

THE CAPITAL OBSERVER

December 2020



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featuring MJT's timing methodology



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THE CAPITAL OBSERVER

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

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In a recent paper, D Cutler and L Summers estimated the total cost of the CV19 situation to the US alone at \$16tn. This amounts to 75% of a year's US GDP. The total cost is, they judge, four times that of the recession after the 2008 financial crisis. If the cost to the world were also to be 75% of annual GDP, it would be around \$96tn. A very significant amount."

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4/ Executive Summary

12 / Uptrend for bond yields should persist into year-end, but early Q1 2021 may find the long bond yield falling hard - Long yields have been rising in response to the seasonal upswing in liquidity and the upside pressure from the massive monetary and fiscal stimulus that the Fed and the US government are pouring into the US financial system and economy. That should extend to early next year as the US Treasury in the new administration will continue to pour stimulus in 2021. However, the current rates of change in 2020 liquidity flows from the Fed and Treasury have been deteriorating at a fast clip. The current 2020 liquidity profile is so very different from historical norms (see that in the graph above) – we fear that its after effects may be completely different from what we have seen in the past 7 years at least. We may have to reassess how seasonality of the various data we track to project the route of the long bond yield (Fed's Balance Sheet, Treasury Cash Balance, Bank Reserves) are undergoing transformation.

What to expect of bond yields going forward? We see that it is not just the Treasury Cash Balance (TCB) that gets to tilt the long bond yield's direction-- the impact of the growth (or no growth) of the Bank Reserves and the Fed's Balance Sheet contributes significant influence to the trajectory of the long bond as well. The TCB seasonality calls for higher yield over the year-end, followed by a sharp fall in yield in January. That yields go lower in January is also borne out by existing seasonality patterns in the Treasury Cash Balance.

14 / Timing and Tactical Insight - Nominal US yields may push slightly higher into mid Q1, yet probably retrace down thereafter into the Spring. - Until next February, we expect reflationary trades to continue to lead in the fixed income space. US Inflation expectations should continue to rise along with US long term nominal yields, the US to Europe Interest rates differential, Yield curve spreads, EUR/USD and Emerging markets currencies vs the Majors. Yet, this reflationary push is probably already losing momentum. It is gradually becoming more concentrated on US long term yields, while shorter term US tenures such as the US3Y yield may have already topped out in November. German Bund yields also seem to be starting to roll over again. Hence, in this environment, and first into February, we would probably favor US Tips, European Sovereigns, European High Yield and Emerging market debt in local currencies. From mid Q1, however, we then expect a change of focus. US monetary policy would appear to regain its dominance, and fiscal hopes will probably fade. We would then look to switch out of Emerging Market Debt and European High Yield, probably retain some US Tips as well as European Sovereigns, and, from late Q1, carefully consider US long term Treasuries, as some retracement on long term US yields may then be expected into Q2.

23 / Emerging Markets: Is it time to pivot back to EM, based on macro and currency factors - Until May, we saw the impact of a strong US Dollar on EM debt – at that time, hard currency sovereign credits have been worst affected, followed by local currency sovereigns which have done marginally better. But from that time, the strong US Dollar downtrend has since turned around the fortunes of the Emerging Markets. It was the forceful intervention of the Federal Reserve and the US Treasury which laid the foundations for a significantly weaker US Dollar. The Fed led in terms of developed markets, with a range of strong policy measures that even encompass asset purchases, including exchange-traded funds and high-yield securities. The Fed has delivered, and not only for the US markets, but also for EM. There has been a trickle-down effect on emerging market debt as well in terms of keeping the financial system buoyant. Above all, that Fed largess undercut the exchange rate of the former almighty US Dollar. That has allowed the resurgence of the Emerging Markets. The longer-term growth outlook for the global economy continues to improve. EM asset pricing has only seen limited capital flows to these regions. The recent pickup in hospitalizations and fatalities related to the most recent wave of COVID-19 infections will likely slow global growth somewhat and may cause a slight decline in activity in the fourth quarter of this year. This will likely contribute to uncertainty and market volatility in the quarter, but does not impact the longer-term prospects for growth or the basic underpinnings of Emerging Market rise, in our view. If the US Treasury issues new debt to the tune of \$1.3 trillion in 2021, bond yields will collapse and the US Dollar will sink. The point here is that the US Dollar (proxy: DXY) rises and falls with the 10Yr Yield, and both have been positively correlated (on a lagged basis) since QE programs started in November 2008. A declining US dollar should ease EM financial conditions and provide support to EM. Asia, and particularly China, which is ahead in managing the spread of COVID-19, still looks particularly attractive, from the currency-exchange point of view. The Chinese bond market is a large, liquid market that provides significant yield pickup versus the US and Europe. Judging by balance of payments performance, we view the CNY and other EM currencies as arguably still cheap and potentially well-supported in the medium term.

26 / Timing and Tactical Insight - EM markets could lead into mid Q1, DM markets and China could then extend the rally into late Q1 - We are still positive on most equity markets into late Q1. We expect the S&P500 to reach up to the 4'000 mark, while the EuroStoxx50 could retest its February highs. Emerging Markets seem even more dynamic and could add a further 15%, despite China, which is traditionally more countercyclical and could lag (China represents circa 40% of the Index). Hence, other Emerging markets could be strong outperformer over the next couple of months. Shorter term, the current rally on both the S&P500 and the MSCI Emerging Markets could make an intermediate top just after Christmas and retrace down into early January. Both should then rise again into late Q1. Within Emerging Markets we would favor South Korea, Brazil, South Africa or Russia into mid Q1, we would then gradually shift to more defensive profiles such as Taiwan and China as equity markets could start to top out towards mid/late Q1 and may then retrace into the Spring.

34 / Crude oil prices are due for another correction late in the year, but looking at the bigger picture, things are looking up for oil in the years ahead

Near Term Outlook

Western countries continue to suffer from rising COVID-19 case counts as renewed lockdown risks pose the biggest threat to higher oil prices in near term. Synchronized demand recovery will be needed for oil prices to trend higher from here. Germany announced over the weekend that the current lockdowns will likely last into January. This alongside the rest of Europe likely remaining in lockdown territory poses the biggest risk to oil price recovery in the near term.

We can't forecast COVID-19 cases, but we can look at oil market data to see how the oil universe perceives the supply-demand situation as reflected by data. Synchronized demand recovery will be needed for oil prices to soundly push above \$50/bbl. Consider this: despite potentially new lockdown restrictions in the US, the 3-2-1 crack spread or the proxy for refining margins is now trending higher again.

The Capital Observer editors team, London / Geneva, December 18th 2020

to view other issues, please visit our website at: <http://www.thecapitalobserver.com>

5/ Executive Summary

One thing that is important to note: as we enter this period of the recovery phase in demand, destocking storage will be the number 1 priority, so as demand does start to normalize in the coming months, the market will need to see storage drawdown to get comfortable with where prices are. Putting those elements together, our outlook is that we can expect a several more weeks of Oil modest price gains, but the more significant feature of the two models show that there is a price decline into April 2021 thereafter.

Longer-term outlook

We believe we have to start looking at the energy universe post COVID-19 pandemic. Energy is a cyclical business. The larger the swing to the downside, the larger the swing back up. Everything in business and industry moves in a cyclical pattern. And the only way for the world to avoid a future, massive energy price on the swing up is for some type of miracle invention that stops us from using oil. And as far as we know, there's nothing like that even remotely on the horizon. Structural supply deficit will be a key theme over the coming years as the delta created by COVID will be too large to overcome. The decrease in US shale versus the projected increase. The scrutiny on reserved-based lending and the inability to access capital. The oil majors curtailing capex in shale regions and projecting no growth for the incoming years. The shale treadmill resulting in material declines in the production base. And finally, the massive capex cuts resulting in international activity to drop to historic lows. Right now, the market is still fixated on how oil demand is impacted by the COVID pandemic, but eventually, once demand normalizes, it will look to the other side of the equation, and realize that there may be just not enough supplies to go around. For energy investors, the 2014-2020 bear market has been incredibly brutal – that we know first-hand at The Capital Observer. But as the old adage goes, "Low commodity prices is the cure for low commodity prices." Our understanding of US shale and other oil market fundamentals leads us to believe that we are finally entering a multi-year bull market. And that may not just be in oil, but in other commodities as well. This eventuality has been long in coming.

37 / Timing and Tactical Insight - Oil – the Recovery continues into mid/late Q1 - Oil may have made a secular low in April. At least. Shorter term, it is now back in an impulsive uptrend on our Daily graph as it recently broke above resistance around 46 USD/barrel on Brent. We would expect some retracement of the recent rally into early January, perhaps back to the high 40s on Brent, and then a further leg up into February, perhaps even into late Q1. Upside targets do point to levels around 60 USD/barrel until then. Thereafter, Oil could correct down into the Spring. Since early November, the Energy sector has also been bouncing quite aggressively along with most Value plays. We expect this bounce to extend into mid Q1 (late January / February) before starting to roll over again and then reverse down into the Spring. This scenario is similar to the one we have on US long term yields. H2 next year could then see another bounce.

43 / Precious metal may consolidate a bit more but by early January 2020, gold presents a tremendous buying opportunity - It's the end of the year, in two weeks. And gold has been struggling since the middle of October. Gold weakness which started in October has been partly caused by pressure from previously rising bond yields. Also changes in the current (2020) data on Bank Reserves have not deviated much from historical seasonality – hence we still expect Gold Bullion prices to still consolidate, along with equities-- Gold and equities have been correlating positively in recent days. In fact, Gold and equities may bottom together sometime in early January 2021. The timing of this prospective trough is also corroborated by the counterpart of Bank Reserves in the Fed's asset and liabilities spreadsheet – the Treasury Cash Balance (TCB) – BRs being the asset, and TCB the liability. The BRs and TCB have a yin-yang relationship – their general trend goes towards the same direction, but the high frequency fluctuations have opposite polarities. What could change the trend for the yellow metal next year? One of them is the almost certainty that bond yields will not be rising anytime soon. Why? Treasury Secretary-designate Janet Yellen will unleash \$1.3 trillion in new debt issuance in 2021 alone. The medium term prospects of gold are fairly bright.

46 / Timing and Tactical Insight - A bit more patience is probably required until Gold rises again into the Spring - Despite its recent correction, the long term uptrend on Gold is probably still underway. We expect it to continue higher into late Q1 / early Q2 in first instance. By then, Gold may make new highs and reach into the 2'200 – 2'400 USD/oz range. Shorter term, the sell-off in November may have plunged an important bottom. Indeed, it briefly fell through support, around 1'790, but then rapidly stabilized above it again. Over the next month or so, we expect further work in the mid/low 1'800s, but believe that Gold probably holds. It then finally resumes higher at some point in January, along with Silver and Goldmines. The Gold to Silver ratio seems to confirm these dynamics as it probably continues to drop into mid/late Q1. Indeed, historically, a drop in the ratio is usually positive for both Gold and Silver as Silver, which is more volatile, outperforms. We expect Silver to reach up to the low/mid 30s USD/oz by the Spring. Finally, considering other precious metals, Platinum seems to be breaking out to the upside vs Palladium. We expect this nascent uptrend to continue into mid/late Q1 in first instance. Similarly to Silver outperforming Gold, Platinum will hence probably outperform Palladium. Both Silver and Platinum hence have our favors in the precious metals space into February at least.

