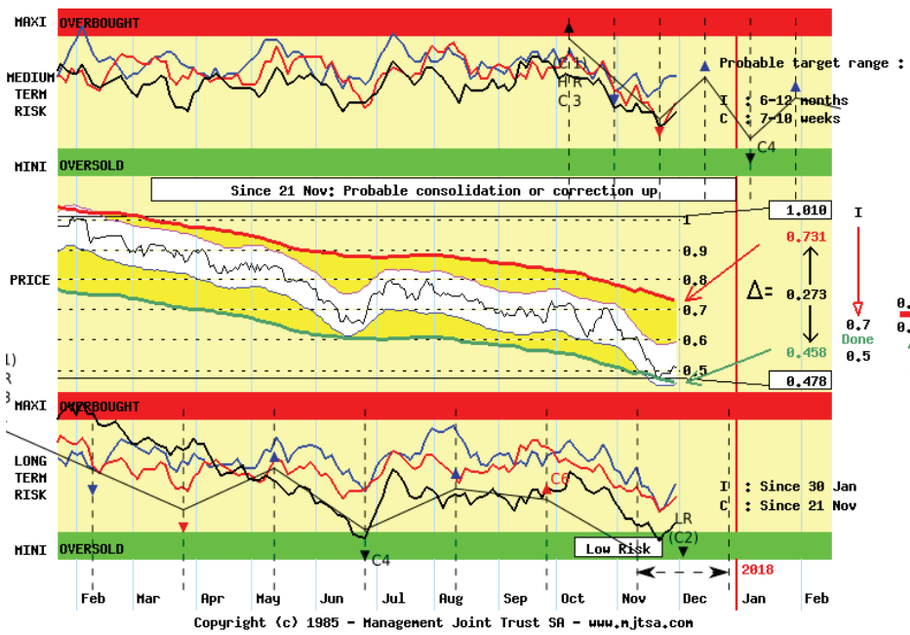
20 / MJT - TIMING AND TACTICAL INSIGHT

The Yield Curve is temporarily Oversold, it should bounce into Q1 2018, at the latest from early January

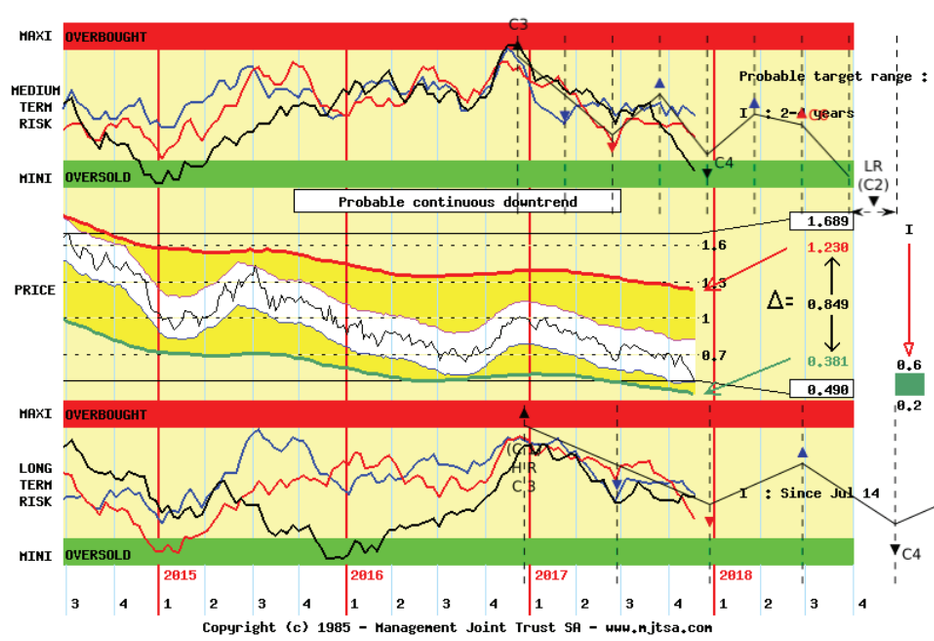
Last month, we expected the pressure down on the yield curve to continue towards late November / early December to create the Oversold conditions for a potential 2 to 3 months bounce. The least one can say is that the flattening US yield curve has now become a concern much relayed in the financial media.

