FX Monthly Report

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Research Desk
research@sucfin.com

Press Enquiries
press@sucfin.com

Authors:

Geordie Wilkes
Head of Research

Daria Efanova
Research Analyst

Daniel Henson
Deputy Head FX

Nimit Khamar
FX Desk Broker

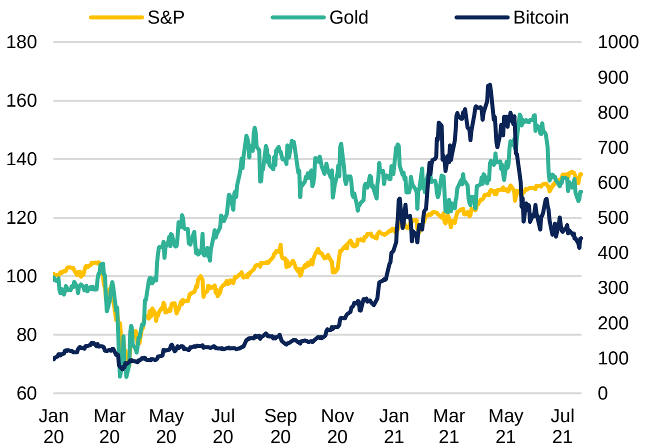
Chris Husillos
FX Desk Broker

Crypto

It has gone a bit quiet in the crypto space, but there is no doubt that bitcoin, Ethereum, and friends will be back. The institutional involvement in crypto tells an essential story here that these assets are not going away. Indeed, the flows into crypto in conjunction with Tier 1 banks having crypto trading desks indicate that crypto is now an official asset. The mindset of the original investors is that they will never sell, and the anti-establishment nature of the market will bring a mixed feeling. However, following an increasing number of companies indicating they will accept bitcoin as payment, the Chinese government moved quickly to ban bitcoin mining in some inland provinces where it was particularly prevalent. Unfortunately for bitcoin, this came swiftly after Elon Musk highlighted the apparent fact that bitcoin mining was terrible for the environment. Bitcoin's energy demand is considerable, and the electricity that powers the servers is predominately coal.

Gold vs S&P 500 vs Bitcoin

Bitcoin and gold softened in recent sessions, whereas the stock markets continued to beat record highs.



Source: Bloomberg

It is easy for established industries to point to this and see it as a flaw, however that is pretty hypercritical when these industries are only just looking at their carbon footprint, and even then, will only make changes to benefit their share price, as high ESG rated firms have outperformed lower-rated firms on the S&P 500 since the GFC. The fact remains that crypto mining is energy-intensive, and according to Cambridge University's Bitcoin Electricity Consumption Index, it reached 133.68TWh in May, which is above Sweden, which used 131.8TWh in 2020 of July 20th, electricity consumption was estimated to be 73.04TWh. The mines will return, and we have seen activity in an increase in Kazakhstan, amongst others, where 90% of the energy mix is powered by coal, might we add.

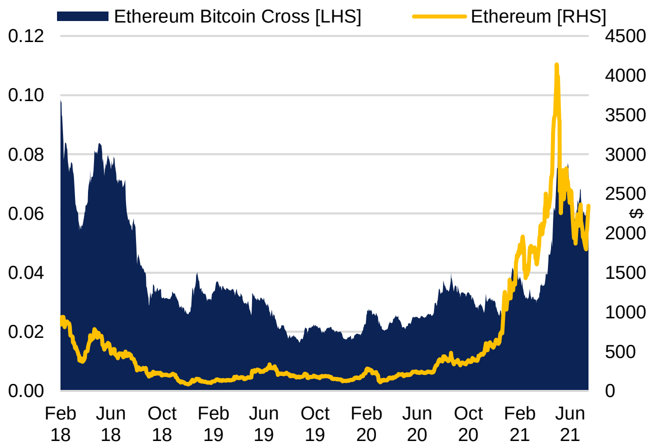
Bitcoin is the most famous of the cryptos, but from a functionality perspective, it is less advanced, and it cannot process thousands of transactions in a second. Ethereum is more advanced, and the ability to transfer money will become free and is being built on the Ethereum network, according to Michael Novogratz when interviewed by Goldman Sachs. Indeed, he says that payments, DeFi, and NFTs are all being built on Ethereum. Therefore, in a similar vein for Myspace paving the way to Facebook, Bitcoin could be doing the same for Ethereum, or maybe even another currency being developed. Ethereum has more capacity to store value and supports smart contracts, and allows developers to build new applications. Therefore, the ether platform can become an extensive, trusted network. Ethereum is also transitioning from a proof of work (PoW) to an explanation of stake (PoS) verification method, which increased the energy efficiency of the system, and Ethereum 2.0 is expected to reach a capacity of 3,000 transactions per section, and with the PoS network, this could reach 100,000 transactions per second.

