exness

Quarterly Outlook 2021

Oct 2021

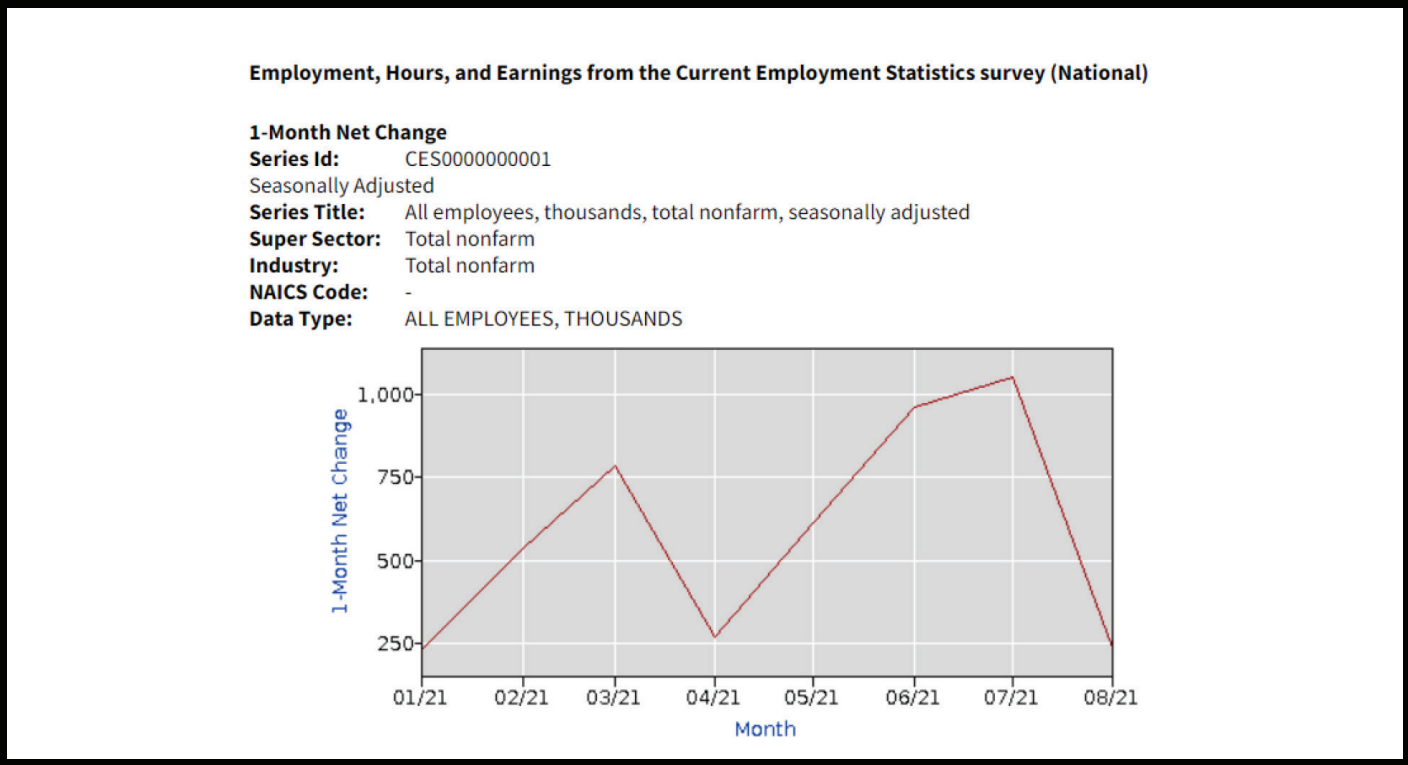
Contents

Overview

We have finally entered the autumn of 2021, the 'promising year', a name that has become controversial in many cases: covid-19 is continuing to spread around the world, inflation keeps growing, while money continues to flow in markets, brought by central banks and governments. However, even now we can observe some shifts in the narrative which might change how the story of covid in markets continues.

