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A DC&C publication,
featuring MJT's timing methodology

DC&C
Diapason Currencies & Commodities

DIAPASON CURRENCIES AND COMMODITIES MACRO ANALYSIS

A Monthly Macro and Asset Review
Featuring MJT's Timing Methodology

CONTENTS

"The external value of the US Dollar has become a barometer of the perception of the late cycle investment risk in America"

C Potts, Head of Economics, KeplerCheuvreux

4/ Executive Summary

12 / **The US Dollar has likely bottomed, as the EUR falters and as capital inflows to the US rise on favorable fiscal and monetary developments -** The reason for the EUR's strength last year: foreign investors bought large amounts of EUR bonds (EUR 1.27 trillion) as a result the European Central Bank's (ECB) Quantitative Easing, and those purchases were mostly unhedged. Another contributor to this move was U.S. investors in exchange-traded funds (ETFs) which shifted from hedged to unhedged European equity exposures. The strength and intensity of this EUR upmove caught many investors and analysts unaware, for good reason-- the European Central Bank (ECB) was continuing both its negative policy rate and quantitative easing programs in earnest at that time. A sharp EUR appreciation at that time was unexpected – the market consensus in Q1 2017 was for a decline in EUR in the near-term. The move higher accelerated when the «fear of missing out» (FOMO) on any further EUR appreciation overcame investors' natural aversion to «timing» currency hedges. However, the EUR's upside momentum (and the US Dollar slide) may be coming to an end or may have even ended-- the greenback's trough may have been made during early February this year-- a USD bottoming process (and EUR peak distribution dynamic) may be going on. Euro bulls have been too optimistic for too long and far too much. It has been reported that open interest on euro futures has increased 36% yoy, while a composite net long position has reached a massive 340,000 futures contracts (as of the end of January)-- an all-time record even if adjusted for higher open interest. Should political developments disappoint in Italy, the EUR bulls could start heading for the exit. That would invigorate a bid for US dollars which is slowly firming and gaining momentum, as fundamentals (which are mainly USD-bullish, longer term) slowly reassert. This is what we are detailing this month.

17 / **Timing and Tactical Insight - The Dollar is Oversold, what kind of counter-trend/reversal can we expect** - Against most currency pairs, the US Dollar currently seems Oversold. On some, it may have bottomed mid February, on others, a further short term retest may materialise until mid March. Following that, we would expect a further bounce into April. Longer term, although quite oversold, the US Dollar may see a further period of retracement and downside re-tests during mid/late Q2. Considering this risk, it may still be a bit too early to enter USD directional trades. We would however consider to take profit on US Dollar bearish bets on any weakness over the next 2 weeks, and possibly put in some asymmetric bets to profit from the rebound.

22 / **The Fed will be the primary determinant of equity markets in 2018, as The Donald choses Main Street over Wall Street; the Fed will stay its tightening regime, or worse -** Mr. Jerome Powell, the new Federal Reserve Chair, and the new FOMC (which will be dominated by new appointees of Mr. Donald Trump) will be the primary determinant of the trajectory of the US stock markets (and global equities, by implication) over the course of the year. The theme that underpins all of these is how Mr. Powell and the new FOMC will view growth going forward. More alarmingly, Mr. Powell stressed that the stock markets are not the economy, and the Fed's focus was the real economy. This was in continuation with Mr Dudley's speech delivered on Dec.1, 2014 when he said «Let me be clear, there is no Fed equity market put. To put it another way, we do not care about the level of equity prices, or bond yields or credit spreads per se. Instead, we focus on how financial market conditions influence the transmission of monetary policy to the real economy. At times, a large decline in equity prices will not be problematic for achieving our goals." Both Messrs. Powell and Dudley have just shot down the notion of a «Fed Put» in the markets. We know now that their focus lies elsewhere, and that the priority is not really to support asset prices but to make sure that financial conditions are optimal for the economy. Sometimes, the Fed over-focuses on inflation, and since inflation lags behind growth and activity, the timing of their reaction-function to this data can sometimes be awkward (to say the least). The Fed will not allow unfettered actual inflation, and the committee will likely overreact to tamp down any inflationary surge. The Fed will «fight inflation» with interest rate increases, even if they are inconvenient to market investors. President Trump will accept possible «normalization» of stock and bond (lower) valuations, if the economy performs well, and jobs (votes) are created. It is choosing Main Street at the expense of Wall Street. This will be one of the key risk for equity markets in 2018.

26/ **Timing and Tactical Insight - An unconvincing bounce on many equity markets may lead to further downside retests into end Q1 / early Q2** - The early February correction on equities created important intermediate tops on many of our long term graphs. The rebound that followed is still underway, yet appears quite weak. We would hence probably expect a further period of downside retesting on equity markets, which could start between now and mid March and last until early, perhaps late April. Relative trends to the downside on Defensive sectors and Goldmines vs the S&P500 seem exhausted for now. These may bounce over the next few weeks, which would confirm that a risk-off period is underway. More generally, equity markets could be approaching the end of their 9 years "Bull" market. We expect them to extend higher one last time from mid Q2 into mid-year, perhaps the Summer, but at this stage, the longer risk/reward on equities seems stretched.

The Capital Observer editors team, London / Geneva, March 8th 2018
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5/ Executive Summary

32 / **Changes in Money Velocity are rising, and that is pushing Core CPI higher; rising interest rates are in turn pushing up changes in MV, and rising CPI pressure rates higher -** We know that inflation expectations have been rising lately, but that Core CPI has been relatively tame so far. So actual inflation was not the issue when the equity market broke down sharply a few weeks ago – but inflation expectation was. So what pushed up inflation expectations in the first place?
The development in MV was totally ignored by the market, but that probably stems from the fact that monetary velocity is not very well understood. Interest rates moves tend to precede movements in money velocity, which is what we would expect from a causal relationship such as this – there is a positive correlation between interest rates, and interest rates are the lead variable in the relationship. And this is where the link between interest rates and MV becomes significant-- changes in money velocity (RoC) cause changes in inflation. Higher interest rates push changes in Money Velocity higher, which in turn, pushes up Core CPI. Then it is easy to see why rising interest rates push up Core CPI after a lag, via the MV transmission link. The relationship between these three variables is very reflexive, as interest rates are affected by inflation, or more properly by the expectations of inflation. And expectations about inflation tend to follow actual, realized inflation. This is where it becomes scary, rising interest rates, and more importantly rising money velocity, create a very unfortunate backdrop of rising inflation. If you combine changes in money velocity with other growth variables, you can easily see why Core CPI will be persistently ascendant in 2018.

34 / **Timing and Tactical Insight - Inflation anticipations may subside until end Q1, yet should rise again in Q2 -** Inflation expectations, Oil, Copper, Gold, long term yields and related sector trades are currently approaching intermediate tops. We expect them to consolidate at high levels probably until early / mid April. Following that, from mid Q2, inflationary/reflationary themes should accelerate up again possibly towards midyear, perhaps the Summer. The sector mix, which we see outperforming during this short pause in inflationary dynamics is quite defensive (high yielding stocks, Gold mines, Utilities), which may imply a rather risk-off bias.

40 / **The long-term price action in the grains sector is about to form a major bottom in Q2 2018 -** The agriculture sub-sector has been one of the most neglected sub-sectors in the commodities asset class, and has just edged out the precious metals sub-sector for the most laggard position since the cyclical trough of commodities in February 11, 2016.
Nonetheless, we believe there are good reasons to revisit the grains sector, as any significant setback from current levels may provide entry levels for long trades positioned for another episodic surge of prices over the next year or so. Over the past decade, grains have exhibited behavior which can be very profitable if timed correctly. Weather developments are also lending a positive spin to the agriculture sector – the dreaded La Nina phenomenon is making an impact on grain prices. As we head into spring season, the current La Nina weather pattern could make the southern portion of the United States experience periods of drought-like conditions. If the 2018 crop year does not turn out to be the sixth consecutive year of bumper production, we could see prices for grains move appreciably higher towards the middle of the year. Demand limits the downside potential for prices while any unexpected weather event could lead to explosive price action on the upside. There has been five consecutive years of bumper crops, but there is no guaranty that we will see the sixth of such bumper crops.

42 / **Timing and Tactical Insight - Agriculture Commodities are typically late cycle reflationary trades; Grains especially have started to react** - Agricultural Commodities have recently broken out of their persistent downtrend. We expect this bounce to gain traction over the next few months and possibly continue higher towards late Summer at least. Indeed, Agricultural Commodities are late stage reflationary assets and at some point during 2018, we would even expect them to take on the lead in the Commodity space (probably once industrial commodities such as Oil and Copper, top-out sometime towards early Summer). Shorter term, Agricultural Commodities may correct a bit towards late Q1 / early Q2. They should then be bought (BUY the Dips). Looking at its individual constituents, the Agricultural sector is quite differentiated. Grains and perhaps Cacao have started to bounce, their price potential is compelling and they look promising for the rest of 2018. Coffee and Sugar, on the other hand, are still down-trending, while Cotton and Lumber, following strong uptrends over the last 2 years, already seem quite exhausted with little upside potential left.

48 / **Splicing the markets - Investment Grade Bonds are stuck between a rock and a hard place -** Until mid 2018 at least, we expect an environment of rising inflation expectations, rising yields and rising risks for risk assets. This is not a friendly environment for Investment Grade Corporate Bonds, which usually thrive when inflation diminishes, and growth and equity markets accelerate up. Indeed, Investment Grade does not address the two main risks in this late cycle environment. High Yield will protect you against short term inflationary pressures, Treasuries will protect you against the deflationary bust that may follow. Investment Grade addresses neither. It's like a siting Duck caught cross current between inflationary and deflationary pressures.

The Capital Observer editors team, London / Geneva, March 8th 2018
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6/ Mapping the markets

In our last newsletter on 8th of February, we believed that the sharp sell-off from late January on Equities markets, and more generally on risk assets, was approaching worthwhile support levels and that a bounce could materialise towards early March. As we write, this rebound is still underway and could push slightly higher until mid March. More generally, however, this whole period from late January to today, with the sell-off and the subsequent bounce, are probably part of a more important consolidation period, which we believe could still extend into April. Indeed, following the current bounce, we expect a new period of downside retesting on most risk assets, probably into early, perhaps late April. Then, from late April, early May, risk assets and reflation trades should resume up one last time, probably towards mid year.

Hence, over the next couple of weeks, we expect reflation trades and inflationary dynamics to enter a new short period of correction to the downside, which could last 3 to 4 weeks. Oil could retest down to the lower 60s USD/barrel (Brent), Copper could move back towards its December lows (around 6'500 USD/t), Equities could retest their February lows, while long term rates in the US could retrace some of their recent gains (probably towards 2.7 %, in worse cases down to 2.5 %). Interestingly, this transitory pause in inflationary dynamics / risk-off period could coincide with the run-up and aftermath of the FED rate decision on March 20th and 21st.

The Dollar is also crucial to watch is this environment. In early January, its positive correlation since September 2017 with rising inflation dynamics and rising long term yields broke down and reversed. The sell-off in the US Dollar was strong and support levels were broken vs most currencies (e.g. strong breakout on EUR/USD, move below longstanding support at 1.07 - 1.08 on USD/JPY). That said, during the early February sell-off, the Dollar did take on a defensive role and seemed to serve as a Flight to Quality alternative to riskier assets (even against the Yen or Gold). We believe these dynamics are still in place, that the Dollar could suffer a bit more until mid March, and then strengthen again into April. Longer term, the US Dollar is getting Oversold, and our macro-economic views would supports its reversal up over the next 6 to 12 months. That said, Q2 could see it retest down one last time. This will probably depend on how strong the last move up on reflation trades and Commodities actually is.

To conclude, we have probably entered the very late stages of our long standing risk assets Bull market. The February sell-off was an important warning and it is probably still being digested. We hence expect more jitters on risk assets as part of a sideways correction that could last into early, perhaps late April. Following that, risk and reflationary assets could initiate a last push higher, which we don't see extending very much longer than mid year.

Main Equities & Government Bonds

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Main Equities	US S&P500	Since late January, the S&P500 has probably entered a consolidation which could last into April. It may retest up into mid March and then retest down into April	From late April, early May, the S&P500 may initiate a last move up towards mid year. Yet, we are very late in the cycle and risk/reward seems already extended.
	Europe EuroStoxx50	The bounce in Europe since early February has been weak, from mid March it could follow the S&P500 lower again into April, possibly making new lows.	During Q2, the EuroStoxx 50 may tag along other markets (the Dollar could retest down again) until it tops out towards mid year
	EMs MSCIEM USD	Similar to the S&P500, Emerging Markets have entered a consolidation period which could last into April. They may retest up into mid March and then retest down into April	If we are correct on calling a last move up on reflation trades during Q2, Emerging markets could accelerate up one last time to new highs
Treasuries	US10Y Bond prices	US Treasuries may bounce short term, probably between mid March and mid April	US Treasuries bottom out towards late Q2, yet before that US10Y could reach the mid 3s%. The move then reverses down in H2 2018.
	Germany 10Y Bund prices	The Bund is already bouncing. This bounce could extend into early / mid April	The Bund could remain under pressure until late Q2 2018 (towards circa 151), this Dip should be bought as the Bund should perform strongly during H2 2018

Legend: Strong Underweight | Underweight | Neutral | Overweight | Strong Overweight

Main Equities

World markets
p 26, 27

Since their early February sell-off, equity markets have bounced, a move which could still extend another week or so into mid March. Following that, we expect a further period of consolidation, probably until early, perhaps late April, and a retest of the February lows is possible. Following that, after circa 3 months of consolidation from late January, equity markets could resume up one last time into mid year.

Main Regional picks
p 26, 27, 29, 30

On a relative basis, Europe and Japan, which had held their ground during the early February sell-off (they even outperformed slightly) have since resumed their downtrends vs US markets. For now, they seem condemned to "fall less" when markets are down (not to outperform when markets are up) . This will probably be the case again over the next few weeks, if we are correct in calling a new consolidation period on Equity into April. The fact that the US Dollar currently seems to be risk-off confirms this view.

Emerging markets
p 31

Emerging Markets are more volatile and may underperform a bit from mid March into April, if the consolidation we expect on equities markets materialises. That said, their longer term uptrend vs developed Markets, although late stage, still seems robust, potentially until midyear.

Volatility

As we write volatility is back below 18, and it could drop further over the next week or so. From mid March, as equity markets start to consolidate again, it may move back up above 20. A strong spike, as was experienced in February is probably out of the cards for now, as much heat has been taken out of the then crowded short volatility trade.

Government Bonds

US & European Benchmarks
p 36

US 10 year yields could make an intermediate top over the next couple of weeks and consolidate back down into early, perhaps late April. The retracement could reach back down towards 2.7 % and in worse cases to 2.5 %. Following that, US long term yields gradually resume up during late April / May and then accelerate up towards mid year, potentially reaching into the mid 3s%.

Equity to Bond Ratios, Fixed Income Dynamics & Commodities

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Equity / Bonds	US	While Equities and Treasury yields consolidate down from mid March into April, the Equity/ Bond ratio should also correct down	Following the end of the consolidation period we expect until April, US Equities should resume their uptrend, along with US interest rates. Equities should outperform until mid year
	Europe	While European equities continue to consolidate from mid March to early/mid April and the Bund bounces, the ratio should temporarily decline	A last move up on European equities from late April/May, even if quite weak, while the Bund resumes lower, should benefit the ratio
Duration		The Yield curve could be finishing off its steepening bounce initiated in December, probably during March. The long term flattening downtrend is still in place in the US	The steepening bounce gradually dies out in all regions at the latest late Q2, the yield curves then flatten again until end 2018
Credit		From mid March to April, Credit Spread could bounce on risk off considerations, yet from mid/end April they should start to resume lower again	The downtrend on Credit spreads resumes until mid year, yet we are very late in the cycle and risk/reward is already stretched
TIPs/Treasuries		The uptrend on TIPs vs Treasuries make take a pause, as inflation expectations consolidate a bit into April	TIPs continue to progress vs Treasuries until mid year, then inflation expectations worldwide will start to fall as risk assets top out
Oil		Oil consolidates down again into the low 60s (Brent) into April	A last push higher during Q2 2018 is still likely. From mid year, Oil should start to reverse down
Industrial metals		Industrial Metals may consolidate down into April, before they resume their uptrend during the rest of Q2	Industrials Metals may extend up from early Q2 to mid year, perhaps Q3. Copper reaches above 8'000 USD/ton on the LME
Gold		Gold consolidates back down from mid March into April, probably retesting below 1'300 USD/oz	From early Q2, Gold starts to build a base and gradually starts to move up again. It may reach 1'500 USD/oz by year-end. Accumulate on the Dip!

Legend: Strong Underweight | Underweight | Neutral | Overweight | Strong Overweight

Equity to Bond Ratios

US Markets

From mid March into April, the ratio should consolidate down as Equities and Bond Yields correct. It should then resume its uptrend until mid year on a last move up in reflationary dynamics.

Eurozone Markets

Similarly in Europe, we expect the ratio to correct from mid March into April, before it resumes up until midyear, probably with less strength as in the US though.

Fixed Income Dynamics

Duration (10Y - 3Y)

The weak bounce on the US yield curve from December will probably come to an end in March, and the flattening will resume probably until year-end. In Europe, the steepening uptrend may persist into mid year, before it also reverts lower. In general, all tenures along both yield curves should continue to rise on both sides of the Atlantic until mid year, so that it is still too early to enter long duration bond exposure.

Credit
p 48, 49

Credit has been outperforming Investment Grade since December on the back of the acceleration up in inflation expectations. It did underperform a bit during the early February risk asset sell-off, could do so again during the new risk-off period we expect into April, but in general should continue to perform well probably towards mid year as a mean to diversify bond portfolios out of pure inflationary risk.

Rate Differentials

Rate differentials in still in favor of the US (vs Europe, Japan or the UK) probably until mid year. They may consolidate at high levels over the next month or so, as US yields retrace a bit.

Tips
p 34

TIPs could correct up slightly over the next month along with other interest sensitive instruments. Their ratio vs Treasuries could consolidate at high levels during that period, as the acceleration in inflationary concerns takes a pause. Following that, from mid/end April, the ratio should accelerate up again towards mid year.

Commodities

Oil
p 35

Oil is currently consolidating down, probably towards early, perhaps late April. Brent for example could retrace back again into the low 60s over the next 3 to 6 weeks. However, from mid/late April, Oil may re-accelerate up, probably towards mid year. Prices targets for this last move are anywhere from 75 to 100 USD/barrel.

Industrial metals
p 35

Similarly, following their strong rally in H2 2017, Industrial metals probably made an intermediate top just recently and could consolidate down into April (towards potentially 6’500 USD/t on Copper for example). From mid/late April, we expect them to resume up towards mid year and potentially accelerate in a typical late cycle Commodity blow-off. Our targets for Copper for example are above 8’000 USD/t (LME).

Gold & PMs
p 37

Gold is still hanging on to its December and January gains, yet from mid March, we expect it to consolidate down into April along with other USD denominated assets, potentially back below USD 1’300/oz and perhaps even towards USD 1’250/oz. We will then be positive for Gold for the rest of the year and it could possibly reach 1’500 USD/oz by then.

Agriculture
p 42- 47

Agricultural Commodities have been bouncing up since December on the back of the acceleration in inflationary perspectives. Indeed, Agricultural Commodities are late cycle reflationary trades. We expect them to consolidate at high levels over the next month or so, before they re-accelerate up towards mid year.

Foreign Exchange

		Next 2 months	3 to 6 months ahead
USD vs	EUR	EUR/USD could still retest its February highs until mid March, following that it consolidates back down, potentially towards 1.20-1.19	During Q2, EUR/USD could move to new highs (1.25 – 1.28), especially if inflation expectation accelerate up again. It then weakens during H2 2018
	GBP	GBP/USD could still retest above 1.40 until mid March, yet it then consolidates back down towards the 1.38 – 1.35 into April	During Q2, GBP/USD moves up once more into the 1.40s. It then weakens substantially during H2 2018
	JPY	USD/JPY could push down to new recent lows until mid March, it then bounces moderately into April.	USD/JPY could also retest down during Q2, yet at some point we expect it to reverse course and follow reflation trades up, potentially from mid/late Q2 into Q3
	CHF	USD/CHF continues to rebound towards April, possibly into 0.96 – 0.98 range, yet it may still retrace a bit until mid March	USD/CHF may then retrace some or all of these gains and build a base during Q2, before it moves up again from midyear
EUR vs	GBP	Following a slight consolidation, EUR/GBP may strengthen moderately until mid April on risk-off considerations	EUR/GBP may linger on higher into late April/May, yet at some point, if reflation trades really accelerate it could sell-off, potentially into mid year
	JPY	EUR/JPY could continue its consolidation, potentially from mid March to mid April on risk-off considerations	At some point towards mid Q2, as reflation trades reaccelerate, EUR/JPY should follow suit, possibly into the Summer and above 140
	CHF	EUR/CHF could retest highs until mid March, before it consolidates back down into April	From mid April, EUR/CHF re-accelerates up into mid/late Q2, when it could top out in the mid 1.20s
GBP vs	JPY	GBP/JPY continues its consolidation down towards 145, potentially until early/mid April	From late April/May, GBP/JPY attempts to resume its uptrend and could retest its early February highs above 155
	CHF	GBP/CHF may attempt to retrace some or most of its February sell-off until mid March, yet then retests to the downside into April	From late April/May, GBP/CHF could resume up and make new highs between 1.35 and 1.40

Legend: Strong Underweight | Underweight | Neutral | Overweight | Strong Overweight

US Dollar
p 17- 21

During the recent Equity sell-off, the Dollar was the only asset that was rising. Although it has consolidated back some vs most currencies since the rebound begun, we expect it to bounce again over the next couple of weeks probably until early perhaps late April as risk assets go through another risk-off period (probably towards early, perhaps late April). Following that, it could retrace these gains during Q2, and possibly make new lows as reflation trades start to accelerate up again. Its downside risk is probably towards 86 on DXY. Finally, the Dollar should regain strength in H2 2018 as risk assets start to correct from mid year / the Summer, possibly into 2019.

Euro
p 17, 18

Following its break-out and subsequent rally to above 1.25 in January, the EUR/USD topped out just before the equity market sell-off. Since then, with the equity market rebound, it has retested highs on several occasions and may continue to do so until mid March. From then on, however, we expect 3 to 4 weeks of consolidation into early, perhaps late April, possibly down to the 1.20 – 1.19 range, or the top of its consolidation range between September and December last year. Thereafter, during Q2, it could resume its uptrend and attempt to make new highs in the 1.25 – 1.28 range. Longer term, we believe that the uptrend on EUR/USD since late 2016 is only a correction, which should die out towards late Q2 2018, before it resumes down quite aggressively in H2 2018. Vs GBP, EUR could actually strengthen moderately from mid March to early April on risk-off considerations, it could still see a last sell-off during Q2, but then gradually accelerates up towards year-end. Vs JPY and CHF, EUR could see a further period of consolidation at high levels into April and then accelerates to new highs towards late Q2. As the risk asset correction takes holds from mid year, JPY and CHF should regain strength vs the EUR, probably towards year-end.

Yen
p 18, 19

The Yen remains a defensive currency, yet on the equity sell-off USD/JPY held up. Since the rebound, however, it has accelerated down and broken its 2017 support around 1.08 – 1.07 and could continue to push lower into mid March. During the risk-off period we expect from mid March to early, perhaps late April, the Yen and the USD may battle for the position of the more defensive currency. USD/JPY may consolidate up slightly during this period. Then during Q2, USD/JPY may retest down again towards May, even June, before it finally joins the reflation trades up and starts to rebound in earnest, probably into the Summer, perhaps even late Summer. For now, we will remain conservative on the targets for this late Q2/Q3 move, yet believe it could probably attempt to retrace back towards its November 2017 highs at 114, maybe more. Other majors have also been correcting down vs the Yen since early February. Following a further period of consolidation into April, they should resume their uptrend during Q2 towards the Summer and make new highs.

Sterling
p 21

Since early February, Cable has been consolidating down, yet it is still attempting to rebound along with equity (Cable is pro-cyclical). From mid March, we expect it to move lower, probably towards early, perhaps late April and the 1.37 – 1.35 range. It may then attempt to push higher again, retesting highs during Q2. Following that, we expect it to weaken vs most currencies during H2 2018 as we believe the UK should be particularly vulnerable in an important market downturn such as the one we are expecting.

Oil & Commodities currencies
p 20

Commodity currencies (our equal weighted portfolio containing AUD, BRL, CAD, NOK, NZD, RUB and ZAR) topped out in early February against the Dollar and have been consolidating down since. We expect this consolidation to see a second leg down probably from mid March into early, perhaps late April. Following that, Commodity currencies seem well positioned until mid year (which may confirm a scenario, where Commodities accelerate up), before they roll-over and underperform aggressively into 2019. Vs EUR, Commodity currencies should continue to move lower into mid April, before they resume up towards mid year.

Asian currencies

Our Asian Growth equal weighted portfolio (CNY, INR, KRW, THB and TWD) could continue to consolidate against USD and EUR until early, perhaps late April and then resume up towards mid year and possibly the Summer.

Equities Markets Segmentation

Core Sector Weightings			Next 2 months					3 to 6 months ahead				
US Sectors - S&P500			**From mid March into April, we expect inflationary pressures to pause, we are downgrading all reflationary sector and upgrading defensive ones until April**					**Commodity related themes could re-accelerate up from early Q2 into mid year, along with Financials, Technology is still showing strong momentum for now**				
Sectors	ETF symbol	Benchmark-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Technology	XLK	26%										
Financials	XLF	15%										
HealthCare	XLV	14%										
Discretionary	XLY	12%										
Industrials	XLI	10%										
Staples	XLP	8%										
Energy	XLE	6%										

			Next 2 months					3 to 6 months ahead				
European Sectors - Europe Stoxx 600			**From mid March into April, we expect inflationary pressures to pause, we are downgrading all reflationary sector and upgrading defensive ones until April**					**Commodity related themes could re-accelerate up from early Q2 into mid year, along with Financials, Technology is still showing strong momentum for now**				
Sectors	Index symbol	Benchmark-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Banks	SX7P	13%										
Industrials	SXNP	12%										
HealthCare	SXDP	11%										
Pers. & HH Goods	SXQP	9%										
Food & Beverage	SX3P	7%										
Insurance	SXIP	6%										
Energy	SXEP	6%										

Main Sectors Allocation

p 27, 37, 38, 39

Since the February sell-off and during the subsequent rebound, defensives stocks have started to build a base, while inflationary sectors such as Financials have failed to progress . We believe that if we are correct in forecasting a new risk off period from mid March into April, these trends should strengthen. We are hence downgrading reflationary sectors and moving defensive sectors to neutral positions.

Following that, we would still expect reflationary sectors to accelerate up again towards mid year, possibly from late April into June.

Countries allocation

Core Countries Weightings			Next 2 months					3 to 6 months ahead				
All World Country Index Currency hedged			**A very Defensive allocation, we are upgrading the US to neutral and downgrading Europe to neutral (except for Switzerland), we are underweighting Asia.**					**As Commodities re-accelerate up, related geographies and Emerging Markets should outperform until mid Year.**				
Sectors	Index symbol	Benchmark-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
US	S&P 500	52%										
Canada	TSX	3%										
Europe	SXXP	21%										
-UK	FTSE	6%										
-France	CAC40	3%										
-Germany	DAX	3%										
-Switzerland	SMI	3%										
Japan	N225	8%										
China	MSCICN	3%										

Main Country allocation

p 26- 27 and p 29- 31

Over the next couple of months we have neutralized much of our country exposure. Indeed, we believe that we are currently in a high level consolidation, that could continue until early, perhaps late April, and that country positioning may be quite unstable. In such an environment, we did however overweight Switzerland because of its defensive mix of companies and have gone underweight China, which could suffer a temporary setback in a risk-off period.

Going forward and looking into mid/end Q2, we still expect a potential Commodity blow-off scenario until mid year and a Dollar that could retrace vs most currencies. Hence, we would favor Commodity related geographies, Emerging markets and China.

Note: the country and regional allocations in the table above are considered hedged for currency risk, ie. the relative performances are anticipated in local currency.

Core factors and Themes

Core Factor/Themes Weightings	Next 2 months					3 to 6 months ahead				
General Comment	**Over the next 2 months, we would favour Themes, which could benefit from a USD rebound and a steepening bounce in the Yield Curve.**					**From late Q1 and into Q2, pro-cyclical and Commodity related profiles are favoured, while defensive profiles remain weak**				
Themes	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Nasdaq 100 (vs S&P500)										
DJ Industrial (vs S&P500)										
Russell 2000 (vs S&P500)										
Wilshire REITs (vs S&P500)										
US Value (vs US Growth)										
Southern EuroZone (vs Stoxx EZ 600)										
EuroZone Small Cap (vs Stoxx EZ 600)										
Japanese Small Cap (vs N225)										
GDX - Goldmines										
XME - Diversified Mining										

Core factors and Themes

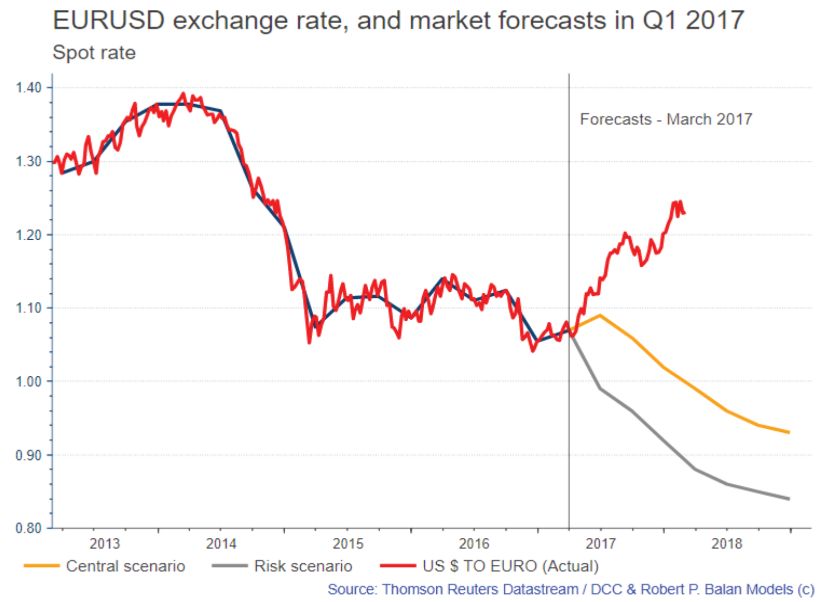
p 28, 38, 39

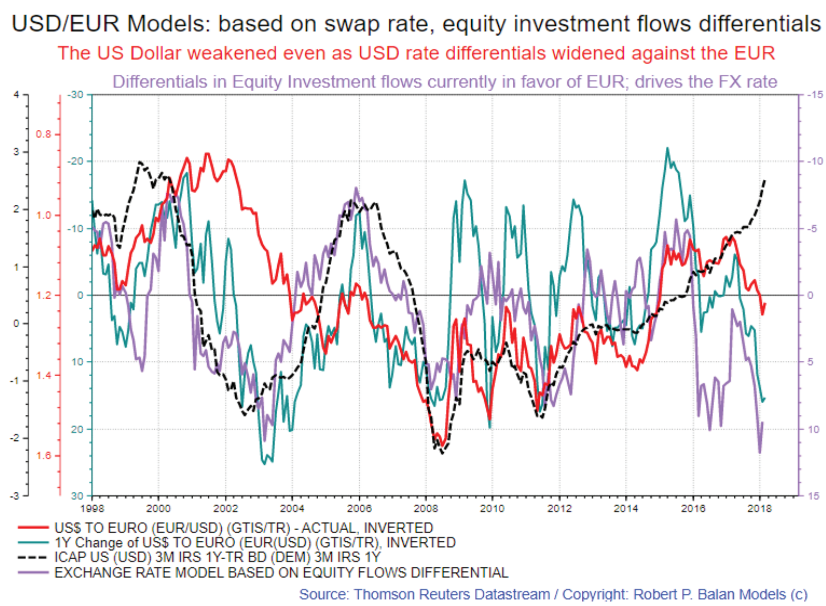
Over the next 2 months, we have upgraded Defensive profiles to neutral given the potential further leg down we are expecting on risk assets into early, perhaps late April. Concomitantly, we are underweighting some reflationary profiles such as the Dow Jones Industrial or Diversified Miners.

