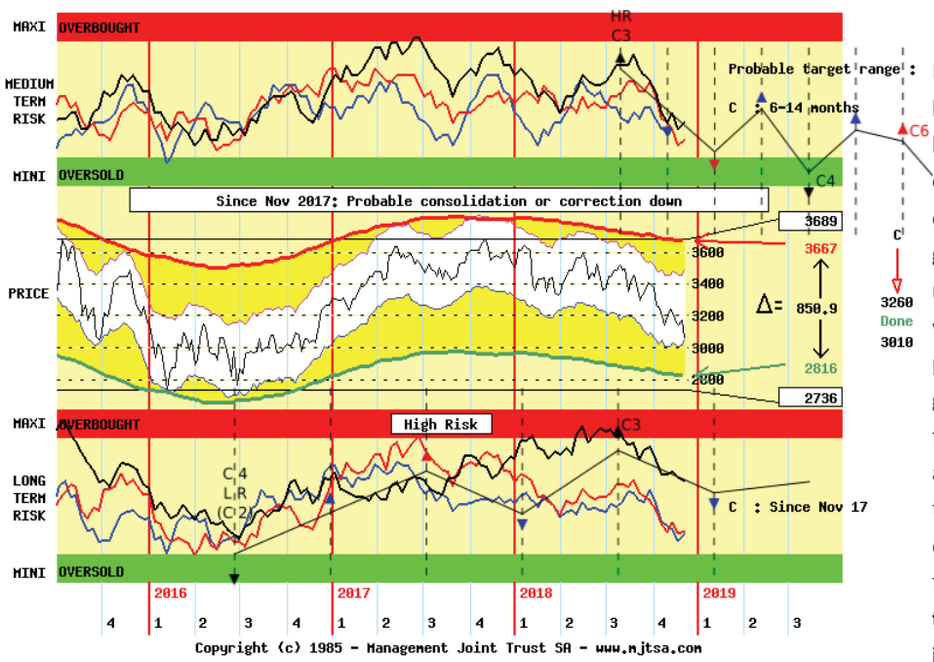
48 / MJT - TIMING AND TACTICAL INSIGHT

Too many risks still looming over Europe

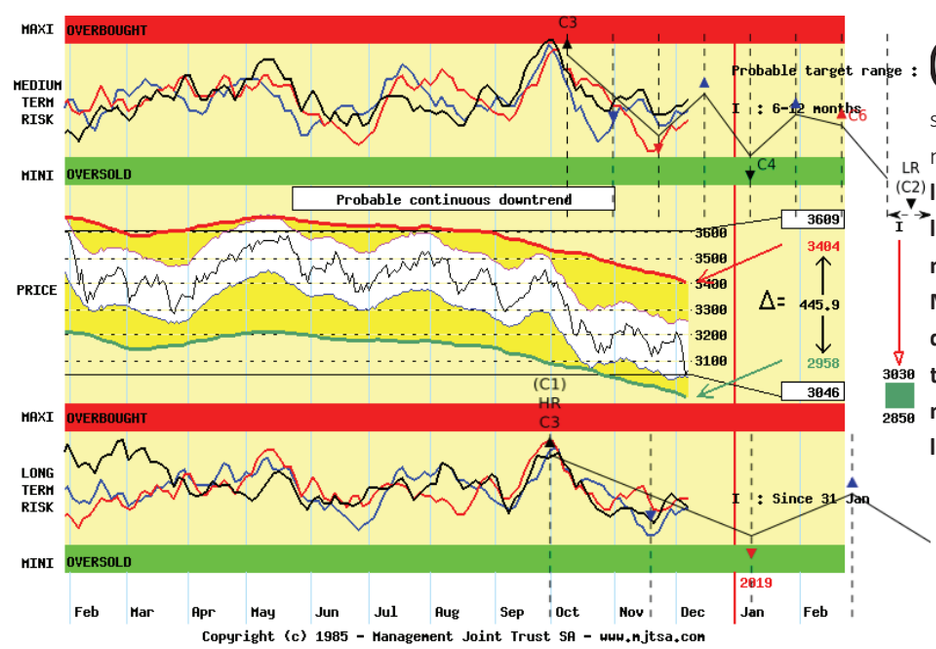
So the Brexit parliamentary vote has been postponed. The Italian Budget issue with the EU Commission is still pending. Germany posted a Q3 GDP contraction, while its political landscape is currently being reshuffled. As for France, the yellow jackets have taken streets and Mr Macron faces the challenge to reconcile an angry middle to lower class with the business elite. One could say that too much bad news probably spells opportunity, yet for now, the clouds still seem pretty heavy on the European investment horizon.