53 / Splicing the markets : While Cyclical remain strong, deep value is less convincing - Both the Russell 2000 and the Nasdaq100 indexes are now in uptrends vs the defensive US Staples sector. These relative ratios do indeed show strong outperformance potential for the Russell 2000 into late Q1, and then again towards late next year. The uptrend of the Nasdaq 100 vs the US Staples sector is rather exhausted in terms of targets, yet, could still extend into Summer/late next year. Both suggest that the mood probably remains risk-ON over the next few quarters and probably into 2022, although an intermediate correction period is probably expected at some point this Spring. Short term, considering the ratio of the Russell 2000 vs the Nasdaq 100, the current cyclical rally seems to extend into late January / February, probably following some short term retracement into early January. As for deep value (e.g. US Energy or US Financials), the risk/reward in our view is still uncomfortable vs more intermediate cyclical plays (e.g. US Industrials or US Materials). Hence, although deep Value will probably hold up another month or so, perhaps even outperform slightly, we would continue to focus on the less deep value cyclical profiles, which anyhow also offers strong potential into mid/late Q1.

6/ Mapping the markets

Last month, we expected some retracement on most reflationary assets into early December and then a resume uptrend situation into year-end and then the Spring. The consolidations on the S&P500, the EuroStoxx 50, EUR/USD or US yield have been very shallow, and reflationary assets have now been resuming higher for about a week. We also expected Gold and Silver to pretty much hold their support levels (1'800 USD/oz for Gold and 21 UDSD/oz for Silver) and US yields to retrace slightly. These projections have materialized.

Going forward, we now expect further upside on reflationary assets into February, although in the meantime, a short countertrend may materialize between late December and early January. The S&P500 and the EuroStoxx50 could reach up respectively to the 3'900-4'000 and 3'700 – 3'800 ranges. China may lag, while other more cyclical Emerging Markets outperform. Cyclical sectors should outperform and deep value ones should hold on to their relative gains. The US Dollar should continue to drop, US long term yields to linger-on higher with Inflation Expectations, while Gold and Silver continue to stabilize and then gradually start to resume their uptrend. Oil also retraces short term towards year-end, but then rises to the mid 50s USD/barrel on Brent by mid Q1.

Mid/late Q1 should remain positive for risk assets, yet we would expect a change of focus. US Yields and Yield curve spreads could make an intermediate top at least. Value profiles could start to lag again (e.g. Energy and Financials), while Growth resumes its outperformance, along with not so Deep Value Cyclical profiles, which could also continue to lead (e.g. US small caps, Industrials or Materials). The S&P500 could push above 4'000, the EuroStoxx 50 above its February highs. Emerging Markets probably also continue to perform strongly as China makes a comeback. The US Dollar probably declines a bit further, especially against other Majors. Gold and Silver could make new highs along with Oil, which could reach up to above 60 USD/barrel on Brent. A top on most of these reflationary assets then materializes late Q1, perhaps early Q2 and we would then expect most of these to correct down into Q2. H2 2021 could then see another risk-assets rally.

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 February in first instance (probably towards 3'900 - 4'000). It may see a slight retracement period late December / early January.	The S&P500 could still push higher into late Q1 and to above 4'000, but then probably corrects down into Q2.
	Europe EuroStoxx50	The EuroStoxx 50 probably continues higher into February in first instance (probably towards 3'700 - 3'800). It may see a slight retracement period late December / early January.	The EuroStoxx 50 could still push higher into late Q1 and to its February highs, but then probably corrects down into Q2.
	EMs MSCIEM USD	Emerging Markets probably continue higher into February in first instance (probably with 5 to 10% of upside potential). They may see a slight retracement period late December / early January.	Emerging Markets could still push higher into late Q1 and another 2 to 5% higher, but then probably correct down into Q2.
Treasury	US10Y Bond prices	The US10Y Treasury yield probably continues higher into late January / February towards 1.1 - 1.2%.	The US10Y Treasury yield probably tops out mid Q1 and then retraces into the Spring.
	Germany 10Y Bund prices	The German 10Y Bund yield may already be rolling over. At best, it could still hold up into late January.	The German 10Y Bund yield probably drops towards its March lows into Q2.

Legend: Strong Underweight Underweight Neutral Overweight Strong Overweight

Main Equities

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Equity markets will probably continue to rise in the new year and towards late Q1, probably towards 4'000 on the S&P500, just shy of it on the EuroStoxx 50 and some ways towards it on the Shanghai Composite. The Spring should then see a correction.

Main Regional picks

US equity markets should underperform in US Dollar terms into mid/late Q1 as the US Dollar continues lower, yet probably outperform when compared on a hedged currency basis. European Equities should outperform in US Dollar terms, but lag in local terms due to their stronger currencies.

Emerging markets

p 23-25, 27, 29-32

More Cyclical Emerging Markets (i.e. ex China) could outperform into late January/February due to the weaker US Dollar and US yields that continue to linger on higher. China should then lead again from mid/late Q1. Overall, Emerging Markets should remain quite strong both on an absolute and relative basis into late Q1 thanks to this mix of profiles.

Volatility

VIX is resuming lower, probably to the mid teens by mid/late Q1.

Government Bonds

US & European Benchmarks

p 12-15, 17

US Treasury yields will probably linger on higher into late January / February, while German Bund yields may be already rolling over. Both should then retrace / resume lower from mid Q1.

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 rise into February in first instance.	The ratio then probably extends higher into late Q1, but probably drops thereafter into the Spring.
	Europe	The European Equity to Bonds ratio (EuroStoxx50 vs 10Y Bund) should rise into February in first instance.	The ratio then probably extends higher into late Q1, but probably drops thereafter into the Spring.
Duration		US Yield Curve Spreads could still rise slightly into February.	As with long term yields, US Yield Curve Spreads could correct down into the Spring.
Credit		US Investment Grade Credit spreads probably continue lower into February in first instance.	Credit spreads should continue their down-trend into late Q1. they could then bounce slightly into the Spring.
TIPs/Treasuries		Inflation Expectations could continue higher into February in first instance. They may see a slight retracement period late December / early January.	Inflation Expectations probably extend higher into late Q1. They could then retrace down into the Spring.
Oil		Oil may retrace slightly towards year-end / early January, but then rises into February in first instance, probably towards the mid 50s on Brent.	Oil probably extends higher into late Q1 and the 60 USD/barrel mark on Brent. It then corrects down into the Spring.
Industrial metals		Industrial Metals should also continue to rise towards February, Copper could reach up to the low/mid 8'000 USD/t. A short period of retracement is also possible towards year-end / early January.	Industrial Metals could continue higher until late Q1 (9'000 on Copper?) and then correct down into the Spring.
Gold		Gold may have plugged a low late November, could still build a base and retest down into early January, but then probably rises to new highs into February.	Gold may extend higher towards the 2'200 - 2'400 USD/oz range into late Q1 / early Q2.

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. they probably remain strong into mid/late Q1).

Fixed Income Dynamics

Duration (10Y - 3Y/3M)

p 16

With short term yields now near zero, the US yield curve will mainly follow the direction of long term yields. Yield curve spreads could hence linger on higher into late January / February and then start to retrace with long term US yields.

Credit p 20-22	Credit Spreads in the US and Europe are back-stopped by the FED's and the ECB's massive buying programs. Hence, their downtrend seems very resilient. The trend probably continues relatively unscathed into mid/late Q1.
Rate Differentials p 17-19	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 hence probably continues to rise into mid Q1, when it could top out and start to retrace down into late Q1 / Q2.
Tips p 16, p 48	The TIPs / Treasury inflation breakeven ratio probably continues higher into late Q1, although a short countertrend may materialize towards year-end / early January.
Commodities	
Oil p 33-38	Brent Oil could also retrace back down to the high 40s USD/barrel on Brent towards year-end / early January and then rises again to the mid 50s, perhaps the low 60s into mid/late Q1.
Industrial metals	Copper and Industrial metals should also continue to rise into mid/late Q1. Copper could reach to above 8'500 USD/ton.
Gold & PMs p 43-52	Gold and Silver saw a sharp sell-off late November, yet support around 1'800 USD/oz for Gold and towards 21 USD/oz for Silver have held. Both metals could still retrace their recent bounce towards year-end / early January, but should again manage to hold support. We then expect them to rise strongly towards late Q1, probably with both metals making new highs. Platinum was an interesting one last month as it broke up to all-time highs. It could reach up to 1'150 USD/oz over the next few months.
Agriculture	Agricultural Commodities should also continue to rally into mid/late Q1, yet may also see a slight counter-trend late this year / early January. Upside potential over the next few months is still between 5 and 10%.

Foreign Exchange

		Next 2 months	3 to 6 months ahead
USD vs	EUR	A short countertrend may still materialize towards year-end / early January. EUR/USD then rises towards the 1.24 - 1.26 range.	EUR/USD continues higher towards late Q1 and could reach the 1.27 - 1.30 range. It then retraces down into Q2.
	GBP	A short countertrend may still materialize towards year-end / early January. GBP/USD then rises towards the 1.40 - 1.42 range.	GBP/USD continues higher towards late Q1 and could reach the 1.46 - 1.50 range. It then retraces down into Q2.
	JPY	A short countertrend may still materialize towards year-end / early January. USD/JPY then drops towards the 102 - 101 range.	USD/JPY continues lower towards late Q1 and could reach below 100.
	CHF	A short countertrend may still materialize towards year-end / early January. USD/CHF then drops towards the 0.88 - 0.87 range.	USD/CHF continues lower towards late Q1 and could reach the 0.87 - 0.85 range. It then bounces into Q2.
EUR vs	GBP	Over the next couple of months EUR/GBP could drop towards the 0.89 - 0.88 range.	EUR/GBP could continue lower into late Q1 and towards the 0.87 - 0.86 range. It then bounces into Q2.
	JPY	A short countertrend may still materialize towards year-end / early January. EUR/JPY then rises towards the 1.27 - 1.28 range.	EUR/JPY may continue to push higher into late Q1 and the high 120s. It then retraces down into Q2.
	CHF	A short countertrend may still materialize towards year-end / early January. EUR/CHF then rises towards the 1.09 - 1.10 range.	EUR/CHF could then rise to above 1.10 by late Q1. It then retraces down into Q2.
GBP vs	JPY	A short countertrend may still materialize towards year-end / early January. GBP/JPY then rises towards the 142 - 144 range.	GBP/JPY may continue to push higher into late Q1 and the high 140s. It then retraces down into Q2.
	CHF	A short countertrend may still materialize towards year-end / early January. GBP/CHF then rises towards the 1.23 - 1.24 range.	GBP/CHF may continue to push higher into late Q1 and the mid/high 1.20s. It then retraces down into Q2.

