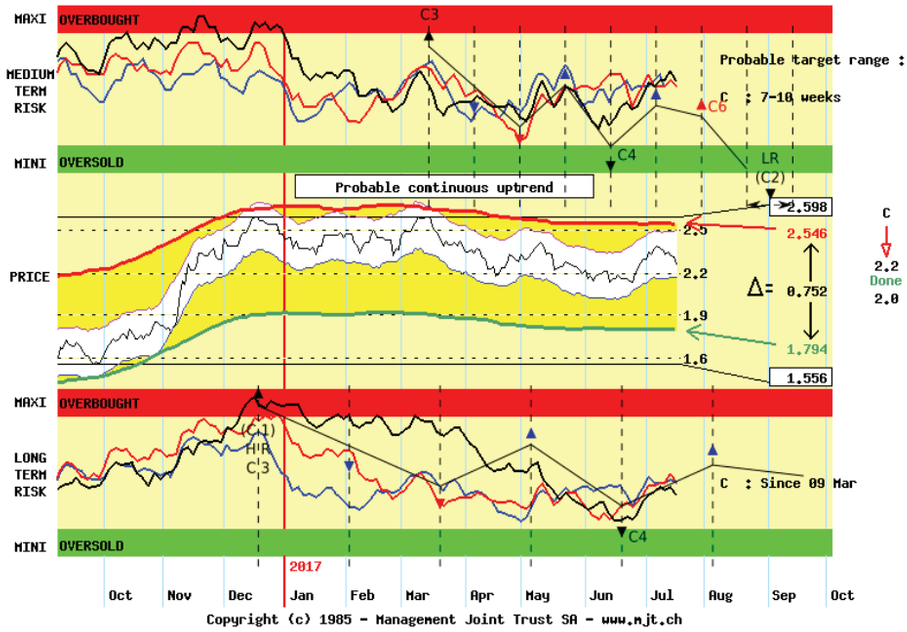
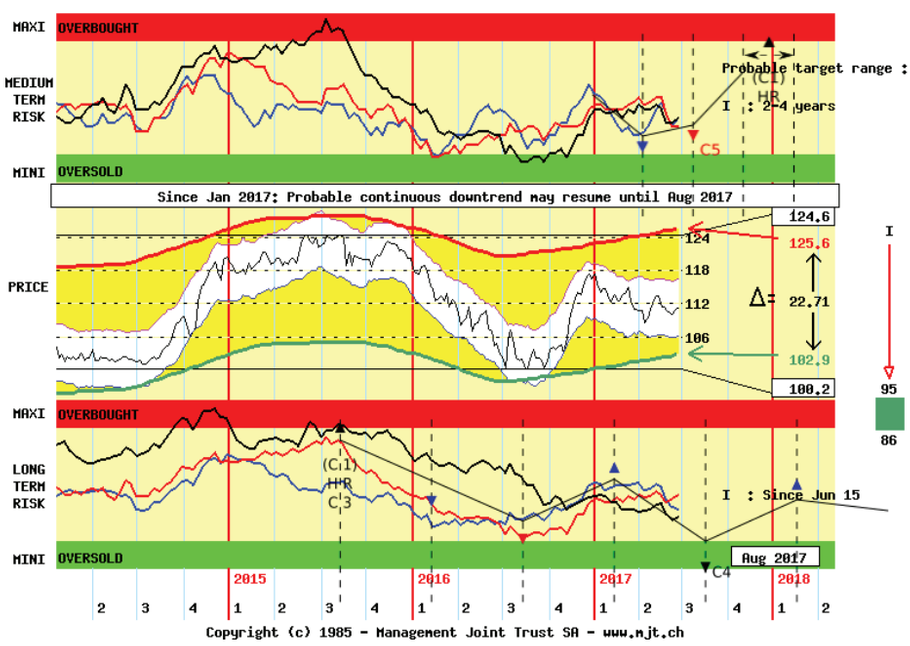
Yields and the Yield Curve remain soft until September, yet the downside is limited from here

