Coiling...

Date: 2021-09-24

Upcoming Economic Events (Singapore Local Time):

- 2021-09-27 20:30 US Durable Goods Orders (Aug)
- 2021-09-28 08:30 Australia Retail Sales (Aug)
- 2021-09-30 09:00 China PMI (Sep)
- 2021-09-30 17:00 Eurozone CPI (Sep)
- 2021-09-30 20:30 US GDP (Q2)
- 2021-10-01 22:00 US ISM Manufacturing PMI (Sep)
- 2021-10-05 22:00 US ISM Services PMI (Sep)
- 2021-10-06 20:15 US ADP Employment Change (Sep)
- 2021-10-08 20:30 US Nonfarm Payrolls (Sep)
- 2021-10-09 09:30 China CPI (Sep)

In the next two weeks, investors will see the major macroeconomic data of September. However, the spotlight will likely continue to be on Evergrande, the troubled Chinese property developer.

Markets in Focus

Figure 1 China Evergrande Group

Evergrande's stock price has lost more than 90% since the high registered in 2017 as its debt crisis intensified recently due to potential missed interest payments on its bonds.

Figure 2 USD/CNH

USD/CNH is a good barometer to gauge global investors' sentiment on Evergrande's contagion risk. The relatively timid price action suggests that the risk is still well contained. It is coiling in the 10-month trading range.

Figure 3 US 10-year Treasury Yield

The US 10-year Treasury Yield has also been coiling in a 3-month ascending triangle and nearing its apex. The direction of the next move seems to be higher as it just broke out of the triangle top.

Figure 4 Generic 1st Lean Hog Future

Lean Hog has decidedly broken its 14-month ascending trendline support. It is consolidating at the 38.2% retracement level. We are watching the price action closely for a potential break lower or a sharp rebound.

Market Views

Concerns have been building over the fate of the indebted Chinese real estate behemoth Evergrande. With global investors closely watching for signs of spillover risks amid Evergrande's liquidity crunch, S&P 500 pulled back more than 5% from the all-time high and temporarily lost its 50-day moving average support at the time of writing.

In the latest FOMC meeting, the Fed offered a clearer path of monetary policy normalization. They signaled that tapering could start as early as November this year and finish by mid-2022. Thereafter, a possibility of six to seven rate hikes through 2024.

When we go through the price actions of all major asset classes, we couldn't help but notice the predominant market regime is in the "coiling" state. Fortunately, the indecisiveness will not last forever, as events around Evergrande rapidly unfold, and investors soon will make a more informed decision on the risk exposures in their portfolios. If the Evergrande crisis turns for the worse, the US Dollar will most likely get bid up, especially against currencies like CNH, and bond yields would fall together with the equity market since the Fed has also signaled to be gradually withdrawing the support.

As exemplified by Lean Hog in Figure 4 and various softs mentioned in *The Rearview Mirror* section below, commodities are also consolidating at significant support levels after a major correction since May. The direction of the next move will largely depend on the US Dollar, which acutely reflects investors' risk sentiment.

In our opinion, it is not the time to run full risk-on. Investors should exercise prudence to reduce exposure and protect capital, possibly via tighter stops and cheap hedges.

How to play the theme out

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

Case Study 1: Long USD/CNH Future

If the investor were to hedge against the potential deteriorating risk of the Evergrande crisis, he could long the USD/CNH future (CNHZ1) at around 6.5 and set the stop at 6.35. His maximum loss per contract would be (6.5 – 6.35) x 100000 = 15000 CNH. An initial target points to the range top at 6.6 and subsequently 6.8, resulting in (6.6 – 6.5) x 100000 = 10000 CNH and (6.8 – 6.5) x 100000 = 30000 CNH.

Case Study 2: Long Micro 10-year Yield Future

If the investor were to long the Micro 10-year Yield future (10YV1) at 1.39 and set the stop at 1.14 near the 50% retracement level, his maximum loss per contract would be (1.39 – 1.14) x 1000 = 250 USD. An initial target points to 1.6 and subsequently 1.8, resulting in (1.6 – 1.39) x 1000 = 210 USD and (1.8 – 1.39) x 1000 = 410 USD respectively.