There were three concerns in markets in the first three quarters of 2021: economic recovery, covid-19, and inflation. While the virus is more of an external factor, economic recovery and inflation are influenced by actions of the Fed and governments. Starting from March 2020, an unprecedented amount of liquidity was brought to markets by the Fed, pumping up commodity prices, stocks, and cryptocurrencies. Late in summer 2021, the word "tapering" became the biggest concern. During the Jackson Hole symposium, the Fed's chief Jerome Powell said that tapering would take place soon, so markets turned off their "risk-on" regime early in September.

Secondly, economic activity in the US slowed down in August based on payrolls. This could become a trigger for the strengthening of the US dollar, but the relatively weak inflation numbers that followed kept volatility under control. However, the dominating tone for markets is moderately negative in September with the US dollar going up and stocks declining.



US non-farm payrolls. Source: bls.gov

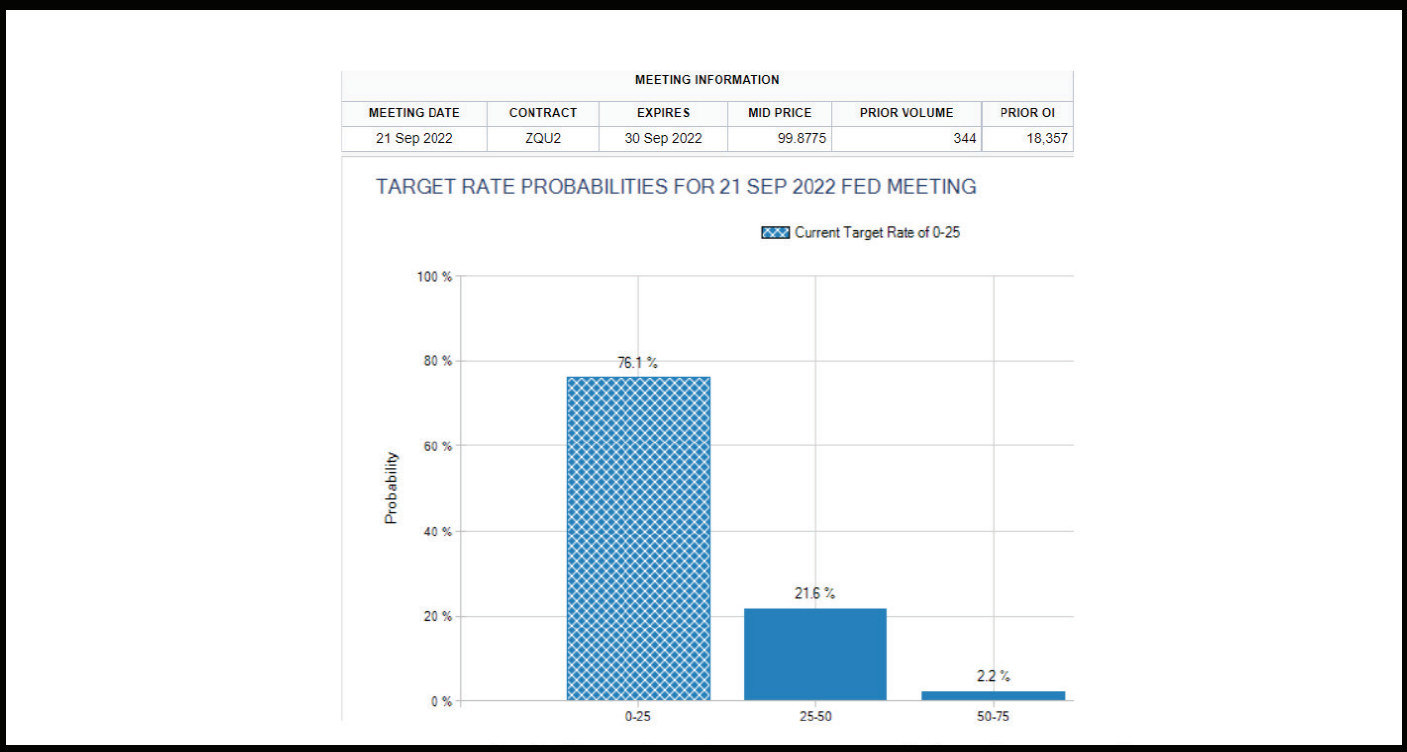
What is notable is that there were some spectacular moves in energy markets, such as a big pump in natural gas futures and, less aggressively, crude oil. With inflation fears and supply at record lows, natural gas has outpaced the high of 2018, achieving more than $5 per contract.