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



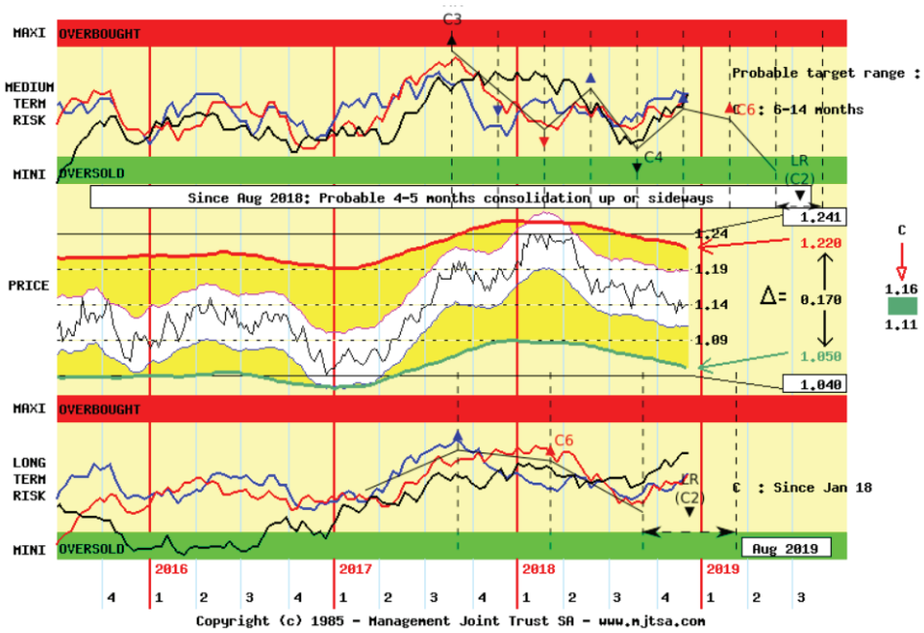
The EuroStoxx 50 was one of the first global indexes to top out in early November 2017. Following a series of lower tops, it then started to accelerate lower in May. According to our targets calculations, it has now reached the crucial support of our C Correction targets to the downside around the 3'000 mark (right-hand scale). If these levels were to break, the downtrend would probably turn impulsive with price targets below the 2016 lows. On the timing front, both our oscillators series (lower and upper rectangles) are suggesting that the current leg down is still underway, probably until early/mid Q1 in first instance. Hence **we would expect the EuroStoxx to dip below 3'000, or into impulsive territory to the downside over the next couple of months. Then, from mid/late Q1, we expect it to bounce into the Spring, before it resumes lower again during H2 2019 towards its 2016 lows.**

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



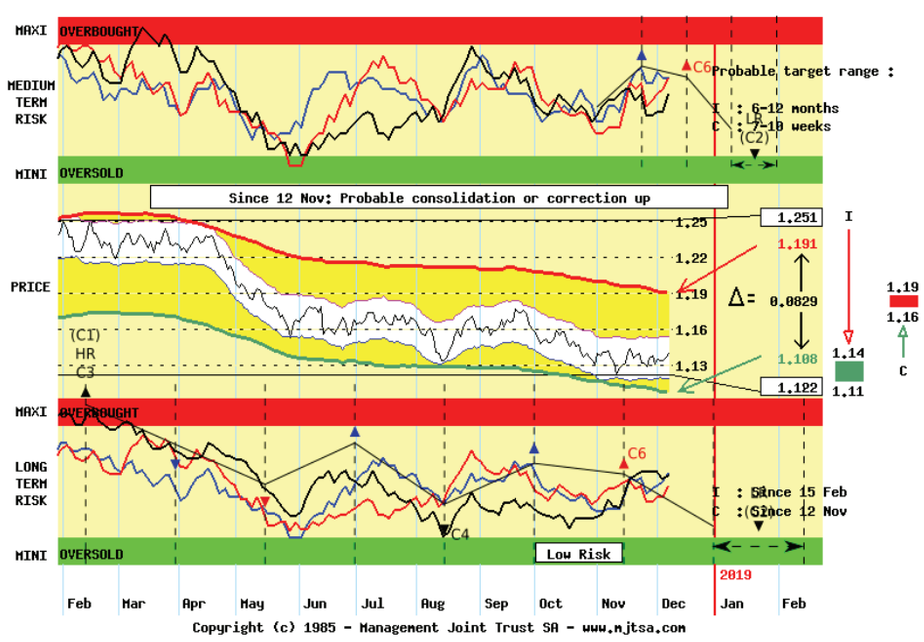
On the Daily graph, the downtrend is still accelerating. Both oscillator series (lower and upper rectangles) are now pointing towards **intermediate lows in the first half of January. Following that, further downside retests may materialize during February and March. Our I Impulsive targets to the downside (right-hand scale) indicate that the EuroStoxx 50 could reach the mid 2'800s by then, or circa 7 to 8% below current levels.**