US 10 years Benchmark Bond Yield
Daily graph or the perspective over the next 2-3 months



On both our oscillator series, US 10 year Treasury yields made an important low in June. While, on our long term oscillators (lower rectangle), this low may mark the end of the correction to the downside since the December/March double top, on a medium term oscillators (upper rectangle), the sequence we project would suggest a further downside retest into late August / early September. We would hence remain **defensive for now on rates although we believe that our 'C' Corrective targets to the downside, between 2 and 2.2% (right-hand scale), should continue to provide support as they have done since the Spring.**

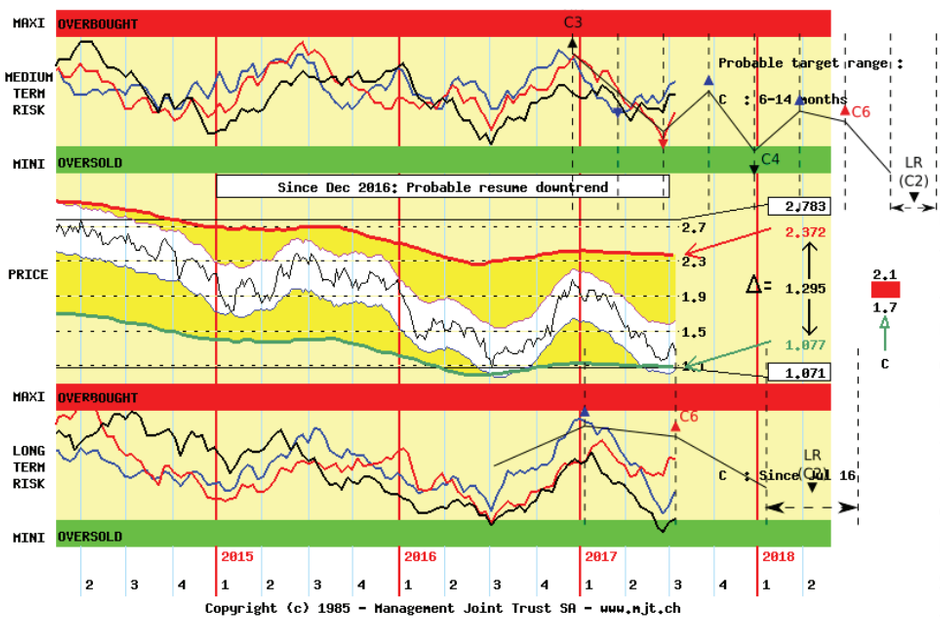
US 10 years Benchmark Bond Yield
Weekly graph or the perspective over the next 2 to 4 quarters



On our Weekly graph of 10 Year Treasury yields, we expect a higher low (compared to the lows made mid 2016) to be confirmed during the Q3 2017 (this would be very positive). The sequence we show on our long term oscillators would position it pretty much now (lower rectangle). On our medium term oscillators (upper rectangle), and in light of the Daily graph above, we would expect **a retest to the downside later during the Summer** before yields start accelerating to the upside again. Also, as mentioned above, we believe the 2% mark is, and will continue to be, the crucial support point that justifies this positive view. From late Q3 2017, we expect Treasury yields to start accelerating up again towards next year and our 'I' Impulsive targets up between 2.9% and 3.4% (right-hand scale).