It seems that markets are waiting for new fundamental narratives and have now turned to a technical type of action. However, negative sentiment has started to accelerate for major markets as of writing this outlook.

The Fed and tapering

Markets are forward-looking. What does tapering mean for their performance? It can potentially lower the prices of long-term bonds (which are usually associated with higher uncertainty) and raise their yields, which might cause capital migration from risky assets to bonds. This might then lead to a rate hike sooner or later. Today, when the interest rate effectively equals zero, stocks and commodities attract increased interest from investors. If yields from bonds rise, though, capital might flow into the US dollar and bonds from stocks.

We don't know whether this would necessarily happen, but that's a dominating concern in the market's narrative. Now we can observe from the FedWatch tool that most investors think that interest rates won't grow for a year or more.



MEETING INFORMATION

MEETING DATE	CONTRACT	EXPIRES	MID PRICE	PRIOR VOLUME	PRIOR OI
21 Sep 2022	ZQU2	30 Sep 2022	99.8775	344	18,357

Probability of an interest rate hike. Source: Cmegroup

Seasonality

September is known as potentially the worst month for stocks. If we take a look at the long-term dynamics of the S&P 500 from Bloomberg (this chart contains the aggregated statistics for 1985 to 2014, though if we extend it to 2020, we will get the same picture), we see that all of September tends to be negative, while the recovery might start in the second half of October.

Seasonal chart of the S&P500 index. Source: Bloomberg

Bottom line

Markets are now in a concerning situation when there are not enough good fundamentals to continue driving stocks and commodities higher. Seasonally, September is the worst month for stocks, which brings some volatility to trading. Previously, in 2020, for example, we've observed the same situation: after having set a peak in early September, large tech stocks plummeted severely (even though they recovered thereafter). In October and November, markets are fueled by earnings season and other fundamental publications.

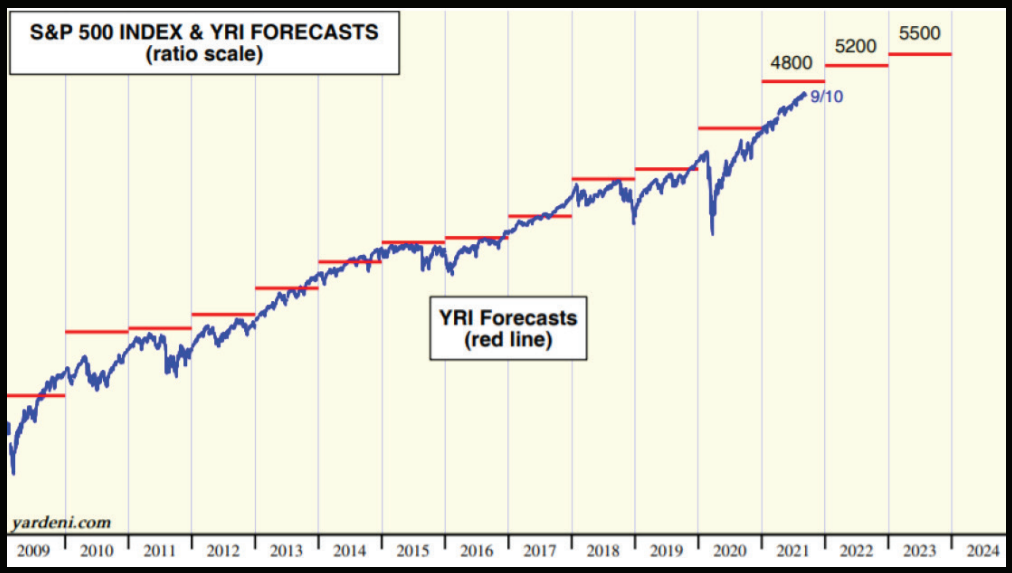
Volatility is not a bad thing for a trader who knows how to deal with it. Their focus might be more short-term: the holding time for positions might be reduced, and special attention should be paid to keeping positions overnight and especially over the weekends. It's not usually recommended at this time of year to hold leveraged positions for more than one or two days.