Looking into mid Q2 and towards mid year, we expect these reflationary profiles to outperform again, along with Growth, which, although expensive, seems to show strong momentum at this late stage in the cycle.

12 / The US Dollar has likely bottomed, as the EUR falters and as capital inflows to the US rise on favorable fiscal and monetary developments

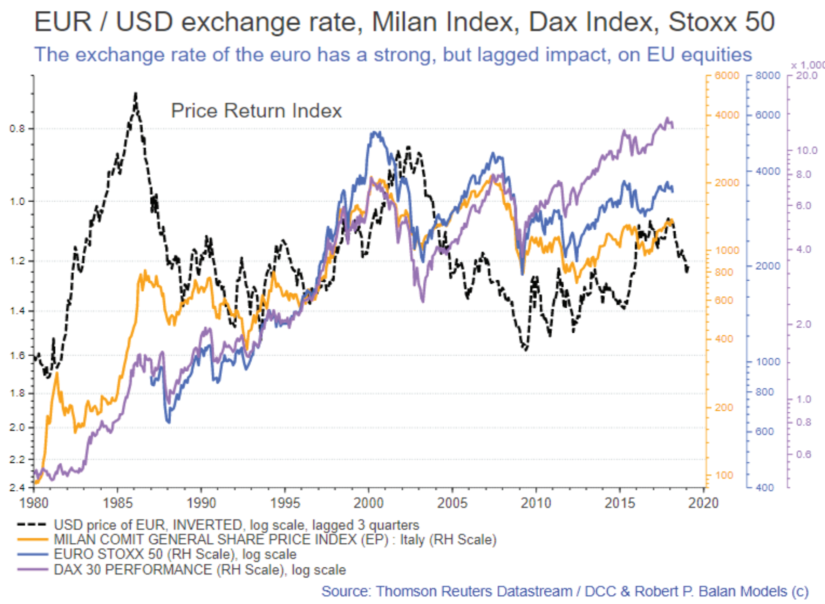
A major factor which caused the US Dollar TWI´s collapse in 2017 was the euro´s strength -- the USD weakened more than 12% against the euro. **The reason for the EUR´s strength last year: foreign investors bought large amounts of EUR bonds (EUR 1.27 trillion) as a result the European Central Bank´s (ECB) Quantitative Easing, and those purchases were mostly unhedged. Another contributor to this move was U.S. investors in exchange-traded funds (ETFs) which shifted from hedged to unhedged European equity exposures. The strength and intensity of this EUR upmove caught many investors and analysts unaware, for good reason -- the European Central Bank (ECB) was continuing both its negative policy rate and quantitative easing programs in earnest at that time**. A sharp EUR appreciation at that time was unexpected – the market consensus in Q1 2017 was for a decline in EUR in the near-term (*see 1st chart on this page*). The move higher accelerated when the «fear of missing out» (FOMO) on any further EUR appreciation overcame investors' natural aversion to «timing» currency hedges. **However, the EUR´s upside momentum (and the US Dollar slide) may be coming to an end or may have even ended -- the greenback´s trough may have been made during early February this year -- a USD bottoming process (and EUR peak distribution dynamic) may be going on**.

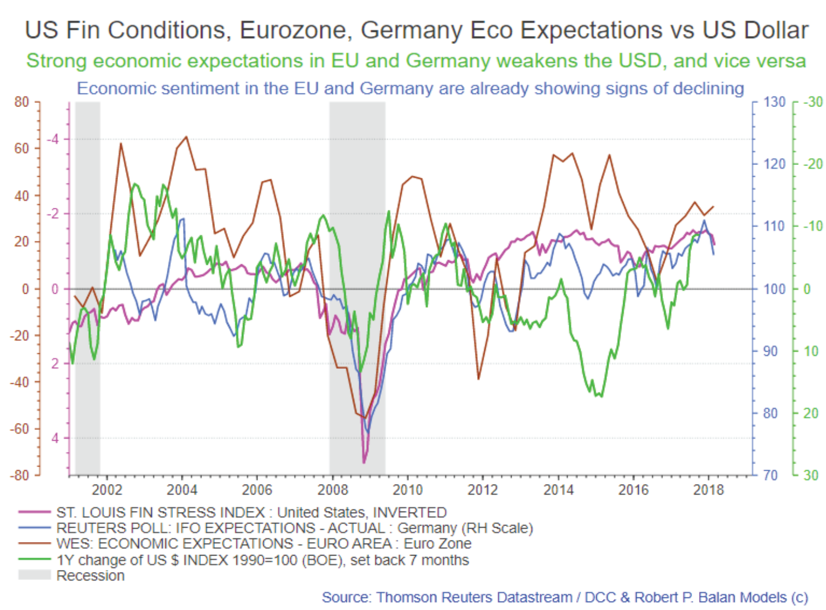




This possible reversal in EUR fortunes comes as the eurozone faces a new elevation of political risks. There were two short-term political risks: general elections in Italy (due on Mar. 4) and voting on grand coalition in Germany (March 4). In the first case, there was the risk that a euro-sceptic La Lega party in Italy unexpectedly wins more votes than anticipated, which they did. In the second case, the risk was that the members of Social Democratic Party of Germany (SDP) vote against the deal with Angela Merkel´s CDU party. The German risk was removed after the SDP voted to join the coalition on March 4. The Italian electoral risk, the fact that La Lega won more votes than expected on March 4, had not impacted the EUR as badly as the market thought it would, but the framework of a new Italian government is still unknown -- this could weigh on the currency going forward. **Moreover, euro bulls have been too optimistic for too long and far too much. It has been reported that open interest on euro futures has increased 36% yoy, while a composite net long position has reached a massive 340,000 futures contracts (as of the end of January) -- an all-time record even if adjusted for higher open interest. Should political developments disappoint in Italy, the EUR bulls could start heading for the exit. That would invigorate a bid for US dollars which is slowly firming and gaining momentum, as fundamentals (which are mainly USD-bullish, longer term) slowly reassert.**

One US Dollar-positive factor is the divergent monetary policy between the Fed and the European Central Bank (ECB). **The Fed minutes from the FOMC January 30-31 meeting, indicated that the Fed sees increased economic growth and an uptick in inflation as justification to continue to raise interest rates**. New Fed Chair Jerome Powell actually affirmed increased growth prospects in his first report to the US congress, but he clawed back some of it in a subsequent speech. We actually believe that the Fed is even more hawkish today than several weeks ago, when the FOMC held their January meeting. Barring an exogenous shock to growth or markets, there will be four rate hikes this year. **By contrast, the ECB is keeping its monetary policy unchanged. In fact, as recently as December last year, the ECB said that it stands ready to extend stimulus if needed. A few days ago, Mario Draghi stated that there are «very few chances» that ECB will change interest rates this year**. Indeed, the chart above most vividly demonstrates the divergent expectations of central banks´ policy. The spread between US Dollar and EUR 3m swap rates is nearing 2.35%, a huge divergence in favor of the US currency, something that is currently not imputed in the EUR/USD exchange rate. **The factor that is currently driving the EUR/USD exchange rate is the differential in equity investment capital flows** (*see 2nd chart on previous page*). But that advantage is already fading as the equity flows start to favor the US again as a delayed response to the recent strength in the EUR – Eurozone equities historically weaken a few quarters after the common currency has strengthened (*see 1st chart on this page*). We expect equity investment flows to revert to the US stock markets, not too long from now – that would help firm up the US Dollar.





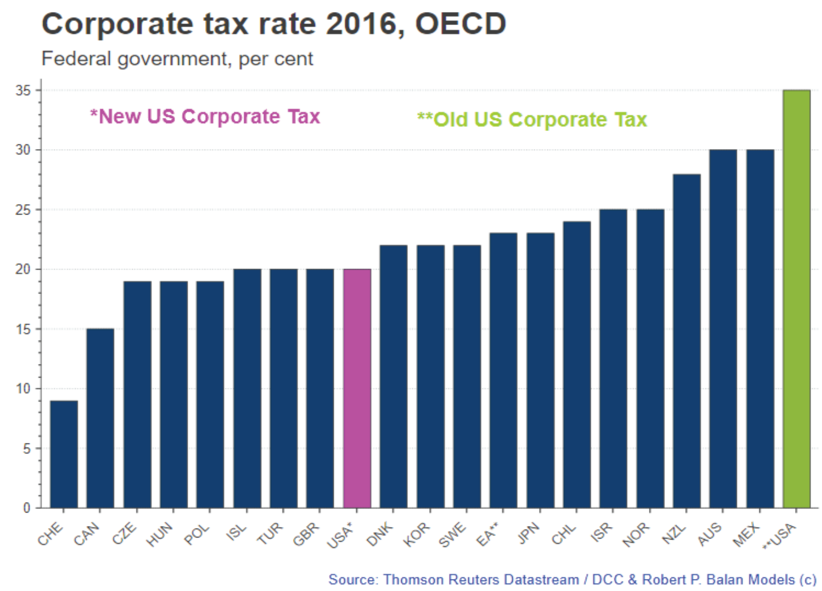
Moreover, economic expectations in German and the Eurozone, which have been rising strongly since Q3 last year, are already showing a topping out process. Historically, the greenback weakens as those metrics rise, on market perception that financial conditions in the EU will correspondingly tighten much faster relative to the US. But that also true in the inverse – the US Dollar tends to rise when those metrics fall, and they are already showing early signs of reversal (*see 2nd chart on this page*), and will be US Dollar-friendly as we go along. The EUR-USD exchanged rate is a harbinger of future strength of the US Dollar Trade Weighted Index (TWI) – if the greenback strengthens against the common currency, the USD TWI is well on its way to strengthen across the currency board (with the possible exception of the Japanese Yen, which runs against the US Dollar according to a different drumbeat).

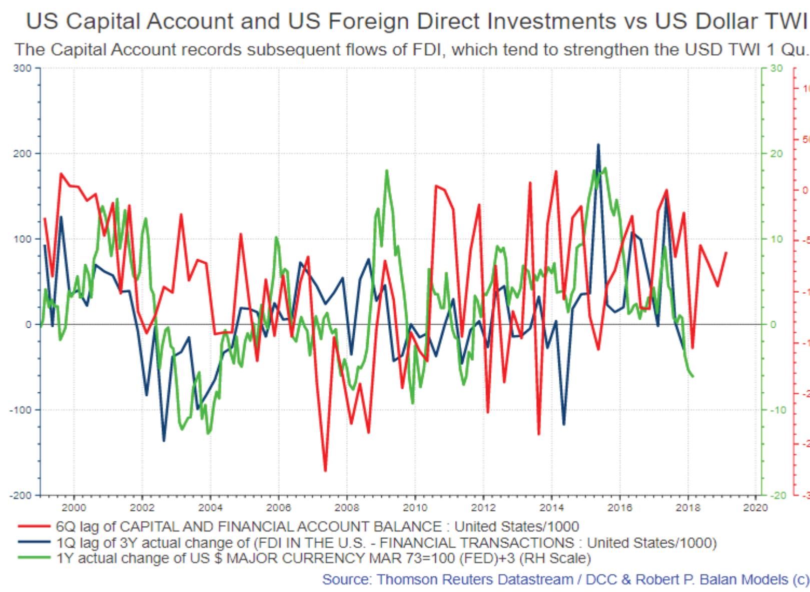
In the February issue of the Capital Observer, we noted that differentials in the incentives created by the combination of monetary and fiscal policy should soon determine the near-term course of the US Dollar and its counterparts. And we also noted that this is an aspect where the US is ahead of G5 countries, by a mile. The Trump administration and the Republican Party dominated Congress passed enacted significant tax cuts even as the economy showed signs of accelerating. The reduced corporate tax should encourage capital repatriation and new inflows of foreign capital. The US has morphed from having the highest tax regime in the G5 to the lowest (*see 1st chart on this page*). The IMF estimates that benefits from the new tax laws could add 1.5% a year to the US GDP until at least 2020. A stronger growth outlook could be a game-changer for Foreign Direct Investments (FDIs), driven by capital inflows, which play a large part in a currency's long term valuation *(see second chart on this page*). And even though it does not make it into the headlines often, the deregulation efforts by the Trump government are also significant contributors to growth. On top of this, an infrastructure initiative is expected to be unveiled shortly.

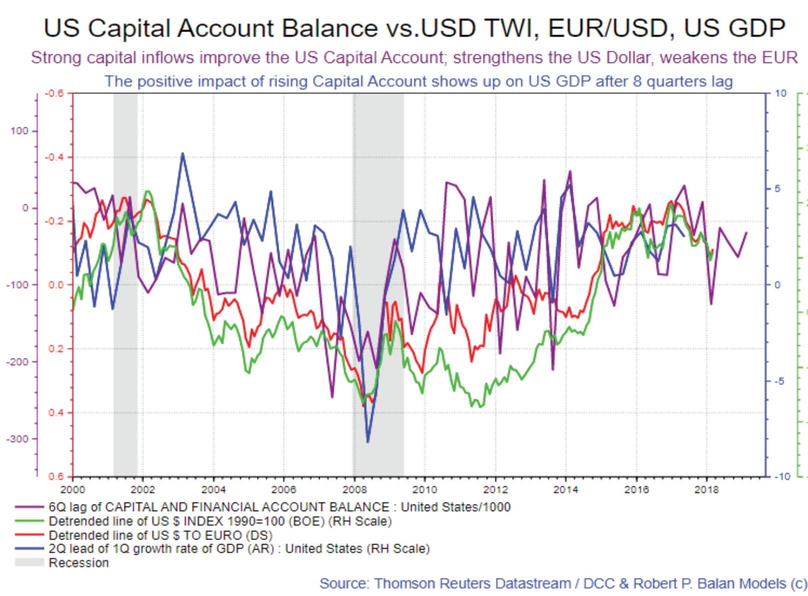
Let us sum up what we expect of the US Dollar and its counterparts to do in 2018:

In the immediate-term (6 to 9 months), the trajectory of the US Dollar will likely depend less on what the Fed and the other global central banks will do – it may depend more on the lagged effect of the fiscal policy measures taken by the Trump administration last year. **The recently enacted US tax reforms will likely encourage capital repatriation to the US and encourage the inflow of foreign capital. This will have significant impact on the course of US bond yields and the US Dollar during 2018 and perhaps beyond.**

The transmission mechanism of those capital inflows to the real economy is via the US Capital Account, which at its simplest definition is the net change in ownership of national assets, i.e. whether there is surplus or there is deficit. A surplus (or improvement) in the capital account balance means money is flowing into the country, the inbound flows represent non-resident borrowings or purchases of assets. A deficit (or deterioration) in the capital account means resident capital is flowing out of the country, in the pursuit of ownership of foreign assets. These statements are simplification of relatively intricate balance sheet operations, but they describe the flows well. We believe that the US Dollar would be significantly stronger later in the year due to the influx of domestic and foreign capital which has already been going on for several quarters. **The impact of those capital inflows on GDP growth should be seen during H1 2018** (*see last chart above*).





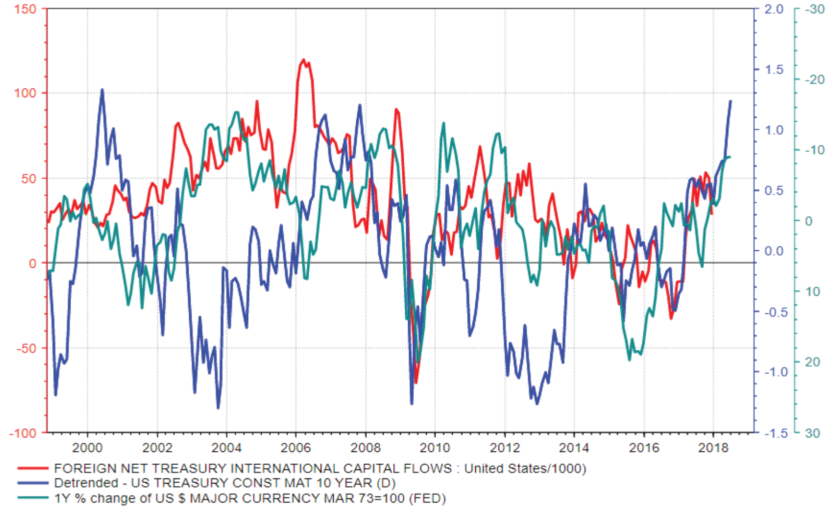


It is also supportive of the US currency that conditions are optimum for foreign central banks and entities to purchase US debt, and that is reflected at the Foreign Net Treasury International Capital (TIC) Flows. According to Bloomberg, foreign holdings of U.S. securities rose to a record $18.4 trillion as of the end of June, per a preliminary data released by Treasury in early March. Foreign investors have been buying US debt again due to the optimum conditions currently availing. Foreign central banks buy more Treasuries when rates are rising (*see 1st chart on this page*), and USD is falling, like seen recently. The TIC data (which currently lag behind by almost 1 quarter) will show that foreign buyers have been buying massive amount of US paper as from Q1 2018 and should be the case until at least the end of Q3 2018. That will support the sentiment for the greenback. The sell-off in USD in H2 2017 was due to negative sentiment generated by a "strike" of foreign US debt buyers due to unfavorable conditions, which caused several failed Treasury auctions in Q4 2017. By late Q1 2018, that is being reversed. Central banks have fiduciary duties to optimize their balance sheets -- hence they increase purchases of US debt paper when optimum conditions appear, as is the case today. **If the conditions are favorable, foreign central bank and investors will buy US paper. It is a pure asset-liability management exercise -- no ideology involved.**

As we also noted in the February Capital Observer, the US dollar is the most important asset class to watch in 2018. The combination of rising US Dollar and rising inflation, which we both expect to see not too long from here (*see 2nd chart on this page*)**, will lead to US and tighter global financial conditions and lower USD excess liquidity later in the year**. If the Fed follows through with its self-imposed regimen of three policy rate increases of 25 basis points for 2018 (and possibly four), that would push the USD even higher -- and the tightening of USD excess liquidity would bring on a deflationary bust. It all depends on how the Fed will respond to an uptick in inflation later in the year – and we do see potential for a Fed overreaction, especially as an inflation surge may be fueled by tightening labor conditions, which the Fed is starting to sound alarm about. And this all happening as the US output gap disappears, which will further embolden the Federal Reserve to ratchet up monetary policy (*see 2nd and 3rd charts above*).

Impact of higher rates, lower US Dollar on purchases of US debt instruments

Foreign central banks buy more Treasuries when rates are rising, and USD is falling, like now

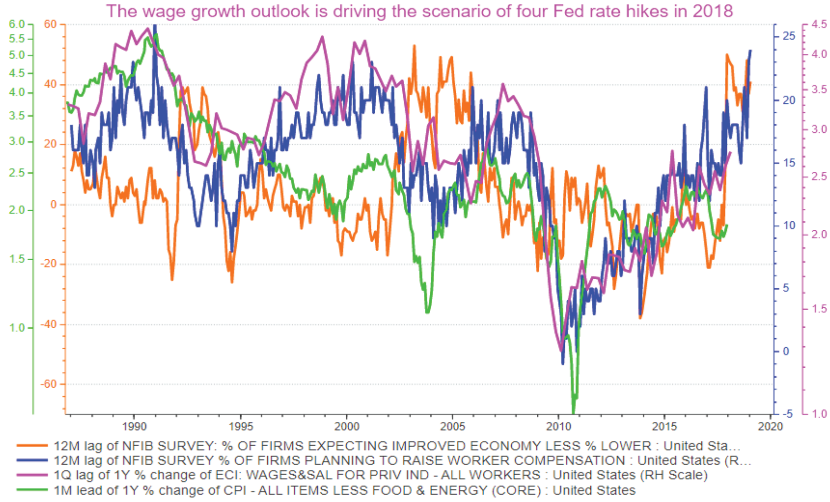


Source: Thomson Reuters Datastream / Copyright: Robert P. Balan Models (c)

US NFIB growth and wage survey vs ECI raising wages and Core CPI

The future wage outlook provides a case for rising Core PCE later in the year

The wage growth outlook is driving the scenario of four Fed rate hikes in 2018

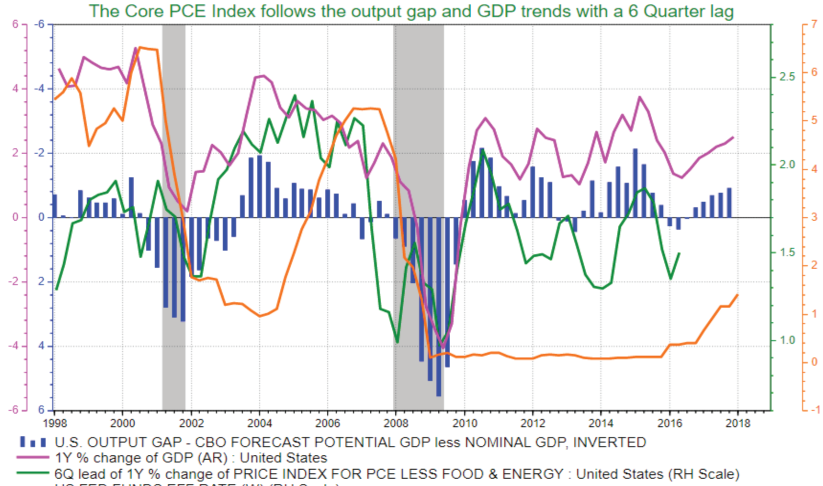


Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

US Output Gap, US GDP, Core PCE Index, Fed Funds Eff. Rate

The US Output Gap has vanished; there is little slack over-all in the US economy

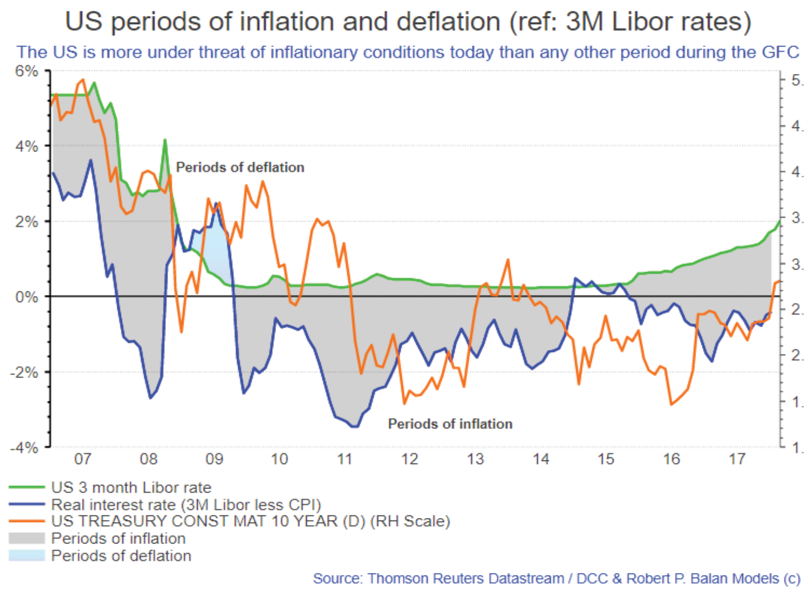
The Core PCE Index follows the output gap and GDP trends with a 6 Quarter lag



Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

If the Fed allows inflation to rise, it is also possible that we could have an inflationary bust instead. But for us, that is the least likely scenario. It is of course difficult to predict what a Powell-led Federal Reserve will eventually do, but allowing inflation unchecked is simply not in the genes of the Federal Reserve (or any central bank for that matter). More so at this time, when the US economy is today more under threat of inflationary conditions than any other period during the Great Financial Crisis (GFC), see (*1st chart on this page*). The only possible reason we can see for the Fed to allow unfettered inflation (or even allowing it to go beyond their line in the sand) is to help offset some of the sting from a national debt that is building up (and will likely build further during the term of office of The Donald). But that is not the remit of a central bank, so this likelihood has little to no chances of happening.

We do fear a deflationary bust late in the year, as we expect the Fed to overreact and to overtighten – killing growth prospects and inflation on their tracks. Some may ask the importance of differentiating the two -- a bust is still a bust whether it is inflationary or deflationary. But it does matter – your investment strategy later in the year could be radically different from that today, depending on which kind of bust we may have. A deflationary bust, for one, could be deleterious to the health of commodities, but good for the bond market (yields tend to fall sharply on outlook of deflation). It is of course, the other way around, in case we have an inflationary bust – good for commodities, and bad for bonds.

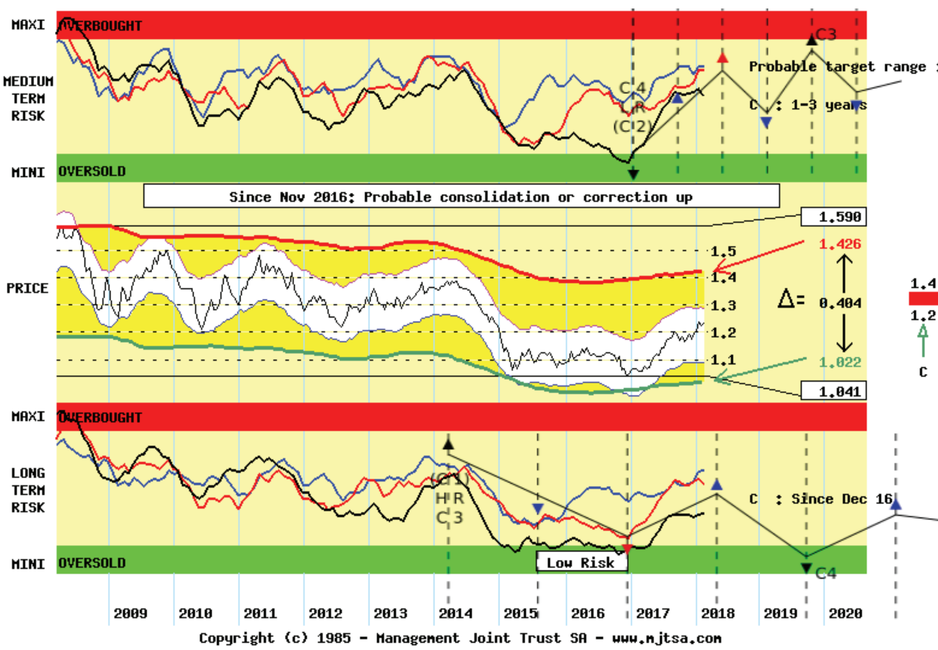


17 / MJT - TIMING AND TACTICAL INSIGHT

The Dollar is Oversold, what kind of counter-trend/reversal can we expect

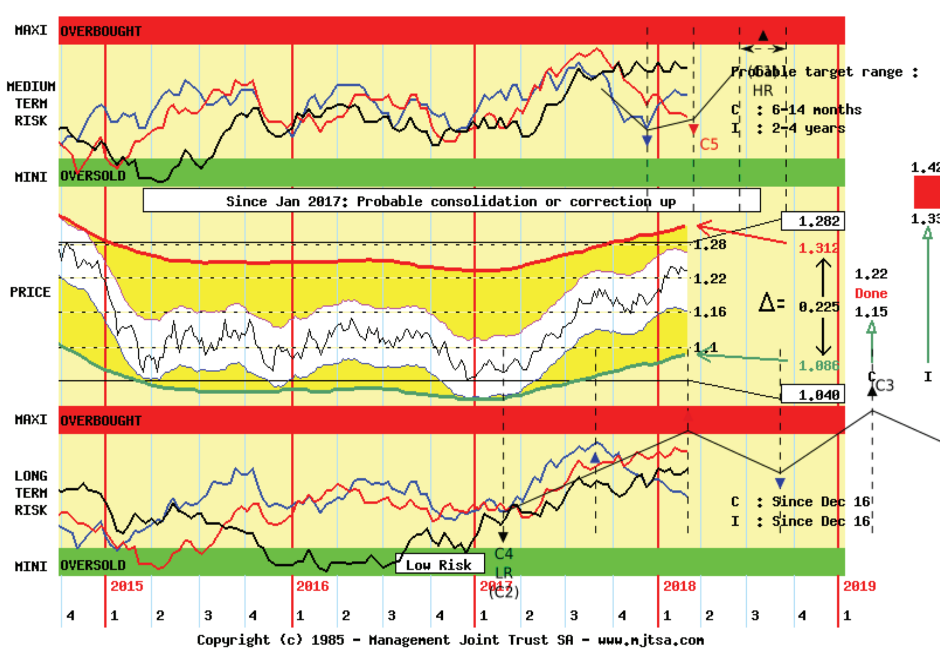
Following its persistent downtrend throughout 2017 and its strong sell-off year-to-date, the US Dollar seems Oversold vs most currency pairs. Indeed, since the early February Volmageddon sell-off, the Dollar is taking on a Flight to Quality status. Can it achieve more over the next 6 to 12 months on the back of the FED's more hawkish monetary policy vs the ECB or the new tax plan, which should encourage capital repatriation, Foreign Direct Investments and more generally boost growth expectations.

