An Unexpected Turn

Date: 2022-01-14

Upcoming Economic Events (Singapore Local Time):

- 2022-01-17 10:00 China GDP (Q4)
- 2022-01-18 11:00 BoJ Interest Rate Decision
- 2022-01-20 09:30 PBoC Interest Rate Decision
- 2022-01-26 23:00 BoC Interest Rate Decision
- 2022-01-27 03:00 Fed Interest Rate Decision
- 2022-01-27 21:00 US GDP (Q4)

With the latest US CPI number reaching the highest in 40 years, investors are waiting for clearer signals from major central banks, especially the Fed, concerning the policy normalization path forward.

Markets in Focus

Figure 1 US Dollar Index

The US Dollar abruptly reversed course as it broke down from the seven-month uptrend channel. The big picture shows that the US Dollar Index is still stuck in the middle of its 90-105 range since 2015. However, if the Dollar's weakening continues towards the lower end of the range, it will affect many other risk assets in 2022.

Figure 2 EUR/USD (Weekly)

In Q2 2020, the EUR/USD pair broke its long-term downtrend resistance, as the US Dollar weakened against the Euro post-pandemic. This pair then spent a good part of 2021 consolidating and retracing towards the broken trendline. It is typical to see the retest of the resistance after price breaks out from such a significant long-term pattern.

Figure 3 EUR/USD (Daily)

When we zoom in on the daily chart of EUR/USD, we can see the retest was near perfect as the trendline has now become strong support. On top of that, it has broken out from an ascending triangle bottom established since late November 2021, which suggests the Euro will likely resume its next leg higher.

Figure 4 BRL/USD

The same goes for emerging market currencies, such as the Brazilian Real. Since last July, it has been weakening against the US Dollar towards the lower end of a symmetrical triangle bottom. Recently it has also broken out from the downtrend. These charts show that the US Dollar is weakening broadly against DM and EM currencies.

Figure 5 Soybean Oil Future v.s. Crude Palm Oil Future (March 2022)

Soybean Oil has been consolidating in a six-month bull flag after registering its all-time high in June 2021. The Malaysian Crude Palm Oil, a closely related product, has already broken out from its own consolidation and continued to make new highs. Combined with the weaker US Dollar view suggested in the previous charts, Soybean Oil will likely break out from the bull flag and resume its rally soon.

Market Views

The latest US CPI number came out at a whopping 7%, beating Wall Street consensus again. The last time we saw a 7% CPI print was in the 1980s. Back then, the Fed Funds Rate was around 12%. Some food for thought.

Not only are the Fed officials starting to voice concerns about the running inflation, but the market also has priced in two to four interest rate hikes in 2022 and more in 2023. We are hardly surprised, as we have been pounding the table with our views on inflation for the past seven months.

What took an unexpected turn was the US Dollar. An investor would assume that persistently high CPI prints would normally lead to a more hawkish Fed who tries to tighten the financial conditions, making the US Dollar strengthen. As a matter of fact, the Dollar sharply weakened last week. Since Q3 2021, even before the economic releases and Fed's narratives came out, the Dollar had already done its stealth rally. As the market anticipation has materialized now, the recent drop is more of a "Buy the rumor, sell the news" scenario.

The Dollar Index has broken its seven-month uptrend channel, and many other Dollar pairs are showing similar trend reversals from a technical perspective. Nevertheless, we are still waiting for more confirmation to see if it is only a temporary retracement or the beginning of much more weakness to come. Don't forget that the US is still running extremely loose monetary and fiscal policies, while many other countries are already on the path of tightening and rate normalization.

We want to dabble in some short Dollar trades to start the year, albeit with tight stops, just in case the recent moves turn out to be a head fake.

How to play the theme out

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

Case Study 1: Long BRL/USD Future

If the investor were to long the BRL/USD future (6LG2) at around 0.18 and set the stop below 0.172, his maximum loss per contract would be (0.18 – 0.172) x 100000 = 800 USD. An initial target points to 0.185 and subsequently 0.195, resulting in (0.185 – 0.18) x 100000 = 500 USD and (0.195 – 0.18) x 100000 = 1500 USD.

Case Study 2: Long Soybean Oil Future

If the investor were to long the Soybean Oil future (ZLH2) at around 59 and set the stop below 57.5, his maximum loss per contract would be (59 – 57.5) x 600 = 900 USD. A measured target points to 66, resulting in (66 – 59) x 600 = 4200 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.

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