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



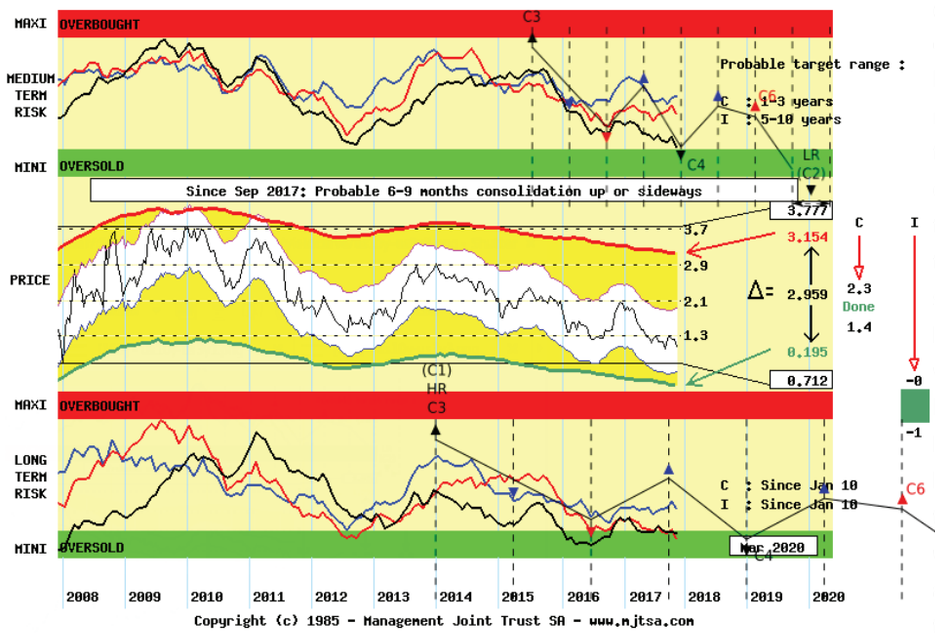
Last month, we expected the pressure down on the yield curve to continue towards late November / early December to create the Oversold conditions for a potential 2 to 3 months bounce. The least one can say is that the flattening US yield has now become a concern much relayed in the financial media. On our long term oscillators (lower rectangle), **a Low Risk condition was indeed just validated. These usually trigger 2 to 3 months of correction to the upside.** On our medium term oscillators (upper rectangle), the yield spread may suffer one last re-rest towards year-end, yet our I Impulsive targets down (right-hand scale) have now been reached so that we do not see much more downside potential for now. **Hence, we expect a bounce in the first half of December, some retracement towards year-end, and then a further bounce towards end January at least.** C Corrective targets up for this bounce (right-hand scale) could bring us back towards 60-70 bps on this spread.

US 10 years Benchmark Bond Yield - US 3 years Benchmark Bond Yield Weekly graph or the perspective over the next 2 to 4 quarters



