
ROHR SPECIAL ALERT!! Powell Drives Inflation Psychology

1 message

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Dear Subscribers,

As noted in Monday's 'Inflation Bifurcation' ALERT!!, the previously noted impact of the energy price surge is only "...part of broader inflation which is now looking more stubbornly durable." Rather than just focusing on the obvious influence of higher energy prices on the significant bifurcation of emerging currencies trends (as we cited from late last week), it was obvious that the higher prices as well as yields were a combined negative which is driving the greater divergence there.

Please see Monday's analysis for our initial assessment of that more pernicious influence on those trends, which was also clear confirmation of the inflation psychology shifting into a higher gear based on the price activity in the various asset classes. We explore that further below, and especially for global govies which historically spend quite a bit of time consolidating, then in straight-line moves which do not allow for the ebb and flow of 'normal' trending activity.

As noted Monday, the front month US T-note future (September until its expiration last Tuesday) had continued to churn not too far below its key 134-00 area for the past month-and-a-half. Yet after it expired at midday Tuesday, December T-note future fell to the top of the 132-00/131-16 support it is now slipping below.

That December T-note future weakness is particularly telling both in the context of how quickly it weakened into that area, and the next historic support not being until the 130-00 area (as it tends to run in two point increments.) That is allowing that the previous sharp selloff into early April held at 130-255, essentially not any sort of historic congestion. This opens the door to a 10-year yield swing to a new high above the April-May 1.70-1.75% area, after which it might react back down.

On the other hand, the previous downside leader December Bund future Monday drop into its 170.00-169.50 range key support has not seen any further weakness below that area, representing a yield rally to -0.20%. While that may sound low to others, it is up from nearly -0.50% as recently as mid-August. Its importance is highlighted by this being the key support this side of the 168.00-167.50 range. However, much like the T-note, its selloff into May did not quite reach that area.

That said, front month Gilt future (officially December today), which had been the weak sister previous, failed to hold its 128-00 support last week on the September contract selloff. With the typical full point discount at expiration in the 'second month' December Gilt future, it is back to well below its 126-00 support. That is striking in being so far back below the 126.86 May trading low (March-May high yields near 0.90%), and insofar as the cash rate is now into the psychologically important 1.00% with the next futures support not until the 124.30-123.60 range.

As such, even considering how far global govies prices have fallen and yields have risen, the 'straight-line' factor means they may have further to go prior to any stabilization or counterpoint reaction. That anticipation is driving the 'risk-off' psychology in the vulnerable emerging currencies, and even more of a US dollar 'haven' bid at present in the developed currencies. While that bid may also be partly on the basis of the recent surge in US yields, that is historically less of a significant factor compared to the prospects for inward investment overall.

Yet the market activity is clear on the US Dollar Index rising above 93.40 area once again. Also above the August 93.72 trading high makes this a new 10-month trading high, with next resistance not until the 94.30-74 Fall 2020 trading highs. That is also the case for the EUR/USD weakening again below the 1.1700 key level below its August 1.1800 area weekly Head & Shoulders DOWN Break.

However, unlike the minor new high in the US Dollar Index, EUR/USD is still holding slightly above its 1.1664 mid-August trading low. Yet this still leaves the burden of proof on bulls to create an immediate return to strength, even if next lower support is as nearby as the 1.1600 area Fall 2020 trading lows. (Please see Monday's ALERT!! for links to each of those markets' previous weekly charts.)

And further reinforcement for all of the inflation psychology based on what is a strong yet still disjointed US economy comes from Fed Chair Powell's testimony today, extending the comments from his prepared testimony released Monday afternoon (<https://bit.ly/3m5okAL> for our marked-up version.) This noted again that the Fed still sees inflation being based on reopening supply bottlenecks, and it coming back down into the Fed's two percent target range across time.

That is something many folks are questioning, especially due to extended wage increases which have the potential to foster more pernicious 'wage-price spiral' inflation expectations. In any event, Powell allowed Fed inflation expectations to date were a bit more sanguine than the real world seems to allow at present.

In response to a question from the financially savvy Senator Toomey (R-PA and successful ex-foreign exchange and derivatives trader), Powell confirmed that "...inflation has not only not gotten better, on the supply disruptions it has gotten worse." Yet once again he cited 'supply disruptions' instead of rising wages(??)

That additional spending power of the US working class may explain why the US equities have been able to at least partially withstand the pressure which has so heavily affected some of the other financial markets. As noted on Monday this is less of a critical issue for corporate profits "...while companies can pass along higher input prices." Of course, that is also tied into 'real wages' after allowing for a certain degree of spending power erosion due to inflation. As such, it is of note this morning that after such a sharp December S&P 500 future recovery from last week's early 'Evergrande debacle', it is back below the 4,420-00 range to nearer the still important 4,347.75 mid-August trading low. It's going to be interesting.

Courtesy Repeat of Monday's 'Inflation Bifurcation' ALERT!!

While we had inferred that the significant divergence in foreign exchange on the difference between the developed currencies and the emerging currencies was due to continued elevation of energy prices, it is now apparent that is only part of the broader story. The full perspective on a renewed energy market price surge is that it is part of broader inflation which is now looking more stubbornly durable.