EUR/USD
Bi-monthly graph or the perspective over the next 1 to 2 years



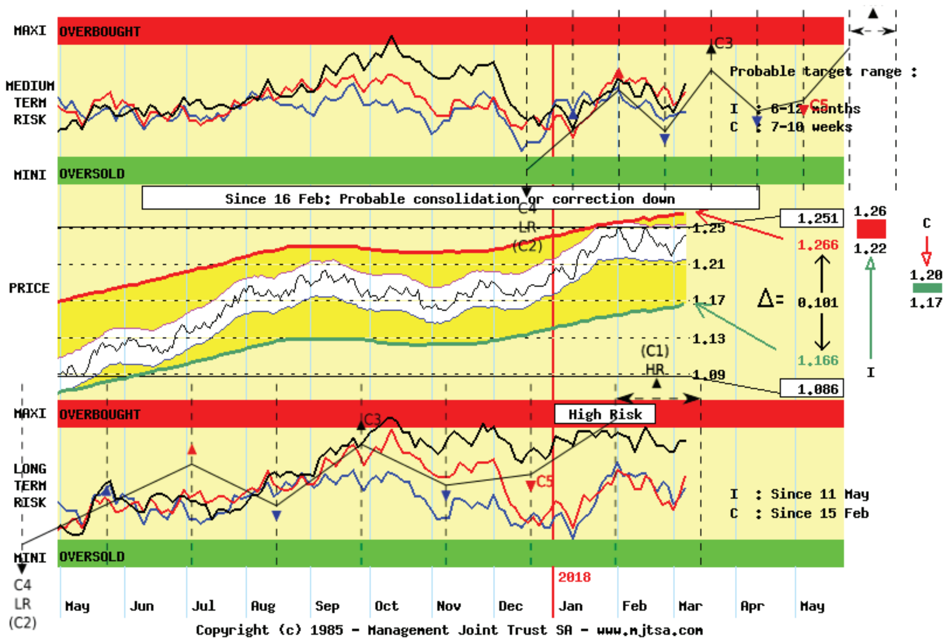
Whereas you consider the move up since late 2016 as the beginning of an uptrend (medium term oscillators; upper rectangle), or a mere counter-trend bounce (long term oscillators; lower rectangle), **EUR/USD should reach a top on both oscillators series sometime during H1 2018. The correction to the downside that follows could last between 2 and 5 quarters or towards early or late 2019**. Prices have reached our C Corrective targets up (right-hand scale) between 1.24 and 1.36 (with rounding 1.2-1.4 on the graph), **which would suggest that our upside corrective targets may have been completed (their lower end at least).**

EUR/USD
Weekly graph or the perspective over the next 2-4 quarters



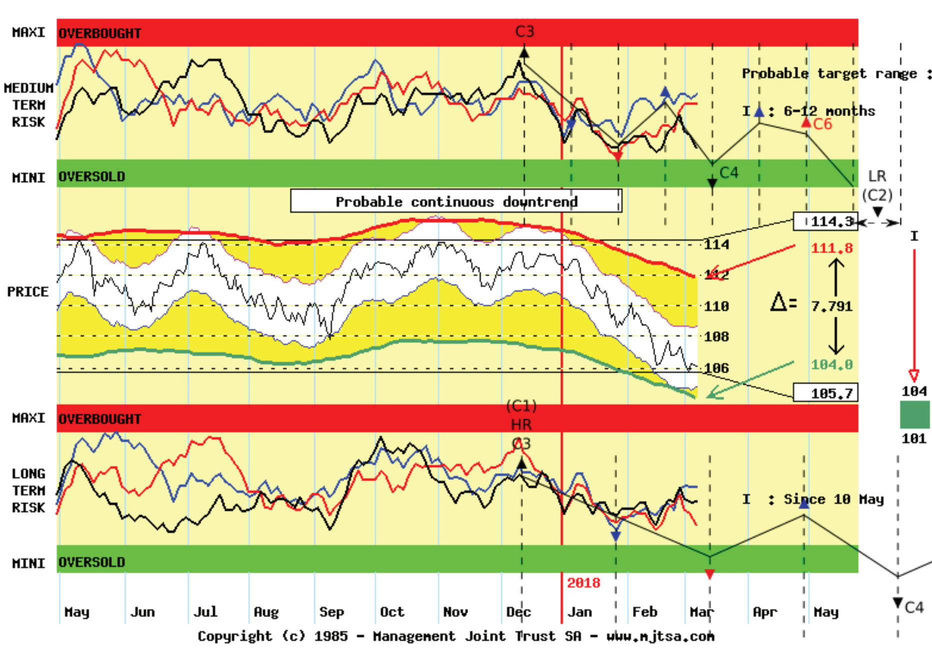
The Weekly graph is still somewhat unclear. Indeed, on the Bullish front, prices have made it above our C Corrective targets up and opened the door to much higher I Impulsive targets price targets up in the mid/high 1.30s (right-hand scale). Our medium term oscillators (upper rectangle) would also leave some room for a further acceleration up towards mid-year / Q3 2017. That said, **the more classic interpretation of the current configuration would be to consider it as an intermediate top in the making from a sequence that started in Q1 2017 (long term oscillators; lower rectangle). We would favor this second interpretation for now, at least into end Q1 / early Q2, and seek confirmation that a first leg down may start to weaken the uptrend in place since late 2016.**

EUR/USD
Daily graph or the perspective over the next 2 to 3 months



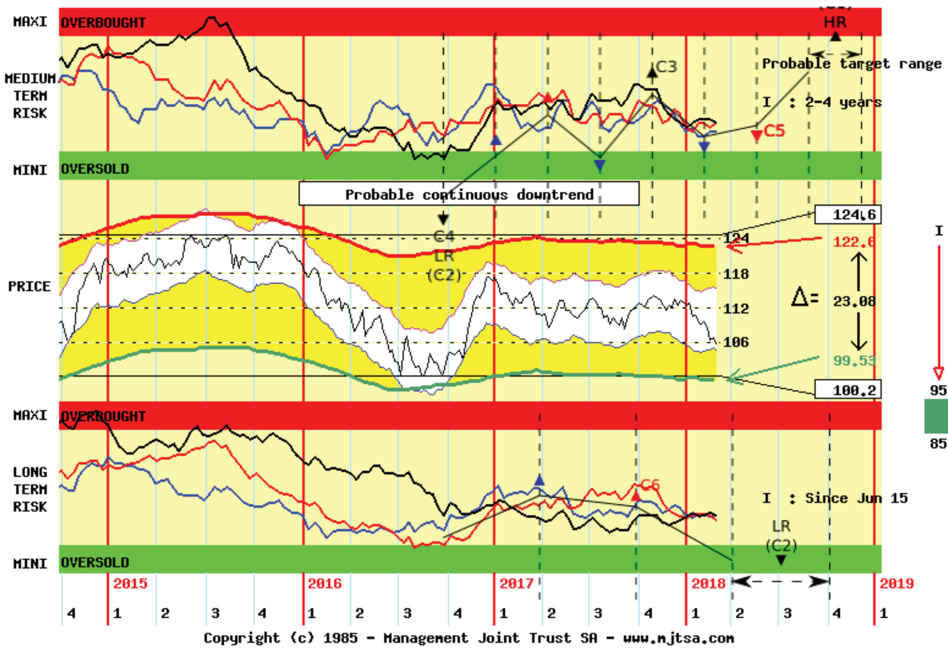
On the Daily graph, EUR/USD may now have completed a full sequence up on our long term oscillators (lower rectangle), and as indicated by our Automatic Messaging, these are now in a High Risk position. On the price target front, our I Impulsive targets up (right-hand scale) were also recently achieved (1.22 – 1.26 range). **Hence, the move up since last year is theoretically exhausted.** For now, the correction to the downside is rather lateral, and at high levels. Our corrective targets to the downside (right-hand) suggest that once/if it accelerates, it could reach the 1.20 to 1.17 over the next 1 to 2 months. **Shorter term, our medium term oscillators, would suggest one last upside attempt over the next couple of weeks. Following that, the correction down could initially last into mid April. It will be crucial to watch how much downside potential can be achieved until then.**

USD/JPY
Daily graph or the perspective over the next 2 to 3 months



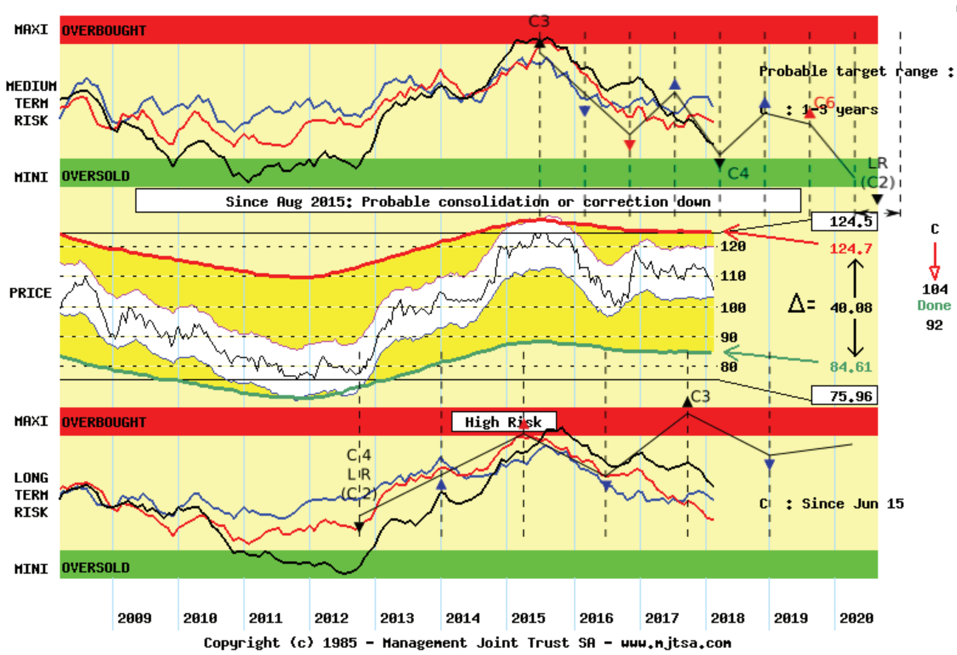
Last month, USD/JPY broke through crucial support around 1.08-1.07, a level it had tested twice last year, in April and then early September. This downside breakout does weaken the long term picture, yet shorter term an intermediate low may be in reach. Indeed, on both oscillator series (lower and upper rectangles), **an intermediate bottom is expected during the first half of March**. Although over the next few days, a bit more patience may be required (our I impulsive targets down could still justify short term risk towards the 1.04 – 1.01 range; right-hand scale), the bounce that may then follow could last several weeks toward early, perhaps late April. Given our current level of historical volatility “Delta” (here at 7.757 figures; middle rectangle, right-hand side), it could amount to between 4 and 6 figures (or 0.5 to 0.8 times “Delta”) for a start.

USD/JPY
Weekly graph or the perspective over the next 2 to 4 quarters



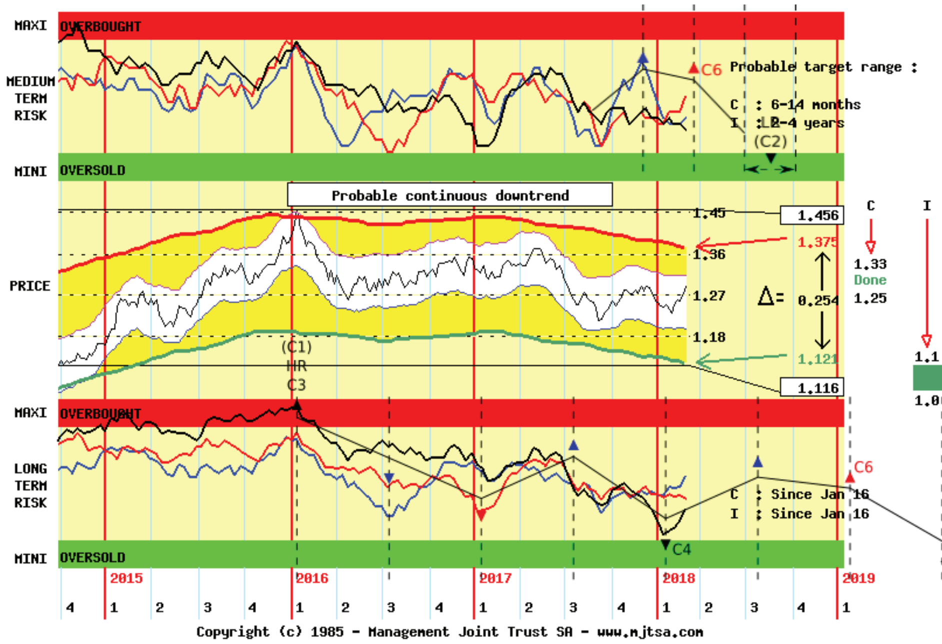
Our medium term bullish projection on USD/JPY, towards late Summer could still materialise (as shown on our medium term oscillator; upper rectangle). That said, before we can reconfirm it, more patience is required, as USD/JPY first needs to climb out of the current Dip. Indeed, the downtrend sequence we currently show on our long term oscillators (lower rectangle) is quite negative, while the potential downside risk towards our I Impulsive targets down (95 – 85 range) is compelling. **Obviously if we do break below 100 (2016 lows) any bullish projection will probably be invalidated**. That said, until then, we remain constructive: first we would need to see a good reaction to the upside on the initial low we show during Q1 on our medium term oscillators (upper rectangle), then following some retracement early Q2, a higher low could materialise during Q2 and serve as a base for a move up towards mid/late Summer.

USD/JPY
Bi-monthly graph or the perspective over the next 1 to 2 years



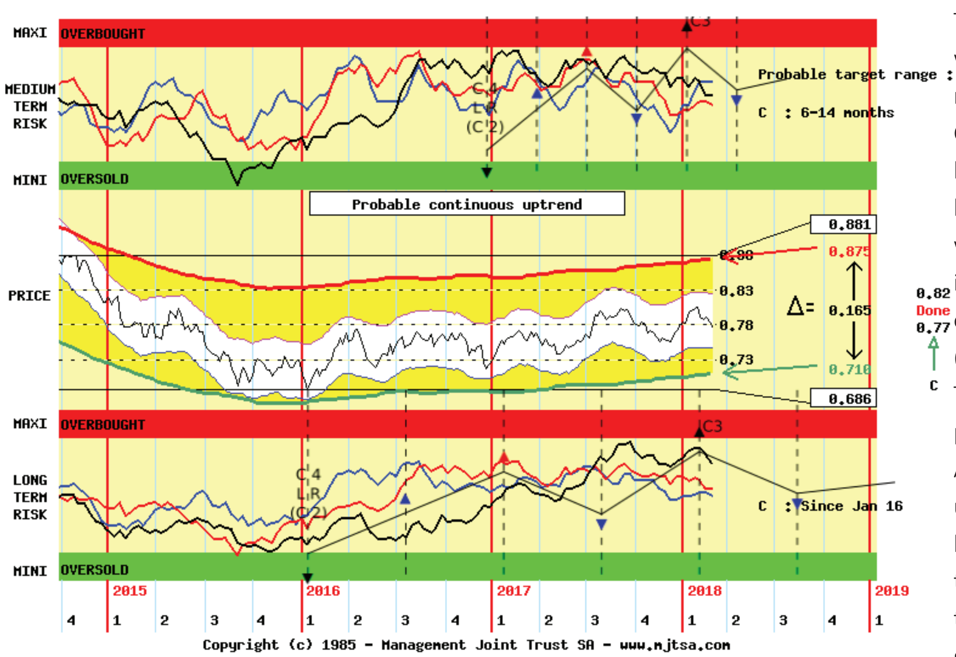
Looking at the longer term picture, 1 to 2 years out, the sequences we show on both oscillator series are downtrending. They could both extend lower towards 2019 and beyond. For example, on our long term oscillators (lower rectangle), the sequence has failed to pursue its uptrend sequence started in 2012 (i.e. currently making lower highs that the ones achieved in 2015 on our black, long term, oscillator). Such situations will usually keep prices under pressure for 1 to 2 years on a bi-monthly graph. On our medium term oscillator (upper rectangle), the situation is also downtrending, possibly towards late 2019/2020, **yet shorter term, it is approaching an intermediate low. These can usually trigger counter-trend bounces that can last 2 to 3 quarters (possibly towards the Summer, perhaps the Fall 2018)**. Following that, our C Corrective to the downside (right-hand scale) would suggest price targets below 100 in 2019 / 2020, with the next support levels towards 92.

USD/CAD
Weekly graph or the perspective over the next 2 to 4 quarters



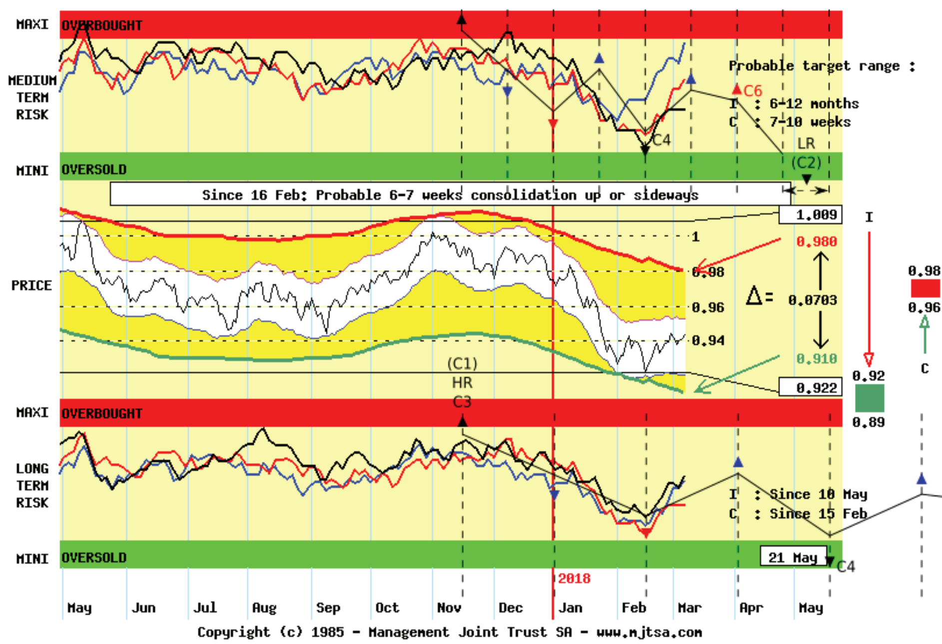
Turning to other Dollar pairs, we first look at the USD vs CAD on a Weekly basis. Since early 2016, the pair has been very much inversely correlated with reflation trades. On our long term oscillators (lower rectangle), an important intermediate low was made early this year. It may lay the basis for a potential reversal up, which could last towards year-end. That said, our medium oscillators (upper rectangle), as with EUR/USD, still suggest one last period of USD weakness during Q2. Hence coordinating both, **we would probably expect that the current rebound continues until end Q1, before a last move to the downside materialises towards mid year**. On the target front (right-hand scale), holding above 1.25 would be reassuring for the USD vs CAD, as below that, our I Impulsive targets down could justify much more downside.

AUD/USD
Weekly graph or the perspective over the next 2 to 4 quarters



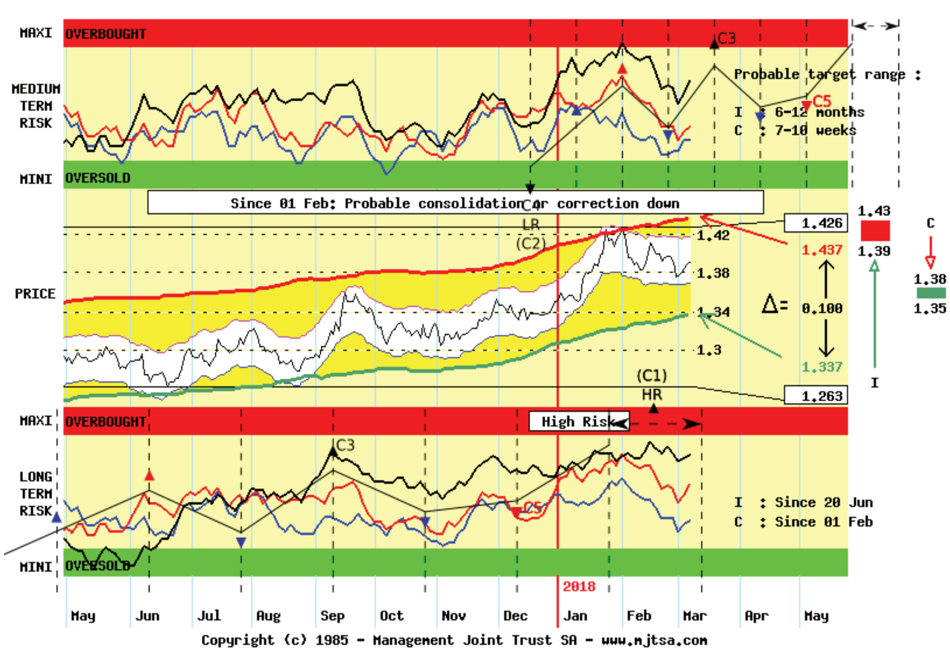
The uptrend on AUD/USD, which started early 2016, never managed to break above our C Corrective targets up (right-hand scale), i.e. it remains below 0.82. Furthermore, this weak uptrend has now met important intermediate tops on both our oscillator series (lower and upper rectangles). These should put downside pressure on AUD/USD towards April (medium term oscillators; upper rectangle) and potentially towards the Summer (long term oscillators; lower rectangle). Hence, taking the longer term view, one may consider that **following 2 years of unconvincing positive price actions, AUD/USD may be getting ready to resume lower.** A move above 0.82, in Q2 for example, may lead us to review this negative projection, especially if the rebound we show from early Q1 on our medium term oscillators (upper rectangle) is stronger than currently projected.

USD/CHF
Daily graph or the perspective over the next 2 to 3 months



USD/CHF has recently been quite similar to USD/JPY. Both have regained some of their defensive historical bias over the last 3 months. **On our long term oscillator series (lower rectangle), USD/CHF may have made an intermediate bottom mid February. It could now bounce towards early April. On our medium term oscillators** (upper rectangle), **the rebound could at least hold until early April. In general, USD/CHF could bounce towards the 0.96 - 0.98 range until early April** (C Corrective targets up; right-hand scale). Following that, further retests to the downside are possible during the Spring.

GBP/USD
Daily graph or the perspective over the next 2 to 3 months



Cable is quite similar to EUR/USD, yet more cyclical. On our long term oscillators (lower rectangle), **it has probably reached a "High Risk" zone** as confirmed by our Automatic Messaging. Such situations usually lead to **2 to 3 months of consolidation in an uptrend (to the downside or sideways)**. On our medium term oscillators (upper rectangle), we would expect a further push up towards mid March and then a new period on correction to the downside towards mid April. During this period, **GBP/USD could first retest up into its I Impulsive targets to the upside between 1.39 and 1.43, and then move lower again towards its C Corrective targets down in the 1.38 – 1.35 range** (right-hand scale).

Concluding remarks

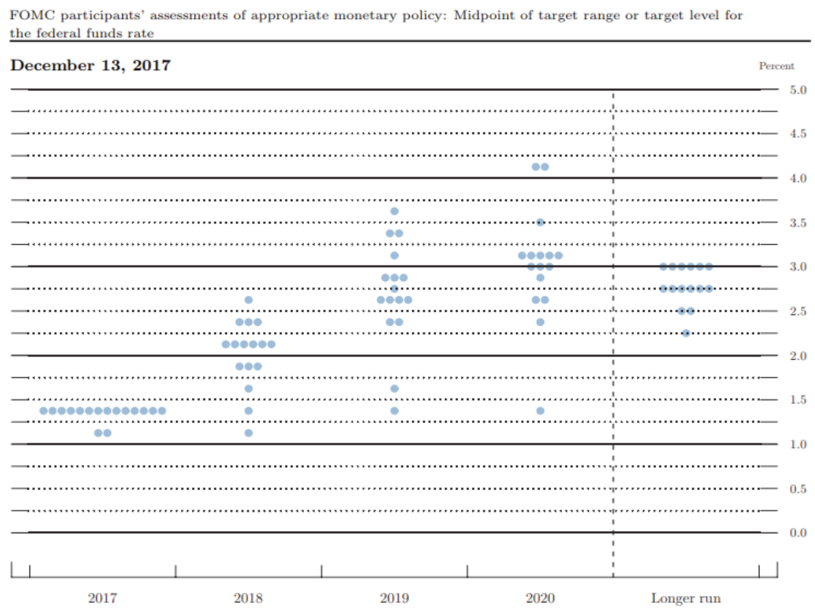
Against most currency pairs, the US Dollar currently seems Oversold. On some, it may have bottomed mid February, on others, a further short term retest may materialise until mid March. Following that, we would expect a further bounce into April. Longer term, although quite oversold, the US Dollar may see a further period of retracement and downside re-tests during mid/late Q2. Considering this risk, it may still be a bit too early to enter USD directional trades. We would however consider to take profit on US Dollar bearish bets on any weakness over the next 2 weeks, and possibly put in some asymmetric bets to profit from the rebound.

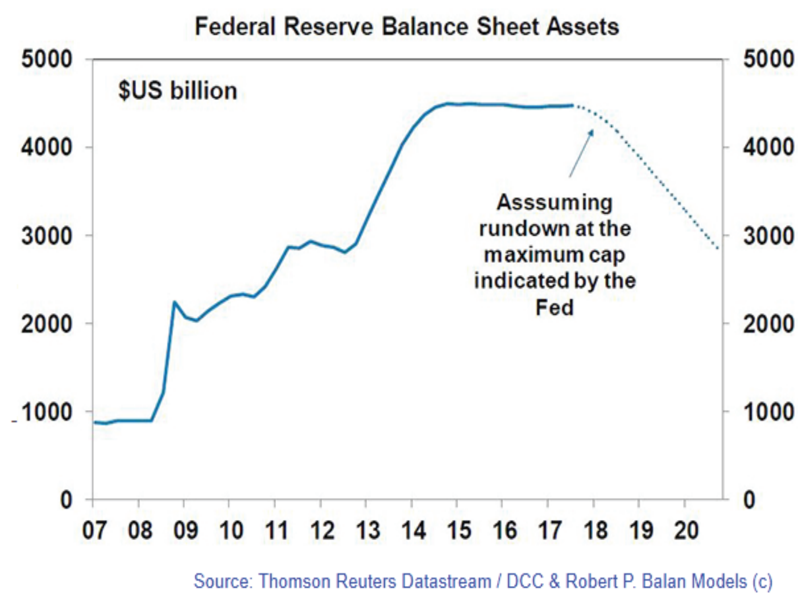
22 / The Fed will be the primary determinant of equity markets in 2018, as The Donald choses Main Street over Wall Street; the Fed will stay its tightening regime, or worse

Mr. Jerome Powell, the new Federal Reserve Chair, and the new FOMC (which will be dominated by new appointees of Mr. Donald Trump) will be the primary determinant of the trajectory of the US stock markets (and global equities, by implication) over the course of the year. The theme that underpins all of these is how Mr. Powell and the new FOMC will view growth going forward. Mr. Powell has been in the Fed Chair´s office for about two months, so we don´t know much about his, and the new FOMC´s thought-processes, regarding the issue. But we do know the following:

(a) Mr. Powell defended and reaffirmed the Yellen Fed´s policies of interest rate hikes, in his recent testimony to Congress. After all, Powell voted for the current policies, and he is not backing away from those commitments. **Mr. Powell told the Senate Banking Committee on Thursday last week: "By continuing to gradually raise interest rates over time, we're trying to... achieve inflation moving up to target but also make sure the economy doesn't overheat... There's no evidence the economy is currently overheating."** That kind of reasoning goes a long way towards justifying the course of both interest rate hikes (at least 3 in 2018) and shrinking of the Fed´s balance sheet on a regular, periodic basis over time (*see two first charts on this page*). **More alarmingly, Mr. Powell stressed that the stock markets are not the economy, and the Fed´s focus was the real economy. That was the reason why US equities sold off sharply on his testimony.**

(b) Mr. Powell´s views on the stock market are a distillation of New York Fed chair William Dudley's sentiments, on a speech delivered Dec. 1, 2014. **Dr. Dudley took pains to deny and decry the idea that the Fed was managing the stock market. He said: «Let me be clear, there is no Fed equity market put. To put it another way, we do not care about the level of equity prices, or bond yields or credit spreads per se. Instead, we focus on how financial market conditions influence the transmission of monetary policy to the real economy. At times, a large decline in equity prices will not be problematic for achieving our goals.** For example, economic conditions may warrant a tightening of financial market conditions. If this happens mainly via the channel of equity price weakness — that is not a problem, as it does not conflict with our objectives.» This is essentially true – the Fed had paid close attention to domestic financial conditions rather than to Core CPI and asset prices during the past few years (*see 1st chart on next page*).





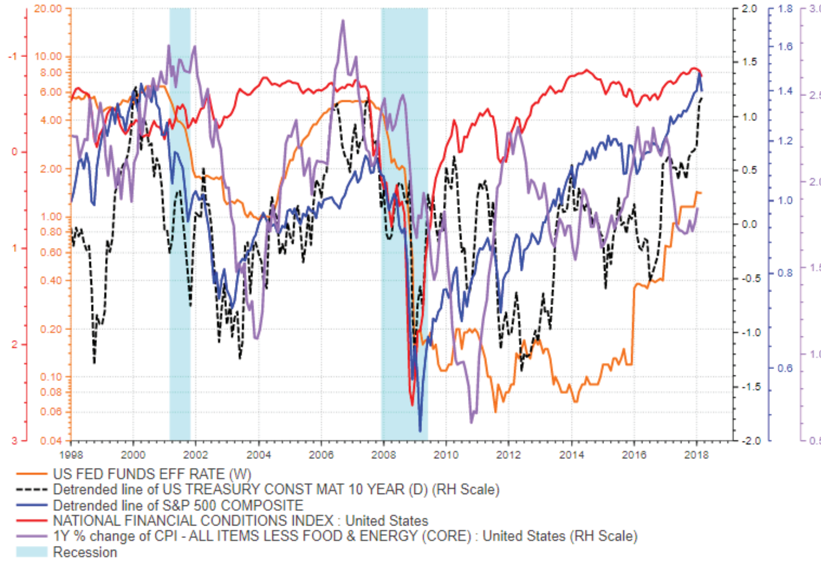
Market lore has been insistent that there is a so-called «Fed Put» on the stock markets, meaning that the Fed establishes a price floor under the market, preventing serious declines, so the optimal strategy is to «buy the dip» if one occurs, because the Fed will come to the rescue. **Both Messrs. Powell and Dudley have just shot down the notion of a «Fed Put» in the markets. We know now that their focus lies elsewhere, and that the priority is not really to support asset prices but to make sure that financial conditions are optimal for the economy** (*see 1st chart on this page*).

(c) We do know that the Fed can be inflation-phobic when it is focusing on this issue -- and the FOMC is now doing exactly that. **Sometimes, the Fed over-focuses on inflation, and since inflation lags behind growth and activity, the timing of their reaction-function to this data can sometimes be awkward (to say the least)**; *see 2nd chart on this page*.

Example: the FOMC´s statement following its late June, 2008 meeting. The Great Financial Crisis (GFC) is already full-blown by that time but nobody, not even the Fed, knew it. During the 7th month of the GFC, the Fed said, after acknowledging the existence of certain financial strains: «Recent information indicates that overall economic activity continues to expand... the upside risks to inflation and inflation expectations have increased.» The Fed was not aware that a recession was going on even though it was month 7, and it kept a tightening bias. The FOMC was so overly concerned with inflation that there was one dissent, from a voting member who wanted the Fed to raise interest rates then and there.

Lesson: **the Fed will not allow unfettered actual inflation, and the committee will likely overreact to tamp down any inflationary surge. The Fed will «fight inflation» with interest rate increases, even if they are inconvenient to market investors (and for the economy, as it turned out)**. But this zeal often creates issues for the central bank and the markets because the Fed's reaction function is often late, and lags behind developments in growth and inflation (*see 2nd chart on this page)*.