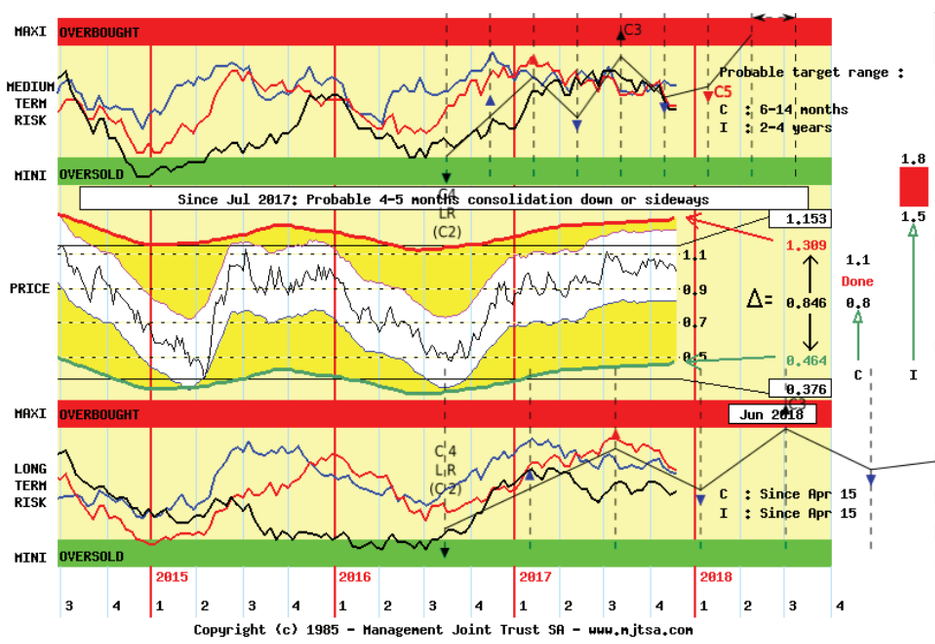
Medium term, on this Weekly graph, the 10Y-3Y yield spread is also approaching an intermediate low towards year-end on both our oscillator series (lower and upper rectangles). **We expect the yield curve to temporarily steepen during Q1 2018 at least**. Following that, it may flatten again towards end 2018. The downside potential is also limited for now as we have pretty much achieved our I Impulsive targets down (right-hand scale). Theoretically, C Corrective targets up we can calculate for this bounce could amount to 0.5 times our historic volatility measure Delta (middle rectangle, right-hand side) or circa 85 bps time 0.5 = 40 bps.

US 10 years Benchmark Bond Yield - US 3 months Benchmark Bond Yield
Bi-monthly graph or the perspective over the next 1 to 2 years



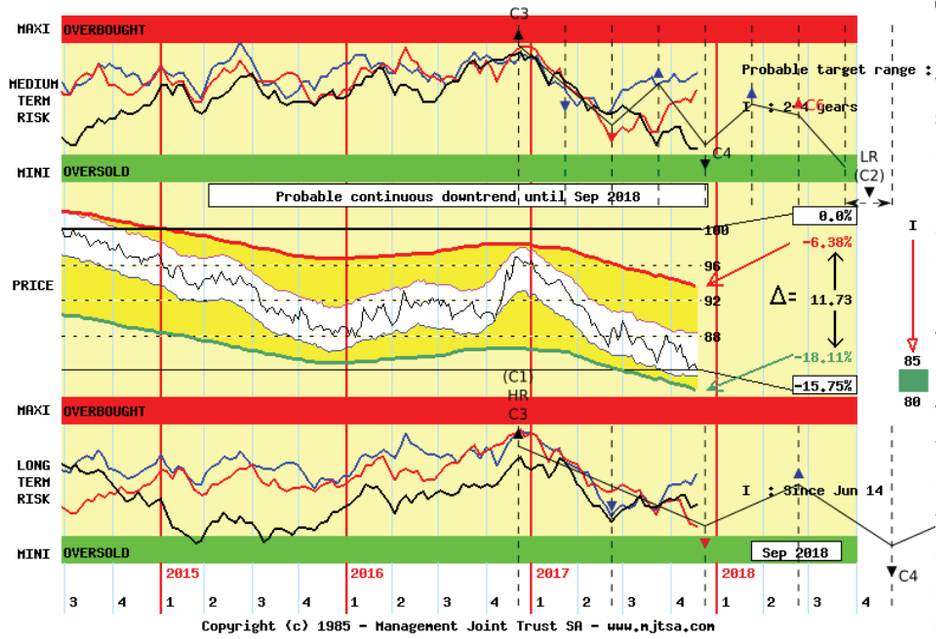
Switching to the 10Y-3M spread for which we have longer data history, we now review the long term graph of the US Yield Curve. On the sequence we show on our long term oscillators (lower rectangle), the yield spread may still **be down-trending towards late 2018/early 2019.** However, on our medium term oscillators (upper rectangle), **it may have reached an intermediate low and could be getting ready to bounce during H1 2018. We will remain prudent beyond any 2 to 3 months bounce as the I Impulsive down target potential (right-hand scale) still looks quite important over the next 12 to 18 months (the 10Y-3M spread may invert).**

