SURGETRADER OCTOBER 2022 **MARKET Outlook**

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EQUITIES

We can't remember the last time a single economic report carried so much weight as this month's CPI release, due October 13th. After a brutal September that saw equities give up all the gains of the summer rally and fall to fresh yearly lows, investors are sorely in need of some policy relief, and that relief can only come from the Fed.

As we noted last month: "Chair Powell's speech at Jackson Hole [in August] stopped the equity rally dead in its tracks and price action in equities has been as bearish at the start of the back to work season as it was bullish during the dog days of summer."

The Fed is gung-ho on stopping inflation at any cost and many investors fear that its tightening policies have already tipped the U.S. economy into a recession. Meanwhile, many of the leading commodity price inputs are well off their highs and corporate earnings calls are starting to warn of marked slowdown in demand with FedEx (NYSE: FDX) perhaps the most prominent example of clear concern about the health of the economy going forward.

Last month's CPI data was heavily skewed by the Owners' Equivalent Rent input which is nothing but a survey number and is therefore a feel input rather than a fact input. Looking at the latest data on housing, it's clear the market has peaked at least a quarter ago. Zillow's rent index reached its apex in February and has been falling off a cliff ever since, and even the most casual observer can see that all the For Sale signs in all the desirable suburbs of America have long been yanked out of the front yard.

With mortgage rates doubling in a year, the cost of home purchases has become prohibitive for much of the U.S. population and that dynamic will eventually weigh on the rental market as well.

So, the only question ahead of this month's CPI data is just how much residual price pressures will be left. As many analysts have pointed out, very soon the base effects will begin to kick in earnest and the year over year figures will begin to compress dramatically.

All of this tension sets up for a dramatic battle between bulls and bears mid-month. With equities completely decimated by the relentless selling of the past few weeks, the potential for a short covering squeeze could be substantial. In fact, the rally may have already started as the first few days of the month have seen a vicious upside move and it is very possible that the CPI will simply serve as a "sell the news" event.

For now, however, the shorts may have overplayed their hand and the massive liquidation and hedging flows are likely to create a bounce in the weeks ahead.

OIL

We continue to view oil as a range-bound trade of $70-$90 per barrel for the foreseeable future, albeit with a slight bias to the upside as the Chinese lockdowns are likely to ease after CCP Congress in October and Russian East Siberian production is likely to falter without the necessary expertise from the West.

Still with the Ukraine war destroying Russian material by the hour, the need to replenish state coffers will be immense and Russian production is likely to operate at maximum capacity to obtain revenues any way they can.

Many analysts have pointed out that Russia's fiscal condition will not be as fragile as anticipated, as higher prices will require far less volume to achieve the same revenue level. But Putin may have overplayed his hand by cutting off gas supplies to Europe completely, early in the season. It's forced EU governments to quickly pivot to other sources of supply, which could result in a permanent shift in the market, leaving Russia with a much more limited market to which they can sell.

There is no doubt that winter weather in Europe will be the wild card in the energy markets over the next few months. The long-term forecast is for average to mild temperatures, in which case the whole energy complex will remain steady at best or begin to sell off at worst. However, any cold spell could result in one more vicious price spike in crude as Europeans will scramble for any source of energy to stay warm.

The oil market, therefore, will be the weather market for the next months creating possible treacherous conditions for all but the swiftest of traders.

GOLD

Last month we asked: "Could gold actually be a buy? We've been negative about the yellow metal much of this year as it has easily ground lower despite the 'Greatest inflation ever!' shouts from the perpetually dour gold bugs, but recent price action suggests that the 'precious' metal may be in the process of forming a long-term bottom. Technically the charts are screaming bottom in gold now and that may be the most important signal to listen to in this market."

That proved prescient as the yellow metal held the $1,600 level and popped above the $1,700 mark. Part of the reason for the strength may be financial markets growing concerns about the fiscal stability of OECD credit. The calamitous debut of Liz Truss' budget proposal in the UK was a clear signal that markets will balk at any further unfunded fiscal schemes by politicians, and it is precisely when faith in sovereign debt begins to wane that gold begins to shine.

So, a bet on a much larger rally in gold really rests on further deterioration of the fiscal space in the OECD, and that is not an unreasonable position to hold given the state of geopolitical turmoil we face. Ironically enough, although gold is a zero-yield asset, it will be the rise in sovereign yields that could prove positive for the precious metal in what can only be described as the "Argentina effect" — i.e., it doesn't matter what yield you offer us, we have no faith in you paying us back.