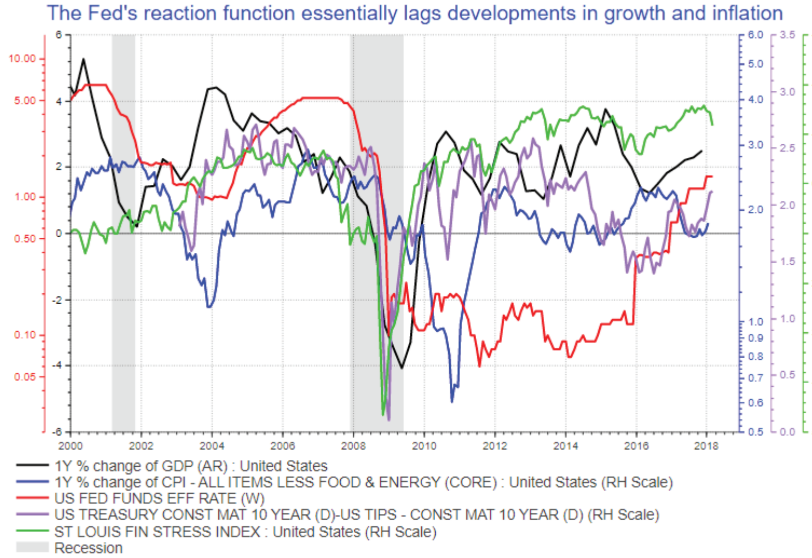
The Fed paid closer attention to US financial conditions vs CPI, asset prices



Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

US GDP, Core CP, FF Rate, Breakevens, Financial Conditions Index

The Fed's reaction function essentially lags developments in growth and inflation



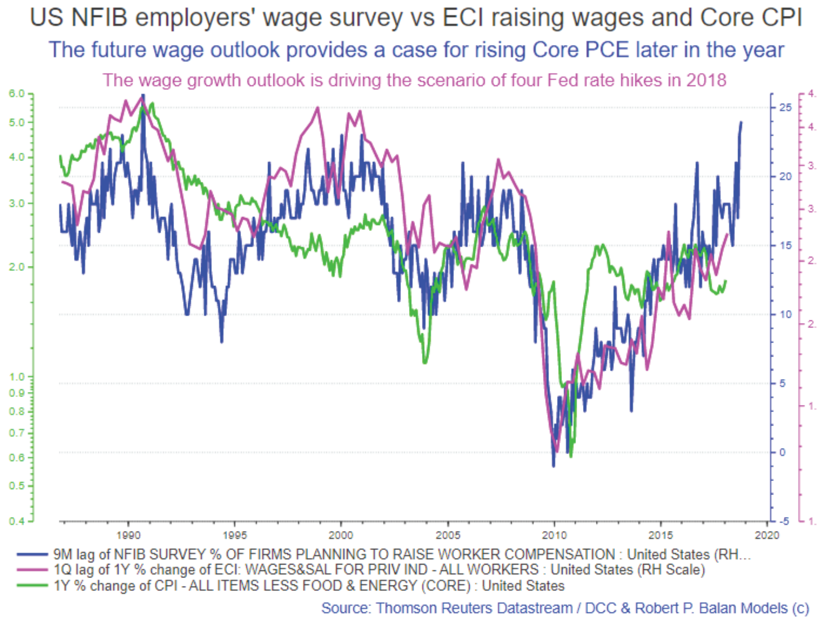
Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

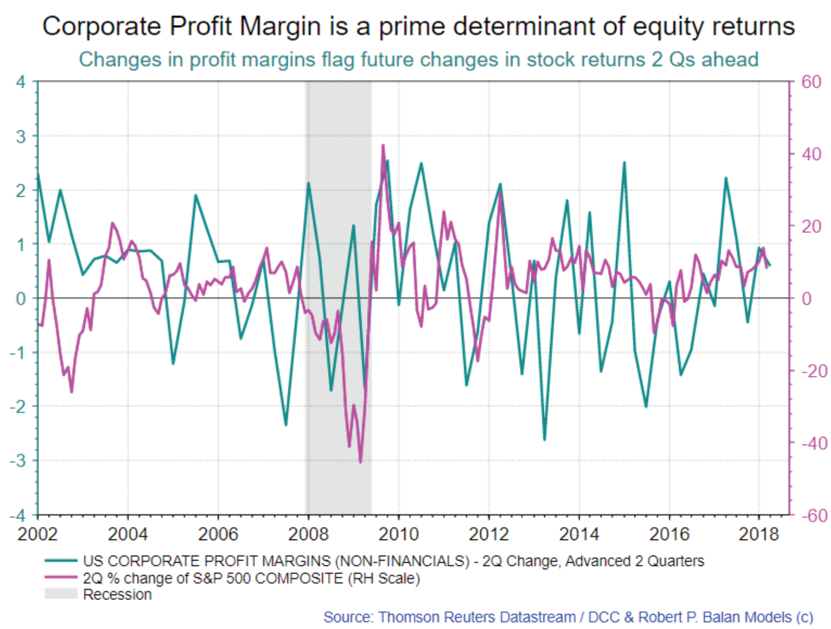
(d) **What is a complete surprise is the lack of a push-back from Mr. Donald Trump** regarding Mr. Powell's stance of tighter future policy. Many observers (including us), fully expected Mr. Trump to champion «lower rates for longer,» and in fact The Donald said so in many occasions that he likes low interest rates. The expectation was that Powell would want to move the Fed away from Quantitative Tightening and/or interest rate hikes to please the president who appointed him -- but no; here you are, Mr. Powell and the new FOMC are touting prospective growth, and as consequence of that, the tightening regime decided by the Yellen Fed will stay on course.

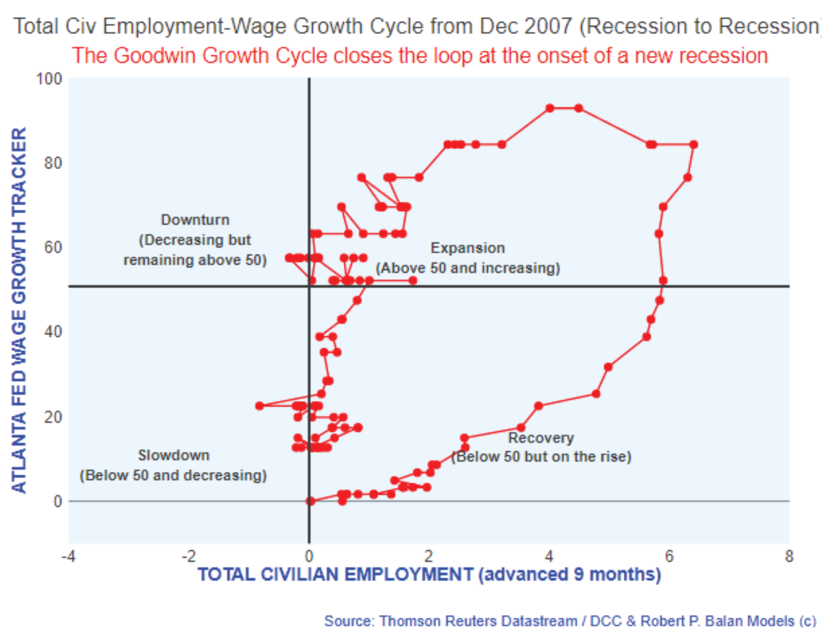
We are not implying, of course, that Mr. Powell takes instructions from Mr. Trump, but we believe that there was convergence of interests which should allow the Powell's Fed to pursue their agenda without the risk of receiving tweeted potshots from The Donald. And obviously, something has changed in the priorities of Mr. Trump, for we do not believe for a second that Mr. Powell would go on full tilt with the tightening regime, without some detente/understanding with The Donald. **To us, Mr. Trump´s focus has turned to jobs, jobs, jobs, rather a buoyant stock market. All his recent legislative and administrative decisions (illegal immigration (jobs for Americans!), lower corporate tax, higher defense spending, tariffs, and soon, infrastructure) are focused towards job-creation**. And so it is too much to expect that with accelerated job creation (and corresponding wage growth), inflation will not become a problem. Already, NFIB survey of employers planning to raise wages and the Employers' Compensation Index (ECI) are already flagging a substantial boost to Core CPI up to September 2018, at least (*see 1st chart on this page*).

Jobs are vote-getters, and if that comes with a buoyant stock market so much the better, putting ourselves in the shoes of Mr. Trump. But between jobs and the stock markets, we believe The Donald will opt for the former. **Conclusion -- the focus at least this year should be on job-creation, the wage-push inflation that it brings, and the reaction-function of the Fed to contain inflationary pressures. President Trump will accept possible «normalization» of stock and bond (lower) valuations, if the economy performs well, and jobs (votes) are created. It is choosing Main Street at the expense of Wall Street** -- Main Street growth involves higher wages which redound to lower corporate profit margins. And lower profit margins will hurt equity prices; the only good thing about it is that profit margins flag the likely stock returns 2 quarters ahead (*see 2nd chart on this page*).

Certainly, risks have risen in terms of inflationary pressures, although that is somewhat mitigated by the absence of rip-roaring US GDP growth. Gains in the US jobs market have not been, so far, accompanied by similar domestic growth gains – and that has basically tied down wage growth. That presents a peculiar kind of risk, which is that the job market could become over-extended, then peak and tip-over, before wage growth has reached escape velocity. This is not mere speculation – employment data has been slowing for several quarters now on year-on-year basis, and that is causing our model to flag potential distress in the jobs market. Our modeling work suggests that wage growth is almost just about to close the cycle loop with Civilian Employment (*see 3rd chart on this page*), then the cycle repeats from square one (recession). The risk that this model is outlining is that wage growth may fail to take off before unemployment starts to rise – and we know what happens thereafter: wage growth will stop dead on its tracks (*see 3rd chart on this page*).



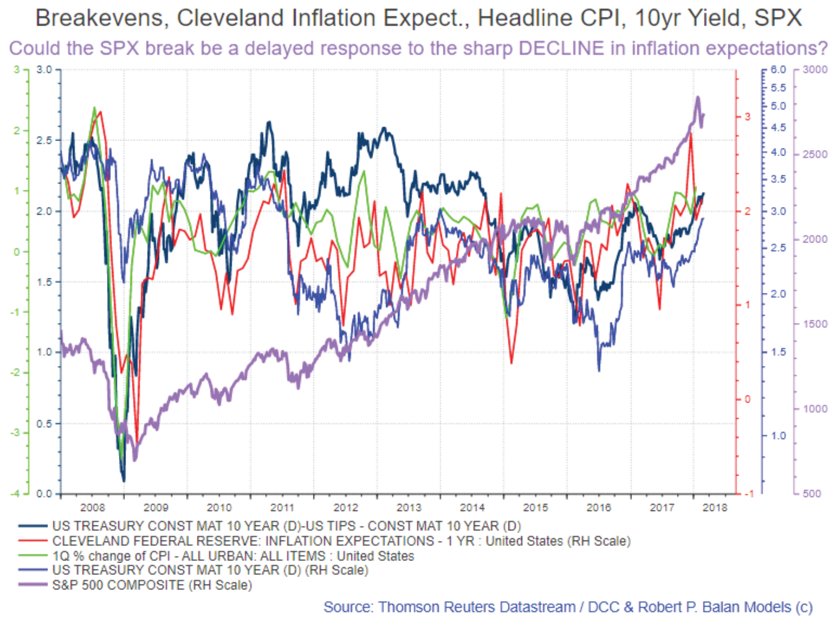


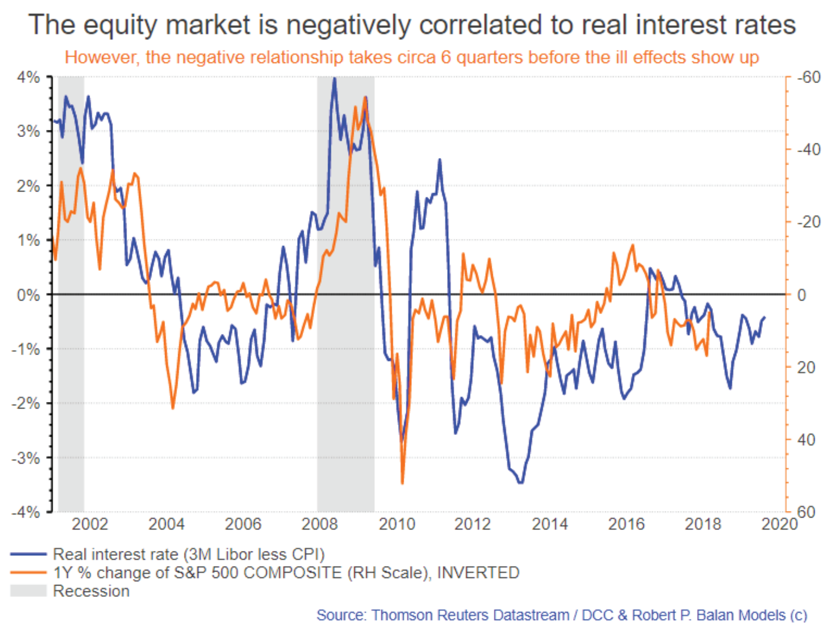


Food for thought:

The stock markets have been recently dealt a sharp blow due to jitters that rising inflation (signified by a sharp rise in the breakevens and long-term bond yields) could mean that equity valuations will be at risk if the condition gets any worse (see first chart below). However, we reserve judgement because the 10yr bond yield, and indeed, the breakevens, have risen to these levels before without triggering a negative response from the equity markets. What we know is that there was a sharp drop in inflation expectations two weeks prior to the equity break. An equity market sell-off would be the correct response to falling inflation expectations – it is easy to show that rising inflation has been a positive for rising stock markets, without exception, during the course of the Great Financial Crisis, and vice versa (*see 1st chart on this page*).

Moreover, it is not nominal bond yields that correlate with the twists and turns of the stock market. It is real short term interest rates (3 mo. Libor rate deflated by CPI as proxy) which make the difference. The equity market is negatively correlated to real interest rate trends – the stock market performs well when real interest rates are falling or are turning negative, and vice versa. However, the impact of the negative relationship takes circa 6 quarters before the ill effects show up (*see 2nd chart on this page*).

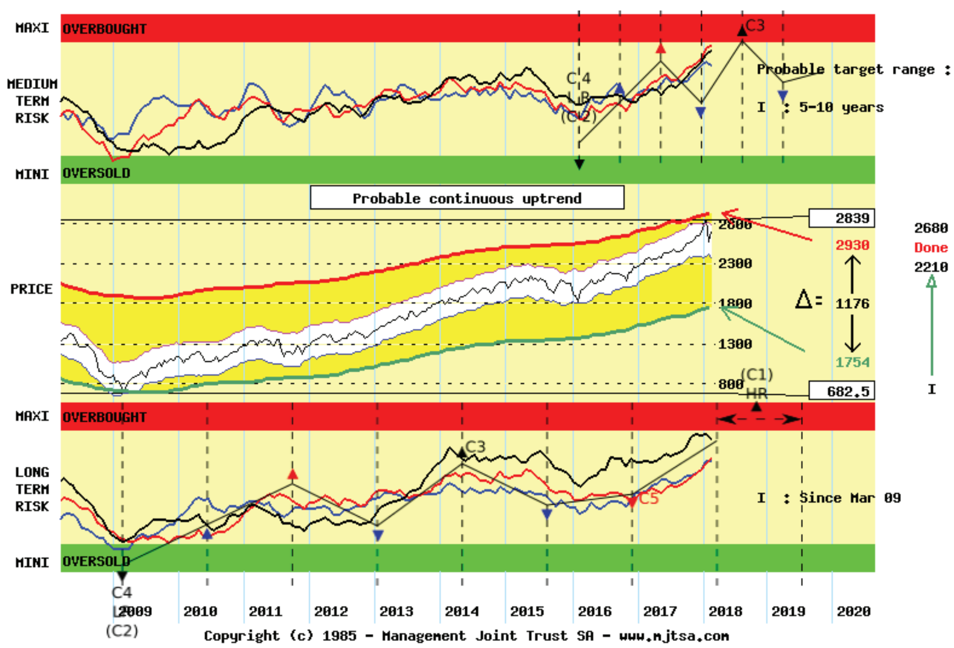




An unconvincing bounce on many equity markets may lead to further downside retests into end Q1 / early Q2

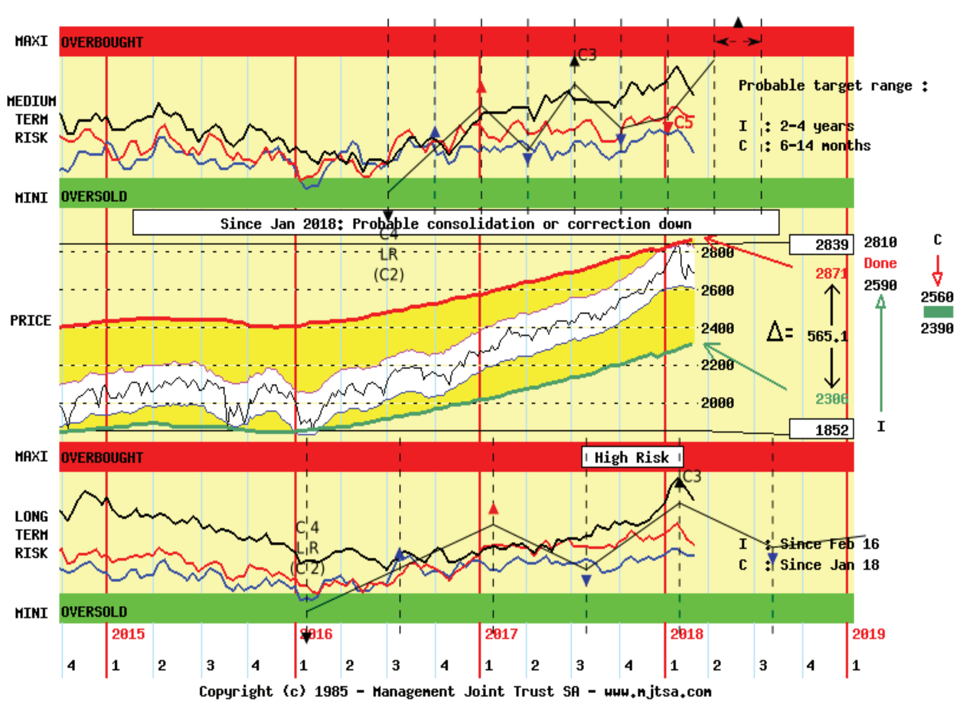
Last month, we had published in the middle of the crisis, on the 8th of February. The sell-off had been quite deep and we were hitting important support levels. We then believed that a rebound would materialise, probably towards early March. As we write, the rebound may still be underway, on US markets at least. In Europe and Japan, it has come and gone, prices have recently retested their February lows, yet are currently attempting to bounce up again. Across the board, however, the rebound has been quite weak, and as new intermediate highs are approaching on most of our oscillator series, we would probably expect further downside retests over the next few weeks. Longer term, we still remain constructive, tentatively from early/mid Q2 towards mid-year, although we are probably approaching the last stages of the 9 year equity bull market, which started in 2009.

S&P500 Index - Bi-monthly graph or the perspective over the next 1 to 2 years



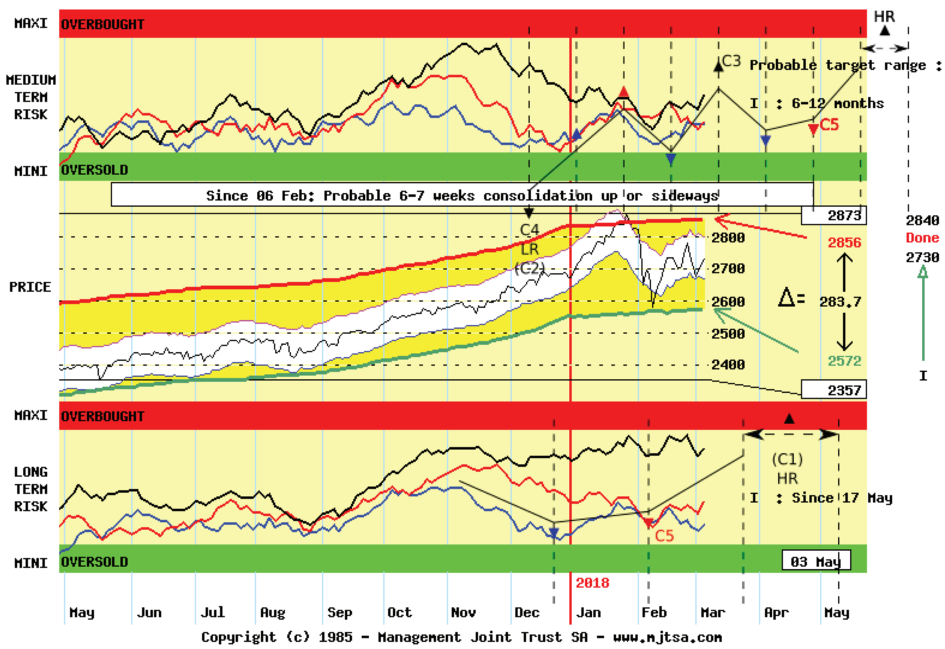
This long term uptrend is slowly reaching exhaustion. Our I Impulsive targets up have been achieved (right-hand scale), and our long term oscillators (lower rectangle) are approaching a "High Risk" zone. Shorter term, on our medium term oscillators (upper rectangle), **a last sequence up may still be underway, possibly until mid year. Such extended conditions on a bi-monthly graph can usually trigger consolidation periods that could last between 1 and 2 years**. The C Corrective potential to the downside we can currently calculate, given our historical measure of volatility "Delta" (here at 1'176 points, middle graph, right-hand side), is between 590 and 940 points (or 0.5 to 0.8 times "Delta"), i.e. somewhere towards **a 20 to 35% correction from current levels**.

S&P500 Index - Weekly graph or the perspective over the next 2 to 4 quarters



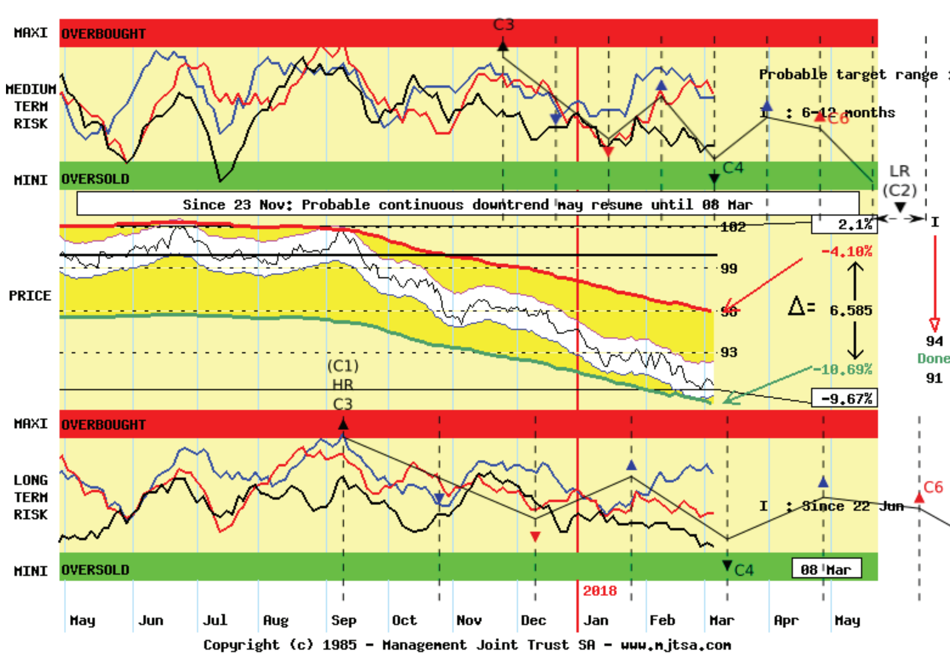
Here also, the uptrend since early 2016 seems quite exhausted. Our long term oscillators recently made an important intermediate top, which our "Automatic Messaging" is labeling as a "High Risk" situation. Our I Impulsive targets to the upside (right-hand scale) have also been reached. With some creativity, we can extend our medium term oscillator sequence up until mid year (upper rectangle). Yet, if correct, we would consider such a last move up, as a mere extension, not the beginning of a new uptrend. Looking to the downside, our C Corrective targets down (right-hand scale) are suggesting that the crucial support zone lies between 2'560 and 2'390. Its upper boundary has already been tested during the February sell-off. Any foray below its lower end (below circa 2'400), would probably tip the S&P500 into an outright Bear market.

S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



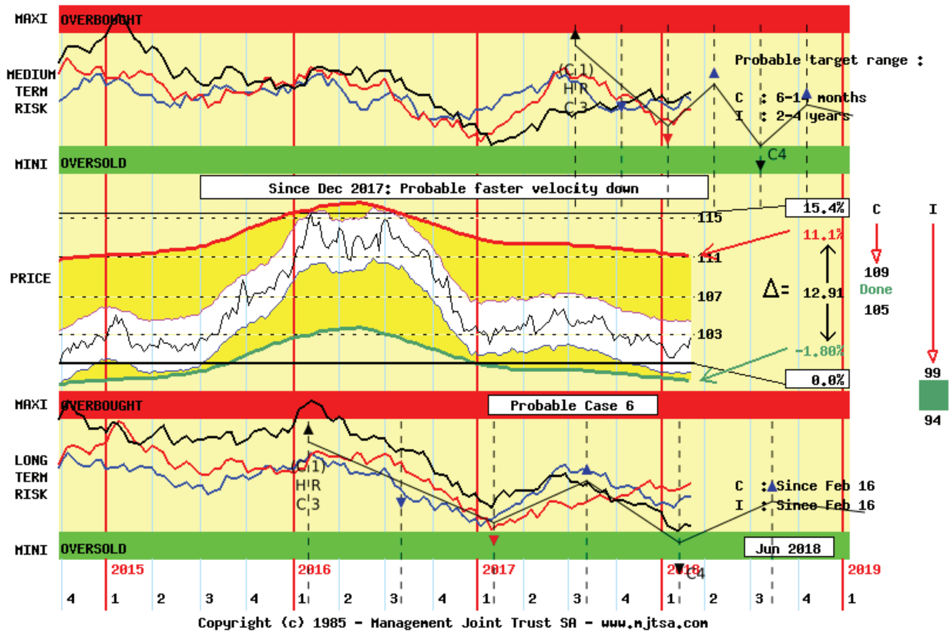
On our long term oscillators (lower rectangle), the rebound is still underway, and it may last into the end of March, even into April. That said, we believe this sequence is probably too aggressive to the upside for now. Indeed, **the sequence we show on our medium term oscillators (upper rectangle), may soon reach a new top position, probably between now and mid March. Such configuration usually trigger further downside corrections, especially when prices remain below their previous highs (which is the case at the moment). We would hence expect, the rebound to die out, sometime over the next week or so, which could trigger a new retest to the downside, potentially towards early April, perhaps even end April**. The support level we can calculate using our historical measure of volatility “Delta” (here at 283.7 points) is towards 2’650 (or 0.8 times “Delta” subtracted from the top). Below that, prices could theoretically move towards our I Impulsive targets to the downside, i.e. towards the 2’500 – 2’400 range (1.3 to 1.7 times “Delta” subtracted from the tops).

Cap. weighted portfolio of US defensive sectors vs the S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



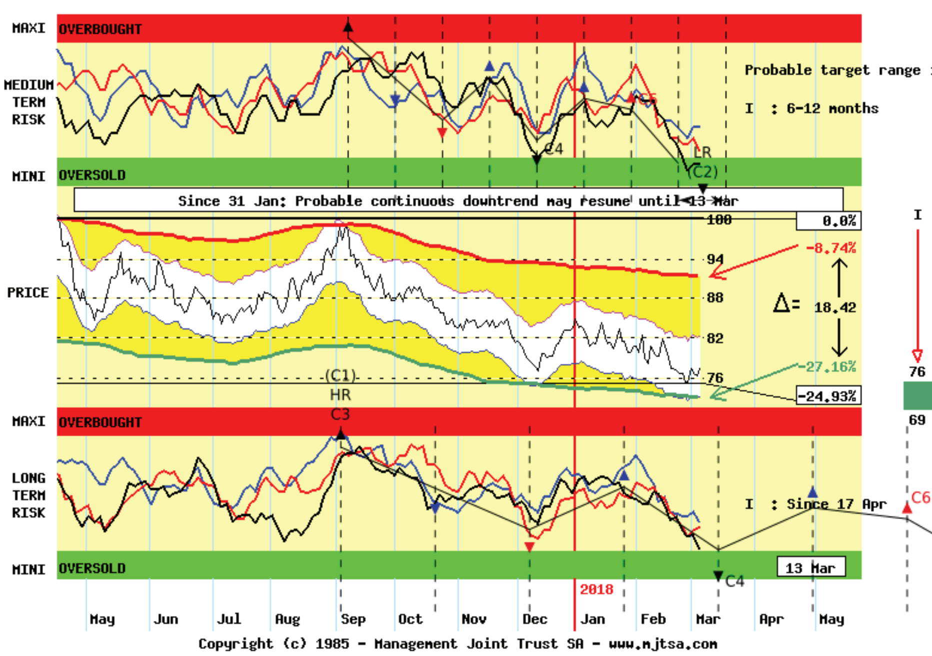
This Cap. Weighted portfolio of Healthcare (XLV), Staples (XLP), Utilities (XLU) and REITS (RWR) is Oversold vs the S&P500 Index. In addition, our I Impulsive targets to the downside (right-hand scale) have been reached, signaling that **the downside potential is probably exhausted for now. This defensive portfolio could hence be getting ready to bounce, which would confirm that a possible risk-off period lies ahead**. Indeed, both our oscillator series (lower and upper rectangles) are reaching intermediate lows over the next week. They could **bounce during 3 to 6 week (until early April, perhaps late April)**. Following that, defensive stocks resume their downtrend vs the S&P500, possibly towards mid year.