Euro Swap Rate 10 Years - Euro Swap Rate 2 Years
Weekly graph or the perspective over the next 2 to 4 quarters



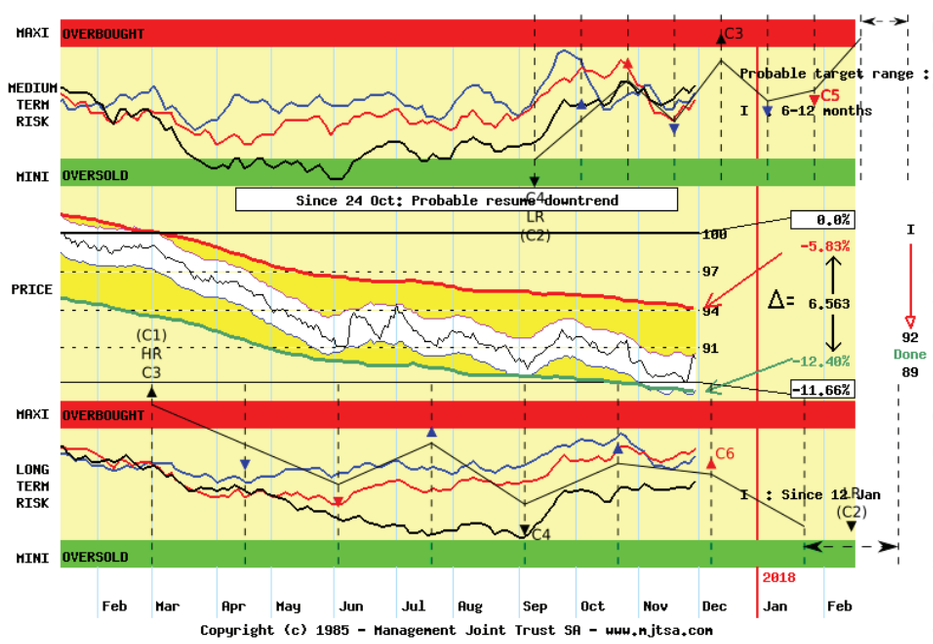
In the EuroZone, the yield curve has been pretty much stable in 2017. On our medium term oscillators (upper rectangle), the 10Y-2Y IRS spread may have reached a support point to resume its uptrend. **Another support point in January on our long term oscillators (lower rectangle) should help the spread resume its uptrend into Spring 2018**. The potential up may be quite important as shown by our I Impulsive targets up (right-hand scale).

