

Hulk... SMASH!

Date: 2022-07-15

Upcoming Economic Events (Singapore Local Time):

- 2022-07-20 09:30 PBoC Interest Rate Decision
- 2022-07-21 11:00 BoJ Interest Rate Decision
- 2022-07-21 20:15 ECB Interest Rate Decision
- 2022-07-28 02:00 Fed Interest Rate Decision
- 2022-07-29 17:00 Eurozone HICP (July)
- 2022-08-02 12:30 RBA Interest Rate Decision
- 2022-08-02 22:00 US ISM Manufacturing PMI (July)

Most central banks continue their hawkish stance despite the selloffs in most assets since the beginning of the year. The effects of aggressive tightening have propagated to every part of the financial system.

Markets in Focus

Figure 1 US Dollar Index (Weekly)



Some people have been calling the rapid strengthening of the greenback the USD Wrecking Ball. How prescient! The US Dollar Index smashed through 104 and reached above 108, the highest level in 20 years. It is a broad strengthening against most other currencies, from the Euro and the Yen to many emerging market currencies. Huge repercussions are being felt in the entire financial market.

Figure 2 Chicago SRW Wheat Future (December 2022 Contract)



Wheat was one of the most prominent commodities affected by the Russia-Ukraine conflict, as these two countries are among the world's top wheat producers and exporters. However, since early May, the wheat price sharply reversed. After breaking the neckline of the Head-and-Shoulder top, it continued to drop like a stone, now giving back the entire gain post the conflict. It is finding some support at the 14-month trendline.

Figure 3 Soybean Future (November 2022 Contract)



Soybean has erased the entire gain of 2022 in a matter of a few weeks. When the 1400 level was broken, it gapped down immediately to further drop to 1300, which is another significant support.

Figure 4 Generic 1st WTI Crude Oil Future



Crude oil has given back its entire gain since the geopolitical conflict started. It is currently trading around a significant support level of 93, which has turned back the decline multiple times this year. It is crucial to see if the support holds this time.

Figure 5 Henry Hub Natural Gas Future (August 2022 Contract)



After a sharp decline of more than 40% from the high of 9.5 to the low of 5.5, natural gas seems to have completed an inverse Head-and-Shoulder bottom. If it manages to break above 7.0, we should see much further rally to ensue.

Market Views

The US June CPI data beat consensus again, accelerating to 9.1%. Global central banks are resolutely hawkish in fighting inflation. Large rate hikes, shrinking balance sheets, and draining liquidity from the system have undeniably created the demand-destruction effect, such that the debate of the market has now become when, not if, the recession will hit. The aggressive tightening is like the Hulk of the Avengers, smashing everything in front of him, from the “puny god” Loki to the great Chitauri army.

As an old Wall Street adage goes: the market takes the stairs up and the elevator down. We have witnessed the substantial decline of many financial assets over the past few weeks. The Nasdaq index lost 34% in half a year, with many high-flying names dropping more than 70% from the recent highs. The Euro and the Yen weakened by 18% and 26% against the US Dollar since 2021, respectively. Some emerging market currencies, such as the Chilean Peso and the Sri Lankan Rupee, are in free fall because of the perfect storm created by the strong US Dollar and high energy and food prices, which have wreaked havoc on these debt-laden countries.

Commodity investors felt the most pain, just as more and more people started to believe the super-cycle was finally here. The reversals, especially of industrial metals and agriculture commodities, have been nothing short of jaw-dropping. Copper plunged 37% since March. Lumber lost more than 60% from the high. Wheat has one of the deepest declines among grains. At nearly 40% below the high, it has completely given back the gains since the Russia-Ukraine conflict broke out. Indeed, everything from equities to bonds, currencies, and commodities have all been smashed hard.

Amid the widespread pessimism, the recession fear, the forced selling, and the headline-driven FOMO buying been largely cleared, we find the opportunity to own agriculture and energy commodities a lot more attractive from a risk/reward perspective than a few months ago. Take wheat, for example, although the export situation in Ukraine is improving, we should ponder how much lower the price can go, given it is already trading at levels before the conflict, against the backdrop of a severe global food and energy shortage, and countries banning fertilizer exports as the price went through the roof. We cannot help but be reminded of Warren Buffett’s famous quote, “Be fearful when others are greedy, and greedy when others are fearful.”

How to play the theme out

A hypothetical investor can consider the following trades¹:

Case Study 1: Long Chicago SRW Wheat Future

If the investor were to long the Chicago SRW Wheat future (ZWZ2) at 819 and set the stop below 700, his maximum loss per contract would be $(819 - 700) \times 50 = 5950$ USD. An initial target points to 1050 and subsequently 1300, resulting in $(1050 - 819) \times 50 = 11550$ USD and $(1350 - 819) \times 50 = 26550$ USD.

Case Study 2: Long Henry Hub Natural Gas Future

If the investor were to long the Henry Hub Natural Gas future (NGQ2) at 6.76 and set the stop below 5.90, his maximum loss per contract would be $(6.76 - 5.90) \times 10000 = 8600$ USD. An initial target points to 8.20 and subsequently 9.60, resulting in $(8.20 - 6.76) \times 10000 = 14400$ USD and $(9.60 - 6.76) \times 10000 = 28400$ 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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