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



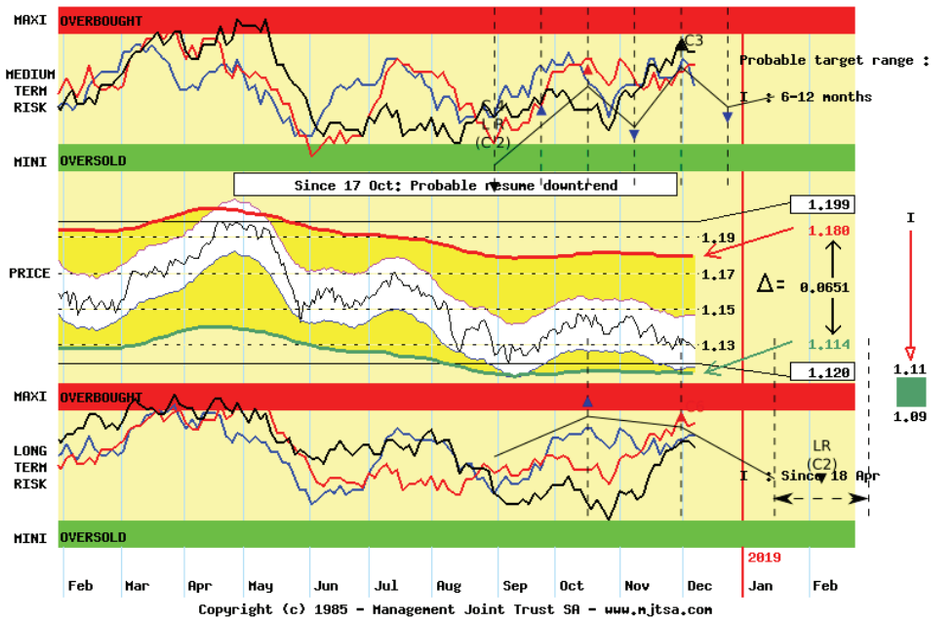
One of the main conundrums this year was that European markets have underperformed alongside a weaker EUR. Yet, the end of the European recoupling story earlier this year and the emergence of political problems in Europe did also help kick-start the strong US Dollar rally we have seen this year. These negative newsflows have weighed on the Euro and European markets, which indeed have fallen in synch. Going forward, both our oscillator series (lower and upper rectangles) are suggesting that the downtrend on EUR/USD is still underway. **We hence expect the pair to extend lower into Q1 2019 on our long term oscillators (lower rectangle), perhaps further on our medium term ones (upper rectangle). EUR/USD may then probably go and test the support of our C Corrective to the downside around 1.11 (right-hand scale).**

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



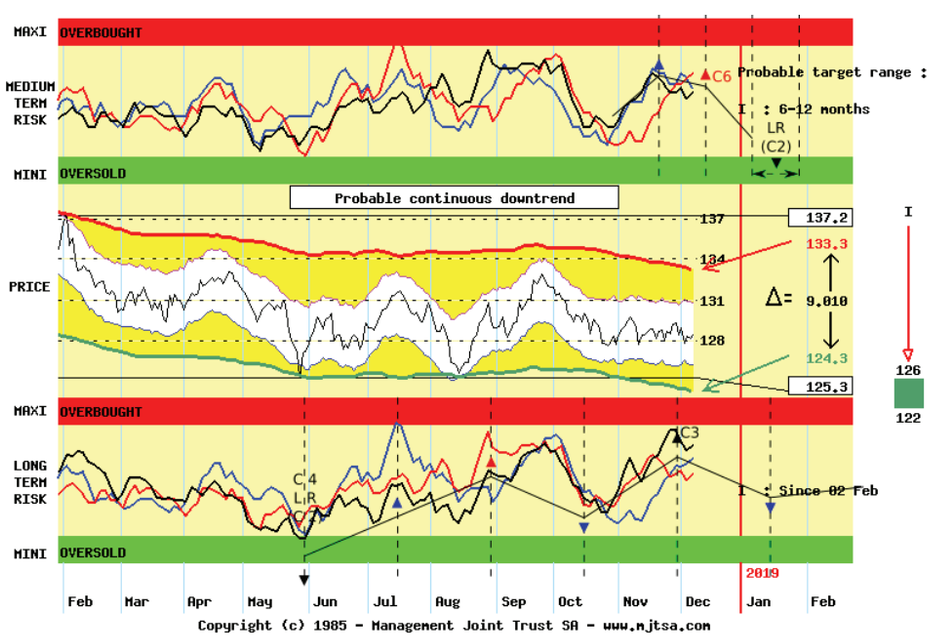
Our automatic messaging on the Daily graph of EUR/USD is labeled "Low Risk", yet the sequences we show on both oscillator series (lower and upper rectangles), would suggest **one last downside retest into late January / February. Our I impulsive targets to the downside also point to further potential, probably towards 1.11 over the next couple of months.** This new leg lower should start to materialize over the next week or so (upper rectangle).

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



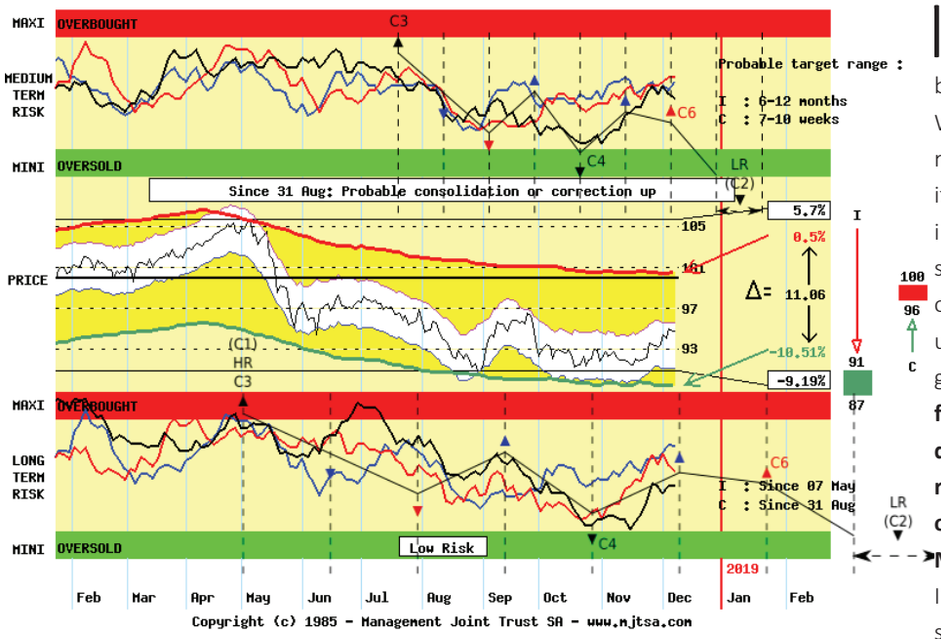
We also expect the Euro to start dipping again vs Defensive currencies. Against Swiss Franc, it managed a weak consolidation to the upside since early September. It now seems ready to resume its downtrend on both oscillator series (lower and upper rectangles). **This new move to the downside, which should materialize between now and late January / February, could go down and test crucial support around 1.10 according to our I impulsive targets to the downside (right-hand scale).**