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



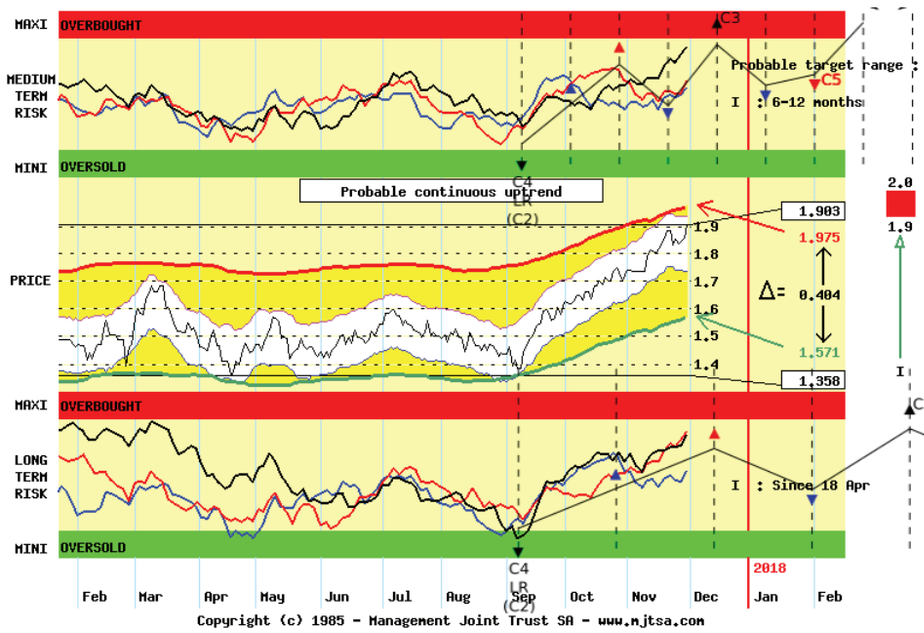
The Value to Growth relationship in the US is very much dependent on the shape of the yield curve. Indeed, Growth profiles in the US are usually very long duration stocks and benefit from lower long term yields. **As with the 10Y-3Y yield spread above, this ratio is approaching an important intermediate bottom** on both oscillator series of this Weekly graph (lower and upper rectangles). According to the sequence we show on our medium term oscillators (upper rectangle), **Value could bounce vs Growth until mid/late Q1 2018**. Following that, its should resume its under-performance towards end 2018.

IVE - iShares S&P 500 Value ETF / IVW - iShares S&P 500 Growth ETF
Daily graph or the perspective over the next 2 to 3 months



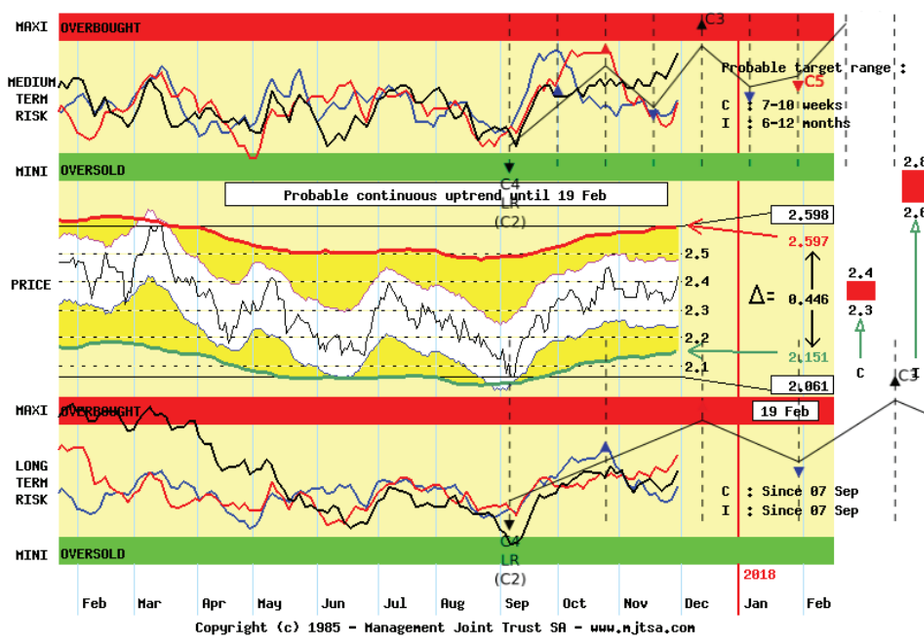
On this Daily graph, **Value has started to bounce vs Growth**. The trend was indeed quite exhausted as the ratio had reached below its I Impulsive targets to the downside (right-hand scale). Our medium term oscillators (upper rectangle) would suggest **that the current bounce continues until mid December, then retraces into early January, before it moves up again towards February / March**. Our longer term oscillators (lower rectangle) would suggest more weakness into late January / February, yet given that the downside potential seems limited at this stage, and that our Weekly graph above shows that a clear support point is coming, such persistent weakness would not be our preferred scenario.