Legend: Strong Underweight Underweight Neutral Overweight Strong Overweight

US Dollar	The US Dollar (i.e. the Dollar Index) could bounce slightly towards year-end and early January as the environment could turn more defensive short term. It then resumes its downtrend into mid/late Q1. By then, it could reach down to the 88 – 84 range.
Euro p 18	EUR/USD could also see a short period of retracement late December / early January, following its current rally. It then resumes higher, probably towards the 1.24 – 1.26 by mid Q1 and perhaps even towards the high 1.20s by late Q1. It then probably retraces down into the Spring
Yen	USD/JPY will probably drop to the 102- 101 range by mid Q1 and perhaps even break below 100 by late Q1. EUR/JPY and GBP/JPY may see a dip late December / early January, but their uptrends then probably continue into mid/late Q1. EUR/JPY could reach the high 120s by then, GBP/JPY the high 140s.
Sterling	Cable could rise to above 1.40 over the next couple of months and perhaps even to the high 1.40s into late Q1. Obviously, this bullish view is widely dependent on the UK and Europe reaching a Brexit deal.
Swiss Franc	USD/CHF could reach down to 0.88 – 0.87 by mid Q1 and perhaps even drop to the mid 0.80s by late Q1. It then probably bounces during the Spring. EUR/CHF could push to above 1.10, while GBP/CHF may reach the mid/high 1.20s by late Q1.
Oil & Commodities currencies p 19, 33, 39	Commodity currencies (our equal weighted portfolio containing AUD, BRL, CAD, NOK, NZD, RUB, CLP and ZAR) are in a strong uptrend vs the US Dollar and could continue to rise against it into late Q1. Vs the Euro, they have been bouncing since late Summer, and could continue slightly higher into February. They should then start to roll-over again and probably will retest down vs the Euro this Spring.
Asian currencies	Our Asian Growth equal weighted (CNY, INR, KRW, THB and TWD) portfolio also appears strong vs the USD into late Q1. Vs the Euro, it did bounce between August and November, yet has since been retracing. It could attempt to bounce again in January, yet then probably rolls-over again vs the Euro from mid Q1.

Equities Markets Segmentation

Core Sector Weightings			Next 2 months					3 to 6 months ahead				
US Sectors - S&P500 (general comment)			Following a short retracement period into year-end / early January, we would then favor cyclical themes into late January / February.					From late January/February into late Q1, we would add back Growth, reduce Deep Value and keep other Cyclical overweight.				
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%										

			Next 2 months					3 to 6 months ahead				
European Sectors - Europe Stoxx 600 (general comment)			Following a short retracement period into year-end / early January, we would then favor cyclical themes into late January / February.					From late January/February into late Q1, we would add back Growth, reduce Deep Value and keep other Cyclical overweight.				
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 40- 42, 54

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

Our sector allocation Overweights cyclical sectors for now, probably into February. Deep value could still outperform, yet marginally vs other cyclical sectors. Growth is rather neutral, while Defensive sectors will probably underperform.

From mid Q1, we then expect Growth to make a comeback, some less Deep value cyclical sectors such as US Industrials or Materials could also remain strong, while Deep Value (e.g. US Energy and Financials) could start to lag again. Defensive sectors should finally make a comeback towards late Q1 / the Spring.

Countries allocation

Core Countries Weightings			Next 2 months					3 to 6 months ahead				
All World Country Index Currency hedged (general comment)			We would Underweight the US in USD terms (only) and Underweight Europe in local currency terms (not in USD terms).					We would Neutralize Europe (in local ccy terms), Neutralize the US in USD terms and start Overweighting China again.				
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

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

The US could continue to underperform in US Dollar terms vs other markets into mid/late Q1, while compared on a hedged currency basis, it may lead. Inversely, Europe could outperform on a US Dollar denominated basis, yet underperform on a local currency basis. China is currently retracing given its counter-cyclical nature, yet, by mid Q1 could start resume its outperformance vs the All Country World Index.

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 would Overweight pro-cyclical themes into February and Underweight more Defensive ones. A short period of risk-off may materialize towards year-end / early January.					From mid Q1, we would neutralize Cyclical themes, Underweight Value and Overweight Growth and Miners.				
Themes	Strong Underweight	Underweight	Neutral	Overweight	Strong Overweight	Strong Underweight	Underweight	Neutral	Overweight	Strong Overweight
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

p51, 53, 54

On the factor front, we see similar dynamics. We would overweight cyclical themes such as small caps in the US and Europe as well as diversified mining, first into mid Q1 and even into late Q1. Defensive profiles such as the Dow Jones and Japanese Small Caps could lag into mid Q1 at least. Value could hold on to its recent relative gains into February, but should then start to lag again into late Q1 / Q2. Goldmines should gradually stabilize into early/mid January and then rise into late Q1 to new highs.

12 / Uptrend for bond yields should persist into year-end, but early Q1 2021 may find the long bond yield falling hard

The last time we wrote about the US bond market was in July, this year. Our take at that time was encapsulated in the headline of The Capital Observer article: ***The 10yr yield should spiral lower until early September, then rise until early December; but fast deterioration of 2020 liquidity flows could keep yields low until year-end.***

The 10yr bond yield bottomed earlier (in August), but it did rise until December, and remained poised so. Bond yields did keep relatively low, below 1.00% during this entire episode.

This is what we said then:

What do we expect from here:

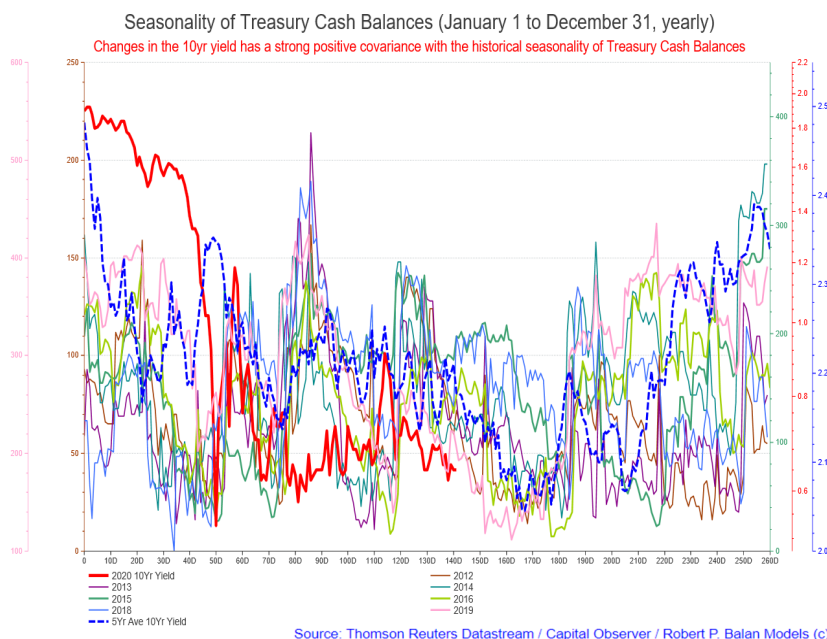
The 10yr yield has been faithfully following its own trajectory in previous years (relative to the seasonality of the Treasury CASH Balance, TCB). Notable was the persistence of similarities between current, 2020 yield, and its trajectories in 2015 and 2019 (see 1st chart on this page)

If the 10yr yield remains faithful to the TCB performance during those years, there will just a few days of rising yields in mid-July before yields spiral lower until late August-early September. At that time, we could see again the lows made in March. That would be the 0.41 % area in the 10yr yield; we may even see lower lows at that time.

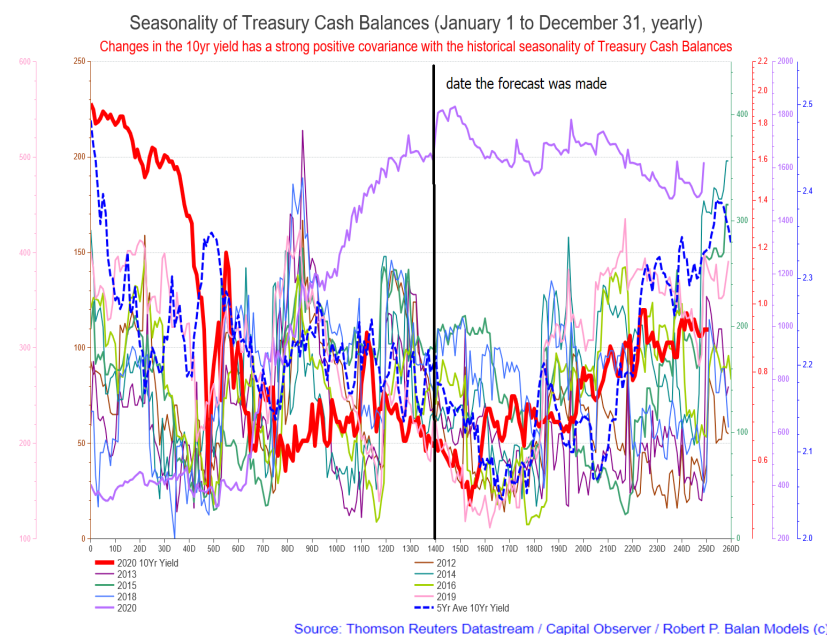
That forecast did come to pass, showing the power of systemic liquidity seasonality to project and predict the likely trajectory of the long bond yield.

The models not only predicted the high-frequency turns that preceded the plunge in the long bond yield, but also anticipated the degree which the long bond yield actually did fall. More importantly the models provided evidence that yields in the back-end may have already made seasonal troughs, even a cyclical bottom.

Original graph in the July 2020 Capital Observer



This is how the chart above looks now



More importantly, long yields are now rising in response to the seasonal upswing in liquidity and the upside pressure from the massive monetary and fiscal stimulus that the Fed and the US government are pouring into the US financial system and economy. That should extend to next year, as the US Treasury in the new administration of Mr. Joseph Biden will continue to pour stimulus in 2021 (an article for the Capital Observer in January 2021).

Future issues with this analytical platform

Effective as this analytical platform has been, we have issues nonetheless regarding the continued use of this seasonality paradigm in the quarters up ahead. The current rates of change in 2020 liquidity flows from the Fed and Treasury have been deteriorating at a fast clip. This adds a new wrinkle to the forecasting of interest rate levels based on liquidity flows. **The current 2020 liquidity profile is so very different from historical norms (see that in 2nd the graph above) – we fear that**

its after effects may be completely different from what we have seen in the past 7 years at least.

We may have to reassess how seasonality of the various data we track to project the route of the long bond yield (Fed's Balance Sheet, Treasury Cash Balance, Bank Reserves) are undergoing transformation. However, the changes could impact the way we tract rates only as from Q2 2021.

What to expect of bond yields going forward ?