[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.*

The Rearview Mirror

A look into history could help us position better for the future. This section provides a rundown of market moves across major asset classes between early July and September.

Figure 5 Generic 1st E-mini Dow Future

The breakout of the Dow could not carry further as it was soon halted by the Evergrande-related equity sell-off. However, it is still within the rectangle trading range established in early May.

Figure 6 Generic 1st Russell 2000 Index Future

The Russell 2000 Index continues its extended rounding top as we sit comfortably on the short position from [mid-September](#).

Figure 7 Generic 1st Nikkei (USD) Future

Our short Nikkei position was quickly stopped out after Japanese Prime Minister Suga announced his plan to resign. The market expects the successor to increase stimulus and better handle the pandemic.

Figure 8 CAD/USD

After we flagged out that the CAD/USD pair had broken out of its ascending channel in the [July 20 Edition](), CAD continued to weaken against the US Dollar, despite a rebound in oil prices.

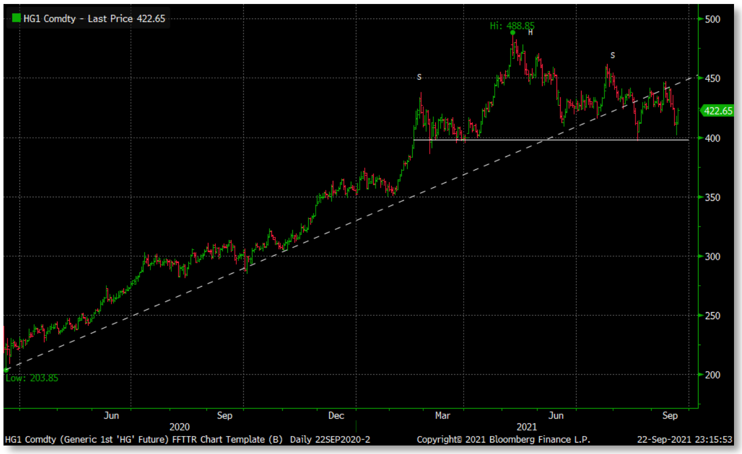
Figure 9 Generic 1st Silver Future

The recent US Dollar strength was a headwind for Silver as it is now trading at the bottom of a 14-month descending triangle, the breaking of which would potentially point the Silver price to below 20.

Figure 10 Generic 1st Platinum Future

Similar to Silver, Platinum also could not catch a bid since early May. It has now fallen back to the previous trading range between 800 and 1050.

Figure 11 Generic 1st Copper Future



After breaking its 16-month trend support, Copper has been coiling between 400 and 450 and has essentially gone nowhere since March.

Figure 12 Generic 1st Corn Future

Corn is trading in a tight range at the bottom of the descending triangle. Our strangle position established in the [September 14 Edition](#) still has time for it to play out.

Figure 13 Generic 1st Soybean Oil Future

In the [August 17 Edition](#), we flagged the completion of a textbook Diamond Top pattern in Soybean Oil. Subsequently, the price dropped more than 10% to around 55.

Figure 14 Generic 1st WTI Crude Oil Future

We have been unequivocally bullish on Crude Oil since early May. In addition, we cautioned readers to temporarily reduce long positions in early July, anticipating a likely short-term correction. It helped to avoid the 18% pullback from the recent high. Oil seems to have completed the bull flag, and its rally should resume from here.

Figure 15 Generic 1st KC Wheat Future

Our bullish call on KC Wheat also turned out to be right on the spot. It reached above our second target of 750 in early August.

Figure 16 Eurodollar December 2023 Future

December 2023 Eurodollar future is trading near the bear flag bottom. As the Fed is turning more hawkish in the face of rampant inflation impacting both producers and consumers, EDZ3 will likely break out from the bear flag soon and resume the down move, suggesting more aggressive rate hike expectations.

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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