# A Market Note

Steve Hallett

steve@macro-ops.com

## Trades Mentioned

- We're moving our stop-loss on our Copper long UP to a tick below yesterday's lows ($4.4805).
- Stop-loss on FULL Copper Long: $4.4805

## Quote

*In our daily intercourse with men, our nobler faculties are dormant and suffered to rust…though we have gold to give, they demand only copper. ~ Henry David Thoreau*

## A Copper VBO Case Study

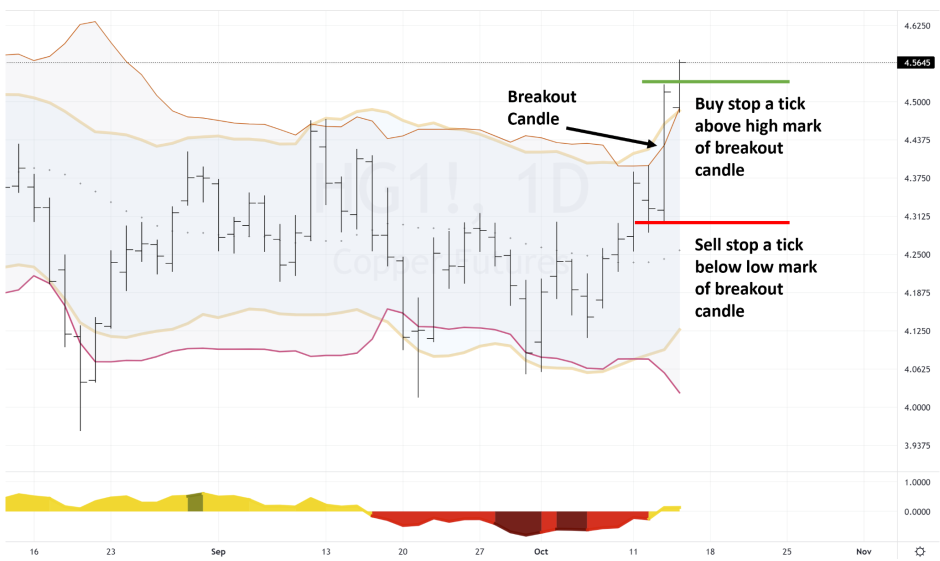
You've heard us mention a Failed Volatility Breakout Strategy (FVBO) numerous times. An FVBO is designed to capitalize on mean-reversion trends in a neutral regime. What happens when the opposite occurs?

A **Volatility Breakout Strategy (VBO)** captures occurrences when the underlying successfully breaks out and does **not** mean revert. This is commonly observed in a blended bull-quiet regime, however can be observed in natural regimes with favorable tape setups as the SQN is inherently a lagging indicator.

There are three steps to the **VBO Setup:**

- Identify a breakout candle either to the upside or downside. This is observed when price action closes outside of both Bollinger bands **and** the Keltner channel.
- Place a buy stop a tick above the high mark of the breakout candle.
- Place a sell stop a tick below the low mark of the breakout candle.

Visually this setup is shown below (from our recent Copper Long):