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



We now turn to US Treasury yields to picture how a tightening bounce could materialize along the US yield curve. The US3Y Treasury yield has had a strong run since early September. It is currently approaching its I Impulsive targets to the upside (right-hand scale) and an **intermediate top is planned for circa mid December** on both oscillator series (lower and upper rectangles). Following that, we expect **some retracement into early January, before the trend resumes up towards February / March. That said, our I Impulsive targets up have been pretty much reached, so that there is little potential up left for US 3Y Treasury yields into Q1 2018.**

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

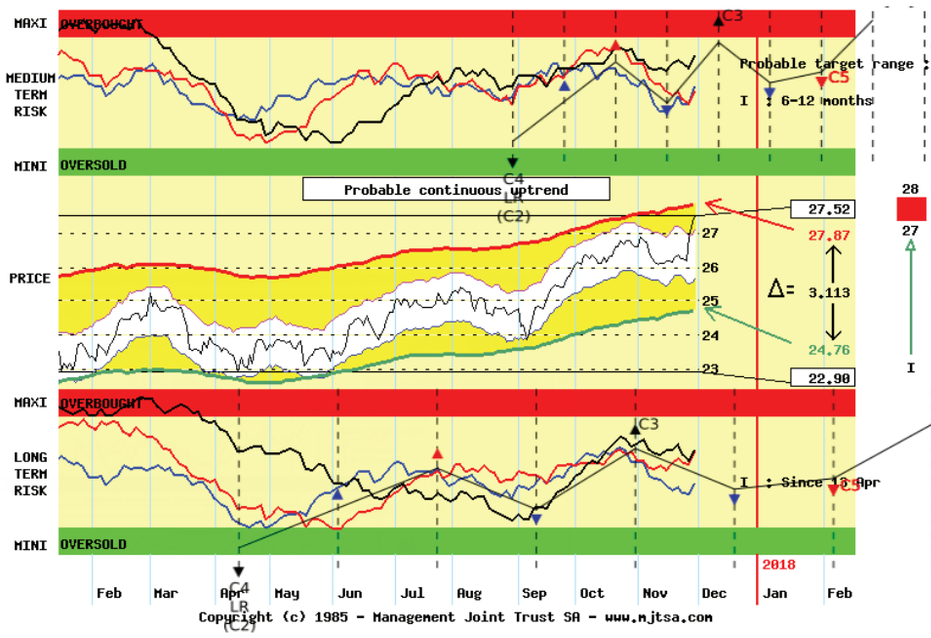


On the US 10Y Treasury yield, the move up since early September has been more timid, hence the flattening we have seen in the curve. It did however make it back above our C Corrective targets up at 2.4% on two occasions already, justifying that I Impulsive targets up (right-hand scale) are achievable over the next few months. **These point to levels that could revisit last March highs and above (2.6% -2.8% range). As with the US3Y yields, we would expect an intermediate top mid December, some retracement into January and then further upside towards February / March.**