Stock markets

Stock indices have finally started a meaningful correction after the “evergreen” rally (almost a seven-week rally for the S&P 500 without notable pullbacks). Two major sectors - technology and healthcare stocks, which were the biggest gainers early in September - began to liquidate, pushing other sectors down.

Let’s start with some fundamentals. The focus here is on the US stock market, which is the largest in the world, but not the only one. Most of the big and well-known companies are traded on the NYSE and/or Nasdaq.

The most important question is whether the S&P 500 is expensive or cheap. If we take a look at the p/e ratio, we will find out that it is close to 20 for the entire S&P 500. Having projected corporate earnings forward, we will get the picture close to that on the chart below. The correction can happen, but the broad market seems not to be very expensive and has the capability to move forward.



S&P 500 price projection. Source: Yardeni.com

Let's watch the technical performance of stock indices. The S&P 500 and Nasdaq have broken their trendlines and turned to correction.

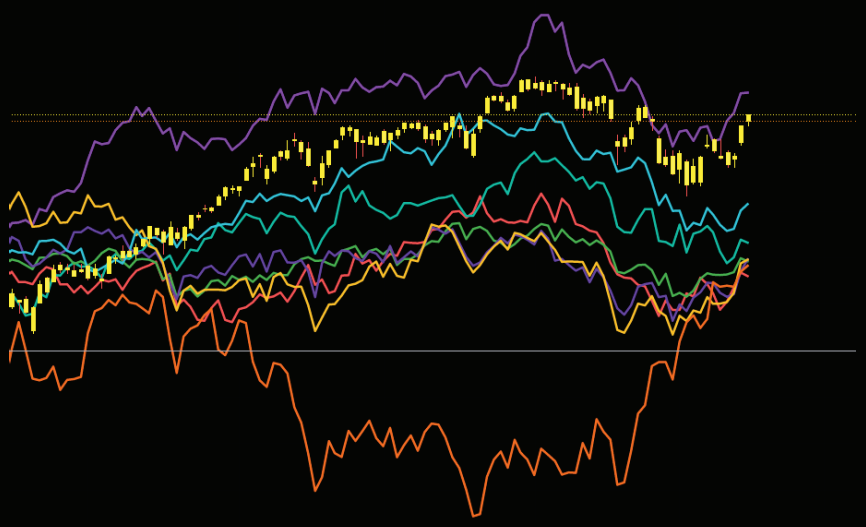
S&P500 index. Source: Exness.com

According to seasonal projections, indices can stay in correction mode for a while before the beginning of earnings season (mid October). Until then, it might be difficult to find any specific buying trades since sentiment now is generally negative.

Nasdaq index. Source: Exness.com

Sectors

Let's break down the performance of the broad market into sectors. Here we have seven key ETFs which cover the performance of major US stock market sectors (from top to bottom: technology, real estate, communication, consumer, industrial, basic materials, energy).



Performance of US stock market sectors. Source: Tradingview.com

From the picture above, there's a broad correction across all sectors with no specific groups outperforming others. This doesn't mean that there would be absolutely no stocks going higher, but it would be relatively difficult in this context to find workable buying trades.

However, one might pick stocks with an intermediate-term view. Let's break it down to specific stocks and try to find the most interesting ones. Don't forget that this perspective is built with respect to current conditions, which are likely to change in the future sooner or later.

NVDA

Nvidia is one of the promising candidates for a trend-following trade. Having excellent EPS growth, and being one of the top tech shares, producing technologies for cutting-edge, innovative industries, it might be a good pick soon.

Every time NVDA has tested the 200-day moving average, it has retraced, never showing even a two-day close below this technical reference. Now, it is within an area of dynamic support, so if things don't get worse for tech, there might be another upward wave.

NVDA stock. Source: Exness.com

TSLA

TSLA was underperforming for most of 2021, building a base pattern within a range of $600-750. It was relatively stable during the last selloff, which might be an indication of good potential. There's a rotation mechanism in the stock market when investors take the cash out of the winners and put it into underperforming assets, such as TSLA. That's why it's possible to see TSLA testing its previous highs from April 2021.