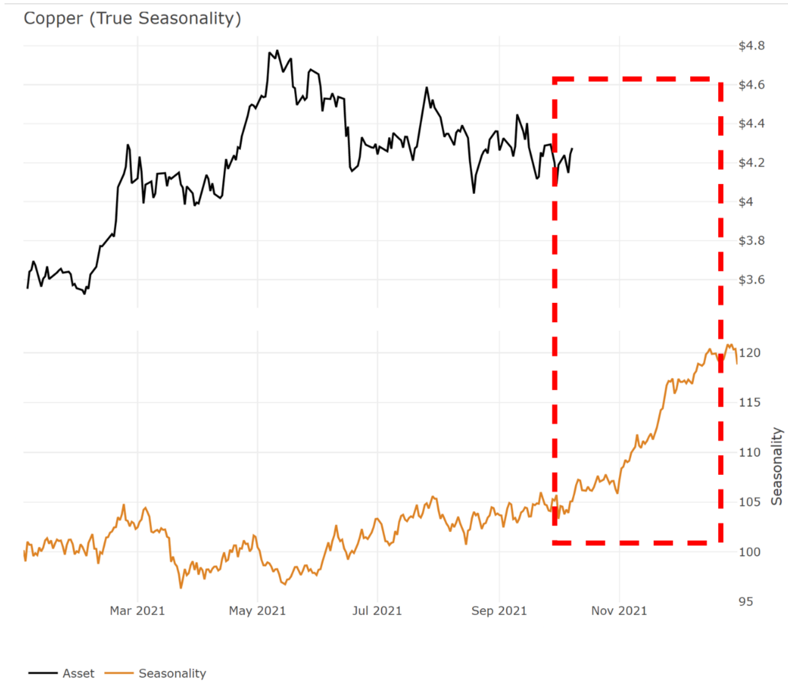
Managing a VBO following the steps above ensures a wide stop to protect against large shakeouts if a mean reversion trend threatens in addition to an appropriate sizing with regards to risk. We're not betting the farm here. If the breakout is of considerable magnitude the position can grow to a larger notional percentage on its own.

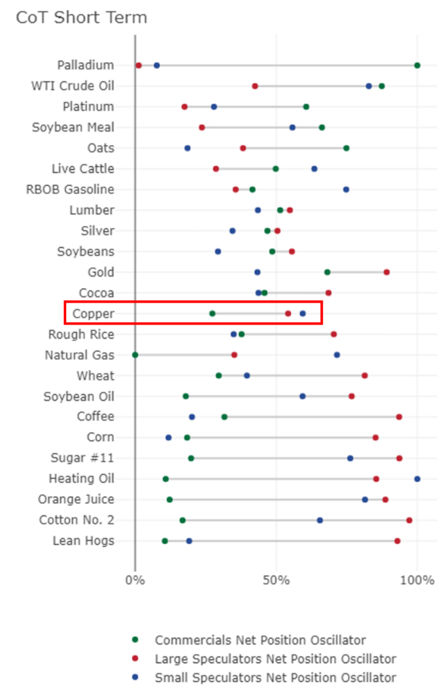
Common characteristics of how to treat this market move are:

- Higher average wins and lower average losses are commonly observed here
- The phrase "let your winners run and cut your losers short" rings true, especially in a trending market.
- Adding to a position in a trending market is recommended if the underlying price action is strong, but *only* add if it's strong. Do not try to be a hero.

Lucky for us, we're seeing a textbook VBO play out in front of us.

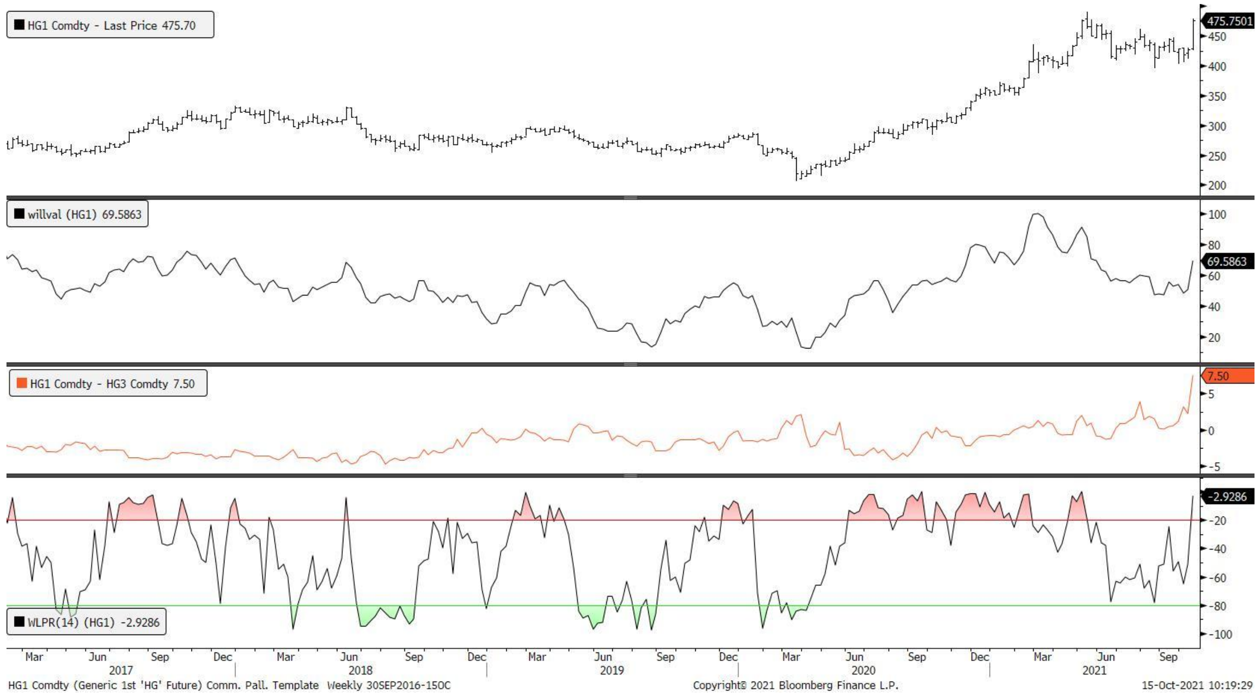
Copper is breaking out of a several-month long symmetrical triangle, drafted by a large seasonality tailwind:



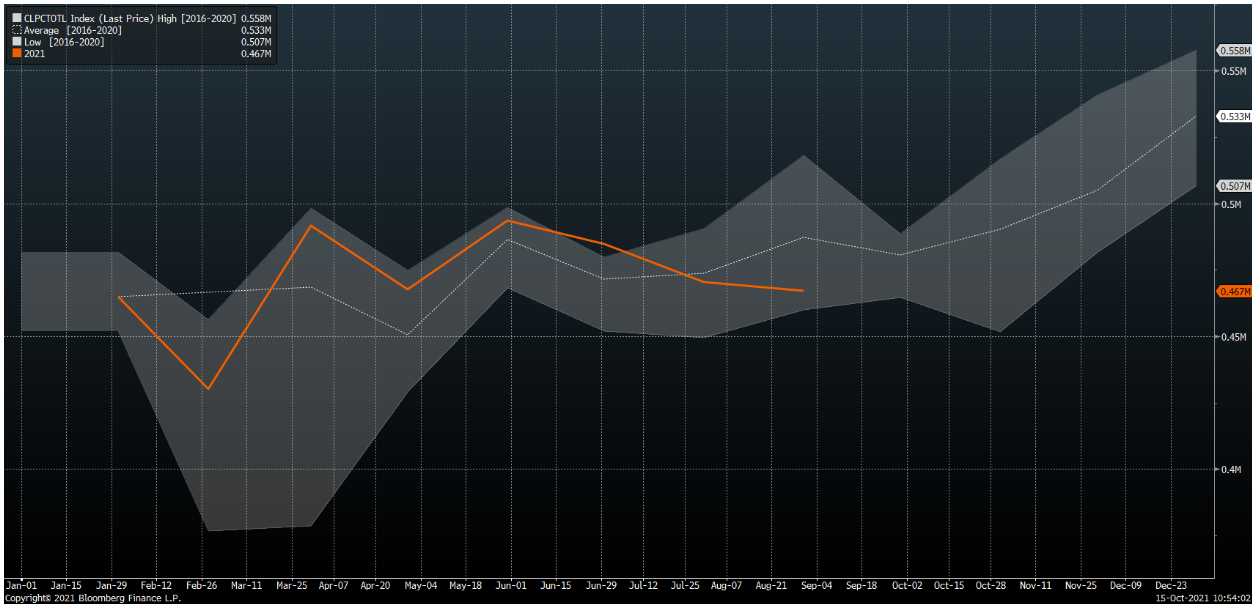

Positioning isn't at extremes for all trader tiers, indicating smaller levels of selling in Copper relative to other commodities at the moment. This 'complacency' with the most recent breakout indicates that we'll likely see it run in the short-to-medium term.