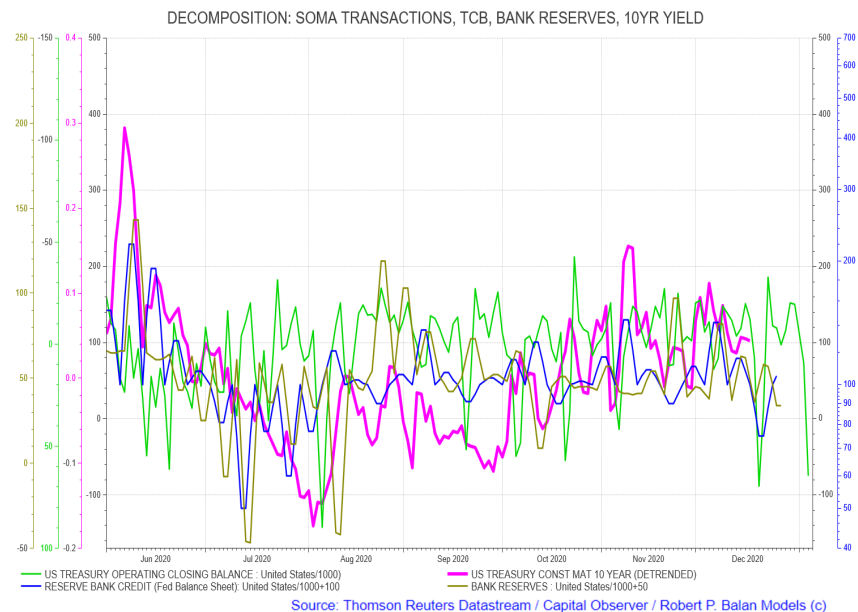
Meanwhile, the current algorithm using the lagged impact of these various data still seems to work. We have developed several high frequency models to enable us to detect whether or not the current transformational changes in 2020 liquidity data will still work with historic seasonality patterns. So far, it does seem that the old models should still make some effective trading calls on bond yield changes (see 1st graph on this page).

We see that it is not just the Treasury Cash Balance (TCB) that gets to tilt the long bond yield's direction -- the impact of the growth (or no growth) of the Bank Reserves and the Fed's Balance Sheet contributes significant influence to the trajectory of the long bond as well.

Timing-wise, what the aggregate model tells us is this: the period bracket for a yield immediate trough is from December 18 to December 22. If we assume the lead of the TCB change rate to be 15 days, then the 10yr yield tops out today, and bottoms December 21. Then the TCB seasonality calls for higher yield over the year-end, followed by a sharp fall in yield in January.

(Nota bene -- it is not the changes in the nominal data which influences the yield/ price -- it is the change rate. Why? -- a price is a change rate -- transforming the liquidity data to a change rate makes compatible comparison between the two variables).

That yields go lower in January is also borne out by existing seasonality

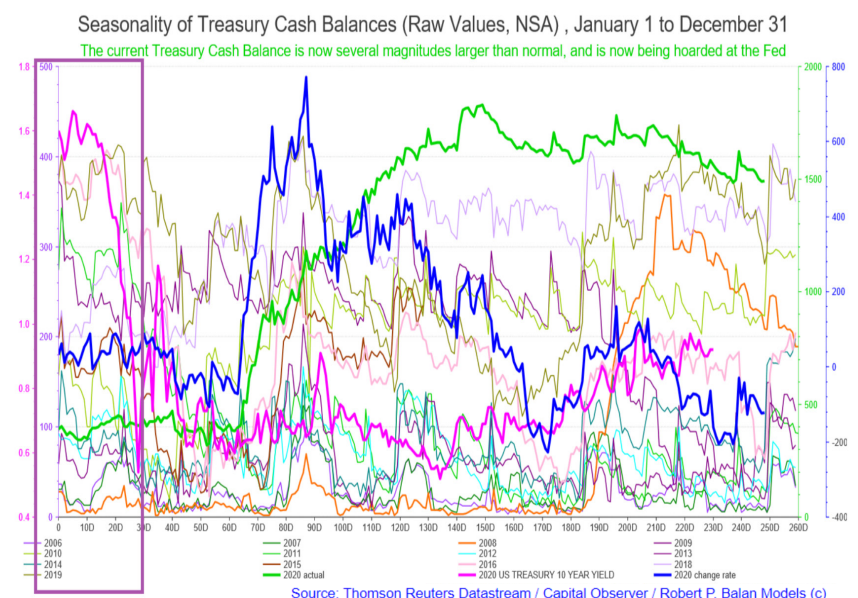


patterns in the Treasury Cash Balance situation comes with a twist: institutional investors are familiar with the regular seasonality of liquidity flows so therefore front-run those expected changes. These front-run periods are highly variable -- that, in turn, could alter the expected inflection points of the price data relative to the liquidity data.

Note what happens to the TCB in January -- the data falls lower, historically speaking. But the impact on yield will be only seen when we are already in late January or early Feb -- allowing for the lagged effect. The problem is that this natural lagged effect liquidity has on price variables (due to monetary transmission frictions) is further exacerbated by the early positioning of some institutions -- the period of which also varies.

We explained the role of those institutions (Primary Dealers and large investment banks) in the July 2020 bond article. We said then: We can show that changes in systemic liquidity have profound impact on the trajectory of bond yields. However, the

The fundamentals of bonds are conceptually simple -- the market is driven by money flows. But there are so many peripheral influences that trading day to day using these liquidity concepts (in addition to auction and issuance matters -- and interference from the institutions) can really provide market uncertainty. Systemic liquidity seasonality and the models we are showing here are most effective with a near-term view, not on day-to-day trading view.

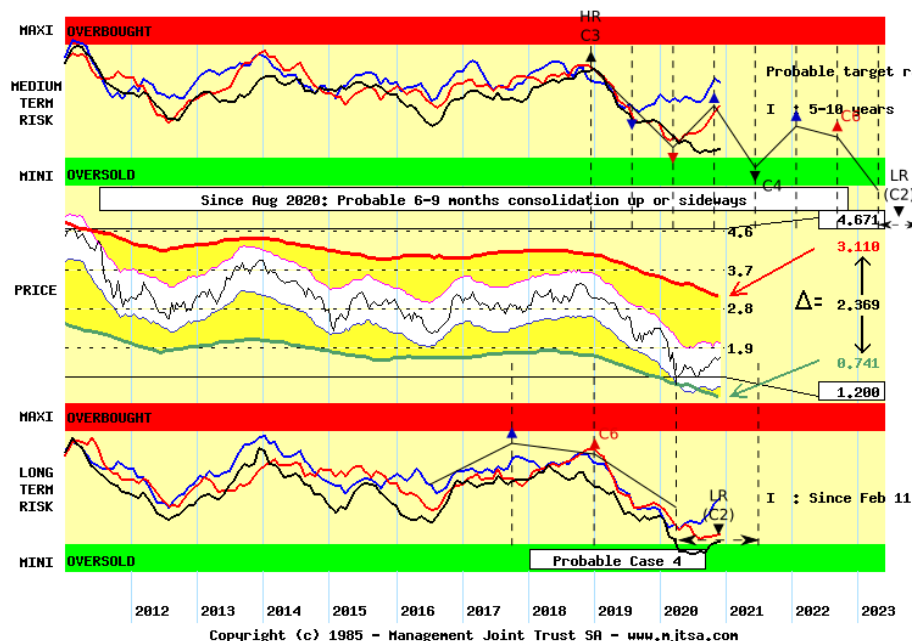


Nominal US yields may push slightly higher into mid Q1, yet probably retrace down thereafter into the Spring.

The uptrend on yields since early August has been fueled by fiscal stimulus and more recently vaccine hopes. Investors are indeed looking beyond the current lockdowns and the possibility of a US political gridlock (following Georgia's senate run-off in early January) as they anticipate an acceleration of the recovery in 2021. As a result, over the last couple of months, Cyclical assets have been rallying, Value plays have bounced strongly and nominal rates have been rising. Yet, many residual risks remain, while valuations are getting very rich. Furthermore, deficits need to be financed. We hence believe that the FED will probably need act strongly in the new year in order to avoid any dislocation.

US30Y Benchmark Bond yield

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

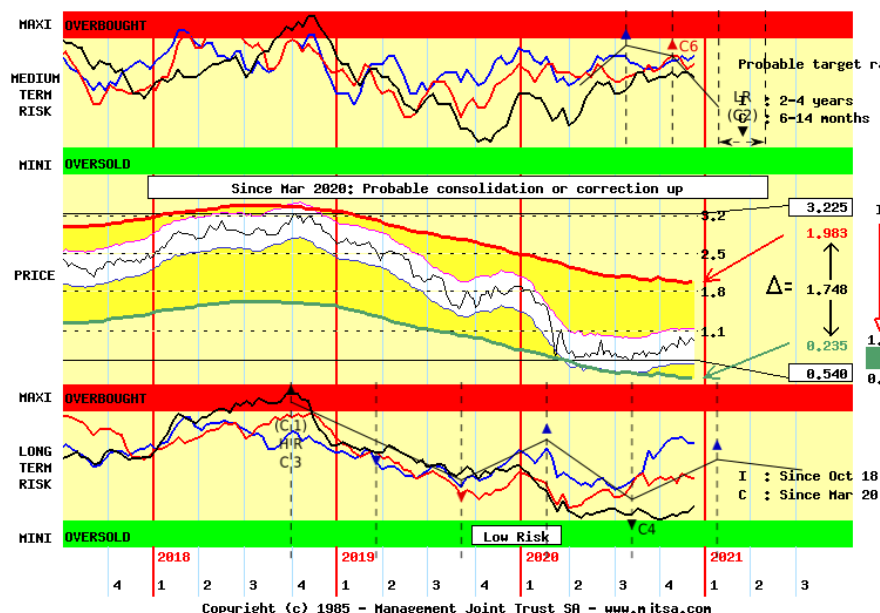


US long term yields reached strong Oversold conditions this Spring on our long term oscillators (lower rectangle). They have since been bouncing. Yet, for now, our medium term oscillators (upper rectangle) still suggest that a further downside retest is possible during H1 next year. It could be the result of a strong risk asset correction and corresponding flight to the safety of US Treasuries. Yet, the sell-off last March now probably sets a precedent where falling risk assets can also be accompanied by rising rates and a rising US Dollar. We believe the FED will probably want to avoid a similar US Dollar deleveraging spree at all

cost, and hence will probably front-run such developments. **Strong liquidity provision, while keeping a cap on longer term yields, is probably the FED's only option to safeguard the recovery and avoid another market crash. This may explain further base building on long term yields over the next few quarters.**

