THE CAPITAL OBSERVER

AUGUST 2020

the technical analyst
AWARDS 2018
WINNER

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

DC&C
Diapason Currencies & Commodities

MJT

THE CAPITAL OBSERVER

A Monthly Macro and Asset Review

Featuring MJT's Timing Methodology

AUGUST 19, 2020

CONTENTS

> *Market consensus is shifting against the dollar and it does look as if traders are looking for any opportunity to sell dollars and pick up currencies with greater appreciation potential. The dollar is at its most oversold level in over 40 years, said investment bank Morgan Stanley*

4/ Executive Summary

12 / **A V-shaped GDP recovery is due in Q3 2020: government help and drawing down on personal savings rescued consumer spending, ISM** - The reactions to the COVID-19-crisis and the lockdown shutdown policies enacted have put us in an economic disaster period that has not been seen for decades. Comparing it to the disaster period of World War II can provide some answers to what may happen in the next months and years. While GDP may increase dramatically post-crisis, this may not be accompanied by a full bounce back in employment for a while. But government help has been providential in restoring retail sales, and subsequently, economic activity. The economy inevitably went into a recession, but as we expected that did not stop the equity markets from going into new all-time highs. It has become apparent that the financial markets have taken a look at the future prospects of the economy, and have voted to go with a spectacular recovery. Booming financial markets are both indicator of, and contributor to, the real economy down the road. Therefore, it was very telling that the most generic of activity data, the ISM, is confirming what the financial markets seem to know in advance. The V-shaped recovery in the financial and ISM variables argue for a much better Q3 GDP data that have been flogged by many analysts. Economic data reported over the last two weeks continue to support a V-shaped growth narrative being drawn by the financial market and employment data. Much of the recent economic releases are positive and when plotted on a graph, the data trace out a V-shaped pattern as well. More importantly, the ISM Services (Non-Manufacturing) composite data and its internals were also upbeat.

16 / **Timing and Tactical Insight - The rally could continue to defy gravity into September -** The current rally is defying macroeconomic gravity as well as market positioning. Indeed, it is heavily driven by retail flows. Yet, when considering both our Weekly and Daily graphs on the S&P500, it doesn't seem quite finished yet and could extend into mid/late September in first instance. By then, it may reach up to 3'600. Comparing the defensive US Staples sector vs the S&P500, seems to offer the clearest confirmation, as the ratio appears to resume lower into late Q3. On the other hand, we expect cyclical sectors (US Industrials, Energy or Financials) to also start to underperform again by late August, while the Russell 2000 US Small Caps index may resist slightly longer into early/mid September. From then on, we would hence favor Growth sectors once again, i.e. the Nasdaq100 and Technology, and perhaps slightly earlier, Consumer Discretionary. These Growth themes could outperform into late September, perhaps even early October. We then expect a rather strong intermediate correction on US equity markets during early/mid Q4 and a defensive sector bounce.

22 / **The Federal Reserve initiate Quantitative Tightening, but the Treasury's remit to sell more debt may restore ample systemic liquidity into the system -** The Fed cited the pandemic as the reason for a $700 billion quantitative easing program, and a coordinated dollar-swap plan with global central banks (the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank and the Swiss National Bank). Thus, the global central banks initiated a new round of global Quantitative Easing. Fast forward five month later. The Fed has shifted the modality of its monetary policy. The Fed has gone into Quantitative Tightening. Monetary outlays destined for the financial markets will become progressively lower. The 2020 SOMA Transactions, Bank Reserves and other Fed assets, have fallen sharply. And every time these variables decline, risk assets tend to struggle. Nonetheless, the seasonal liquidity drought is due to end soon. In its Q3 2020 refunding statement released on Aug. 5, 2020, the U.S. Treasury announced its plan to increase auction sizes across all nominal coupon tenors ((7-year, 10-year, 20-year and 30-year) over the August-October quarter. That pledge was done on March 23, 2020, when the Fed said it would buy securities "in the amounts need to support smooth marketing function and effective transmission of monetary policy to broader financial conditions. The Fed has kept that pledge, at the end of July 2020, the Federal Reserve held 28% of outstanding U.S. Treasury notes and bonds, the highest since 2003, compared with 11% in March 2009, when the Fed announced U.S. Treasury purchases in QE1. So what could be the consequences? For one, we have to be watchful on the maturity composition of the Treasury's issuances and the increase in the average maturity of government debt will inexorably put pressure at the back end of the yield curve. That could steepen the yield curve.

25 / **Timing and Tactical Insight - Reassessing the Inflation / Deflation situation** - Inflation Expectations measured by the breakeven ratios between US TIPs and US Treasuries have been rising linearly over the last few months and are approaching their long term downside trend-lines. They are hence starting to draw attention. Our timing suggests that they could continue to linger on higher into mid/late September, perhaps early October, but that they then probably retrace down into mid/late Q4. Other inflationary / deflationary indicators seem to confirm this timing. While Copper and Oil, on an absolute basis, may continue higher into late September, perhaps early October, the Copper to Gold ratio, US10Y Treasury yields or Yield Curve spreads may be already starting to roll-over. Gold may see some short term dips during September, but probably then rises again more linearly during Q4. Overall, the cross asset picture appears to point to some deflationary retracement from late Q3 into mid/late Q4. This probably matches the cyclical weakness we then also expect in other articles of this issue of The Capital Observer.

5/ Executive Summary

31 / **The lagged impact of the US capital account balance, extreme short positioning should give the Usd some support from late Q3 -** In a broad macro sense, changes in the US Dollar valuation stem from shifts in broad international, systemic liquidity flows among countries and economic regions. These shifts in the transfer of money and investment capital are tallied in a country's current and capital accounts, and for this purpose, the capital account is one of the primary data that we track. Changes in the US capital account normally show up in the valuation changes of the US currency 5 to 6 quarters later. The sharp improvement in the domestic capital account from Q4 of 2018 to Q4 2019 will therefore likely result in a recovery of the US dollar from Q3 this year as a lagged effect. Against the EUR the dollar's most stalwart rival, GDP growth spreads now lean favourably towards the U.S. This spread leads the EUR/USD exchange rate by almost six months. The shift lower means that US growth is outpacing that of the Eurozone. This will become even more significant if the growth outlook for the US in Q3 hews close to what we expect. Furthermore, shorting the US Dollar has become a one-way bet and a very consensual theme. As of this past week, the number of futures contracts amid the speculator community that were net short the DXY (via other FX pairs) was tied for the highest on record going back to the late 1990s...

35 / **Timing and Tactical Insight - US Dollar weakness continues into late Q3 in first instance** - Most currencies had suffered a 2 years downtrend since early 2018 vs the US Dollar as cyclical factors then started to weaken and the US Dollar and US markets became the only game in town. These trends were further exacerbated early this year, and especially during March, as the US Dollar revealed itself as the ultimate deleveraging currency. This trend has now reversed thanks to the huge amount of monetary and fiscal stimulus that have since been provided by Central banks, and the FED especially. The US Dollar has since started to weaken, while risk assets have been rising. We believe, this relation should continue until the massive stimulus measures finally start to grip and interest rates start to rise again on a long term basis. In 2016 (a similar period of US Dollar weakness across the board), this happened within 6 months, from early July, but at the time the dislocation was far less severe. Today, it is hard to anticipate when the US economy will eventually fully recover, probably in a few quarters. In the meantime, the US Dollar may bounce during risk-off phases, but rapidly, these will probably be met with further stimulus in continued support for the recovery. Over the next couple of quarters, our oscillators suggest further downside for the US Dollar until late Q3, then a defensive bounce during early/mid Q4, and then renewed downside pressure with probably new lows into next Spring. EUR/USD may reach into the high 1.20s by then.

41 / **Equities: liquidity deterioration, internal rotation may lead to an inflection point before the end of the quarter -** The Fed has started to tighten up Quantitative Easing (implementing Quantitative Tightening in a sense). Fiscal outlays will be lower, and money supply also declines soon -- in aggregate, a triple whammy for risk assets this coming September time window. However, though we don't believe that the risk asset markets can continue to ignore the collapsing current liquidity situation, but we still have no idea how long a sell-off would last. The modality of the Fed's support for the market represents the primary unknown and challenge. The Fed indicated that market support will not be withdrawn right away, but will QE be increased accordingly if the market suffers a sharp decline? Will the Fed defer to partisan politics and pause QE 4 just before the November presidential elections? The answers to these questions will play a large role in shaping up the profile of the next phase, which we believe could commence before the end of this quarter. It may be prudent to prepare for that phase.

44 / **Timing and Tactical Insight - Considering Global markets, cyclical factors may fade from September on -** Europe and Emerging markets still seem to be uptrending on an absolute basis into mid, perhaps late September. The EuroStoxx 50 may approach its February highs, while the MSCI Emerging Markets index may rise more than 10%. On a relative basis, however our analysis in more nuanced. Europe for example, is more cyclical than the US. On a US Dollar denominated basis, it could hold up into mid September vs the S&P500, thanks to EUR/USD strength, but percentage wise in Euros, it will probably starts lagging the S&P500 in US Dollars from late August. Sector-wise, European Banks probably start to underperform again from late August, while Technology outperforms. Similarly, we would favor Germany over France into late Q1 and would probably underweight Southern Europe and the UK. Defensive Switzerland then becomes appealing from late September on a relative basis. We believe these rotations point to a transition period into mid/late September, when Growth takes up the lead again and cyclical factors fade. Defensive trades should then bottom out vs the market once equities top out late September. We expect similar developments in Emerging Markets, and will start favoring China again from late August, following 6 weeks of underperformance vs more cyclical Emerging Markets since early/mid July.

52 / **Splicing the markets - Promising Growth segments into late Q3** - Considering the Growth extension, we expect from late August / early September into late September, perhaps early October, we have decided to seek out several segments which could outperform even the Nasdaq100 during this period. Our interest has focused on different profiles, Global Social Media, as one of the more dynamic segment of the Technology sector, Genomics as a proxy for the most Growth oriented Biotech companies, Solar Energy, which should continue its stellar outperformance started in March and perhaps US Homebuilding, which could benefit from renewed weakness in US Interest rates. According to our calculations, all four could outperform the Nasdaq100 by more than 10% into late Q3.

6/ Mapping the markets

Last month, when we published on the 16th of July, we believed that equity markets and more generally risk assets could remain in a positive trend into late Q3. These projections are still valid today. In the meantime, however, we were wary that the consolidation period since early June on risk assets was not be quite finished yet, and thought that the risk of further dips until late July/ early August was quite high. These dips were quite shallow but did materialize across the board on most risk assets. Then, during August, we expected most risk assets to resume their uptrend, probably towards late August / September. The S&P500 could see new all-time highs, while the EuroStoxx 50 may approach its year-to-date highs. Emerging markets and China as well as cyclical Commodities could be particularly strong as the US Dollar probably resumes lower into late Q3. Yields may bounce slightly or at least hold up. All these projections are currently still valid.

Going forward, indeed, we expect the risk assets rally to continue into mid/late September. The S&P500 could reach up to 3'600, while the EuroStoxx 50 may reach the 3'500 – 3'600 range. Oil and Copper could see further upside, probably into the 50s USD/barrel on Oil and up to 7'000 USD/ton on Copper. Over the next week or so, cyclical factors may still hold up on a relative basis. The US Dollar could still bounce slightly, along with yields. Yet, from late August / early September, we believe Growth themes should be back in the lead, probably into mid/late September. We would favor the Nasdaq100, Consumer Discretionary and China. Yields should start to roll-over again, yet, the US Dollar remains under downside pressure, while precious metals continue to rise. Gold may reach above 2'100 USD/oz range into late Q3 / early Q4.

From late Q3 / early Q4, we then expect the risk assets rally to gradually fade out. Equities could enter a 10 to 15% correction into November. Defensive equity plays could outperform, while the US Dollar bounces. Yields could also continue lower, probably making new lows. Gold probably holds up rather well. Following that, a year-end rally could then materialize from mid/late Q4, probably extending into Q1 2021. It will probably be driven by Growth trades in first instance at least.

Main Equities & Government Bonds

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Main Equities	US S&P500	The S&P500 probably continues higher into mid/late September, potentially towards new all time highs towards 3'600.	From late Q3 / early Q4, we expect the S&P500 to enter an intermediate correction. It could last 1-2 months into mid/late Q4.
	Europe EuroStoxx50	The EuroStoxx 50 probably resumes higher into mid/late September, potentially approaching its February highs into the 3'500 - 3'600 range.	From late Q3 / early Q4, we expect the EuroStoxx 50 to enter an intermediate correction. It could last 1-2 months into mid/late Q4.
	EMs MSCIEM USD	Emerging Markets should also continue another 10% higher at least into mid/late September.	From late Q3 / early Q4, we expect Emerging Markets to enter an intermediate correction. It could last 1-2 months into mid/late Q4.
Treasuries	US10Y Bond prices	The US10Y Treasury yield is still in a persitent downtrend, yet was recently quite Oversold. It could continue its current weak bounce into late August. It then starts to roll-over again	The US10Y Treasury yield should resume its downtrend by late Summer, probably making new historical lows this Fall in the 0.5 - 0.2% range.
	Germany 10Y Bund prices	The German 10Y Bund yield could continue to rise moderately into late August. It then starts to roll-over again	The German 10Y Bund yield should resume its downtrend by late Summer, probably retesting down towards its March lows during Q4.

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

Main Equities

p 16, 41-44

Global equities probably continue higher into mid/late September. The S&P500 may reach up towards 3'600, while the EuroStoxx 50 could break out above 3'400 potentially towards the 3'500 – 3'600 range. From late Q3, a new period of intermediate correction may materialize to the downside into mid/late Q4. It may be deeper that the one suffered in June/July, but should remain well above its March lows (i.e. perhaps back into the June/July consolidation range).

Main Regional picks
p 45

We believe the rally into late Summer on equities will continue to be accompanied by a weaker US Dollar although in terms of targets, a large portion on its initial move down may be already done. Europe may still hold up in US Dollar terms, but probably starts to underperform on a currency hedged basis. Similarly, Global markets denominated in US Dollars continue to outperform the US into late Q3.

Emerging markets
p 36, 49-51

Emerging markets probably remain strong into late Q3. Their index could still rise 10 to 20% over the next month or so. This performance and outperformance vs global markets will probably be concentrated on China and Taiwan, while other more cyclical Emerging Markets gradually lose momentum on a relative basis.

Volatility

VIX barely bounced late July as some of the weaker equity markets did attempt to correct. It now probably resumes lower into the mid/low teens and into mid/late September.

Government Bonds

US & European Benchmarks
p 28-29

The weak bounces since late July on Treasury and Bund yields could still hold up into late August. Their scope probably remains quite subdued (i.e. circa 20-30 bps from the lows). From September, we expect them to gradually roll-over again and probably retest down towards their March lows, or even below in the US, into mid/late Q4.

Equity to Bond Ratios, Fixed Income Dynamics & Commodities

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Equity / Bonds	US	The US Equity to Bonds ratio (S&P500 vs 10Y Treasuries) should continue to rise into mid/late September and approach its February highs.	The ratio probably tops out again by late Q3 and corrects down into mid/late Q4.
	Europe	The European Equity to Bonds ratio (EuroStoxx 50 Futures vs Bund Futures) should resume its uptrend towards mid/late September, possibly approaching its February highs.	The ratio probably tops out again by late Q3 and corrects down into mid/late Q4.
Duration		US Yield Curve Spreads may still hold up into late August, and then start to roll over again.	US Yield Curve spreads probably resume lower from late Summer into mid/late Q4.
Credit		US Investment Grade Credit spreads probably continue to drop linearly into late Q3 as the market is backstopped. High Yield Bonds may outperform again into mid September.	From late Q3, Credit Spreads could widden again into mid/late Q4 although Credit markets will probably remain well supported.
TIPs/Treasuries		Inflation Expectations probably continue to rise moderately into late Q3.	From late Q3, Inflation expectations could retrace down moderately again into mid/late Q4.
Oil		Oil probably continues to rise into late Q3. Breaking above 49 USD/barrel on Brent would be a strong bullish signal.	From late Q3, Oil could correct down again for 1 to 2 months into mid/late Q4.
Industrial metals		Industrial Metals and Copper probably continue to rise into late Q3. Copper could even reach above 7'000 USD/ton by then.	From late Q3, Industrial Metals and Copper could correct down again into mid/late Q4.
Gold		Gold may continue to consolidate in a range into late August (support around 1'900 USD/oz) , but its uptrend remains resilient into early Fall at least.	Gold may see some consolidation this Fall, but its uptrend probably remains intact until Spring next year (targets probably towards 2'300 USD/oz).

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

Equity to Bond Ratios

US & Eurozone Market

Equity to Bond ratios should follow equity markets up and down as the equity side is clearly more volatile than the bond one (i.e. up into mid/late September, followed by an intermediate correction into mid/late Q4).

Fixed Income Dynamics

Duration (10Y - 3Y/3M)
p 30

With short term yields now near zero, the yield curve will mainly follow the direction of long term yields. Yield curve spreads may hence hold up along with long term yields until late August, but should then roll-over / flatten again into the Fall.

Credit Credit Spreads in the US and Europe are back-stopped by the FED's and the ECB's massive buying programs. Hence, they should continue to contract into late Q3 at least. US High Yield probably also rises again into late Q3 along with risk assets.

Rate Differentials The rate differential between the US and Europe should follow US rates up and down as US rates are more volatile than European ones. The spread may hence hold up into late August, but then gradually rolls over again into the Fall.

Tips
p 25
The TIPs / Treasury inflation breakeven ratio should continue to rise moderately into late Q3. It could the retrace down into mid/late Q4.

Commodities

Oil
p 27
Brent Oil probably continues to rally into late Q3, potentially breaking above our corrective resistance at 49 USD/barrel and then into the mid/high 50s USD/barrel, perhaps even higher. It could then retrace down into mid/late Q4.

Industrial metals
p 26- 27, 35
Copper and Industrial metals should continue to rise into late Q3. Copper may reach 7'000 USD/ton by then. It could then retrace down into mid/late Q4.

Gold & PMs
p 28-29, 36
Gold remains in a strong long term uptrend. It should lead it above 2'200 USD/oz into early Q4, perhaps even 100-200 USD/oz higher into Spring next year. Shorter term, following its huge rally during late July / early August, it may continue to consolidate at high levels during August (support probably lies around 1'900 USD/oz). Silver has been exceptionally strong over the last few months, and the Gold/ Silver ratio has seen an almost 40% reversal from its all time highs in March. This trend probably continues into late Q3 / early Q4 and Silver could reach into the mid 30s USD/oz by then.

Agriculture Agricultural Commodities continue to underperform other risk assets, except perhaps for more cyclical plays such as Cotton and Lumber. This early recovery environment is not very supportive for the segment, which usually thrives in late cycle economic expansions when inflation starts to pick up. Their recent bounce since mid July should die out towards late August / early September.

Foreign Exchange

		Next 2 months	3 to 6 months ahead
USD vs	EUR	EUR/USD probably continues to rise into late Q3 / early Q4 and towards 1.21.	EUR/USD may then suffer an intermediate correction (4-6 figures) during early/mid Q4, but then probably rises again into late Q1 next year and new highs.
	GBP	GBP/USD probably continues to rise into late Q3 / early Q4 and into the 1.32 - 1.38 range	GBP/USD may then suffer an intermediate correction (7-11 figures) during early/mid Q4, but then probably rises again into late Q1 next year and new highs.
	JPY	USD/JPY probably continues lower into late Q3 / early Q4 and the 104 - 102 range.	USD/JPY could then bounce during early/mid Q4 (3-5 figures), but then probably resumes lower again into late Q1 next year and new lows.
	CHF	USD/CHF probably continues lower into late Q3 / early Q4 and perhaps towards 0.89 - 0.88	USD/CHF could then bounce during early/mid Q4 (3-5 figures), but then probably resumes lower again into late Q1 next year and new lows.
EUR vs	GBP	EUR/GBP probably consolidates into the high/mid 0.80s (potentially into the 0.88 - 0.85 range) into late Q3.	During early/mid Q4, EUR/GBP then probably retests up again into the mid/low 0.90s, but then probably consolidates down again towards 0.90 and the high 0.80s into early next year.
	JPY	EUR/JPY probably continues to rise into late Q3 / early Q4 and into the 1.26 - 1.29 range.	During early/mid Q4, EUR/JPY probably enters an intermediate correction (4-6 figures), but then probably resumes higher again into late Q1 next year and new highs.
	CHF	EUR/CHF probably continues to rise into late Q3 / early Q4 and towards the 1.10 - 1.12 range.	During early/mid Q4, EUR/CHF probably enters an intermediate correction (2-3 figures), but then probably resumes higher again into late Q1 next year and new highs.
GBP vs	JPY	GBP/JPY probably continues to rise into late Q3 / early Q4 and the mid 140s.	During early/mid Q4, GBP/JPY probably enters an intermediate correction (8-12 figures), but then probably resumes higher again into late Q1 next year and new highs.
	CHF	During August, GBP/CHF finaly breaks above 1.20 again, probably towards the mid 1.20s into late Q3 / early Q4.	During early/mid Q4, GBP/CHF probably enters an intermediate correction (back to the low 1.20s/ high teens), but then probably resumes higher again into late Q1 next year and new highs.

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

US Dollar
p 32-34

The US Dollar (i.e. the Dollar Index) was Oversold early August and attempted to bounce. It could still see another intermediate bounce into late August. Yet, from late August / early September, it should resume its downtrend, probably towards mid/late September at least, perhaps even into early October. It may lose another 2-3 figures until then. Following than, early/mid Q4 should see a new, more substantial bounce as risk assets probably enter an intermediate correction. We then expect a year-end rally, and renewed US Dollar weakness, a trend that probably extends into early Spring next year.

Euro
p 35, 37

EUR/USD was Overbought early August, did correct slightly, and may still see more consolidation at high levels over the next couple of weeks. It should then resume its uptrend probably towards 1.21 into late Q3 / early Q4. We then expect a further, probably deeper, intermediate correction during early/mid Q4 (potentially retracing 4 to 6 figures), before the pair rises again towards new highs, probably towards early Spring next year. EUR/JPY and EUR/CHF are following a similar dynamic, probably rising into late Q3, then retracing during early/mid Q4, to finally rise again into early Spring next year.

Yen
p 40

The US Dollar appears weak across the board until late Q3 at least, even vs the Yen, and despite our rather risk-On scenario until then. We hence expect it to test below 104 over the next month or so. Thereafter it may bounce back 3 to 5 figures during early/mid Q4, before dropping again towards year-end and into early Spring next year, probably towards new lows.

Sterling
p 38

The Pound could rise vs all the other majors into late Q3 / early Q4. It may reach into the mid 1.30s vs USD, the mid 140s vs JPY, the mid 1.20s vs CHF, while EUR/GBP could drop into the 0.88 – 0.85 range. Then, during early/mid Q4, we expect a rather short, but strong intermediate correction, before the Pound rises again vs all the majors into Spring next year and potentially new highs.

Swiss Franc
p 40

Similarly to the Yen, Swiss Franc, probably strengthens further vs the US Dollar into late Q3 at least. USD/CHF could test down below 0.90 (e.g. towards 0.89 - 0.88). It could then bounce 3 to 5 figures during early/mid Q4, before dropping again towards year-end and potentially Spring next year towards new lows (e.g. 0.86).

Oil & Commodities currencies
p 39

Commodity currencies (our equal weighted portfolio containing AUD, BRL, CAD, NOK, NZD, RUB, CLP and ZAR) were Overbought late July / early August vs the US Dollar and have since consolidated. Over the next couple of weeks, we expect them to resume their uptrend, probably into late Q3 / early Q4. Early/mid Q4 may then see an intermediate correction before Commodity currencies rise again vs the US Dollar into next Spring. Vs EUR, Commodity currencies have retested down since early June. We expect them to bounce again into September but they could then suffer a further retest down this Fall (we are rather neutral over the next 6 months on them vs the Euro).

Asian currencies
p 39

Our Asian Growth equal weighted portfolio (CNY, INR, KRW, THB and TWD) is more defensive that the Commodity portfolio above. Vs US Dollar, it does show a similar profile than it, but probably with less upside potential into late Q3 / early Q4. Vs the EUR however, the situation is less clear as the EUR still appears strong into late Summer. We would hence probably also remain neutral over the next 6 months on the EUR vs Asian Growth Currencies.

Equities Markets Segmentation

Core Sector Weightings | **Next 2 months** | **3 to 6 months ahead**

US Sectors - S&P500 (general comment)			**The cyclical bounce we expected into August may die out towards late August, Growth themes should then outperform into late September / early October.**					**Defensive themes may bounce early/mid Q4, Cyclicals should then underperform again, while Growth holds up and then leads once more into Spring next year.**				
Sectors	Proxy ETF symbols	Benchmark-weights	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Technology	XLK	21%										
Healthcare	XLV	15%										
Financials	XLF	14%										
Discretionary	XLY	10%										
Communication	XLC	10%										
Industrials	XLI	10%										
Staples	XLP	7%										
Energy	XLE	6%										

European Sectors - Europe Stoxx 600 (general comment)			Next 2 months: **The cyclical bounce we expected into August may die out towards late August, Growth themes should then outperform into late September / early October.**					3 to 6 months ahead: **Defensive themes may bounce early/mid Q4, Cyclicals should then underperform again, while Growth holds up and then leads once more into Spring next year.**				
Sectors	Index symbols	Benchmark-weights	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 17, 20-21, 46, 52-53

Please read the detailed allocation comments in our time frame boxes above.

On the sector front, the cyclical rally we expected from late July into August is underway. Yet, we believe it could die out over the next couple of weeks. Following that, Growth themes may take up the lead again into late September, perhaps early October.

While we do expect some retracement on equity markets this Fall, and hence a Defensive bounce, from mid/late Q4, we believe a year-end rally should materialize and extend into Spring next year. Growth themes should lead throughout this period, while defensive ones lag and cyclical factors underperform.

Countries allocation

Core Countries Weightings: All World Country Index Currency hedged (general comment)			Next 2 months: **Into late Q3, we would Underweight most developped markets, except perhaps for Germany, and Overweight China.**					3 to 6 months ahead: **During Q4, we will probably Underweight most of Europe, except for Switzerland, continue to favor China and neutralize the US and Canada.**				
Countries	Index symbols	Benchmark-weights	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 45, 47- 51

Please read the detailed allocation comments in our time frame boxes on the previous page.

Regionally, we would continue to underweight the US as a weaker US Dollar could continue to weigh on its relative performance into late Q3. We would also underweight Canada and Switzerland, probably into late Q3 because of their defensive profiles. In local currency terms, Europe and Japan may continue to suffer from their stronger currencies vs the US Dollar. During this period, we would Overweight China, and perhaps neutralize Germany in Europe as its relative outperformance in Europe is often related to Chinese strength.

Thereafter, from early Q4, we would probably underweight Europe and Japan (except for Switzerland during early/mid Q4), which will probably underperform during early/mid Q4 due to their more cyclical profile, and then, once equities resume their uptrend into early next year, probably lag once again in local currency as their currencies continue to strengthen vs the US Dollar. We would probably neutralize the US and Canada, at least during early/mid Q4, as the US Dollar could bounce and given their more Growth/Defensive profiles.

Until Spring next year, China appears to be an all-weather trade and we will probably keep it as Overweight throughout the period.

Note: the country and regional allocations in the table above are considered hedged for currency risk, i.e. the relative performances are compared and forecast in local currency (except for the S&P500 and the MSCI China Index vs the All Country World Index as both are denominated in US Dollars).

Core factors and Themes

Core Factor/Themes Weightings **Next 2 months**

General Comment	**We continue to favor the same factor allocation as last month, i.e. Overweight US Small Caps, Goldmines and Diversified Mining into late Q3, and add the Nasdaq 100 from early September.**					**From early Q4, we would Underweight the more cyclical themes, continue to Overweight the Nasdaq100 and neutralize the rest.**				
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 18-19

On the factor front, the cyclical bounce we expected from late July and during August is still underway. While some of these themes may roll over the next couple of weeks (e.g. value vs growth, Southern EuroZone vs EuroZone), US Small Caps seem quite resilient into mid/late September along with Diversified Mining. Goldmines may continue to consolidate short term, yet by late August should rise again into late Q3 / early Q4. In the meantime, the Nasdaq100 could gradually start to regain relative strength from early September

During early/mid Q4, we expect some retracement on risk assets and believe that cyclical factors will probably suffer the most. We would hence underweight most cyclical themes. Thereafter, we expect a new risk assets rally into next Spring, yet, do believe that Growth themes could be in the lead once again. Hence, we are Overweighting them (e.g. the Nasdaq100) over the next 6 months.

12 / A V-shaped GDP recovery is due in Q3 2020: government help and drawing down on personal savings rescued consumer spending, ISM

In March 2020 we had a look at what to expect in terms of US GDP growth and economic activity. The article at that time was titled: "*US GDP may suffer after Q1 2020, but that wouldn't preclude large equity and yield rallies until May-June this year.*"

We said at that time:

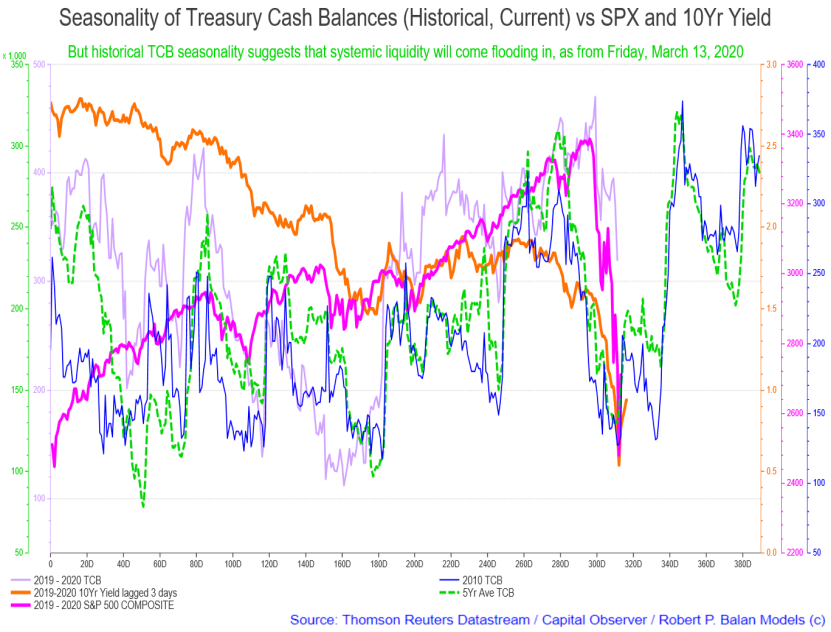
The role of liquidity drought in the Great COVID-19 sell off

The equity market aspect has become even more interesting and intriguing in the context of the global COVID-19 virus epidemic that is running rampant, and will remain a negative factor for growth and the risk asset markets for a while. From what we see in the situation captured by the series of graphs below, the COVID-19 infestation struck at the same moment that the markets have been weakened systemically by a seasonal liquidity drought. The main actors, capital flows and fiscal expenditures have been on a simultaneous downswing, and at the same time, the change rates of bank reserves and of the Fed's balance sheet were also on a yearly seasonal contraction (see 1st chart on this page).

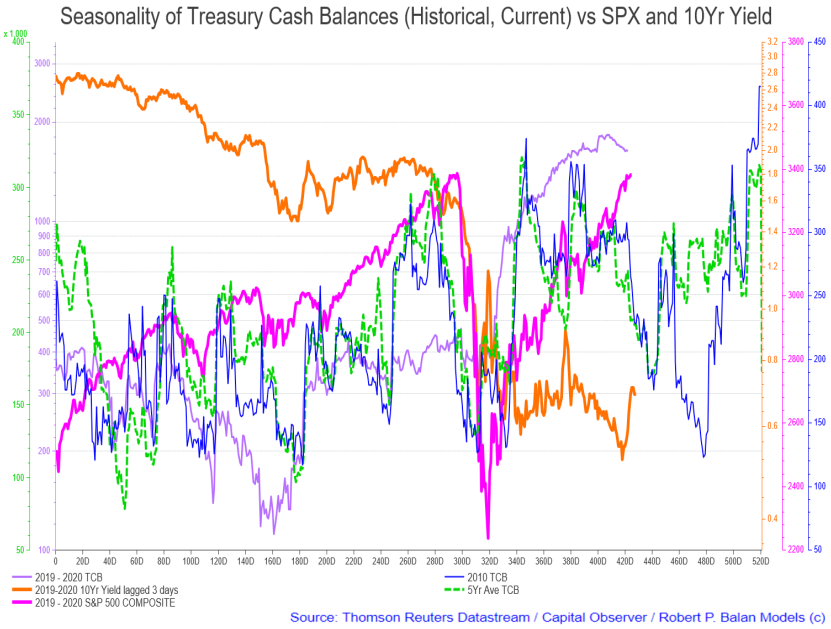
The result – a perfect storm of liquidity drought (which would have cut down risk asset prices on its own merit), and then the COVID-19 virus struck. You can see the potential extent of the fall in yields and equities pre-determined by negative liquidity factors, and further depressed by the panic generated by the spread of the CV virus.

The conclusion of some pundits that the equity markets and other risk assets will be severely hampered by the sharp fall in demand due to mandated or voluntary quarantine of the populations, in the US and elsewhere, especially Europe. Hence, they said, the equity bear market will extend further as whatever central banks or government do will not alleviate the fall in demand, and therefore the US and global economies will fall into a recession.

Original graph in the March Capital Observer



This is how this model looks today



The economy inevitably went into a recession, but as we expected that did not stop the equity markets from going into new all-time highs (*see 2nd graph on the next page*). It has become apparent that the financial markets have taken a look at the future prospects of the economy, and have voted to go with a spectacular recovery. Booming financial markets are both indicator of, and contributor to, the real economy down the road. **Therefore, it was very telling that the most generic of activity data, the ISM, is confirming what the financial markets seem to know in advance.**

One of our favoured tools are the ISM surveys, both manufacturing and services, and a hybrid ISM, which is composed of 82% Services and 18% manufacturing (*see 1st graph on the next page*). We juxtaposed the ISM, the S&P 500 Index and GDP data to get a visual cue of what to expect. **The V-shaped recovery in the financial and ISM variables argue for a much better Q3 GDP data that have been flogged by many analysts.**

What kind of growth trajectory can we expect?

The next question was what kind of trajectory a recovery will take. Since we have not had a COVID-19 pandemic before, we need another example to provide us guidelines. The period including World War 2 and the time shortly thereafter seems useful for this exercise.