Why is this important for broader market psychology where 'risk-on' psychology had been able to ignore the inflation implications until now? It is more prominent on the current front month WTI Crude Oil future (November) pushing back above the 70.00-71.00 area to the key 75.00 area. That is important July-November 2018 topping activity (ultimate high 76.90) of the trend up from the 26.05 early 2016 low.

Retested in early July, there was a fresh 75.15 DOWN Closing Price Reversal (CPR) with a Tolerance 76.22. This is very important for inflation, where Europe is already vexed by more immediate energy price inflation than the US. While there is no assurance it will occur, if front month WTI Crude Oil future should overrun the general 75.00 area (ultimately the highs around 77.00), that would be a new seven year high with the next prominent resistance not until the 85.00 area.

The important issue for broader psychology is this now being more glaringly apparent in the global govies yields, as apparent in their futures miserable performance after rallying early last week on Evergrande implosion fears. Yet that proved very temporary, with cooling of the immediate debt default fears (see Friday's 'Risk Limbo' ALERT!! repeated below) leading to global govies reverting to a focus on the previously almost completely ignored inflation indications.

That has seen the 10-year US T-note yield pushing up above a recent key 1.37% area to around 1.50% not seen since late June. That leaves the December T-note future back below the top of the key 132-

00/131-16 area, also not seen since then. Similarly for December Bund future, the drop back to the top of the 170.00-169.50 range key support has not been seen since around the same time, representing a yield rally to -0.22%. While that may sound low to others, it is up from near -0.50% as recently as mid-August. It may also be influenced by the looming change of government since the more liberal and profligate SPD won the recent election.

Recent reaffirmation of central bank accommodation along with stronger US data will likely support the US equities for now. And higher yields are consistent with a 'risk-on' psychology, and rarely any cause for skepticism while the companies can pass along higher input prices. That seems to be the case for now based on recent corporate earnings reports in spite of much higher wages for workers.

Yet that is the US and the other developed countries, and much less so for the more highly indebted and export earnings dependent emerging economies. Hence the full bifurcation being more so between the developed currencies and emerging currencies on the current surge in energy prices, inflation and global yields. Examples abound in the 'steady' activity in developed currencies, like the US Dollar Index stalling above 92.70 resistance into only the next key 93.40 area.

This is closely correlated with EUR/USD slipping below its Head & Shoulders Top 1.1800 DOWN Break. Yet it is holding around its next lower 1.1700 support despite recently retesting that support, which was also seen in mid-August. While they are on a different projection basis, you can see both of those annotated weekly charts updated through last week Monday (US Dollar Index <https://bit.ly/3tZLcFp> and EUR/USD <https://bit.ly/39mpRwa>) for that clear indications of 'steady' activity.

Those were updated last Monday instead of the previous Friday's end-of-week developments due to the SPECIAL ALERT!! nature of the research update, which is the same today on the recent bifurcation of the trend indications.

The full 'bifurcation' is far more apparent between various emerging currencies, based on their sensitivity to energy prices and yields. The South African rand is suffering the most, as evidenced by the USD/ZAR swing from an encouraging drop below 14.50-.40 and 14.20 to a surge above 14.70-.80 and now even 15.00.

Similarly the Turkish lira has seen recent strong sister activity on USD/TRY trending steadily lower into the 8.30 area turn into a push above the mid-June 8.7918 previous all-time high. That is very weak in both cases, taking away from any sense a full return to a 'risk-on' psychology can maintain in the near term.

The middling activity is the Mexican peso, which has weakened on USD/MXN pushing back up again from 19.80 area to above 20.00. Yet any weakness there is likely buffered to some degree by higher energy prices. Yet the real obvious winner of the stronger Crude Oil prices is (not surprisingly) the Russian ruble, which has USD/RUB stuck in the lower 73.00-72.50 support range for weeks.

Courtesy Repeat of Friday's 'Risk Limbo' ALERT!!

As noted in Thursday's 'Delta Dependent' ALERT!! (we suggest a review for anyone who has not done so already), the central banks are all acknowledging the continued growth, yet are citing the stubborn resilience of the COVID-19 Delta variant as grounds to remain accommodative for now. That is a variegated situation with, for example, lower infection rates in a few countries encouraging lifting of pandemic restrictions, yet higher infections elsewhere.

That is still with higher new cases among the less vaccinated nations, and better results elsewhere. Yet it is adding to the uncertainty on individual country GDPs and international trade, which justify the continued central bank largesse. It is also the case that the 'rearview mirror' economic data has also weakened of late. This week that includes Thursday morning's weaker global Advance PMIs, and this morning's German IFO Surveys. This is another aspect of the global picture (even if also driven by the COVID-19 pandemic) supporting central bank largesse.

Then there is mitigation of the influence from Evergrande's situation, even though it missed a dollar-bond interest payment Thursday (more below.) The swing from 'the Agony' of the international economic and financial fears into midday Monday to 'the Ecstasy' of Wednesday's post-FOMC rally was palpable (with apologies again to Irving Stone for borrowing his novel's title.) It was already becoming apparent this is not a 'contagion' crisis regarding (as we noted on Monday) "*...this is not likely a sustained major issue for the broader global economy after the dust settles on the current panic selling...*" ...not enough Western exposure.

