIs reported across Europe showed some solid improvement from the April numbers. It should go without saying that all economies in the region remain in contraction, but the rebound from the April numbers was solid. Total Eurozone manufacturing PMI was 39.5 vs. a forecast for 38.0 and April's 33.4 reading. On tap today in the US we have the weekly look at jobless claims. Expectations call for another 2.4 million initial claims, which would mark the ninth straight week of claims above 1 million.

Energy

As noted above, we're starting to see more and more talk about a Chinese oil demand recovering back to pre-Covid levels. The chart at the right shows a calculation that attempts to estimate China's oil demand total. You can see that it dipped sharply through March due to the lockdowns across the country. Although not yet shown in officially reported data, many analysts are starting to estimate that Chinese oil demand is back to 13.0 mbpd or maybe even slightly higher. While note back to the highs, it would be a very solid recovery. It should be noted that not everyone is as optimistic, with the IEA saying just last week that oil demand will remain well under year ago levels for the remainder of 2020.



Demand from India, the world's third biggest oil consumer, is likely to recover at a much slower pace. There is an article on Bloomberg this morning noting that oil demand is now estimated to be running about 40% lower YOY. The article says it could be until the end of 2020 before demand makes a full recovery.



Today's Calendar (all times Central)

- Jobless Claims – 7:30am
- Export Sales – 7:30am
- Philly Fed Index – 7:30am
- Existing Home Sales – 9:00am
- EIA Natural Gas Storage – 9:30am

Thanks for reading.

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