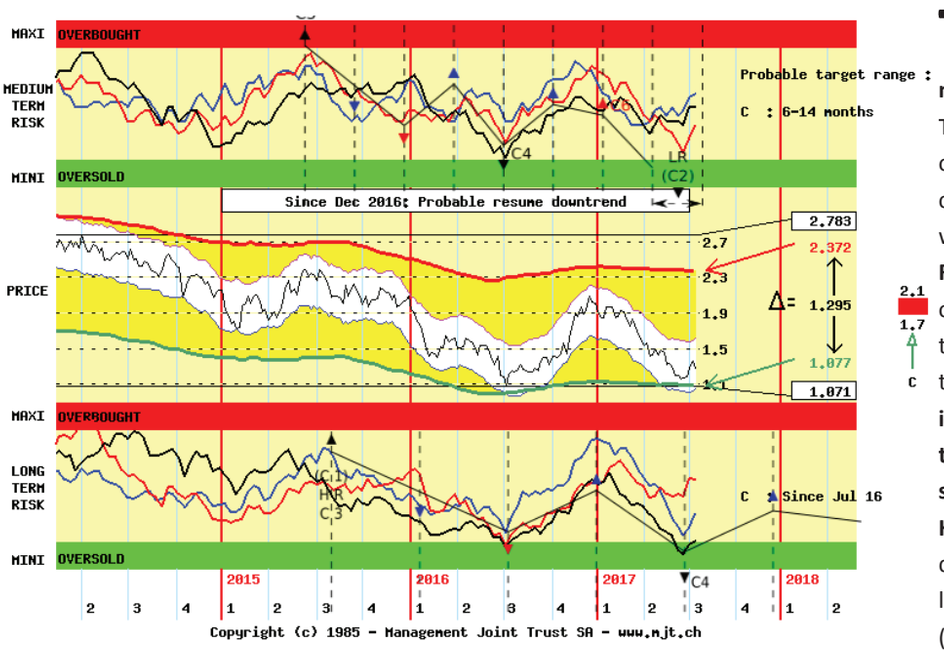
US Yield curve: 2 scenarios, one negative, one positive. We weigh towards the positive one.

US 10 years - 3 months Benchmark Bond Yields (NEGATIVE SCENARIO)
Weekly graph or the perspective over the next 2 to 4 quarters



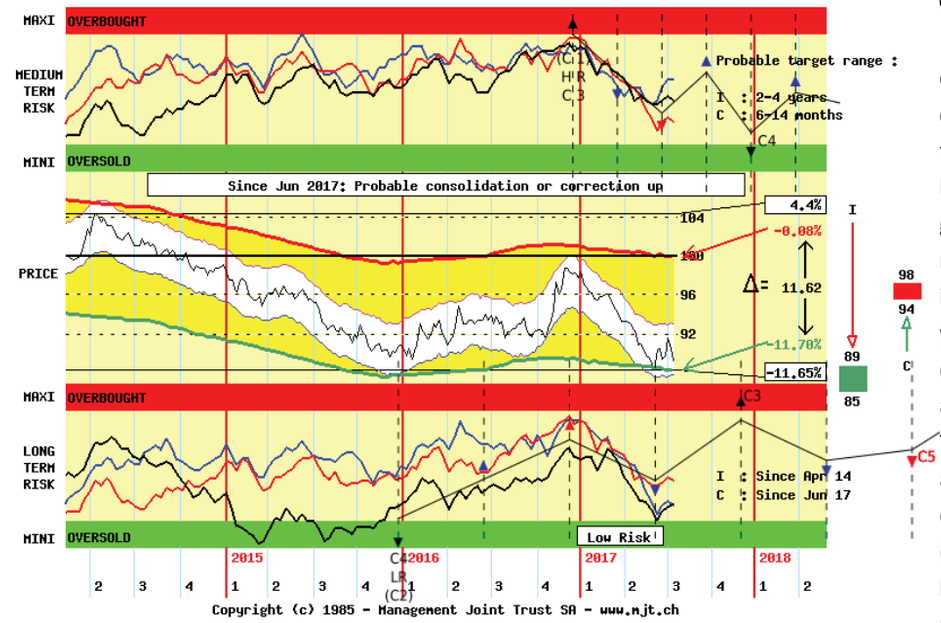
The flattening since December has been impressive and is closely linked to the FED's rate hike schedule. As shown, on both our oscillator series (lower and upper rectangles), the low made in June and its short rebound may justify the negative sequences we project (declining tops: one in December 2016, the other in June 2017 on our long term oscillators). It would imply a limited reaction during the Summer and further lows towards year end (further flattening of the curve). This scenario would be quite negative for reflation trades, and possibly for risk assets in general, suggesting that the FED would be expected to continue its sustained rate hike schedule, while the long end of the curve (and inflation perspectives) remains subdued.