Initial remarks

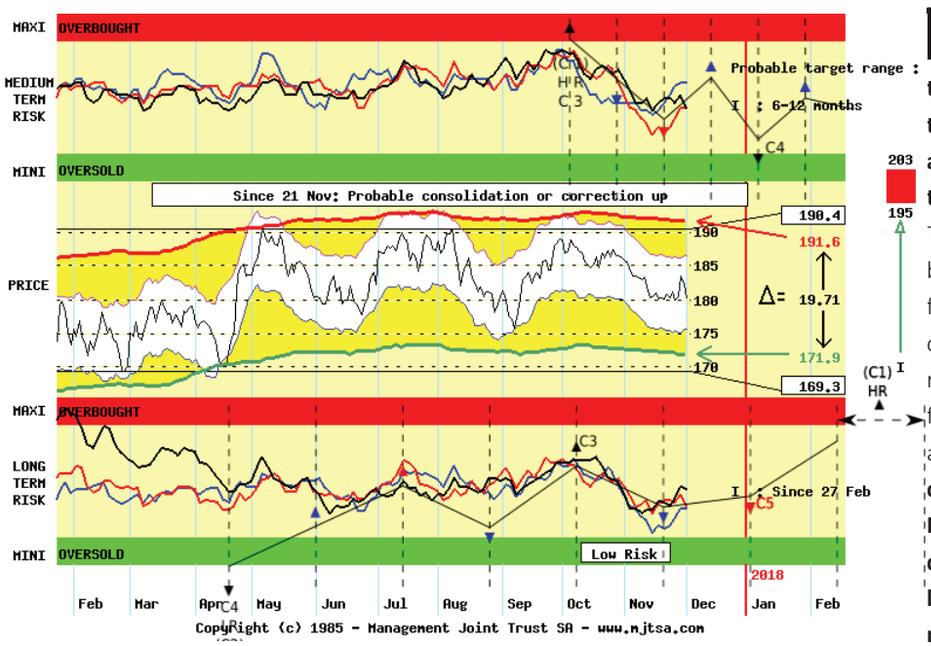
The Yield Curve and the Value to Growth relationship are heavily Oversold, and our Weekly and Daily graphs suggest that an intermediate low is currently being made. We would expect a bounce that could last into February / March. It may take until early January to really get started. Indeed, both US3Y and US10Y Treasury yields should make an intermediate top towards mid December and then retrace towards early January. However, during the uptrend that follows US10Y Treasury yields have more potential up left than US 3Y Treasury yields. They could accelerate further thereby steepening the Yield Curve.

XLF - Financial Sector SPDR Fund
Daily graph or the perspective over the next 2 to 3 months



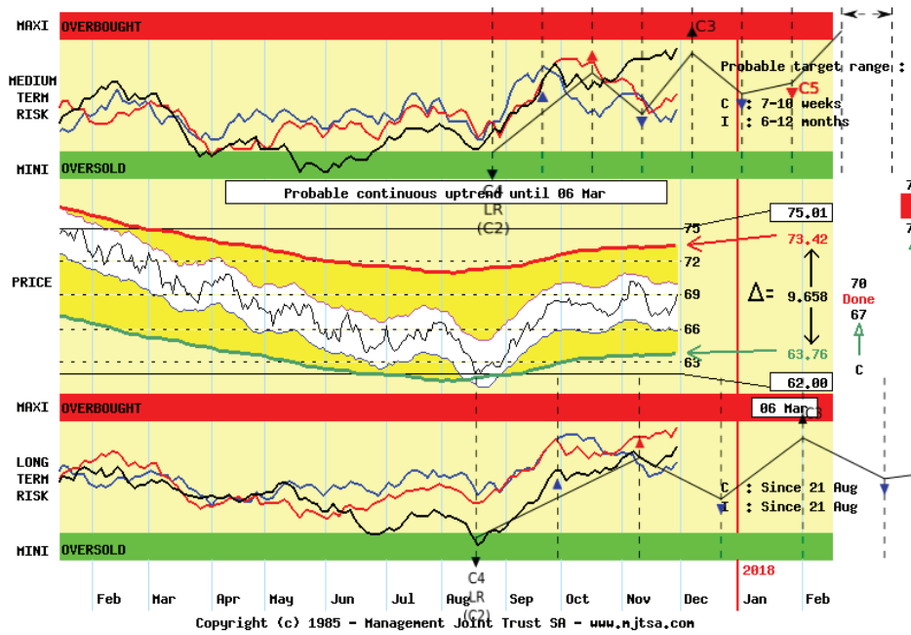
Some Value sectors are already reacting to a potential steepening bounce of the yield curve. Financials, for example, have made a strong move over the last few days. On both oscillator series (upper and lower rectangles), **this move is set to continue until mid December in first instance. Following some retracement into early January, Financials may resume their uptrend into February / March**. The I Impulsive potential up into Q1 2018 (right-hand scale) seems however somewhat exhausted for now.