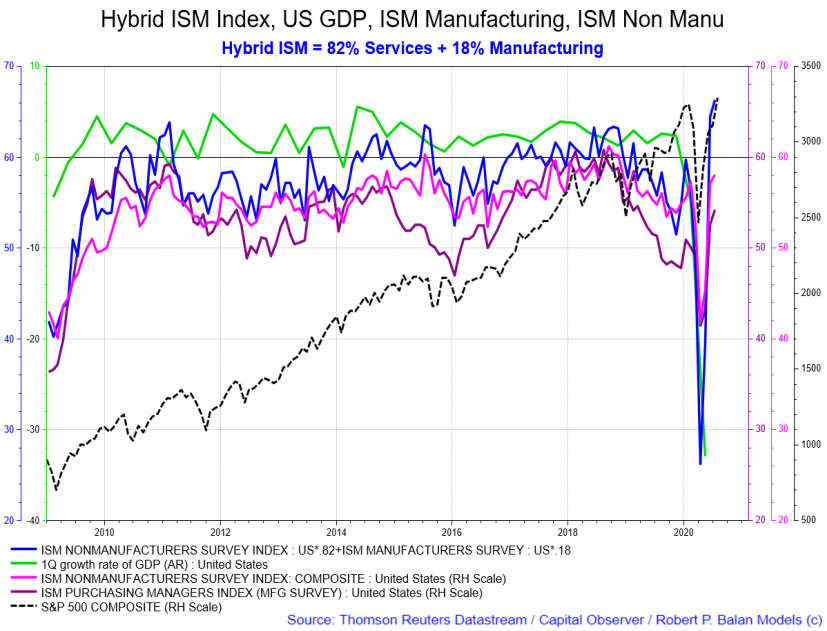
In the period of World War II, the economy shrunk by 58.83%, a massive decline, with the military spending stripped out. While the actual impact of the virus was less than this pessimistic eventuality, COVID-19 related stoppages were still substantial knock on the US economy. However, with the experts seemingly in agreement that there will be a vaccine available by the end of the year, it seems as this time of COVID-19 is ending, albeit with a possible second wave coming before the end of 2020.

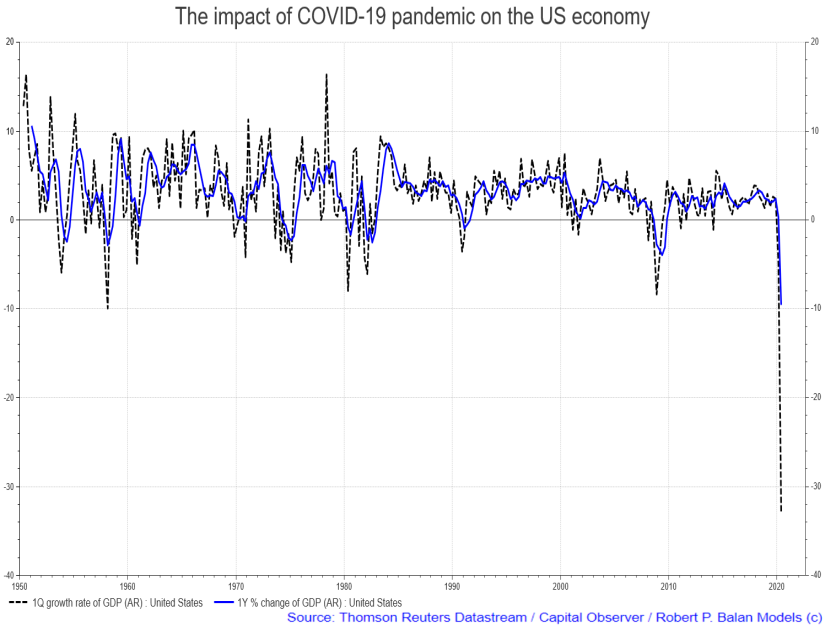
While the effect of COVID-19 isn't as serious as a 59% decline in GDP during WW 2, the economic damage is still very large (*see 2nd graph on this page*).

The decline in GDP over the first two quarters is 37.9% on an annualized basis, with 32.9% decline in the second quarter is one of the largest, if not the largest, decline in a single quarter in US history.

However, we are looking towards a post-COVID-19 world and, particularly, the rebound in the economy after the Second World War. During the following 4 years, the economy grew 182.70%. As such, from the period of 1940 to 1949, the US economy grew by 16.4% and had fully recovered from the crisis. Of interest is that the economy recorded a greater than 40% increase in the first year alone.

And, while COVID-19 comes with challenges of its own, this was a period where the economy had to shift from significant military production to civilian production once more. **Hypothetically, this means that the post-COVID-19 recovery may be sharper than what has been seen in the post WW2 recovery.**





We need to see a few primary data to support or shoot down this thesis – the major ones are Employment, ISM data and Retail Sales:

Employment

This is the primary data to watch for. With over 15 million individuals unemployed based on the latest jobs report and an additional 10.7 million individuals receiving Pandemic Unemployment Assistance, labor market improvement cannot happen fast enough. However, the trend of employment-related reports this past week indicate the job market is improving. **Initial jobless claims for the week ending August 7 were reported at 963,000, a far cry lower than the nearly 7 million claims filed at the peak of the pandemic shutdown in March/April.**

Although last week's claims level is too high, they are declining. That trend is very encouraging (*see 1st graph on the next page*).

The latest Job Openings and Labor Turnover Survey (JOLTS) in the above chart shows, job openings increased by 518,000. To gauge the health of the job market, one variable worth evaluating is the Total Separations category reported in the JOLTS report minus the Job Quits. This net figure provides one with

insight into job losses that are more in the category of involuntary. The JOLTS report notes the separation category "includes quits, layoffs and discharges, and other separations." Quits on the other hand are "generally voluntary separations initiated by the employee." As the 2nd graph on this page shows, these involuntary job losses are back to a level seen prior to the virus mandated shutdown.

ISM

Economic data reported over the last two weeks continue to support a V-shaped growth narrative being drawn by the financial market and employment data. **Much of the recent economic releases are positive and when plotted on a chart, the data trace out a V-shaped pattern as well.** *(see 3rd graph on this page)*

Last week the New Orders Index reported by the Institute for Supply Management (ISM) in their manufacturing showed new orders increased 5.1 percentage points to 62.5%. The report noted:

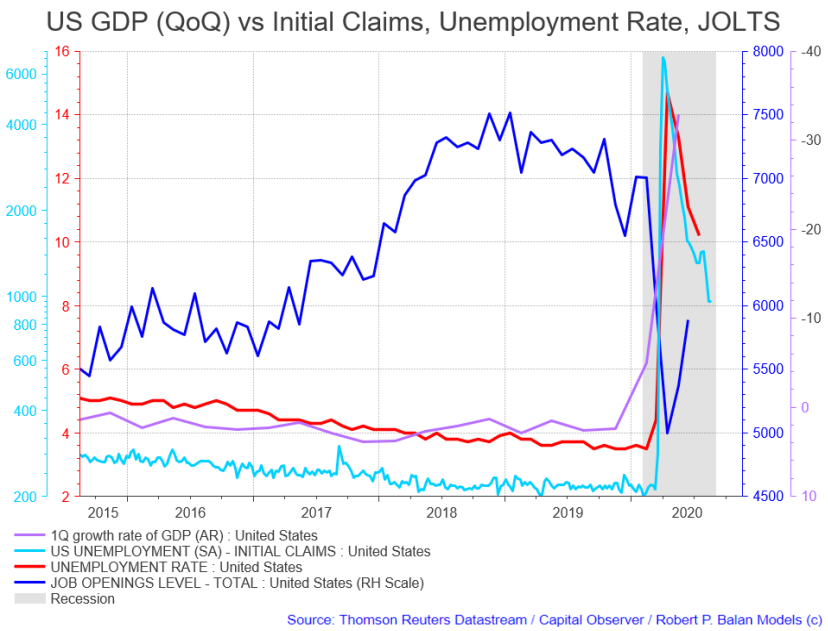
- New Orders Index growing at a strong level, supported by the New Export Orders Index re-entering expansion, and
- Backlog of Orders Index returning to expansion for the first time in five months.

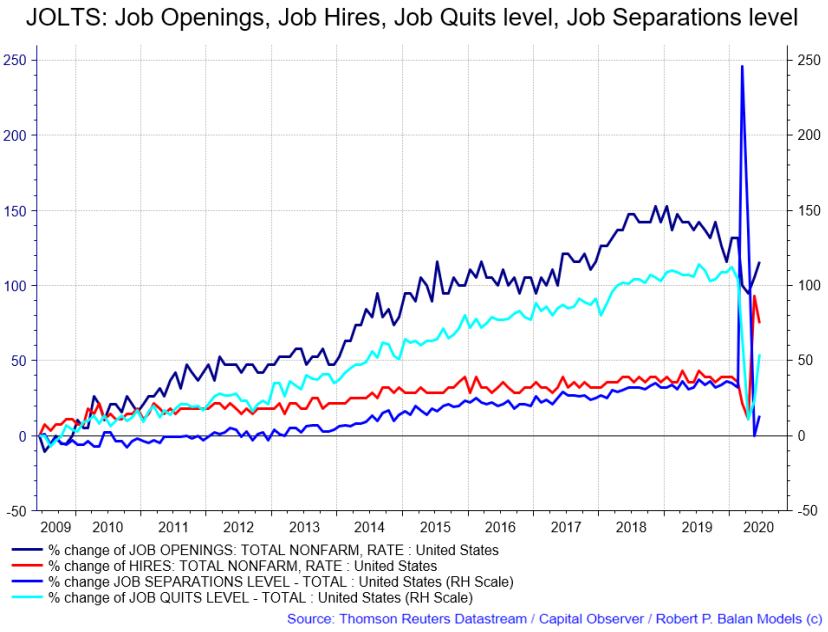
(see 1st graph on the next page)

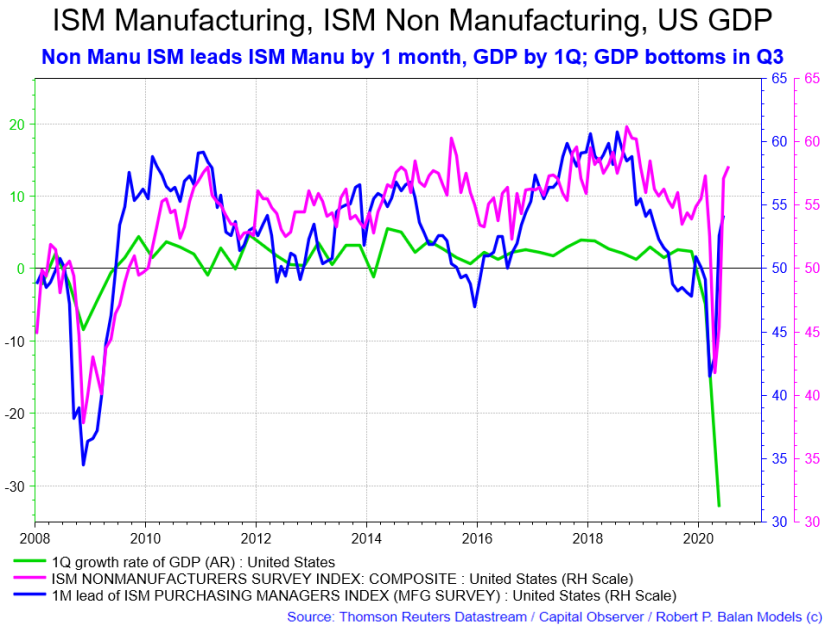
More importantly, the ISM Services (Non-Manufacturing) composite data and its internals were also upbeat.
(see 2nd graph on the next page)

Retail Sales

The recent report on retail sales shows total retail sales has now gone back close pre-crisis levels. Clearly, the below chart shows the "V-shaped" recovery in this economic data point. **Consumers account for 70% of the economy or GDP. The additional unemployment support that expired**



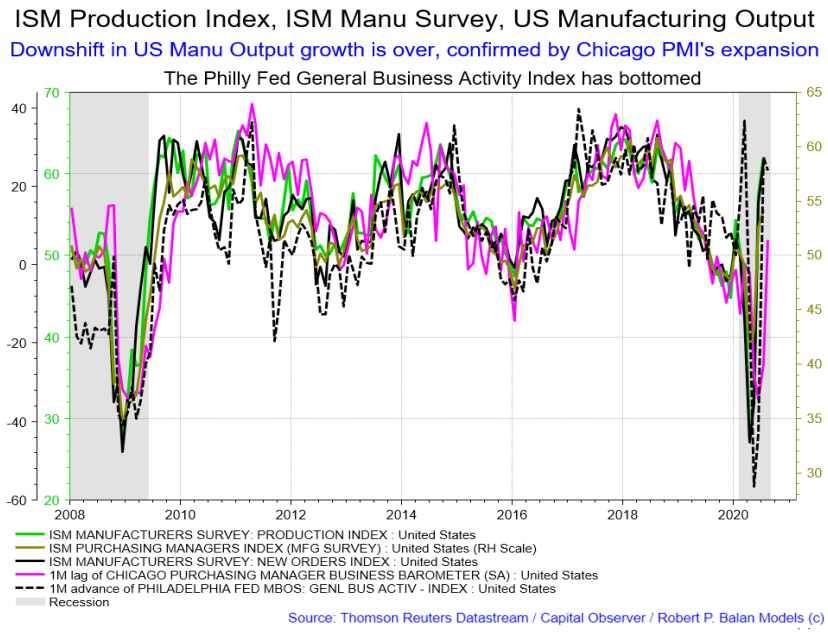


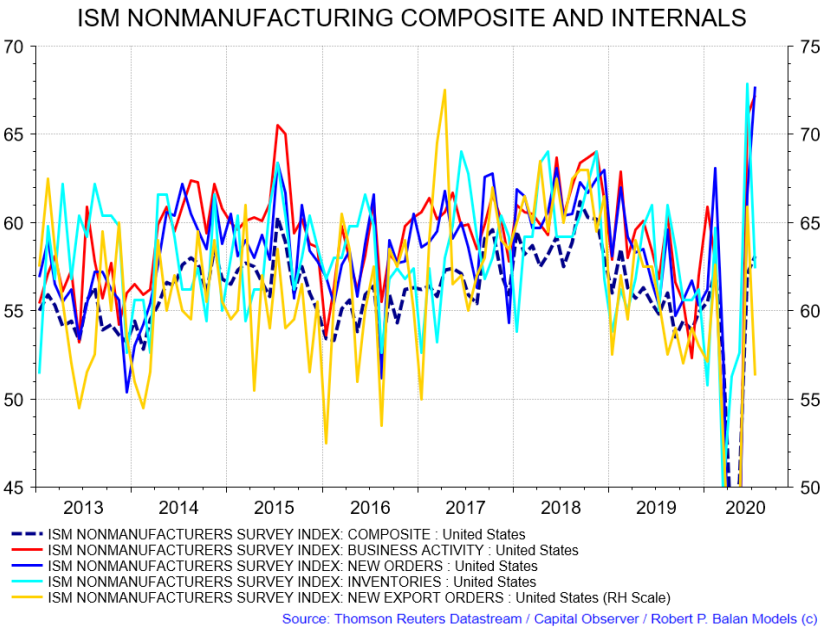


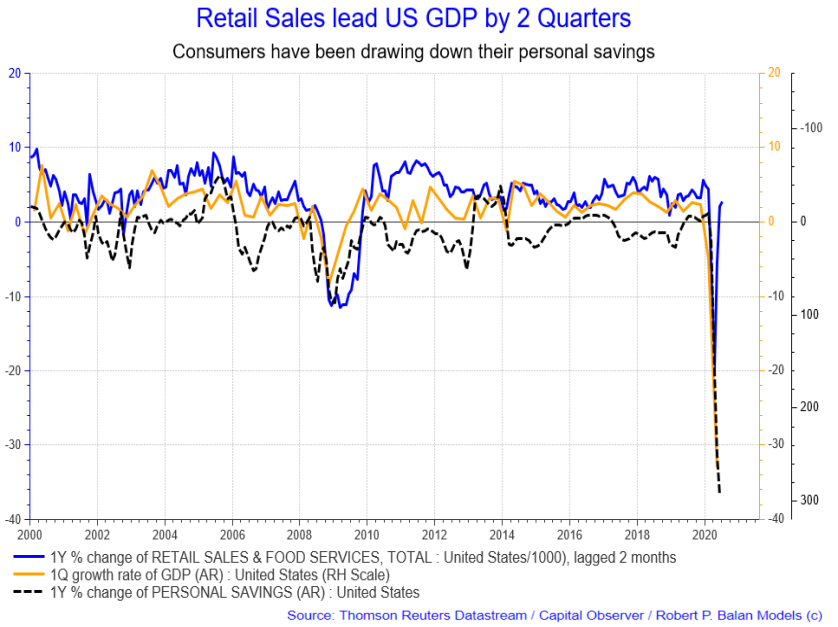
at the end of July contributes to positive consumer sentiment which has contributed to a positive retail sales environment.
(see 3rd graph on this page)

This type of data will need to be watched as that particular unemployment insurance support program has expired. The new COVID-19 stimulus bills now being discussed by the Trump government and Congress should continue to support the recovery of consumer purchasing over the rest of the year, until the country can go back on normal mode.

In summary: The reactions to the COVID-19-crisis and the policies enacted have put us in a disaster period that has not been seen for decades. Comparing it to the disaster period of World War II can provide some answers to what may happen in the next months and years. While GDP may increase dramatically post-crisis, this may not be accompanied by a full bounce back in employment for a while. But government help has been providential in restoring retail sales, and subsequently, economic activity.





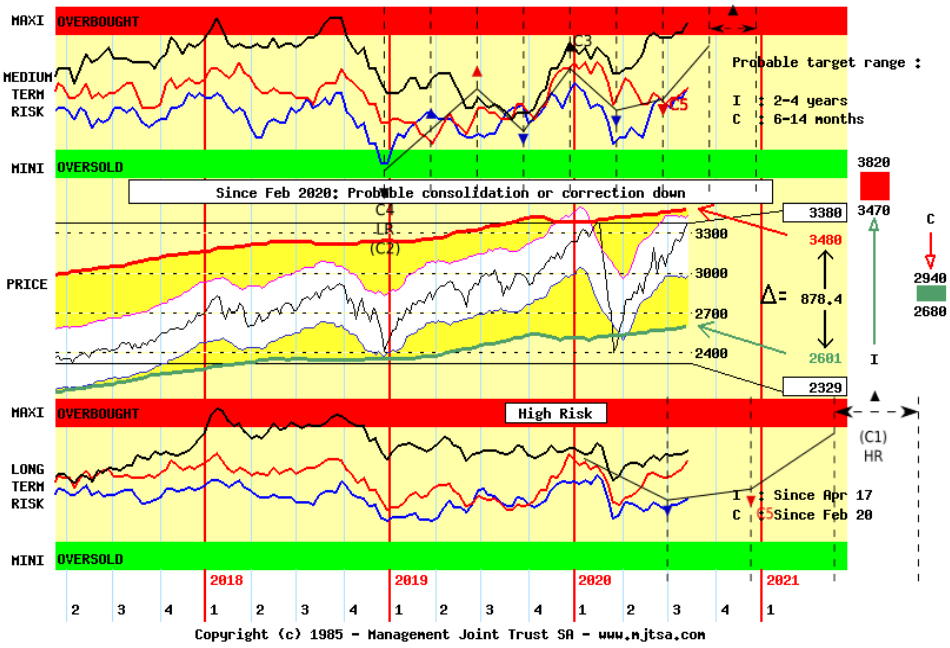


16 / MJT - TIMING AND TACTICAL INSIGHT

The rally could continue to defy gravity into September

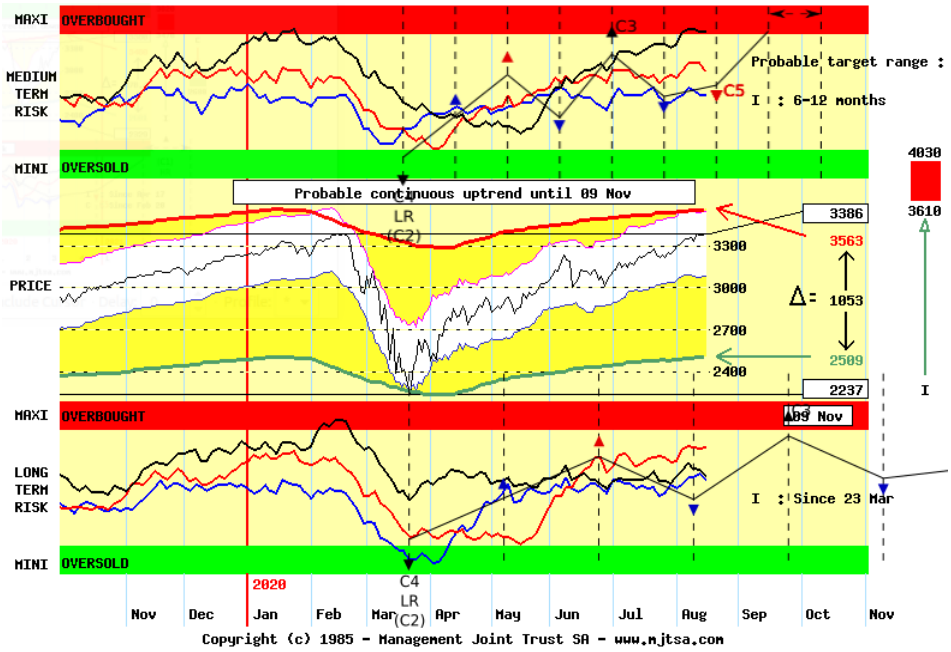
While millennials are flocking to the US stock and retail brokers are raking in record profits, many institutional investors are probably still sitting on the sidelines, watching in awe as the spectacular bull run since March continues to defy gravity and to diverge from a gradually recovering US economy. Smart Money indeed seems to have remained on the sidelines and as a proxy Money Market funds have seen massive inflows (up to 4.5 Trillion US Dollars early August, from 3.5 trillion back in February). What will eventually follow is still difficult to assess. Will retail traders be punished for their greed or will institutional investors succumb to the fear of missing out? In this article, we attempt to assess the situation on US equity markets by comparing different equity profiles / sectors to the S&P500. We aim to assess if the recent bounce in cyclical factors is sustainable, if a growth extension could still pull US equity markets higher into September, or if a defensive shift is on the verge of materializing.

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



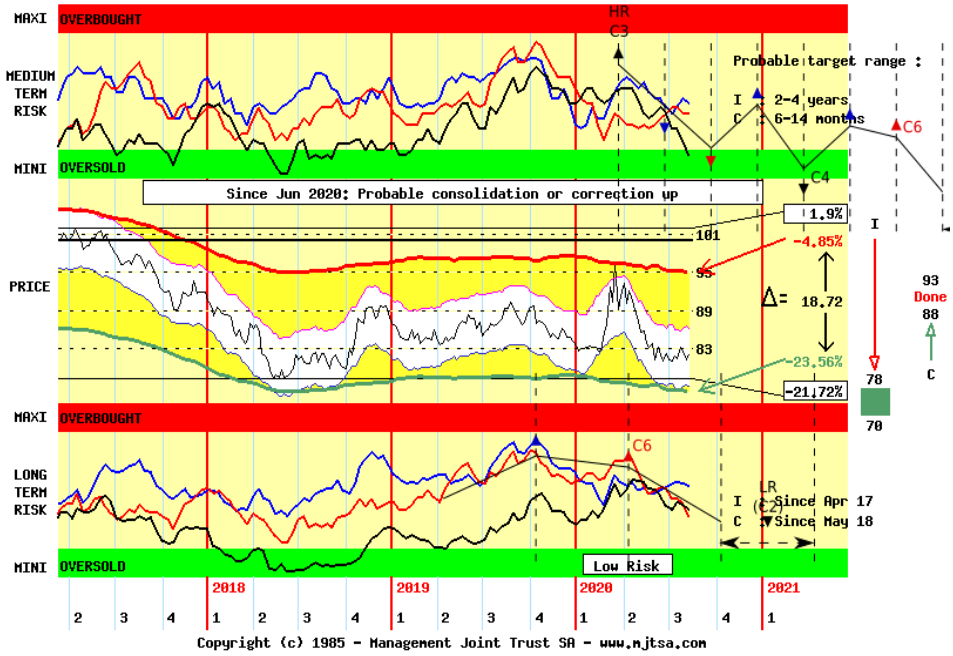
We start our analysis with the S&P500, which is approaching the 6 months anniversary from its February highs and has just closed above them. **While our medium term oscillators (upper rectangle) have entered the Overbought zone, the sequence we show probably found renewed support late June, a situation, which as shown, could help the current rally extend into late Q3 / early Q4**. On our long term oscillators (lower rectangle), the sequence is also in a resume uptrend situation. A retracement period towards a higher low mid/late Q4 may be expected, but then the trend probably also resumes higher into Spring next year. On the targets front (right-hand scale), our I Impulsive targets to the upside suggest potential towards the 3'470 – 3'820 over the next 6 to 12 months, while support probably lies towards the June lows just below 3'000.

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



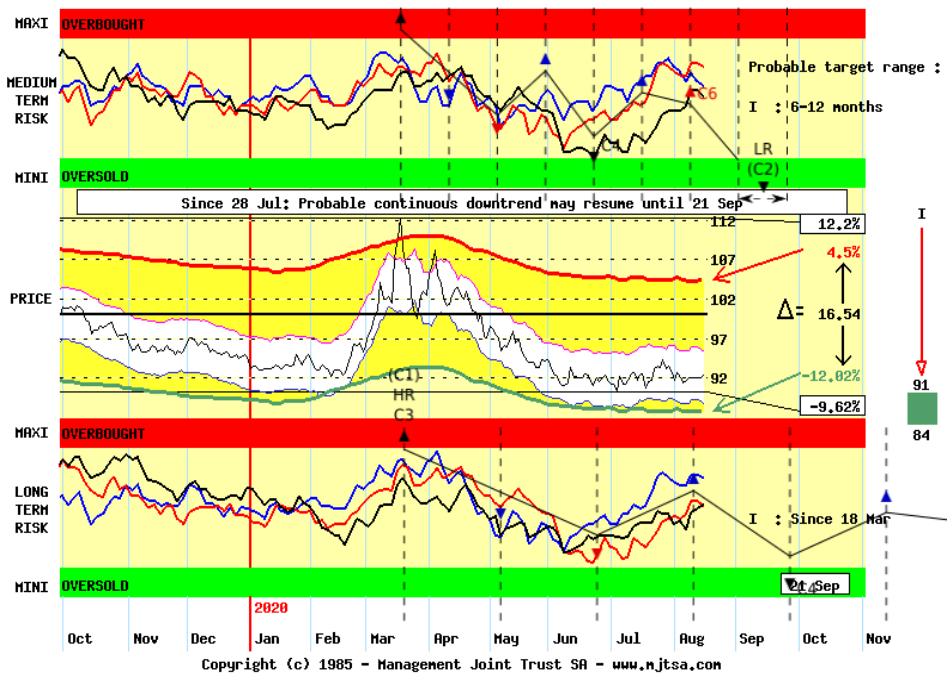
The Daily graph may also appear uncomfortable given the wedge type configuration which has developed since late June. Yet, both oscillator series (lower and upper rectangles) **are still uptrending and probably extend higher into mid/late September.** Our I Impulsive targets to the upside (right-hand scale) suggest that by then, the S&P500 could reach the 3'600-4'020 range.

US Staples sector vs the S&P500 Index
Weekly graph or the perspective over the next 2 to 4 quarters



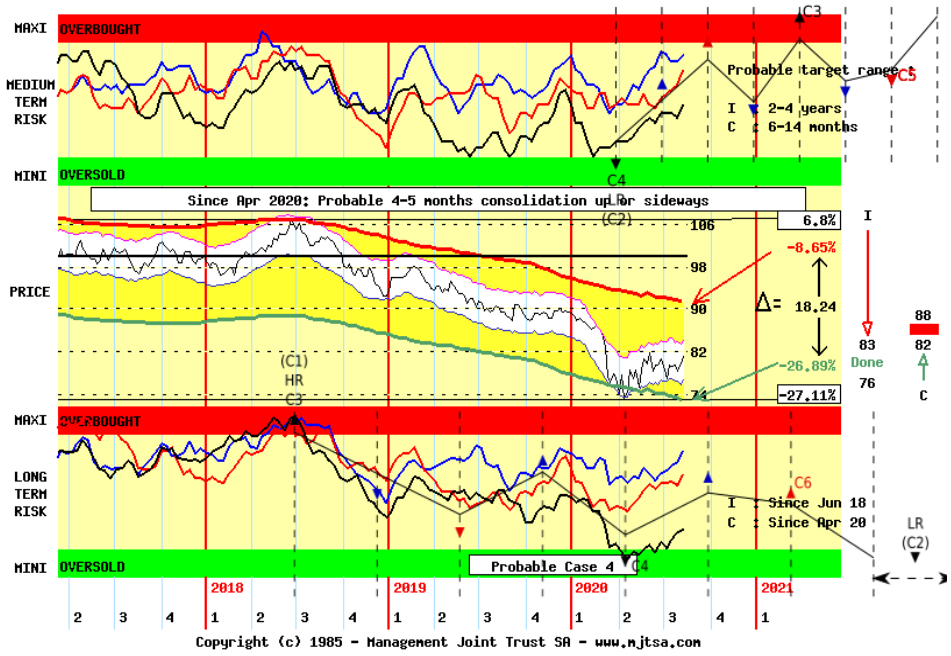
As shown above, our oscillator sequences on both the Weekly and Daily graphs of the S&P500, seem to extend higher for another month or so. Yet, the situation is quite unique given the growing dichotomy between US equity markets and the economy. We hence go on to analyze various equity profiles to seek further confirmation. We first start with the ratio of the defensive US Staples sector vs the S&P500. On this Weekly graph, the relative performance of US Staples culminated in March this year. **We believe this peak probably concluded 2 years of defensive rebound, which started in early 2018, when most cyclical factors topped out with the Chinese and European economies. As shown on both oscillator series (lower and upper rectangles), we believe that US Staples probably started to resume their long term downtrend vs the S&P500 in March, and now believe that the ratio should continue lower, first into late Q3, and then possibly into Spring next year.**

US Staples sector vs the S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



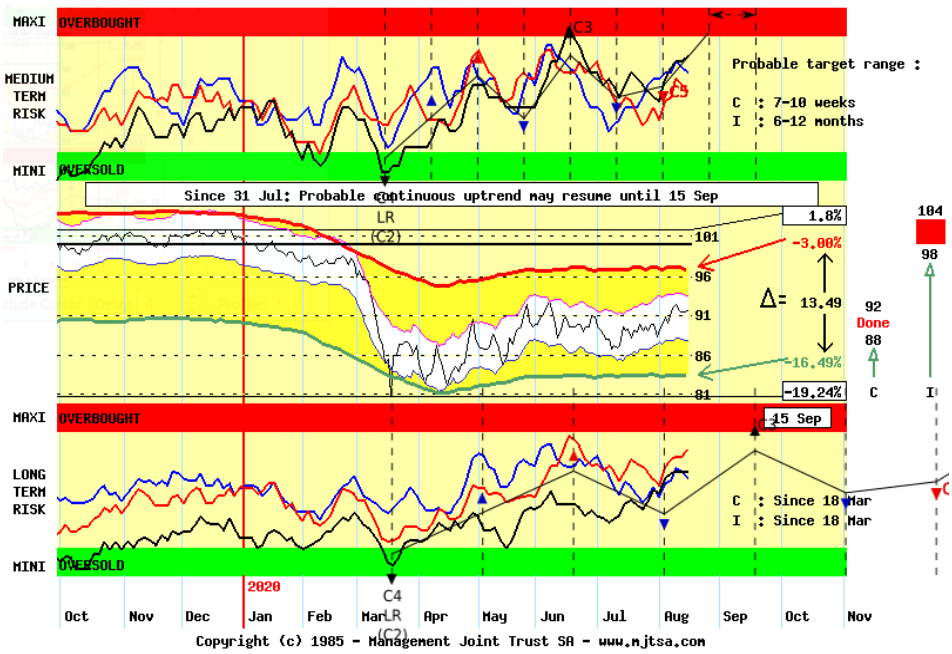
On a Daily basis, the ratio of US Staples vs the S&P500 has been attempting to bounce since June. As of today, this bounce appears quite weak and according to both our oscillator series (lower and upper rectangles), **the ratio should soon resume its downtrend, probably into mid/late September in first instance. We believe that this defensive weakness into late Q3 does confirm our persistent bullish view on the S&P500 until then.**

Russell 2000 vs the S&P500 Index
Weekly graph or the perspective over the next 2 to 4 quarters



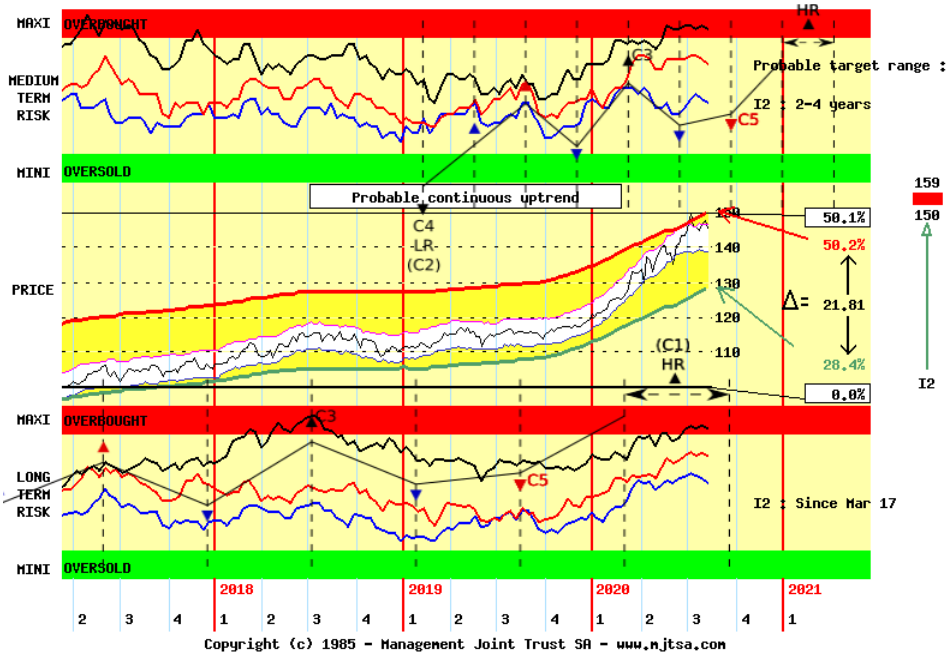
Another ratio, which is worthwhile looking at, is the one of the US Russell 2000 small caps index vs the S&P500. US Small Caps had underperformed since mid 2018 when they topped out with many US cyclical factors and their ratio vs the S&P500 may have suffered a climax liquidation in March. They have since been rebounding and outperforming. **While on our long term oscillators (lower rectangle), we expect the bounce since March to extend into late Q3, we have pictured an even more positive scenario on our medium term ones (upper rectangle) considering that their cycle may have bottomed in March and that following some retracement this Fall, the ratio could extend higher into next Spring**. This medium to long term bullishness does require a leap of faith for cyclical factors, yet following almost two years of relative weakness (and more generally of longer term underperformance since 2014), and the massive amount of liquidity that has been injected since March, we believe it is not totally implausible.