Amundi MSCI Europe Minimum Volatility ETF/ Amundi MSCI Europe ETF
Weekly graph or the perspective over the next 2 to 4 quarters



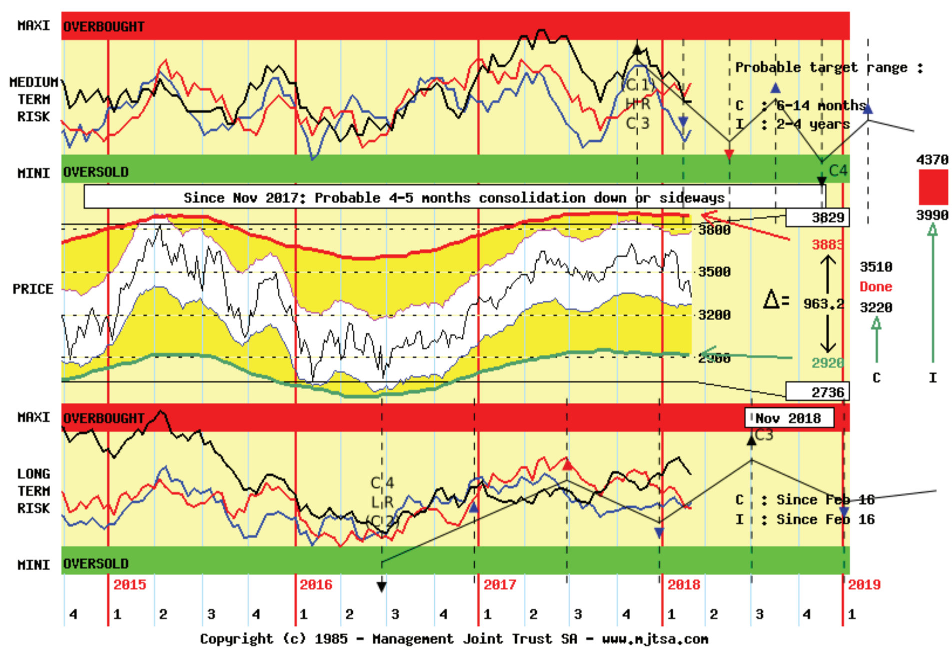
Similarly in Europe, we use the ratio between the Amundi Minimum Volatility ETF and the Amundi Europe ETF to capture the defensive factor vs the general market. On both our oscillator series (lower and upper rectangles), **Minimum Volatility stocks have reached an intermediate low vs the European index**. The sequence we show on our medium term oscillators (upper rectangle) suggests that **a relative bounce of Defensive stocks could last into early Q2, before Minimum Volatility resumes lower vs the European Index until early Q3 2018.**

GDX - Market Vectors Gold Miners ETF / SPY - SPDR S&P 500
Daily graph or the perspective over the next 2 to 3 months



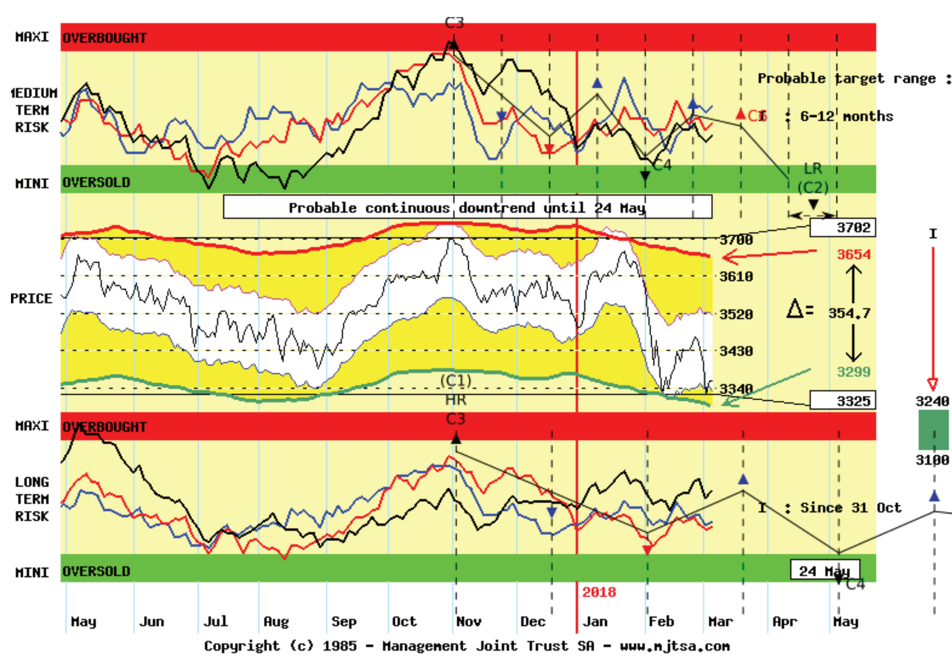
Lately, there hasn't been many occasions when Goldmines have outperformed the S&P500. The last time it really happened was during the August risk asset correction. Yet, on both our oscillator series (lower and upper rectangles), **Goldmines may be getting ready to bounce again. The move, which could start between now and mid March, could last into early, perhaps late April. It would probably confirm that the further risk off phase is underway.**

EuroStoxx 50
Weekly graph or the perspective over the next 2 to 4 quarters



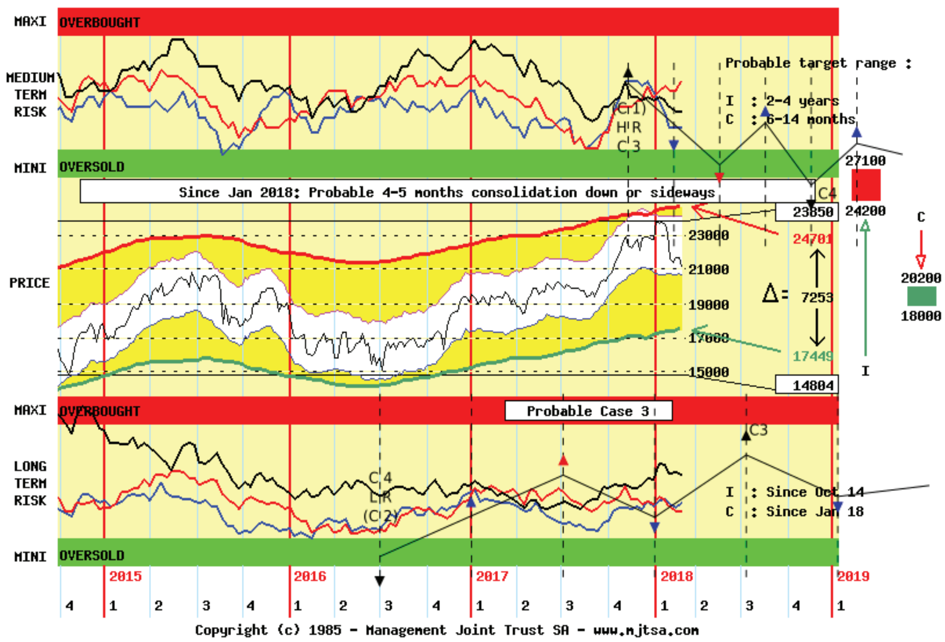
In Europe, the recent sell-off has been quite damaging. On our long term oscillators (lower rectangle), we will maintain our positive projection for now, probably towards mid year. That said, on our medium term oscillators (upper rectangle), **the uptrend sequence has been broken, and the next bottom we can expect is probably towards mid Q2. It will probably be the EuroStoxx 50's last chance to find support and accelerate up towards mid year / early Summer, provided the damage until then is pretty much contained.**

EuroStoxx 50
Daily graph or the perspective over the next 2 to 3 months



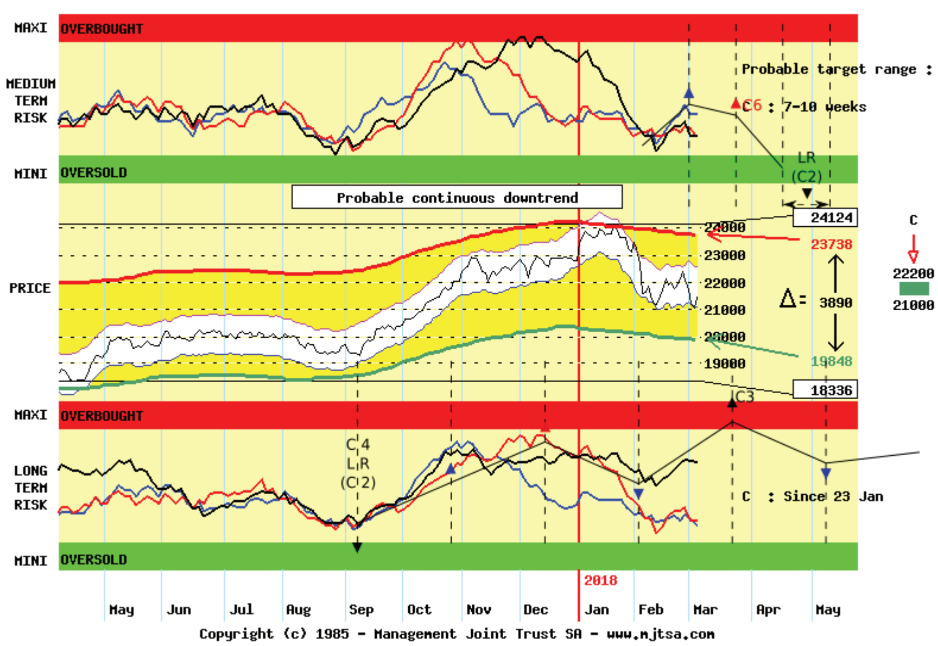
The February rebound was short lived on the EuroStoxx 50. Going forward, both our oscillator series (lower and upper rectangle) would suggest that the EuroStoxx 50 resumes lower from mid March to late April, even early May. Our I Impulsive targets down (right-hand scale) still show compelling downside risk, potentially towards the 3'240 – 3'100 range. **Given these negative prospects over the next month or so, we would put any bullish projections on hold, at least from mid March to mid April.**

Nikkei 225
Weekly graph or the perspective over the next 2 to 4 quarters



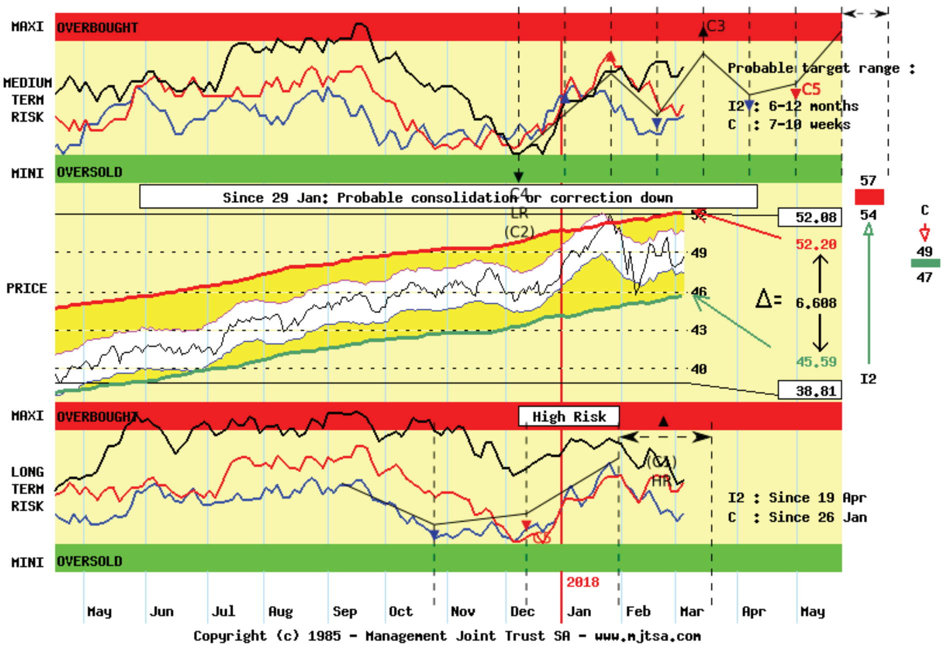
The Nikkei is in a similar situation as the EuroStoxx 50. On our long term oscillators (lower rectangle), we would also maintain, for now, our positive projection, possibly towards mid year. That said, on our medium term oscillators (upper rectangle), we have switched to a downtrending sequence, where the **next bottom is expected sometime in mid Q2. We will probably remain defensive until this support point is reached**. On the target front, our I impulsive targets to the upside still show strong potential towards the 24'000- 27'000 range (right-hand scale), yet in the meantime, it is the C Corrective targets to the downside which we believe are more important. They should provide **support somewhere in the 20'000 to 18'000 range (or 7 to 15% below current levels).**

Nikkei 225
Daily graph or the perspective over the next 2 to 3 months



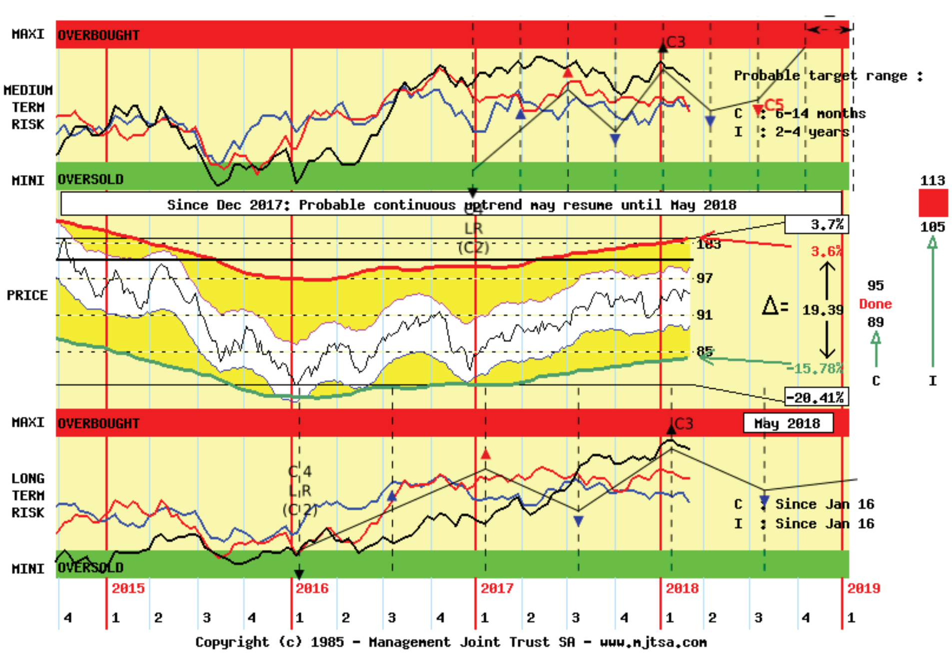
During the sell-off, the Nikkei has held the support of its C Corrective targets to the downside around 21'000 (right-hand scale). Both our oscillators series (lower and upper rectangle) are also suggesting that **it could hold up and even bounce slightly longer into mid/late March. That said, both our projections are now negative into April, and we would probably use any decent rally to put some downside protection into place**. We would probably remain defensive into mid April, perhaps even early May. Indeed, if at some point, our C Corrective targets to the downside are broken (right-hand), the next level of targets we can calculate is towards the 19'000 – 17'500 range (1.3 to 1.7 times our historical volatility measure "Delta", here at 3'890- middle rectangle; right-hand side – subtracted for the highs at 24'124). **These possible downside targets are somewhere between 10 and 20% below current levels, which is compelling.**

EEM - iShares MSCI Emerging Index Fund
Daily graph or the perspective over the next 2 to 3 months



On Emerging markets, following their acceleration up from early December to late January, a "High Risk" situation has now been reached. This is shown on our long term oscillators (lower rectangle), and confirmed by our Automatic Messaging. In such situations, we would usually expect some consolidation that may last for 2 to 3 months. On our medium term oscillators (upper rectangle), we would also expect **a period of consolidation, probably from mid March into early April, before prices accelerate up again into May/June.** To confirm this scenario, EEM will first have to hold above its C Corrective targets to the downside, i.e. above 47 (right-hand scale). Indeed, below that, the downside risk is much more compelling, probably towards the 43 – 41 range. This would definitely end the current uptrend.

EEM - iShares MSCI Emerging Index Fund / ACWI - iShares MSCI ACWI
Weekly graph or the perspective over the next 2 to 4 quarters



On our long term oscillators (lower rectangle), the uptrend since 2016 has now reached an important intermediate top. That said, on our medium oscillator (upper rectangle), the sequence we show could still justify one late push up, probably into late H2 2018. Putting this discrepancy aside for now, we can conclude that **on both oscillator series some consolidation to the downside is expected until early Q2 at least. Following that, Emerging markets may start to accelerate up again and could outperform the All Country World Index (ACWI). Although we will still need to confirm this last move up during Q2, its potential could be compelling** (I Impulsive targets up showing between 10 and 20% outperformance potential; right-hand scale).

Concluding remarks:

The early February correction on equities created important intermediate tops on many of our long term graphs. The rebound that followed is still underway, yet appears quite weak. We would hence probably expect a further period of downside retesting on equity markets, which could start between now and mid March and last until early, perhaps late April. Relative trends to the downside on Defensive sectors and Goldmines vs the S&P500 seem exhausted for now. These may bounce over the next few weeks, which would confirm that a risk-off period is underway. More generally, equity markets could be approaching the end of their 9 years "Bull" market. We expect them to extend higher one last time from mid Q2 into mid-year, perhaps the Summer, but at this stage, the longer risk/reward on equities seems stretched.

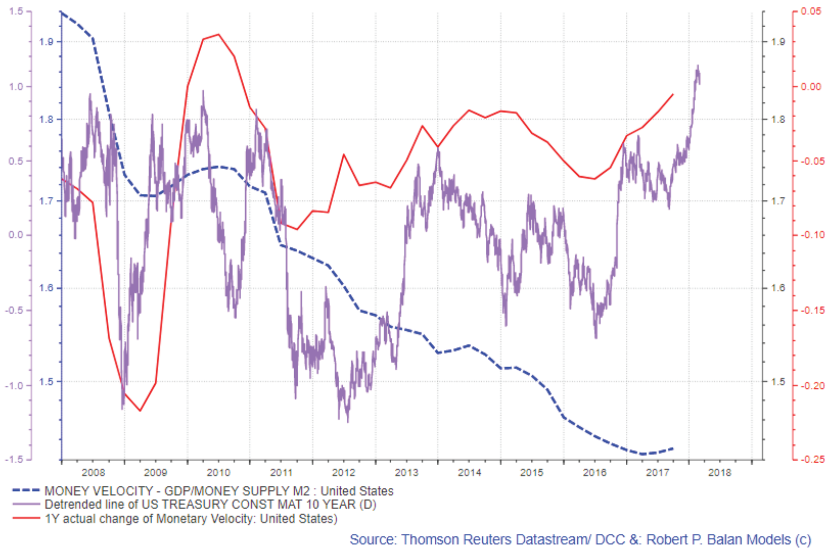
32 / Changes in Money Velocity are rising, and that is pushing Core CPI higher; rising interest rates are in turn pushing up changes in MV, and rising CPI pressure rates higher

Let's talk about inflation, but not in the usual way newswire would do, which is just to provide some narratives – we will do some expository work. **We know that inflation expectations have been rising lately, but that Core CPI has been relatively tame so far. So actual inflation was not the issue when the equity market broke down sharply a few weeks ago – but inflation expectation was. So what pushed up inflation expectations in the first place?** We believe we have some answers.

There was a potentially important development in inflation-related issues sometime in November, but not a great lot of market analysts paid attention to it. It was mostly overlooked because **not many analysts understand monetary velocity (MV)**. In November 2017, the MV put in a bottom, but it was way too early to tell (at that time) if the incipient uptrend in MV would develop in such a way that it could eventually cause an adverse reaction in the market. Unfortunately, we should have taken more proactive steps, as we believe now that it probably contributed to the equity market break a few weeks ago.

The development in MV was totally ignored by the market, but that probably stems from the fact that monetary velocity is not very well understood. And not a great lot of analysts are interested in MV in the first place, so the event came and went, and we understand its significance only after the fact. Some people think that money velocity – the number of times a unit of money is transacted in a year, on average, in a given economy – is somehow tied to nervousness about the economy or is related to money demand. This was brought about by the spectacular decline of money Velocity during the Great Financial Crisis (GFC). Many observers attributed that to savers stuffing dollar bills in the proverbial mattress. While investor or consumer proclivity to save money during a financial crisis is a fact, that kind of behavior was not the direct cause of why MV fell during the GFC.

The relationship between Money Velocity and interest rates 1



The relationship between Money Velocity and interest rates 2

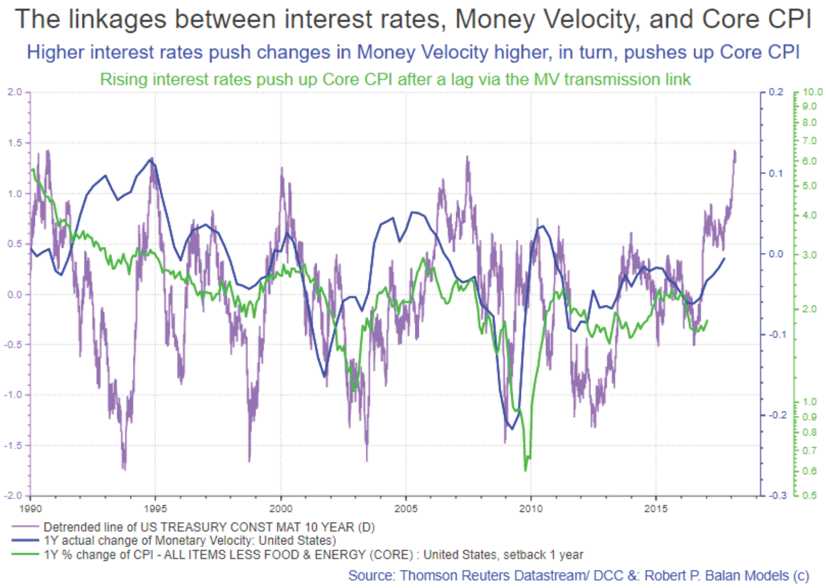
The main cause of changes in monetary velocity is framed preference and is relatively simple: when the cost of holding money is high, we prefer to hold less of it (put it in an interest bearing account), and when the cost of holding money is low, we don't mind holding more of it. In the last case, it can be said that the interest yield in a savings account is not significantly higher that the convenience yield of having the money at hand. This is not a new discovery; Milton Friedman first noticed this in the 1960s. Monetary economists describe MV as the "inverse of the demand for real cash balances," and the demand for such balances depends of course on the relative cost of cash balances relative to other investments (savings interest vs convenience yield). The operative framed preference can be easily demonstrated. We plot the data of a sufficiently high interest yield (5-yr bond yield as proxy) against MV, *see 2nd chart above.*

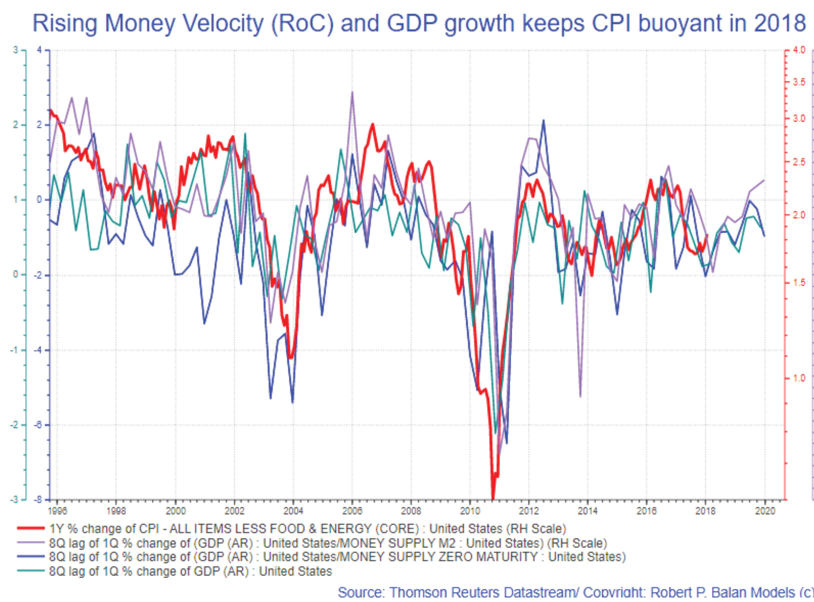
This chart shows this relationship. It's easy to envision the effect of the framed preference. When interest rates are at 6% (as an example), then money does not sit idle for very long or accumulate without limit in your current account – you will invest those monies in, say, a 5-year Treasury Note (another example), rather than earn basically nothing in a checking account. But when interest rates are at 1%, the urge to do so isn't as much. In this situation, having the cash available anytime offsets the meager 1% interest rate alternative.

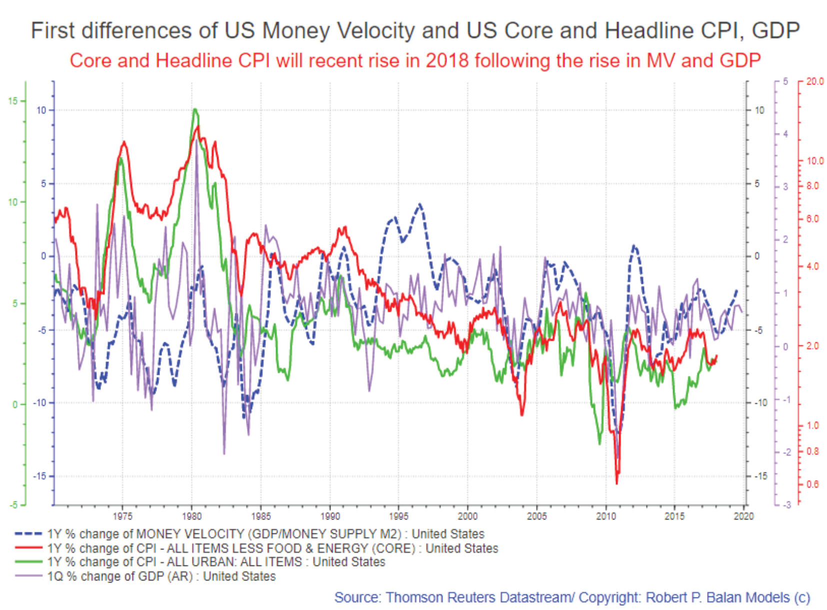
The two previous MV charts make this clear: interest rate moves tend to precede movements in money velocity, which is what we would expect from a causal relationship such as this – there is a positive correlation between interest rates, and interest rates are the lead variable in the relationship. The MV conundrum during the GFC becomes clear – MV plunged simply because interest rates fell, taking away the incentive to invest longer-term.

And this is where the link between interest rates and MV becomes significant -- changes in money velocity (RoC) cause changes in inflation. Higher interest rates push changes in Money Velocity higher, which in turn, pushes up Core CPI. Then it is easy to see why rising interest rates push up Core CPI after a lag, via the MV transmission link *(see 1st chart on this page)*.

The relationship between these three variables is very reflexive, as interest rates are affected by inflation, or more properly by the expectations of inflation. And expectations about inflation tend to follow actual, realized inflation. This is where it becomes scary, rising interest rates, and more importantly rising money velocity, create a very unfortunate backdrop of rising inflation. This is the origin of the persistence of the trending nature of inflation and its concomitant 'long tails': higher rates create higher velocity, which creates higher inflation, which in turn, cause higher rates. However, the converse has been true, and for nearly 40 years money velocity, interest rates, and inflation have been falling -- 40 years of bliss for monetary policymakers.







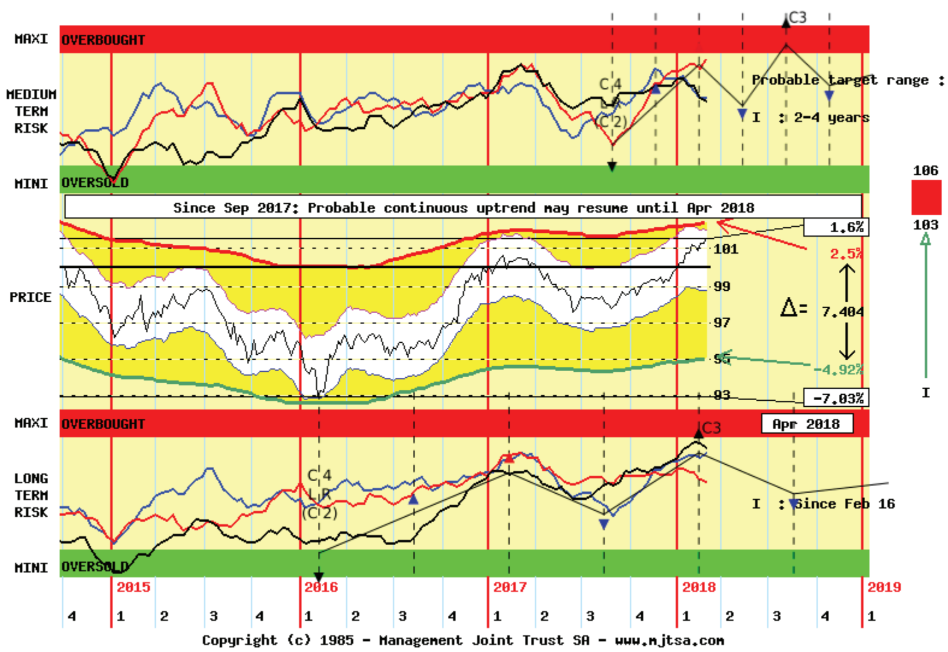
If you combine changes in money velocity with other growth variables, you can easily see why Core CPI will be persistently ascendant in 2018. The M2 Money Supply is not the only monetary aggregate that has the same predictive properties – the Zero Maturity aggregate (MZM) also does the same job and has the advantage of sharp inflection points (s*ee 2nd chart above*).

You can also add the US GDP to round up your CPI forecasting toolbox, and that also provides satisfactory results (s*ee 3rd chart above*) – **Core CPI will be rising during most of 2018.**

Inflation anticipations may subside until end Q1, yet should rise again in Q2

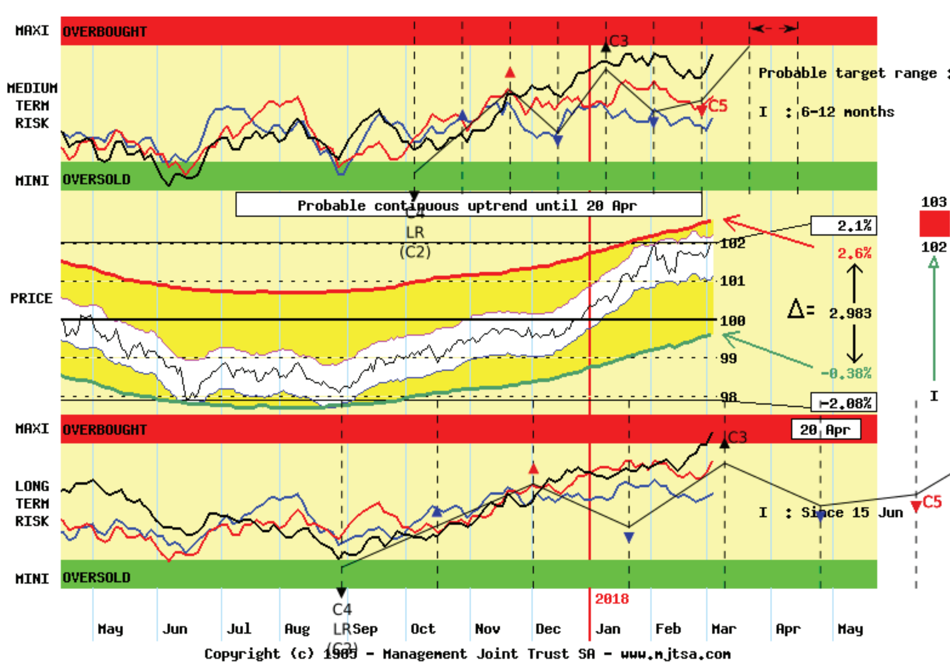
We are late in the business cycle and typically, a tight labour market, rising commodities and weakening US Dollar are putting upside pressure on prices. The inflation dynamics have started to accelerate, and the market seems to anticipate that they could continue to do so, as proxied for example the strong performance of breakevens (Tips vs Treasuries) and Gold over the last 3 months. In this article, we will consider these market expressions of inflation, and several others, in order to assess the current state of the inflation perception by the markets and its dynamics going forward.

TIP/IEF - Weekly graph or the perspective over the next 2 to 4 quarters



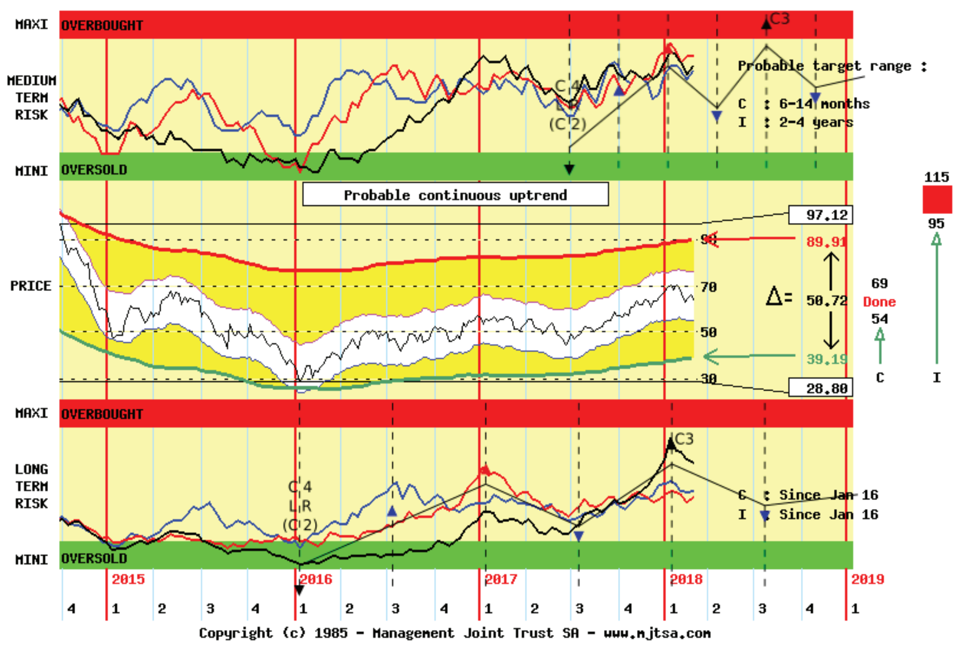
The TIP to IEF ratio compares inflation protected Treasuries vs Treasuries. When investors feel there is not enough inflation priced into Treasuries, they will buy Tips rather than Treasuries, the breakeven ratio then rises. Vis versa, when investors feel that there is too much inflation priced into Treasuries, they will revert to these and the ratio will fall. **Over the last 6 months, the ratio has been rising steadily, yet on both our oscillator series (lower and upper rectangles), it may be approaching an intermediate top and could consolidate into end Q1, and perhaps early Q2. Following that, the ratio should accelerate once more towards the Summer** as shown on our medium term oscillators (upper rectangle). Indeed, the uptrend does not seem exhausted yet, and there is still 2 to 5% upside left according to our I Impulsive targets up (right-hand scale). This is quite substantial given the low level of historic volatility of the ratio.