US 10 years – 3 Months Benchmark Bond Yields (POSITIVE/ PREFERRED Scenario)
Weekly graph or the perspective over the next 2 to 4 quarters



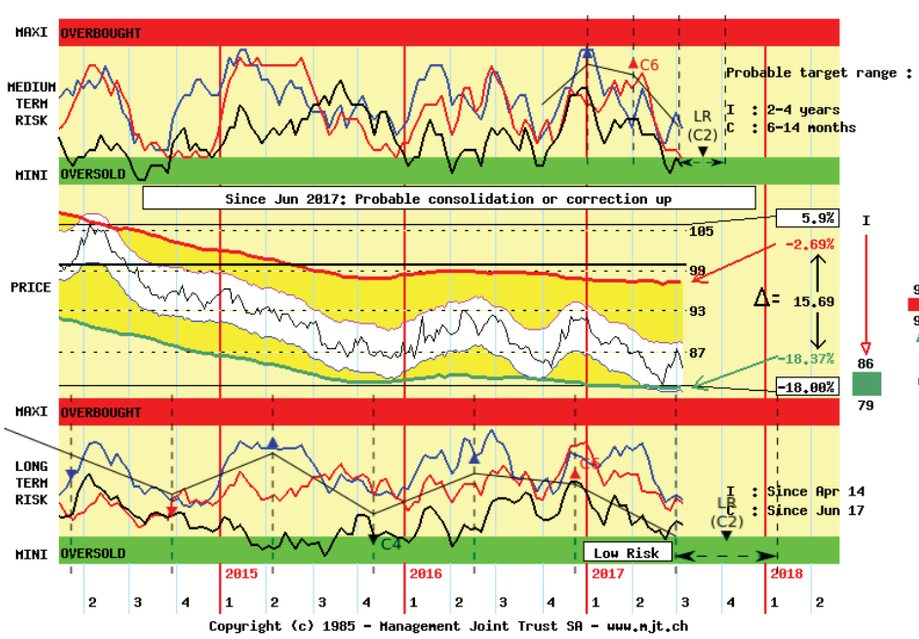
This scenario suggests that the yield curve is making a double bottom. The sequence we project on our medium term oscillators (upper rectangle) would have reached **a "Low Risk" position,** while the one we show on our long term oscillators (lower rectangle) **suggests that a base is currently being made so that the yield curve could start to steepen again in H2 2017.** This base appears quite comfortable, with our long term longer oscillator (the black one) in an Oversold position as well as our standard deviation envelopes (middle rectangle) touching each other to the downside (i.e. this shows a temporary exaggeration). **This scenario would suggest that reflation trades and inflation expectations make a come back in H2 2017, while the FED momentarily tames its rate hike ambitions (i.e. appears somewhat more dovish). It is our preferred scenario.** Let's see why in the following pages.

IVE - iShares S&P 500 Value ETF vs IVW - iShares S&P 500 Growth ETF
Weekly graph or the perspective over the next 2 to 4 quarters



