

The Great Rotation

Date: 2022-03-12

Upcoming Economic Events (Singapore Local Time):

- 2022-03-17 02:00 Fed Interest Rate Decision
- 2022-03-17 20:00 BoE Interest Rate Decision
- 2022-03-18 11:00 BoJ Interest Rate Decision
- 2022-03-21 09:15 PBoC Interest Rate Decision
- 2022-03-24 16:30 SNB Interest Rate Decision
- 2022-03-24 20:30 US Durable Goods Orders (Feb)
- 2022-03-29 20:30 US GDP (Q4)

The coming two weeks are packed with central banks' meetings and interest rate decisions. The most important is the FOMC meeting, where investors will likely see the Fed's first rate hike and its forward guidance of the policy normalization path ahead.

Markets in Focus

Figure 1 Generic 1st E-mini S&P 500 Index Future



The S&P 500 index spent the last two weeks making consecutive lower highs and lower lows, confirming our observation in the [Feb 15th issue](#) that “Sell the Rally” is the new sheriff in town given the current macro and geopolitical situations. Gone are the days when buying every dip of the US equities was a high probability investment strategy.

Figure 2 Generic 1st Nikkei 225 USD Future (Weekly)



The Japanese Nikkei 225 Index also fell out of its 2021 trading range and is quickly approaching the 24000 level, which used to be a strong resistance that rejected the index's advance multiple times since 2018. After successfully breaking out in late 2020, the index will now find this region a critical support.

Figure 3 USD/JPY



After breaking out from a massive long-term triangle, the Japanese Yen continued to weaken against the US Dollar, mainly due to the divergence in central banks' policies. What is the path of the least resistance for this pair? Heading up. A weaker Yen is also a tailwind for the Japanese equities.

Figure 4 S&P 500 vs. Nikkei 225 Ratio (Weekly)



On a relative basis, the S&P 500 index has outperformed the Nikkei 225 index by the most in history, reaching the previous high in 2012. We couldn't help but wonder if global investors will start rotating out from a decade-long US-heavy allocation into other under-allocated countries, including Japan.

Figure 5 Generic 1st Silver Future



Silver broke out from the 15-month descending triangle in early March and reached as high as 27.5 last week. It has sharply retraced back, but the former resistance near 25.5 has become the new support. If Silver can find its footing around this level, chances are it will launch higher soon.

Market Views

In these perilous times, with so many cross-currents in the global financial market, we saw heightened volatility in all asset classes, notably in the commodity space. Looking beyond the headline events, we know that volatility

is mean-reverting, and inevitably, it will subside once the uncertainty is removed. Subside to what level is another debate.

In our [Feb 15th issue](#), we have already precluded a potentially seismic change in macro and market regimes. After all, inflation is something the developed world has not had for almost half a century, as suggested by the latest US CPI numbers reaching levels only seen in the 1970s. Therefore, it is reasonable to start questioning many of the financial market's status quos, which might have been deeply ingrained in investors' minds.

Over the past decade, the US enjoyed a continuous inflow of funds from global investors, most of which went into the mega-cap tech stocks. It created a virtuous cycle for the outperformance of US assets, leading more inflows into the US equity market and pushing the latter to record high valuation by any metrics imaginable.

However, the tide might be turning. We have witnessed an unwavering Fed getting very serious and worried about inflation and seemingly quite adamant about the rate hike and tightening moves, even when the Nasdaq has already fallen more than 20% from the recent high, technically entering into a bear market. The "Fed Put," to many people's surprise, could still be far away.

What do we have under the radar? Japan was one of the places underloved by international investors for the past decade. The BoJ, unlike the Fed, is most likely continuing its current easy monetary policies and ready to support the equity market whenever needed. The inflationary pressure is also considerably less in Japan than in the US or Eurozone. We can foresee a further divergence of the central banks' policies which could mark the beginning of a long-term US underperformance. Meanwhile, another potential rotation is from technology into the "real-stuff" commodities, including Silver, as the world suddenly finds itself short of many such things like energy, food, and metals.

How to play the theme out

A hypothetical investor can consider the following trades¹:

Case Study 1: Short S&P 500 vs. Nikkei 225 Ratio

The investor could construct a notionally neutral spread by selling 6 Micro E-mini S&P 500 futures (MESM2) at 4200 and buying 1 Nikkei 225 USD future (NKDM2) at 25000 at an implied ratio of 0.168. Both legs have a notional value of around 125000 USD. The target is for this ratio to drop back to 0.14 and potentially 0.11. Stop-loss would be when the ratio breaks above 0.175.

Case Study 2: Long Micro Silver Future

If the investor were to long the Micro Silver future (SILK2) at around 26.16 and set the stop below 24.4, his maximum loss per contract would be $(26.16 - 24.4) \times 1000 = 1760$ USD. An initial target points to 28.5 and subsequently 30, resulting in $(28.5 - 26.16) \times 1000 = 2340$ USD and $(30 - 26.16) \times 1000 = 3840$ 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 above commentary 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.