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



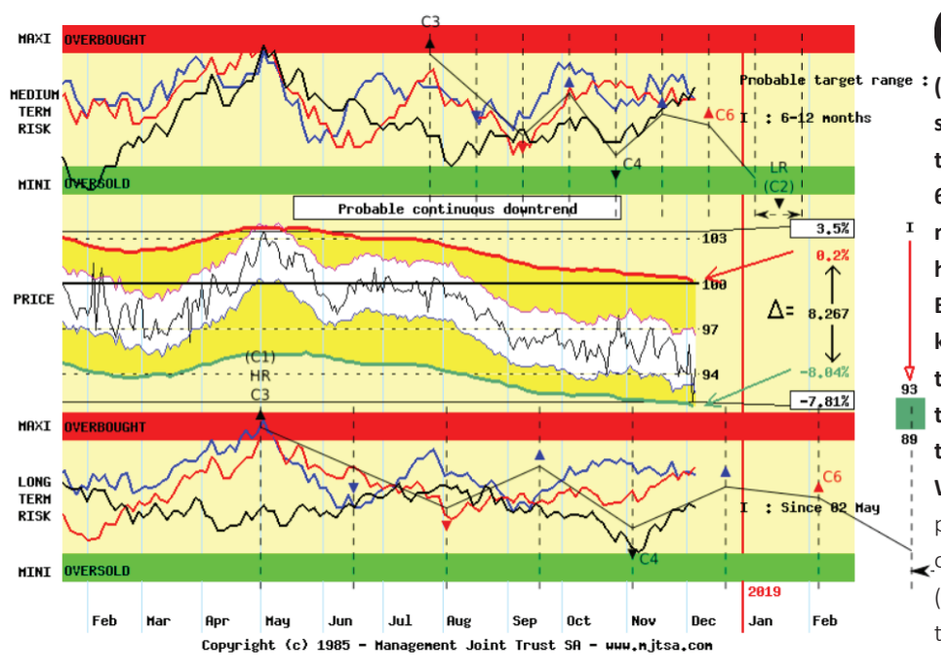
EUR/JPY is traditionally considered a good risk-ON / risk-OFF indicator. It first sold-off in May during the Italian political crisis, before holding and then correcting up until late September, just before equity markets started to dive. It has since been resuming lower, and according to both oscillator series (lower and upper rectangles) **could now start to accelerate to the downside again, probably towards our targets in the 126 – 122 range. Indeed, we expect it to retest its May lows around 125 by mid/late January.**

FTSE- MIB vs EuroStoxx 600
Daily graph or the perspective over the next 2 to 3 months



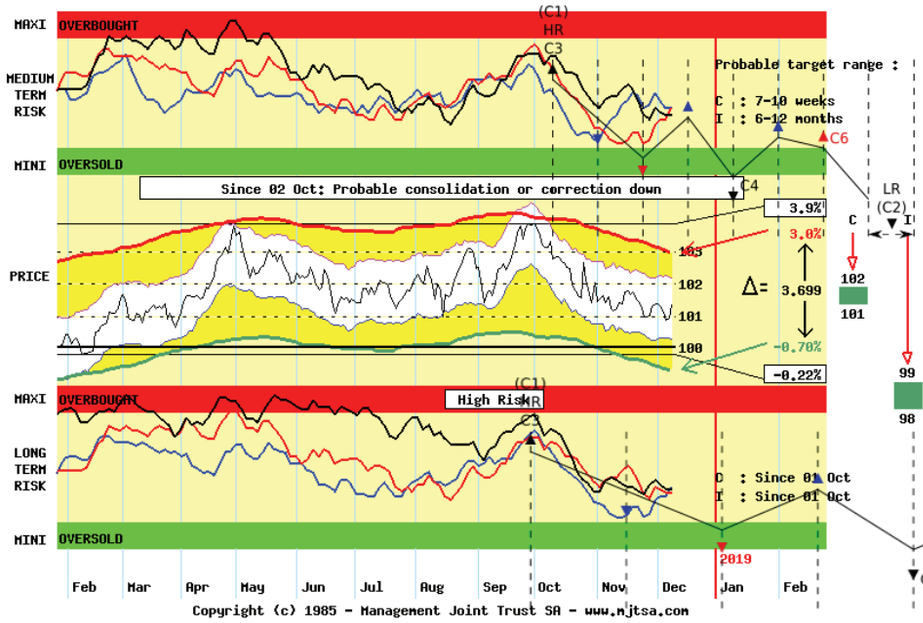
Indeed, Italy's FTSE MIB has been a proxy for political problems in the EuroZone this year. We compare it here to the EuroStoxx 600 in order to assess its negative impact. Surprisingly in the recent sell-off, it has resisted rather well. Yet, both our oscillators series (lower and upper rectangles) are now suggesting that **it could underperform again soon, first towards early/mid January (upper rectangle), and then probably once again towards February / March (lower rectangle)**. Our I Impulsive targets to the downside (right-hand scale) suggest that it could make new relative lows by then.