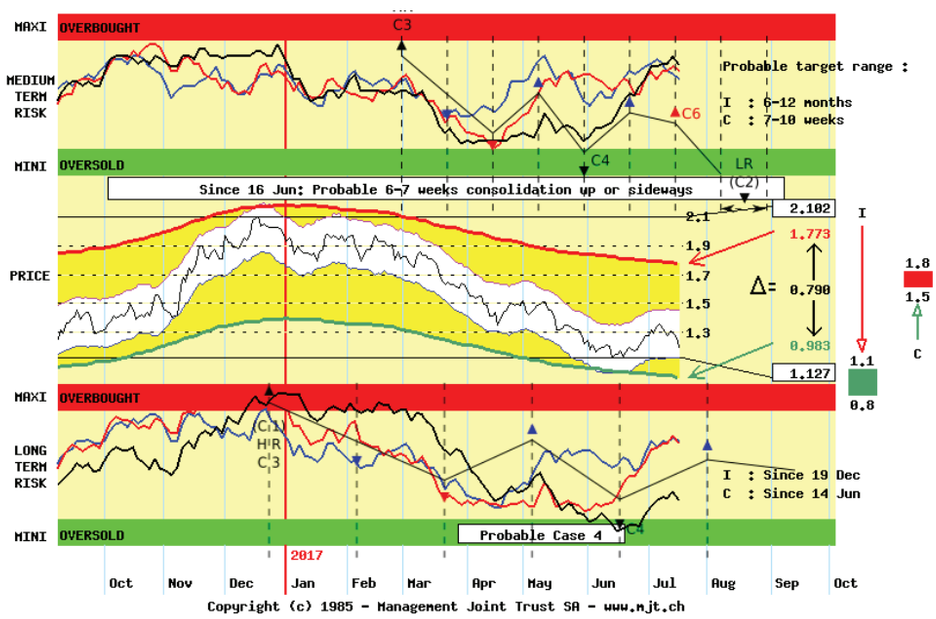
The Value vs Growth relationship in the US is closely linked to the shape of the yield curve. It arbitrages cyclical, often low value stocks vs long duration, growth plays. The configuration on this relative graph is indeed very similar to the yield curve one above, yet it did start to move up earlier at the beginning of 2016. This allows us to show an ascending sequence on our long term oscillators (higher highs during 2016; lower rectangle). Furthermore, **the recent sell-off has created a "Low Risk" situation** on our long term oscillators as mentioned on the graph. We caveat this view with the sequence we show on our medium term oscillators (descending into year-end; upper rectangle), yet would expect the reaction during Q3 2017 to gradually shift the sequence to a more positive outcome. So, this is no a clear cut situation yet, however **Value vs Growth seems quite Oversold at this stage**.

Dow Jones Industrial Index vs QQQ - PowerShares Nasdaq100 ETF
Weekly graph or the perspective over the next 2 to 4 quarters



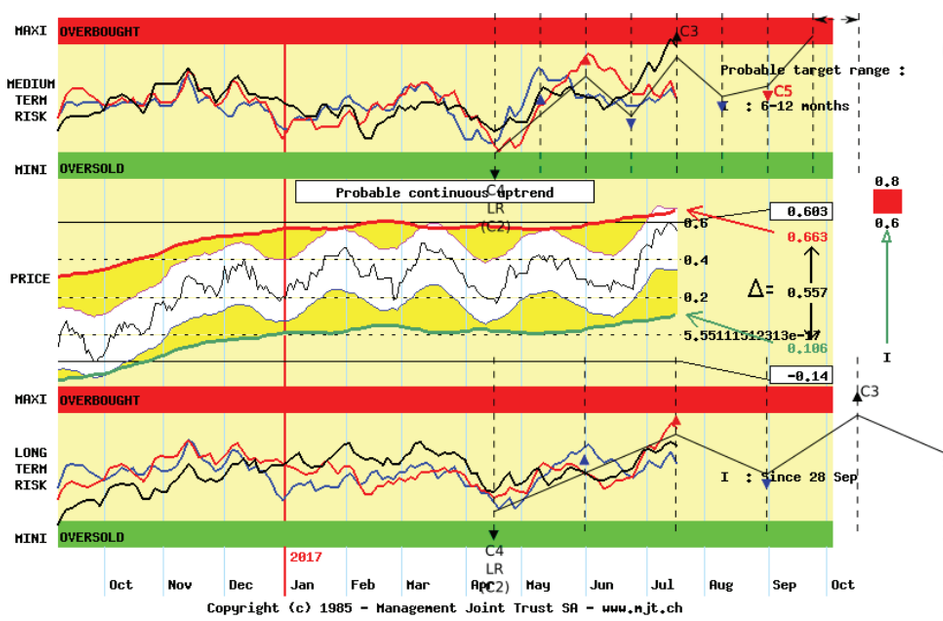
Taking the Value vs Growth relationship to the Index levels and echoing our risk parity article from our last newsletter ("The secular trends favoring Risk Parity strategies could take a pause until early 2018"), we compare the Dow Jones Industrial Index (a price weighted index with little Tech exposure) with the Nasdaq skewed towards Growth and Big Tech. **The Dow Jones has reached a "Low Risk" position on both our oscillators series vs the Nasdaq (lower and upper rectangles) and could rebound to the upside during H2 2017.** Our 'I' Impulsive targets to the downside had been met on the lows made in June (right-hand scale). Hence, again, cyclicality seems to be bottoming out vs Growth.