Russell 2000 vs the S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



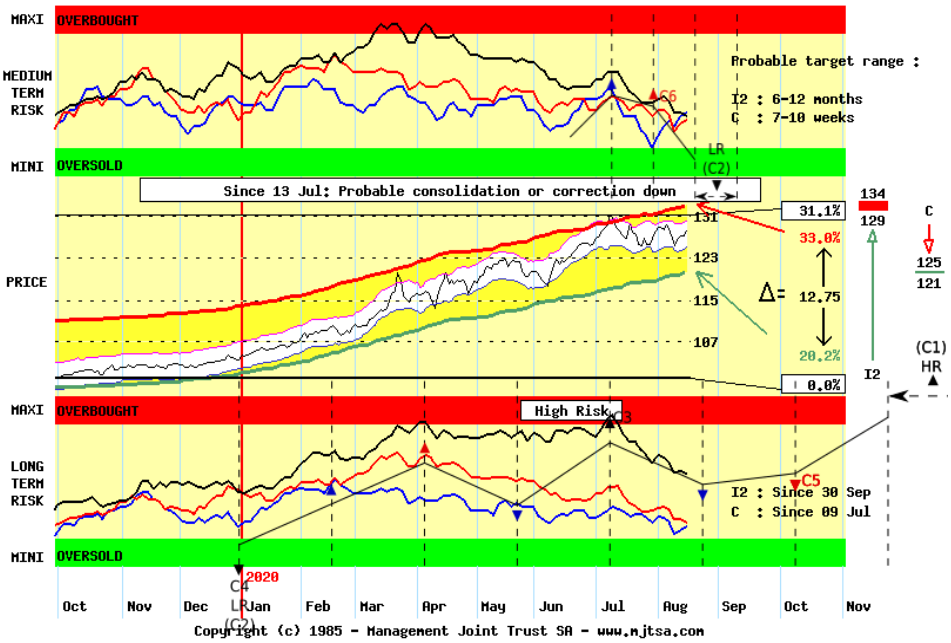
On a Daily basis, both oscillator series (lower and upper rectangles) suggest that the Russell 2000 US Small Caps Index probably continue to bounce vs the S&P500 until early/mid September. The ratio's outperformance since March could appear quite surprising given that large Tech stocks have also performed quite well, especially in the initial phases of the recovery, but does probably correspond to investors seeking domestic opportunities, following many years of underperformance as well as the massive climax sell-off in March. More generally, it may correspond to a leveraged bet on further US economic recovery, probably driven by long standing Government support and liquidity provision. On the targets front (right-hand scale), the ratio is working through the resistance of our C Corrective targets to the upside around 92 (right-hand scale). A break above these levels would be very promising over the next few weeks, but also for the long term prospects of the US Small Caps.

Nasdaq100 vs the S&P500 Index
Weekly graph or the perspective over the next 2 to 4 quarters



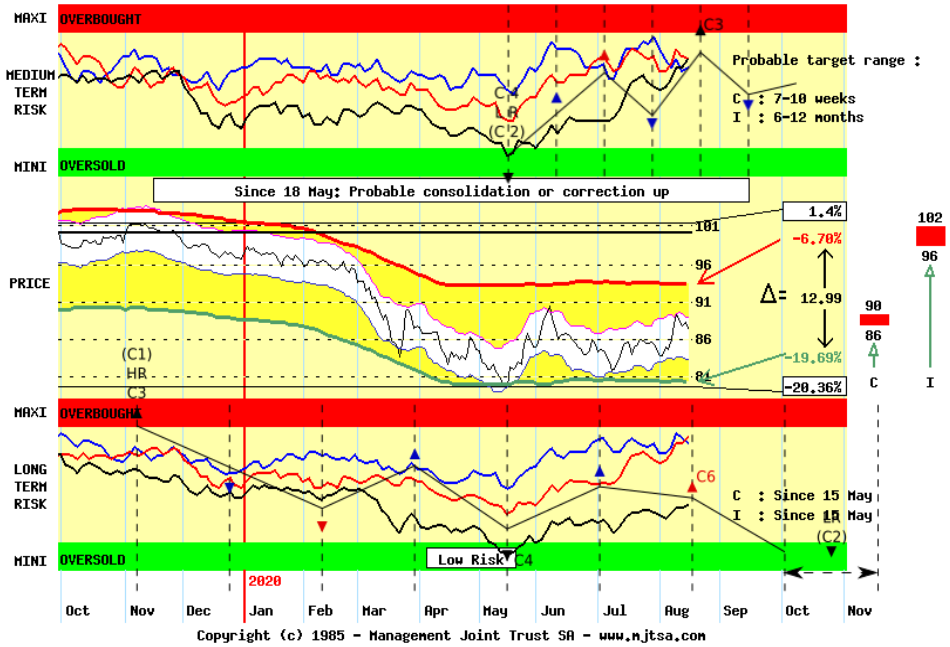
The Nasdaq 100 has seen massive outperformance vs the S&P500 over the past 10 years, and also since late 2018 when bond yields started to drop again. On our Weekly graph, most of the ratio's outperformance may be behind us (our long term oscillators – lower rectangle – have reached a High Risk position, while we are approaching our I2 extended Impulsive 2 targets to the upside – right-hand scale). Yet, this is persistent uptrend and for now we would probably refrain in calling for its secular reversal. Indeed, **while our medium term oscillators (upper rectangle) do suggest some consolidation during mid Q3, the ratio then probably resumes higher into early next year at least.**

Nasdaq100 vs the S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



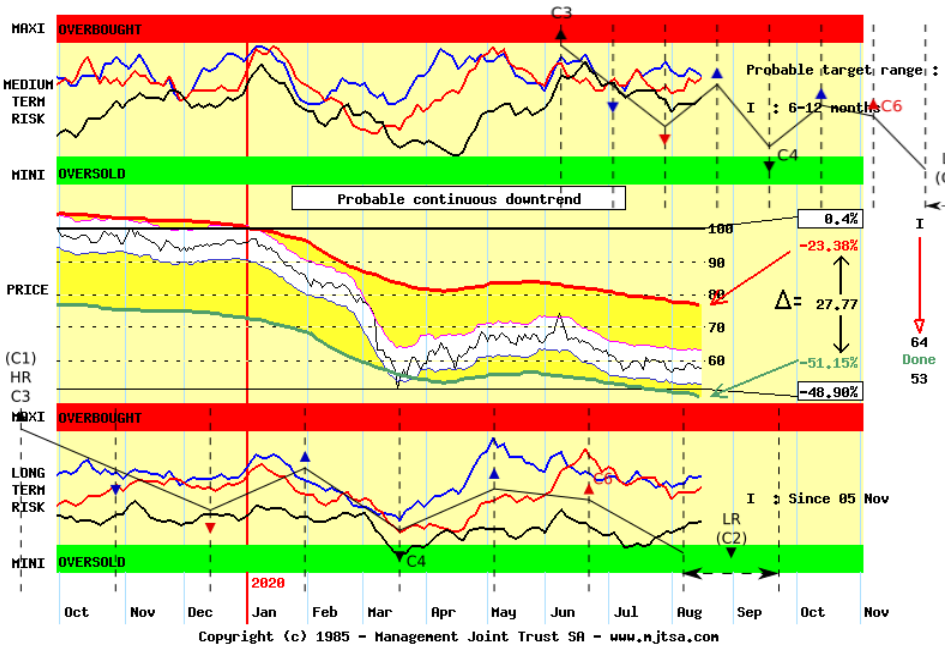
Since early July, the Nasdaq100 has been consolidating at high levels vs the S&P500. According to both oscillator series (lower and upper rectangles), this move may last another couple of weeks, perhaps into late August / early September. The ratio then gradually regains strength and probably outperforms again into early next year. Short term downside targets are probably limited to our C Corrective targets to the downside 2 to 6% below current levels (right-hand scale), while the subsequent upside may then achieve new highs on the ratio. Hence, we believe **the current soft patch in the Nasdaq100 is probably transitory.**

US Industrials sector vs the S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



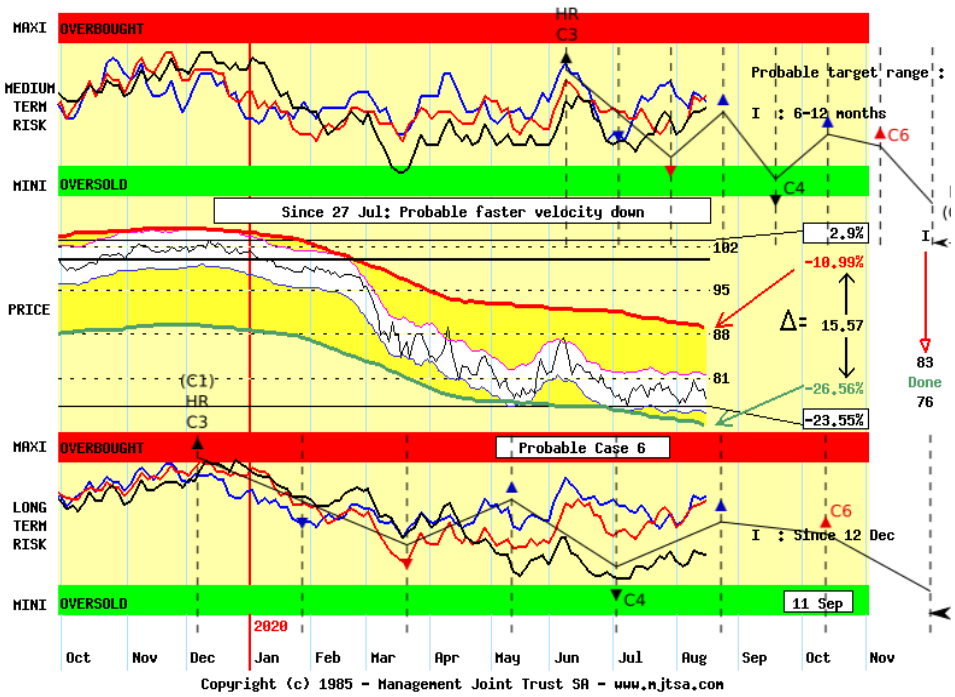
We now consider more specific sectors vs the S&P500 and first turn to cyclical sectors. The ratio of US Industrials vs the S&P500 has bounced since April. Yet, according to both oscillator series (lower and upper rectangles) **could soon resume its downtrend, probably from late August and into the early/mid Fall at least**. Although it is also working through the resistance of our C Corrective targets to the upside, around 90 here (right-hand scale), we are less positive for the ratio into September as for the one of the Russell 2000 vs the S&P500 (a few pages above).

US Energy sector vs the S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



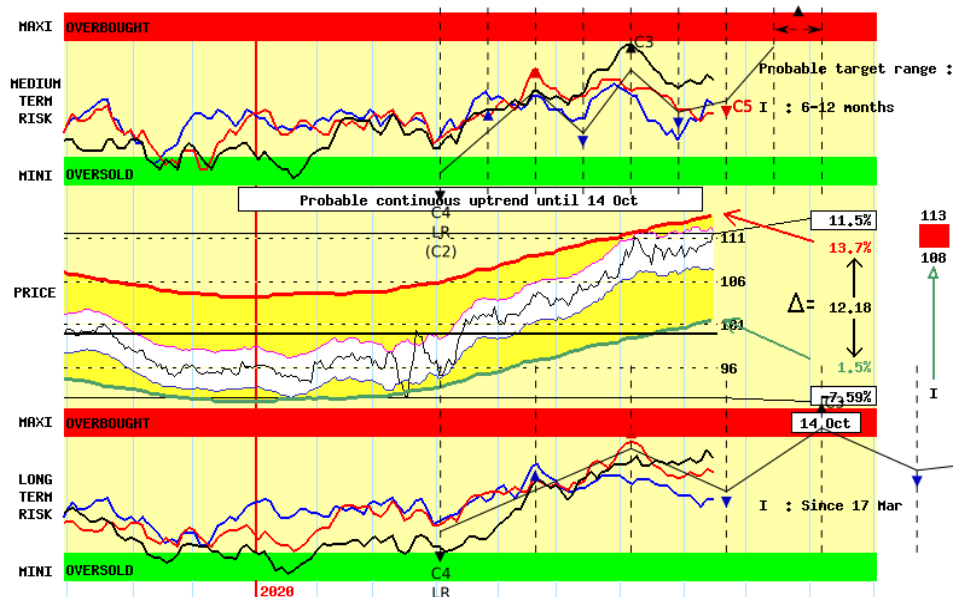
While quite Oversold on our long term oscillators (lower rectangle), the ratio of the US Energy sector vs the S&P500 has been attempting to bounce since mid July. Yet, this effort has been quite weak and according to our medium term oscillators (upper rectangle), **we expect it to soon resume its downtrend, probably from late August into late September in first instance and then potentially towards mid/late Q4**. Our I Impulsive targets to the downside (right-hand scale) have pretty much been achieved. If we were to calculate our next level of downside targets, our I2 Impulsive 2 extended targets to the downside, these would suggest targets circa 10 to 20% below the March lows, i.e. a deep downside retest into the Fall.

US Financials sector vs the S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



US Financials have also attempted to bounce since early/mid July vs the S&P500. Yet, here also, the rebound has been quite weak and both oscillator series (lower and upper rectangles) and would suggest that **by late August, the ratio could start to resume its downtrend, probably into late September in first instance and then potentially towards mid/late Q4**. Our I Impulsive targets to the downside (right-hand scale) have pretty much been achieved. If we were to calculate our next level of downside targets, our I2 Impulsive 2 extended targets to the downside, these would suggest targets circa 5 to 10% below the March lows, i.e. a deep downside retest into the Fall.

US Consumer Discretionary sector vs the S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



Finally, we turn back to growth sectors, and consider the US Consumer Discretionary sector vs the S&P500. It is a Growth sector such as US Technology, but is more cyclical and slightly less Overbought on a long term basis. **It may provide an interesting all-weather type of trade in the late stages of the current rally. Indeed, both oscillator series (lower and upper rectangles) seem to suggest that following a shallow consolidation since early July, it is currently resuming its uptrend vs the S&P500, probably into late September, perhaps even into early October.** Our I Impulsive targets to the upside are exhausted , yet if we were to calculate our extended I2 Impulsive 2 targets to the upside, these may suggest 7 to 10% of further outperformance over the next couple of months.

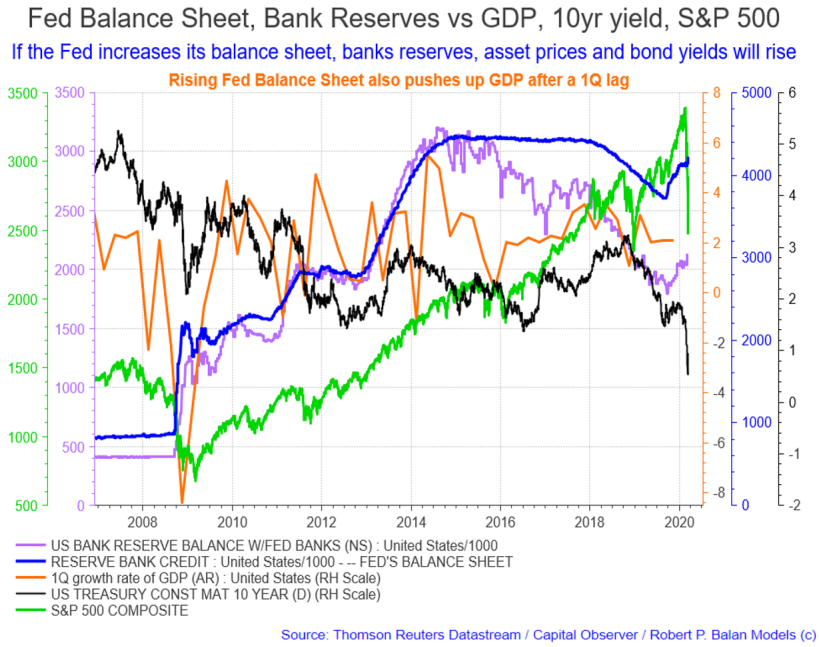
Concluding remarks:

The current rally is defying macroeconomic gravity as well as market positioning. Indeed, it is heavily driven by retail flows. Yet, when considering both our Weekly and Daily graphs on the S&P500, it doesn't seem quite finished yet and could extend into mid/late September in first instance. By then, it may reach up to 3'600. Comparing the defensive US Staples sector vs the S&P500, seems to offer the clearest confirmation, as the ratio appears to resume lower into late Q3. On the other hand, we expect cyclical sectors (US Industrials, Energy or Financials) to also start to underperform again by late August, while the Russell 2000 US Small Caps index may resist slightly longer into early/mid September. From then on, we would hence favor Growth sectors once again, i.e. the Nasdaq100 and Technology, and perhaps slightly earlier, Consumer Discretionary. These Growth themes could outperform into late September, perhaps even early October. We then expect a rather strong intermediate correction on US equity markets during early/mid Q4 and a defensive sector bounce.

22 /The Federal Reserve initiate Quantitative Tightening, but the Treasury's remit to sell more debt may restore ample systemic liquidity into the system

The last time we discussed the central bank's role in the COVID-19 was in March 2020, as the panic over the pandemic was approaching a crescendo. We bannered the headline: "***The Fed, global central banks and governments pull out all the stops in arresting the sell-off: we have seen the worst of the Great COVID-19 Crash of 2020***."

We said then: "The worse this COVID-19 situation gets, the larger the ultimate policy response" – *we have been repeating that mantra for readers of Capital Observer who have been asking us about the likely policy responses from central banks and governments.*

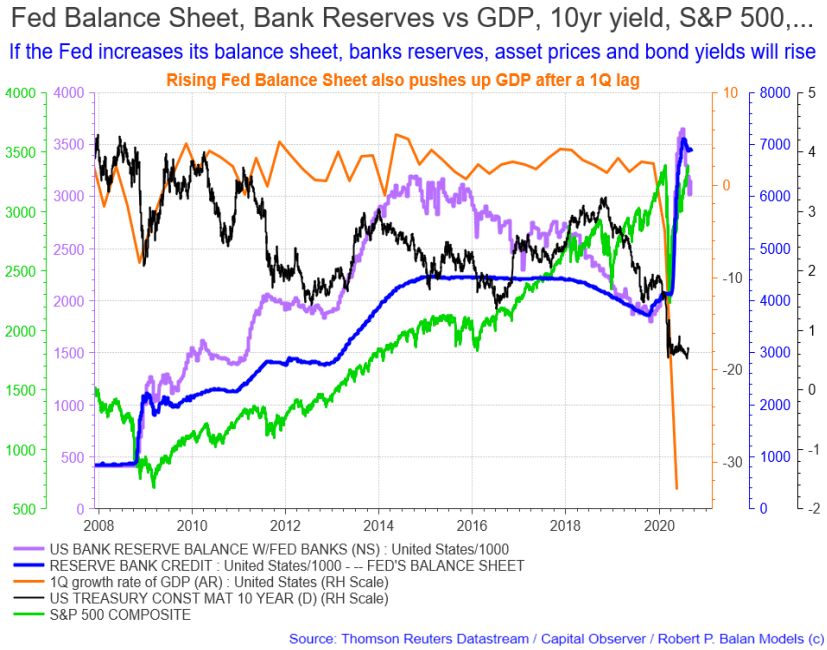


In the US, fiscal policy finally got its act together. Treasury Secretary Steven Mnuchin and House Dems reached an agreement last night to move forward with legislation that would shore up the US public health response to COVID-19, while also blunting some of the economic impact.

In the part of the Fed, the central bank pledged nearly $4.5 trillion through April 13 that the Fed is offering to create to bail out Wall Street, repo market participants, the asset holders, the banks, and Corporate America. It would more than double the already re-ballooned balance sheet (currently $4.3 trillion). It could push the balance sheet to nearly $9 trillion by April 13. And this is important because rising Fed balance sheet has always led to higher equity prices and bond yields (see 1st chart on this page).

And the markets responded correspondingly. The group which acquired all that buying power (which we call the "Masters of the Universe" (MOTUs)) chose early European trading to make their move to deploy – pushing equity futures to limit up hours before the New York trading day opened. It was a very fitting gesture, on a Friday, the 13th day of the March month.

This is how the graph looks now



A chorus of central banks followed suit, after the Fed launched a package of programs to help fix problems on Wall Street that have emerged in the aftermath of COVID-19. The Fed cited the pandemic as the reason for a $700 billion quantitative easing program, and a coordinated dollar-swap plan with global central banks (the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank and the Swiss National Bank).

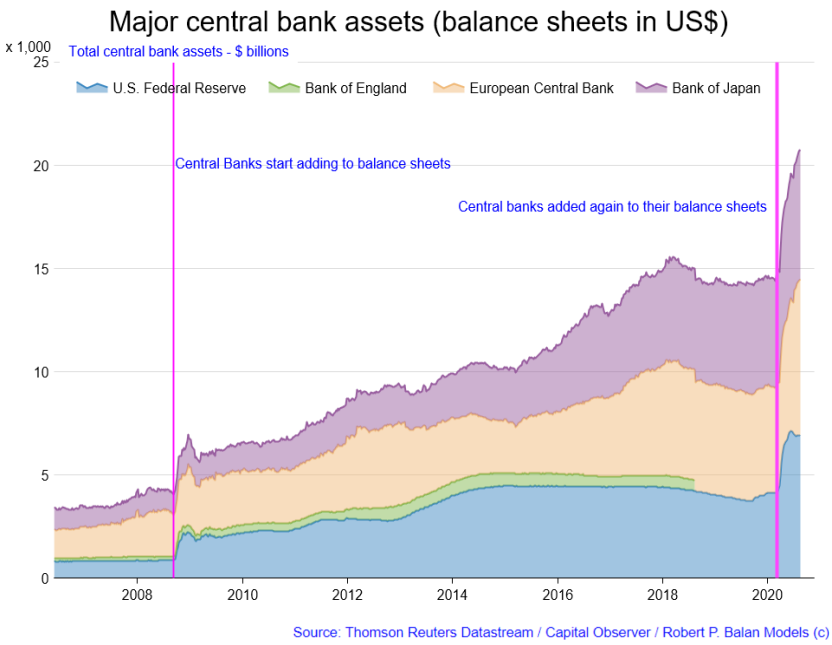
Thus, the global central banks initiated a new round of global Quantitative Easing (see 1st graph on this page).

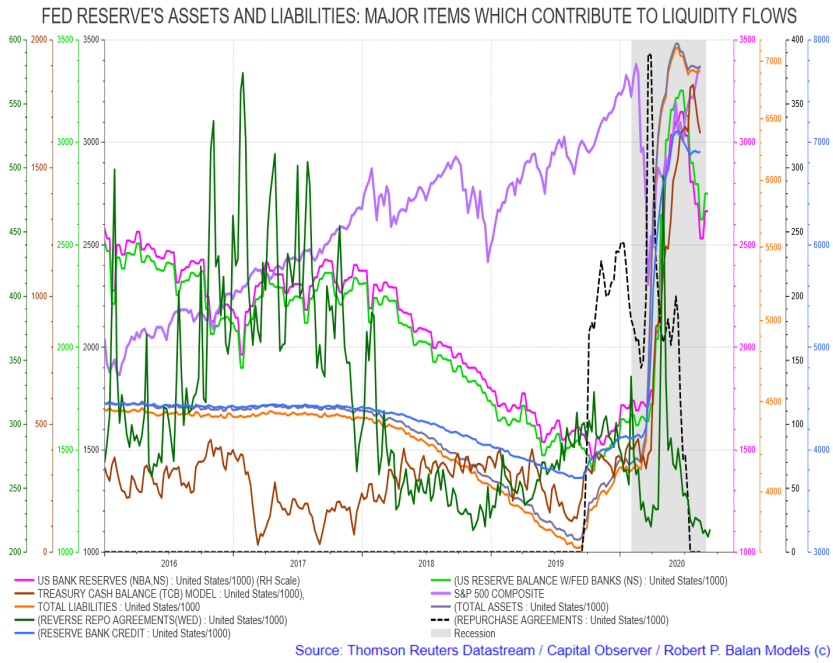
Fast forward five month later. The Fed has shifted the modality of its monetary policy. The Fed has gone into Quantitative Tightening. Monetary outlays destined for the financial markets will become progressively lower. That does not bode well for risk assets.

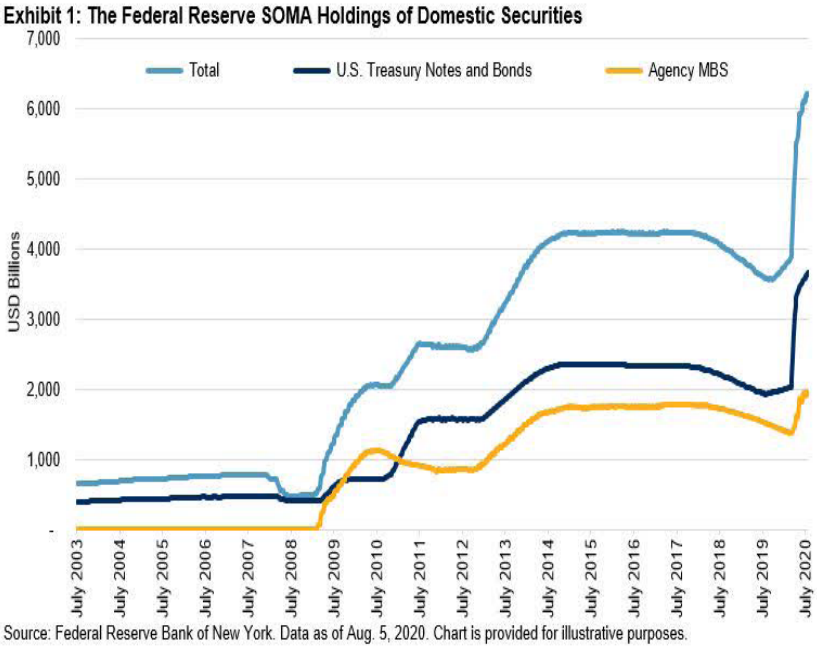
The 2020 SOMA Transactions, Bank Reserves and other Fed assets, have fallen sharply (as shown in the graph of Fed balance sheets items, 2nd graph of this page). And every time these variables decline, risk assets tend to struggle. While risk assets have meantime hewed to historical seasonal patterns, it is silly to believe that there will be no impact from such large change-over in liquidity flows. **As in all thing systemic liquidity, it is all a matter of time lag -- the hammer will eventually catch up.**

Nonetheless, the seasonal liquidity drought is due to end soon. In its Q3 2020 refunding statement released on Aug. 5, 2020, the U.S. Treasury announced its plan to increase auction sizes across all nominal coupon tenors ((7-year, 10-year, 20-year and 30-year) over the August-October quarter. The Fed will be the largest buyer of these securities. This is part of the Fed remit to limit the economic damage from the COVID-19 pandemic, including the resumption of security purchases. **That pledge was done on March 23, 2020, when the Fed said it would buy securities "in the amounts need to support smooth marketing function and effective transmission of monetary policy to broader financial conditions."**

The Fed has kept that pledge. Since the end of February 2020, the total amount of securities held in the Federal Reserve System Open Market Account (SOMA) increased from USD 3.8 trillion to USD 6.2 trillion, with 69% of that increase (USD 1.6 trillion) in U.S. Treasury notes and bonds (*see 3rd graph on this page*).

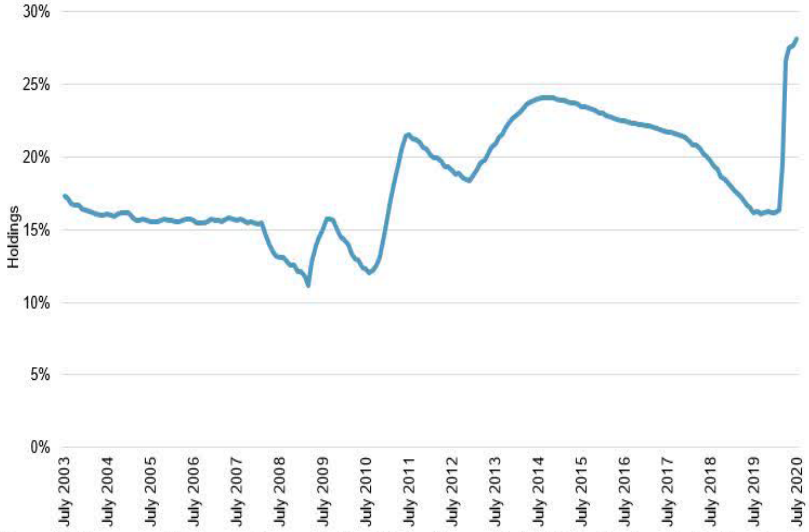






And, at the end of July 2020, the Federal Reserve held 28% of outstanding U.S. Treasury notes and bonds, the highest since 2003, compared with 11% in March 2009, when the Fed announced U.S. Treasury purchases in QE1. *(see graph on this page)*

Exhibit 2: The Percentage of the Federal Reserve's Holdings in Outstanding U.S. Treasury Notes and Bonds Held by the Public



Source: U.S. Department of the Treasury Bureau of the Fiscal Service. Data as of July 31, 2020. Chart is provided for illustrative purposes.

What does all of these signify?

For one, we have to be watchful on the maturity composition of the Treasury's issuances. Indications are such that the Treasury's focus will be on issuing long-term debt, taking advantage of current low interest rates. Minutes from the Treasury Borrowing Advisory Committee (TBAC) stated, "Committee members favoured increasing issuance of long-term securities in light of the large increase in financing needs, the importance of managing rollovers, and the historically low level of interest rates." As these dynamics continue to play out, the level and structure of interest rates are also important area to watch.

Particularly, the Treasury announced increases of $5 billion to both the new and re-opened 20-year bond auction sizes starting in August. Additionally, the 30-year will also see increases of $4 billion to both the new and reopened 30-year bond auction sizes. This additional issuance and duration in the long-end could lead to a rate concession out the curve. **Simply put, the increase in the average maturity of government debt will inexorably put pressure at the back end of the yield curve. That could steepen the yield curve.**

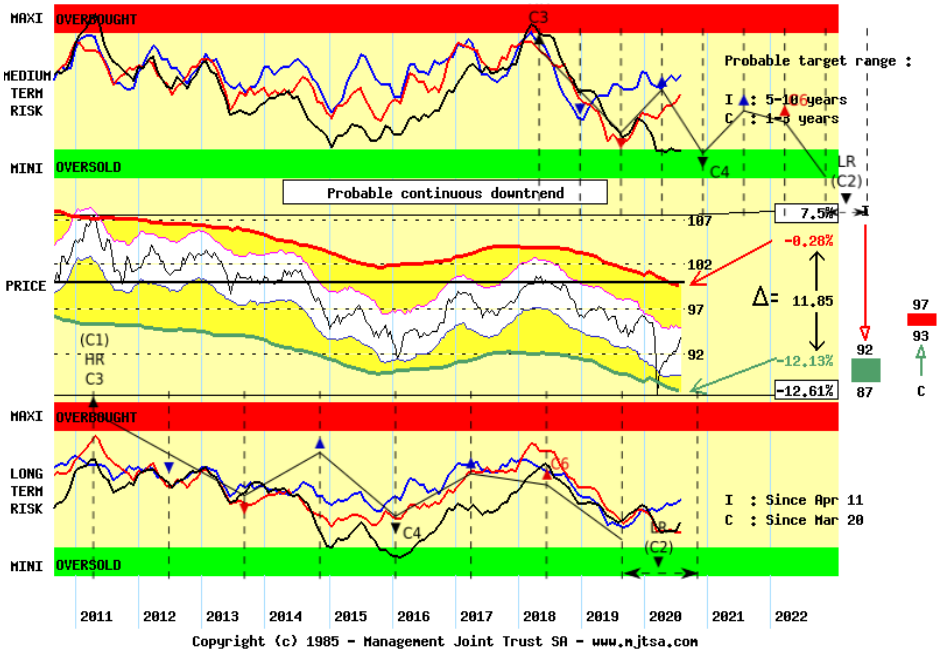
This is where the Fed could play a significant part with regards to the issue. The central bank has clearly anticipated this eventuality, and so even now, the market anticipates what kind of yield curve control the Fed will eventually deploy. **It is more than an academic exercise – adoption of a yield control policy, and the means to implement it, will play a significant part how risk assets will be priced if/ when these policies are implemented.**

25 / MJT - TIMING AND TACTICAL INSIGHT

Reassessing the Inflation / Deflation situation

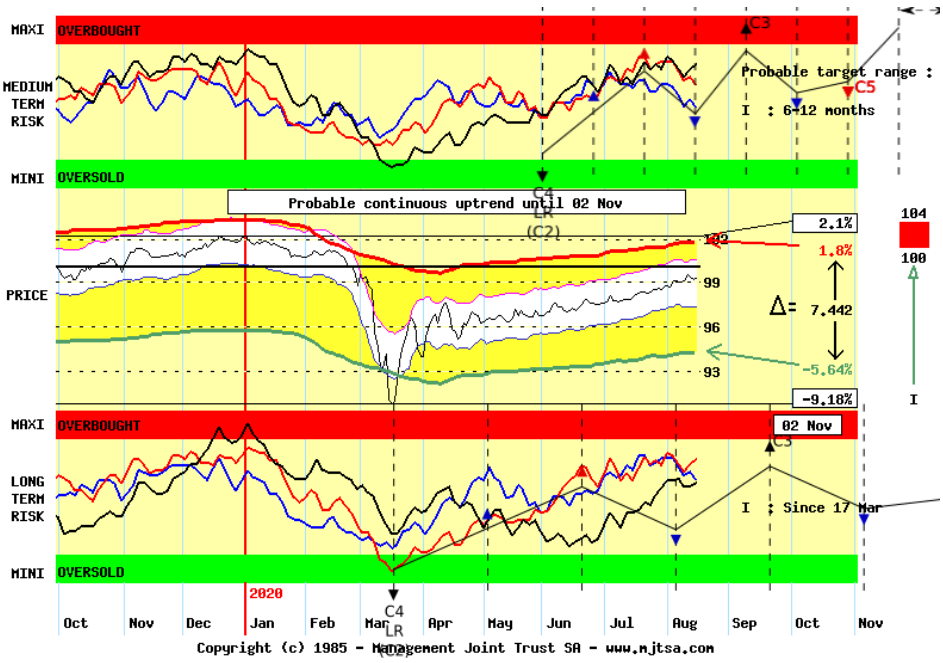
Massive monetary stimulus usually creates inflation down the line. Yet, depending on how dire the economic situation remains, or how deep the general debt pool that needs to be refinanced actually is, it may take quite a long lag before it actually starts to gain traction. In the current situation, the stimulus is certainly massive, but the economic dislocation also is, along with the leverage in the system. In this article, we review several inflation / deflation metrics in order to assess the current situation.