US10Y Benchmark Bond yield

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

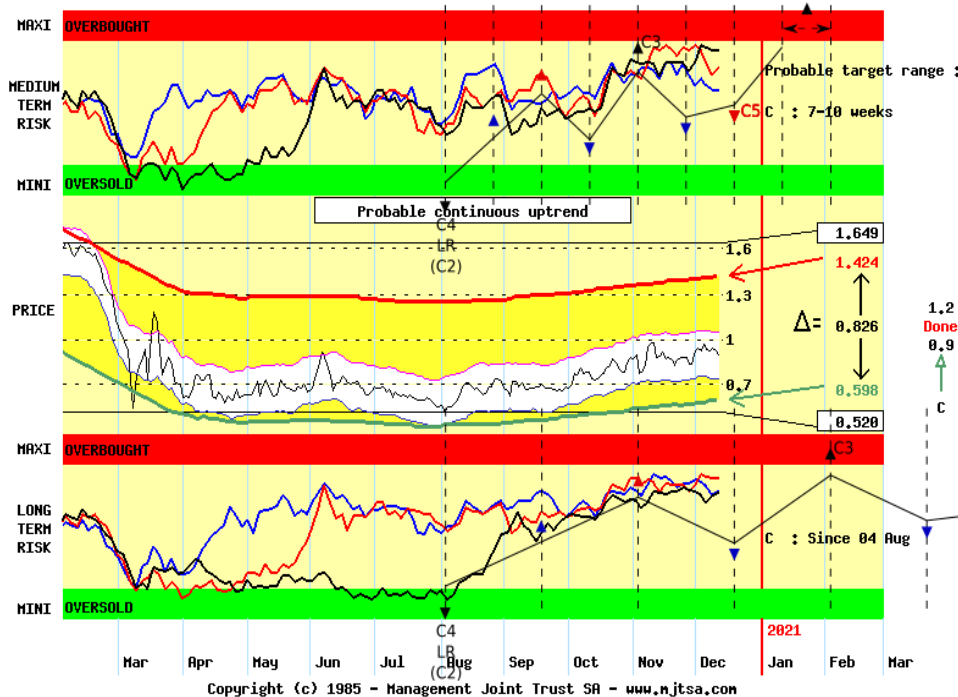


On the Weekly graph of the US10Y yield, our medium oscillators (upper rectangle) still suggest a resume downtrend situation. Yet, for now, it is failing to materialize. On our long term ones (lower rectangle), despite the top made mid Q4, the rebound seems resilient for now. Considering the lows made mid Q3, we would probably expect that **the US10Y Treasury yield manages to progress slightly longer, or hold-up at least, until mid Q1. Thereafter, both oscillator series are suggesting some retracement / downside retesting into the Spring.** From a price target perspective (right-hand scale), the rebound since July is

still quite subdued, and we see no evidence for now that it can gather much more upside dynamic.

US10Y Benchmark Bond Yield

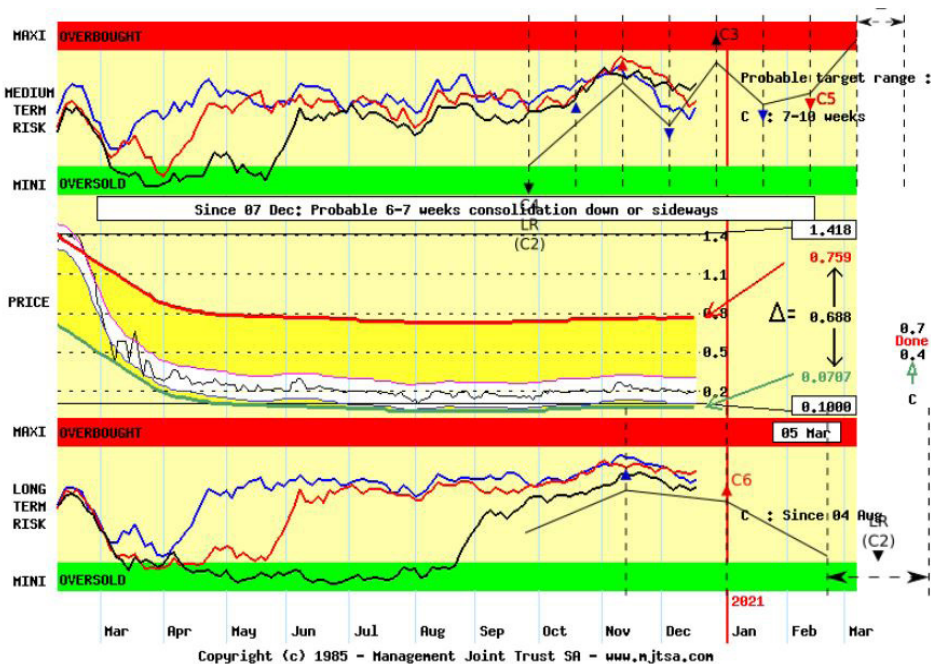
Daily graph or the perspective over the next 2 to 3 months



On the Daily graph, the US10Y Treasury yield is in a persistent rebound since early August. We are refraining from labelling it as an uptrend for now as it is still well below the resistance of the upper end of our C Corrective targets to the upside around 1.2% (right-hand scale). Nevertheless, this upside move doesn't seem quite finished yet, and **probably continues slightly higher into late January / early February** on both our oscillator series (lower and upper rectangles). **For now, we believe levels between 1.0% and 1.2% should continue to serve as strong resistance.**

US3Y Benchmark Bond Yield

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

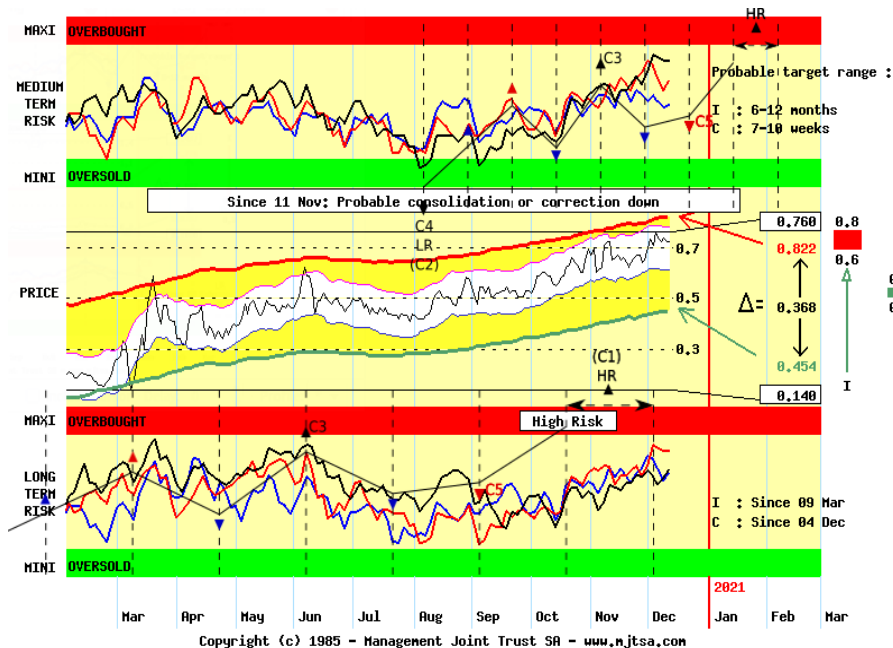


The short end of the curve is not following through with this upside move. Indeed, while a rebound is also visible since early August on the US3Y Treasury yield, it has been very weak for now and may even have topped out early/mid November on our long term oscillators (lower rectangle). On our medium term ones (upper rectangle), a further attempt to rise is possible into year-end (and then perhaps into late Q1). Yet, when considering both series, there seems to be little chance for now that it could gather much momentum. **Our favored view is hence one of**

further downside retests into Q1 on the short term tenures, as shown on our long term oscillators (lower rectangle).

US10Y – US3Y Benchmark Bond Yield spread

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

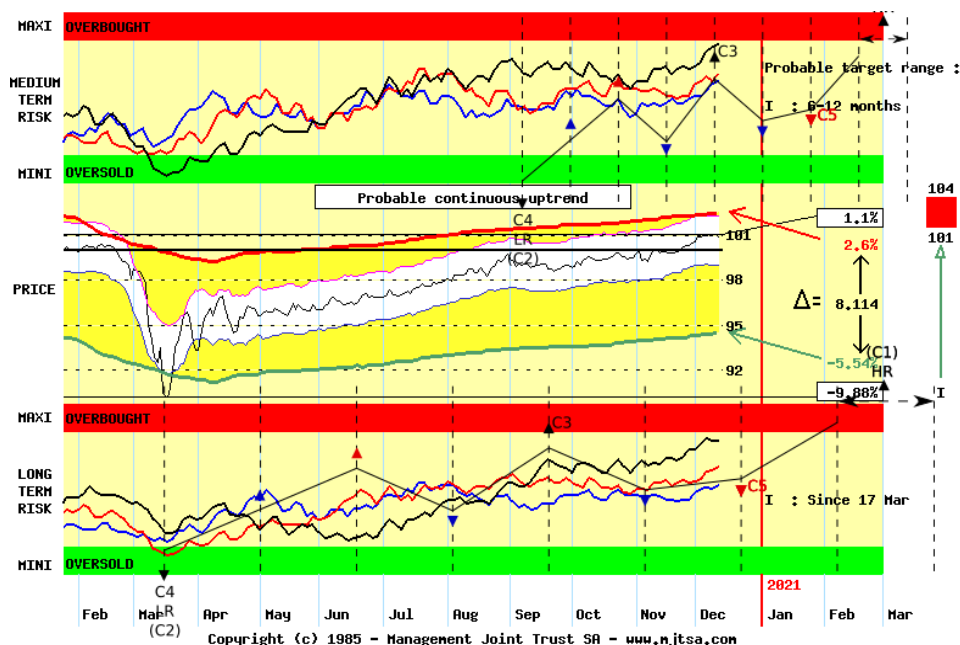


Considering our projections above on US10Y and US3Y yields, we would expect a continuation of the recent steepening move, although we don't expect it to progress much further. As described above, the US 10Y may still rise slightly into late January / February, while the US3Y remains extremely low. This Daily graph of the spread confirms this view. Indeed, our long term oscillators (lower rectangle) have probably entered a High Risk position, and our I Impulsive targets to the upside (right-hand scale) have been achieved. **The uptrend is hence rather exhausted.** Shorter term, on our medium oscillators (upper rectangle), a

further extension is possible into late January / February (along with the US10Y yield), yet we do not expect it to rise much further.