US 10 years – 3 months Benchmark Bond Yield
Daily graph or the perspective over the next 2 to 3 months



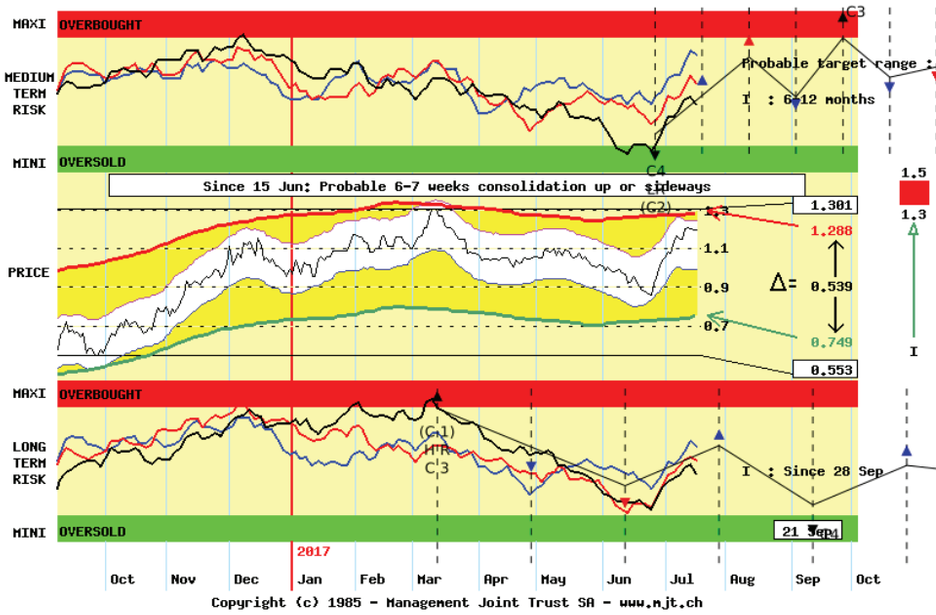
We now consider the Daily graph of the US yield curve to understand how a reversal could materialize over the next few months. As with US treasury yields, the sequence down we show on our long term oscillators (lower rectangle) **has reached an important bottom in June.** That said, on our medium term oscillators (upper rectangle), **we would expect one last retest of lows into late August.** There is still some risk for new lows as our 'I' Impulsive targets down have not quite been met yet (right-hand scale). Does this jeopardize our rather bullish scenario above? Well, we believe not, and **would consider it as part of the bottoming process.** Over the following pages, we also look at yields in Europe for more comfort.

Germany 10 years Benchmark Bond Yield
Daily graph or the perspective over the next 2 to 3 months