Tips to Treasuries ratio
Bi-monthly graph or the perspective over the next 1 to 2 years



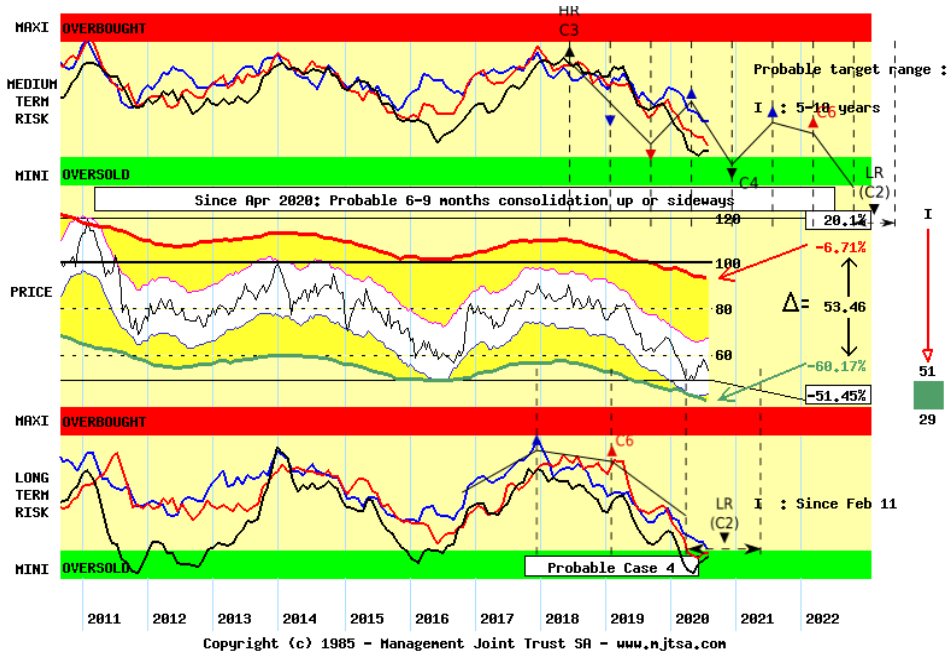
Traditionally, breakeven ratios between US TIPs and Treasuries have been a reliable indicator of a pickup in inflation expectations. Indeed, as inflation fears rise in the market, investors will tend to allocate more funds to inflation protected bonds, thereby pushing the ratio higher. On this long term graph of the ratio, the sell-off in cyclical factors since early 2018, and with it of inflation expectations, is clear to see. This downtrend seems to have ended with a climax sell-off last Spring. The rebound has since been strong. **Yet, according to the sequence we show on both oscillator series (lower and upper rectangles), this rebound does come slightly earlier than we would have expected. Indeed, a bottom late this year would have been more in line** with the downtrend sequence on our medium term oscillators (upper rectangle). The massive stimulus measures since March probably explain this early reversal.

Tips to Treasuries ratio
Daily graph or the perspective over the next 2 to 3 months



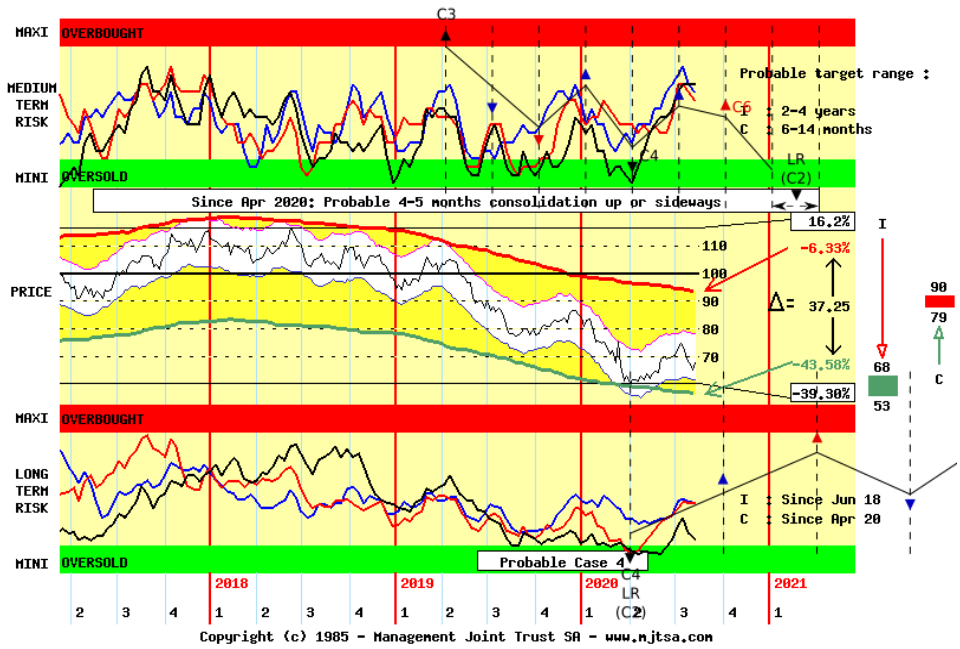
The Daily graph of the ratio in quite interesting in its linearity. Indeed, while both TIPs and Treasuries are supported by the FED, the ratio is gradually ascending, probably as investors expect the FED to hold by its word that interest rates will remain low for a very long time. As the economy gradually recovers, inflation expectations gradually rise while expected real rates eventually fall deeper into negative territory. When considering both oscillator series (lower and upper rectangles), it seems that **the current uptrend may persist for another few weeks, into early September on our medium oscillators (upper rectangle) and into mid September on our long term ones (lower rectangle). Thereafter we expect some retracement into October on our medium term oscillators and perhaps into November on our long term ones**. This timing matches the timing of the theoretical downside retest, which could have been expected late this year on our bi-monthly graph above.

Copper / Gold ratio
Bi-monthly graph or the perspective over the next 1 to 2 years



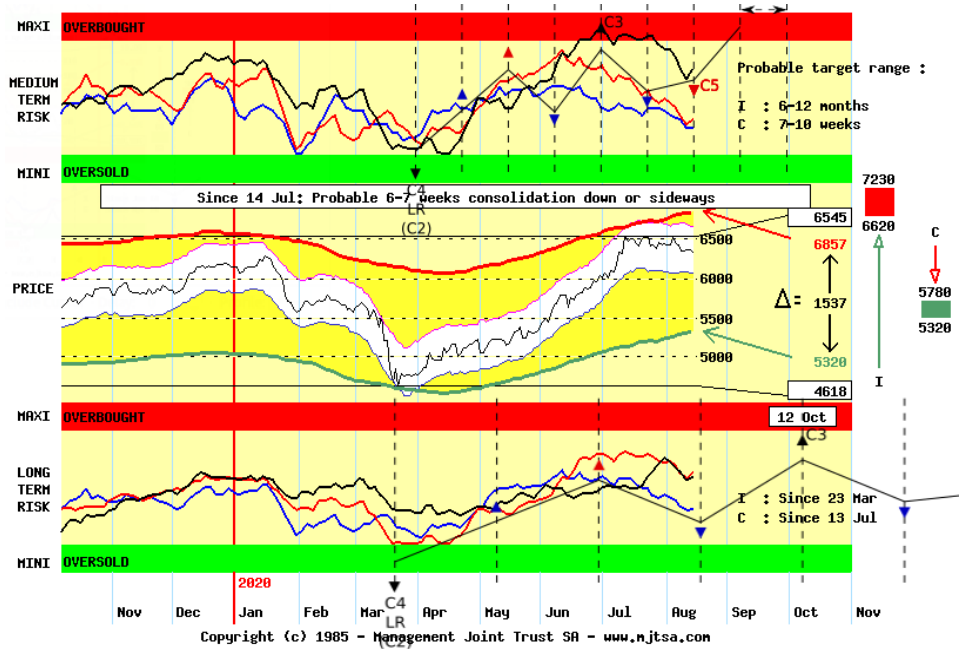
Another inflation / deflation gauge, which currently may be less subject to direct FED policy influence, is the Copper to Gold ratio. Both metals have been rising since March, yet it is the differential which is important here in signaling a more inflationary or deflationary environment. **While the ratio was very Oversold last March and had entered a Low Risk position on our long term oscillators (lower rectangle), here also, as with inflation expectations, the sequence we show on our medium term oscillators (upper rectangle) is still suggesting some kind of downside retest into late this year.**

Copper / Gold ratio
Weekly graph or the perspective over the next 2 to 4 quarters



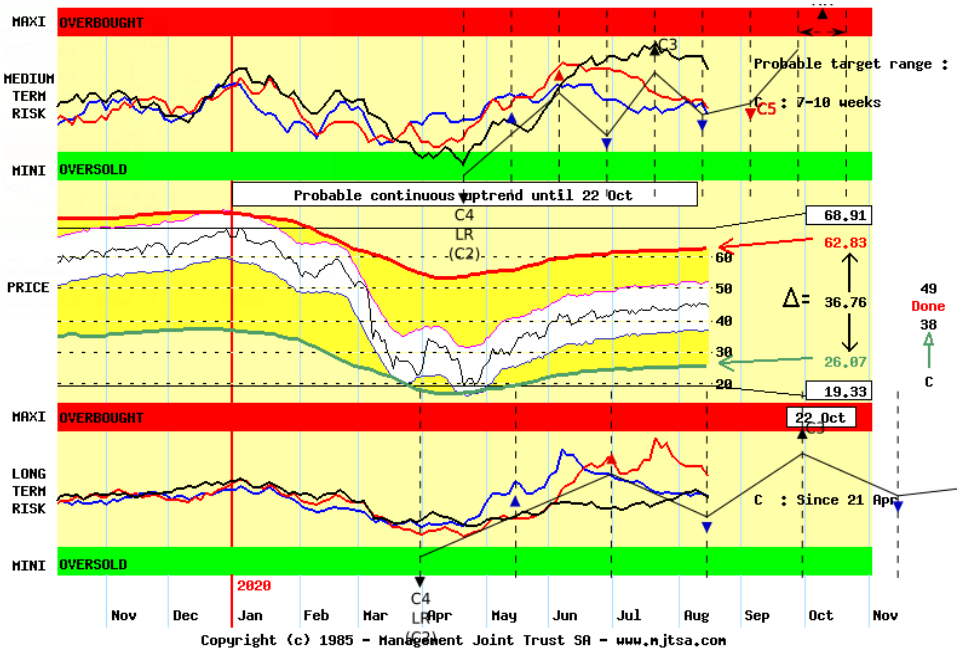
We now focus down to the Weekly graph of the Copper to Gold ratio. **When considering the bottom made in March, there are several interpretations one can make**. On the one hand, as shown on our long term oscillators (lower rectangle), this climax low may conclude a two years cyclical downturn that started in early 2018. The ratio could hence have initiated an important and worthwhile reversal and may continue to rise well into 2021. Yet, for now, the price reaction is still limited and a first intermediate top is approaching late Q3. It should create at least some retracement during Q4. Another interpretation we can make is that the bottom made in March wasn't a final bottom and that following a 3 to 6 months rebound, the ratio could retest down towards new lows into late this year, perhaps even early next year. This is what we show on our medium term oscillators (upper rectangle) and the sequence suggests that by late Q3, this downside retest should start to accelerate. **When considered together, both interpretations do point at least an intermediate top late Q3 and some retracement / downside retesting during Q4. This suggest some kind of deflationary countertrend at least during Q4.**

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



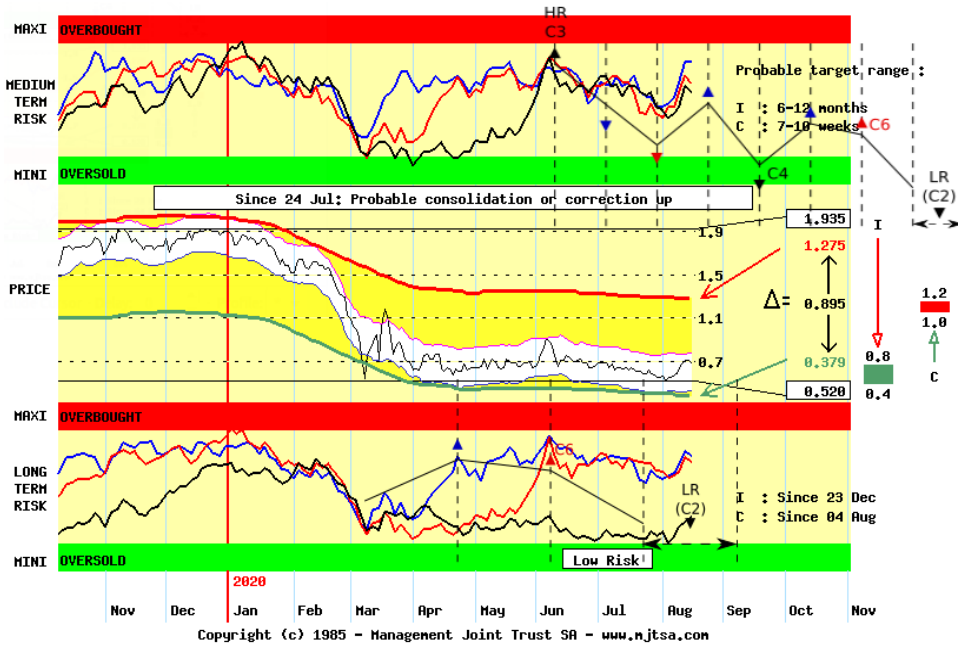
We now consider cyclical commodities on an absolute basis. Indeed, as long as these continue to recover, a strong deflationary correction, and related drop in inflation expectations is probably uncalled for. We first look at Copper, which has been consolidating since early/mid July. As such, its dynamics are closer to China (it's main source of demand) that to other cyclical profiles (which have been bouncing since mid/late July). **Both oscillator series (lower rectangle) suggest that Copper should soon resume its uptrend, probably into late September, perhaps early October**. This again is quite similar to our scenario on Chinese equities. **Our I Impulsive targets to the upside point to some remaining upside potential, probably into the 6'620 – 7'230 USD/ton range** (right-hand scale).

Brent Oil (USD/barrel)
Daily graph or the perspective over the next 2 to 3 months



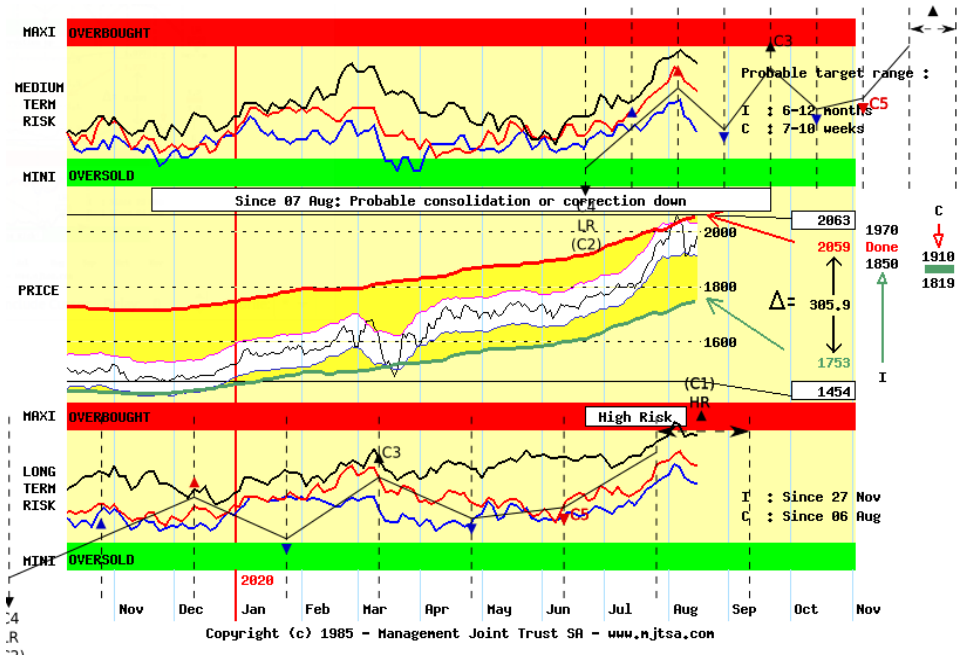
Oil is the other large cyclical Commodity. Its demand is driven as much by China than the US. As long as it continues to hold up and progress, inflation expectations will probably continue their gradual accent. We draw 2 uptrend sequences from both lows made in late March and late April (respectively on our long term and medium term oscillators – lower and upper rectangles). **These suggest that the current uptrend may persist into late September, perhaps even October**. **For now, we are still below the resistance of our C Corrective targets to the upside around 49 USD/barrel (right-hand scale). A break above these levels may trigger a rapid acceleration to the mid/high 50s USD/barrel at least. Considering these prospects, which remain positive for now, we would probably refrain on turning too negative too early on inflationary assets, probably not until late September**. Nevertheless, we would still expect some retracement to the downside during Q4.

US10Y Treasury yield
Daily graph or the perspective over the next 2 to 3 months



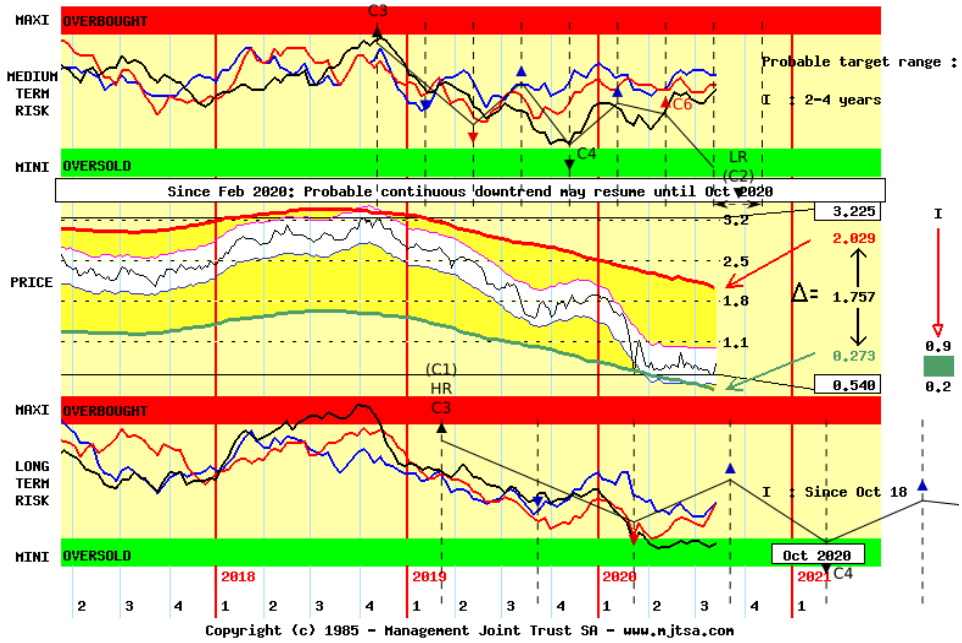
We now turn to the other side of the inflation / deflation debate and consider US long term yields and Gold. On US10Y Treasury yield, our long term oscillators are in a Low Risk position (lower rectangle). Yet, the rebounds for now have been weak and short lived. As shown on our medium term oscillators (upper rectangle) we believe **this environment of persistent downtrend with weak rebounds will continue until late Q3 / perhaps early Q4 (i.e. a downside retest into mid September, perhaps another rebound late September / early October), before US yields resume they downtrend again into mid/late Q4, probably making new lows.**

Gold spot (USD/oz)
Daily graph or the perspective over the 2 to 3 months



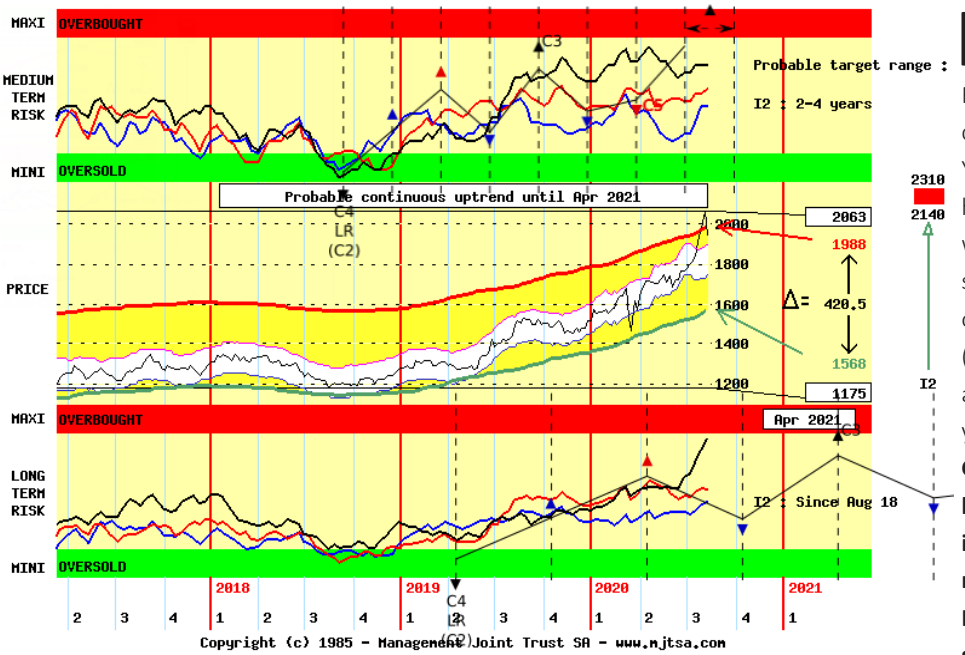
Over the next few months, Gold should see opposite dynamics to the US10Y yield. It has reached a High Risk position on our long term oscillators (lower rectangle) and may look somewhat exhausted in terms of upside targets (right-hand scale). Yet, it **probably continues higher in stages into late Fall as shown on our medium term oscillators (upper rectangle). Hence, we believe Gold remains in an ongoing uptrend probably for another few months at least. The extended I2 Impulsive 2 targets we can calculate point to the 2'158 – 2'377 range towards year-end and early next year** (2.3 to 2.7 times our historical volatility measure "Delta", here at 305.9 – middle rectangle, right-hand side – added to the graphs lowest point at 1'454).

US10Y Treasury yield
Weekly graph or the perspective over the next 2 to 4 quarters



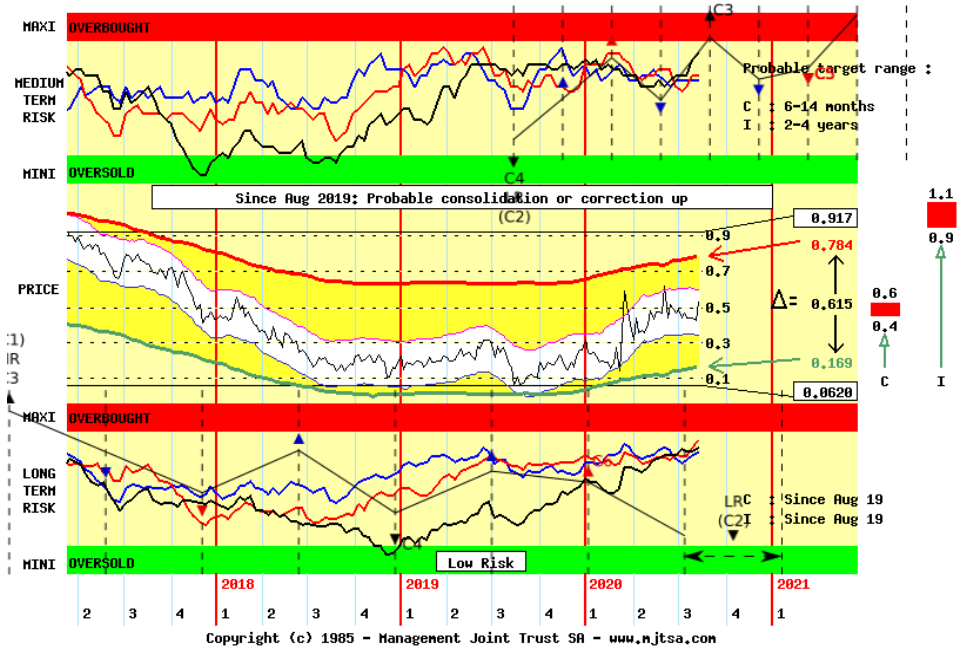
Longer term, on our Weekly graph, we also consider both the US10Y Treasury yield and Gold. Initially, we had expected that yields could bottom out towards late Q3 / early Q4 as shown on our medium term oscillators (upper rectangle). Yet, the sell-off in March was so strong that it created a new intermediate bottom on our long term oscillators (i.e. a new red bottom – lower rectangle), which usually calls for a continuation of the downtrend for circa another year. This is the sequence we show on our long term oscillators (lower rectangle). Considering both, **we believe US 10Y Treasury yields are already quite Oversold, but that the downside pressure should continue probably into Q1 next year. Our I Impulsive targets to the downside also point to some remaining downside potential towards 0.2% (right-hand scale).**

Gold spot (USD/oz)
Weekly graph or the perspective over the next 2 to 4 quarters



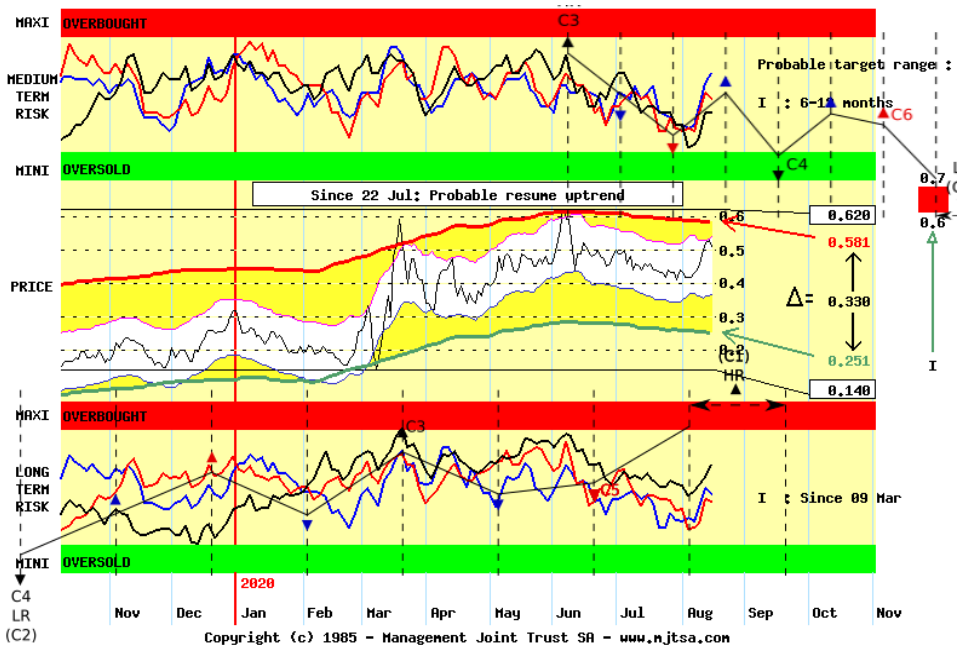
Inversely to rates, Gold may be reaching an initial High Risk zone on our medium oscillators (upper rectangle). Yet, here also, the uptrend has been so strong that it was able to create a second sequence, which we show on our long term oscillators (lower rectangle). It probably also extends into Spring next year. Hence, **the uptrend on Gold may appear quite Overbought, but we do believe it will probably extend into next Spring. Our extended I2 Impulsive 2 targets to the upside are pointing to the 2'140 – 2'310 range as a possible target range over the next 2 to 3 quarters (right-hand scale).**

US10Y – US3Y yield curve spread
Weekly graph or the perspective over the next 2 to 4 quarters



We finally consider the US yield curve and the US10Y-US3Y spread. We US3Y yield is stuck between 0.1% and 0.2%, which implies that the spread for now mostly reacts to movements in the more volatile US10Y Treasury yield. With the drop to 0% in Fed Fund Rate in March, the spread did spike quite massively. Yet for now, it has failed to confirm this upward momentum. It has also pretty much stalled on the resistance of the upper end of our C Corrective targets to the upside around 0.6% (right-hand scale). While our long term oscillators (lower rectangle) are still in the timing of a downside retest, our medium term ones (upper rectangle) suggest **at least some retracement from late Q3 into mid/late Q4. This again could imply some downside pressure on US10Y rates and a rather deflationary environment during most of Q4.**

US10Y – US3Y yield curve spread
Daily graph or the perspective over the next 2 to 3 months



Shorter term, on the Daily graph, the spread has been bouncing with US10Y yields since late July. While our long term oscillators (lower rectangle) are already in a High Risk position, our medium term ones suggest that the bounce may already be coming to an end. **We expect the yield curve to gradually roll-over during September and early October and then even potentially sell-off into late October / November. Again, we believe this points to a possible deflationary downside retest during Q4.**

Concluding Remarks:

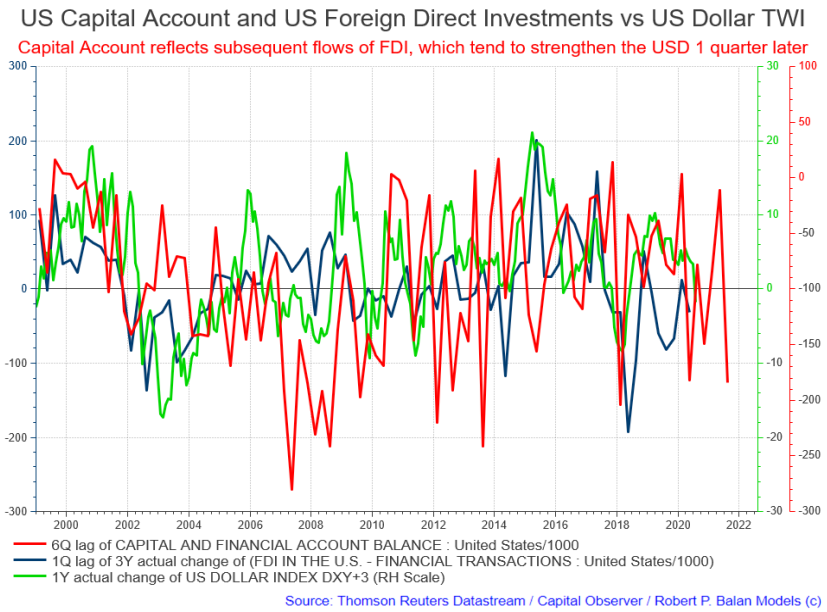
Inflation Expectations measured by the breakeven ratios between US TIPs and US Treasuries have been rising linearly over the last few months and are approaching their long term downside trend-lines. They are hence starting to draw attention. Our timing suggests that they could continue to linger on higher into mid/late September, perhaps early October, but that they then probably retrace down into mid/late Q4. Other inflationary / deflationary indicators seem to confirm this timing. While Copper and Oil, on an absolute basis, may continue higher into late September, perhaps early October, the Copper to Gold ratio, US10Y Treasury yields or Yield Curve spreads may be already starting to roll-over. Gold may see some short term dips during September, but probably then rises again more linearly during Q4. Overall, the cross asset picture appears to point to some deflationary retracement from late Q3 into mid/late Q4. This probably matches the cyclical weakness we then also expect in other articles of this issue of The Capital Observer.

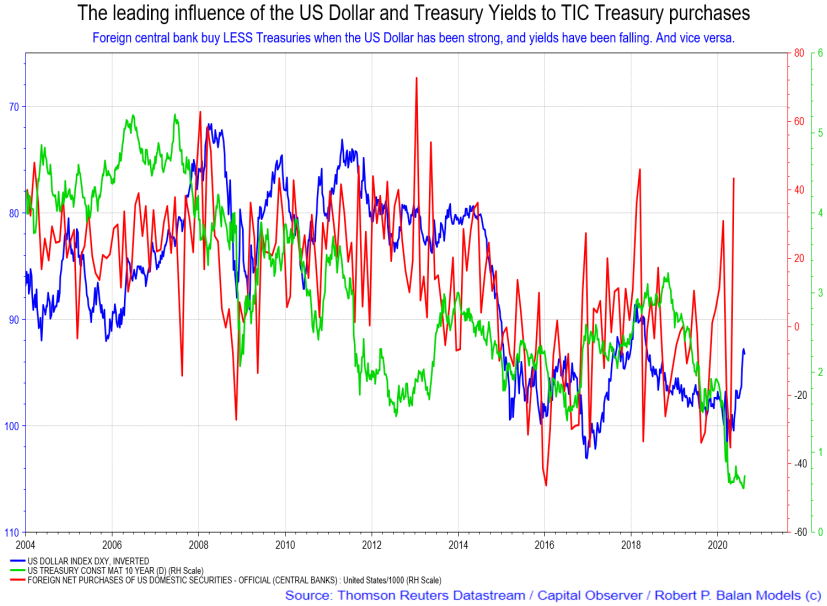
31 / The lagged impact of the US capital account balance, extreme short positioning should give the Usd some support from late Q3

In a broad macro sense, changes in the US Dollar valuation stem from shifts in broad international, systemic liquidity flows among countries and economic regions. These shifts in the transfer of money and investment capital are tallied in a country's current and capital accounts, and for this purpose, the capital account is the primary data that we track.

The capital account balance reflects net change in ownership of national assets and is one of the components of a country's Balance of Payments ledger, the other being the Current Account Balance. 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 (*see 1st graph on this page*).

Although a higher interest rate relative to those of other major central banks tends to attract funds via the capital account, which acts to raise the value of the domestic currency (USD in this case), **rate differentials may not be the primary impetus for the recent improvement of the capital account balance**. For instance, pre-COVID-19 pandemic, anecdotal evidence of US real estate assets being attractive to external investors (the US property market was booming) have been highlighted in recent quarters. Foreigners are snapping up US residential and office building properties in increasing quantities, requiring more US Dollar denominated funds. Foreigners have also been eyeing to buy ownership of smaller US technology companies (especially desired by the Chinese), prior to President Donald Trump's crackdown on Chinese companies operating in the US.





The recent decline in yields of US Treasury and agency bonds, along with the recent weakness of the US Dollar also provide some empirical evidence, via the Treasury International Capital (TIC) flows, that non-resident capital has been moving into the US fixed income markets.

It is interesting to note that as bonds becomes more expensive in price (lower yields), and as the US dollar's exchange rate rises, the cross-border TIC volume dries up. **Conversely, higher bond prices (lower yields) and weaker US Dollar exchange rate tend to speed up the international inflows through the TIC process** (*see 2nd graph above*).