EuroStoxx 600 vs the MSCI World Index (currency hedged ratio)
Daily graph or the perspective over the next 2 to 3 months



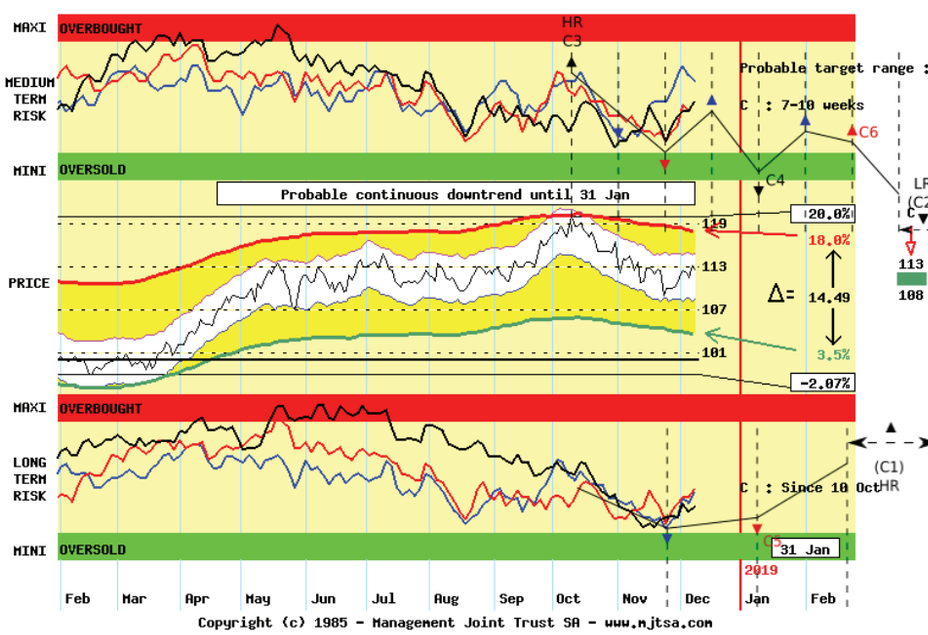
Comparing the EuroStoxx 600 vs the MSCI World (hedged for currency risk) shows a similar pattern as the FTSEMIB vs the EuroStoxx 600 ratio above. It shows how much the Italian problems have been weighing on the EuroZone and its equity markets since May. Similarly to the graph above, we expect the EuroZone equity markets to resume lower vs the MSCI World over the coming weeks, probably towards mid January on our medium term oscillators (upper rectangle) and potentially towards February /March on our long term oscillators (lower rectangle). Our I Impulsive potential to the downside is still quite compelling over the next couple of months (right-hand scale).

CAC40 vs Europe Stoxx 600
Daily graph or the perspective over the next 2 to 3 months



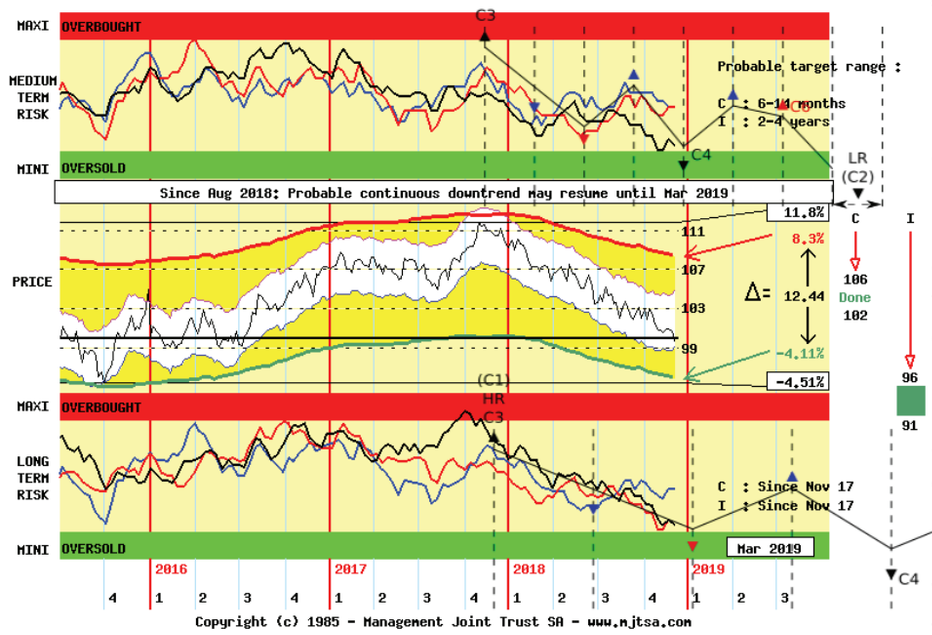
We now compare the French CAC to the broader Europe Stoxx 600 index. It has been underperforming since early October, or probably since Oil started to correct down. Indeed, Oil & Gas is one of the largest sectors in the CAC (along with Industrials which have also been falling sharply recently). Both our oscillator series (lower and upper rectangles) are suggesting that **the CAC could continue to underperform the Europe Stoxx 600, probably into early January at least, and potentially into February / March**. Prices briefly dipped below our C Corrective targets to the downside last week (right-hand scale), theoretically opening the door to lower levels and higher risk over the next few months.