US Tips vs Treasuries Breakeven ratio

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

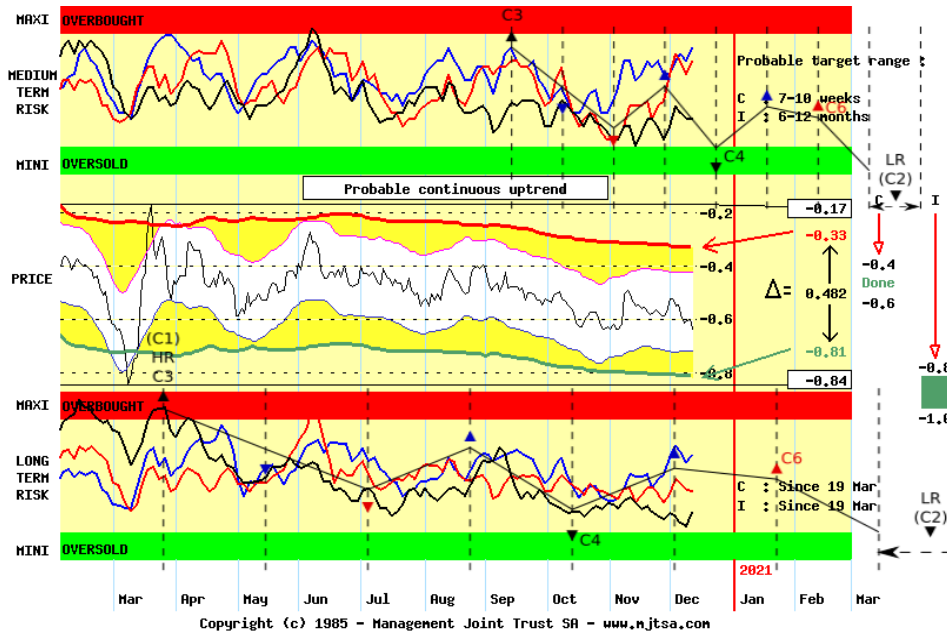


US 10Y Inflation Expectations (proxied by the TIP vs IEF ETF ratio) are the main driver of the continuation of the current rebound in the US 10Y yield. They are keeping real rates under pressure for now (see the absolute graph of TIPs on page 48 of this issue of The Capital Observer), while pushing nominal rates slightly higher. **While, the ratio may see a slight correction over the next few weeks, both oscillator series (lower and upper rectangles) are pointing to further upside into mid/late Q1.** As long as this state perdures (i.e. rising US TIPs/Treasury ratio, ri-

sing TIPs on a standalone basis), the reflation remains predominantly nominal, a trend that probably suggests further financial asset reflation and a weaker US Dollar (a continuation of the monetizing effect). Note: during Q1 next year, it will probably be crucial to follow the US TIPs/Treasury ratio as well as TIPs on a standalone basis, in order to identify either a deterioration in US inflationary sentiment (a declining TIPs/Treasury ratio), or an acceleration of the recovery in real terms (declining TIPs on an absolute basis). Both would probably be US Dollar positive, yet for different reasons. The FED's actions over the couple of months will probably be crucial in determining the future of this relationship.

German 10 Y Bund Yield

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

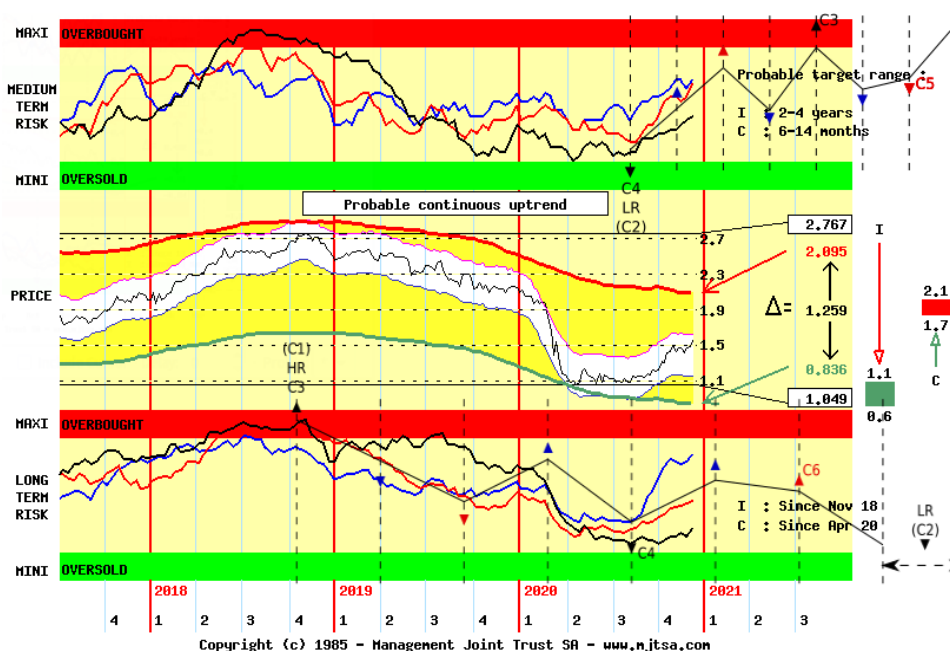


Shifting to Europe, the rates situation is quite different. Yield did indeed bounce with US ones in March, yet have since been following a series of declining highs and lows, i.e. the downtrend is still in place. Worse, the German 10Y Bund yield could be on the verge of breaking to the downside. It is interesting to note that European breakeven ratios, and hence European Inflation Expectations, are also rising, yet less rapidly than in the US. This progression for now seems outweighed

by declining real yields in Europe. On both oscillator series (lower and upper rectangles), **European Bund yields are downtrending, may sell-off over the next few weeks, rebound slightly into January and then continue lower into late Q1.** German 10Y Bund yields are now back below the support of our C Corrective targets to the downside (right-hand scale) and potentially eyeing our I Impulsive target range to the downside, between minus 0.8 and minus 1.0% over the next few months.

US10Y – German 10Y Benchmark yields spread

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

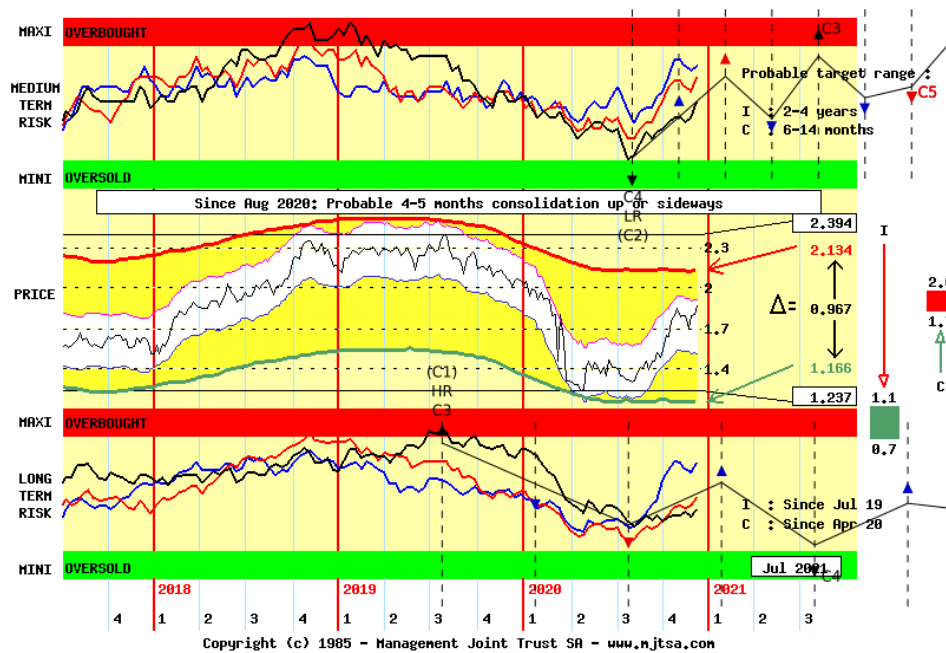


We now consider the interest differential between the US and Europe and first concentrate on 10Y tenures. With real rates already quite low in both regions, the progress of the differential in real rates is probably marginal in effect compared to the more dynamic differential of inflation expectations. Indeed, inflation expectations are currently rising quicker in the US than in Europe, and this effect is probably the main driver behind the recent rise in the US to Europe Interest rate differential as well as the one of the EUR/USD exchange

rate. According to both oscillator series (lower and upper rectangle), **the current uptrend in the differential probably continues into early/mid Q1 in first instance.** As we have seen above, these dynamics probably correspond to further upside (although limited) in US yields, while European ones are already starting to roll-over again. We then expect some retracement into the Spring and then perhaps a further upside attempt into next Summer.

US30Y – Bund 30Y Benchmark Bond Yield spread

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

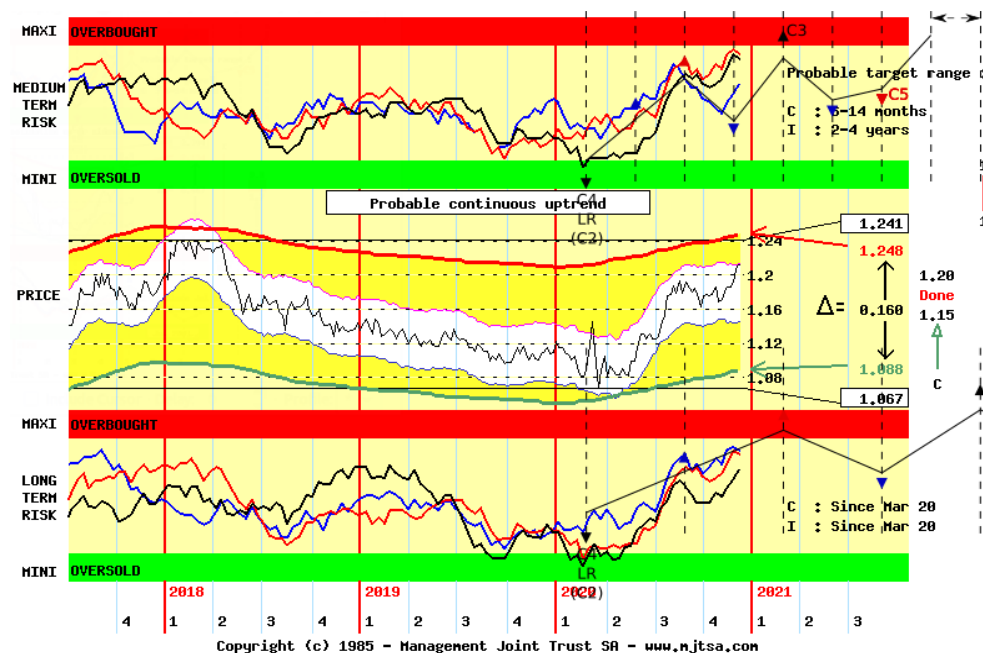


We now perform a similar analysis on the longer term 30Y differential, which we believe is even more correlated to the EUR/USD exchange rate (featured below). Here also, we expect the current bounce to extend into early/mid Q1 before retracing down into the Spring, perhaps even the Summer. In the meantime, a break above 2.0% (the resistance of the upper end of our C Corrective targets to the upside – right-hand scale)

would be a strong signal suggesting further upside in this differential into H2 next year (it would probably also suggest that following some retracement into the Spring, the rates differential and EUR/USD could rise again next Summer). The differential currently stands at 1.9%, and with two months left to go to the upside, this break-out seems achievable.