This bit of information is useful to us, as we see it as evidence that non-resident investors have been buying US Treasury assets on cheaper price, and on the opportunity of locking in higher yields. That is certainly true in the fixed income market, but we can only speculate if it is also true in the equity markets.

The latest TIC data shows that inflows have recently risen sharply. The fixed income market condition has seen the favourable backdrop of a weakening US dollar plus the outlook of rising rates over the next few months. That of course tends to strengthen the US Dollar which further enhances the yield capture on Treasuries that were purchased.

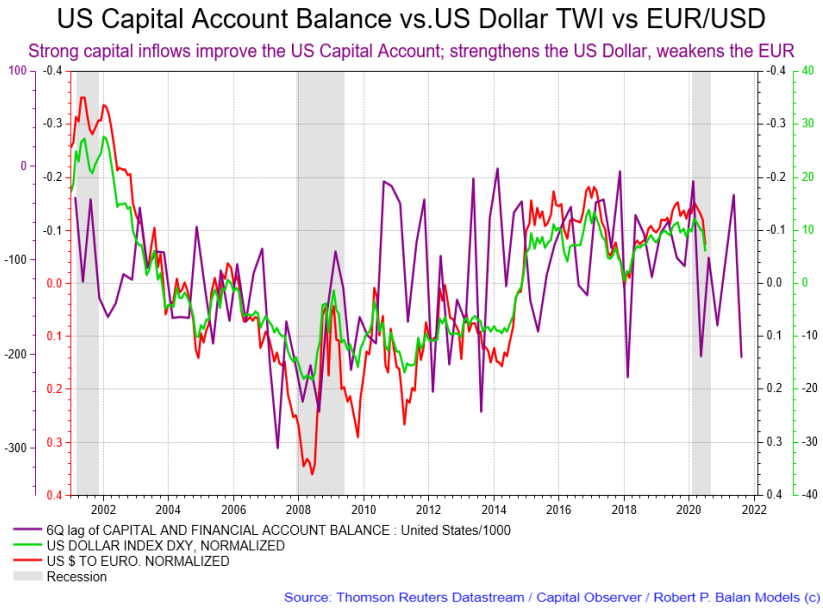
Changes in the US capital account balance lead long-term USD changes by 5 to 6 quarters

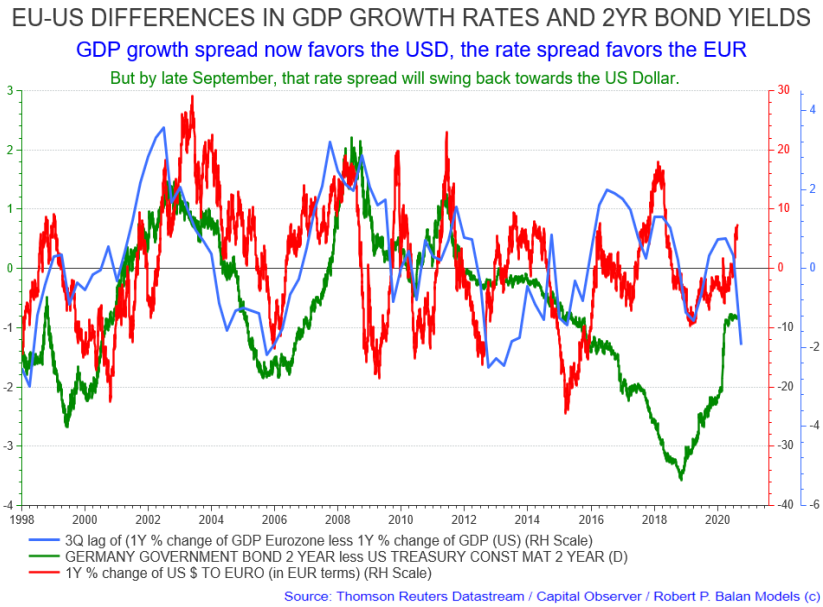
Changes in the US capital account normally show up in the valuation changes of the US currency 5 to 6 quarters later. Capital accounts improve when non-resident (external) capital inflows increase or resident (domestic) capital outflows slow. **The sharp improvement in the domestic capital account from Q4 of 2018 to Q4 2019 will therefore likely result in a recovery of the US dollar from Q3 this year until Q2 of 2021 according to this factor.**

As we see from the preceding graphs as well as the 1st graph on this page, the recent US Dollar weakness was due to the lagged impacts of recent capital outflows. But this data is also suggesting that this short episode of weakness is coming to an end. We further suggest that the next bout of US dollar's continuing strength will come from the lagged impact of the steady improvement of the US Capital Account Balance which took place during the period of Q4 2018 to Q4 2019.

The US dollar lost the FX "beauty contest" but it is fighting back In the last several months, almost all the macro factors in region to region, country to country comparison were against the US currency, especially those that matter in FX currency valuation. Interest rate spreads between US and Germany (as proxy for EUR short term rates) were in favour of the latter, as post COVID-19 measures taken by the Federal Reserve brought US short term rate to near zero. However, that may end soon. US interest rates have rise sharply in recent days, and by late September, the seasonal upturn in US rates across the board should turn that spread in favour of the US Dollar. *(see 2nd graph on this page)*

Moreover, against the EUR, the dollar's most stalwart rival, **GDP growth spreads** now lean favourably towards the U.S. This spread leads the EUR/USD exchange rate by almost six months. The shift lower means that





US growth is outpacing that of the Eurozone. This will become even more significant if the growth outlook for the US in Q3 hews close to what we expect (as discussed below). The EUR should keel over by late September.

Short-term changes in US Dollar valuation stem from changes in US long term bond yields

The US Dollar (with the DXY Index as proxy) has been weak against a bevy of Developed Market (DM) currencies since March 20 earlier in the year when the 10-year yield (red line) started to weaken. The Dollar has traded sideways as bond yields also went sideways. But in late June, bond yields started to decline in earnest, which of course undercut the DXY significantly (green line, *see 1st chart on the next page*).

The graph underlines the fact that one of the primary mover of the short-term changes in the US Dollar exchange rate are US long term rates, specifically the 10yr yield. However, a closer look also suggests that bond yields are to a large degree influenced by changes in systemic liquidity, in this case represented by the Treasury Cash Balance. Therefore, in the final analysis, short term moves in the US Dollar are driven by changes in US systemic liquidity flows.

There are other factors which support the US dollar going forward. Bond yields have risen since early August, and given the phase transitioning from liquidity drought to ample supplies of systemic money as from the middle of September, we expect yields to find some support over the rest of H2 2020.

There is also the matter of what GDP growth should be expected. One of our favoured tools is the ISM surveys, both manufacturing and services, and a hybrid ISM, which is composed of 82% Services and 18% manufacturing.

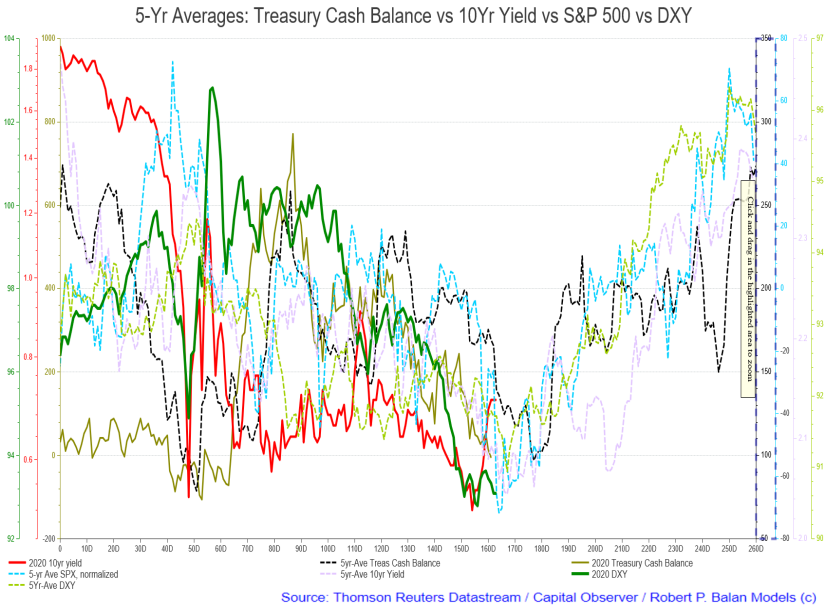
The graph underlines the fact that one of the primary mover of the short-term changes in the US Dollar exchange rate are US long term rates, specifically the 10yr yield. However, a closer look also suggests that bond yields are to a large degree influenced by changes in systemic liquidity, in this case represented by the Treasury Cash Balance. Therefore, in the final analysis, short term moves in the US Dollar are driven by changes in US systemic liquidity flows.

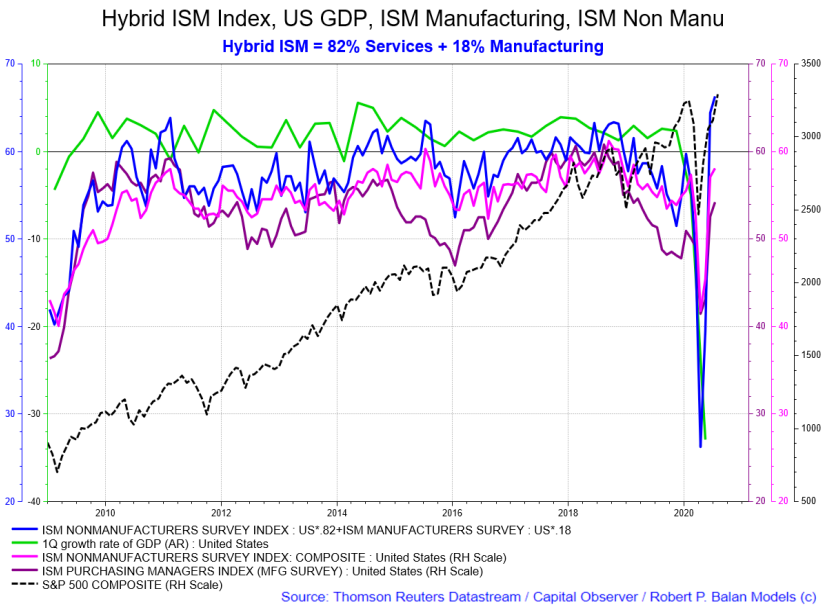
There are other factors which support the US dollar going forward. Bond yields have risen since early August, and given the phase transitioning from liquidity drought to ample supplies of systemic money as from the middle of September, we expect yields to find some support over the rest of H2 2020.

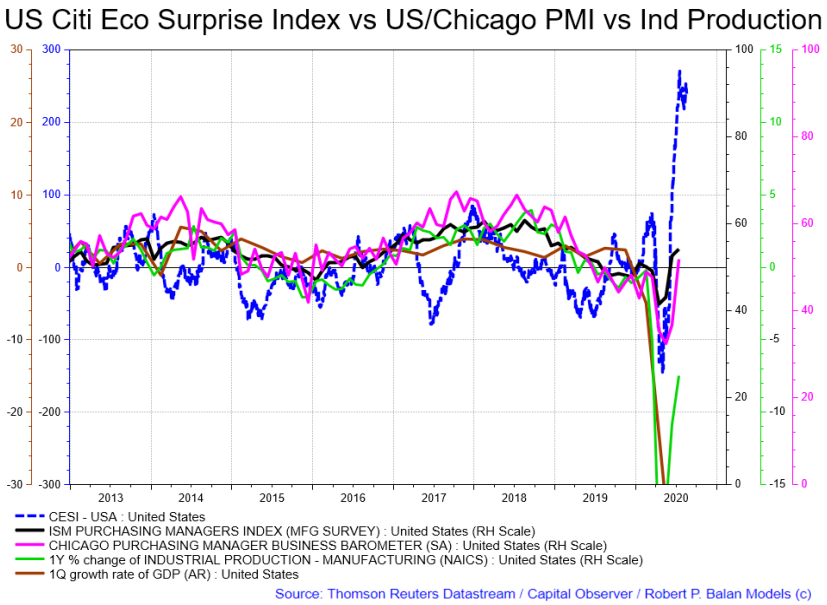
There is also the matter of what GDP growth should be expected. One of our favoured tools is the ISM surveys, both manufacturing and services, and a hybrid ISM, which is composed of 82% Services and 18% manufacturing (*see 2nd graph on this page*).

The V-shaped recovery in these variables argue for a much better Q3 GDP data that have been flogged by many analysts.

The Citi Economic Surprise Index also shows the potential rebound in growth during the H2 of 2020 (*see 3rd graph on this page*).



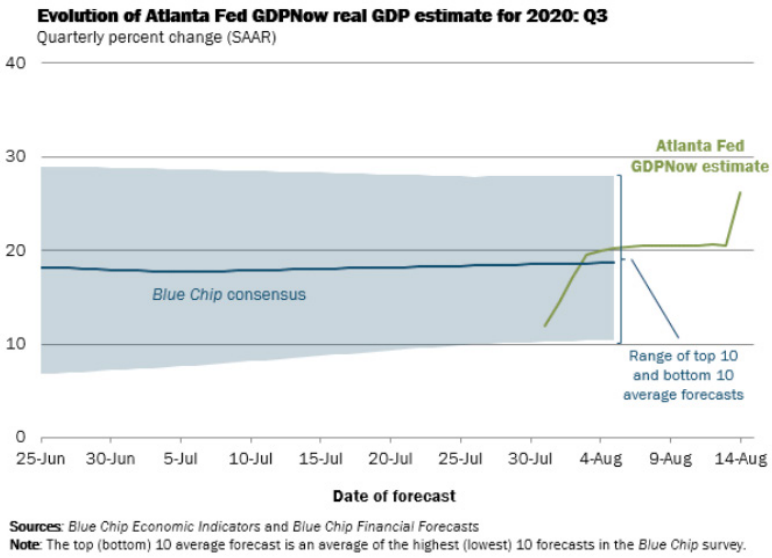




The variables at the Atlanta Fed also suggest a strong rebound in growth in Q3 2020. From the website of the Atlanta Fed:

Latest estimate: 26.2 percent — August 14, 2020

The GDPNow model estimate for real GDP growth (seasonally adjusted annual rate) in the third quarter of 2020 is 26.2 percent on August 14, up from 20.5 percent on August 7. After this week's data releases by the U.S. Bureau of Labor Statistics, the U.S. Department of the Treasury's Bureau of the Fiscal Service, the Federal Reserve Board of Governors, and the U.S. Census Bureau, the nowcasts of third-quarter real personal consumption expenditures growth and third-quarter real gross private domestic investment growth increased from 21.9 percent and 9.5 percent, respectively, to 27.8 percent and 19.7 percent, respectively, and the nowcast of third-quarter real government spending growth increased from 14.0 percent to 14.3 percent.



Moreover, given the prospects of support in yields and better than expected GDP growth in Q3, a non-consensual positioning in US Dollar should be considered to conclude the summer.

Conclusion

The episode of weakness of the US Dollar could be about to come to a terminal phase by the end of this quarter. Shorting the US Dollar has become a one-way bet and a very consensual theme. Therefore this short dollar trade could unwind quickly and generate a sharp move up in the dollar. While there is still some momentum in the Euro, GBP, AUD as of this past week, the number of futures contracts amid the speculator community that were net short the DXY (via other FX pairs) was tied for the highest on record going back to the late 1990s.

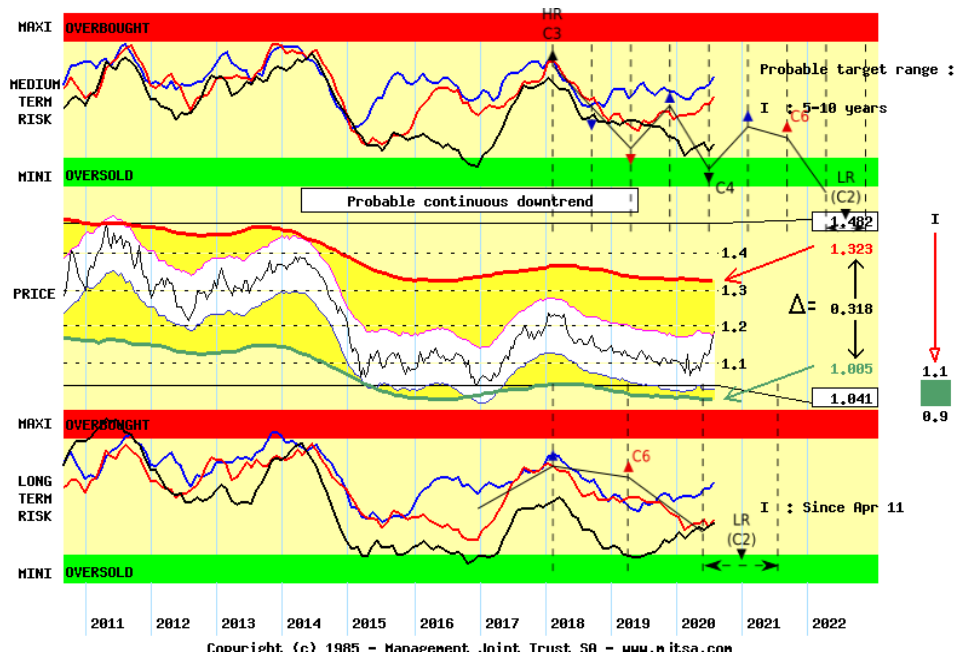
With everyone - literally - on Wall Street now short the dollar, the only possible real conclusion is that there is virtually nobody else left who can add to dollar shorts, which means that absent some unexpected socio-economic disaster in the US, the only possible next move for the dollar by the end of the quarter should be higher.

35 / MJT - TIMING AND TACTICAL INSIGHT

US Dollar weakness continues into late Q3 in first instance

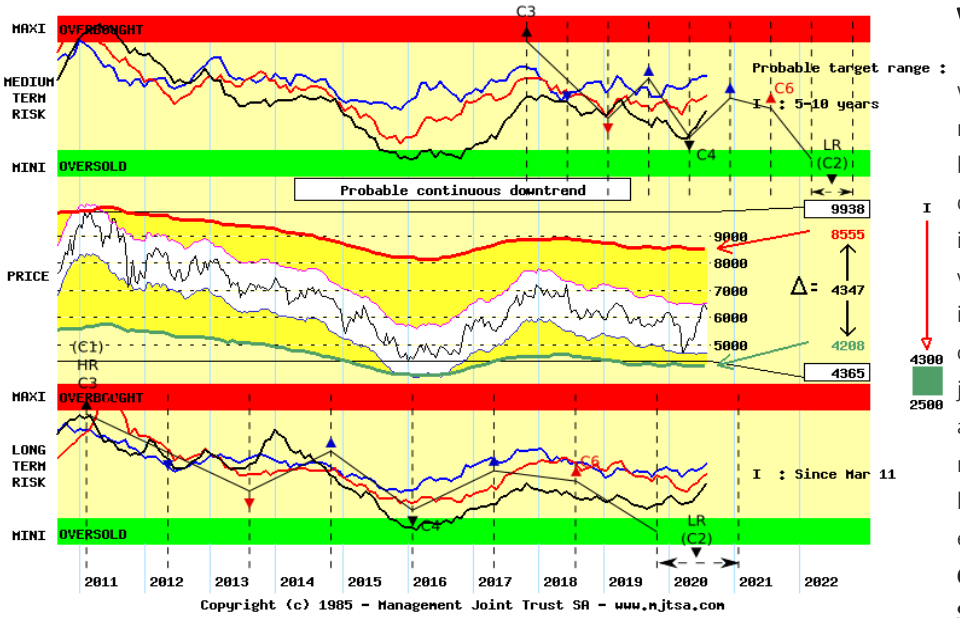
Following the strong monetary and fiscal measures that were pushed through by FED following the March Coronavirus sell-off and the related lock-downs, the US Dollar may have begun a strong reversal to the downside. We believe that as long as widespread stimulus will be necessary, the FED will do its utmost to provide it. This will perdue until economic recovery eventually accelerates, yields start to rise again and the US Dollar finally gets a strong bid (i.e. a bigger / longer version of what happened during both semesters of 2016, USD down in H1 2016 and then back up in H2 2016). In the meantime, shorter term, we expect some countertrend reaction this Fall as the FED may have to pause some of its stimulus provision in light of its required political neutrality as the November election date approaches.

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



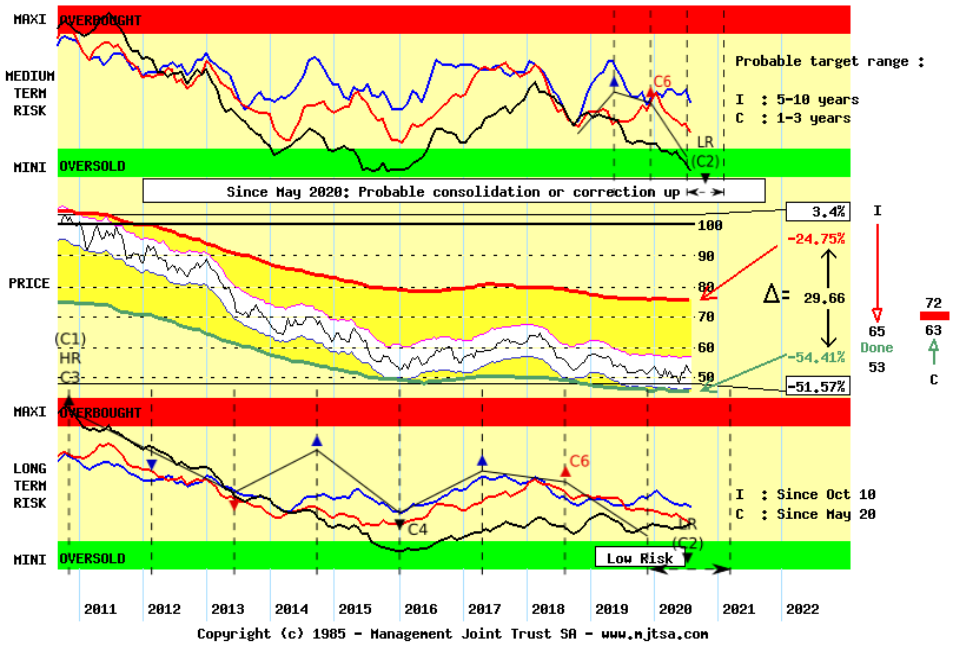
On our long term oscillators (lower rectangle), EUR/USD probably reached **a Low Risk position earlier this year. It could justify 1 to 2 years of correction to the upside, if not a long term reversal**. On the targets front, downside targets below 1.10 were reached again in March without new lows, which may hint to a double bottom structure between Q1 2020 and Q4 2016. On on medium term oscillators (upper rectangle), **we can certainly confirm that an important intermediate bottom was made. Remain to be seen if the bounce dies out at some point next Spring**. In the meantime, the C Corrective targets to the upside we can calculate are pointing to the 1.20 – 1.30 range (or 0.5 to 0.8 times our historical volatility measure "Delta", here at 31.8 – middle rectangle, right-hand side – added to the graph's lowest point at 1.041). Theoretically, their higher end could be achieved towards next Spring.

Copper Spot (LME USD/ton)
Bi-monthly graph or the perspective over the next 1 to 2 years



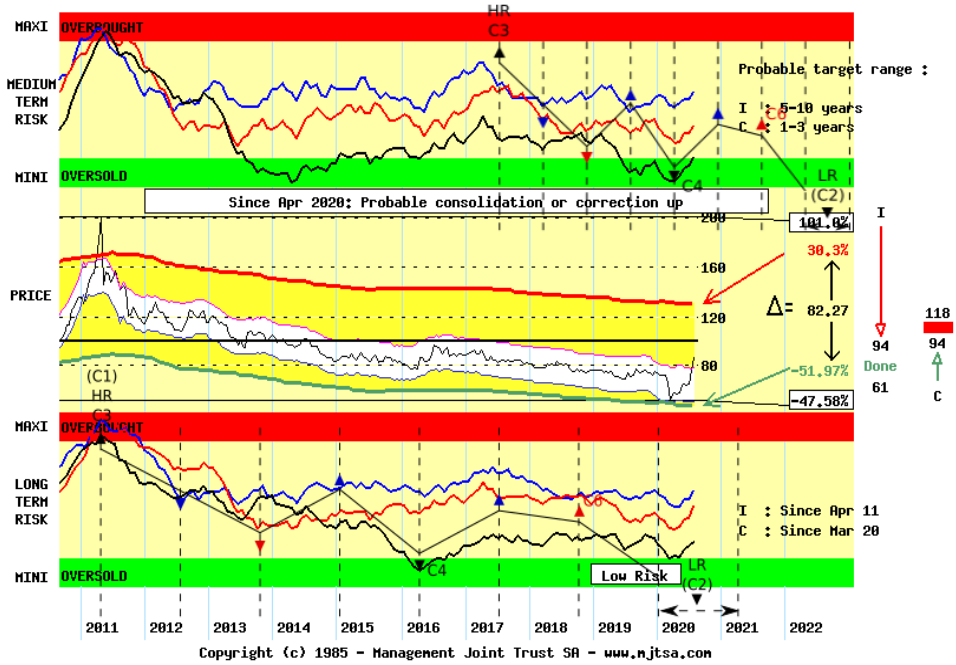
We aim to confirm the likelihood of a long term upside reversal in EUR/USD with other assets, which are usually negatively related to the US Dollar, and which may also be in the process of reversing their long term downtrend. Copper is one of them, and indeed its reversal to the upside since March has been very strong. Similarly to EUR/USD, we believe it may have bottomed in a Low Risk position on our long term oscillators. This again could justify 1 to 2 years of correction to the upside at least. On our medium term ones (upper rectangle), the initial bounce may extend into late this year / early next year, before Copper eventually retests down. **All in all, we expect Copper to probably hold up at least into next Spring, which probably implies further upside for most risk assets until then, while the US Dollar could continue to weaken.**

MSCI Emerging Markets vs the MSCI World Index
Bi-monthly graph or the perspective over the next 1 to 2 years



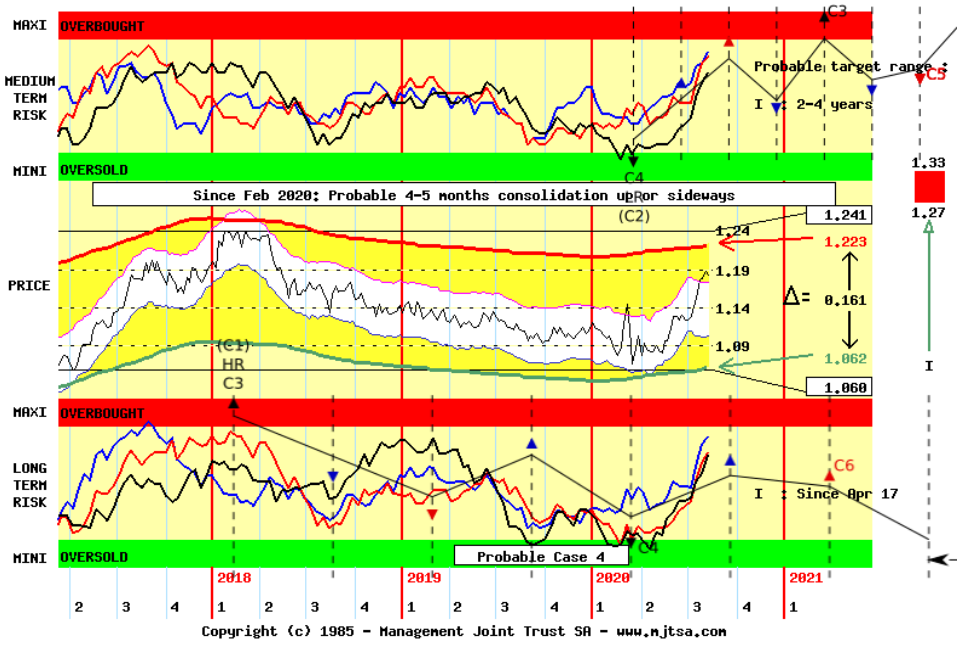
Another theme which is usually quite well negatively correlated to the US Dollar is the ratio of Emerging Markets vs Developed ones. Indeed, on this long term graph, the ratio also entered a **Low Risk position on our long term oscillators earlier this year (lower rectangle), but also seems to be in one now on our medium term ones (upper rectangle)**. This suggest at least 6 to 12 months of rebound (into next Spring), perhaps 1 or 2 years, if not, a long term upside reversal. More generally, **Emerging Markets do appear secularly Oversold and their upside reversal, if confirmed would, coordinate quite well with a longer term downside reversal of the US Dollar.**

Silver/Gold ratio
Bi-monthly graph or the perspective over the next 1 to 2 years



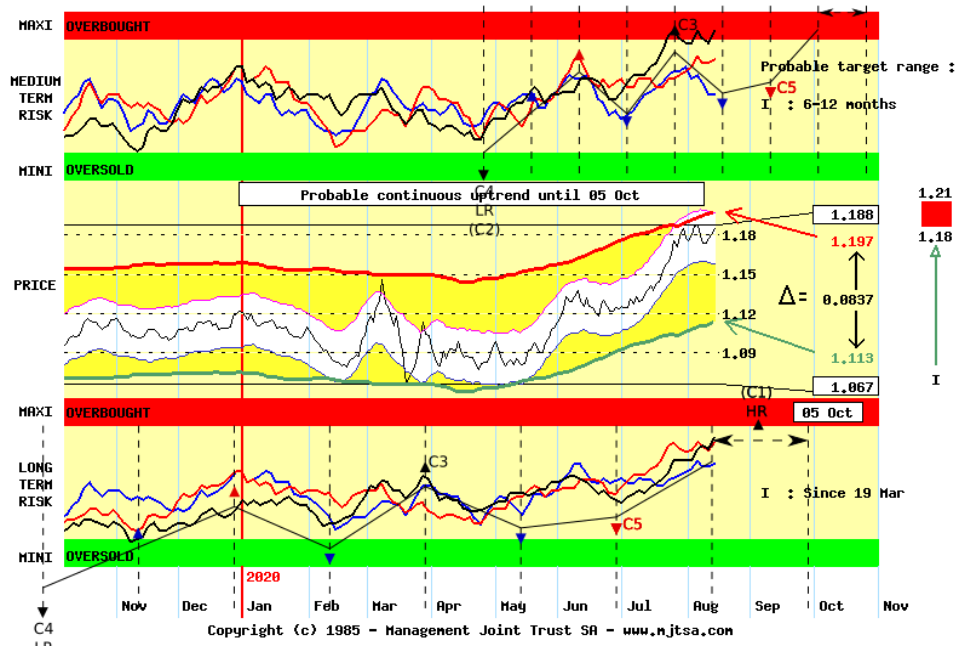
Another ratio,which is currently benefiting from US Dollar weakness since March is the Silver to Gold ratio. **After 9 years of a rather linear downtrend, it had indeed reached a long term Low Risk position (lower rectangle), a situation that usually justifies 1 to 2 years of upside bounce, if not a secular reversal.** Similarly to the other graphs above, our medium term oscillators (upper rectangle) are also suggesting an important bounce, probably into early next year at least. Strong rebounds in the Silver/Gold ratio are typical of periods of reflationary efforts by Central banks, while the economy is still weak. They are usually accompanied by a weaker US Dollar (e.g. 2009, H1 2016).

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



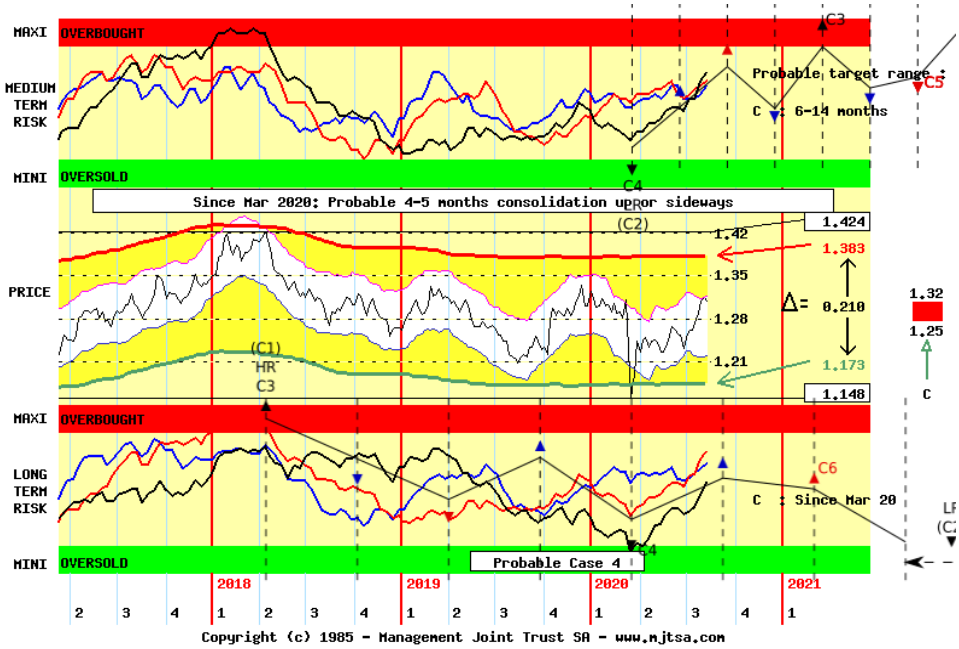
Similarly to many cyclical assets, EUR/USD dropped from early 2018 into early this year. Since March, the reflationary efforts by the FED and other Central Banks have helped it stage an impressive reversal. We believe that the US Dollar, as was apparent during the March sell-off, is currently the ultimate defensive currency, and that as long as monetary and fiscal stimulus do keep risk assets rising, it should continue to fall. According to both our oscillator series (lower and upper rectangles), **EUR/USD probably continues to rise into late Q3 in first instance. We then expect some retracement during Q4, but then further upside and probably new highs into next Spring. The pair may reach into our I Impulsive targets to the upside by then, or towards the 1.27 – 1.33 range (right-hand scale).**

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



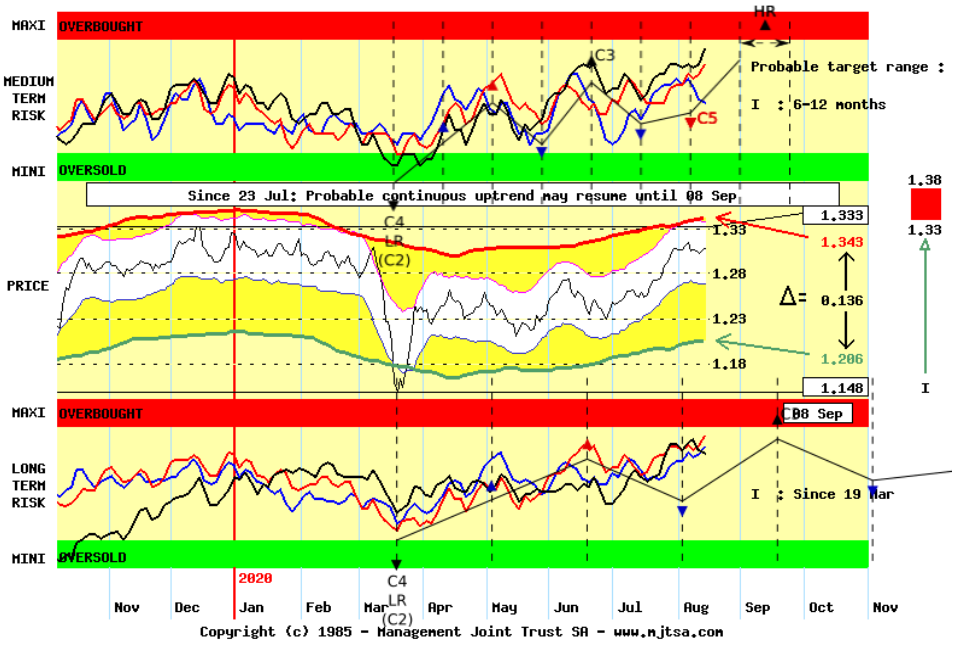
Shorter term, EUR/USD made an intermediate top late July on our medium oscillators (upper rectangle) and has since been consolidating at high levels. It should however **resume its uptrend soon, at the latest early September, for a new move higher into late September, perhaps early October**. Our long term oscillators (lower rectangle) could also justify further upside into late September. By then EUR/USD may reach higher into our I Impulsive targets to the upside, probably towards 1.21 (right-hand scale). EUR/USD could then see a 1 or 2 months correction during early/mid Q4, which could see it retrace 4 to 6 figures (or 0.5 to 0.8 times our historical volatility measure "Delta", here at 0.0837 – middle rectangle, right-hand side).