TSLA stock. Source: Exness.com

XPEV

The Chinese market is becoming increasingly risky, but there are names that hold less risk while still keeping the potential. One of them is XPEV, the stock of XPENG, a company that produces electric vehicles. Though it represents the Chinese market, it also correlates with TSLA, which might give it some acceleration to the upside.

The market cap of electric vehicles could possibly grow several times over the next five to ten years as petrol cars are phased out. The US government had already announced plans for a massive transition to electric vehicles by 2030, so companies making them might present good opportunities.

TSLA stock. Source: Exness.com

Oil

1. Supply and demand

With the recent hurricane Ida and an increase in economic activity in the US over Q2-Q3 on the whole, crude oil finally moved above $70 per barrel again. With the supply shock and also an increase of demand, there is no doubt that the price can go up if these factors remain in focus. With the reopening of various economies and - generally speaking - deceleration in COVID-19 cases, economic expansion seems to be coming. Unfortunately, there's another hurdle, namely fewer people eager to go back to work or at least less loyal to their employers, causing higher turnover. One of the biggest questions now is whether the current economic activities that are starting will be sustainable.

2. Technical outlook

From a technical perspective, the price of crude oil failed to break its boundary around $76. With the current formation driving a bounce from $62 to $73, there is another chance of the price going even higher if it can break $74 and close above $76. If the price fails to break those areas, though, more losses might be ahead.

Bitcoin

1. Current condition

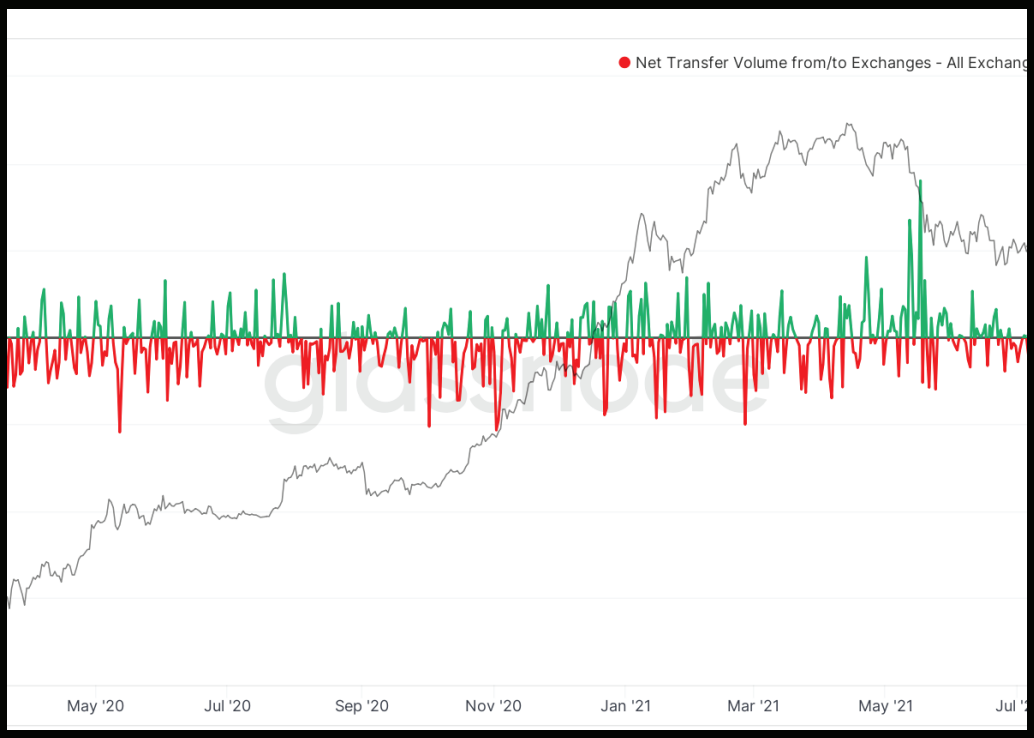
The mixed conditions of the global economy have generated higher uncertainty. Concerns have included increasing worries over inflation in the US, the Fed's tapering, and most recently Evergrande's problems.