BANKS - Dow Jones STOXX Europe
Daily graph or the perspective over the next 2 to 3 months



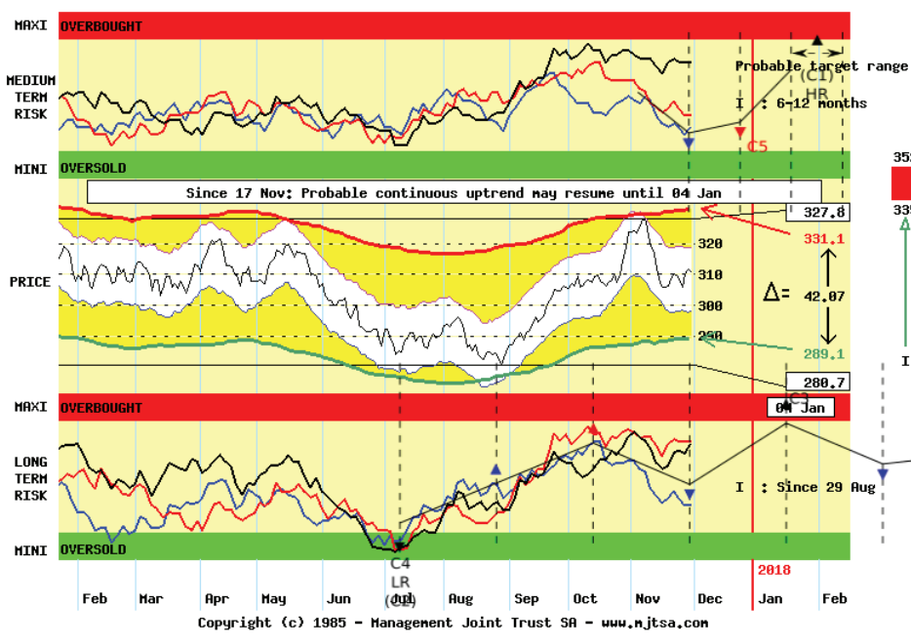
In Europe however, Banks seems to have plenty of potential left into Q1 2018, up to 10% more upside potential according to our I Impulsive targets up (right-hand scale). That said, their uptrend has been in trouble over the last few months. On both our oscillator series (upper and lower rectangles), we expect them to finally resume up between now and January. **A slight bounce could materialize until mid December, before a last retest down into early January. Following that, the trend should resume up towards February / March.**

XLE - Energy Select Sector SPDR Fund
Daily graph or the perspective over the next 2 to 3 months



US Energy is another Value sector, which has been moving up over the last few days. Both our oscillators series (lower and upper rectangles) are slightly contradictory during December. That said we view December as a period where the XLE could be building a base to move higher in January. On on medium term oscillators (upper rectangle), **we would expect an intermediate top during the first half of December, some retracement towards late December, before the uptrend resume in January until February. Our I Impulsive price targets up (right-hand scale) still show some important potential over the next few months, towards the 75 to 78 range or 10 to 20% above current levels.**

ENERGY - Dow Jones STOXX Europe
Daily graph or the perspective over the next 2 to 3 months



European Energy has had quite a bumpy ride over the last two months with the spike it saw early November. **That said, its trend is still pointing up probably into late January / February. Indeed, during December, both oscillator series (lower and upper rectangles) should find support points to resume their uptrend. Our I Impulsive price potential up (right-hand scale) can justify a further 8 to 15% of price potential over the next few months.**

Concluding remarks

Over the last few days, typical US Value sectors such as Financials or Energy seem to have anticipated a potential bounce in the yield curve. They will probably make an intermediate top mid December, yet should accelerate up again thereafter from early January into February / March. Banks and Energy sectors in Europe show similar configurations, but will probably be slower to react. We however expect more potential from them in Q1 2018.