

# A Chilly Summer

Date: 2021-07-16

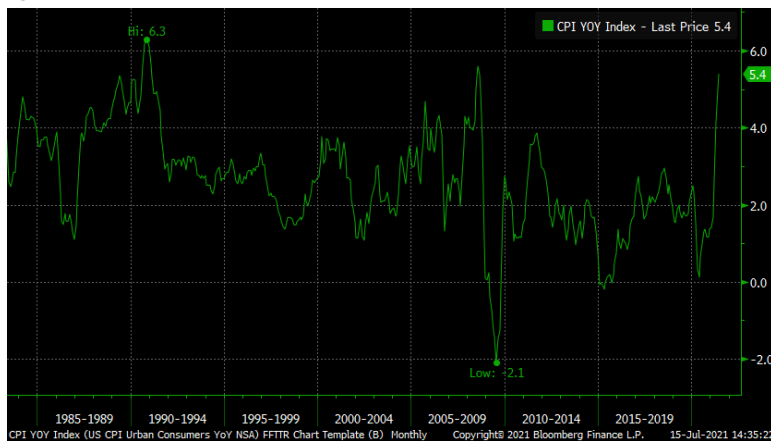
## Upcoming Economic Events (Singapore Local Time):

- 2021-07-20 09:30 PBoC Interest Rate Decision
- 2021-07-22 19:45 ECB Interest Rate Decision
- 2021-07-27 20:30 US Durable goods Orders (June)
- 2021-07-28 09:30 Australia Consumer Price Index (Q2)
- 2021-07-29 02:00 US Fed Interest Rate Decision
- 2021-07-29 20:30 US GDP (Q2)
- 2021-07-30 17:00 Eurozone CPI (July)
- 2021-07-30 17:00 Eurozone GDP (Q2)
- 2021-07-31 09:00 China PMI (July)

All eyes are on the central banks' interest rate decisions in the next two weeks. Last month the market interpreted some hawkishness from the June FOMC meeting. Investors should pay close attention to any sign that points to a clearer view of the Fed's path ahead.

## Markets in Focus

Figure 1 US CPI YoY



The latest US Consumer Price Index (CPI) figure came out at 5.4%, the highest in more than a decade. It beat the market consensus, suggesting inflation continues to run hot.

Figure 2 Lumber futures



Lumber price has had a wild ride – in a few months, it quadrupled from the low of last year, only to have erased all 2021 gains since May.

Figure 3 Generic 1<sup>st</sup> Soybean Oil futures



Soybean Oil price has developed into a possible diamond formation - often a reversal pattern suggesting the market has topped. However, there are also occasions when the diamond formation serves as a continuation pattern.

Figure 4 Generic 1<sup>st</sup> Copper futures



Copper has experienced a 16% correction but managed to hold the ground above its 15-month trendline support.

Figure 5 Generic 1<sup>st</sup> CAD/USD futures



Canadian dollar has broken down from its 15-month ascending channel. Note that historically, CAD/USD and crude oil are highly correlated as Canada earns much of its US dollar from the sale of crude oil.

## Market Views

Inflation seems to have increasingly become a consensus on both Wall Street and Main Street. Notwithstanding, the latest CPI once again beat the market expectation, suggesting inflation runs hotter and longer than many

people thought. “Overheating,” as they might call it. However, we want to caution readers that the coming summer may be a bit chilly for the market.

First, we need to understand the “base effect” to interpret the CPI numbers correctly. The YoY number looks stellar mainly due to last June’s dismal reading as the “base” before the recovery started to reflect in H2 2020 numbers. Therefore, from now on, it is unlikely to see CPI continuing the same pace of increase. It does not mean inflation will turn negative; it will still go up, only at a slower rate of change.

As exemplified by Lumber, most commodities have had deep pullbacks since early May, except those in the energy space (oil and gas). For many commodities, the pace and magnitude of the rally are comparable to those seen in the last commodity supercycle a decade ago. We are not proclaiming the end of the current inflation cycle or the commodity bull market. We are merely suggesting the market has gotten quite ahead of itself, and the next few months would be much choppier than the first half of the year.

As suggested in the [July 6 Edition](#), we remain a long-term bull in oil but expect short-term corrections. The recent breakdown of CAD/USD, a currency pair highly correlated with crude oil, is in line with this view. Having a tactical short CAD/USD position kills two birds with one stone: on the one hand, it expresses the opinion of anticipating an oil correction; on the other hand, it hedges against the mounting pressure that may challenge the reflation narrative over the summer by being long the US Dollar.

On the other hand, copper brings more comfort and assurance as it still holds above the 15-month trendline support despite a 16% pullback earlier. What underlies the bull case? The demand for copper will skyrocket in the next few years as more countries move towards electric vehicles which require a substantially larger amount of copper than traditional combustion engine vehicles.

## How to play the theme out

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A hypothetical investor can consider the following two trades<sup>1</sup>:

### Case Study 1: Short CAD/USD futures

If the investor were to short the CAD/USD future (6CU1) or the Micro CAD/USD future (MCDU1) at around 0.80 and set the stop at 0.82, his maximum loss per contract would be  $(0.82 - 0.8) \times 100,000 = 2,000$  USD for 6CU1 and 200 USD for MCDU1. An initial measured target points to 0.77, resulting in  $(0.8 - 0.77) \times 100,000 = 3000$  USD for 6CU1 and 300 USD for MCDU1.

### Case Study 2: Long Copper Oct21 4.5x4.8 call spread expires on 2021-09-27

Suppose the investor is bullish on copper but concerned about market choppiness in the summer, he could buy Copper Oct21 4.5x4.8 vertical call spread (HXEV1 4.50C – HXEV1 4.80C) at 0.073. The maximum loss would be the premium of  $0.073 \times 25000 = 1825$  USD if Copper futures (HGZ1) settles below 4.5 by expiry. The maximum potential payoff of this position would be  $(4.8 - 4.5) \times 25000 = 7500$  USD less the premium paid (1825 USD) if Copper futures (HGZ1) settles above 4.8 by expiry.

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<sup>1</sup> 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.

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## Background

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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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## Disclaimer and Warning

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