European Energy Sector vs Europe Stoxx 600
Daily graph or the perspective over the next 2 to 3 months



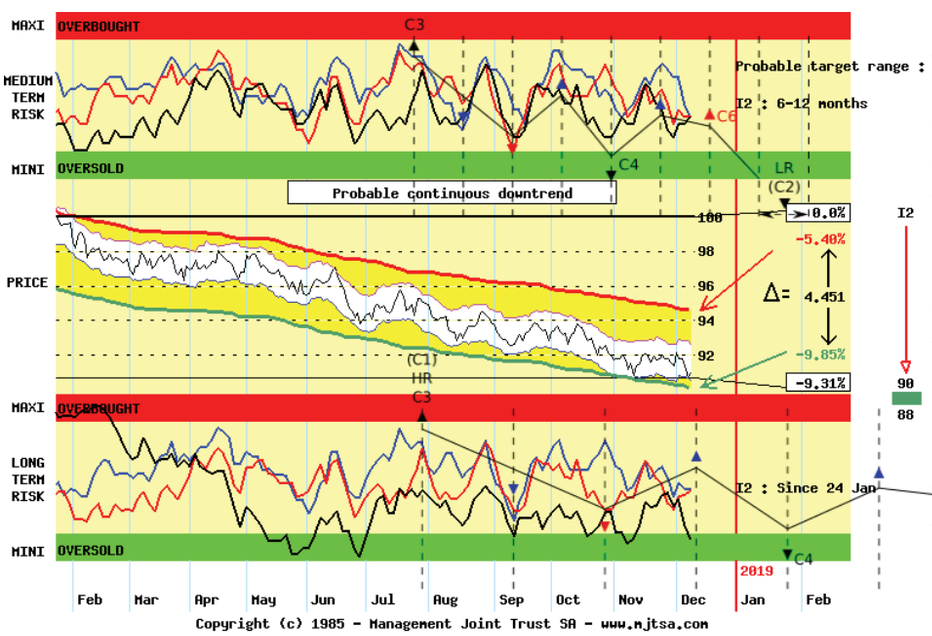
Indeed, this graph comparing the European Energy sector to the Europe Stoxx 600 is quite similar to the relative strength graph of the CAC above. For now, the Energy sector remains under pressure vs European markets. Both our oscillator series (lower and upper rectangles) are suggesting that this should continue to be the case until early January at least. These dynamics are confirmed in the last article of this issue of The Capital Observer, where we expect Oil and the Energy sector globally to also remain under pressure until early next year.

DAX Kurz Index (Price Index) vs Europe Stoxx 600
Weekly graph or the perspective over the next 2 to 4 quarters



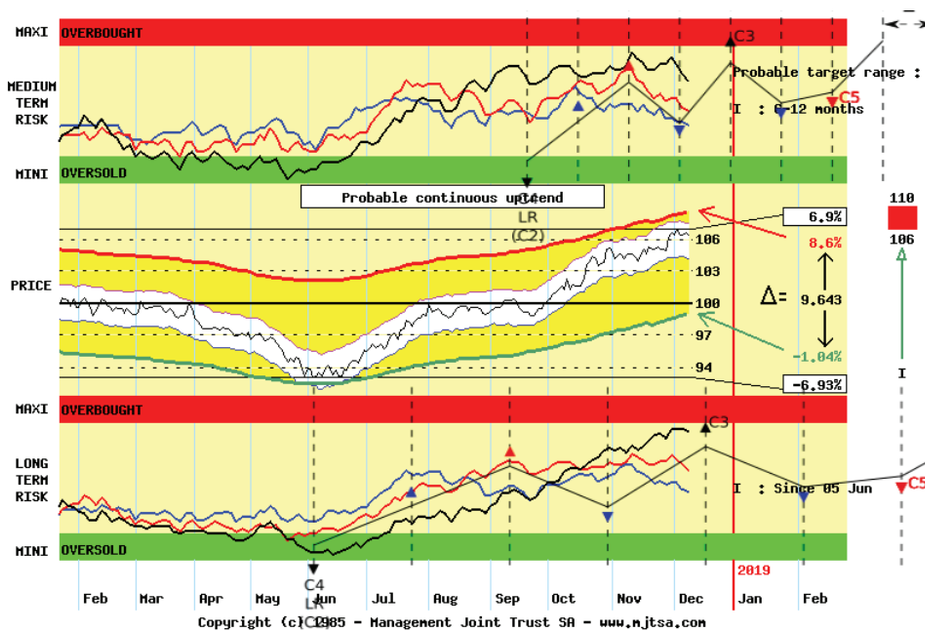
The DAX is the higher beta index of the European markets. It indeed outperformed quite nicely during 2016 and 2017, yet has since seen a reversal of fate. Add to that the political problems in Germany and the index has underperform the Europe Stoxx 600 Index by circa 10% year-to date. Both our oscillators series (lower and upper rectangles) are suggesting that **this underperformance should be coming to an end soon, probably between now and January. We would however still refrain for now on overweighting the DAX (waiting for the right timing)** as the ratio has made it below the support of our C Corrective targets to the downside (right-hand scale), thereby opening the door to further downside risk over the next few quarters. **Yet, from early/mid Q1, the DAX may provide an interesting opportunity to play the rebound we expect on global equity markets as well as in Europe (i.e the timing still seems early for now) .**