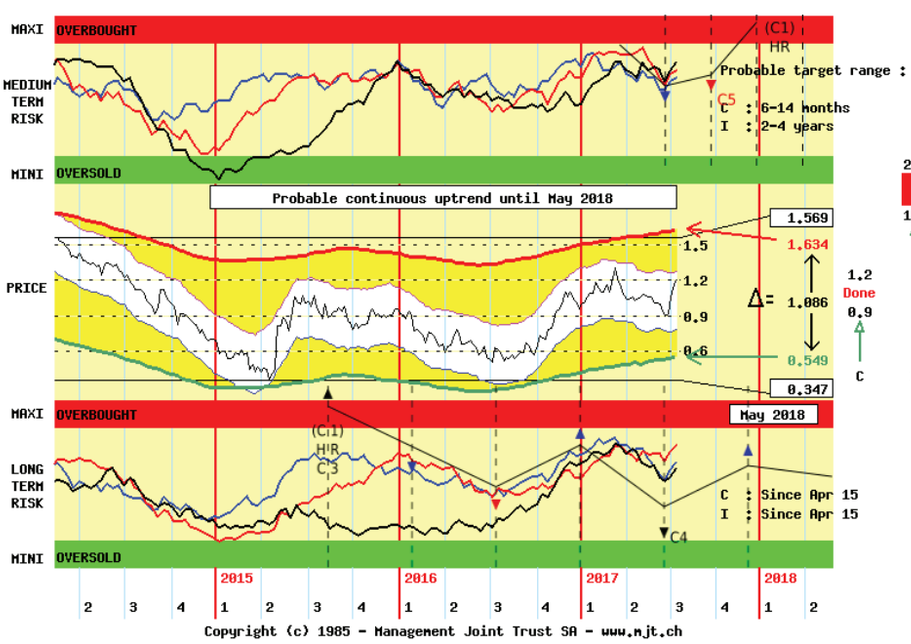
German 10Y Government yields have also been consolidating since last December (a rather flattish consolidation). By and large, they remain well synchronized with US yields, just with a more positive twist. Just recently, in July, they broke out to new territory. In our view, this **confirms their medium term uptrend (towards early next year).** The sequence we show on both oscillator series (lower and upper rectangles) is very similar to the one we describe further up in this document on the S&P500 or EUR/JPY. It is one where risk assets continue their uptrend towards October at least. In the meantime, however, as with other risk-ON proxies, **German benchmark bond yields should see a correction into the 1st Half of August,** at the worst into late August. This should indeed put some downside pressure on US yields, yet a short lived one (as discussed above).

Germany 10 years – 2 years Benchmark Bond Yields
Daily graph or the perspective over the next 2 to 3 months



Looking at the yield curve in Germany, which had been flattening since March, the sequences we show on both our oscillator series (lower and upper rectangles) have probably bucked their downtrend consolidation. On our medium term oscillators (upper rectangle), we show an **nascent uptrend sequence with a possible correction to the downside in August.** On our long term oscillators (lower rectangle), we expect that the curve could flatten again into early September. We believe that **any retracement into August / September should find support within our corrective targets to the downside**, which given our current volatility measure "Delta" would calculate around the 1.05 – 0.90 area (minus 0.5 to 0.8 times our delta of 54 basis points substracted from the graph highs; middle rectangle, right-hand side) or slightly above the lows made in June. **This would deliver a nice set-up for renewed steepening of the European curve into the Fall and possibly year-end.**

Germany 10 years – 2 years Benchmark Bond Yields
Weekly graph or the perspective over the next 2 to 4 quarters



Scoping out to the Weekly graph of the European Yield curve, it seems that the higher low just made in June (following the one made mid 2016) confirms the set-up we expect on our long term oscillators (lower rectangle). **This is a good base to move higher into year-end. On our medium term oscillator, a retest may still materialize towards late Summer, but the sequence we show is clearly positive (upper rectangle).** On the price targets front, we are currently working through our 'C' Corrective targets up above 1.20%. Once this spread clearly manages to break above these levels, the 'I' Impulsive up targets potential is substantial, i.e. towards the 2% mark.

Concluding remarks

US 10 Years Treasury Yields have started to react up in June, yet they may still retest during the Summer probably within their recent range. From late August / September onwards, we expect them to accelerate up until early next year. German Yields are stronger, yet quite well synchronized and confirm this positive picture following some retracement into August. The US 10Y – 3M spread has flattened aggressively since December and is currently testing last year lows. We believe that it has reached a "Low Risk" situation that should see it rebound into next year. **Value vs Growth, Cyclicals vs Long Duration or the European yield curve seem to confirm this view.**