According to Goldman Sachs, a small allocation of bitcoin has enhanced a 60/40 portfolio in recent years. Due to the volatility of the crypto space and bitcoin, we favour holding a low percentage of the crypto in a portfolio. Indeed, from a relative value perspective, Ethereum is better priced; this view is compounded when looking at the two technologies as Ethereum is far superior. Bitcoin has the benefit of being the first to market, and retail investors are attracted to it like moths to a flame. However, while bitcoin prides itself on being decentralized, most trades are on a handful of exchanges, and four Chinese mining groups control 60% of the bitcoin supply. This limits the downside, but the philosophy of never selling most likely means it will not go back to zero. A lot has been made of bitcoin being a new safe haven, and while there have been patches of this behaviour, it is hard to imagine an asset that has that much volatility and risk and whose value can plummet following one tweet can be defined as a safe haven. A safe haven, such as gold and collectables, maintains its value as other assets tumble and have other uses such as jewellery.

The crypto space may be quiet for the time being, but rest assured it will be back. Bitcoin may be the darling of the space, but it cannot change payment systems and supply chains as we know them from a technological perspective. But Ethereum is the long-term front runner at the moment but Cardano, is hot on its heals, and if Ethereum 2.0 is not released Cardano will only gather steam. Cardano is looking to solve real problems in developing countries and recently announced a partnership with the Ethiopian Ministry of Education.

Ethereum vs Ethereum Bitcoin Cross

Ethereum Bitcoin cross has been largely driven by the gains/losses by Ethereum in recent months.



Source: Bloomberg

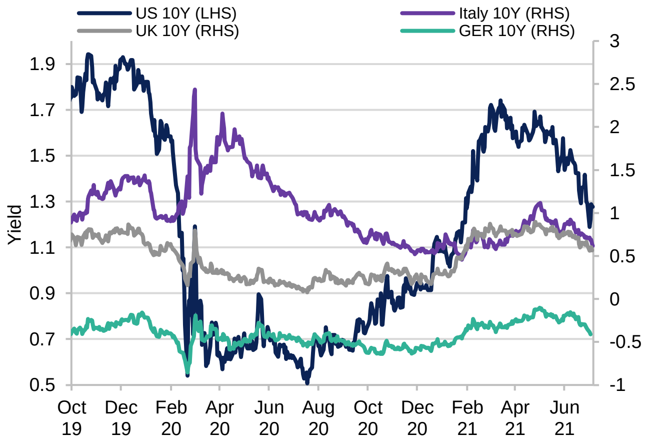
Euro Desk Comments

The euro has depreciated considerably since our last report, moving towards the bottom of our trading range following the Fed's change in tone. The ECB has also made slight changes to their monetary policy which would be deemed more dovish in nature. The ECB has formally adjusted its inflation target to 2%, and Lagarde has indicated that they are not likely to raise rates until inflation rises above their 2% target.

In the short term, we could see small bounces in the EUR amid fears that COVID-19 will be harder to beat due to the delta variant. As we have mentioned previously, the euro has increasingly been used as a funding currency, so a risk-off event would lend support to the euro as market participants look to cover exposure. In the medium term, in the absence of any significant change in risk sentiment, we expect the euro to continue softening against the USD towards 1.17 and then 1.13 by year-end.

Developed Economies Yields

Developed economies' yields continued to decline, with real yields touching record lows.



Source: Bloomberg

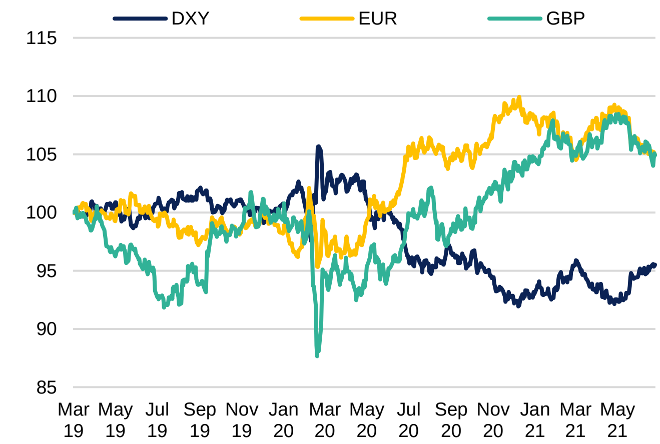
USD Desk Comments

In June, the Fed surprised the markets with a change of tone by signalling potential rate hikes from 2023. Powell acknowledged the higher inflation risks and indicated that the Fed would ensure they remain transitory, while also echoing high confidence in the economic recovery. The US dollar built up strong momentum on the back of this meeting, and when the rally started running out of steam, the US CPI data earlier this month gave US Dollar another boost; in expectation of policy responsiveness from the Fed sooner. The level of inflation in the US is much higher than the rest of the G7 economies, and if levels do not subside or the Fed fails to act, then it is hard to see the dollar continue rising for too long. However, the Fed has a very good track record at meeting inflation targets compared to other majors, so we would expect the same this time.