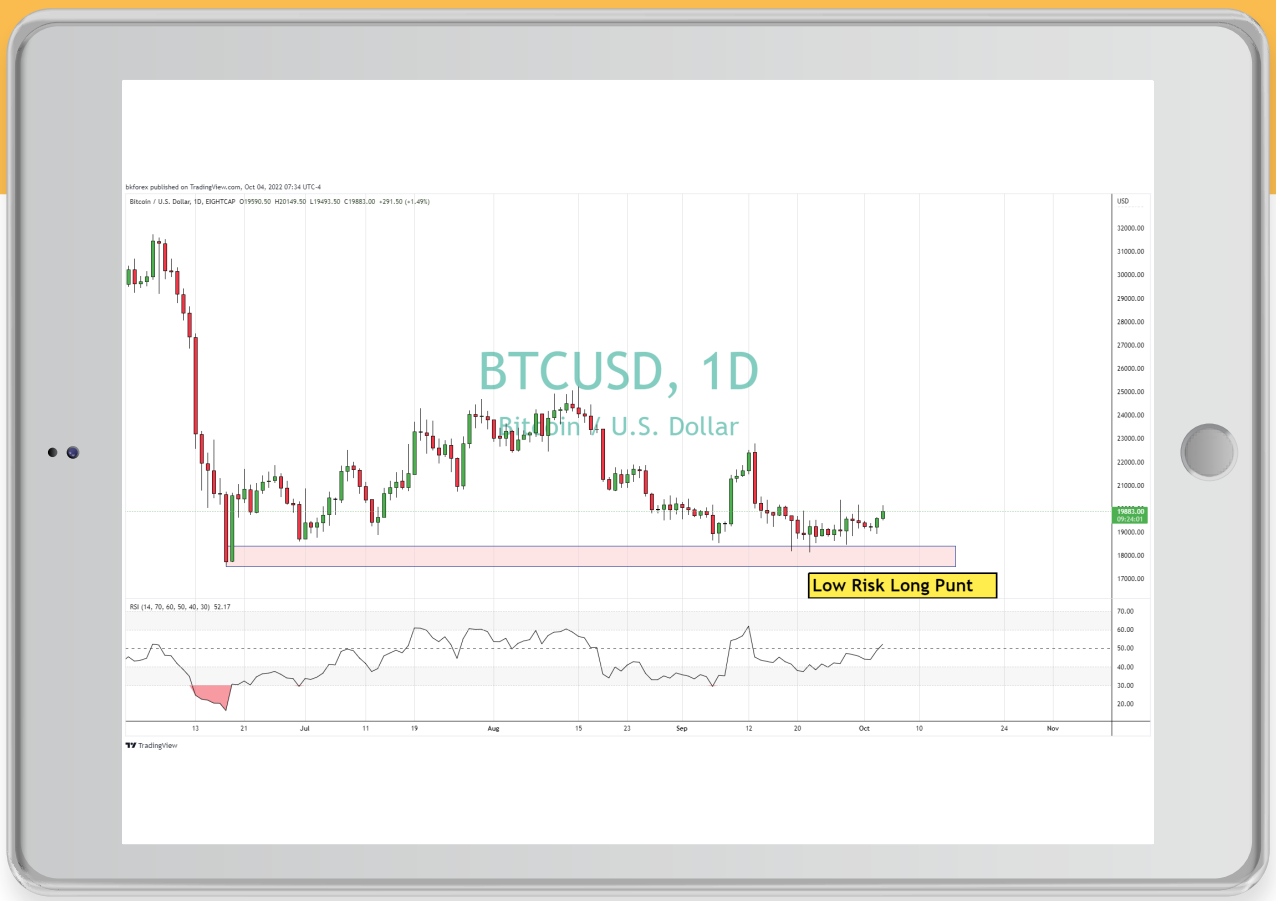
Given these dynamics and the supportive price action, gold therefore remains a buy and hold trade with $1,600 acting a natural stop on the position.

CRYPTO

Well, the Ethereum move to proof of stake turned out to be a complete bust, further highlighting crypto's lack of any use case as an asset.

The whole complex remains mired near its lows, with volatility compressed to the thickness of a Paris crepe — a sure sign that there is absolutely no interest in the asset class as of now. It would be interesting to see if the possible fiscal woes that are starting to attract flows to gold would also revive interest in digital assets, but for now, the space remains moribund and is likely to be dead money for the foreseeable future.

Perhaps the best thing that can be said about crypto is that the asset class is holding above its recent lows set in the summer, and, as such, offer an interesting risk-reward structure for any punters willing to take the trade. But absent momentum, crypto could be just another slow bleed down leg just as it was in 2017 before it finally broke out. That unwind move still has plenty to go while maintaining the long-term upward trend, so any bullish bets here should be small in size.



FOREX

FX is the new crypto. The wanton upheaval of UK politics. The war of economic attrition in the EU. BOJ intervention. If nothing else, this has made FX a much livelier asset class to trade.

However, after a generational rise in volatility, some pause may be due. With the UK government backing off its half-baked budget plans, with BOJ talking softly and carrying the big intervention stick and with the Fed perhaps taking a cue (or at least a notice from the RBA) to take the foot off the interest rate pedal, the dollar rally could see a pause in Q4.

EURUSD at 0.9500, USDJPY at 145.00, and GBPUSD at 1.1000 all represent near-term levels of support for the majors and could serve as decent risk control zones for a counter trend rally, especially if the inflation data begins to cool, creating the perfect condition for a bond rally and a dollar correction as we move towards the end of the year.

ABOUT SURGETRADER

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