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



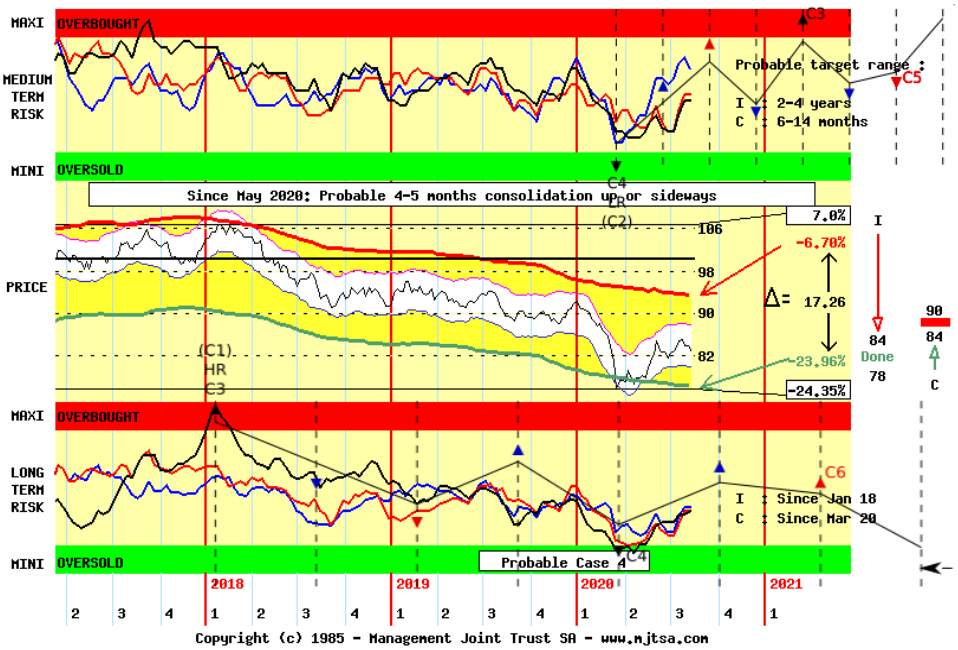
GBP/USD had also been correcting down since early 2018, and its climax low last March may have nailed a secular bottom. It has since rebounded quite swiftly and is now approaching the resistance of our C Corrective targets to the upside around 1.32 (right-hand scale). A break above these levels could justify much higher targets over the next 6 to 12 months, possible towards its early 2018 highs. On the timing front, we expect an intermediate top late Q3 on both oscillator series (lower and upper rectangles), some retracement during Q4, and then a further upside attempt into next Spring. **If indeed, GBP/USD made a secular low in March, which we believe is likely, our medium term oscillators (upper rectangles) would suggest further upside momentum, with new highs above 1.32, and perhaps up to 1.40, into next Spring.**

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



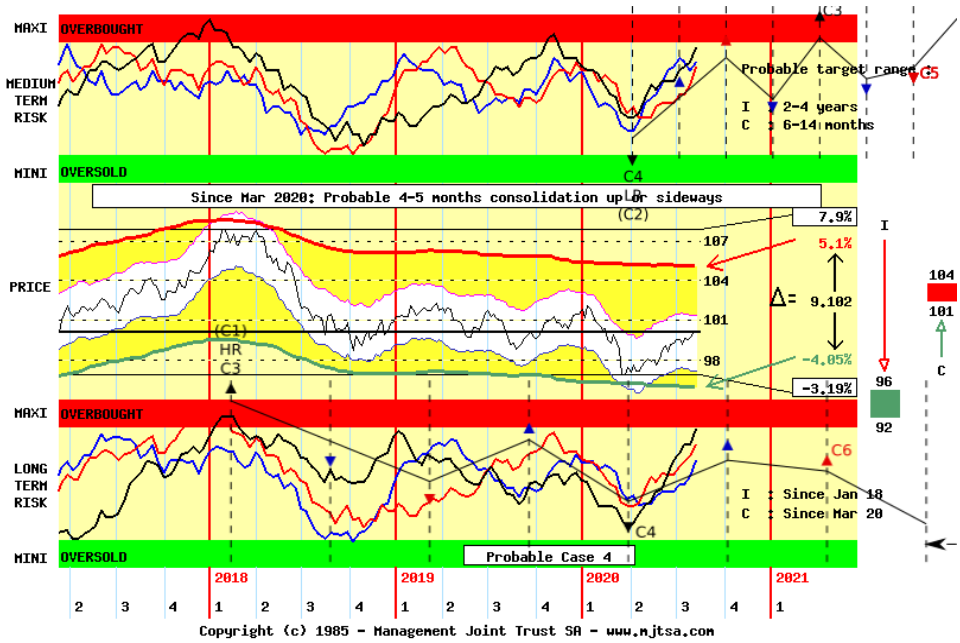
On the Daily graph, **GBP/USD resumed its uptrend in late June and could continue to rise into mid September** on both oscillator series (lower and upper rectangles). Our I Impulsive targets to the upside (right-hand scale) suggest that it could break out **to new 12 months highs in the 1.33 – 1.38 range. Late September / early October could then see the beginning of a retracement period, which may last 1 or 2 months** and theoretically correct between 7 and 11 figures (0.5 to 0.8 times our historical volatility measure "Delta", here at 0.136 – middle rectangle, right-hand side).

Commodity currencies vs the US Dollar
Weekly graph or the perspective over the next 2 to 4 quarters



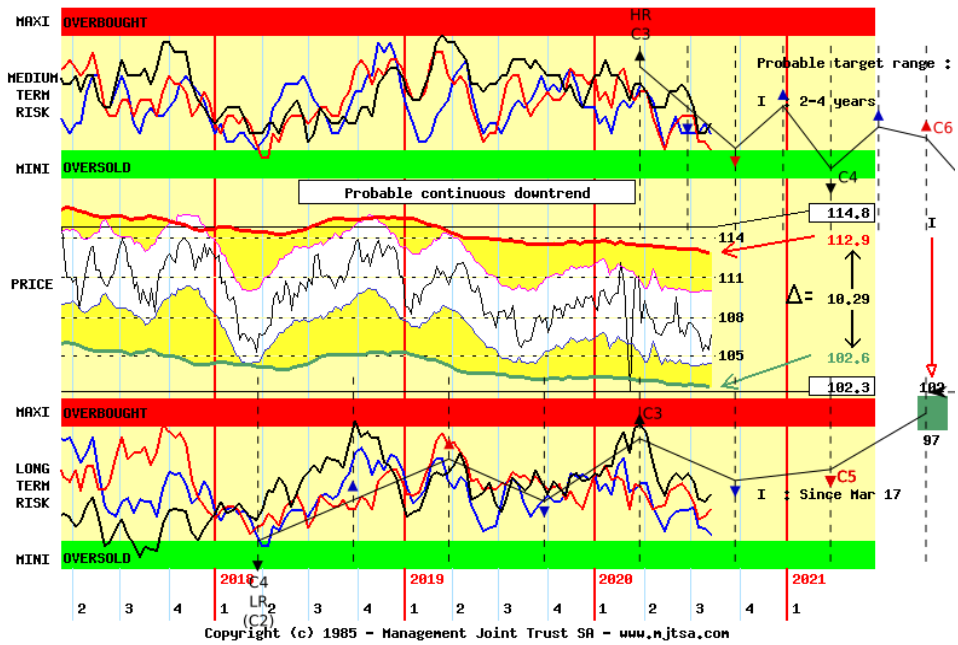
Some of the strong beneficiaries of the US Dollar's weakness since March have been Commodity Currencies. Our equal weighted portfolio presented here vs the USD Dollar includes AUD, NZD, CAD, NOK, RUB, ZAR, BRL and CLP. **Here also, the portfolio had suffered two years of cyclical downtrend since early 2018, and a climax sell-off during Q1 as both Oil and equity markets collapsed. They have since rebounded vigorously into June, have consolidated since then, but could see another push higher into late Q3** according to both our oscillator series (lower and upper rectangles). Following that, from mid/late September probably, we expect them to enter an intermediate correction into mid/late Q4. Yet, here also, we do believe that further highs (fueled by ongoing reflationary efforts by Central Banks) are possible into next Spring as shown on our medium term oscillators (upper rectangle). They could reach up to the resistance of our C Corrective targets to the upside by then, around 90 (right-hand scale), or circa 6-7% above current levels.

Asian Growth Currencies vs the US Dollar
Weekly graph or the perspective over the next 2 to 4 quarters



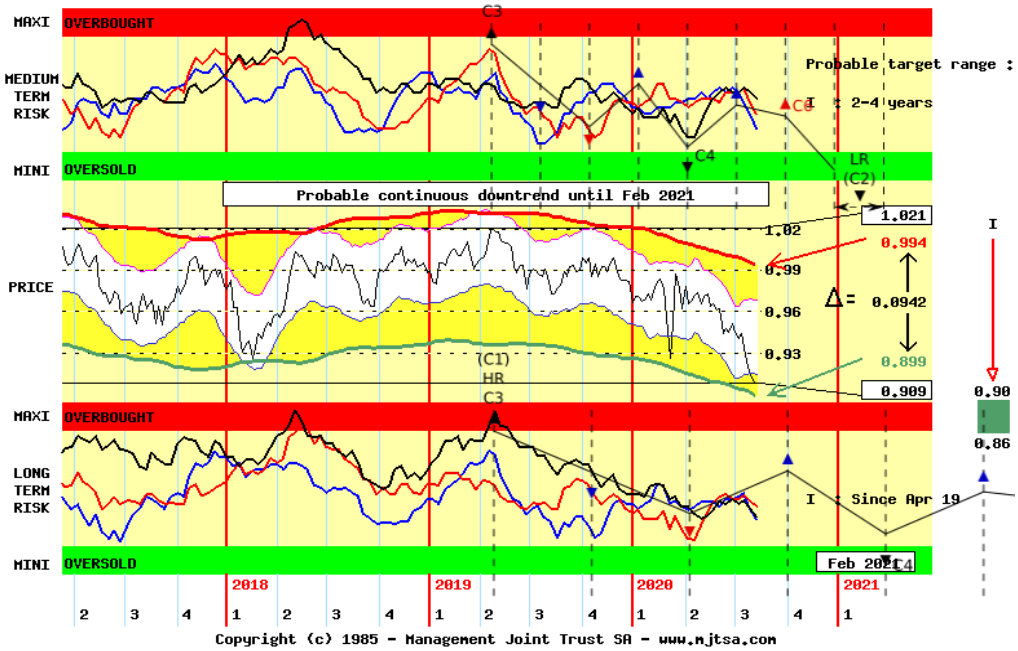
Similarly, we look at Asian growth currencies vs the US Dollar. Our equal portfolio for them includes CNY, TWD, KRW, INR and THB. These have also been bouncing since March following two years of downtrend and a climax sell-off in Q1. **Their upside momentum since then vs the US Dollar has been quite linear and we expect it to extend into late Q3 in first instance** according to both oscillator series (lower and upper rectangles). Following some retracement during Q4, we then expect another upside attempt into next Spring. As with Commodity Currencies vs the US Dollar in the graph above, Asian Growth currencies could then make new highs. Our C Corrective targets to the upside (right-hand scale) would point to important resistance towards 104 or circa 4% above current levels.

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



We now shift to defensive currencies, which we believe should also continue to strengthen vs the US Dollar into Spring next year, i.e. the US Dollar should remain weak across the board (this is quite similar to what happened in H1 2016). In the meantime, both our oscillator series (lower and upper rectangles) would suggest **further downside until an intermediate bottom is made towards late Q3, and a possible bounce during Q4. Yet, renewed downside pressure is then expected into Spring next year, probably towards lower lows** if we follow the sequence on our medium term oscillators (upper rectangle) as well as consider our I Impulsive targets to the downside, which point to the 102 – 97 range. This could be explained by ongoing and sustained efforts by the FED to support the US recovery.

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



USD/CHF also seems to continue lower on both oscillators series (lower and upper rectangles) into Spring next year. The downtrend for now is showing little respite and intermediate bounces are hard to time (probably at some point during Q4 with other USD pairs). Our I Impulsive targets to the downside point to **downside targets in the 0.90 – 0.86 range over the next 6 to 12 months.**

Concluding remarks:

Most currencies had suffered a 2 years downtrend since early 2018 vs the US Dollar as cyclical factors then started to weaken and the US Dollar and US markets became the only game in town. These trends were further exacerbated early this year, and especially during March, as the US Dollar revealed itself as the ultimate deleveraging currency. This trend has now reversed thanks to the huge amount of monetary and fiscal stimulus that have since been provided by Central banks, and the FED especially. The US Dollar has since started to weaken, while risk assets have been rising. We believe, this relation should continue until the massive stimulus measures finally start to grip and interest rates start to rise again on a long term basis. In 2016 (a similar period of US Dollar weakness across the board), this happened within 6 months, from early July, but at the time the dislocation was far less severe. Today, it is hard to anticipate when the US economy will eventually fully recover, probably in a few quarters. In the meantime, the US Dollar may bounce during risk-off phases, but rapidly, these will probably be met with further stimulus in continued support for the recovery. Over the next couple of quarters, our oscillators suggest further downside for the US Dollar until late Q3, then a defensive bounce during early/mid Q4, and then renewed downside pressure with probably new lows into next Spring. EUR/USD may reach into the high 1.20s by then.

41 /Equities: liquidity deterioration, internal rotation may lead to an inflection point before the end of the quarter

The last time The Capital Observer discussed the equity markets last month (July 2020), we made the following observation:

In the last 4 weeks since we wrote the June article, the Fed did a remarkable volte-face with regards to its QE regime. Thus, the bar for higher highs in September relative to peaks in May has just become significantly higher. In the updated graph (see 1st graph on this page), we see that the change rate of 2020 liquidity flows fell drastically. And no relief is in sight yet.

What exacerbates the situation is that the current liquidity profile has been waning during the period from late July to late August, a time window that has historically been dangerous for risk assets. And this is why:

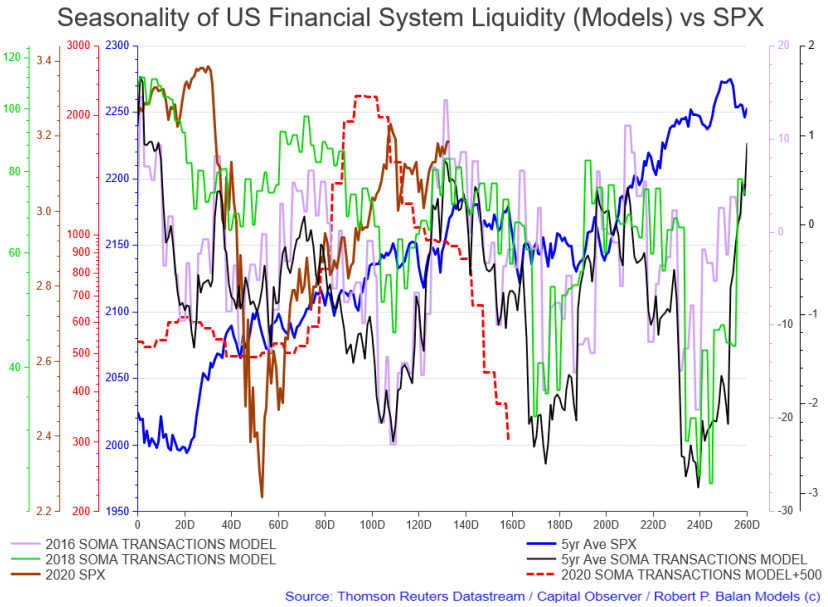
The late July-early September is a seasonally dangerous period for risk assets because all the major sources of systemic financial liquidity (fiscal and monetary) are receding at that time frame, as shown by the 2nd chart on this page.

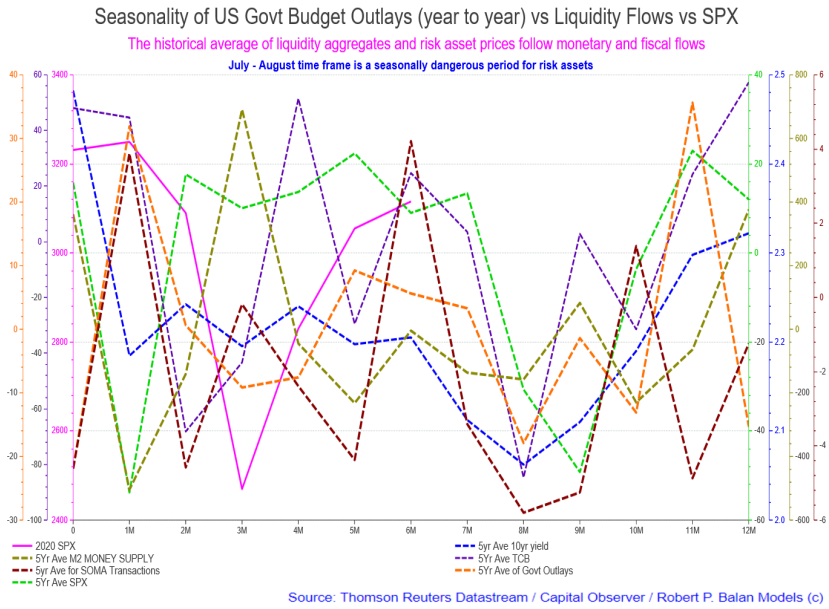
The support which should come from fiscal policy will also be absent during the forthcoming August-early September time frame, as illustrated by the 3rd graph on this page. In effect, risk assets are currently running on liquidity fumes. This has transpired in the market with a lot of sector rotation. However this could lead to a set back in a few weeks in equities back in a few weeks.

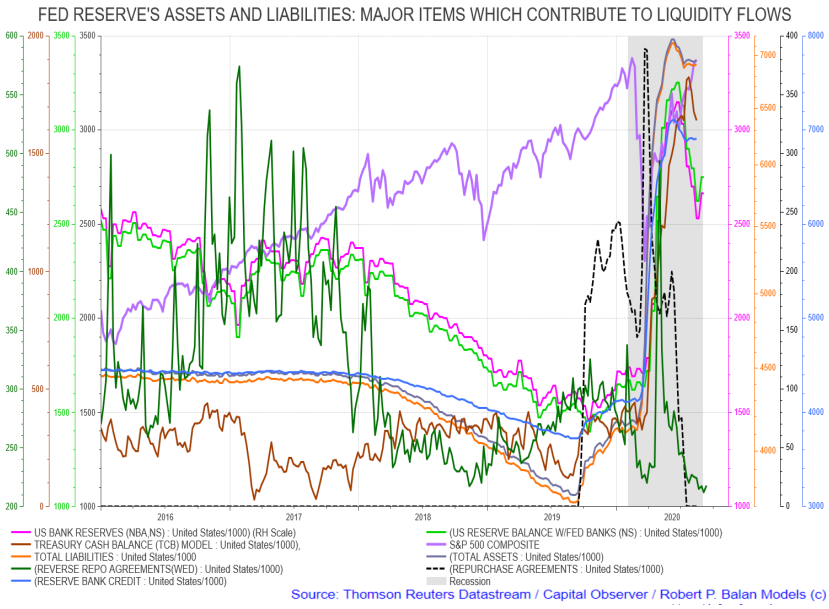
Moreover, we also noted In July:

..the Fed has become less generous to the financial markets, what with some indices hitting new all-time-highs, and liquidity flows should become less and less supportive
(see 3rd graph on this page). Nonetheless, we stand by our May projections that QE (in various forms) should continue in much smaller amounts, until September, when the Fed should declare a moratorium ahead of the November presidential elections.

Original graph from the July Edition of The Capital Observer







With 2020 liquidity aggregates falling sharply as we have shown in the graph above, lack of current support comes at a time when institutional memory is cued into the great seasonal drought of late summer (as we illustrated in *the 3rd graph of the previous page*). As the seasonality of the S&P 500 Index shows, the largest valuation decline in any given year in the past ten years at least, has happened during the August month period (*see 1st graph on this page*).

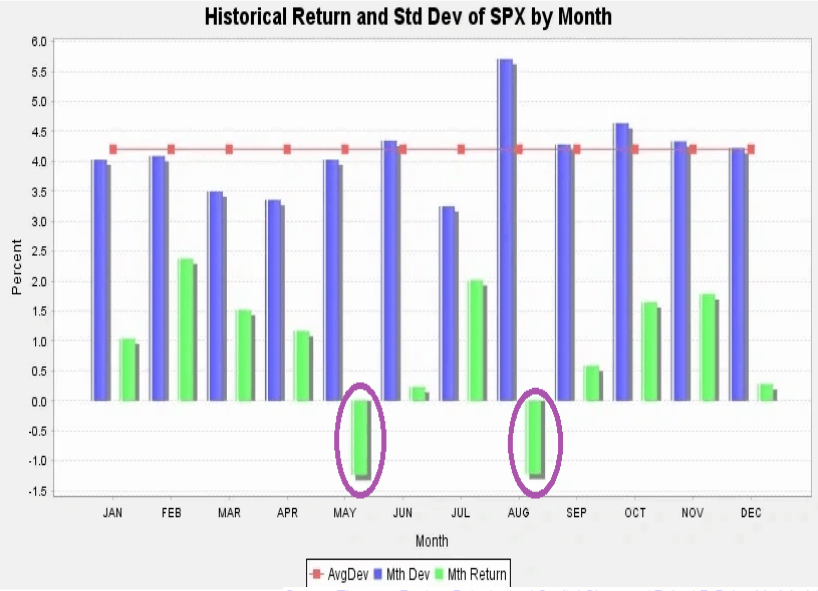
Put simply, we may have a problem with the markets from September as the reduced liquidity may start to bite.

To provide the backdrop for that statement, we said in July:

Our biggest fear at this time is that institutional memory of support (from historical liquidity flows pattern) may not show up this time around, aside from localized support provided by high frequency liquidity data. (see 2nd on this page)

There is a distinct possibility that from a peak sometime within the next three to four weeks, equities may just descend progressively until year end. The Fed's current Quantitative Tightening and a likely full stoppage of any market support by September could derail the markets from patterns that have been historically set by the impact of the seasonality of systemic liquidity flows.

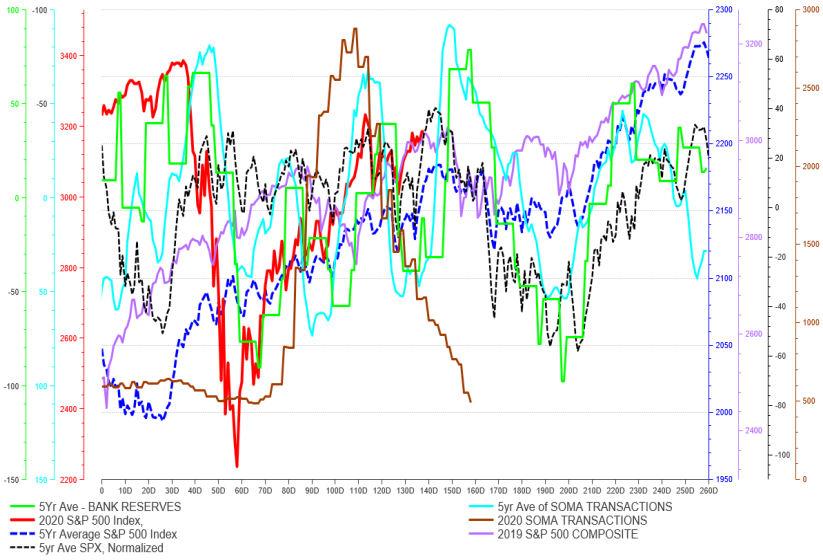
Markets have been grinding higher with a lot of rotation but an inflection point may be upon us towards the end of the quarter. The 3rd graph on this page shows how devastating sell-offs in August could be. Based on history, it would be easy to see the lows of June or the lows of May, even with run-of-the-mill bear phases commencing toward the end of the quarter. The aggregated, historical liquidity outflows during the month show that tendency year after year after year as illustrated by this graph.



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

Original graph from the July Edition of The Capital Observer

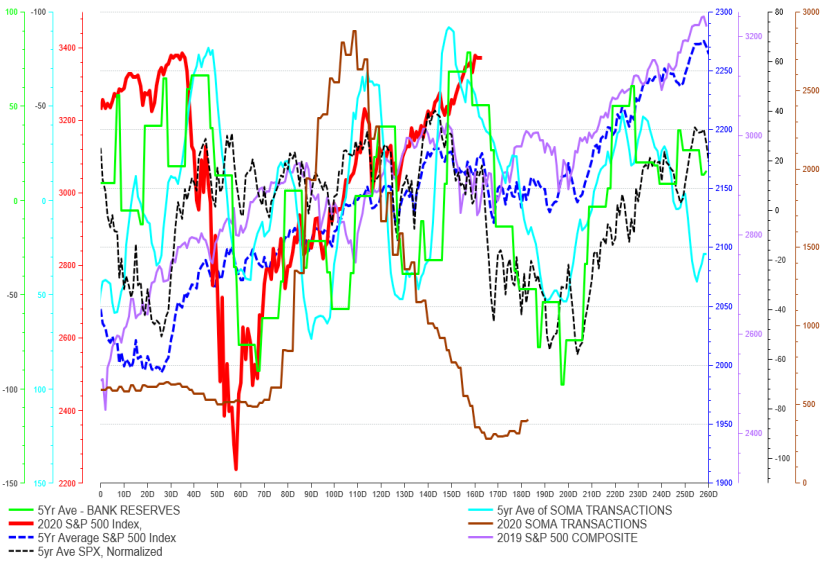
Seasonality of S&P 500 Index vs Seasonality of Bank Reserves and SOMA (Historical)



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

This is how this graph looks now

Seasonality of S&P 500 Index vs Seasonality of Bank Reserves and SOMA (Historical)



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

Moreover, this year, something is different. There are conditions this time around which could make a bad seasonality feature a lot, lot worse. The rate of change of 2020 SOMA Transactions (brown line in graph above) has fallen precipitously. And every time these variables decline sharply, very bad things happen to risk assets. Risk assets have meantime hewed to historical seasonal patterns, but it is silly to believe that no impact from such large disruption in liquidity flows will have no impact. It is just a matter of time lag.

To sum up: The Fed has started to tighten up Quantitative Easing (implementing Quantitative Tightening in a sense). Fiscal outlays will be lower, and money supply also declines soon -- in aggregate, a triple whammy for risk assets this coming September time window.

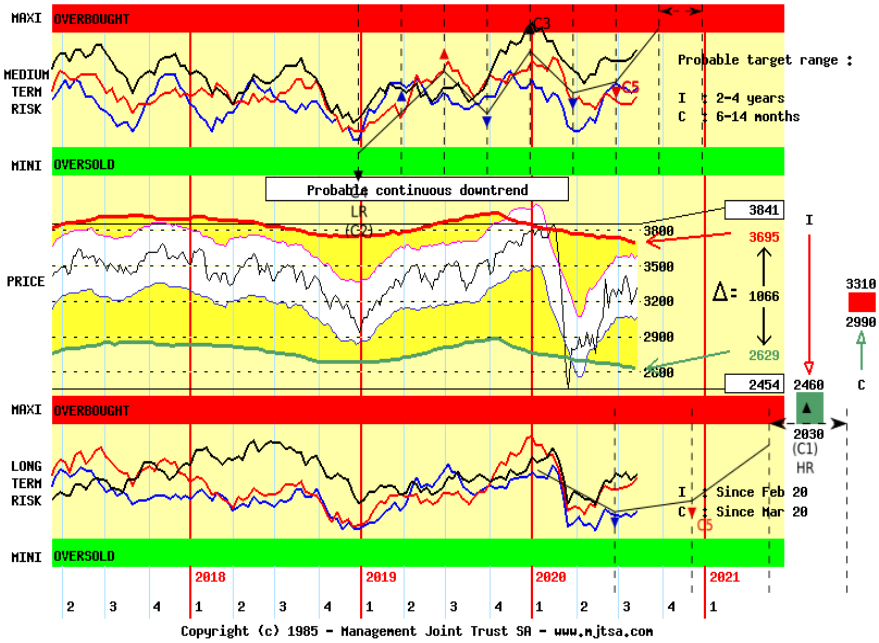
However, though we don't believe that the risk asset markets can continue to ignore the collapsing current liquidity situation, but we still have no idea how long a sell-off would last. The modality of the Fed's support for the market represents the primary unknown and challenge. The Fed indicated that market support will not be withdrawn right away, but will QE be increased accordingly if the market suffers a sharp decline? Will the Fed defer to partisan politics and pause QE 4 just before the November presidential elections?
The answers to these questions will play a large role in shaping up the profile of the next phase, which we believe could commence before the end of this quarter. It may be prudent to prepare for that phase. That’s what we will do at The Capital Observer.

44/ MJT - TIMING AND TACTICAL INSIGHT

Considering Global markets, cyclical factors may fade from September on

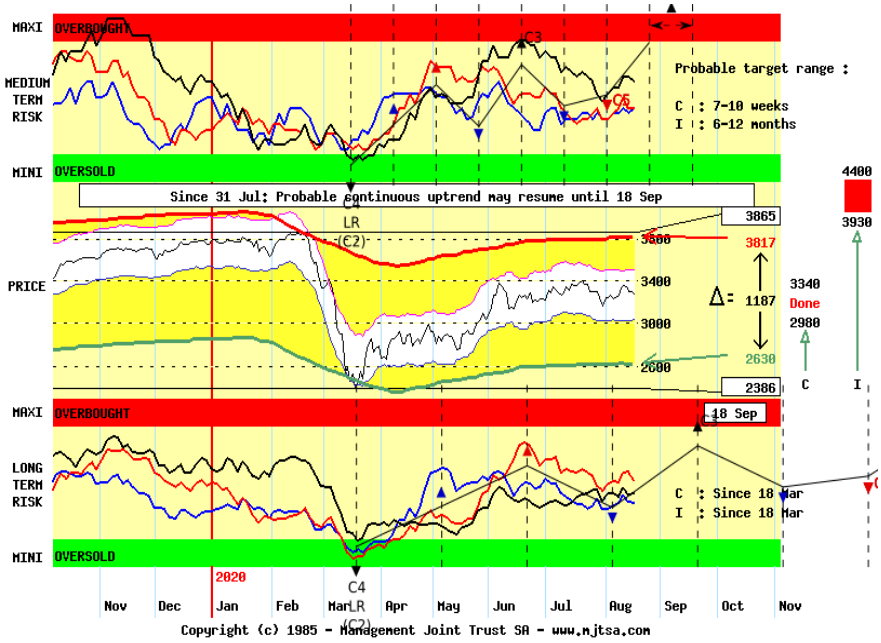
As we have analyzed in the first article of this issue of The Capital Observer, Equity markets may hold up into mid/late September, yet cyclical factors may start to weaken before-hand, probably from late August / early September. In this article, we review equity markets outside of the US to assess if similar dynamics are at play.