Whilst the change in tone from the Fed is earlier than we expected, it is not entirely surprising. The market is now pricing in a rate hike as early as Q4 2022; this would be the earliest, in our opinion, as before the rate hikes can commence, tapering has to be completed. Over the next few months, we expect the dollar to consolidate around these regions as markets debate the timing of the first hike, especially given the fears that a fresh COVID-19 wave could impede the economic recovery pace. Towards the end of the year, we see the dollar starting a new appreciation cycle as we expect the Fed to become more hawkish.

The Dollar vs Euro vs Pound

Both Euro and the Pound weakened against a stronger Dollar.



Source: Bloomberg

GBP Desk Comments

The Pound has depreciated considerably over the last month due to stronger USD and as COVID-19 cases rise in the UK, making sterling investors nervous. The world appears to be watching numbers in the UK closely to see the impact of rising cases on hospitalisations and fatalities after the economy fully opened up on July 19.

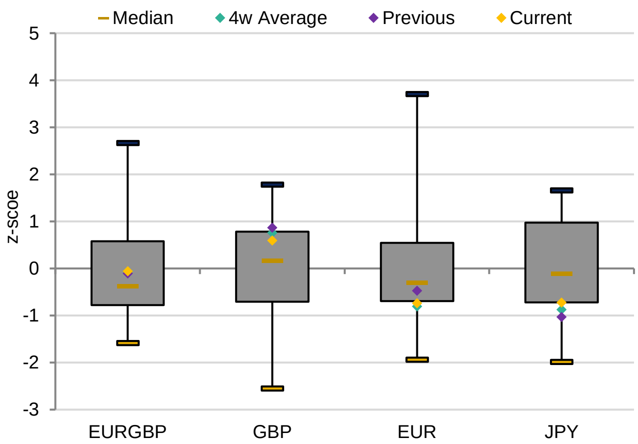
Predicting markets in short terms is extremely difficult amid the unpredictability of COVID-19 spread, which continues to have a large bearing on risk sentiment. However, there are a few things we do have a good indication of when looking longer term. Firstly, we know that the BoE and the Fed are likely to raise rates/ tighten monetary policy sooner when compared to the ECB and some other central banks. MPC members Saunders and Ramsden both made hawkish remarks recently, suggesting recent economic data could trigger earlier tightening than previously envisaged.

We know vaccination numbers in the US and UK are a lot higher compared to Europe. Furthermore, years of underinvestment amid Brexit uncertainty is likely to see more investment into the UK compared to most other majors in the coming quarters, as economies start normalising. Despite the rising cases baring any serious mutations and surges in hospitalisation from COVID-19, large scale lockdowns are highly unlikely in our opinion.

Therefore, we believe this pullback presents us with good opportunities to initiate longs as we expect GBP to bounce back. We expect the GBPUSD to rise back above 1.40 and potentially retest recent highs @ 1.4248 by end of the quarter. Those looking to get long GBP speculatively may be better rewarded by going long against EUR /CHF/JPY.

Major Currency Non-commercial Positioning

EUR and JPY current position remains below the median, whereas ERUGBP and GPB are above.