DAX Kurz Index (Price Index) vs Europe Stoxx 600
Daily graph or the perspective over the next 2 to 3 months



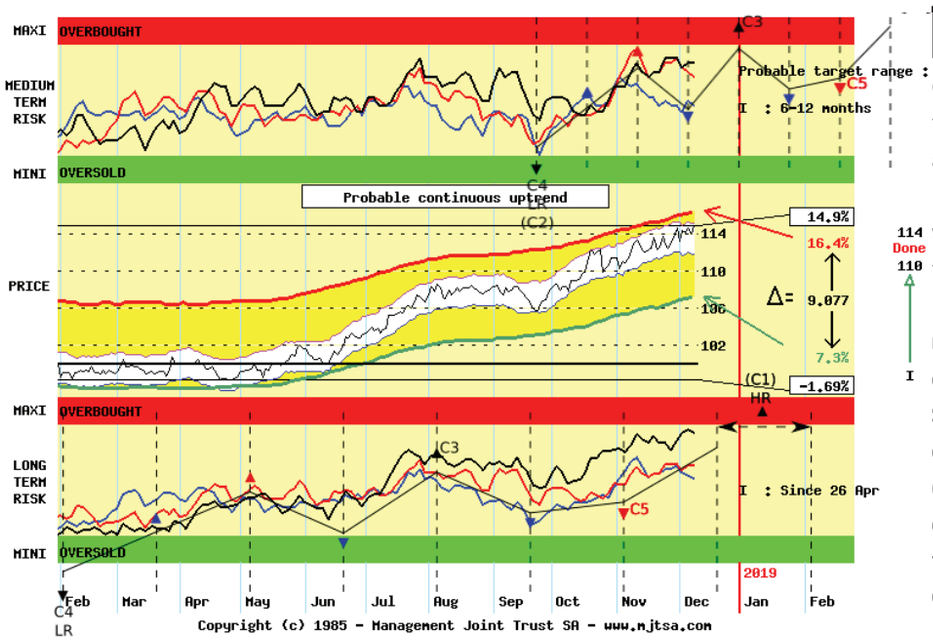
Shorter term, the DAX is very much Oversold vs the Europe Stoxx 600. Our price targets have now reached our extended I2 Impulsive 2 targets to the downside (right-hand scale). This Daily graph hence suggest that **the risk of strong underperfomance is limited at this stage**. Yet, both our oscillator series (lower and upper rectangles) are calling for **a bit more patience, probably towards mid/late January when we expect the DAX to bottom out relative to other European markets.**

Swiss Market Index vs Europe Stoxx 600 (currency hedged ratio)
Daily graph or the perspective over the next 2 to 3 months



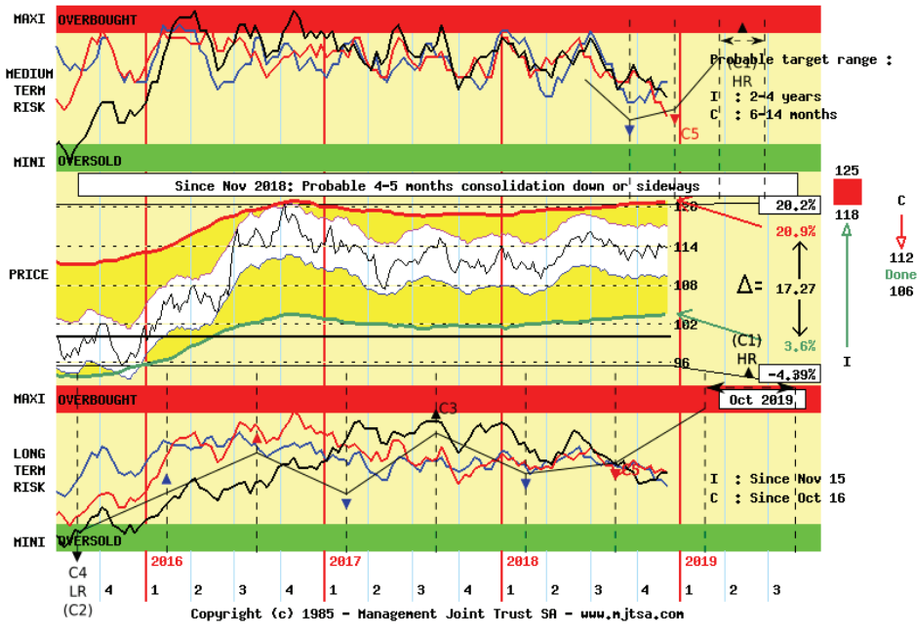
The Swiss market vs the Europe Stock 600 is under a dual influence. On the one hand, it benefit from its very defensive mix (predominantly Pharma and Food & Beverage), on other hand it suffers from from the strength of the Swiss Franc given that its main constituents are large exporting businesses. As mentioned above in this article, we expect EUR/CHF to weaken over the next couple of months, while the equity environment remains quite defensive. Hence, as shown on both oscillator series (lower and upper rectangles), **the Swiss markets could outperform slightly longer vs the Europe Stock 600, and then the ratio starts to consolidate into the new year.** On the price target front, the ratio is also close to exhaustion, having reached its I Impulsive targets to the upside (right-hand scale).