Furthering the bull thesis, we note the largest divergence between the front and 3rd-month premium in the last five years (orange trace below), indicating an elevated level of demand to procure the metal in the immediate term. Williams Indicators are indicating the start of an elevated area of buying, however, we believe that this latest uptick is just getting started.



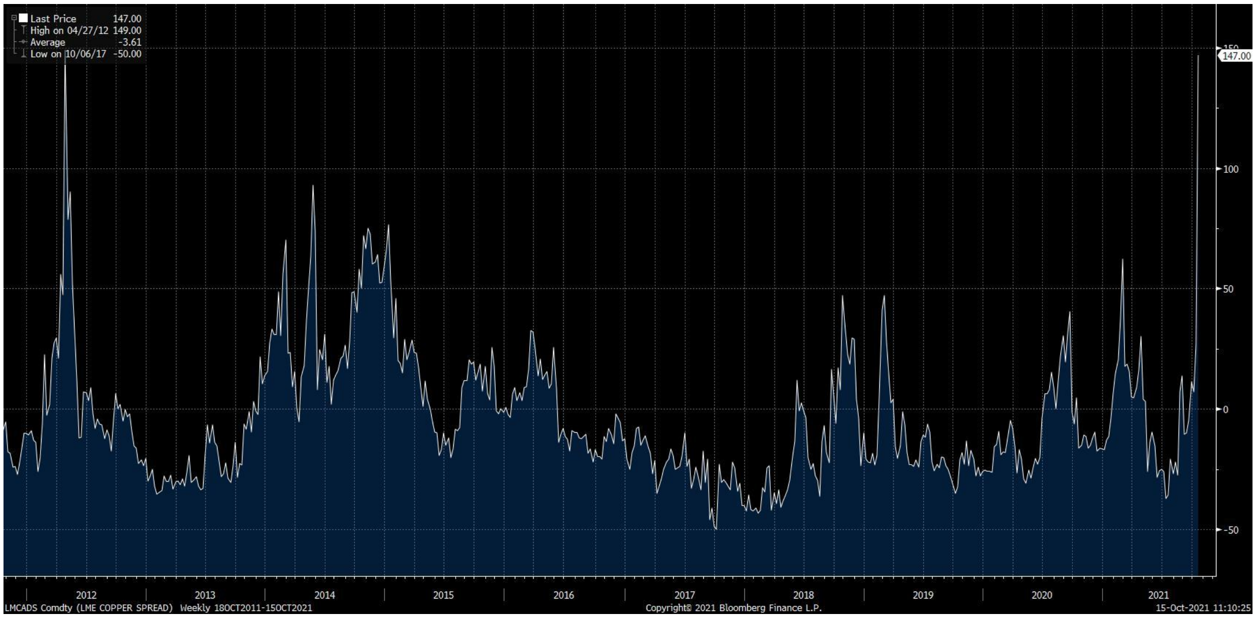

This is all perched upon a considerable tightness within macroeconomic supply catalyzed mainly by the Chinese industrial uncertainty, the backdrop of the energy problems of the past few months, and unrelenting COVID disruptions. The Rio Tinto Group released a statement Friday delaying the Oyu Tolgoi project based in Mongolia by at least three months.

New mines are coming online in Peru and the Congo, which will introduce new supply into the market likely leading to slightly lower prices, however, this takes months to fully come online.  Production this year leading into early next year looks to remain lower relative to average, indicated in the figure below:




Also fanning the flames for a short term spike in price is the metal's cash/three-month spread soaring to the highest levels since April 2012.

Translating this, there's a very large divergence in the price difference between innate copper and the normalized prices of products derived from Copper.




In conclusion, all of what's listed above points to a short to intermediate-term bullish outlook for copper. As such, we're making the following adjustments to our port:

- **We're moving our stop-loss on our Copper long UP to a tick below yesterday's lows ($4.4805)**. The trade is working in our favor and we don't want to roundtrip the position into a loss. After moving the stop-loss up we're left with ~10bps of notional risk.

- **Stop-loss on FULL Copper Long: $4.4805**

Let me know in the Collective if you have any questions.

Your Commodities Operator,

Steve Hallett