TIP/IEF - Daily graph or the perspective over the next 2 to 3 months



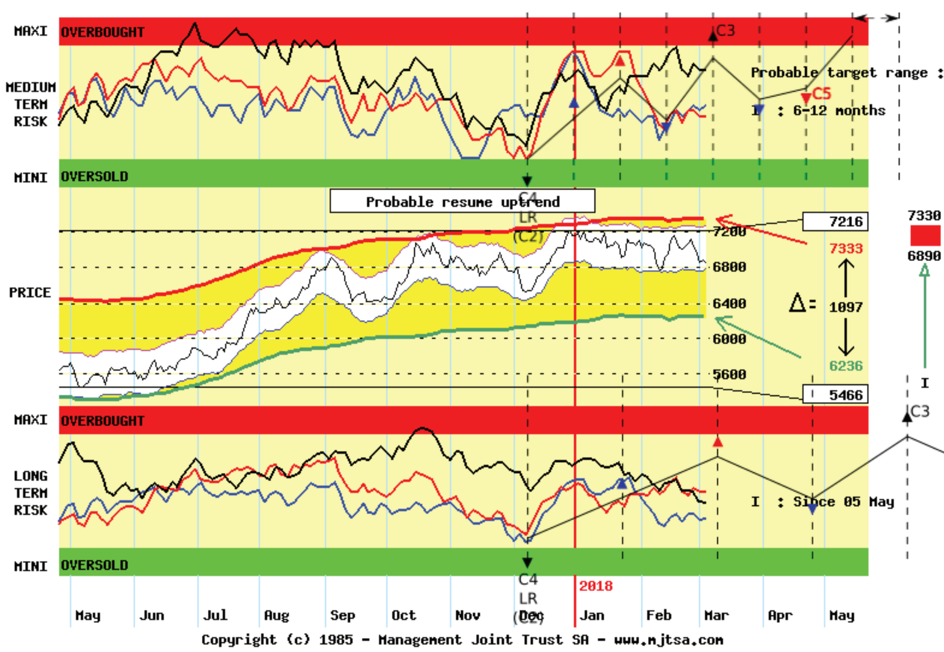
On our Daily graph, the uptrend sequence we show on our medium term oscillators (upper rectangle), and which is confirmed by our Automatic Messaging (message in the middle rectangle), would imply that the ratio could rise into late April. That said, our I Impulsive targets up (right-hand scale) have almost been reached and **the upside potential could be almost exhausted**. We hence show another sequence on our long term oscillators, which we expect to top earlier, probably over next week or so (lower rectangle). Given this discrepancy in timing, **we do not expect a huge sell-off of the breakeven ratio, but rather a high level consolidation, which could start soon and take place over the next couple of months. Following that, the ratio could start accelerating up again from early/mid Q2 into the Summer**.

Brent Oil
Weekly graph or the perspective over the next 2 to 4 quarters



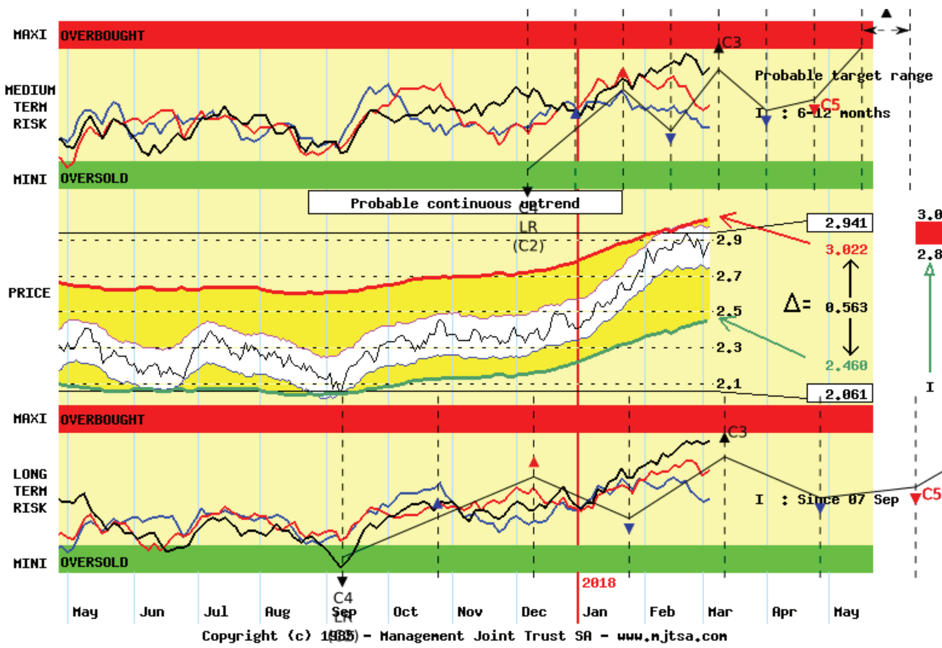
Inflation expectations have been closely linked to the rise of Commodities over the last 6 months. On our Weekly graph, Oil seems to have reached an important intermediate top on our long term oscillators (lower rectangle). The correction that follows may however be temporary. Indeed, on our medium term oscillators (upper rectangle), **we would expect Oil to correct into early Q1, before it reaccelerates up into mid year, possibly the Summer**. On the target front, we have reached the higher end our C Corrective targets up (right-hand scale) in the high 60s USD/barrel. Above that, the **next levels of targets could potentially reach up to the USD 100 mark/barrel. If this scenario (or even half of it) materialises during Q2, it should trigger a new acceleration in inflation expectations.**

Copper LME Spot USD/ton
Daily graph or the perspective over the next 2 to 3 months



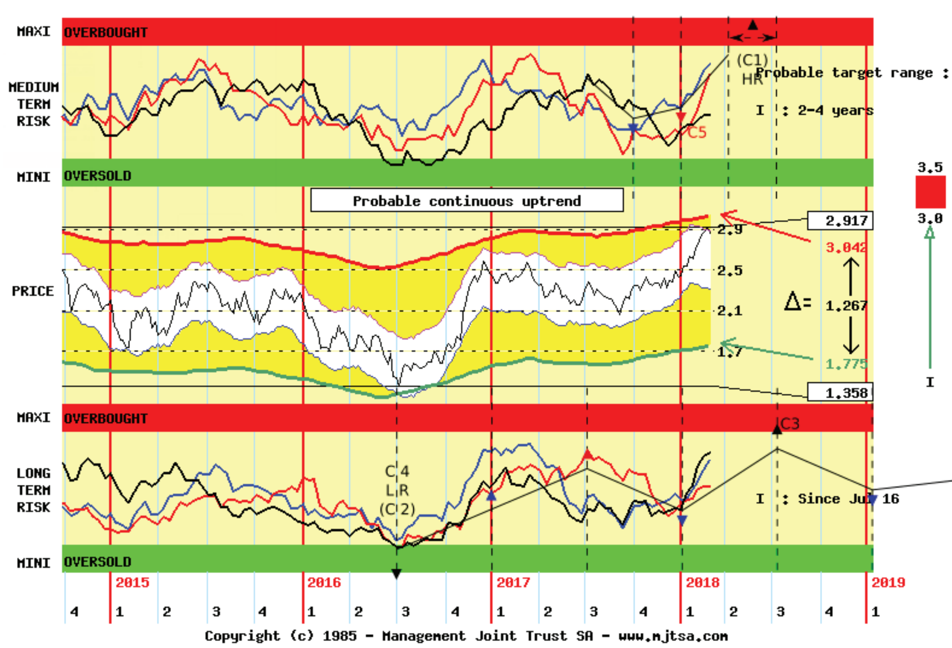
On this Daily graph, Copper may have already entered a high level consolidation. As show on both oscillator series (lower and upper rectangles), **we expect Copper to push slightly higher over the next week or so, before it consolidates down into April. Following that, we would await that Copper accelerates up again, possibly into mid year and perhaps even the Summer.**

US10Y Benchmark Bond Yields
Daily graph or the perspective over the next 2 to 3 months



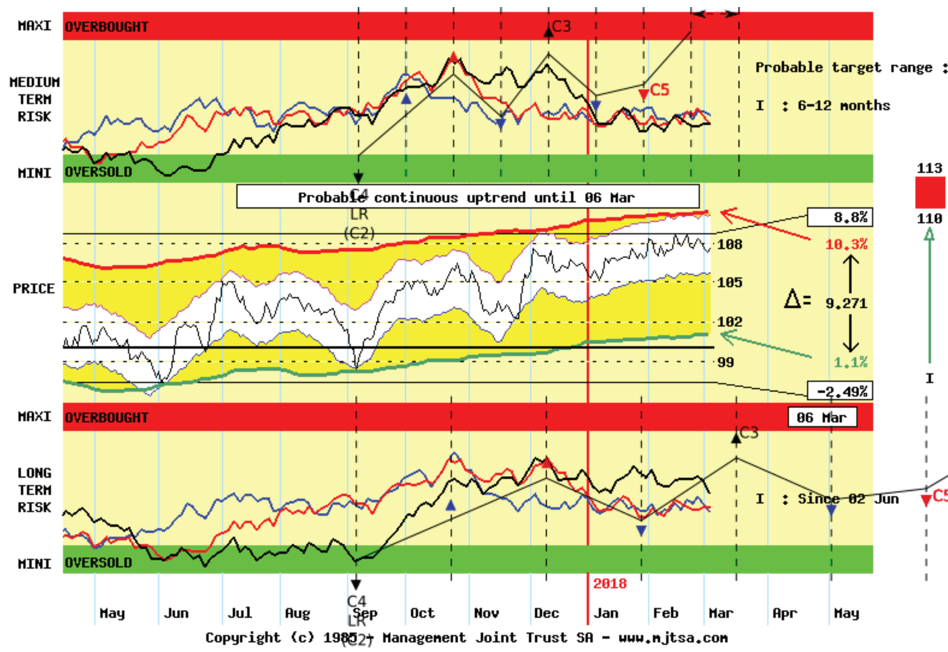
If the rises in inflation expectations pauses over the next couple of months, while Brent and Copper consolidate, US long term interest rates should follow suit. This effectively seems to be the case: on both our oscillator series (lower and upper rectangles), we would expect US 10Y benchmark bond yields to make an intermediate top early March and start consolidating towards early, mid April**. Indeed, the move up since September is quite exhausted for now, it has reached our I Impulsive targets to the upside (right-hand scale). The C Corrective potential to the downside we can calculate is between 25 and 45 bps (0.5 to 0.8 times our historical volatility measure “Delta”, here at 56 bps; middle rectangle, right-hand side), and could **hence bring the US 10Y treasury yield back into the 2.7 – 2.5% range**. Following that, US long term yields could start accelerating up again towards mid year (as shown on our long term oscillators series; lower rectangle).

US10Y Benchmark Bond Yields
Weekly graph or the perspective over the next 2 to 4 quarters



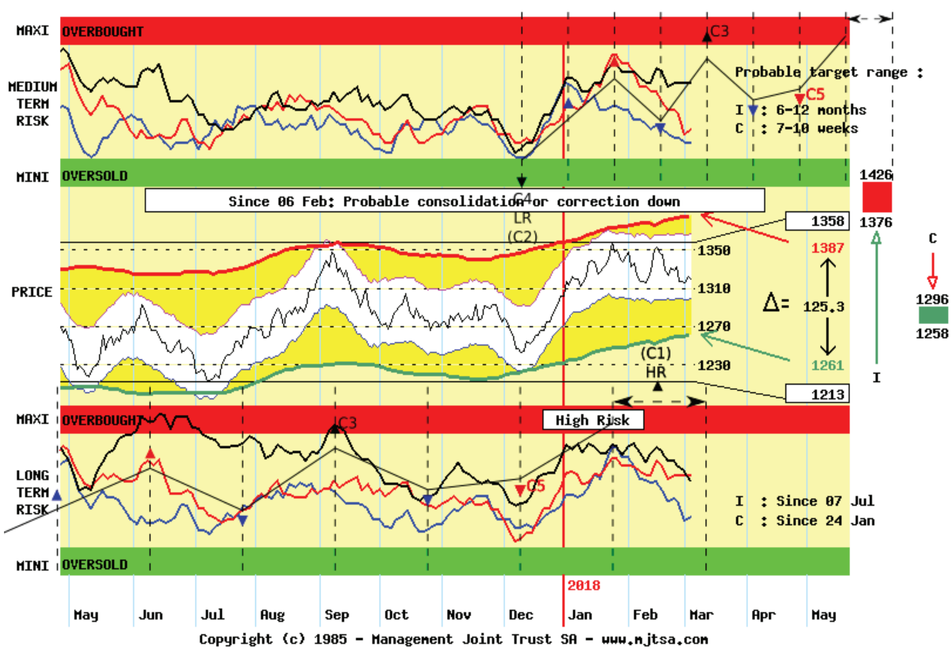
Our Weekly graph would confirm this view: our medium term oscillators (upper rectangle), may be entering a High Risk zone, while our longer term oscillators (lower rectangle) would still have time to rise towards mid year / early Summer. **This may confirm a succession of two final tops, one towards the lower end of our I Impulsive targets up (right-hand scale) around 3.0%, which is probably currently being made. Another in 4 to 5 months time towards the higher end of these I Impulsive targets up towards 3.5%.**

XLF - Financial Sector SPDR Fund / SPY - SPDR S&P 500
Daily graph or the perspective over the next 2 to 3 months



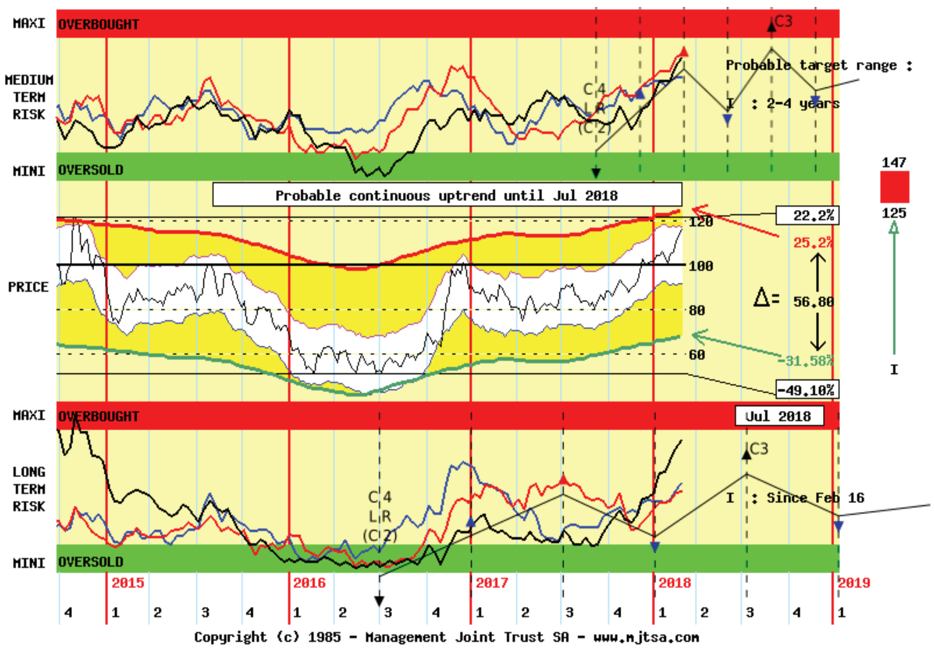
The Financials sector also confirm that long term yields, and by analogy inflation expectations, may be reaching an intermediate high. Indeed, on both our oscillator series (lower and upper rectangles), its Daily relative graph vs the S&P500 is also getting ready to consolidate down. **A top is expected on both sequence between now and mid March, and the consolidation could last into April. Following that, Financials should outperform again towards mid year.**

Gold Spot USD/oz
Daily Graph or the perspective over the next 2 to 3 months



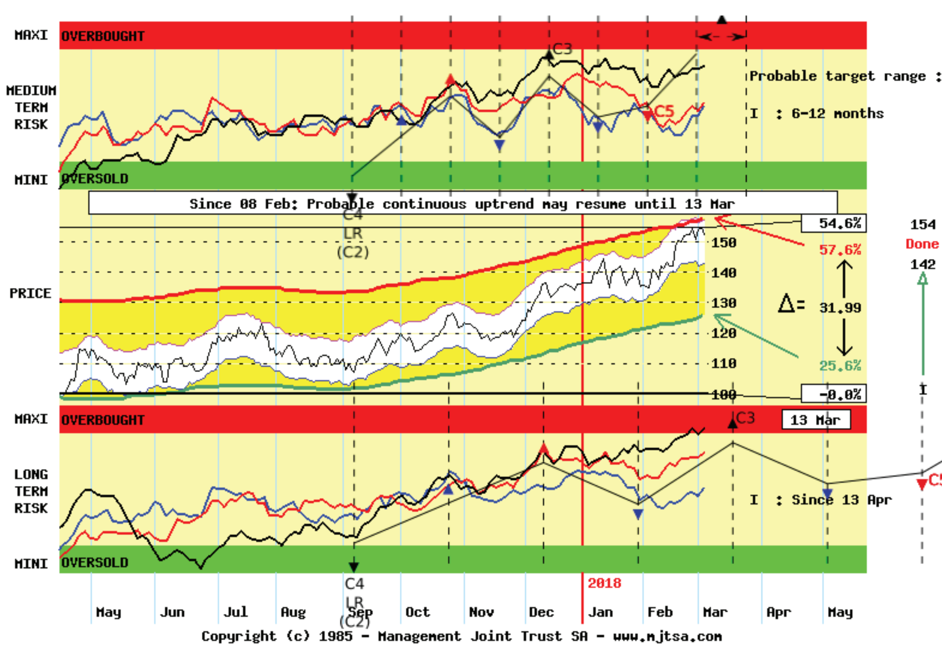
On the back of higher inflation expectations and a weaker US Dollar, Gold has been quite strong since December. **Yet, on our long term oscillator series (lower rectangle) it has probably reached a High Risk situation. Our medium term oscillators (upper rectangle) may justify one last push up over the next couple of weeks, yet following that Gold should correct down into early / mid April**. Our C Corrective targets to the downside (right-hand scale) suggest that Gold may move back below 1'300 USD/oz and possibly even towards USD 1'250 USD/oz. Such a correction down in Gold would fit quite well with a pause in the rise of inflation expectations as well as the US Dollar bounce we expect.

XME - SPDR S&P Metals & Mining ETF / HUI - Gold Bugs Index
Weekly graph our the perspective over the next 2 to 4 quarters



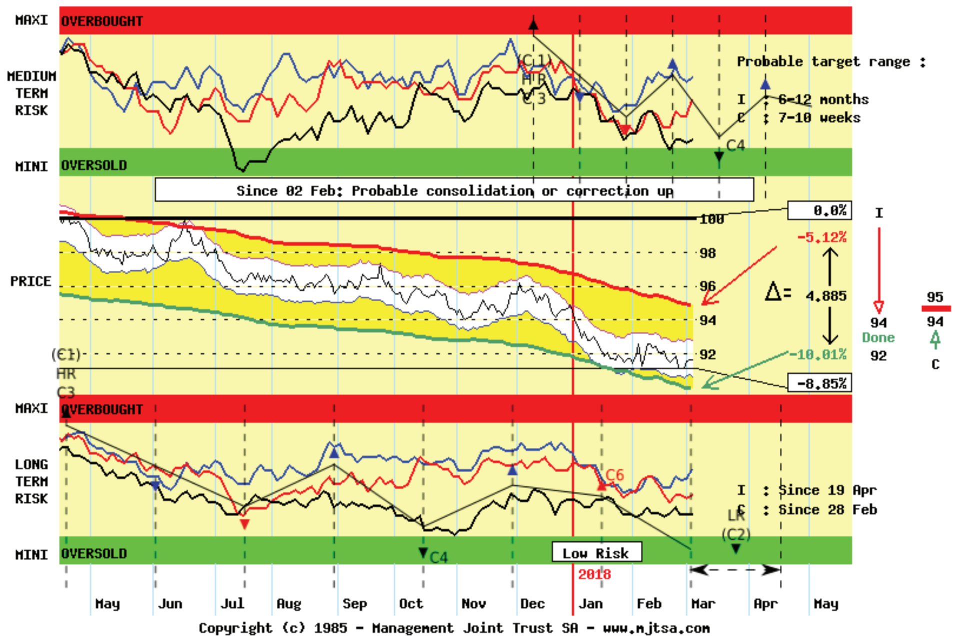
On the sector front, an interesting pair trade we have been monitoring, is the ratio between Diversified mining and Gold mines (XME vs HUI). **It is quite amazing how much this Weekly graph resembles the one on US long term yields shown two pages above. Similarly, we would also expect a succession of two tops over the next 6 months:** one pretty much now as shown on our medium term oscillator series (upper rectangle). The correction that follows could last into early/mid Q2. Another towards mid year, perhaps the Summer ,as shown on both oscillator series (lower and upper rectangles). Our I Impulsive targets to the upside (right-hand scale) still leave quite a lot of outperformance potential for XME vs HUI. Hence, the last leg up into the Summer could be quite strong. This we believe is quite bullish for US long term yields and inflation expectations from mid Q2 into Q3.

XME - SPDR S&P Metals & Mining ETF / HUI - Gold Bugs Index
Daily Graph or the perspective over the next 2 to 3 months



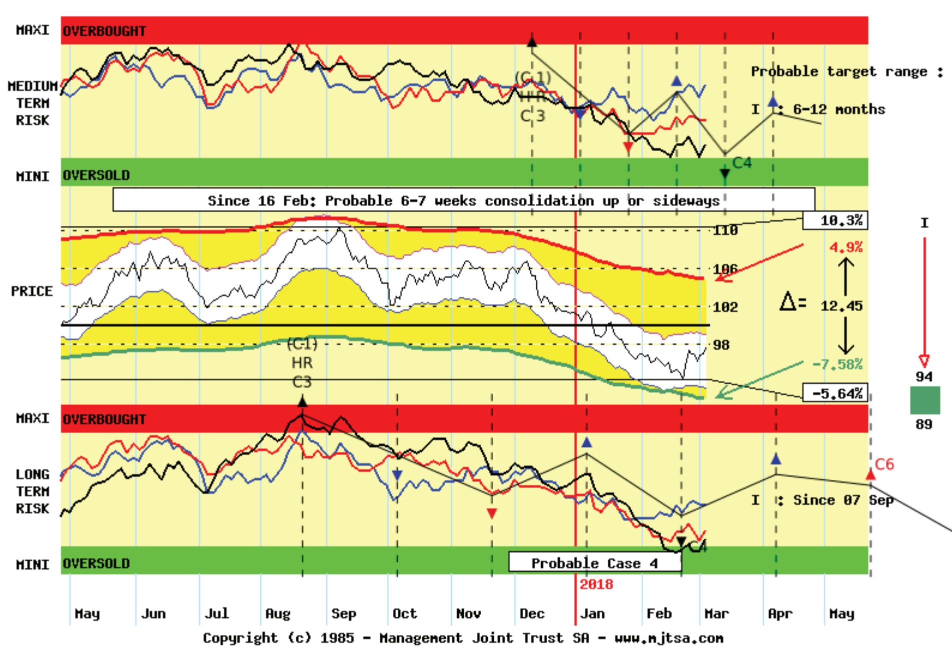
On the Daily graph of XME vs HUI, the picture is also similar to the ones on US long term yields, the TIP/IEF breakeven ratio or the Financials sector vs the S&P500. Indeed, on both oscillator series (lower and upper rectangles), we expect it to top out over the next couple of weeks and enter a consolidation period, which could last into mid/end April, before it accelerates up again towards the Summer.

DVY - iShares Select Dividend ETF / SPY - SPDR S&P 500
Daily Graph or the perspective over the next 2 to 3 months



We now look at the other side of these inflationary/reflationary trades, and for example at he Daily graph of higher yielding Equities (DVY ETF) vs the S&P500. These bond proxies have underperformed during most of 2017 on the back of the persistent risk-on environment which then prevailed, and since September especially have accelerated down as long term Treasury yields have started to rise again. On our long term oscillator series (lower rectangle), **we believe DVY is now in a Low Risk situation vs the S&P500 and is probably getting ready to bounce**. On our medium oscillators (upper rectangle), **the ratio could see a last downside retest over the next couple of weeks and then start moving up. This is the exact opposite of what we expect on the reflationary trades and ratios covered above.**

Utility sector - Dow Jones STOXX Europe / Dow Jones STOXX Europe 600
Daily Graph or the perspective over the next 2 to 3 months



In Europe, the situation is similar. Indeed, the ratio of the Utility sector vs the Europe Stoxx 600 is also reaching intermediate lows on both oscillators series (lower and upper rectangles). **Over the next couple of weeks, it may start to bounce, possibly into early / mid April. Following that, Utilities should underperform again, possibly towards mid year.**

Concluding remarks

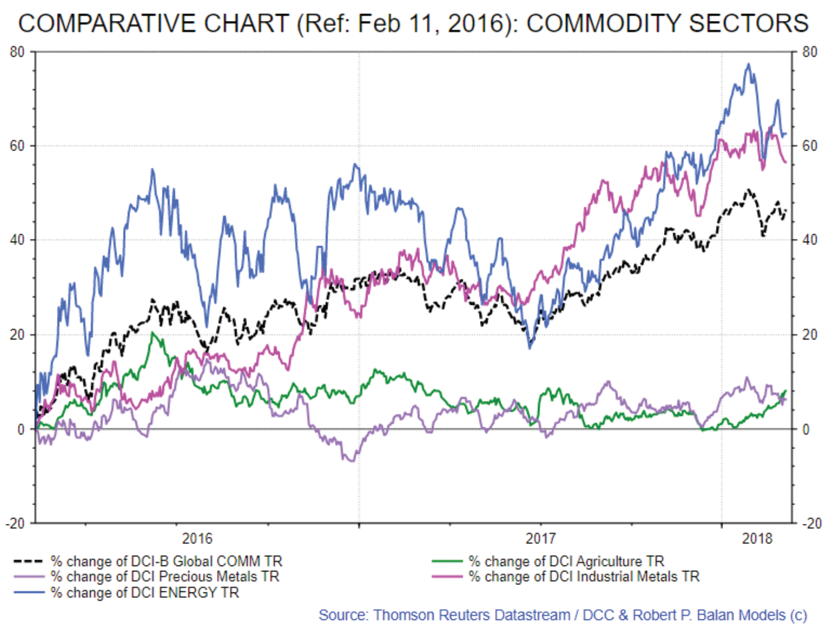
Inflation expectations, Oil, Copper, Gold, long term yields and related sector trades are currently approaching intermediate tops. We expect them to consolidate at high levels probably until early / mid April. Following that, from mid Q2, inflationary/reflationary themes should accelerate up again possibly towards midyear, perhaps the Summer. The sector mix, which we see outperforming during this short pause in inflationary dynamics is quite defensive (high yielding stocks, Gold mines, Utilities), which may imply a rather risk-off bias.

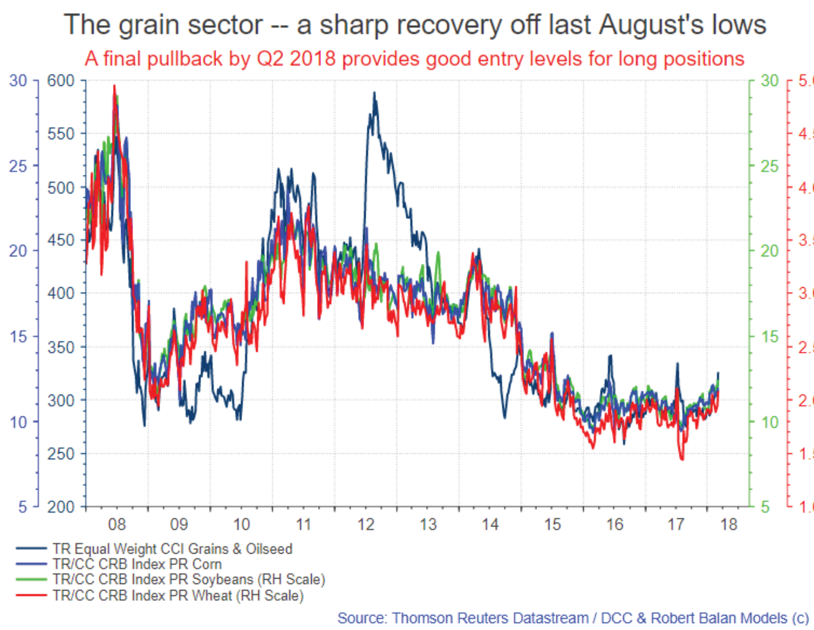
40 / The long-term price action in the grains sector is about to form a major bottom in Q2 2018

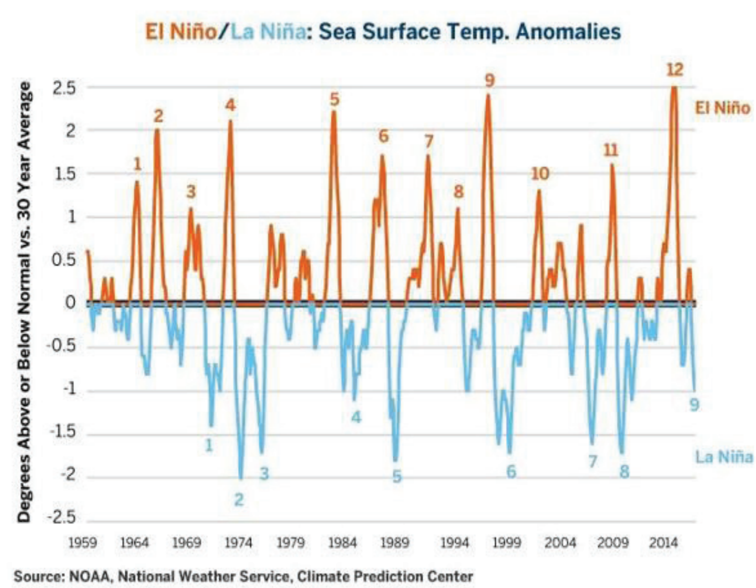
The agriculture sub-sector has been one of the most neglected sub-sectors in the commodities asset class, and has just edged out the precious metals sub-sector for the most laggard position since the cyclical trough of commodities in February 11, 2016 *(see 1st chart on this page).*

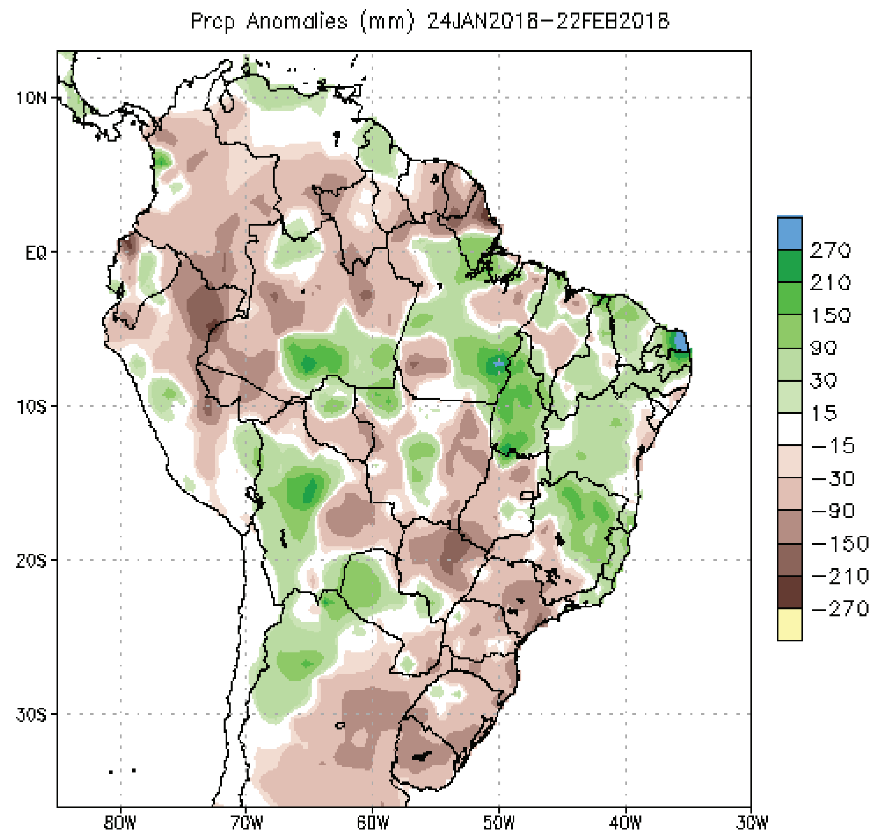
Nonetheless, we believe there are good reasons to revisit the grains sector, as any significant setback from current levels may provide entry levels for long trades positioned for another episodic surge of prices over the next year or so. . Over the past decade, grains have exhibited behavior which can be very profitable if timed correctly. Technically, grains are starting to show stable structures as corn, soybeans, and wheat prices have been rising strongly off the lows seen in August last year. A decline in Q2 2018 may provide good entry levels for long trades. *(see 2nd chart on this page).*

Weather developments are also lending a positive spin to the agriculture sector – the dreaded La Nina phenomenon is making an impact on grain prices. . La Nina is a cooling of the water in the equatorial Pacific Ocean that takes place at irregular intervals. The weather condition typically lasts from 10 to 12 months. The phenomenon favors the northern jet stream and that tends to weaken the southern jet stream – which in turn drives more moisture towards the northern part of the United States, while the southern tier stays drier than normal. The latter event is what makes La Nina important to grain prices. The La Nina event is the obverse of the more famous El Nino – La Nina is the other side of the coin, so to speak, of El Nino (*see 3rd chart on this page*).