EUR/USD

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

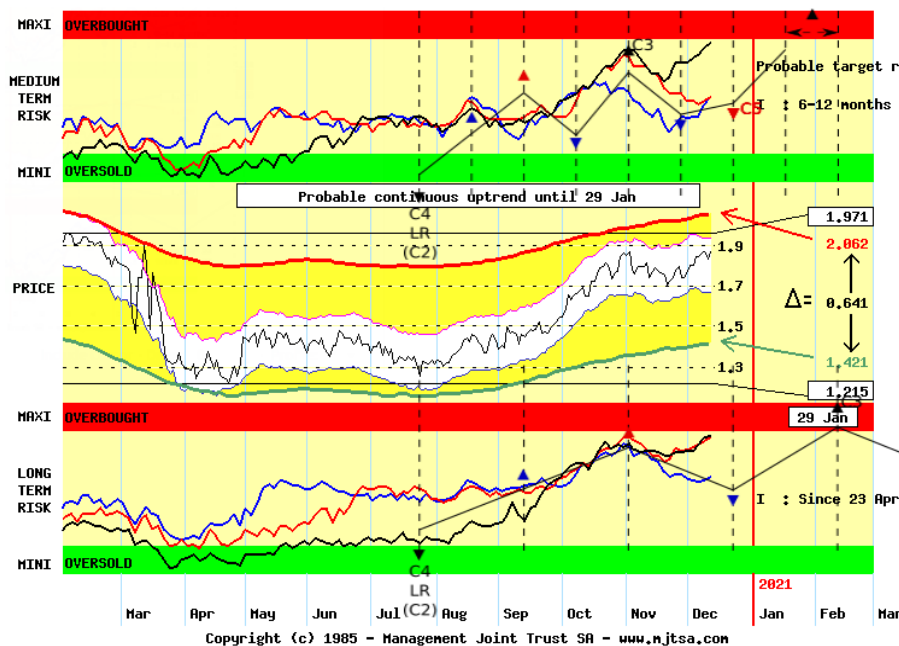


As a cross reference, we now consider the EUR/USD exchange rate, which although it does seem a bit extended short term (over the last few weeks), **probably continues higher into mid Q1 at least** on both our oscillator series (lower and upper rectangles). The pair is now above the resistance of our C Corrective targets to the upside around 1.20 (right-hand scale)

and **probably eyeing the 1.28 – 1.34 range over the next few quarters**. Their lower end may be achieved over the couple of months (i.e. a break above the early 2018 highs), while as with the US to Europe 30Y interest rates differential, a further leg up could well materialize during H2 next year, possibly to above 1.30.

US30Y – Bund 30Y Benchmark Bond Yield spread

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

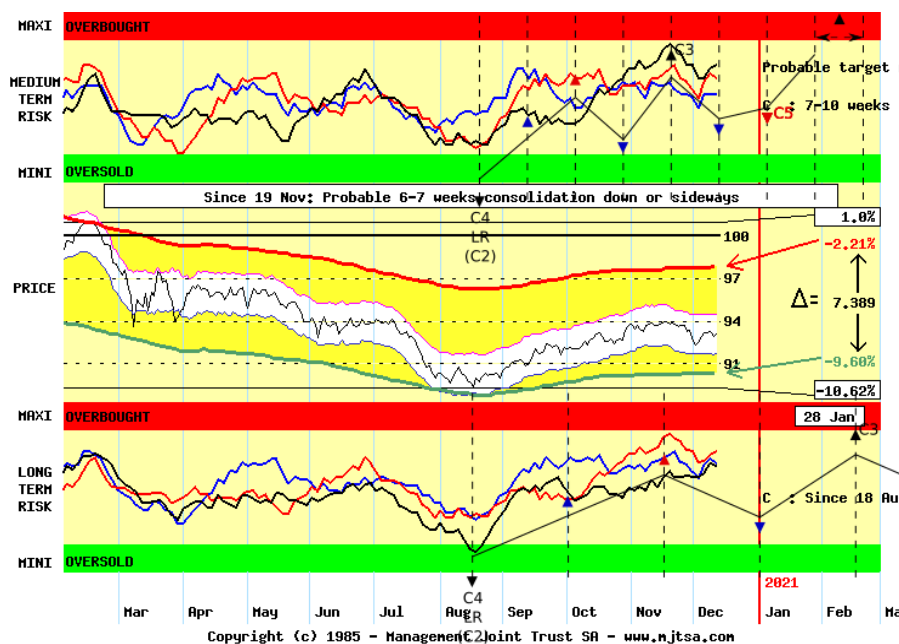


The Daily graph of the differential between US30Y and the Bund 30Y yield seems to confirm this scenario over the next couple of months. Indeed, on both oscillator series, it probably **rises into late January / February**, and according to our Impulsive targets to the upside (right-hand scale), **should break above the 2.0% resistance mark already discussed on the Weekly graph (perhaps even rises towards 2.3%)**. Our analysis suggests that most of this progression may result from a drop in European

yields rather than a strong move up in US ones.

Next 6 EM Currencies (after the Chinese Yuan) vs the Euro

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

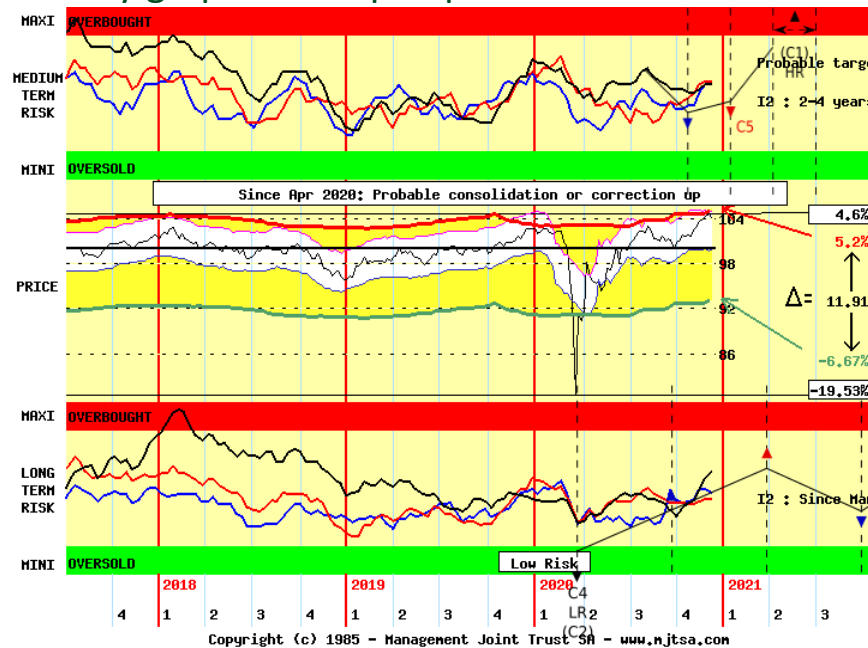


As a further confirmation, we consider the top 6 Emerging Currencies vs the Euro (ex China, equal weighted according to their MSCI EM Cap weights, i.e. KRW, TWD, IND, BRL, ZAR and RUB). Indeed, while the rising differential in US to Europe interest rates is currently favoring the Euro vs the US Dollar (due to the differential in rising inflation expectations), the relationship of Emerging markets currencies vs the Euro (mostly from Commodity producing

countries) is **more closely correlated to the nominal path of US long term Interest rates**. On both oscillator series (lower and upper rectangles), the ratio may continue to rise, or at least hold up, into late January / February (EM currencies outperforming the Majors as the US10Y yield pushes slightly higher), but then probably drops back into the Spring. Hence, considering EM currencies at the margin (i.e. vs the Euro) is probably a good indicator to monitor the path of US interest rates over the next few months.

US Investment Grade vs US Treasuries

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

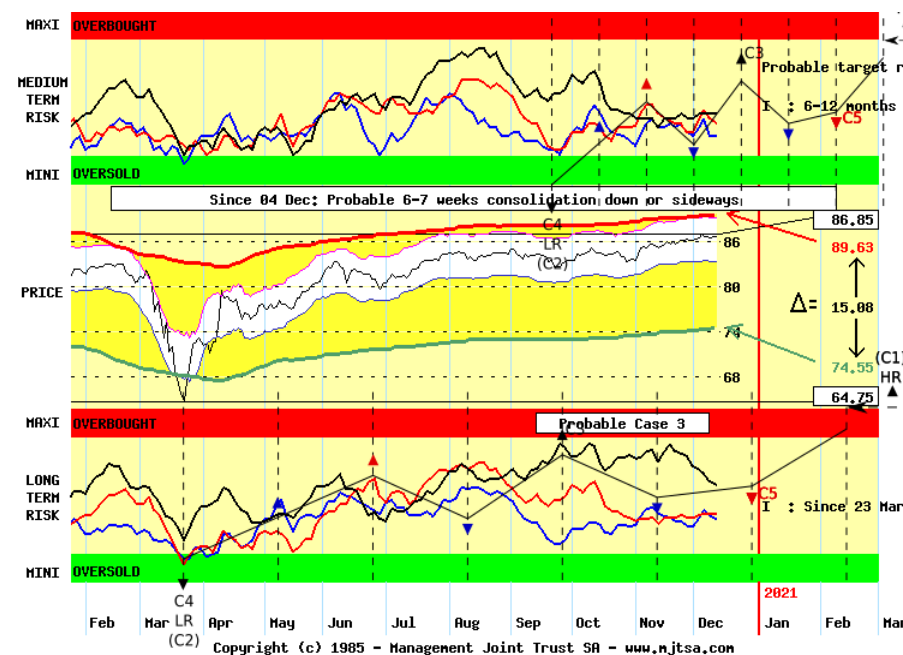


We now move on the Credit and first to US Investment Grade vs Treasuries. According to our long term oscillator series (lower rectangle), the recovery, which started last March, probably finds an important intermediate top towards late Q1 next year. Our medium term oscillator (upper rectangle) are more difficult to interpret at the moment, yet still seem to be positioned in an uptrend. We would expect a slight period of consolidation into early Q1 and then a further rise

into next Spring. All in All, considering both, **we are still positive on US Investment Grade vs Treasuries until late Q1 next year**. Target-wise, we are now above our I Impulsive targets to the upside and eventually eyeing our I2 Impulsive 2 extended ones (right-hand scale). Although these indicate that 5 to 10% of upside is still theoretically possible, such extended targets are usually quite hard to achieve. We would hence tame these expectations for now and consider that **the uptrend on US Investment Grade vs Treasuries since last Spring is probably quite exhausted but probably lingers on higher into the Spring**.

US High Yield Bonds

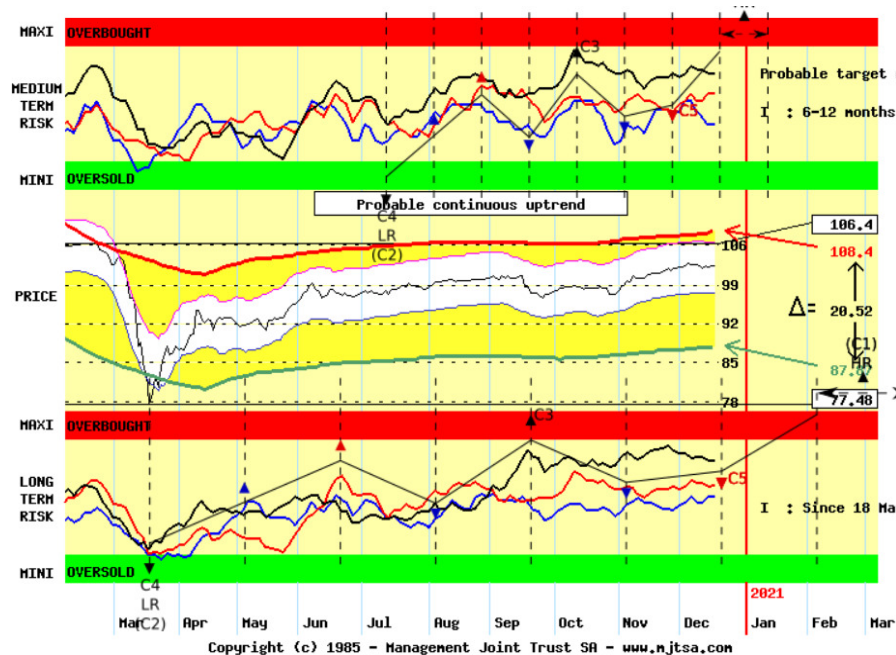
Daily graph or the perspective over the next 2 to 3 months



US High Yield (HYG ETF) has also staged a strong recovery since March. As with equities, it consolidated at high levels between September and October and has since started to resume its uptrend. A further dip cannot be excluded on both oscillator series towards late this year / early January (lower and upper rectangles), but in general, **the uptrend since March is still in place and probably extends into late Q1**. Upside potential as shown by our I Impulsive targets to the upside (right-hand scale) is circa 3 to 4%.