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



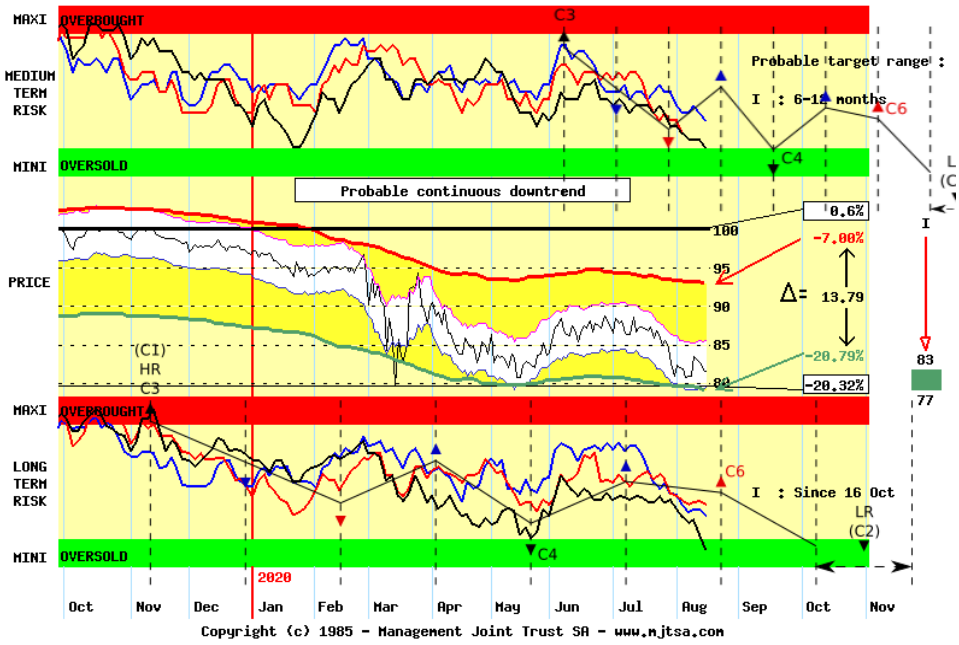
On an absolute basis, Europe did drop more severely than the US during March, yet, has since rebounded quite decently, or at least as much as the US in percentage terms. That said, for now, it is still some ways away from its February highs. Both oscillator series are however still positive (lower and upper rectangles). On our medium term ones (upper rectangle), **the EuroStoxx 50 made a higher base in June and could continue higher into late Q3 at least.** On our long term ones (lower rectangles), probably **following some retracement during early/mid Q4, EuroZone markets could climb again into Spring next year**. On the targets front (right-hand scale), the index **is still working through the resistance of the upper end of our C Corrective targets to the upside around 3'310. A break above these would confirm that it may approach its February highs over the next 6 to 12 months.**

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



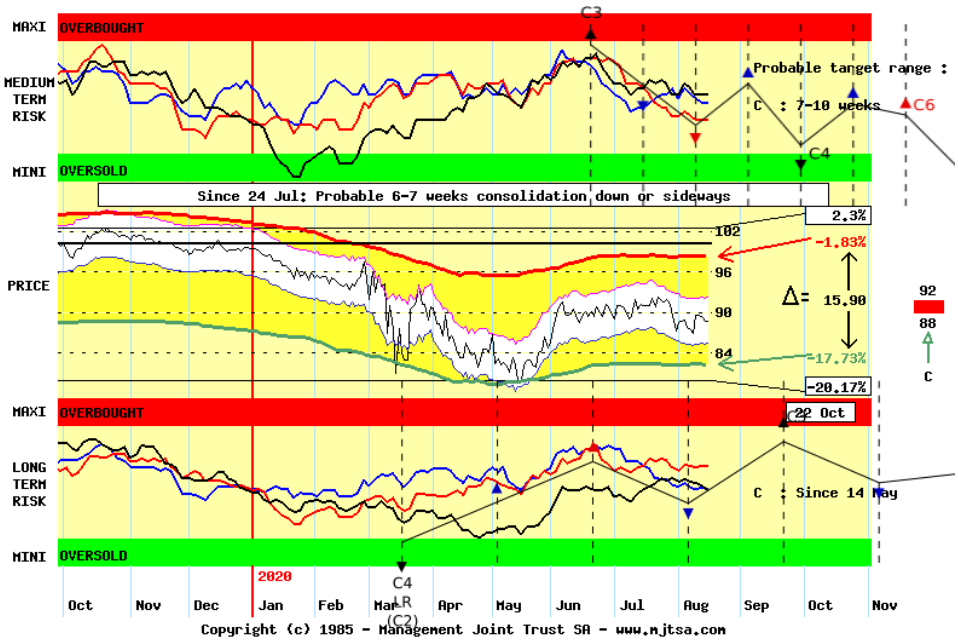
Shorter term, on its Daily graph, the EuroStoxx 50 is still uptrending, probably until early, perhaps mid September when considering both oscillator series (lower and upper rectangles). Following that, 1 or 2 months of correction to the downside may follow. Here also, the index is still working through the upper end of its C Corrective targets to the upside around 3'330 (right-hand scale). A break above these would confirm that it may approach its February highs over the next 3 to 6 months. **Hence, a continuation of the rally over the next month or so will be crucial in confirming further upside potential into early next year, even though, in the meantime, the EuroStoxx 50 may retrace during early/mid Q4.**

EuroStoxx 50 vs S&P500 Index (currency hedged ratio)
Daily graph or the perspective over the next 2 to 3 months



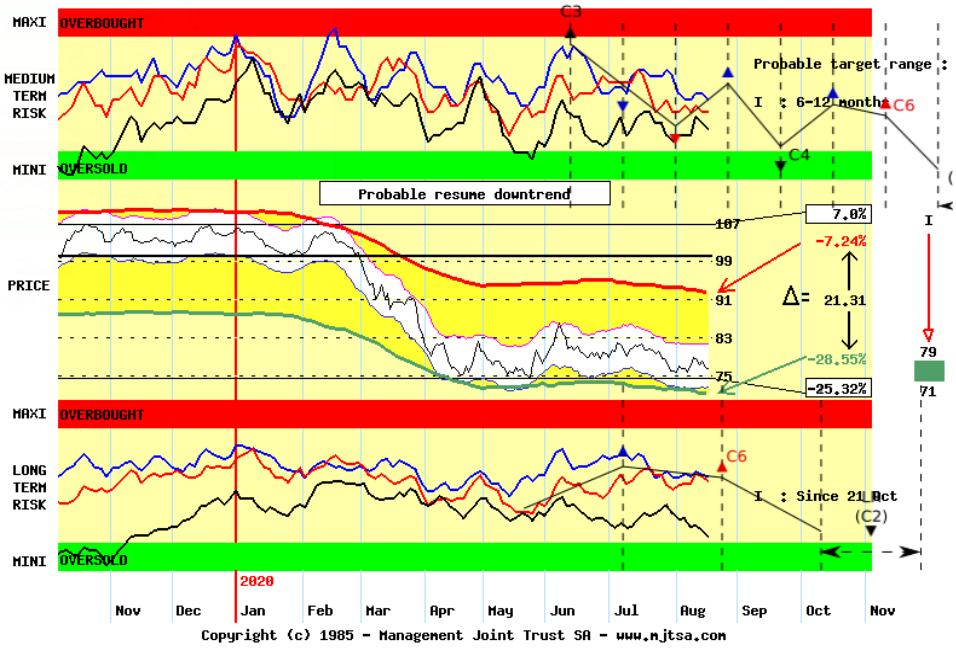
We now compare the EuroStoxx 50 index vs the S&P500. This first comparison is done on a currency hedged basis, i.e. by just comparing the nominal performance of both indexes in percentage points. Although the ratio did bounce in late March, and then in June, it has since given back most of its outperformance since March. Both our oscillator series (lower and upper rectangles) still suggest **a slight bounce into late August, but following that, European markets should then underperform into the mid/late Fall on a hedged currency basis**. The strong performance of EUR/USD may have acted as a headwind since early July. It may continue to do so during September. Following that, the ratio may suffer more structural issues as the risk assets rally retraces during early/mid Q4, and the more cyclical EuroZone equity markets could underperform along with the Euro.

EuroStoxx 50 vs the S&P500 Index (both in US Dollars)
Daily graph or the perspective over the next 2 to 3 months



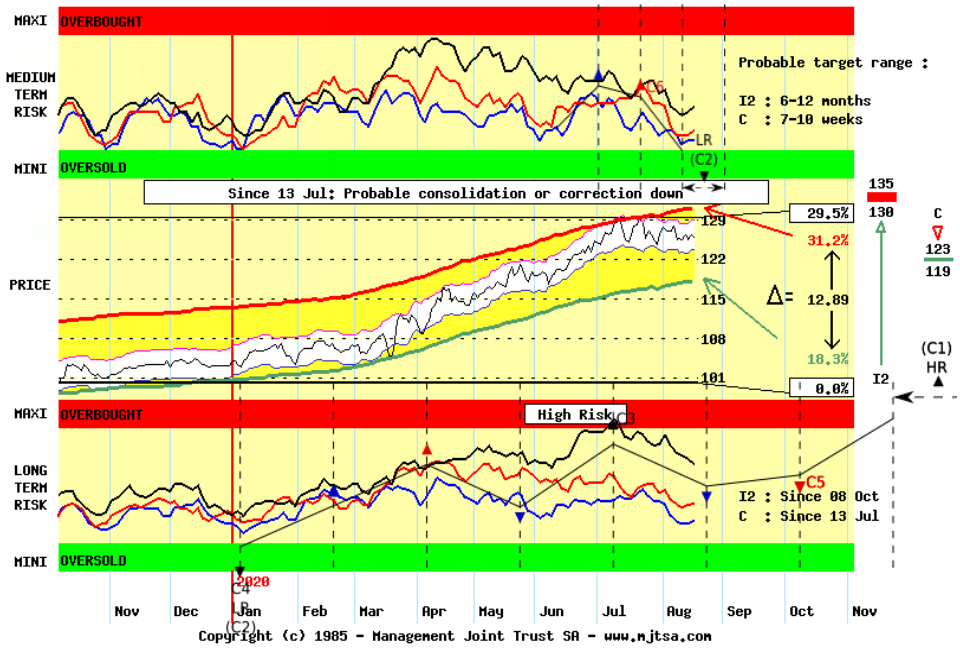
When compared in US Dollar terms, the resultant ratio has performed better since March thanks to the pick-up it has gathered from EUR/USD strength. **The ratio for now is still slightly uptrending and could hold up slightly longer than the currency hedged ratio presented above**, probably into early, perhaps mid September according to both our oscillator series (lower and upper rectangles). **Hence, when taking into account both ratios, we would probably underweight European markets again from late August, but would retain some exposure to EUR/USD for another 2 to 3 weeks into mid September.** Following that, both should correct down into Q4.

European Banking sector vs the Europe Stoxx 600 index
Daily graph or the perspective over the next 2 to 3 months



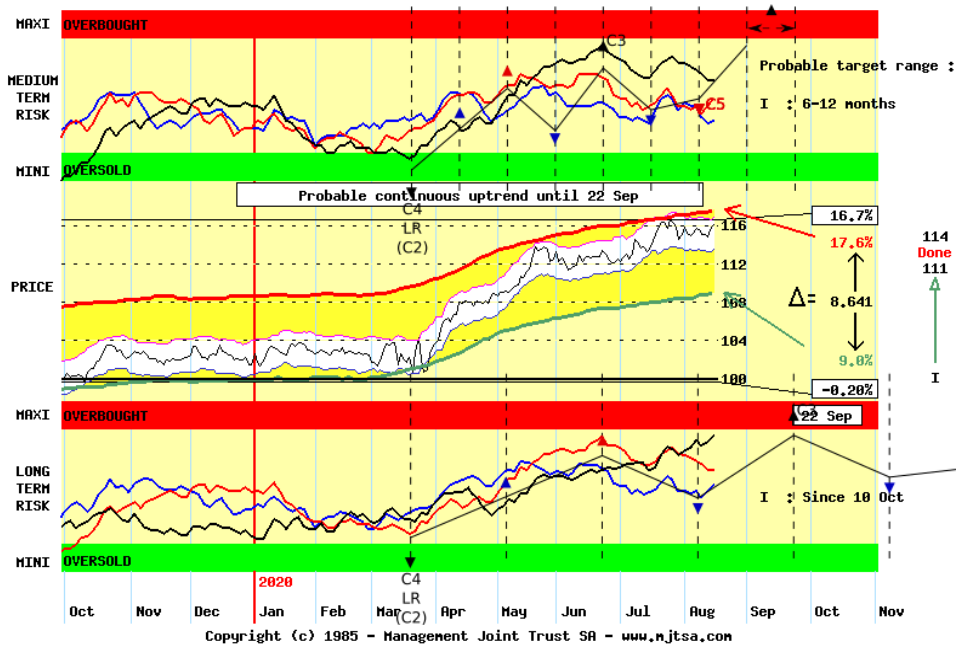
We confirm these prospects through a brief sector analysis. First, we compare the Europe Stoxx Banking Index vs the Europe Stoxx 600. The ratio did attempt do bounce between April and July, but never really managed to gain momentum. Both oscillator series (lower and upper rectangles) are now suggesting that **from late August, the European Banking sector could underperform again into the Fall. To a certain extent, this profile does serve as a proxy for the whole of Europe vs the rest of the world as its sector composition is more tilted towards cyclical profiles than other regions.**

Technology sector vs the Europe Stoxx 600 index
Daily graph or the perspective over the next 2 to 3 months



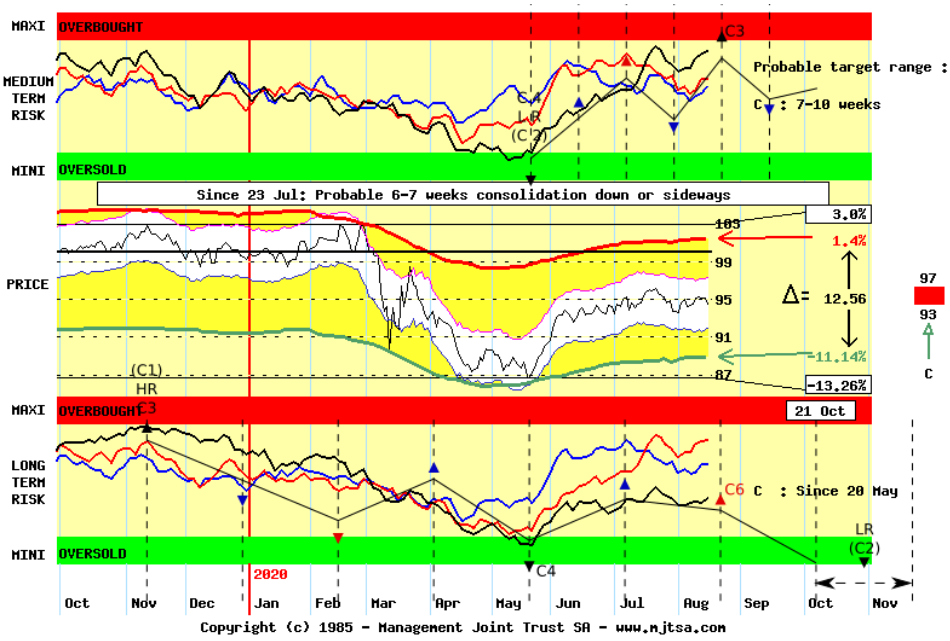
At the other extreme of the spectrum, we now compare the European technology sector vs the Europe Stoxx 600. The ratio has consolidated slightly since early/mid July and may continue to do so for **a couple more weeks on both oscillator series (lower and upper rectangles). Following that, our long term oscillators (lower rectangle) are suggesting that the ratio resumes its uptrend probably into mid/late Fall and will probably make new highs** according to our I2 Impulsive 2 extended targets to the upside (right-hand scale). The sector unfortunately is a small component of the European equity markets and is usually more closely related to the US Nasdaq100. Its relative strength probably also implies renewed European underperformance from September onwards.

Germany vs France
Daily graph or the perspective over the next 2 to 3 months



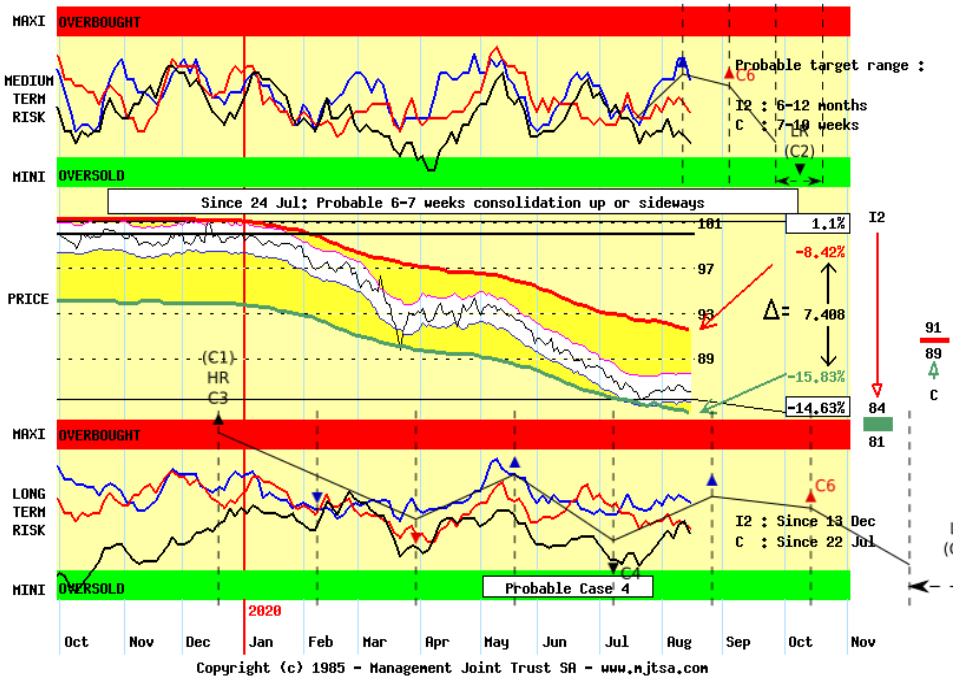
Within Europe, we now consider geographical relative strength. **Into late September and perhaps even into early October, we would probably favor Germany (EWG ETF) over France (EWQ ETF)**. This is what both our oscillator series are suggesting (lower and upper rectangles). Indeed, the ratio does look slightly more Growth than Cyclical having corrected slightly during the early June cyclical acceleration, and more recently since mid July. **Longer term, the uptrend since March could be staging a strong long term reversal. Indeed, Germany had been underperforming France since early 2015. A possible explanation for this reversal may be found in the rather loose correlation that sometimes links German and Chinese markets.**

Italy vs Europe
Daily graph or the perspective over the next 2 to 3 months



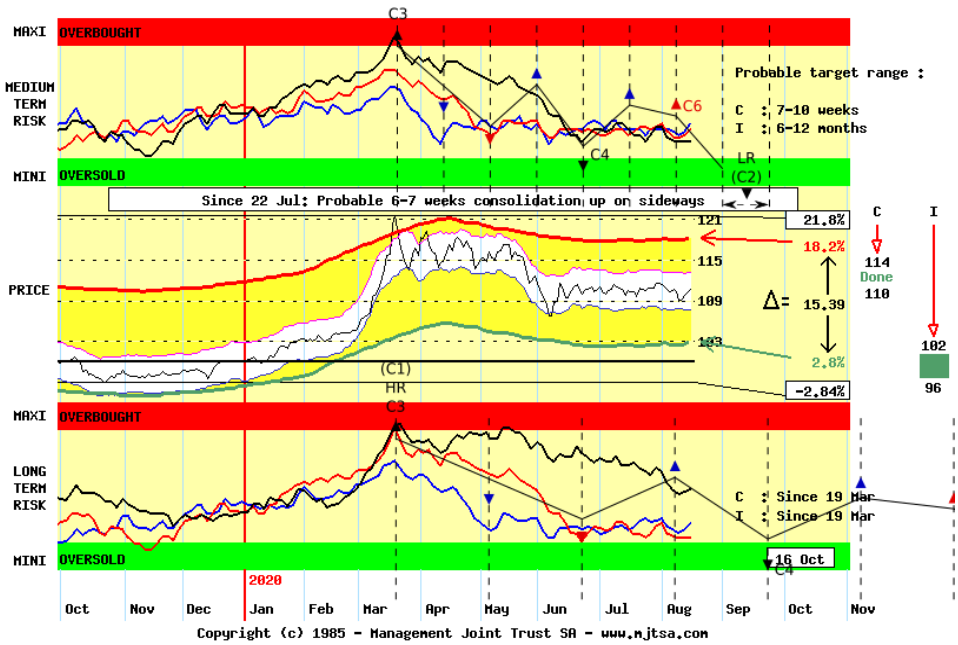
Italy (EWI ETF) has been performing quite well since May vs other European markets (IEV ETF). Indeed, the ratio has made it up to the resistance of our C Corrective targets to the upside around 97 (right-hand scale). Yet, we believe it will probably stall at these levels given that the ratio's time window to rise further in closing soon on both oscillator series (lower and upper rectangles). Indeed, **we would expect it to top out late August and then retrace down into the Fall as shown on our long term oscillators (lower rectangle). We would hence probably start to underweight Southern Europe again starting late August.**

UK vs Europe
Daily graph or the perspective over the next 2 to 3 months



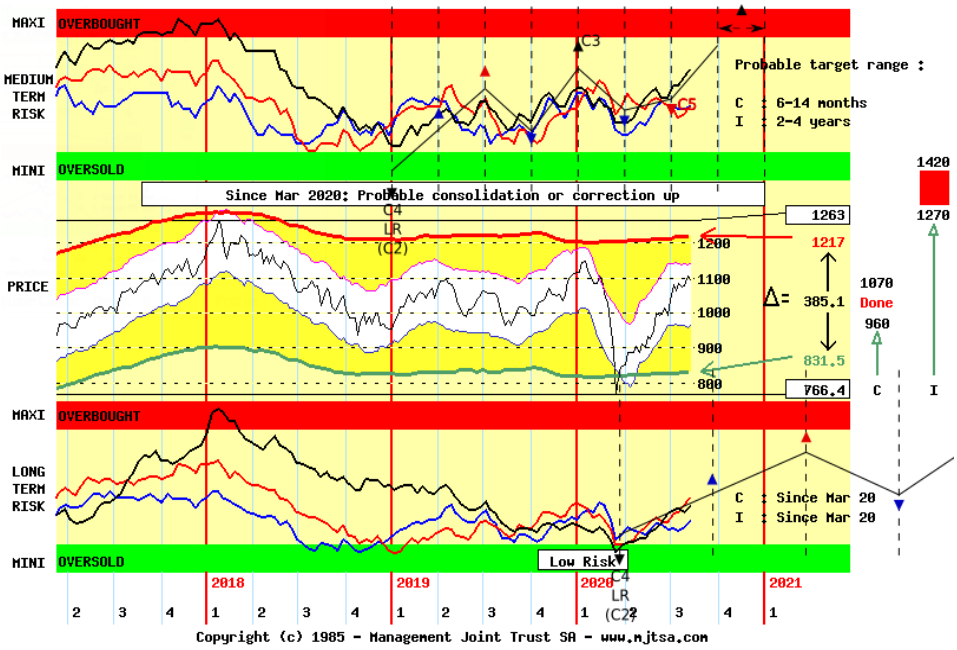
We move on to compare UK equity markets (EWU ETF) to European ones (IEV ETF). Both ETFs we use here are in US Dollars and hence the comparison does take into account currency movements. While the Pound has performed on par with the Euro since late June, the ratio's underperformance is quite impressive. Indeed, UK markets seem to be suffering from a double whammy situation. They tend to lag European ones when the Pound and the Euro strengthen vs the US Dollar, yet fall more, along with the Pound during period of deleveraging such as the one we saw in March. Hence, **the UK's underperformance seems quite structural and according to both our oscillator series (lower and upper rectangles), it should resume from late August into the Fall.**

Switzerland vs Europe
Daily graph or the perspective over the next 2 to 3 months



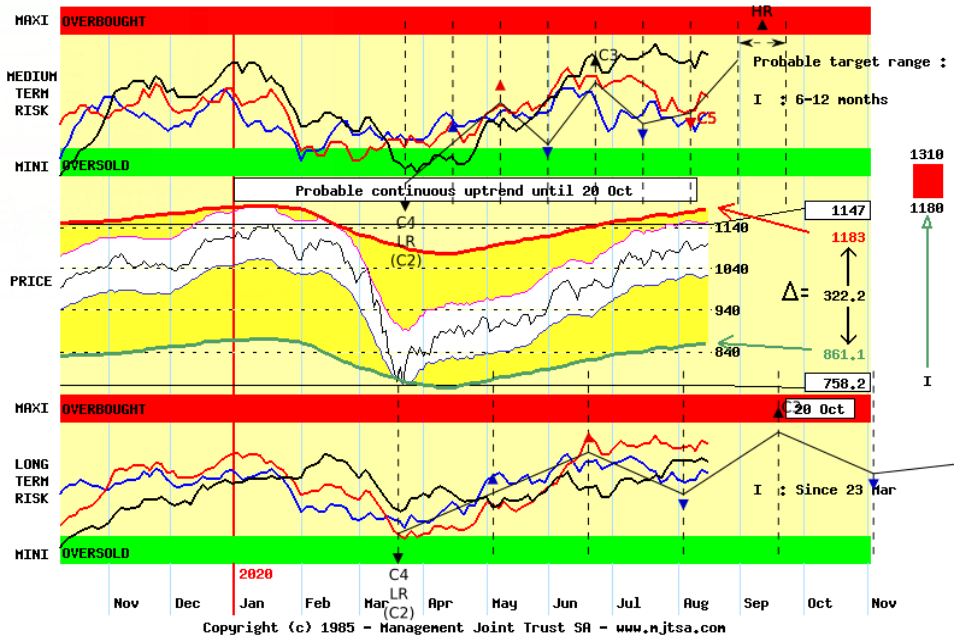
Finally, we consider defensive Switzerland (EWL ETF) vs European markets (IEV ETF). **The ratio has been dropping since March. Both oscillator series suggest that it could continue to do so into mid/late September** (lower and upper rectangles). Following that, Switzerland may outperform into the Fall as equity markets start to retrace down. More generally, we would hence probably start to consider defensive themes vs the market from mid September.

MSCI Emerging Markets Index
Weekly graph or the perspective over the next 2 to 4 quarters



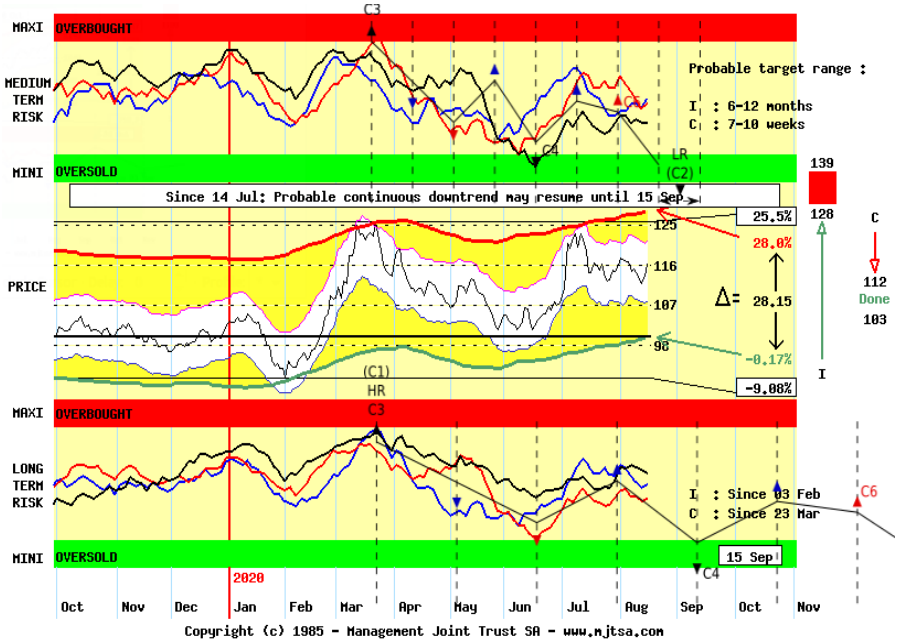
We now switch to Emerging Markets, which have staged a strong comeback since March. Indeed, the MSCI Emerging Markets Index is very close to reaching its year-to date highs. Since early 2018, Emerging Markets had suffered a strong bear market with a drop from peak to through of almost 40%. **The climax sell-off in Q1 may have hence nailed a secular bottom**. This is the scenario we show on our long term oscillators (lower rectangle) where **we start a new long term uptrend sequence in March. It suggests an intermediate top late Q3 (confirmed by a High Risk position on our medium term oscillators – upper rectangle), probably some retracement during early/mid Q4 and then further upside into next Spring**. The index recently made it above the resistance of the upper end of our C Corrective targets to the upside around 1'070 (right-hand scale). This would open the door to further upside potential towards our I Impulsive targets to the upside int the 1'270 – 1'430 range over the next 6 to 12 months.

MSCI Emerging Markets Index
Daily graph or the perspective over the next 2 to 3 months



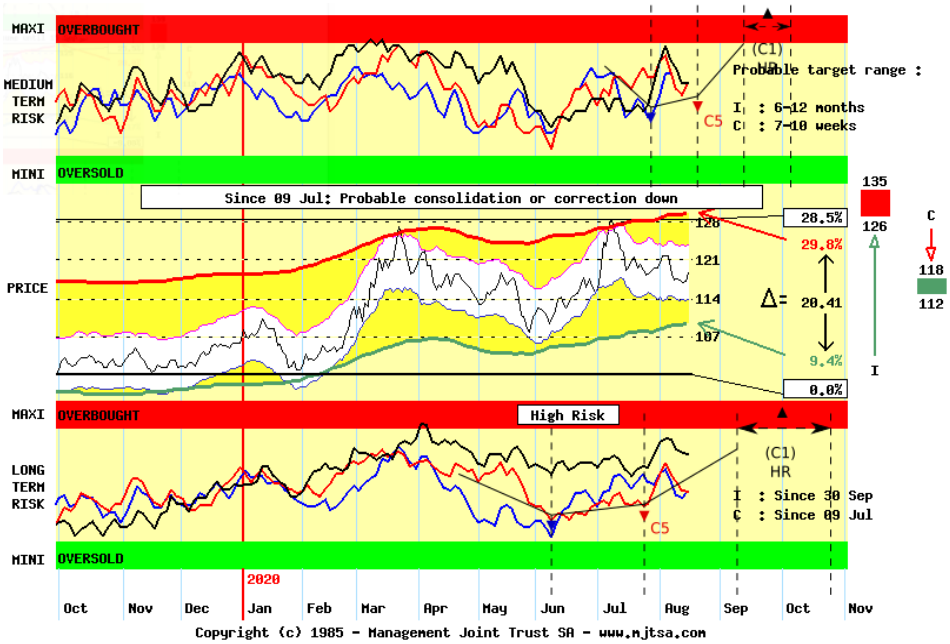
Shorter-term, on the Daily graph, both oscillator series (lower and upper rectangles) seem to confirm **that the current uptrend probably continues another month or so into mid September. By then, prices may reach our I Impulsive targets to the upside (right-hand scale) between 1'180 and 1'310, 10 to perhaps 20% above current levels**. Following that, we would then expect some retracement into early/mid Q4. Our current historical volatility "Delta", here at 322 (middle rectangle, right-hand side) suggests circa 161 to 258 of retracement potential (i.e. 0.5 to 0.8 times "Delta"), or between 15 to 20% of downside risk from late Q3 into the Fall. Hence, **while the upside potential over the next month or so is appealing, the subsequent correction risk is also quite high.**

China's CSI 300 Index vs the All Country World Index
Daily graph or the perspective over the next 2 to 3 months



On a relative basis, we believe it is important to differentiate between China (and perhaps Taiwan) and other more cyclical Emerging Markets. Hence, we first compare China's domestic CSI 300 Index (ASHR ETF in US Dollars) to the All Country World Index. On our long term oscillators (lower rectangle), the ratio could still retrace into early/mid September. Yet, for now, the correction since early/mid July has been quite shallow and has held well above the resistance of our C Corrective targets to the downside (right-hand scale). **We hence believe that China may outperform again, perhaps sooner than later. This is what the sequence on our medium oscillators is suggesting (upper rectangle) with a Low Risk situation that probably starts within a week or so, i.e. towards late August. On the target front (right-hand scale), our I Impulsive targets to the upside still point to compelling outperformance, potentially between 10 and 20% over the next few months.**

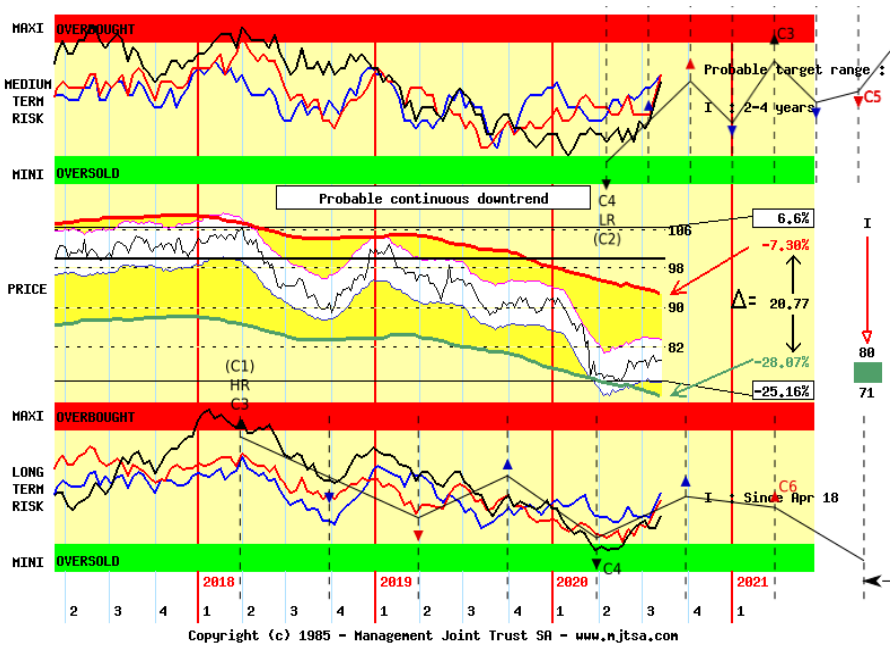
MSCI China vs the All Country World Index
Daily graph or the perspective over the next 2 to 3 months



Another Chinese Index, which is worth analyzing is the MSCI China Index (MCHI ETF), which is more focused on Chinese international listings as well as big tech companies such as Tencent, Alibaba or Baidu. It is hence more Growth oriented, while the CSI 300 is more counter-cyclical. In this perspective, and considering our cross asset scenario where we expect cyclical factors to fade from late August, while Growth themes may extend higher into mid/late September, **the MSCI China index may provide a better transition trade than the CSI 300 Index until mid September.**

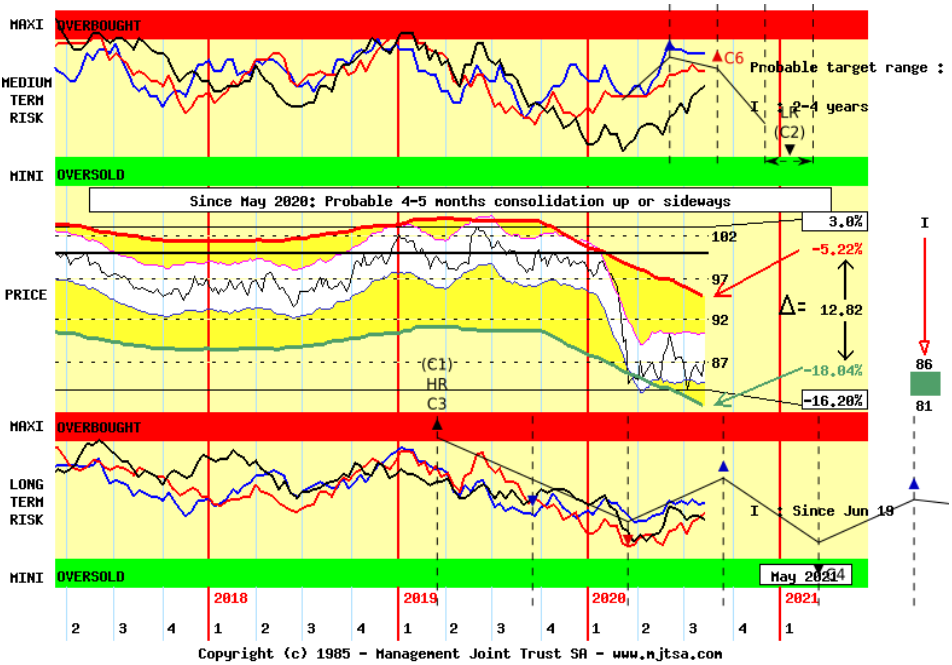
Indeed, its ratio vs the All Country World Index is probably still uptrending on our long term oscillators (lower rectangle), while it could resume this uptrend over the next week or so on our medium term ones (upper rectangle). **Our I Impulsive targets to the upside (right-hand scale) on the ratio, between 7 and 15% on a relative basis, are slightly less aggressive than for the ratio above, which will probably justify a switch into the more defensive CSI300 Index at some point towards mid September when equity markets could start to top out.**