Data Source: CPC Unified (gauge-based & 0.5x0.5 deg resolution) Precipitation Analysis Climatology (1981–2010)

As we head into spring season, the current La Nina weather pattern could make the southern portion of the United States experience periods of drought-like conditions. Parts of Southern California, Arizona, Utah, Colorado, New Mexico and Texas could be a lot drier than average over coming months. **The dryness is already starting to be felt in those regions**. That becomes more significant in a few weeks, when farmers across the US will start planting crops for the 2018 season.

The outlook of La Nina on the prowl is what has been pushing grains higher in the past several weeks. **If the 2018 crop year does not turn out to be the sixth consecutive year of bumper production, we could see prices for grains move appreciably higher towards the middle of the year**. It is of course possible that La Nina will not materialize in the US; on the other hand, dry weather could turn out to be worse than expected, and could spread across the fertile plains of the country. What is sure is that the prevailing weather conditions in the near-term will determine the size of the crop yields, and therefore the path for the prices of corn, wheat, and soybeans over the months ahead. We believe there is a good chance that La Nina impact will be at least as expected (which is bad for crops), but it could be much worse than expected (which is very good for prices).

The current example of an errant weather regime can be found in Argentina. Argentina and large swaths of South America have been suffering their worst drought in decades and this has created a bullish spiral in soybean futures in the last few weeks, even in the midst of huge global stocks.

Developments over the past several years could make the current La Nina episode very positive for prices, even if we do not get the worse that the weather phenomenon has to offer. The world has become accustomed to abundant supplies of agricultural commodities over past years, causing prices to moderate. There were significant shortages in 2008 and 2012 caused by adverse weather developments (El Nino in these instances) but those memories have faded. The prices have become consistently low, so most consumers have been purchasing requirements on a hand-to-mouth basis rather than hedging or locking in price risk. A La Nina or another weather event in 2018 could therefore have potential to push prices appreciably higher.

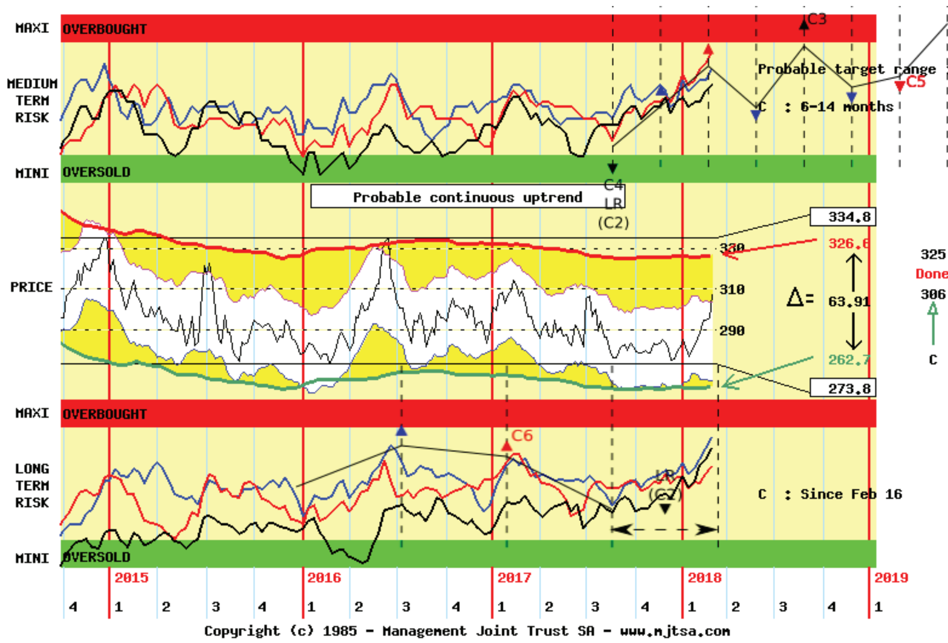
The drought of 2012 provides a stark example. In 2012, agricultural prices exploded higher, and supply deficits took corn, soybeans, and wheat to dizzying heights. In 2012, the price of wheat rallied on the back of dry weather; the price went to a high of $9.4725 per bushel -- more than double the price of wheat today. Corn reached $8.4375 per bushel, while beans traded to a high of $17.9476 in 2012. Corn price today is less than half the price that traded in 2012; beans are also appreciably lower today compared to that prevailing in 2012.

Demand limits the downside potential for prices while any unexpected weather event could lead to explosive price action on the upside. Grain prices have been firm despite significant stock levels because of the rising level of global demand from increasing population and wealth has been keeping pace. Each quarter there are twenty million more people on the earth and more mouths to feed. The global growth uptick means more money is available to bus these staples, putting upward pressure on prices. **There has been five consecutive years of bumper crops, but there is no guaranty that we will see the sixth of such bumper crops**. An opportunity to open long positions will come within the next few weeks (in Q2 2018), We will be tracking agriculture price, and inform readers of such an opportunity.

Agriculture Commodities are typically late cycle reflationary trades; Grains especially have started to react

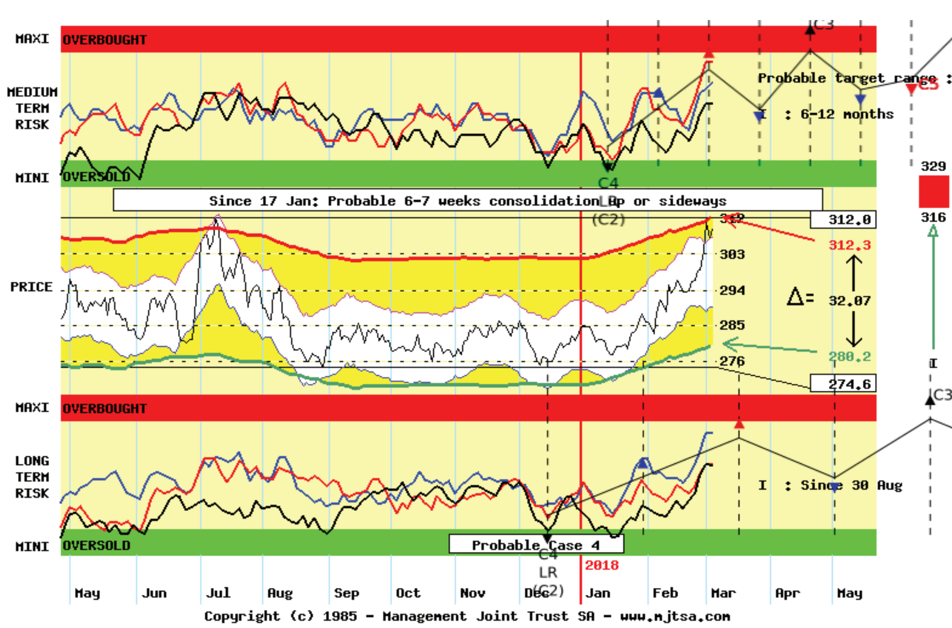
While Oil, Industrial metals and even Gold were strong performers in 2017, most agricultural commodities have remained subdued. Notable exceptions include Cotton and Lumber, which are more pro-cyclical. Yet, over the last couple months, other agricultural commodities have started to move up. In general, Agricultural Commodities are very late cycle reflationary trades, and this is exactly where we believe we are today. We would hence expect that Agricultural Commodities gather further momentum as the year progresses.

Goldman Sachs Agriculture Index
Weekly graph or the perspective over the next 2 to 4 quarters



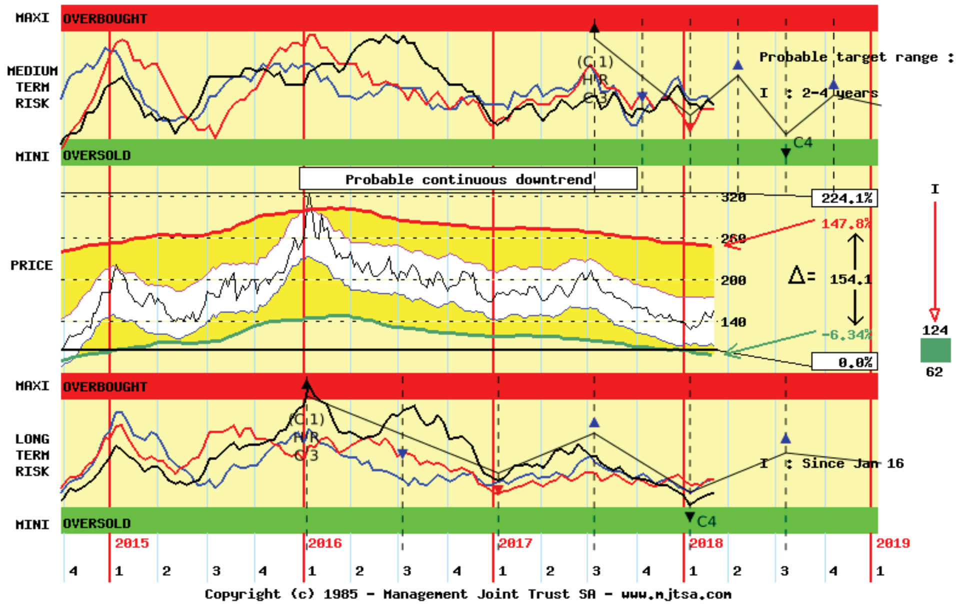
The GS Agricultural Index lingered on lower throughout last year. We believe it has now reached a Low Risk position on our long term oscillators (lower rectangle). Our medium term oscillators (upper rectangle) started to move up mid last Summer. **They have probably reached an intermediate top and could retrace some of their recent gains into late Q1 / early Q2. Following that, we expect the GS Agricultural Index to resume up, possibly until late Summer**. The current trend up for now is still labeled as a correction and it would need to make it above our C Corrective targets to the upside (above 325; right-hand scale) in order to really start accelerating.

Goldman Sachs Agriculture Index
Daily graph or the perspective over the next 2 to 3 months



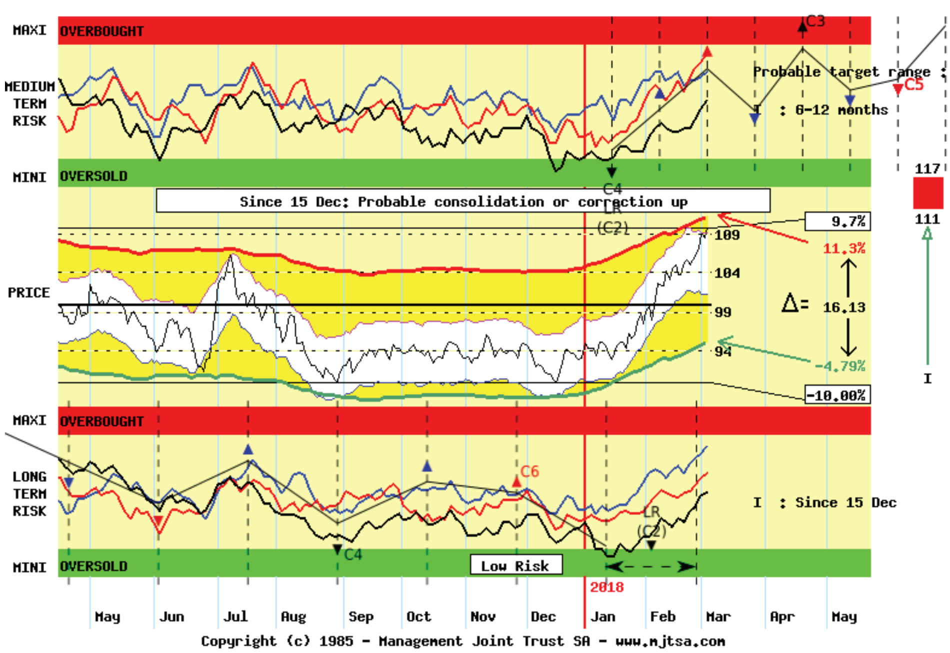
On our Daily graph, the acceleration of the GS Agricultural Index is already visible. It has now reached the lower end of its I Impulsive targets to the upside (right-hand scale) and their higher end still leaves more upside potential towards 330 over the next few months. Once we achieve these levels, we may be able to consider **much higher levels over the next few quarters**. In the meantime, our long term oscillators (lower rectangle) may enter a consolidation until late April, while our medium term ones (upper rectangle) are still quite dynamic to the upside. **Coordinating both, we would expect some consolidation into late March, a neutral situation during April and a new acceleration up during May and June**.

Goldman Sachs Agriculture Index / Brent Oil
Weekly graph or the perspective over the next 2 to 4 quarters



Agricultural Commodities are usually more late stage assets than industrial commodities. They are also less pro-cyclical and hence often appear more defensive. Their ratio vs Oil, for example, has been on the opposite side of the reflationary trade since early 2016. Yet, on our long term oscillators (lower rectangle), Agricultural Commodities may have just made an important intermediate low vs Oil. This may be signaling an important turning point. That said, on our medium term oscillators, one last retest is still possible until early Summer. Coordinating both, we can probably conclude that while **Oil corrects, probably into April, Agricultural Commodities should remain strong on relative basis. Following that, they will probably underperform again into the Summer until they reach a new relative low sometime in Q3 2018. Following that, they could start to take up the lead in the Commodity space.**

Goldman Sachs Agriculture Index / TLT - iShares 20 Year Treasury Bond ETF
Daily graph or the perspective over the next 2 to 3 months



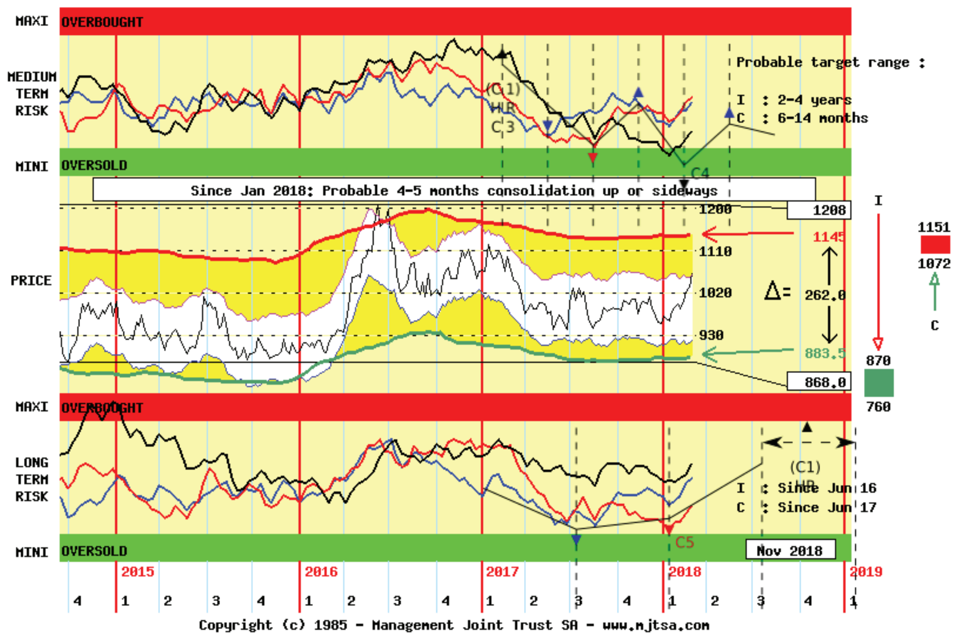
From the graph above, we concluded that Agricultural Commodities were probably less reflationary than industrial commodities (Oil for example). Nevertheless, they are still a reflationary asset. Indeed, on this graph, we compare Agricultural Commodities to long term Treasuries (TLT ETF). As we can see, the ratio has built a base between September and December (Low Risk; lower rectangle) and as for other reflationary assets, it has since accelerated up quite substantially. On our medium term oscillator series (lower rectangle), **the ratio is now in a strong uptrend. It may consolidate down a bit during March, but should accelerate up thereafter, possibly towards mid-year. This is very similar to what we expect on other commodities and more generally on reflationary assets.**

Initial remarks

Agricultural Commodities have recently broken out of their persistent downtrend. We expect this bounce to gain traction over the next few months and possibly continue higher towards late Summer at least. Indeed, Agricultural Commodities are late stage reflationary assets and at some point during 2018, we would even expect them to take on the lead in the Commodity space (probably once industrial commodities such as Oil and Copper, top-out sometime towards early Summer). Shorter term, Agricultural Commodities may correct a bit towards late Q1 / early Q2. They should then be bought (BUY the Dips).

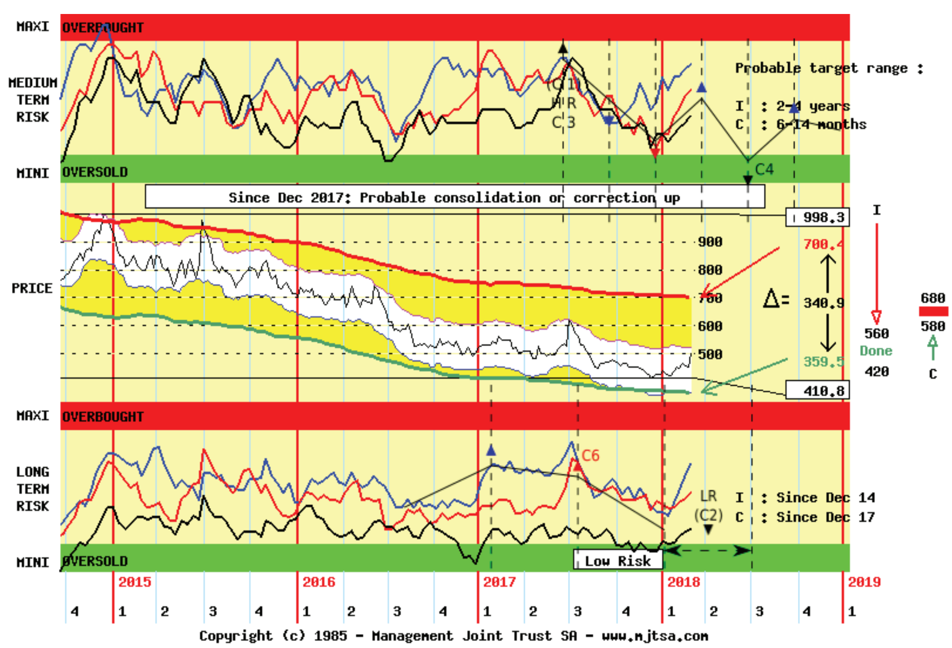
Over the following pages, we will review several Agricultural Commodities. We will start with Grains which have probably reversed up and are showing strong potential over the next few quarters.

Soybeans Three Months (Chicago Futures, Mar)
Weekly graph or the perspective over the next 2 to 4 quarters



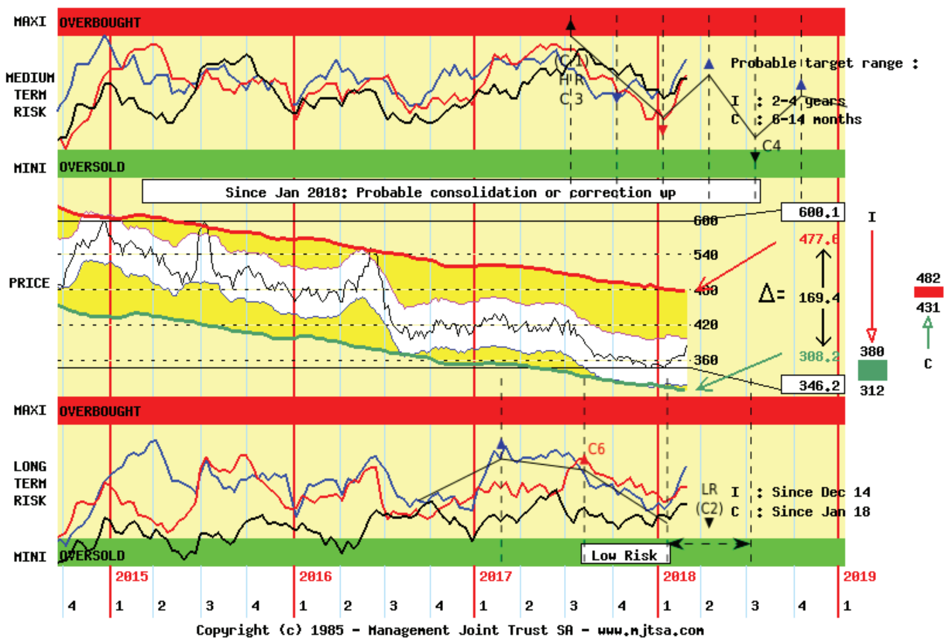
Soybean is currently the strongest of the Grains. It bottomed out in Q2 2017 and formed a base with higher lows towards year-end 2017. Since then, it has been accelerating up. On both our oscillators series (lower and upper rectangles), **we would expect it to continue higher at least into mid Q2 and probably into late Summer.** For now, the move up is still corrective (below the upper end of our C Corrective targets up range at 1'151; right-hand scale). Above these levels, the potential may be much more substantial.

Wheat Three Months (Chicago Futures, May)
Weekly graph or the perspective over the next 2 to 4 quarters



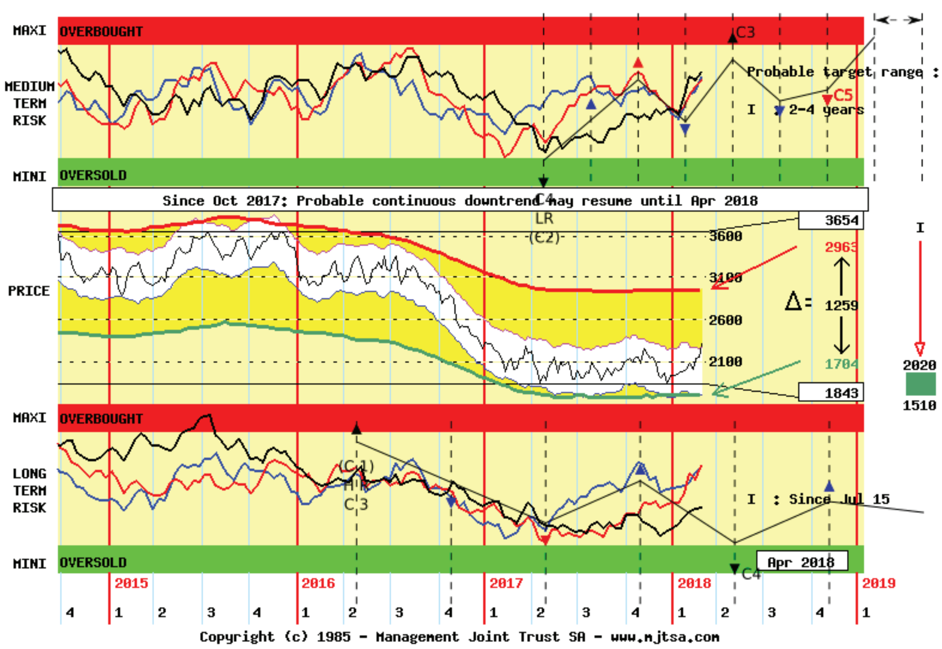
Wheat has been weaker that Soybeans. It took until December 2017 until it eventually bottomed out. Hence, for now, its reaction up is in its early stages. **Our long term oscillators are very low and in a "Low Risk" position (lower rectangle). On the other hand, our medium term oscillators could still justify on last push to the downside into mid-year**. We find some comfort from the fact that risk/reward seems quite advantageous. Indeed, our I Impulsive targets to the downside have bee reached (right-hand scale), suggesting **limited downside risk**, while our C Corrective targets to the upside could justify **between 15 to 25% further upside potential in the current rebound.**

Corn Three Months (Chicago Futures, May)
Weekly graph or the perspective over the next 2 to 4 quarters



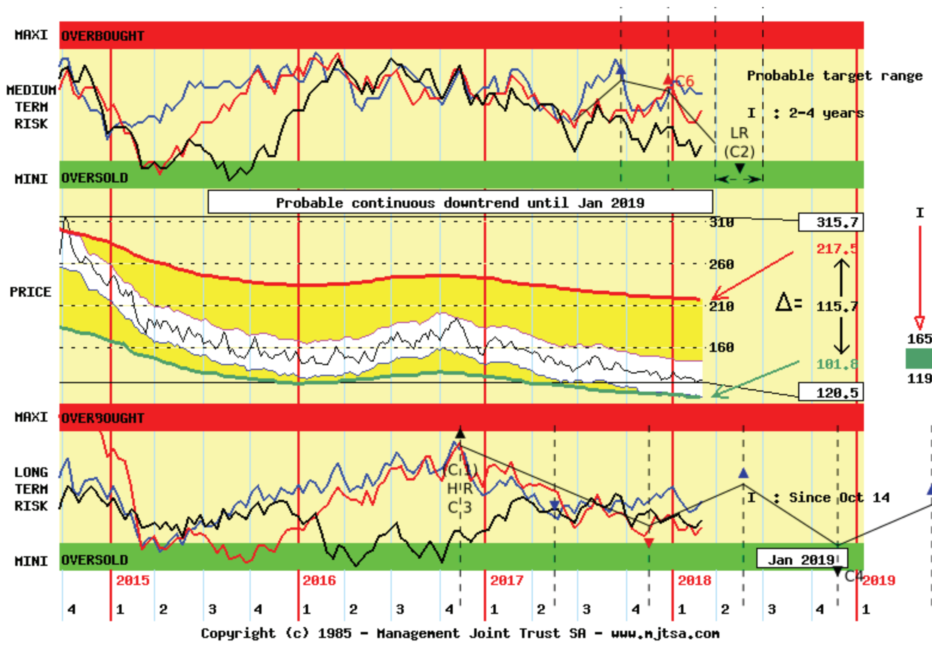
Corn is very similar to Wheat and it did also take until December until it finally started to rebound. While our long term oscillators (lower rectangle) are in a "Low Risk" position, or medium term oscillators (upper rectangle) could still justify one last sell-off towards mid-year. That said, the Risk/Reward on Corn is also quite advantageous. Indeed, our I Impulsive targets to the downside have been reached (right-hand scale), suggesting **limited downside risk**, while our C Corrective targets to the upside could justify **between 15 to 25% further upside potential in the current rebound.**

Cocoa Three Months (Nyf, May)
Weekly graph or the perspective over the next 2 to 4 quarters



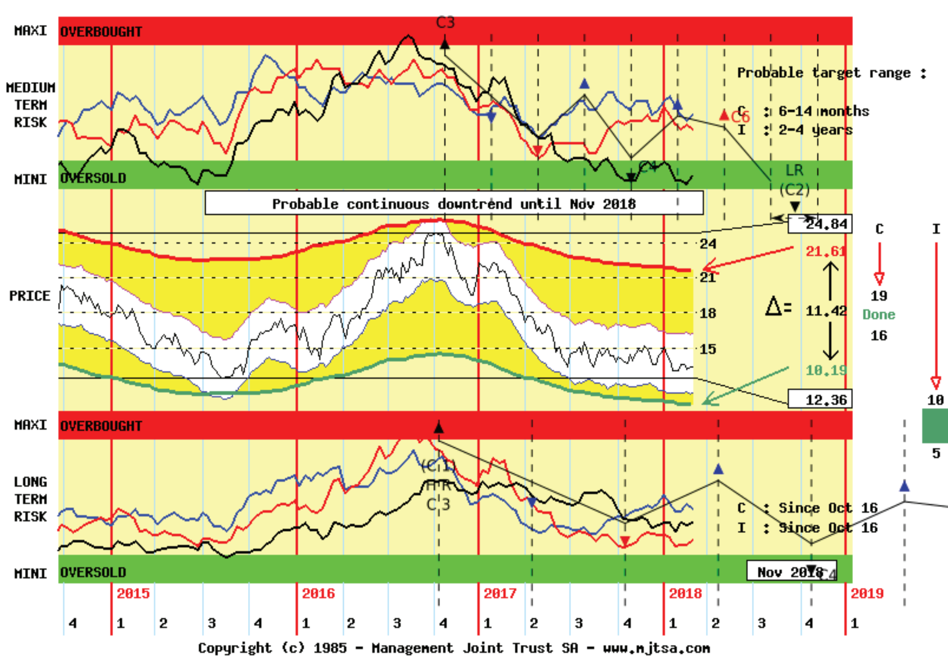
We now turn to the "Soft" segment of Agricultural Commodities and to Cacao, which has been forming a base since Q2 2017 and started to accelerate up from late December 2017. Going forward, the sequence we show on our long term oscillator series (lower rectangle) is supportive until Q4 2018. Our medium term oscillators (upper rectangle) would suggest **some retracement towards late Q2 2018, but in general the trend continues up towards year-end**. Here also, the Risk/Reward seems advantageous. Indeed, our I Impulsive targets to the downside have been reached (right-hand scale), suggesting limited downside, while the C Corrective **potential to the upside we can calculate is between 7 and 25%** (i.e. towards a range between 0.5 to 0.8 times our historical volatility measure "Delta", here at 1'259, added to the low of the graph).