Along with the very limited Western exposure, that is in line with the fact noted yesterday that the interest payment (along with the one due next Wednesday) has a 30-day grace period before Evergrande is in default on those payments... hence today's 'Risk Limbo' title. In part this is a period for Evergrande to consider all of its payment options and ready cash sources. That is going to be very interesting.

However, it is also a period for the Chinese government to consider the domestic financial implications along with the social fallout. As this morning's very good Reuters article (<https://reut.rs/2WcxWRg>) notes, "*The conundrum for China's leaders is how to impose financial discipline without fuelling social unrest, since an Evergrande collapse could crush a property market which accounts for 40% of Chinese household wealth...*" It is also a major sector for the Chinese economy.

Given that impact on both the Chinese economy and its social compact, that is another important aspect. That is due to the Chinese central government already signaling local governments they should prepare for the financial fallout and even social unrest if Evergrande fails. And now there may be other problems in the property sector, where many have paid substantial amounts for homes yet to be built. As such, the markets are likely in for a further phase of 'thrills and spills' on the evolution of Evergrande itself, and the overall Chinese property sector.

However, at least so far US equities response to the 'grace period' realization has been to fully recover from Monday's radical weakness. December S&P 500 future has rallied all the way back above 4,400-20 range trend support cited last week.

Global govies back under pressure after Monday's temporary squeeze from previous weakness is a sign of renewed 'risk-on' psychology, even if some inflation influence must be allowed. That is with the previously resilient front month T-note future seeing the September contract rally back to the 134-00 area just prior to its Tuesday expiration, yet just three days later seeing the discounted December contract fail all the way down to lower major 132-00 area congestion.

Foreign exchange is a more mixed picture. The developed currencies are a bit stuck with the US Dollar Index in the 93.40 area, and EUR/USD in the 1.1700 area (more below, with chart links.) Emerging currencies are still under pressure, and this may be due to the China uncertainty factor having more of an impact there.

Courtesy Repeat of Monday's critical consideration

After the early July downside reaction the recovery back above the 4,300 area violated support left the higher resistance into the previous week's 4,360 DOWN Closing Price Reversal with a Tolerance to 4,364. That is clear on the S&P 500 future weekly chart (<https://bit.ly/3ickAw2> updated through Friday.) It is of note the September S&P 500 future had managed to retest that area right into the ECB press conference prior to weakening once again the following Thursday morning.

And the September S&P 500 future subsequently sustaining activity above the 4,425 and 4,450 weekly Oscillator thresholds was a sign of continued strength as they were still rising \$25 per week. As such, the Oscillator indications remain important after what was the 'lackluster jailbreak' after the previous outstanding US Employment report. With the market dropping back below the 4,450 level two weeks ago (on weekly MA-41 up \$25), there seemed to finally be some real risk.

Yet even below the key lower interim levels into the recent 4,425 area congestion and 4,380-65 area bottom of that, it also held key lower support in mid-August looking forward into the following week.

That bigger level was 4,340 under weekly MA-13 (loosely held on all sharp reactions) at that time, and the significant aggressive weekly UP Channel from the major 2,174 March 2020 cycle low.

In the event, the recent late week recovery back above the 4,425 area pointed to the strength of the psychological recovery as well as exceeding the key technical resistance areas. That led to the recent new all-time highs above the previous week's 4,476.50 trading high (prior to the temporary selloff.) That again left the near-term Oscillator thresholds into 4,515 and 4,540 areas last week (on the rising MA-41), which it failed to maintain two weeks ago, fomenting the reaction.

This led to the violation of the 4,492 interim daily chart congestion after trading around it previous, with the more prominent 4,462 area also being violated two weeks ago. And while it traded back above that as well early last week, recent softening below it spoke of an ability to trend lower in the near term. That left the more major 4,420-10 area as next support on both weekly MA-13 as well as that significant aggressive weekly UP Channel from the major March 2020 low.

Having tested that area into the Close two weeks ago and violating it from the beginning of last week was a fresh 4,410 DOW Break. That fed further weakness which was already anticipated from the negative fundamental influence flowing out of China. As usual there is a Tolerance below that (as seen on selloffs in both June and July) down to the 4,350 area lower congestion developed during the temporary July topping activity, and retested on the mid-August sharp temporary reaction to a 4,347.75 trading low. While that may seem to be a broad berth, on past form only below the 4,350 area does the market signal a full reversal.

Yet as always with these matters, the weekly Close was more important than temporary trading weakness below it. And the December S&P 500 future held overall against interim low-4,300 support, and ended the week back above the low 4,400 area. The extent of the temporary selloff means that it needs to be treated as a 4,410 weekly up channel DOW Break. Yet that also means the Close back above it establishes it as a Negated DOW Break, and therefore a support area. That is also consistent with weekly MA-13 moving up to the 4,430 area this week.

Thanks for your interest.

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