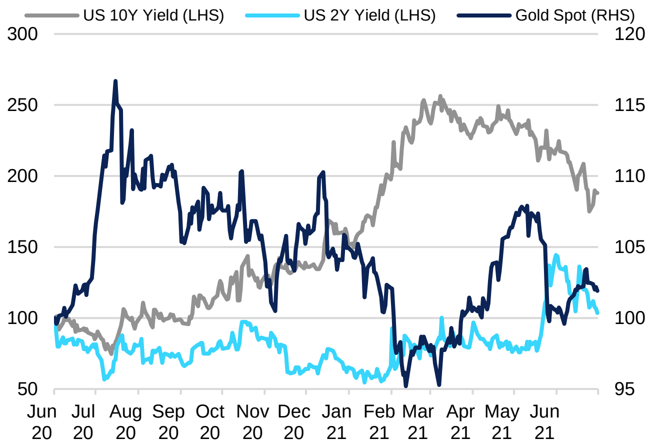
Source: CME, Sucden Financial

Gold

Gold prices have gained momentum so far in July, as continued safe-haven appeal, as well as its inflation hedge properties, supported the precious metal. The gain, however, was not strong enough to recover from the losses that occurred at the end of June, when the Fed signalled that it would raise interest rates earlier than expected. Additionally, the strong response from governments to aid economic recovery in the form of monetary and fiscal policies, with some central banks still pledging to add more support to the economy, continues to provide liquidity for the metal. Monetary policy is likely to remain loose in both Europe and the US, however, the latter might start to consider the tapering of its bond-buying programme. Regardless, in the medium term, we expect inflation growth, both from consumer and producer sides, to remain elevated, supporting gold as an inflation hedge. We believe that markets are unlikely to price in this growth into higher interest rates, as both the Fed and the ECB stated their resolve to tolerate higher-than-expected price growth. This has been indicated by softening nominal yields as well as the breakeven rate. Central banks are conscious of the market response to any changes in the monetary policy rhetoric and will most likely remain cautious in regards to the speed at which they begin asset purchase tapering or hike interest rates. A drastic change in sentiment could result in large market swings and impair economic recovery.

Gold vs 2yr and 10yr US Treasury Yields

Gold has weakened moderately in line with the Treasury yields as an inflation hedge.



Source: Bloomberg

Technical Charts

GBPUSD

GBPUSD broke below the uptrend after failing to close above highs from Feb, but found support at 23.6% fib level. We could now see a period of consolidation between 1.35 and 1.43 (50% fib of the move from 03/16 to 03/20) with upside biases after forming a bullish hammer candlestick pattern. On the upside, a break above resistance @ 1.43 (50% fib of the move from 03/16 to 03/20) and at 1.4382 (High from April 2018) will lead to the next leg higher towards 61.8% fib / 1.50 psychological level. This view remains intact while downside support @ 1.35 holds. A sustained close below 1.35 would lead to a larger pullback to 1.32.

EURUSD

EURUSD has broken below the bottom of the wedge/ neckline of what now looks like a head and shoulders pattern, a sustained close is still needed for confirmation but a move lower looks likely. On the downside, the next support is at may's low @ 1.1702 level and then 1.16 and 1.15. A close below here could pave way for a deeper correction to 1.13 which would also be the target area from the Head and shoulders patterns. On the upside, a close above 1.20 could see a re-test of downtrend and highs from the start of the year @ 1.2349.

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A suite of reports looking at how the global automobile market is changing, and as vehicle manufacturers look to transition to a more environmental fleet of autos we have outlined how prepared the energy markets in the U.S., China, Japan, and Europe are to aid this transition. Electric vehicles go a long way reduce GHG emissions in the auto market, we are not disputing this, and when you factor in the lifecycle of batteries EVs are a lot greener. However, these reports assess the energy mix in these specific regions and outlines what governments are doing to promote renewable energy and transition away from fossil fuels. Using the energy mix we provide emission analysis for different EVs compared to ICE vehicles in that country.

Coffee Investment Research

This report drills down into the detail of the coffee market and is produced three times a year, we also produce shorter more concise updates. We undertake a macroeconomic assessment of major consuming and producing regions before analysing the recent earnings reports from Starbucks, Nestle, Luckin Coffee, Dunkin Donuts, and Costa. This helps us highlight new sales and marketing techniques and any consumption changes, which has been particularly popular during COVID-19. The largest chunk of this report is where we assess the Supply and Demand outlook using our primary data for the coffee market and where we apply our fundamental models. We showcase our crop forecasts and highlight any changes before providing prices forecasts and trading strategies with futures and options.

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United Kingdom
Sucden Financial Limited
Plantation Place South
60 Great Tower Street
London
EC3R 5AZ

Tel: +44 (0)20 3207 5000
Email: info@sucfin.com

Russia
Sucden Financial Limited
Sucden Financial (Russia)
Representative Office
Orlikov per. 3 'B'
Moscow 107139

Tel: +7 495 796 96 40
Email: russia@sucfin.com

Hong Kong
Sucden Financial (HK) Limited
Unit 1001, 10/F
Li Po Chun Chambers
189 Des Voeux Road Central
Hong Kong

Tel: +852 3665 6000
Email: hk@sucfin.com

USA
Sucden Futures Inc.
12th East 49th Street
27th Floor
New York, NY 10017
United States

Tel: +1 212 859 0296
Email: ny@sucfin.com

sucdenfinancial.com

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