The One that Stood Out

Date: 2021-07-02

Upcoming Economic Events (Singapore Local Time)

- 2021-07-06 12:30 RBA Interest Rate Decision
- 2021-07-06 22:00 ISM Services PMI (June)
- 2021-07-08 02:00 FOMC Minutes
- 2021-07-09 09:30 China CPI (June)
- 2021-07-13 20:30 US Retail Sales (June)
- 2021-07-13 20:30 US CPI ex Food & Energy (June)
- 2021-07-14 10:00 RBNZ Interest Rate Decision
- 2021-07-14 22:00 BoC Interest Rate Decision
- 2021-07-15 10:00 China GDP & Retail Sales (June)
- 2021-07-16 11:00 BoJ Interest Rate Decision
- 2021-07-16 22:00 Michigan Consumer Sentiment Index (July)

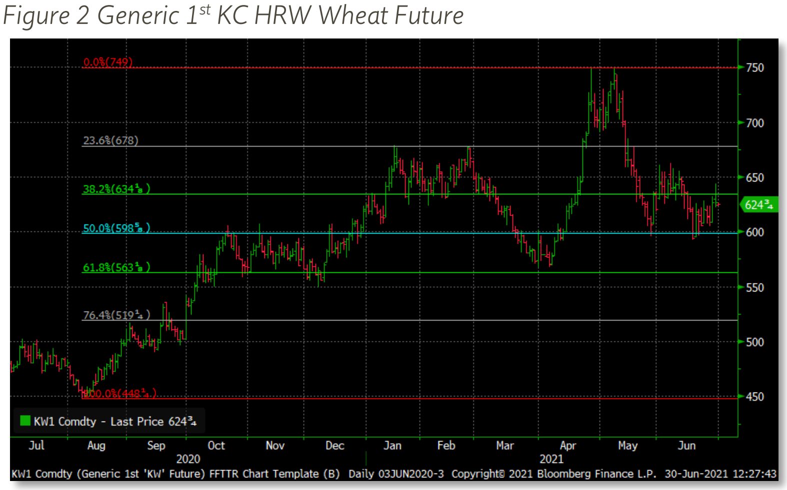
The focus of the next two weeks is on the June Consumer Price Index (CPI) data releases. Meanwhile, investors are also closely watching the major central banks' interest rate and monetary policy decisions, looking for signs of potential tightening if inflation continues to overshoot.

Markets in Focus

Figure 1 US Fed Trade Weighted Nominal Broad Dollar Index

The US Dollar failed its first attempt to break lower in early June, followed by a sharp albeit shallow rebound. Nevertheless, it has registered yet another lower high before quickly turning back down. The temporary setback made no material impact on the bearish trend of the Dollar.

Figure 2 Generic 1st KC HRW Wheat Future



Among most soft commodities, KC Wheat experienced a 25% selloff from the high in early May. Since then, it has found a significant support level above 600, which is also the 50% retracement of the entire up-move since August 2020. If it manages to climb above 650, the next leg up is likely to start.

Figure 3 Generic 1st Copper Future vs. Generic 2nd WTI Crude Oil Future

When we overlay the Copper price and the Crude Oil price, we find them moving in tandem, with Copper leading Crude Oil by 30 days. This pattern is remarkably accurate, especially around major turning points, such as early-2011, mid-2014, early-2016, and early-2020.

Figure 4 Generic 1st Copper Future vs. Generic 2nd WTI Crude Oil Future

Zooming in closely on Figure 3 for a 15-month view, we can see that Copper has corrected 15% since the high in May. If the pattern we observed holds this time, we may see Crude Oil also turning down soon into an overdue short-term correction, despite the longer-term bullish fundamentals.

Market Views

As suggested in the June 22 Edition, we believe the market was shaken but not yet stirred after the June FOMC hawkish surprise. Indeed, the equity market completely erased the post-FOMC selloff on the following Monday (June 21). Both S&P and NASDAQ continued advancing to all-time highs for the remaining of June.

Most of the commodities have experienced substantial pullbacks since May. There could be several reasons, including possible profit-taking and the US Dollar having difficulties breaking lower, as shown in Figure 1. The corrections were arguably overdue, considering that the prices of most agricultural commodities have more than doubled within a short span of 12 months! Many have found significant supports and started to consolidate above these levels. It is now an excellent opportunity to find good risk/ward trade setups to participate in the next leg up in commodity prices.

The commodity that stands out is Crude Oil, which has decidedly launched higher with minimum resistance along the way since May. Overlaying the prices of Crude Oil and Copper, two types of reflationary assets, we find Copper price leads Crude Oil by 30 days, which gives a forewarning to potential short-term Oil pullbacks. If and when that happens, the market's reflation narrative will get challenged.

