

Running Out of Gas?

Date: 2021-09-10

Upcoming Economic Events (Singapore Local Time):

- 2021-09-14 20:30 US CPI ex Food & Energy (Aug)
- 2021-09-15 10:00 China Retail Sales (Aug)
- 2021-09-15 14:00 UK CPI (Aug)
- 2021-09-16 20:30 US Retail Sales (Aug)
- 2021-09-17 22:00 US Michigan Consumer Sentiment Index (Sep)
- 2021-09-22 09:30 PBoC Interest Rate Decision
- 2021-09-22 11:00 BoJ Interest Rate Decision
- 2021-09-23 02:00 Fed Interest Rate Decision
- 2021-09-23 15:30 SNB Interest Rate Decision
- 2021-09-23 19:00 BoE Interest Rate Decision

Major central banks' monetary policy decisions will be the focus of the next two weeks. Investors are watching the Fed closely, seeking more clarity of the tapering timeline, as the latest Nonfarm Payrolls number was a big miss.

Markets in Focus

Figure 1 Dutch TTF Natural Gas Forward 1 Month vs US Natural Gas Future



Even though it is still late summer, natural gas prices have skyrocketed globally, especially in continental Europe, where the Dutch TTF natural gas future traded to above 55 EUR per megawatt-hour. This is over ten times from the recent low registered in early 2020. Currently, its premium to the US natural gas price is above the 99.8 percentile for the past decade.

Figure 2 Global X Uranium ETF



Uranium, an alternative energy source, has seen a huge price spike recently. It finally broke out of a 6-year bottom as Spratt Physical Uranium Trust has amassed over 24 million pounds of uranium, adding fuel to the bull run of this lesser-known commodity.

Figure 3 Generic 1st Russell 2000 Future



The Russell 2000 Index has been trading in a well-defined horizontal range since the beginning of the year. It is arguably a rounding top, and the recent lower high makes the index look much more exhausted than its large-cap peers such as the S&P and Nasdaq.

Figure 4 AUD/USD



The Australian Dollar has been in a downtrend since February when AUD/USD reached 0.8. The decline was temporarily stopped at 38.2% retracement level, and a counter-trend rally followed. It is now at another critical level of near 0.742. The downtrend could resume from here.

Figure 5 Corn Dec2021 Future



The December 2021 Corn future has formed a clean descending triangle top pattern. 512 level seems to be a significant support as the market has sharply bounced back from here three times in the past five months. Could the fourth attempt finally break it?

Figure 6 Generic 1st Copper Future



Copper lost its 16-month trendline support, and the last attempt to regain the support line failed. Coinciding with the neckline of a Head and Shoulder top, 420-440 area is now a formidable overhead resistance.

Figure 7 Bloomberg Dollar Index



Since last November, the US Dollar has gone nowhere despite the market's heated debate on inflation and speculations on the Fed's tapering. However, the US Dollar is trading near the top of the range and has made a few higher highs and higher lows.

Market Views

The price increase in energy, especially natural gas, has grabbed the attention of market participants and affected the lives of millions of consumers. Low storage levels, nervousness about a cold winter, decline of liquified natural gas infusions from the rest of the world have contributed to this “perfect storm,” resulting in the gas price spike. On top of these, the EU Emission Trading System (EU ETS), which forces companies to switch to alternative “cleaner” energy sources and away from coal-burning, also leads to additional demands. The net effect of all these? People are worried that Europe may be short of gas in the coming months.

It has profound implications, even if we do not trade natural gas directly. First, the increase in energy prices is one of the biggest drivers of inflation that directly impacts consumers as cost goes up for heating, electricity, and gasoline. Although the US natural gas is trading at a huge discount to the European natural gas due to better domestic supply conditions, it will inevitably get pushed higher as the demand for export rises. Secondly, as the whole world is moving away from traditional fossil fuels, alternatives such as natural gas, solar, and nuclear energy will also see a sustained increase in demand.

Meanwhile, some equity and commodity markets also seem to be running out of gas. Small-cap companies, as represented by the Russell 2000 Index, seem to be slowly rolling over. Many commodities like Copper and Corn are trading at critical levels. The US Dollar is still one of the most important assets we are watching. If it breaks out from the 10-month trading range, equity and commodities will likely have a substantial reaction.

How to play the theme out

A hypothetical investor can consider the following two trades¹:

Case Study 1: Short Micro Russell 2000 Index Future

If the investor were to short the Micro Russell 2000 Index Future (M2KZ1) at around 2250 and set the stop at 2350, above the range top, his maximum loss per contract would be $(2350 - 2250) \times 5 = 500$ USD. An initial target points to the range bottom at 2100 and subsequently 1850, resulting in $(2250 - 2100) \times 5 = 750$ USD and $(2250 - 1850) \times 5 = 2000$ USD.

Case Study 2: Long November 2021 Corn 490x530 Strangle

If the investor were to long the November Corn 490x530 Strangle (long OZCX1 490P and OZCX1 530C) at a premium of 23, his maximum loss would be $23 \times 50 = 1150$ USD. If, by expiration, December Corn (ZCZ1) price moved above 553 or below 467, the strangle will be in profit.

Case Study 2: Long November 2021 Copper 400x370 Put Spread

If the investor were to long the November 2021 Copper 400x370 Put Spread (long HXEX1 400P and short HXEX1 370P) at a premium of 0.039, his maximum loss would be $0.039 \times 25000 = 975$ USD. His maximum profit would be $(0.3 - 0.039) \times 25000 = 6525$ USD if, by expiration, December Copper (HGZ1) price dropped below 3.7.

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.

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