The current inflation rate in the US is considerably higher than expected. The current running inflation rate is more than 5% YoY, which is 200-300% higher than the usual or expected rate. This has brought concern that the Fed might tighten monetary policy or even to the extreme of absorbing the supply of money.

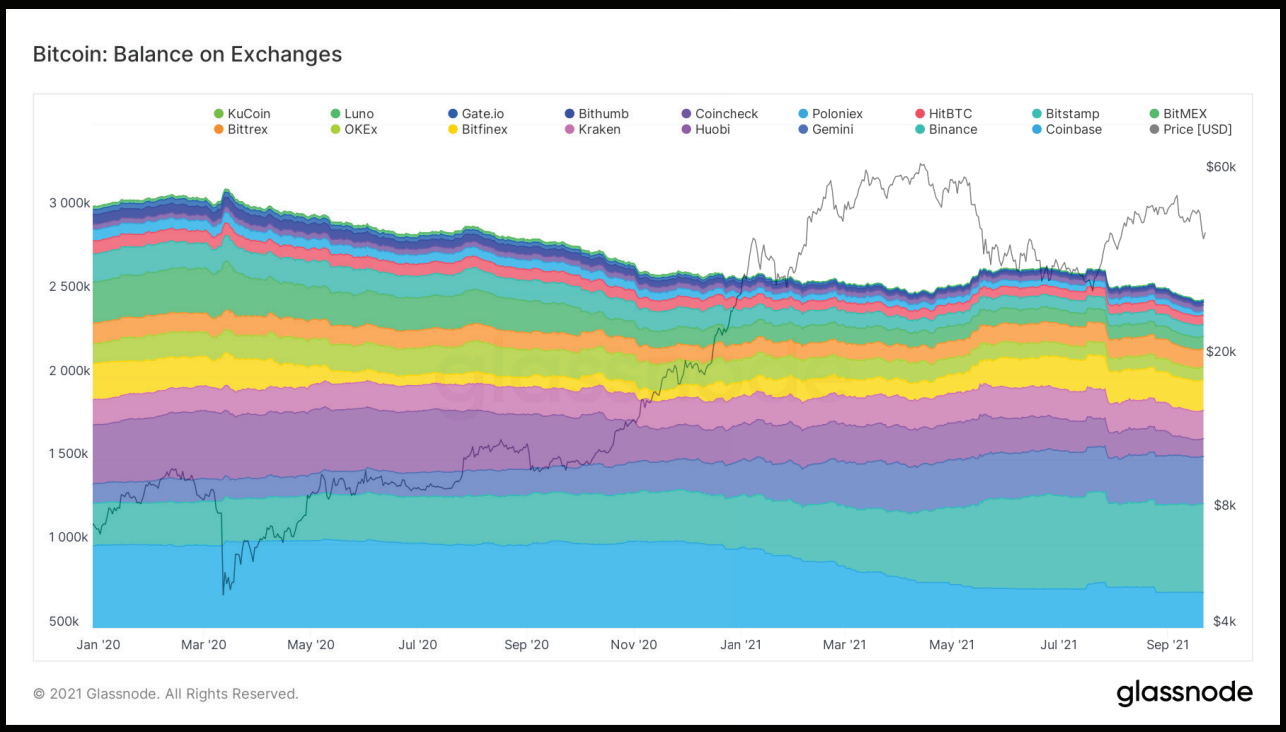
On the other side of the world, Evergrande, a Chinese real estate company with more than two trillion yuan in assets (about 2% of China's GDP), has become the concern of many participants in markets. If the meltdown happens, it could not only drag the economy of China but also the global economy since China imports raw materials from many countries.

If economic recovery slows down significantly or if there's a more serious crisis as a direct or indirect result of Evergrande's debt problems, people might start to liquidate their positions in various assets like shares, mutual funds, ETFs, commodities, and cryptocurrencies.

2. Supply and demand



At the time of writing, a tremendous amount of Bitcoins have been withdrawn within the last few weeks from exchanges globally, more than 94,000 BTC. This number shows the amount of Bitcoin that might be held by long-term holders. The trend of withdrawing Bitcoin to be stored off exchanges has been present for quite some time. According to on-chain data, in the past three months the total outflow was staggering at 192,000 BTC.



