

Is Inflation Transitory?

Date: 2021-05-07

Upcoming Economic Events (Singapore Local Time):

- 2021-05-11 09:30 China April CPI (YoY)
- 2021-05-12 20:30 US CPI excluding Food & Energy
- 2021-05-19 14:00 UK CPI

The focus of the next 2 weeks is on April economic data release in various major economies, especially the Consumer Price Index (CPI) that puts the spotlight on inflation.

Markets in Focus

Figure 1 Commodity Research Bureau BLS/US Spot All Commodity Index



Commodities have had a stellar rally since the pandemic low last year. As exemplified by CRB BLS/US Spot All Commodity Index, it climbed 54% in just 12 months without any major setback along the way. Loose monetary and fiscal policies in the US led to a weaker US Dollar, which historically had been a tailwind to commodity prices. Many believe we have already entered a commodity super-cycle.

Figure 2 Generic 1st 10-Year Treasury Note Future



Bond market has been showing concerns about a persistent rising inflation. US 10-year Treasury Note future lost more than 5% year-to-date. After hitting the low of 130-25 in early April, it consolidated in a tight 2-point range. Relative Strength Index (RSI) has also been reset from Oversold back to normal level.

Figure 3 Generic 2nd WTI Crude Oil Future



Crude Oil has now come to a critical resistance level (around 67 for the 2nd WTI Crude Oil future) after more than tripling its price from a year ago. If it manages to break this level, the next overhead resistance is at around 75.

Figure 4 Generic 1st WTI Crude Oil Future



In a shorter timeframe, WTI Crude Oil has been consolidating in a 10-point range for 2 months. It looks like the Crude Oil is about to break this upper resistance any moment now.

Market Views

There is an ongoing debate in the market on whether inflation is indeed “transitory” as many Federal Reserve officials have suggested. Chairman Powell said that “the Fed is still not ready” for tapering its bond purchase program or raising interest rates. Its implications? The US will probably continue to have very accommodative monetary and fiscal policies into the summer and beyond.

As suggested in the April 26th Edition “Dollar Another Leg Down?”, we believe the US Dollar would resume weakening and likely push commodity prices up further, putting us into the “inflation **not** transitory” camp. This week we pay close attention to two major assets, namely the US 10-year Treasury Note and the WTI Crude Oil.

For both, the price actions in March and April could be seen as consolidations after a substantial move. Markets have spent quite a while stabilizing and finding some grounds at the current price levels. Now the chances of dominant trend resuming are getting higher. In the case of US 10-year Treasury Note future, we believe 133 is a strong resistance and price will likely turn lower, eventually breaking the support of the rectangle at around 130-25. A lower price in the 10-year Treasury Note means higher 10-year yield, which is the bond market expressing higher inflation expectations.

We also believe the rally in the WTI Crude Oil still has room to go once the critical resistance at 67 is penetrated, especially considering many countries are already vaccinating the populations, lifting lockdowns, and reopening businesses. Demand for oil will continue to support the price.

How to play the theme out

A hypothetical investor who is looking to express the higher-for-longer inflation view can consider the following 2 trades¹:

Case Study 1: Short US 10-year Treasury Note

If the investor were to short the US 10-year Treasury Note future (ZNM1) at around 132-14, and set the stop at 134, his maximum loss per contract for the trade would be $(134 - 132 \frac{14}{32}) \times 1000 = 1562.5$ USD. A potential first target would point to the lower support of the rectangle at 130-25 and subsequently a measured target of 129, resulting in $(132 \frac{14}{32} - 130 \frac{25}{32}) \times 1000 = 1656.25$ USD and $(132 \frac{14}{32} - 129) \times 1000 = 3437.5$ USD, respectively.

Case Study 2: Long WTI Crude Oil

If the investor were to buy WTI Crude Oil future (CLM1) at around 66.3 and set the stop below the mid-April low of 62, his maximum loss per contract for this trade would be $(66.3 - 62) \times 1000 = 4300$ USD. A measured target and next overhead resistance would be around 75, resulting in $(75 - 66.3) \times 1000 = 8700$ 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.

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.

Disclaimer and Warning

No reproduction, transmission or distribution permitted without consent of **Inspirante Trading Solutions Pte Ltd** (“ITS”). Unauthorized review, dissemination, distribution or copying of this message is strictly prohibited and could subject you and your firm to liability and substantial fines and penalties. If you would like clarification, please email contact@inspirantets.com. The material contained herein is the sole opinion of ITS. This research has been prepared by ITS using information sources believed to be reliable. Such information has not been independently verified and no guarantee, representation or warranty, express or implied, is made as to its accuracy, completeness or correctness. It is intended for the sole use by the recipient to whom it has been made available by ITS. The delivery of this report to any person shall not be deemed a recommendation by ITS to effect any transaction in any securities discussed herein. No content provided by ITS, whether contained in this report, the website or otherwise, is providing investment, tax or legal advice, including but not limited to any advice which is listed as a regulated activity by the Monetary Authority of Singapore. No content should be used or regarded as an offer or solicitation of an offer from ITS to buy or sell securities.

The opinions and statements contained in the commentary on this page do not constitute an offer or a solicitation, or a recommendation to implement or liquidate an investment or to carry out any other transaction. It should not be used as a basis for any investment decision or other decision. Any investment decision should be based on appropriate professional advice specific to your needs. This content has been produced by Inspirante Trading Solutions Pte Ltd. CME Group has not had any input into the content and neither CME Group nor its affiliates shall be responsible or liable for the same.

CME GROUP DOES NOT REPRESENT THAT ANY MATERIAL OR INFORMATION CONTAINED HEREIN IS APPROPRIATE FOR USE OR PERMITTED IN ANY JURISDICTION OR COUNTRY WHERE SUCH USE OR DISTRIBUTION WOULD BE CONTRARY TO ANY APPLICABLE LAW OR REGULATION.