

Instant Thoughts

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Before the Open

- **The elevated VIX and flattened Treasury curve are sobering signs. Defensive positioning is building beneath surface calm.**
- **Across the five major battles in the Gulf, supply normalisation has taken eight months on average. The optimism unleashed by the Hormuz passage will then be exhausted and overtaken by the fear of supply shortage.**
- **Worsening fiscal profile worldwide introduces unquantified risk to dollar stability.**

Strait open, Strait shut. The seething stalemate in Iranian war doesn't stop Mr. Market from delivering the verdict: The Gulf war would result in a short-term inflation pinch, not a lasting growth hammer.

Commerce is, as French philosopher Montesquieu puts it, "a cure for the most destructive prejudices". \$4-a-gallon gasoline forced one hands. Donald Trump is a war pragmatic, not a war fanatic. As happened in the final act of the tariff theatre, it is only a matter of time before Trump moves on and hands off the whole negotiation to his cabinet to manage.

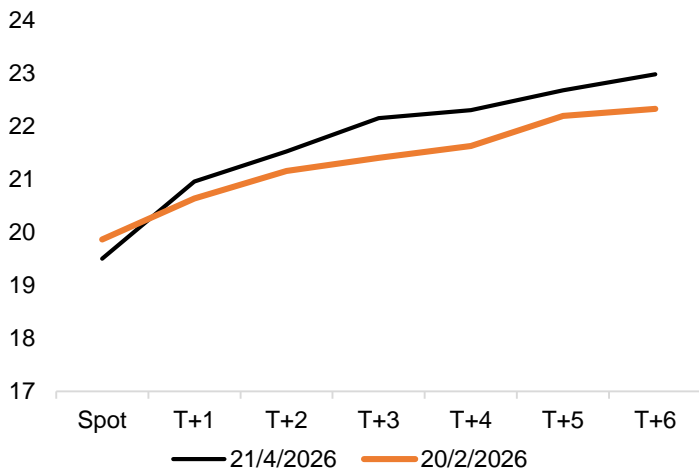
Isn't life taste sweeter now? The sun hasn't come out fully yet. In the Hobbesian new world, everything is connected, but no one in control. The spike in VIX is a sobering sign.

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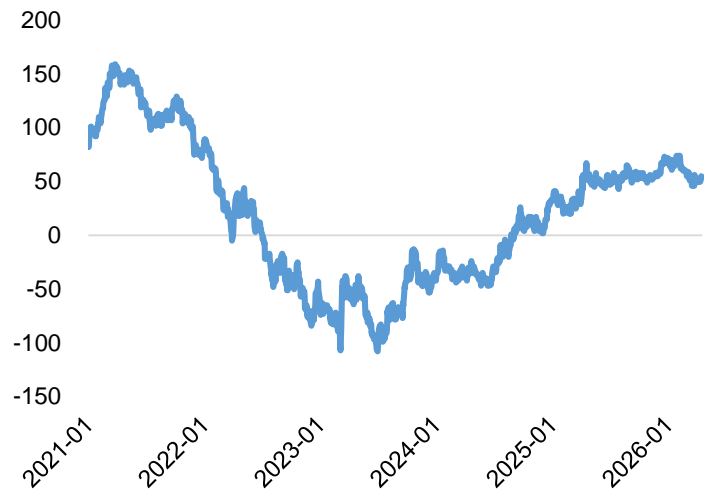
It re-tests 20 with a flattened slope despite the blistering equity rally. The gamma cushion, or the level of volatility tolerance, has thinned to a level that can only be rivalled during peaceful time (Exhibit 1). A compressed yield curve also makes for a split-screen. The yield gap between 2- and 10-year Treasuries stays pinned at around 55bp. Fund managers remain on a bond-buying spree, but not really in the way bulls want. Defensive positioning is building beneath surface calm. “Cautious” didn’t seem strong enough.

Exhibit 1: VIX Curve



Source: Bloomberg, Shanghai Commercial Bank

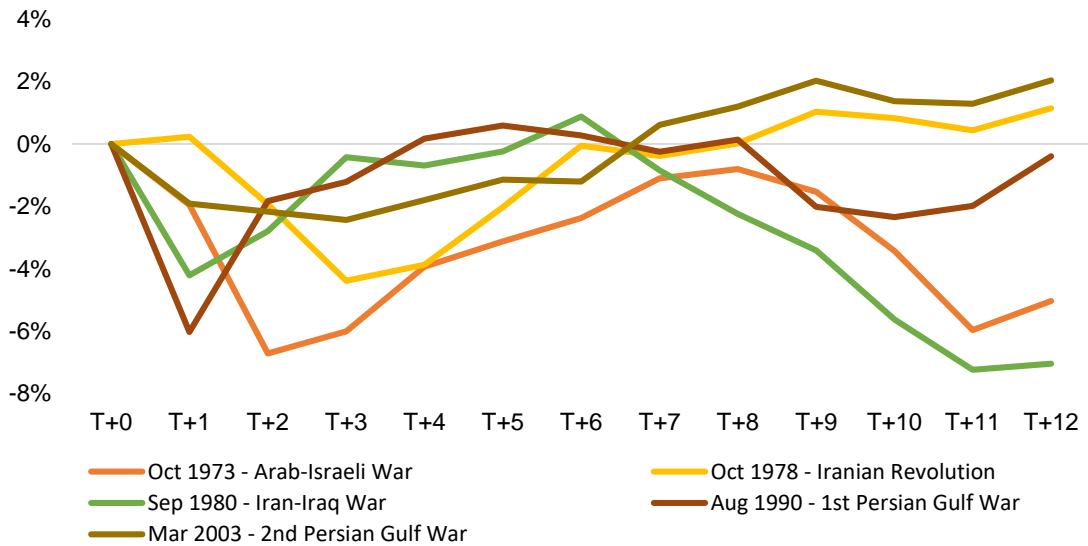
Exhibit 2: 10Y-2Y Yield Gap (bp)



Source: Bloomberg, Shanghai Commercial Bank

If in history lies all the secrets of prosperity, traders are in the front row taking notes. War-induced refinery damage tends to have a long tail. Across the five major battles in the Gulf, supply normalisation has taken an average of eight months (Exhibit 3). Should that happen again, the optimism unleashed by the Hormuz passage will then be exhausted and overtaken by the fear of global shortage of fuel. It typically evolves into a margin compression headwind, thereby suffocating capital expenditure.

Exhibit 3: Oil Production (% Change to Pre-War Levels)



Source: EIA, Shanghai Commercial Bank

Our own glass half empty take? Worsening fiscal profile worldwide introduces unquantified risk to rate expectations and dollar stability. Remember Mr. Market is always a chameleon, and his mood has a bad habit of spinning out of control.

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