How to play the theme out

A hypothetical investor can consider the following two trades[1]:

Case Study 1: Long KC HRW Wheat Future

If the investor were to buy the KC Wheat future (KEU1) at 624 and set the stop below 600, the support and 50% retracement level as shown in Figure 2, his maximum loss per contract would be (624 – 600) x 50 = 1200 USD. An initial target points to 680 as the next resistance level, and subsequently 750 as the previous high, resulting in (680 – 624) x 50 = 2800 USD and (750 – 624) x 50 = 6300 USD respectively.

Case Study 2: Close WTI Crude Oil Long / Short WTI Crude Oil Future

Suppose the investor had entered a hypothetical long position in WTI Crude Oil future at around 66.3 as the case study suggested in the May 10 Edition, he could consider exiting the trade here for (74 – 66.3) x 1000 = 7700 USD per contract. He could also consider selling an E-Mini WTI Crude Oil future (QMN1) for (74 – 66.3) x 500 = 3850 USD.

If the investor were to short the WTI Crude Oil future (CLN1) at around 74 and set the stop at 77, his maximum loss per contract would be (77 – 74) x 1000 = 3000 USD. A short-term pullback target points to the support level at around 68, resulting in (74 – 68) x 1000 = 6000 USD.

[1] *Examples cited above are for illustration only and shall not be construed as investment recommendations or advice. They serve as an integral part of a case study to demonstrate fundamental concepts in risk management under given market scenarios.*

Rear-View Mirror

A look into history could help us position better for the future. In this section, we will look at how different markets have moved since we've launched Fresh from the Trading Room in April.

Figure 5 US Fed Trade Weighted Nominal Broad Dollar Index

The US Dollar's downtrend met with some formidable challenges at the current trading level, coinciding with its decade-long trendline support. 110 is the level to watch for the Dollar to resume its next leg down. The failed attempt to break lower in May contributed to the pullbacks in most of the commodities.

Figure 6 GBP/USD

The GBP/USD pair made several attempts to break 1.425 resistance to no avail. It has since turned down, albeit still trading in the range established since February.

Figure 7 USD/CNH

The temporary US Dollar rebound was also reflected in the USD/CNH pair. It had a fake breakdown at the end of May but bounced back to the 7-month trading range shortly after. As suggested in the May 25 Edition, USD/CNH is at the multi-decade ascending channel support. The consolidation may continue for a while longer.

Figure 8 Generic 1st Gold Future

After we flagged out the bullish setup in the [April 27 Edition](), Gold did breakout from the bull flag and rallied to 1900. It is now back to retest the upper boundary of the flag, a critical level to watch. The Dollar rebound and the rising short-term real yields were both headwinds for Gold.

Figure 9 Generic 1st Silver Future

Like Gold, Silver could not carry on its rally to break out from the year-long symmetric triangle. It now trades at the lower support.

Figure 10 Generic 1st Platinum Future

Similar to Gold and Silver, Platinum has broken down from its ascending channel. It now trades at a critical support level of 1050. Longer-term, we are still bullish on Platinum for its role in the "green transformation" of clean hydrogen production.

Figure 11 Generic 1st WTI Crude Oil Future

Crude Oil is undoubtedly the best performing asset in risk-adjusted returns since we flagged out our bullish view from both fundamental and technical perspectives in the [May 10 Edition]. Right now, we are inclined to tighten risk control, and even to be more tactical and trade a potential short-term pullback.

Figure 12 XLE (The Energy Select Sector SPDR® Fund)

XLE did not follow through as well as Crude Oil. Even though the uptrend is still intact, it is trading at the trend support. We should pay attention to the possible trend breakdown, given our short-term view of Crude Oil itself.

Figure 13 Generic 1st US 10-year T-Note Future

10-year T-Note rebounded right at the bear flag support and is trading within the tight channel. The market is still debating on if inflation is transitory and when Fed would start tapering. As of now, the bond market has not yet arrived at a clear conclusion.

Background

Inspirante Trading Solutions Pte Ltd (“ITS”) was incorporated in Singapore in July 2020. Founded by the partners of Synergy Link Capital Pte Ltd (“SLC”) to consolidate their initiatives in FinTech solutions, research, and training programs for different market participants, while SLC continues its focus in proprietary trading. ITS focuses on providing clients bespoke trading solutions such as algo trading systems, risk management systems, research reports, education and training courses. With a strong technical background, unparalleled understanding and insights from the actual market practitioners, ITS managed to obtain FinTech certification recognized by the Monetary Authority of Singapore within two months of incorporation. ITS is now actively collaborating with various trading groups, exchanges and brokers in multiple countries.

The trainers and researchers in ITS have been regularly speaking on various exchange/broker hosted trading seminars and writing for various research publications over the years. Catering to both aspiring and experienced traders, we want to help in bridging the void between the theoretical and practical aspects of derivative trading, with guidance from our team of seasoned and active traders.

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