StoneWater Capital Management

17th April 2018

"Sometimes you've just got to lick the stamp and send it" Daniel Riccardo

Opportunities to position for a cyclical downturn are starting to present themselves but we patiently follow **Ned Davis' rule, "Listen to the cold, bloodless verdict of the market".** Until key levels are broken and probabilities shift in our favour we won't look to fade any strongly trending markets.

Oil and copper's trend and momentum look to be dwindling as positioning signals a tired market as we approach significant technical resistance. Instead of shorting oil or copper at these levels we have identified trades that will benefit from lower commodity prices but do not require them. USD has broken key technical levels which presents opportunities to be long.

Long USD vs cyclical currencies (AUD, NZD, GBP and CAD) is a great way to express our view that: 1) risk sentiment may continue to decay, 2) US equities outperform RoW on a relative basis and 3) a cyclical downturn and stronger USD pull down commodity prices.

Short AUD and GBP has our highest level of conviction as both currencies are structurally weak and perform poorly in an environment where 1) risk is supported and policy normalises or 2) risk deteriorates.

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Oil testing crucial technical levels

Oil priced in CNY and DXY have both broken and tested multi-year resistance levels. Until there is a close below these support levels oil prices should continue higher. I hold a bearish fundamental view on oil but no matter how good a narrative I could spin to short oil this technical set up screams higher prices.

Source: Tradingview

Open interest turned lower but positioning is still extreme

Until the upward trend channel is broken expect to see prices continue to drift higher lacking any punch due to extreme positioning which will have to unwind at some point, but trying to fight that seems like a low probability trade. Given the context there are superior trades which will greatly benefit if my bearish fundamental bias plays out but does not require lower oil prices.

Source: Tradingview

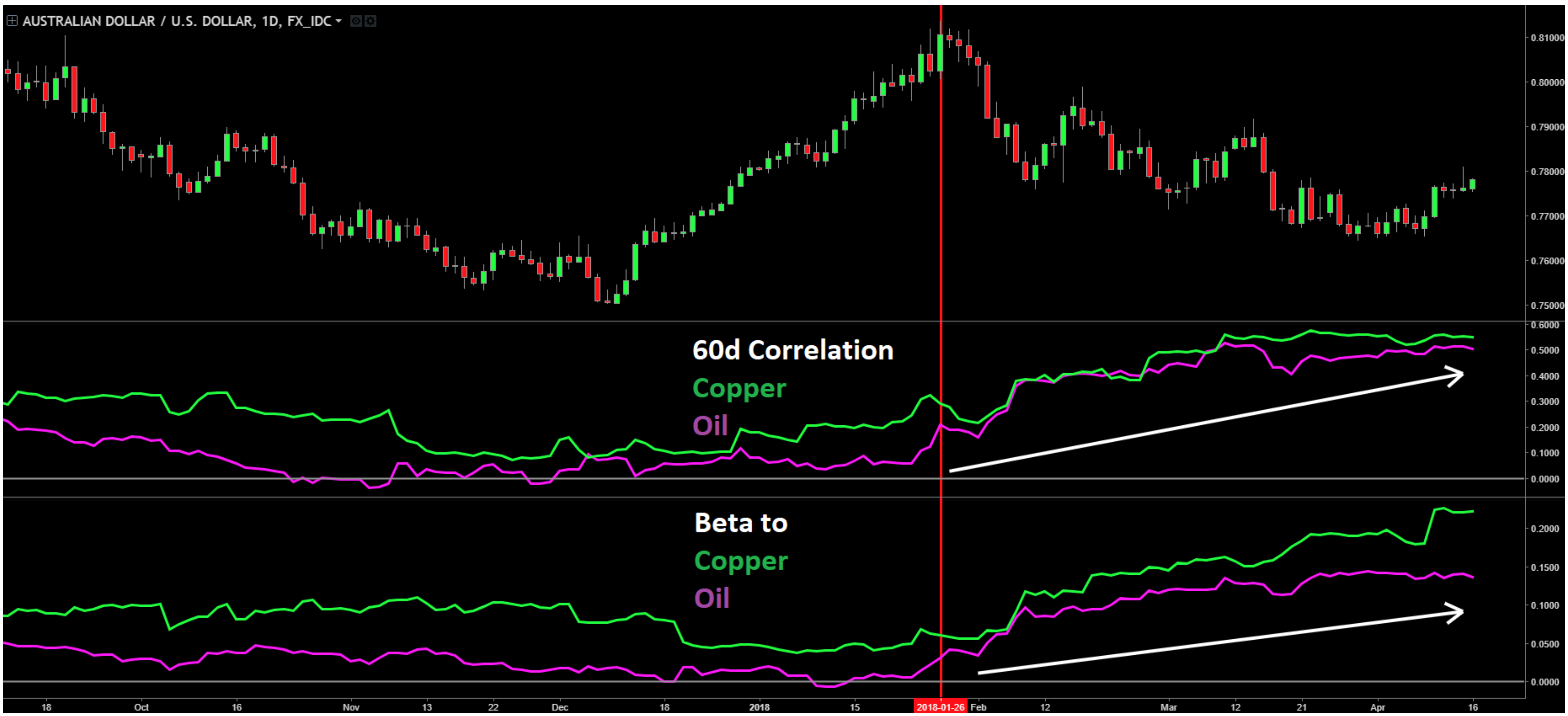
Probability has shifted in favour of a sharp USD rally

Divergence formed at the recent low and the trend line in the DXY inflection points model has been broken which in the past has been followed by a sharp broad-based USD rally.