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



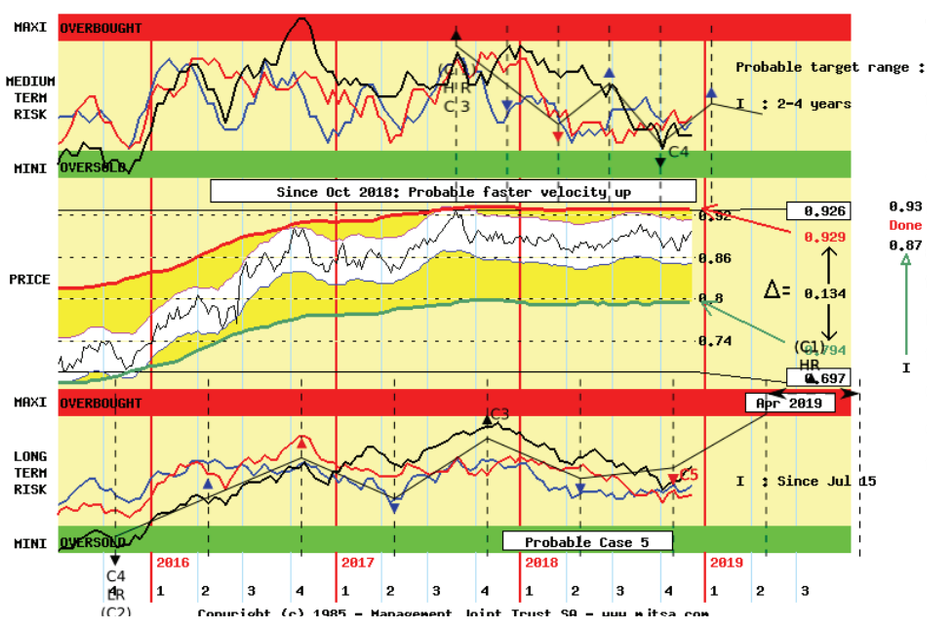
Interestingly, the European HealthCare sector vs the Europe Stoxx 600 shows a similar uptrend than the SMI to Europe Stoxx 600 ratio above, yet it started up earlier in late April, while the Swiss Market was still underperforming (EUR/CHF took a dive between mid April and late May). **Going forward, the European Healthcare sector should outperform slightly longer that the SMI, probably into January according to both our oscillator series (lower and upper rectangles). Indeed, we expect the environment to remain defensive, while EUR/CHF weakens once again**. More generally, as shown on page 44 of this issue, we expect defensive sectors to continue to outperform probably into early next year.

FTSE100 vs Europe Stoxx 600 (currency hedged ratio)
Weekly graph or the perspective over the next 2 to 4 quarters



Brexit has had its share of negative newsflow over the last 2.5 years. Yet, the UK equity market has held up rather well during this period vs the Europe Stoxx 600, when considered on a hedged currency basis. **Indeed, when EUR/GBP falls, the FTSE tends to perform well in GBP terms (less so in EUR terms). This should continue to be the case over the coming quarters, probably until late Spring / mid-year according to both our oscillators series** (lower and upper rectangles). These projections probably imply that the Pound continues to weaken vs the Euro, yet that UK equities should partly compensate for this fall. Hence, for European investors, it might be wise to hedge their currency exposure to the Pound, while for UK investors into Europe, it might be better to leave the currency risk unhedged.

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



The EUR/GBP would confirm our projections above. Indeed, after more than 12 months of high level consolidation, both our oscillator series (lower and upper rectangles) are now suggesting that **the Euro could start to strengthen again vs the Pound, probably towards mid next year and 0.93** in first instance, according to our I impulsive targets to the upside (right-hand scale). Obviously, such projections are very dependent on future developments on the Brexit Front.

Concluding remarks

Short term, we believe it is too early to go bottom fishing in the European equity markets. Indeed, we expect them to continue lower probably into early/mid January in first instance, and then perhaps even retest down into February. Geographically, while Italy may come back to haunt us over the next couple of months, France also continues to underperform along with Oil and the Energy sector, probably into January. Germany, which is high beta, looks rather Oversold, yet we would also wait until early next year before considering it. In the meantime, the Swiss market may outperform slightly longer, yet may also suffer from renewed CHF strength vs the EUR. Across the Channel, UK markets on the other hand, should continue to outperform, provided one hedges them for currency risk, as EUR/GBP probably continues to strengthen. On the currency front, we expect the Euro to continue its slide vs other majors, probably moving towards 1.11 on EUR/USD, 1.10 on EUR/CHF and back below 125 on EUR/JPY. Hence, for now, the environment remains quite defensive in Europe. That said, from mid/late Q1, European markets may start bounce along with other equity markets. This move may be quite pronounced given that European economic fundamentals are still relatively strong, and that political risks would have depressed valuations.