Coffee Three Months (Nyf, May)
Weekly graph or the perspective over the next 2 to 4 quarters



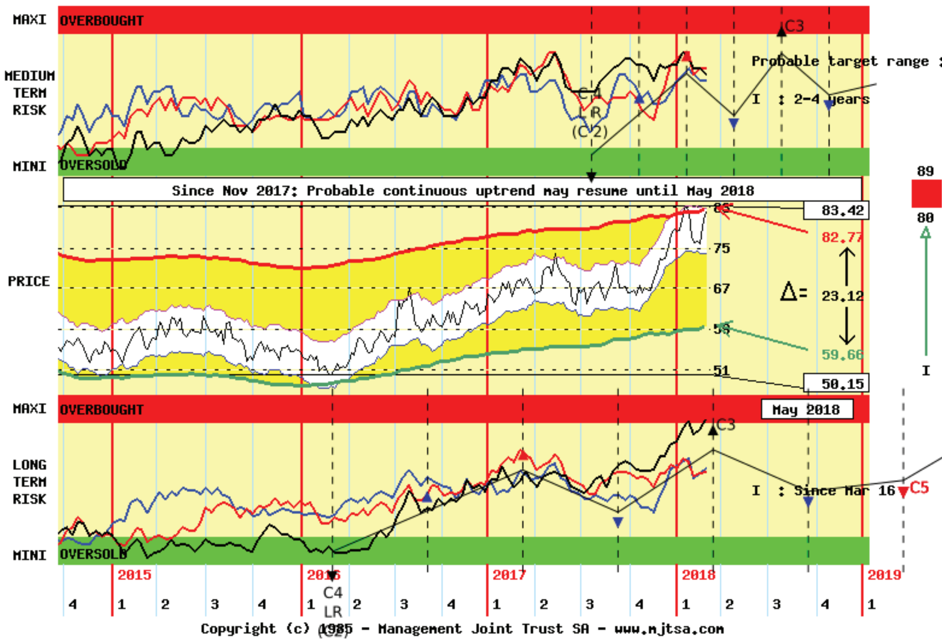
The downtrend on Coffee could also be nearing exhaustion. Indeed, our I Impulsive targets to the downside have now been reached. That said, both oscillator series (lower and upper rectangles) still show some scope for further declines: our medium oscillators (upper rectangle) indicate that the current sell-off may continue into Q2 2018, while our long oscillators may suggest that following a rebound in H1 2018, Coffee resumes lower into year-end. **It is hence still to early to call a reversal, or any significant bounce, on Coffee. This is especially true as for now, prices continue to remain subdued.**

Sugar - World Three Months (Nyf, May)
Weekly graph or the perspective over the next 2 to 4 quarters



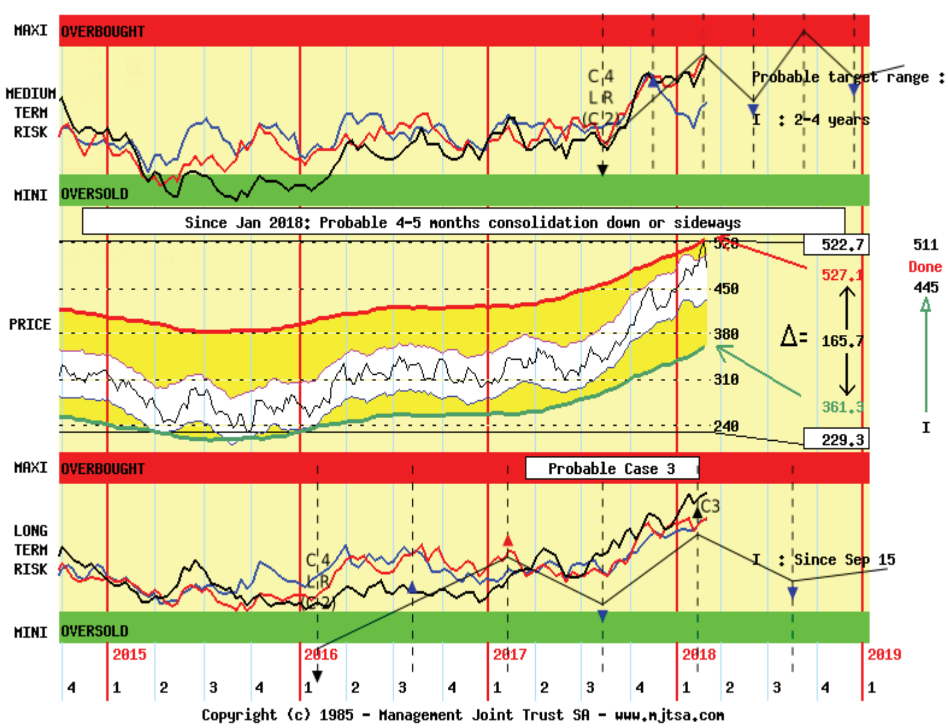
It also seems premature to call a rebound on Sugar. Indeed, on both our oscillator series (lower and upper rectangle), an important intermediate low could have been made early in Q4 last year. For now, the reaction up is non-existent, worse **from early Q2 2018, we would expect Sugar to resume lower towards late 2019. There is also significant downside risk remaining,** possibly below 10, and even towards 5 (circa 50% lower than today) according to our I Impulsive targets to the downside (right-hand scale).

Cotton Three Months (Nyf, May)
Weekly graph or the perspective over the next 2 to 4 quarters



We now switch to a different profile with Cotton, which is one of the more cyclical constituents of the Agricultural Index. Indeed, it started up almost two years ago and its uptrend is already quite mature. On our long term oscillators (lower rectangle), for example, Cotton has reached an important intermediate top, while on our medium term oscillators (upper rectangle), it may correct some during Q1 2018, yet could still accelerate up one more time towards mid-year. On the targets front (right-hand scale), **our I Impulsive targets to the upside could still justify a modest 5% of additional performance over the next couple of quarters.**

Lumber Three Months (CME, May)
Weekly graph or the perspective over the next 2 to 4 quarters



Similarly to Cotton, Lumber started its uptrend more than 2 years ago. It recently reached an important top on our long term oscillators (lower rectangle), while our medium term oscillators (upper rectangle) could see some correction during Q1 2018, before it moves up once more towards mid-year. **Here to, the uptrend is slowly getting exhausted as our I Impulsive targets to the upside (right-hand scale) have now been reached.**

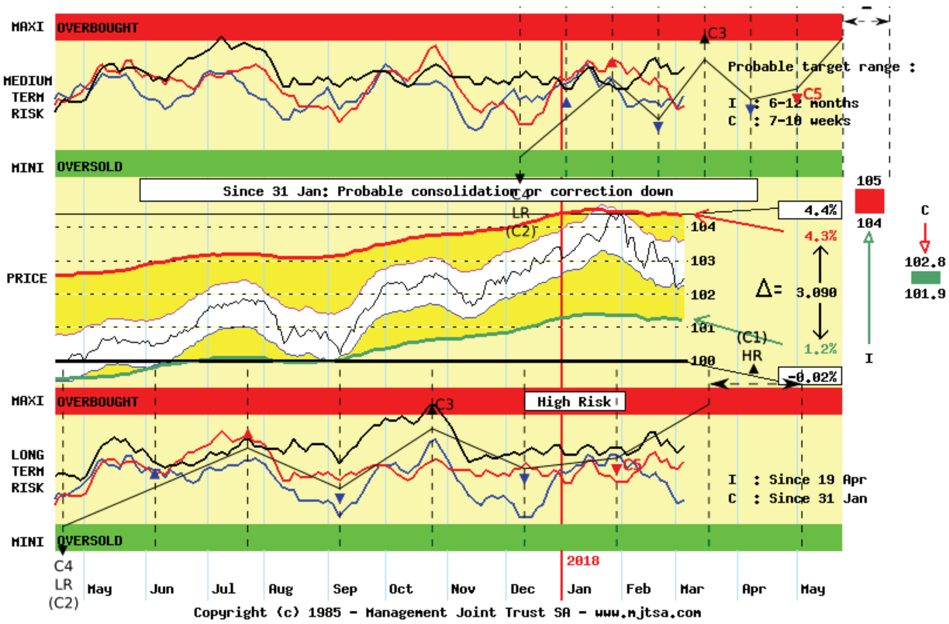
Concluding remarks

The Agricultural sector is hence quite differentiated. Grains and perhaps Cacao have started to bounce, their price potential is compelling and they look promising for the rest of 2018. Coffee and Sugar, on the other hand, are still down-trending, while Cotton and Lumber, following strong uptrends over the last 2 years, already seem quite exhausted with little upside potential left.

48 / Splicing the markets – Investment Grade Bonds are stuck between a rock and a hard place

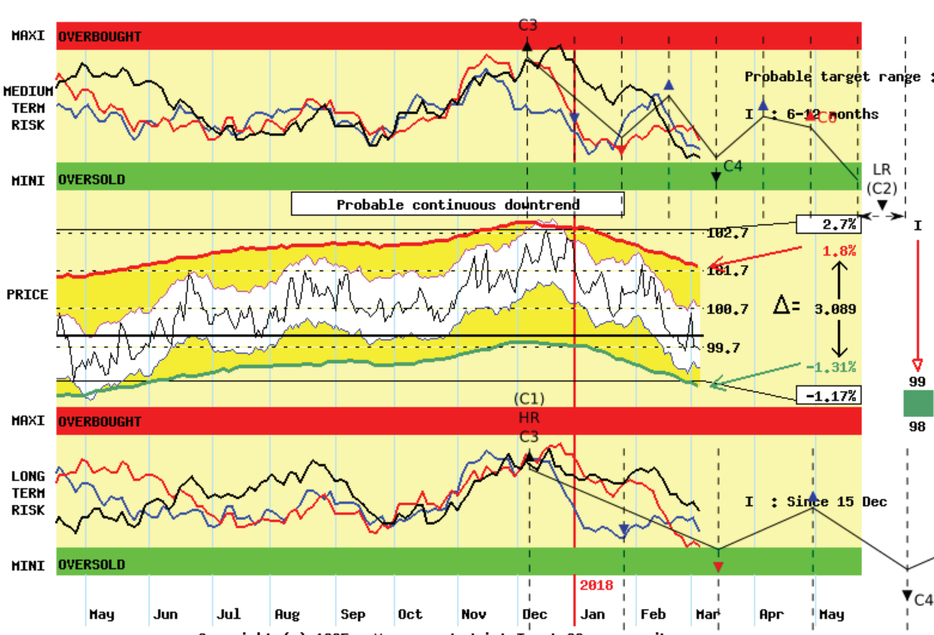
Recently, there's been a lot of negative new-flow on US Treasuries, amid quantitative tightening, massive future debt issuance and a few failed auctions. High Yield is also under some media pressure as concern over credit bubbles are mounting everywhere. Yet, at this late stage in the cycle, both these markets serve a purpose: Treasuries is the only, highly liquid, "Flight to safety" game in town, and High Yield offers protection against rising yields and inflation expectations in the fixed income market. Stuck in the middle, is the Investment Grade Corporate Bond market as it offers little protection against the risk of an inflationary acceleration, nor against the possible deflationary bust that may follow.

LQD - iShares iBoxx $ Investment Grade Corp. Bond ETF / IEF - iShares 7-10 Year Treasury Bond ETF
Daily graph or the perspective over the next 2 to 3 months



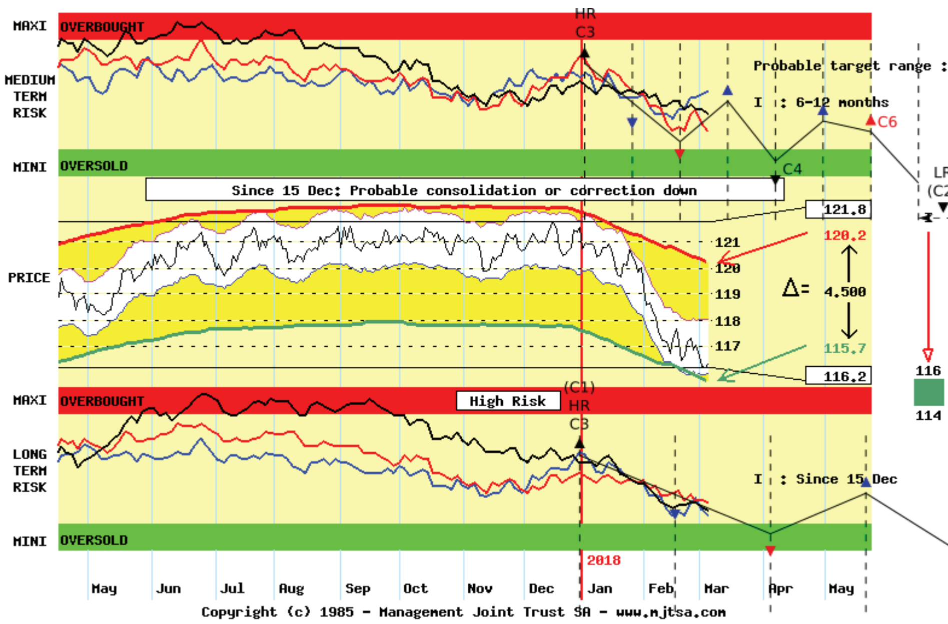
The ratio compares US Investment Grade Corporate bonds to US treasuries (both ETFs have similar durations). It is geared towards Risk-ON perspectives, i.e. when risk assets rise, the ratio usually follows suit, and vis versa. Lately, since the early February equity sell-off, it has been correcting down quite abruptly. While both our oscillator series (lower and upper rectangle) could justify a continuation or a rebound over the next couple of weeks, the uptrend since Spring last year is probably nearing exhaustion. Furthermore, our I Impulsive up targets to the upside (right-hand scale) were reached a month a go in January. There is hence little upside potential left over the next few months. **In the late cycle environment we are currently in, where equities and most risk assets are probably overvalued, there is little marginal advantage to own Corporate Bonds over Treasuries, while the risk of underperformance during market corrections is compelling.**

LQD - iShares iBoxx $ Investment Grade Corp. Bond ETF / HYG - iShares iBoxx $ High Yield Corp. Bond ETF
Daily graph or the perspective ovbert the next 2 o 3 months



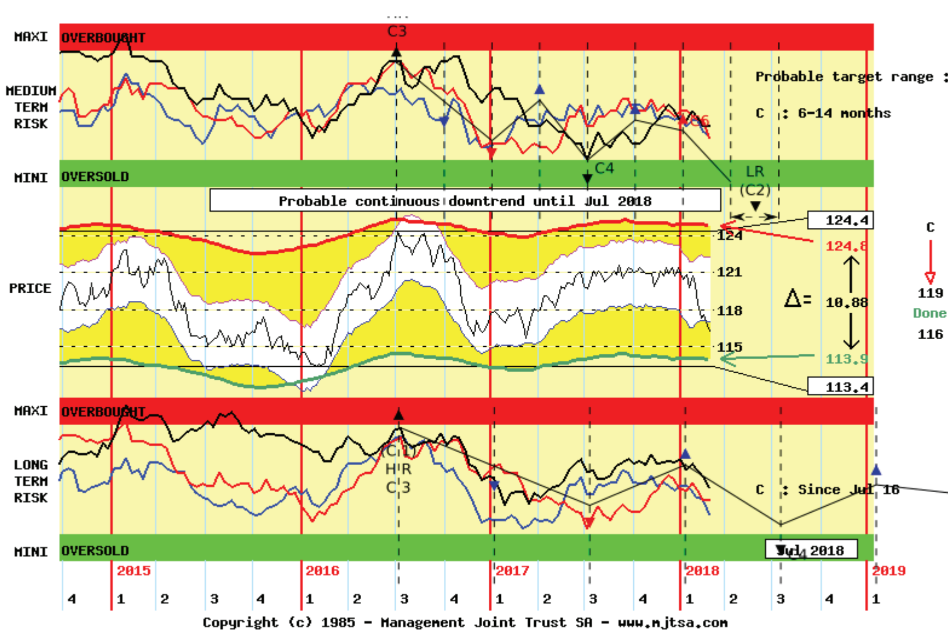
Against High Yield, Investment Grade Corporate bonds feature different dynamics that on the ratio above (the duration is shorter on the High Yield ETF, yet the Credit element is widely predominant). **Yet, interestingly, in this late cycle environment, these are not necessarily inversely correlated**. Indeed, since December, and more recently early February, Investment Grade has also been suffering vs High Yield. On both our oscillators (lower and upper rectangles), a bounce should materialise over the next few weeks into April. That said, following that, Investment Grade should continue to underperform, possibly towards June, i.e. **Investment Grade VS High Yield should suffer from the further inflationary acceleration we expect, probably from mid /late April into mid year.**

LQD - iShares iBoxx $ Investment Grade Corp. Bond ETF
Daily graph or the perspective over the next 2 to 3 months



Investment Grade Corporate bonds have been selling off since December. On both oscillator series (lower and upper rectangles), we would expect the downtrend to continue towards mid year at least, as risk assets corrections alternate with inflationary accelerations. On the sequences, we show, Investment Grade may bounce at some point during April, perhaps following a correction on risk assets during end March, and while inflationary pressures are taking time to re-accelerate, yet the window is probably quite short before the downtrend resumes, probably into May and towards the end of June.

LQD - iShares iBoxx $ Investment Grade Corp. Bond ETF
Weekly graph or the perspective over the next next 2 to 4 quarters



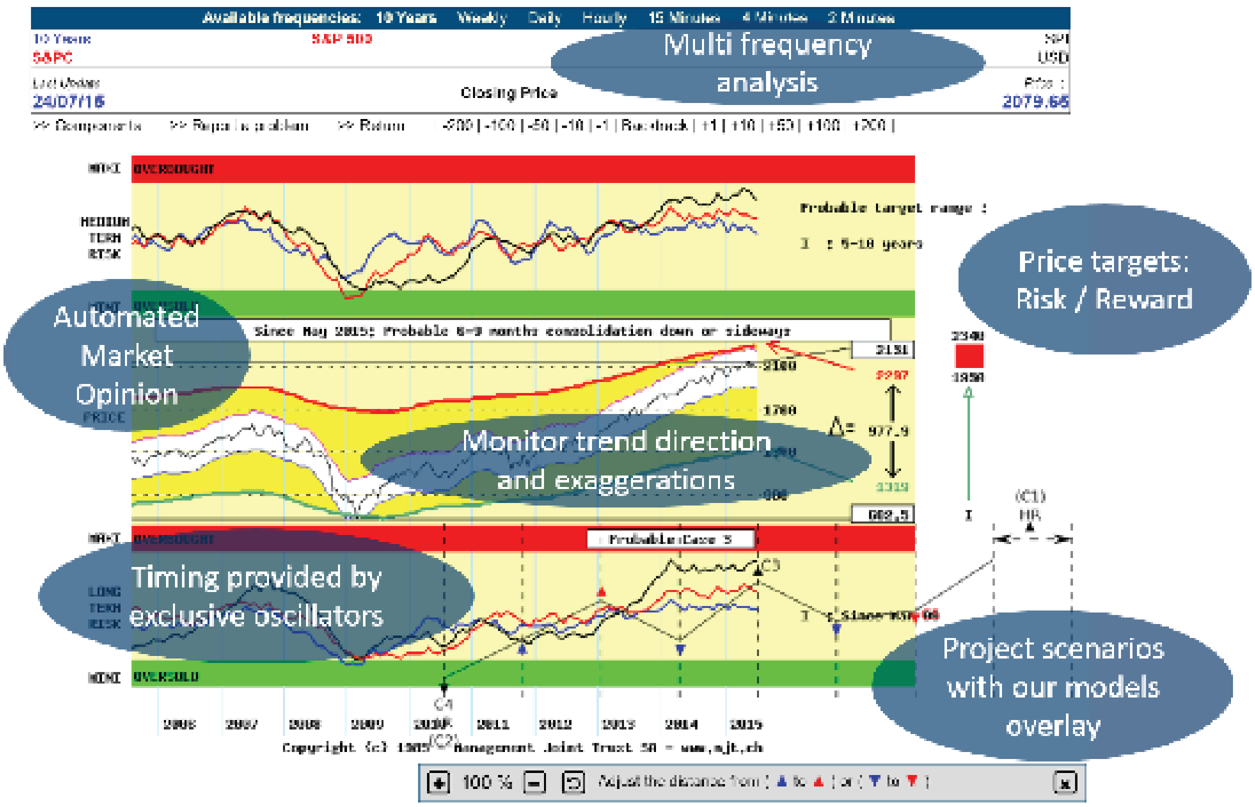
On this Weekly graph of Investment grade, both oscillator series (lower and upper rectangles) point to further declines towards mid year , perhaps even early Q3 2018. Prices have recently reached the support of our C Corrective targets to the downside (right-hand scale). If these break (below 116), our I Impulsive targets down would calculate towards the 110 – 106 range (our historical volatility measure "Delta", here at 10.88 – middle rectangle, right-hand side – multiplied by 1.3 to 1.7 times, subtracted from the the top of the graph at 124.4). **The downside risk on Investment Grade is hence still quite compelling.**

Concluding remarks

Until mid 2018 at least, we expect an environment of rising inflation expectations, rising yields and rising risks for risk assets. This is not a friendly environment for Investment Grade Corporate Bonds, which usually thrive when inflation diminishes, and growth and equity markets accelerate up. Indeed, Investment Grade does not address the two main risks in this late cycle environment. High Yield will protect you against short term inflationary pressures, Treasuries will protect you against the deflationary bust that may follow. Investment Grade addresses neither. It's like a siting Duck caught cross currents between inflationary and deflationary pressures.

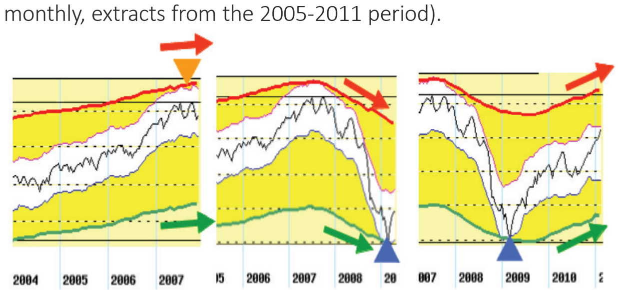
50/ METHODOLOGY

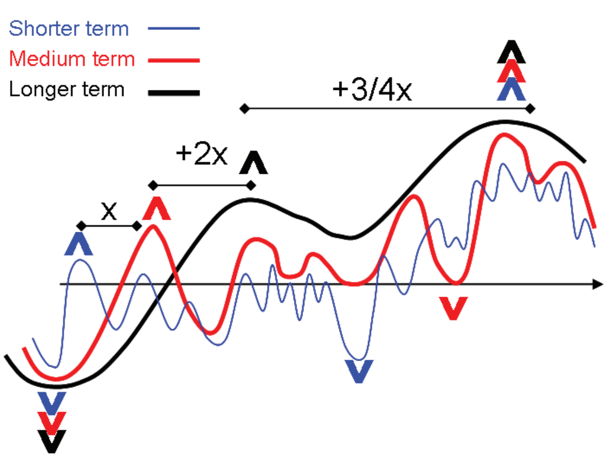
MJT's proprietary methodology uses Timing Oscillators to help investors position themselves either in an uptrend or downtrend. It will hence allow them to anticipate and project the future sequence of events. Coverage extends over 5'000 instruments, long term to intraday, across all asset classes. Relative charts, Opportunity filters, Multi charts monitoring screens and a Portfolio Simulation tool complete the functionality set. See below a description of What's on the Chart, a Methodological brief and an outline of the ideal Uptrend/Downtrend Models (read more on www.mjtsa.com)



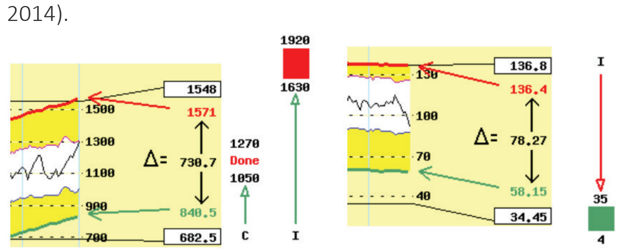
Timing oscillators: Different prices cycles are captured by our 3 Timing oscillators. Monitor how their relative positioning defines specific situations (Cases) to always know where you stand within the Trend (e.g. please see below the ideal Uptrend Case succession sequence)

Trend direction: the direction of FinGraphs' large envelope will help you decide either to apply an uptrend or a downtrend model. Contacts between the wider and thinner envelopes will help you anticipate and confirm market turning points (e.g. S&P500 bi-monthly, extracts from the 2005-2011 period).

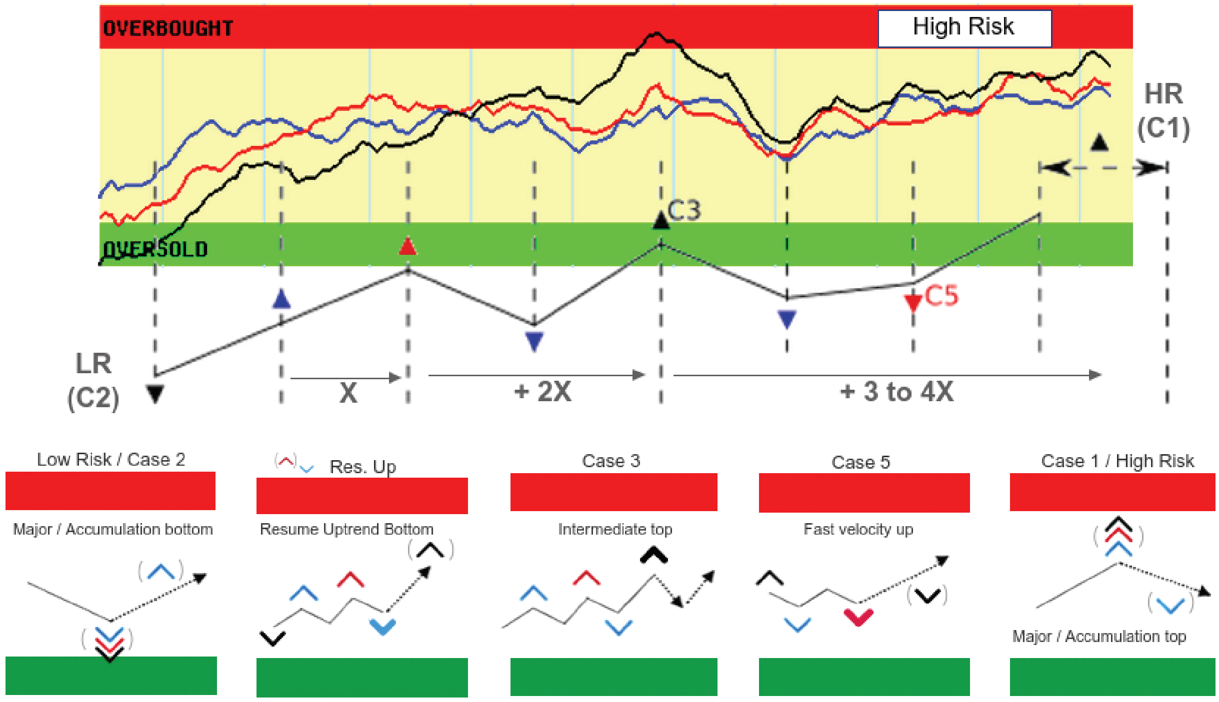




Price targets: based off historical volatility, they can highlight price potential or risk and, once achieved, define take profit or stop loss areas (e.g. below S&P500 in early 2011, Brent in October 2014).



Ideal Uptrend Model



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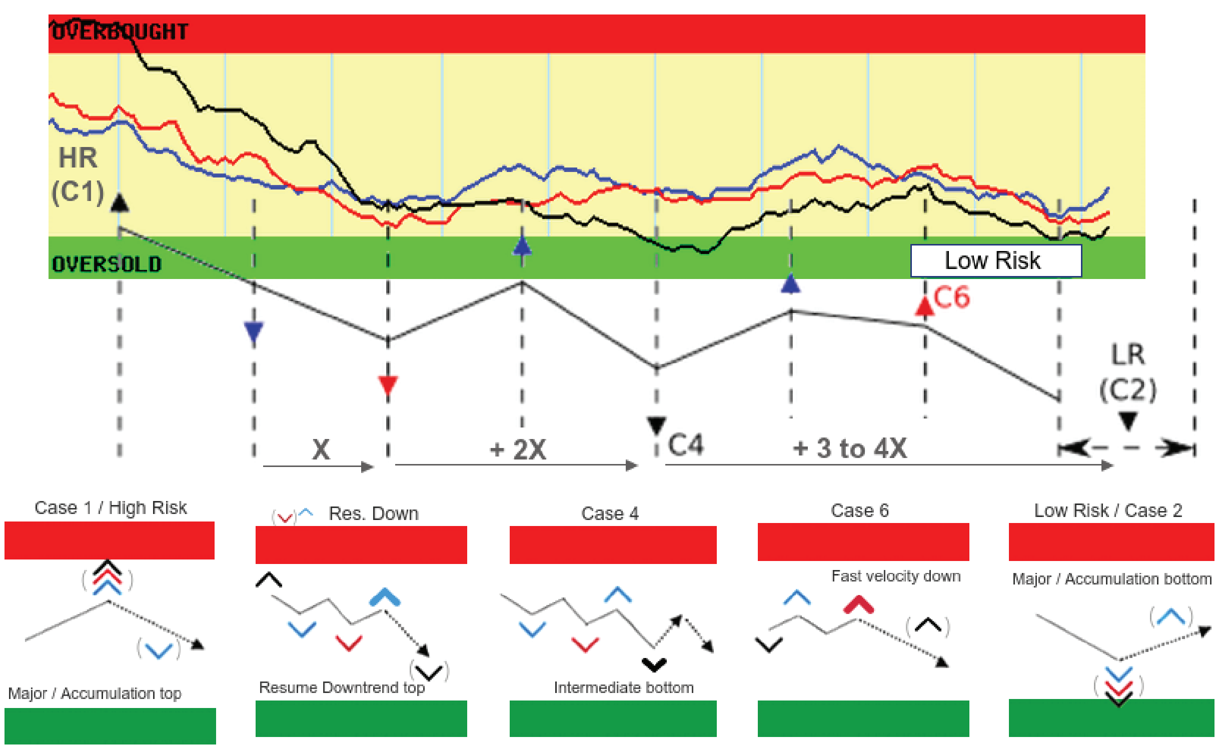
(left to right) from an oscillator black bottom (usually a Low Risk or a Case 2), the oscillators and prices will start moving up. An uptrend is confirmed once a red top can be made above a blue one. The correction down that follows delivers a buying opportunity ("Resume Uptrend") followed by an intermediate top (Case 3). A new period of consolidation down or sideways then starts, ending with a Case 5 acceleration up towards an important top (usually a High Risk or a Case 1). For each time frame, a fixed time unit separates each timing incidence, so that the distance between a blue and red top is usually X, the distance from the red to the black top is then 2X and the distance between the first and second black top is 3 to 4X.

Ideal Downtrend Model



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(left to right) from an oscillator black top (usually a High Risk or a Case 1) the oscillators and prices will start moving down. A downtrend is confirmed once a red bottom can be made below a blue one. The correction up that follows delivers a selling opportunity ("Resume Downtrend") followed by an intermediate bottom (Case 4). A new period of consolidation up or sideways then starts, ending with a Case 6 acceleration down towards an important bottom (usually a Low Risk or a Case 2). For each time frame, a fixed time unit separates each timing incidence, so that the distance between a blue and red bottom is usually X, the distance from the red to the black bottom is then 2X and the distance between the first and second black bottom is 3 to 4X.

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