Source: Tradingview

Short AUDUSD is an excellent way to position for a cyclical downturn, a stronger USD and potentially lower commodity prices

AUDUSD has increasingly become more sensitive to oil and copper prices since AUDUSD peaked. The multi-month rise was driven primarily by USD weakness and AUD underperformed most of the other DM's. AUDUSD is on track to breaking its multi-year corrective pattern.



Source: Tradingview

AUDNZD signals that being short NZDUSD may have a greater return potential over the medium-term

AUDNZD is testing support levels and if the downtrend is broken with a daily close above the trend line we would shift our bias to being short NZDUSD as well as AUDUSD.

Source: Tradingview

Tall order for GBPUSD to break resistance

For the trend in GBPUSD to continue risk needs to remain supported, the BoE will need to be hawkish continuing to raise rates (which will lead to a flatter yield curve which will eventually work against the GBP) and growth needs to be strong. This seems like a tall order given the current conditions. GBP sensitivity to oil and ACWX (MSCI ACWI ex-US) has picked up leaving GBPUSD highly vulnerable to a cyclical downturn.

Source: Tradingview

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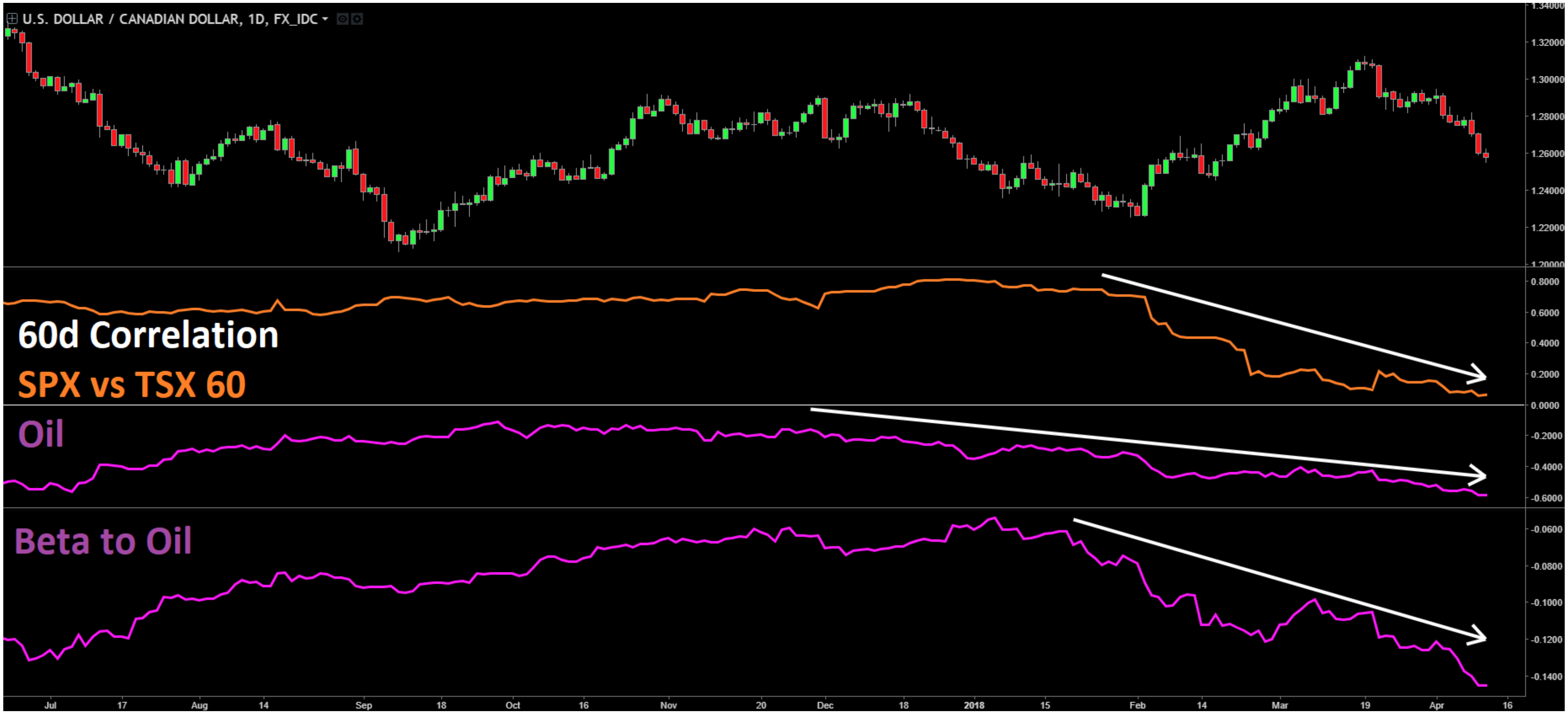
GBP is structurally weak and is a high conviction short but the trend is strong (until it isn’t). The return potential being short GBPUSD is mouth-watering but there is no need to be a hero and fade this technical trend structure until there is a daily close below the trend line.

Source: Tradingview

Long USDCAD is a great way to express our views that US equities outperforming RoW (even though the correlation has broken down), the USD strengthens and oil prices don't push up much higher from here. Longer-term, rate differentials should work in favour of a higher USDCAD but there are better long USD trades on offer. Current levels do offer a good entry level though.



Source: Tradingview

A daily close above the short-term down trend line provides an asymmetric trading opportunity

A rectangle has formed at a key technical level which needs to hold for USDCAD to trade higher. A daily close below 1.25 would signal the higher low formed in February may have just been part of a corrective pattern and USDCAD will weaken. Our bias though is this is a great technical level to look to enter long once the short-term trend line is broken.

Source: Tradingview

DISCLAIMER