Other large EM markets vs the All Country World Index
Weekly graph or the perspective over the next 2 to 4 quarters



We now consider other large EM markets (ex Taiwan, which we believe is quite similar to China). The portfolio we use here is cap weighted according to each country's weight in the MSCI Emerging Markets Index and includes the following ETFs: EWY (South Korean), INDY (India), EWZ (Brazil), EZA (South Africa), ERUS (Russia) and KSA (Saudi Arabia). This combination is clearly more cyclical that the Chinese equity indexes analyzed above. Following 2 years of downtrend since early 2018 and a climax sell-off in Q1, **it too may have made a secular bottom in March. In the meantime, both oscillator series (lower and upper rectangles) do suggest that it may hold up until late Q3 vs the All Country Index. We then expect some retracement during the Fall and another attempt to bounce next Spring. For now, however, it is still working off its lows in terms of targets, and as much as we like the theme over the next 1 to 2 years, we are concerned that this lack of upside momentum may see it retest down again sooner than later.**

Other large EMs vs the MSCI Emerging Markets Index
Weekly graph or the perspective over the next 2 to 4 quarters



Hence, on Emerging Markets, we will probably concentrate on China and related trades from here on, probably into mid/late Q4 at least, and perhaps even until next Spring. This is what this comparison between Other large EM markets (ex China and Taiwan – see portfolio composition in the graph above) and the full MSCI Emerging Markets Index (EEM ETF with more than 50% allocated to China and Taiwan) would suggest. Indeed, according to both oscillator series (lower and upper rectangles), **the ratio could resume its downtrend over the next few weeks**, probably into late this year / early next year on our medium oscillators (upper rectangle) and even into next Spring on our long term ones (lower rectangles). **This refocus on more Growth / Defensive trades in Emerging Markets would fit with the downside retest we expect more generally on cyclical factors over the next few months.**

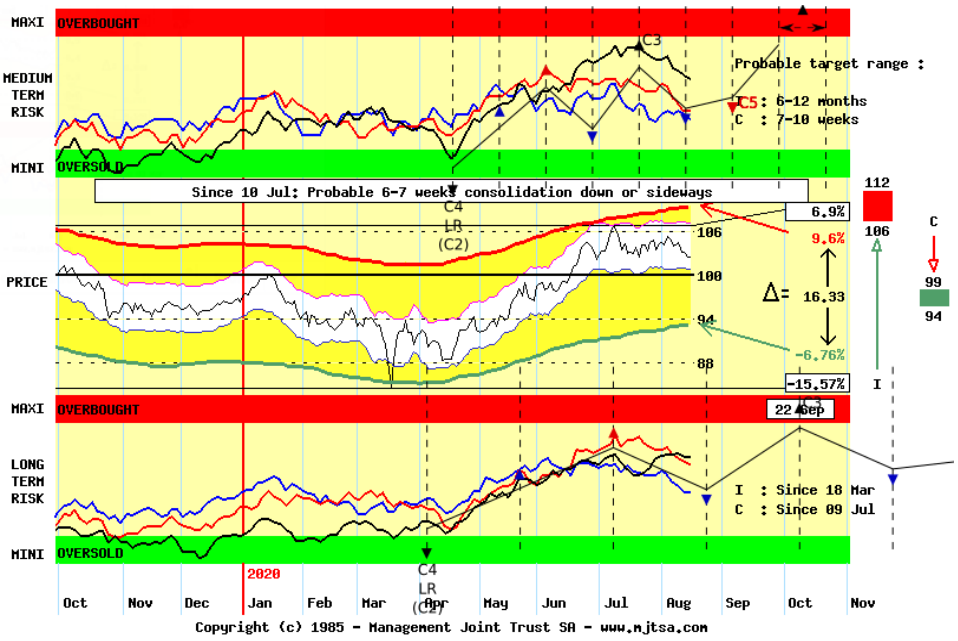
Concluding remarks:

Europe and Emerging markets still seem to be uptrending on an absolute basis into mid, perhaps late September. The EuroStoxx 50 may approach its February highs, while the MSCI Emerging Markets index may rise more than 10%. On a relative basis, however our analysis in more nuanced. Europe for example, is more cyclical than the US. On a US Dollar denominated basis, it could hold up into mid September vs the S&P500, thanks to EUR/USD strength, but percentage wise in Euros, it will probably starts lagging the S&P500 in US Dollars from late August. Sector-wise, European Banks probably start to underperform again from late August, while Technology outperforms. Similarly, we would favor Germany over France into late Q1 and would probably underweight Southern Europe and the UK. Defensive Switzerland then becomes appealing from late September on a relative basis. We believe these rotations point to a transition period into mid/late September, when Growth takes up the lead again and cyclical factors fade. Defensive trades should then bottom out vs the market once equities top out late September. We expect similar developments in Emerging Markets, and will start favoring China again from late August, following 6 weeks of underperformance vs more cyclical Emerging Markets since early/mid July.

52/ Splicing the markets: Promising Growth segments into late Q3

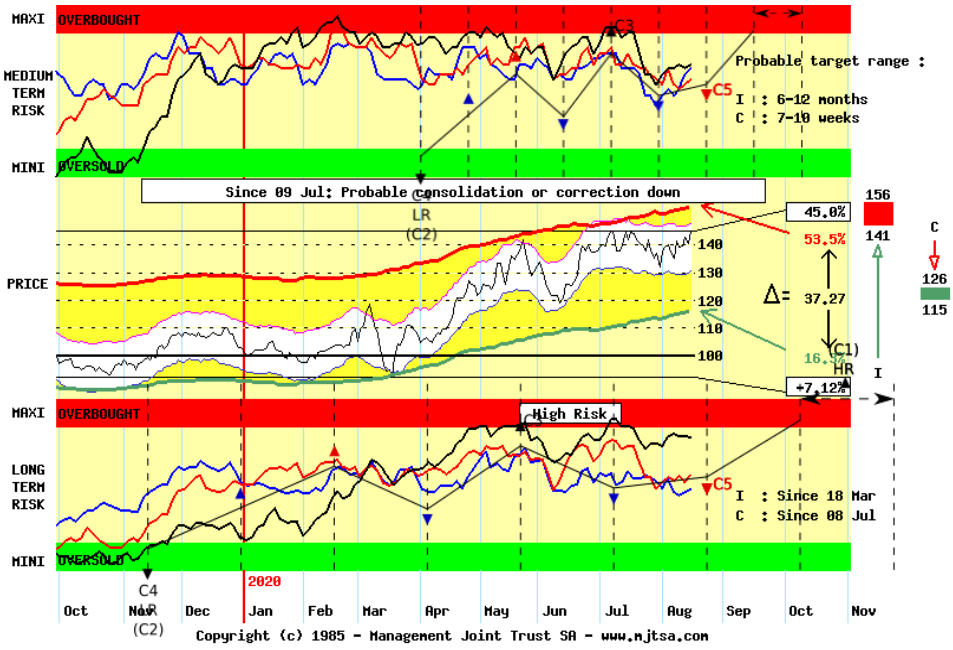
In the first article of this issue of The Capital Observer, we suggested that Growth sectors and themes could start to outperform again from late August / early September, probably into late September, perhaps even early October. What we were describing was a Growth extension in the late stages of the rally which was initiated in March. In this article, we are suggesting a few Growth segments, which may be particularly strong as they do seem to outperform even the Nasdaq 100 over the next month or so.

Social Media vs the Nasdaq100 Index
Daily graph or the perspective over the next 2 to 3 months



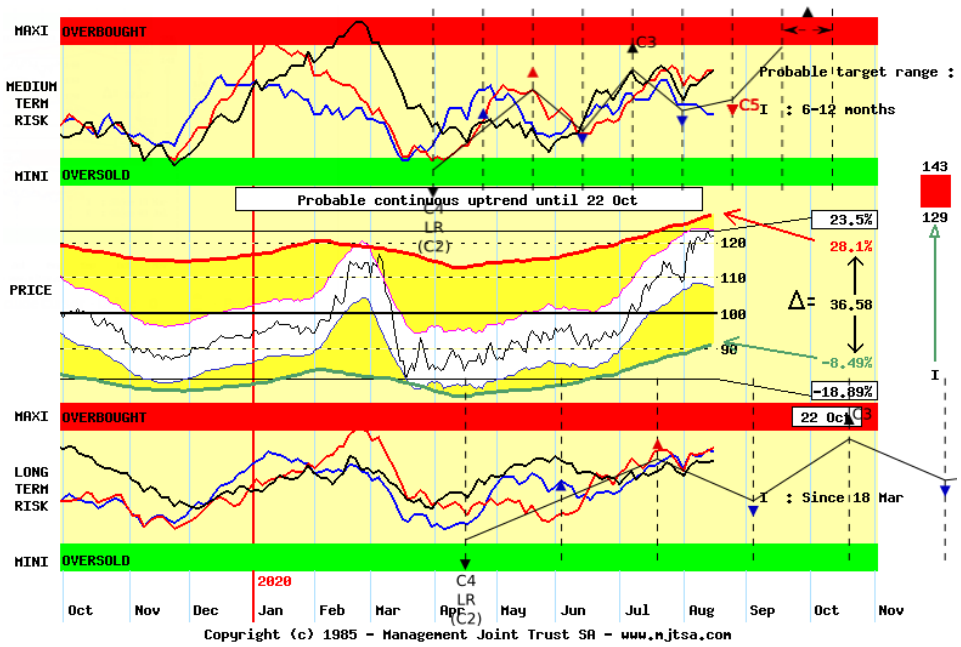
First we consider Global Social Media (SOCL ETF), which includes the US usual suspects but also a series of more international social media companies. The theme appears to be a high beta to the Nasdaq100 as its ratio against it has consolidated at high levels since early/ mid July, similarly to the ratio of the Nasdaq100 vs the S&P500 Index. Both our oscillator series (lower and upper rectangles) suggest that **by late August, at the latest early September, Social Media should resume its uptrend vs the Nasdaq 100, probably into late September / early October**. Our I Impulsive targets to the upside (right-hand scale) do suggest new highs and perhaps even up to 10% of further outperformance.

Genomics vs the Nasdaq 100 Index
Daily graph or the perspective over the next 2 – 3 months



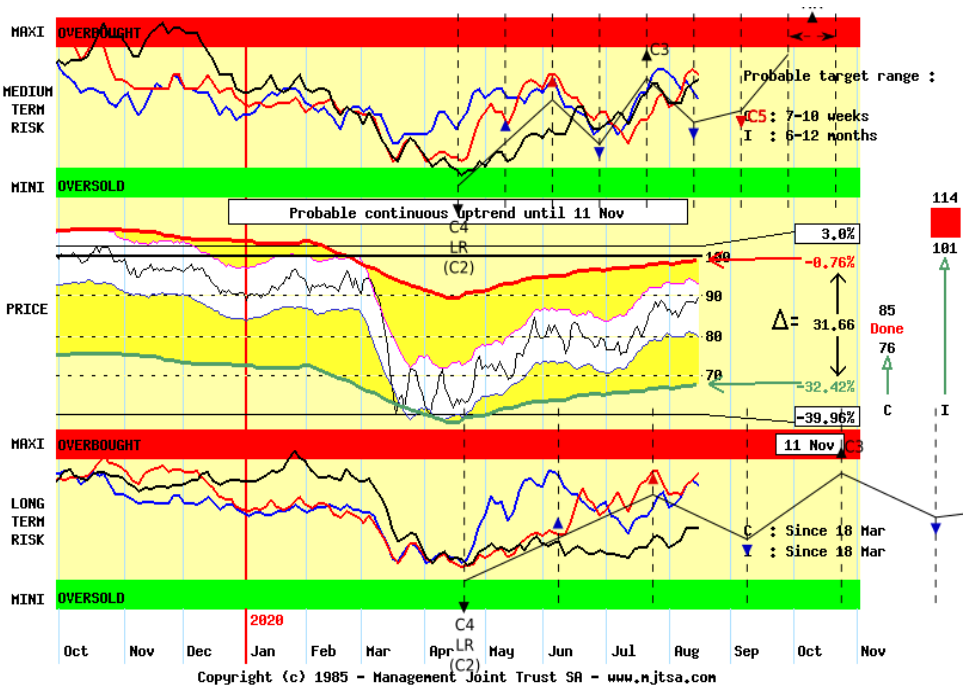
Genomics is another interesting one (ARKG ETF) and represents the more Growth oriented companies of the biotech sector. The theme had widely outperformed in the initial stages of the rally, from late March into late May, but has since been consolidating as cyclical factors did bounce early June and have been attempting to do so again since early/ mid July. Both oscillator series (lower and upper rectangles) suggest that this 3 months consolidation period could be coming to an end soon (towards mid/late August) and that **Genomics could then outperform the Nasdaq 100 again into late September and perhaps October.** Our I Impulsive targets to the upside (right-hand scale) do suggest new highs and perhaps even up to 15% of further outperformance.

Solar Energy vs the Nasdaq100 Index
Daily graph or the perspective over the 2 to 3 months



Solar Energy (TAN ETF) has posted stellar performance since March and recently registered a new all time high vs the Nasdaq100 (while the Nasdaq100 has itself seen a 60% rally since March). Both oscillator series (lower and upper rectangles) now suggest **a couple of weeks of consolidation on the ratio into late August / early September. We believe this should constitute a new buy the dips opportunity on the ratio for further upside into late September, perhaps October. Our I Impulsive targets to the upside suggest that the ratio could still climb another 5 to 15% from current levels until then.**

Homebuilding vs the Nasdaq100 Index
Daily graph or the perspective over the next 2 to 3 months



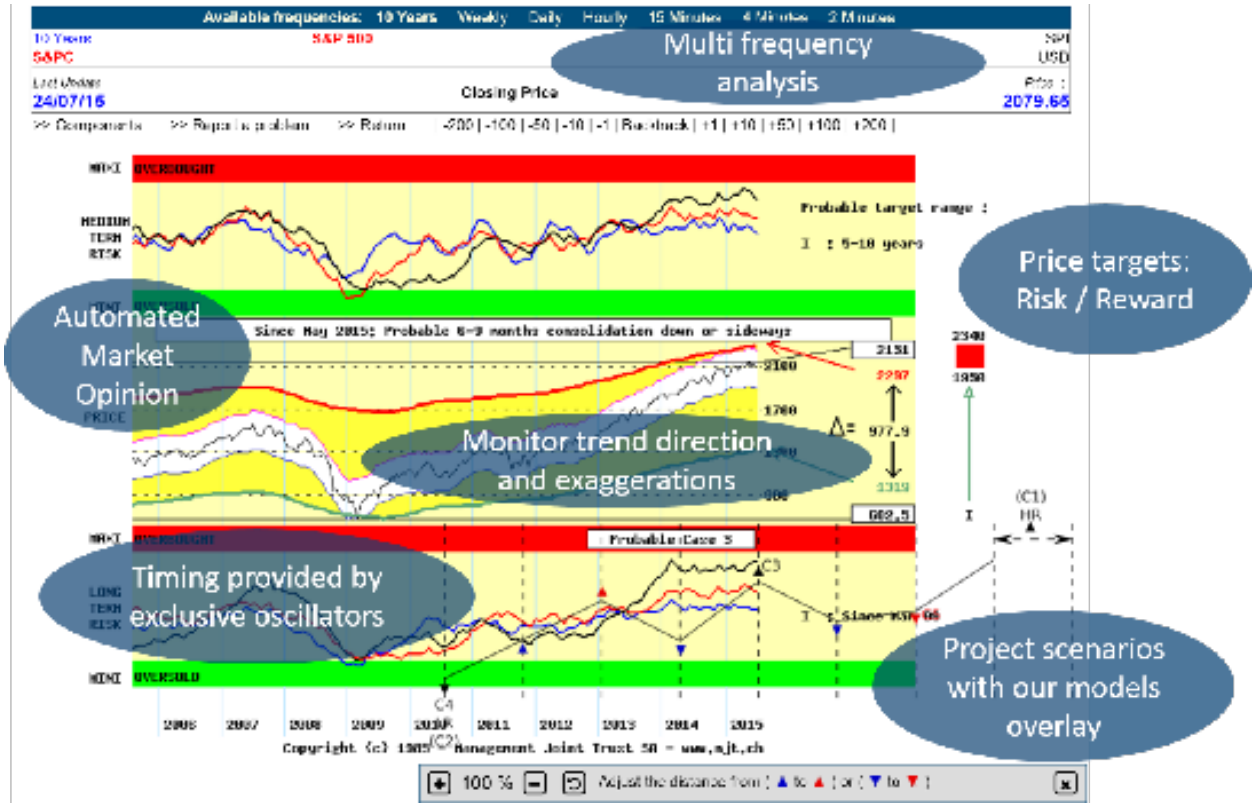
Finally, we focus on the ratio of US Homebuilding (ITB ETF) vs the Nasdaq100. It is probably less intuitive that the previous segments we have considered, yet it should also benefit from a Growth extension and of the prospects of further declines in interest rates which should accompany it. Here also, both oscillator series (lower and upper rectangles) do **suggest some consolidation on the ratio into late August / early September, but would then point to a new period of outperformance into late September, perhaps October**. On the targets front (right-hand scale), the ratio recently made it above the resistance of our C Corrective targets to the upside and may eventually reach up to our I Impulsive ones, 10% above current levels at least over the next couple of months. Hence, **perhaps a more risky bet that the other ones featured in this article, but also one with strong reward if it materializes.**

Concluding remarks :

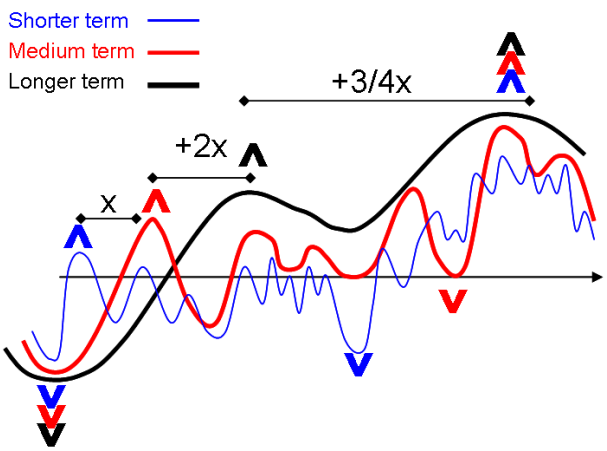
Considering the Growth extension, we expect from late August / early September into late September, perhaps early October, we have decided to seek out several segments which could outperform even the Nasdaq100 during this period. Our interest has focused on different profiles, Global Social Media, as one of the more dynamic segment of the Technology sector, Genomics as a proxy for the most Growth oriented Biotech companies, Solar Energy, which should continue its stellar outperformance started in March and perhaps US Homebuilding, which could benefit from renewed weakness in US Interest rates. According to our calculations, all four could outperform the Nasdaq100 by more than 10% into late Q3.

54/ METHODOLOGY

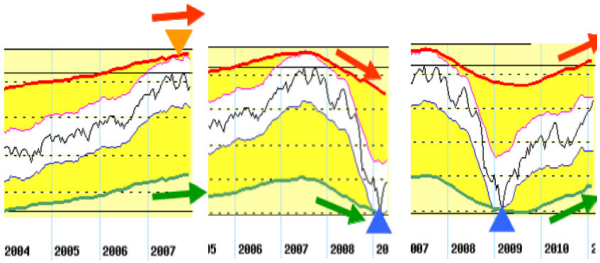
MJT's proprietary methodology uses Timing Oscillators to help investors position themselves either in an uptrend or downtrend. It will hence allow them to anticipate and project the future sequence of events. Coverage extends over 5'000 instruments, long term to intraday, across all asset classes. Relative 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)



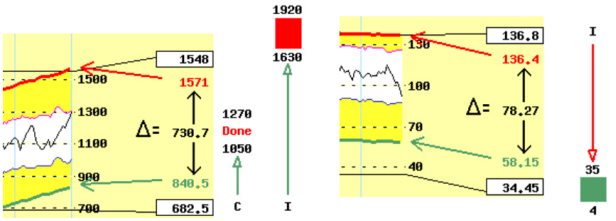
Timing oscillators: Different prices cycles are captured by our 3 Timing oscillators. Monitor how their relative positioning defines specific situations (Cases) to always know where you stand within the Trend (e.g. please see below the ideal Uptrend Case succession sequence)



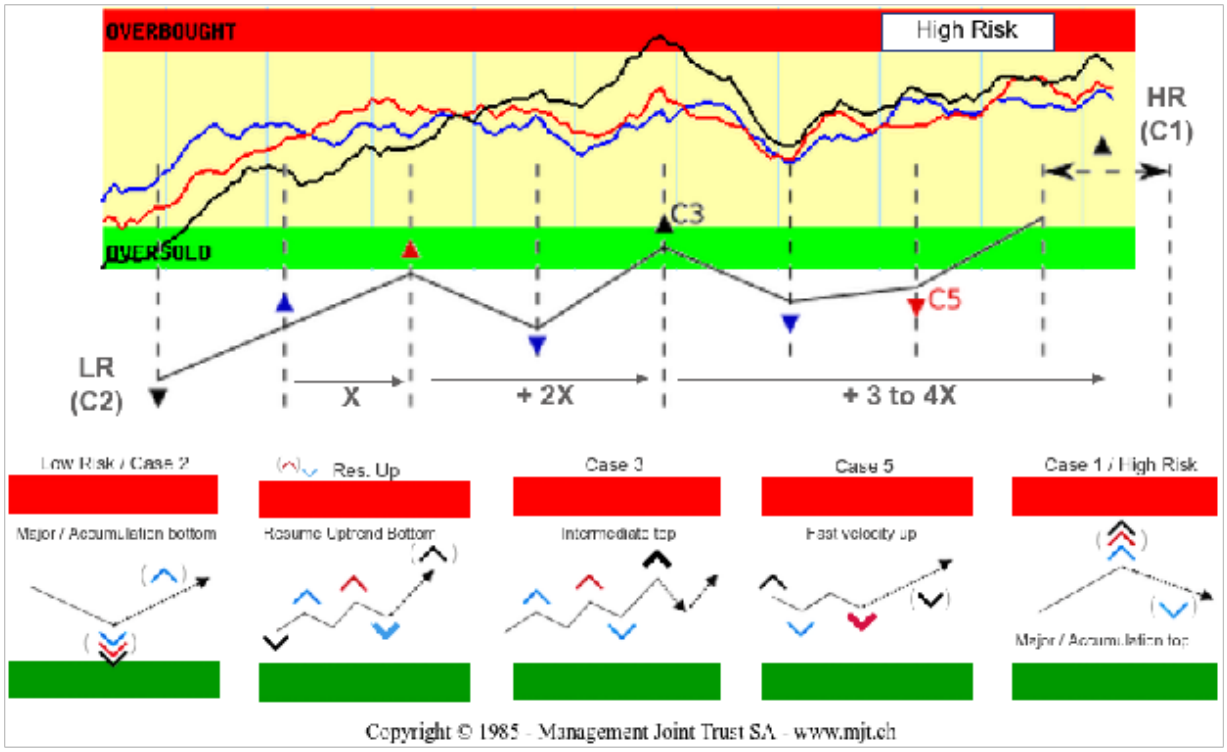
Trend direction: the direction of FinGraphs' large envelope will help you decide either to apply an uptrend or a downtrend model. Contacts between the wider and thinner envelopes will help you anticipate and confirm market turning points (e.g. S&P500 bi-monthly, extracts from the 2005-2011 period).



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).

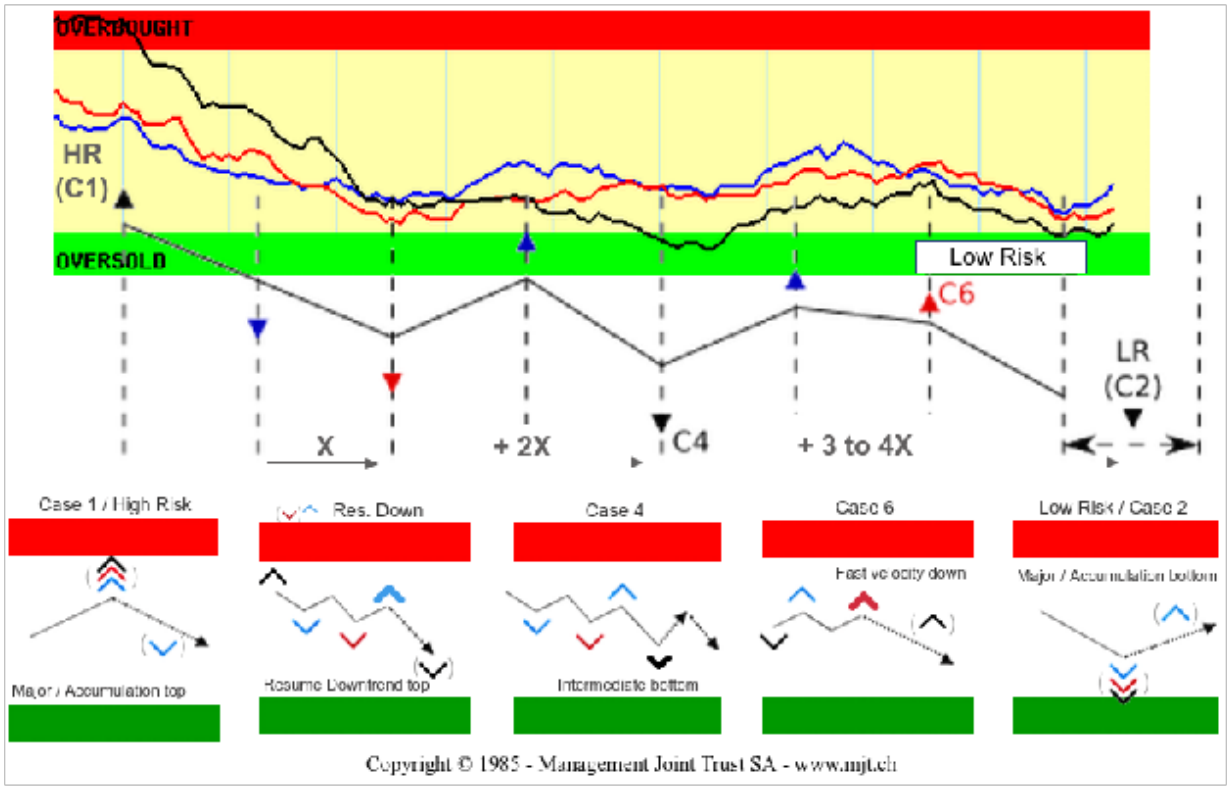


Ideal Uptrend Model



(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



(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.

General Disclosure

This document or the information contained in does not constitute, an offer, or a solicitation, or a recommendation to purchase or sell any investment instruments, to effect any transactions, or to conclude any legal act of any kind whatsoever. The information contained in this document is issued for information only. An offer can be made only by the approved offering documentation, especially the prospectus of the Fund mentioned herein. The prospectus may only be distributed in accordance with the laws and regulations of each appropriate jurisdiction in which any potential investor resides. The investments described herein are not publicly distributed.

This document is confidential and submitted to selected recipients only. It may not be reproduced or passed to non-qualifying persons or to a non professional audience.

This document is only made available to professional clients and eligible counterparties as defined by the Financial Conduct Authority. The services of Diapason may be restricted in some jurisdictions to persons who are professional clients and institutional investors. In such case, they are not available to retail clients and are not subject to the same protections afforded to retail clients. To the extent that this message concerns such products and services, then this message is communicated only to and/or directed only at professional clients and institutional investors and the information in this message about such services should not be relied on by any other person. For distribution purposes in the USA, this document is only intended for persons who can be defined as “Major Institutional Investors” under U.S. regulations. Any U.S. person receiving this report and wishing to effect a transaction in any security discussed herein, must do so through a U.S. registered broker dealer. The investment described herein carries substantial risks and potential investors should have the requisite knowledge and experience to assess the characteristics and risks associated therewith. Accordingly, they are deemed to understand and accept the terms, conditions and risks associated therewith and are deemed to act for their own account, to have made their own independent decision and to declare that such transaction is appropriate or proper for them, based upon their own judgment and upon advice from such advisers as they have deemed necessary and which they are urged to consult. Diapason disclaims all liability to any party for all expenses, lost profits or indirect, punitive, special or consequential damages or losses, which may be incurred as a result of the information being inaccurate or incomplete in any way, and for any reason. Diapason, its directors, officers and employees may have or have had interests or long or short positions in financial products discussed herein, and may at any time make purchases and/or sales as principal or agent. Certain statements in this presentation constitute “forward-looking statements”. These statements contain the words “anticipate”, “believe”, “intend”, “estimate”, “expect” and words of similar meaning. Such forward-looking statements are subject to known and unknown risks, uncertainties and assumptions that may cause actual results to differ materially from the ones expressed or implied by such forward-looking statements. These risks, uncertainties and assumptions include, among other factors, changing business or other market conditions and the prospects for growth. These and other factors could adversely affect the outcome and financial effects of the plans and events described herein. Consequently, any prediction of gains is to be considered with an equally prominent risk of loss. Moreover, past performance is not a guide to future performance and investment may result in loss of capital. As a result, you are cautioned not to place undue reliance on such forward-looking statements. These forward-looking statements speak only as at the date of this presentation. Diapason expressly disclaims any obligation or undertaking to disseminate any updates or revisions to any forward-looking statements contained herein to reflect any change in Diapason’s expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The information and opinions contained in this document are provided as at the date of the presentation and are subject to change without notice.

Electronic Communication (E-mail)

In the case that this document is sent by E-mail, the E-mail is considered as being confidential and may also be legally privileged. If you are not the addressee you may not copy, forward, disclose or use any part of it. If you have received this message in error, please delete it and all copies from your system and notify the sender immediately by return E-mail. The sender does not accept liability for any errors, omissions, delays in receipt, damage to your system, viruses, interruptions or interferences.

Copyright

MANAGEMENT JOINT TRUST SA

Disclaimer, No warranty, Copyright

Management Joint Trust SA is an editor of on-line financial graphics platforms as well as an independent research company. The information and graphics in this publication represent the opinion of Management Joint Trust SA and are not intended to be a forecast of future events and this is no guarantee of any future result. Nobody can predict the future and thus fluctuations of market prices (including market crashes). Past trends are not necessarily signs of future trends. Management Joint Trust SA warns you of the risks involved with any financial transactions (for example on stocks, bonds, raw materials). Derivatives or foreign exchange trades entail even greater risks. You need to be aware that chances of winning are in no way guaranteed and potential of losses may be very significant. As a reader of this publication or a user of our websites, you must take into consideration, as you select investments, of this uncertainty. This publication or any information provided through Management Joint Trust SA' s websites do not constitute a solicitation or offer, or recommendation to acquire or dispose of any investment or to engage in any other transaction. Any reference to a transaction, trade, position, holding, security, market, or level is purely meant to educate readers about our methodology as well as possible risks and opportunities in the marketplace and are not meant to imply that any person or entity should take any action whatsoever without first evaluating such action(s) in light of their own situation either on their own or through a professional advisor. To establish its statistical analysis, Management Joint Trust SA relies on data provided by first class outside providers; however, Management Joint Trust SA does not guarantee you the permanence of such supply, nor its content. More generally, Management Joint Trust SA, their members, shareholders, employees, agents, representatives and resellers or partners do not warrant the completeness, accuracy or timeliness of the information supplied in this publication or on its websites, and they shall not be liable for any loss or damages, consequential or otherwise, which may arise from the use or reliance of the any information or content in this publication or available on the Management Joint Trust SA's websites. Hence, neither you can nor may hold for certain analysis and interpretations provided in this publication or by our websites. Any financial transaction you may instruct is at your own risks. You can not claim nor obtain from Management Joint Trust SA compensation or indemnification for your damages (for example, incidental or consequential damages, losses, unrealised gains, liabilities, Management Joint Trust SA's service fee). If a person or entity does not believe they are qualified to make such decisions, they should seek professional advice. The prices listed are for reference only and are in no way intended to represent an actual trade. This information is not a substitute for professional advice of any nature, including tax, legal, and financial. While we believe the information contained herein to be accurate, all numbers should be verified by the reader through independent sources. Again, trading securities, options, futures, or any other security involves risk and can result in the immediate and substantial loss of the capital invested and every reader/recipient is responsible for his or her own investment decisions. The employees, officers, family, and associates of Management Joint Trust SA may from time to time have positions in the securities or commodities covered in its publications or on its websites. Corporate policies are in effect that attempt to avoid potential conflicts of interest and resolve conflicts of interest that do arise in a timely fashion. MJT is the owner of all its brands and websites (especially www.mjt.ch, www.mjtsa.com or any related websites). These are protected by intellectual property rights, among other copyright, trademark and competition rights. As reader of this publication or a user Management Joint Trust SA's websites, you acquire no rights on the various softwares, services, and information made available by Management Joint Trust SA. In particular, you do not acquire ownership rights. You undertake especially not to: a) Copy, save, reproduce, publish, post, transfer, transmit, exploit or distribute in any way data or components produced or any information or content made available by Management Joint Trust SA (including but not limited to its publications, its software, Internet pages and graphic displays); b) Mention or use in any non-purely private way the name Management Joint Trust SA or any of its trademarks, its or their logos, its or their texts and graphic displays; c) Interfere with or modify data or components published or edited by Management Joint Trust SA (including but not limited to its publications, software, Internet pages and graphic displays); d) Use Management Joint Trust SA in a way not consistent with its natural purpose; e) Access Management Joint Trust SA in an illegal way or without having filled the requested questionnaires, accepted these Terms and Conditions paid the requested fees. These Copyright and Trademark provisions mentioned above do not limit your right to print on paper, for your personal/private use only, pages of this publication or any other content produced by Management Joint Trust SA that you are interested in. Professional use of the printed pages is however strictly forbidden. Similarly you are forbidden to resell these pages. If you want to use any content produced and edited by Management Joint Trust SA not for your personal/private use, you must obtain in advance from Management Joint Trust SA a written authorization by writing to:

Diapason Commodities and Currencies
20 North Audley Street
London, W1k 6WE
UK
+44 207 290 2260

Management Joint Trust S.A.
Rue de Hesse 1
P.O.Box 5337
1211 Geneva 11
Switzerland
+41 22 328 93 33

THE CAPITAL OBSERVER

AUGUST 2020

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

DC&C
DIAPASON CURRENCIES & COMMODITIES

MJT