This has resulted in the amount of Bitcoin on exchanges dropping significantly compared to its highest level in March 2020 at 3,000,000 BTC. The current total holding has dropped about 657,000 BTC or 22% to the lowest level in three years.

Technical view

From a technical perspective, there are two possible scenarios, positive and negative, revolving around different interpretations of charts.

The first scenario is negative, where the price is allegedly forming a head and shoulders pattern. In this scenario, the height of the head is approximately $8,050, so if the pattern is true, the target would be around $35,000-37,000.

The positive scenario meanwhile sees the corrective Elliott Wave ending and creating another continuation of the previous main uptrend. If this is true, a potential new high could form by the end of the year.

Forex

The focus in the third quarter on monetary policy, and American monetary policy in particular, didn't lead to very many clear signals for participants in forex markets. While the Fed's guarded language over tapering and repeated references to 'significant further progress' on inflation contributed to the dollar's gains, these were quite small in Q3, and in few places was there evidence of a clear trend.

Some currencies with more dovish central banks than expected, such as the Kiwi dollar, were more volatile than usual, but commodity currencies in general did well towards the end of summer as various industrial commodities made gains. AUD and NZD started moderately strong recoveries against the greenback in the middle of August.

Of course, one should remember that sustained trends for forex are generally very rare. If, as noted in the overview above, yields from bonds increase and participants rotate out of shares, this still wouldn't necessarily lead to a really extended and strong round of gains for the dollar, since in that situation British, European and other major bonds might well see yields going up too, just probably not to the same extent for European bonds.

Monetary policy, job data and the usual correlations are likely to remain in focus for currencies in the fourth quarter. This section looks specifically at two possible scenarios that might develop if current shifts in sentiment continue: ongoing losses for euro-dollar and strong gains by the pound sterling.

Euro-dollar's 'race to the bottom'

While one obviously couldn't say that any major country's economy is looking really great at the moment, there do certainly seem to be different levels of difficulty. The likely trajectory of monetary policy in the EU and the USA especially seems to be quite different, with many participants expecting the Fed to start raising rates even next year and tapering from this quarter. The ECB though continues to stress the importance of very accommodative policy.

Despite two bounces to around $1.19 in Q3, the technical picture still looks very negative for euro-dollar, with no clear support in view until about $1.16 or even $1.15 for a likely strong support. Volume in September so far hasn't really backed up the idea that this symbol could decline strongly in Q4, but this might just be because few participants here are currently looking beyond the short term.

Ongoing losses could be favourable for euro-dollar based on both TA and fundamentals, especially in the latter case if the Fed commits to or hints at some sort of timeline for tapering and yields from US bonds start rising significantly faster than in the EU. However, this scenario would have the potential to challenge the received wisdom that positions shouldn't be held for more than a day or two in September, so keeping trades small, being prepared to exit relatively quickly and moving stops into profit might help traders make the most of any developing situation.

Focus on inflation remains strong for the pound

Annual inflation in the UK in August at 3.2% was the highest in more than nine years and exceeded the consensus significantly. This came in the context of the Bank of England's fairly sudden pivot toward openness to tightening policy.

September's meeting of the Bank of England in particular was strongly positive for the pound in the short term as policymakers stressed the likelihood of inflation continuing to rise to 4% this winter amid what the media call a looming 'energy crisis'. However, the main question marks over ongoing gains for the pound are shortages of workers and raw materials in the UK, which are likely to limit economic growth.

Q3 wasn't very active for the pound, in keeping with most other major currencies, but the stage might now be set for a round of gains before the end of the year. Markets are still digesting the BoE's newfound (relative) hawkishness, but the third test of ¥149 in the second half of September came with quite a strong upward reaction with relatively high buying volume.

Against the dollar and the euro too the pound seems to have room to move up, but pound-yen might be a better candidate for actually buying given the dollar's possible gains this quarter and the presence of fairly strong technical areas below on the chart of EURGBP. Strengthening for the pound certainly has a question mark over it this quarter because of unknowns in the UK's future trade relationship with various countries and an especially pronounced shortage of workers, but it seems to many participants that the BoE needs to do something in the face of sharply rising inflation.

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