European High Yield

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

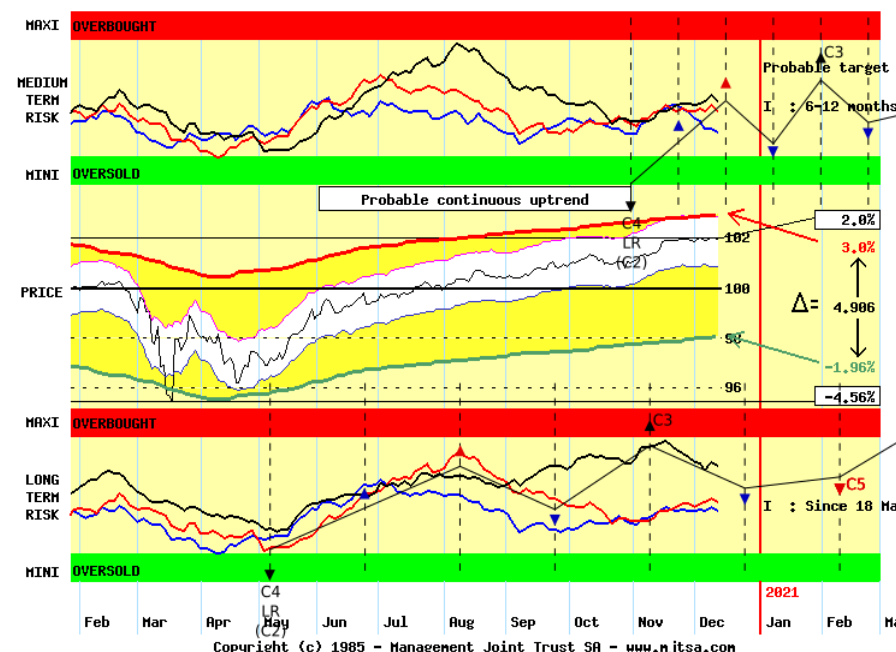


In Europe, High yield (IHYG ETF) is following similar dynamics than in the US. Indeed, while our medium term oscillators (upper rectangle) could be signaling an intermediate High Risk situation towards late this year / early January, our long term ones (lower rectangle) are still **very well positioned into late Q1**. Interestingly, the upside potential does still seem quite compelling here as shown by our 1 Impulsive targets to the upside in the 104 – 112 range (right-hand scale),

possibly 5 to 10% above current levels, i.e. European High Yield seems to offer more potential than US High Yield.

European Sovereign Bonds vs German Bund

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

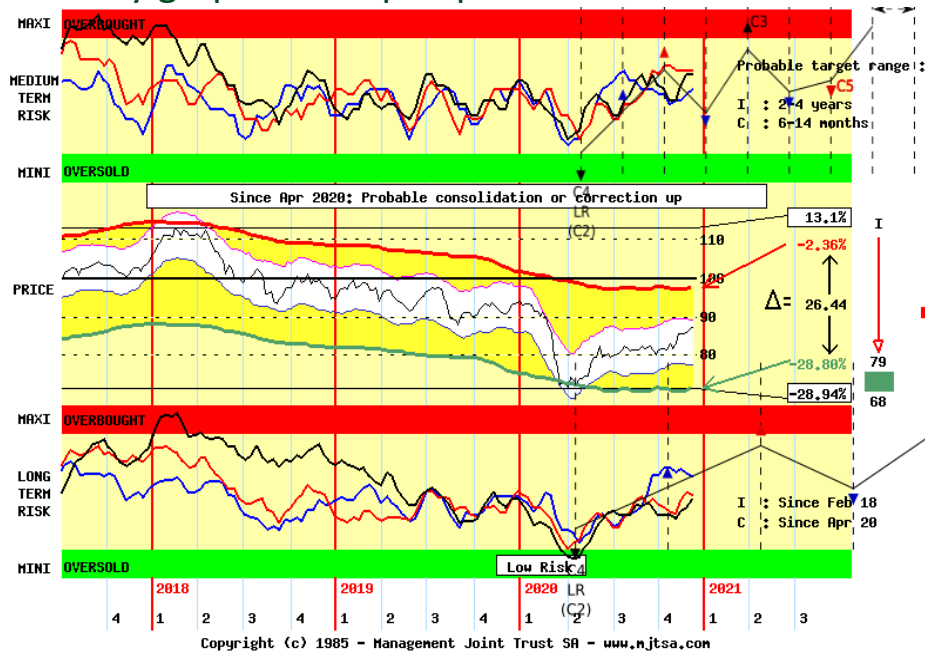


Sovereigns spreads in Europe are also still downtrending (i.e. the ratio, in this case comparing the IBCM vs the RXP5EX ETF, is still uptrending), probably into late Q1 on both oscillator series (lower and upper rectangles). In the meantime, as with other Credit instruments some consolidation may still materialize towards late this year / early January. Upside targets do still leave some leeway, **with circa 2 % of upside into Spring next year** (right-hand scale). If indeed Bund yields do start to roll-over again over the next few weeks (as we describe

further up in this article) focusing on other European Sovereigns might provide an interesting kicker combining both the duration and credit trade over the next couple of months. Indeed, according to this analysis, European Sovereign spreads still seem to continue lower (i.e. higher ratio) into late Q1.

Local Currency Emerging Markets Sovereigns vs US Treasuries

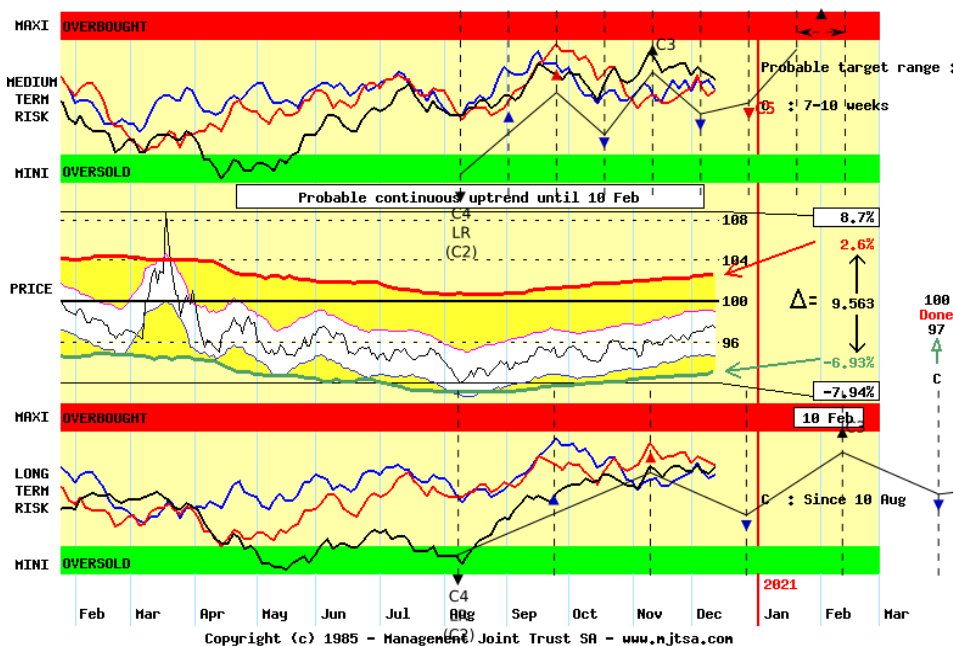
Weekly graph or the perspective over the next 2 to 4 quarters



Shifting to Emerging Markets, we first consider local currencies Sovereigns vs US Treasuries. **The uptrend since March is still underway, and on both oscillator series (lower and upper rectangles) probably continues into next Spring in first instance.** Upside targets should meet the upper end of our C Corrective targets towards 92 (right-hand scale) over the next few months (circa 4% higher than today). Yet, considering other credit instruments, which are still well positioned, we are wondering if the upside potential is not much greater suggesting that the ratio could break out above this resistance. **In short, we are positive on Emerging Market Debt in local currency and would even expect some form of catch-up trade during Q1 next year.**

Local Currency Emerging Markets Sovereigns vs USD denominated EM Sovereigns

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



Shorter term, we compare Local currency EM Sovereigns vs US denominated ones. The dynamics resembles other reflationary trades which we have considered in this article, namely US 10Y yields or Emerging markets currencies vs the Euro. As with these, on both oscillator series (lower and upper rectangles), **the current uptrend probably continues into late January / February.** A short setback may still materialize over the next week or so, yet we would then expect the uptrend to resume into early next year. For now, the move is still below our C Corrective targets to the upside (right-hand scale) and **it will probably meet strong resistance once it approaches the 100 mark at some point during Q1 (i.e. 2 to 3 % above current levels).** If we follow these dynamic, we would

probably expect a strong move on Emerging Debt in local currency into mid Q1, while thereafter the segment probably gives up its lead to USD denominated Emerging Markets debt. As in the period from March to August this year, this may be the result of renewed dominance of the FED's monetary policy (over fiscal policy and vaccines).

Concluding remarks:

Until next February, we expect reflationary trades to continue to lead in the fixed income space. US Inflation expectations should continue to rise along with US long term nominal yields, the US to Europe Interest rates differential, Yield curve spreads, EUR/USD and Emerging markets currencies vs the Majors. Yet, this reflationary push is probably already losing momentum. It is gradually becoming more concentrated on US long term yields, while shorter term US tenures such as the US3Y yield may have already topped out in November. German Bund yields also seem to be starting to roll over again. Hence, in this environment, and first into February, we would probably favor US Tips, European Sovereigns, European High Yield and Emerging market debt in local currencies. From mid Q1, however, we then expect a change of focus. US monetary policy would appear to regain its dominance, and fiscal hopes will probably fade. We would then look to switch out of Emerging Market Debt and European High Yield, probably retain some US Tips as well as European Sovereigns, and, from late Q1, carefully consider US long term Treasuries, as some retracement on long term US yields may then be expected into Q2.

23 / Emerging Markets: Is it time to pivot back to EM, based on macro and currency factors

The last time we wrote about Emerging Markets was in the May 2020 Capital Observer. This is how we described our outlook for EM at that time: **Emerging Markets: post-COVID 19 pandemic, EM is actually coping better than developed ones, and bouncing earlier than DM.**

This is what we said then:

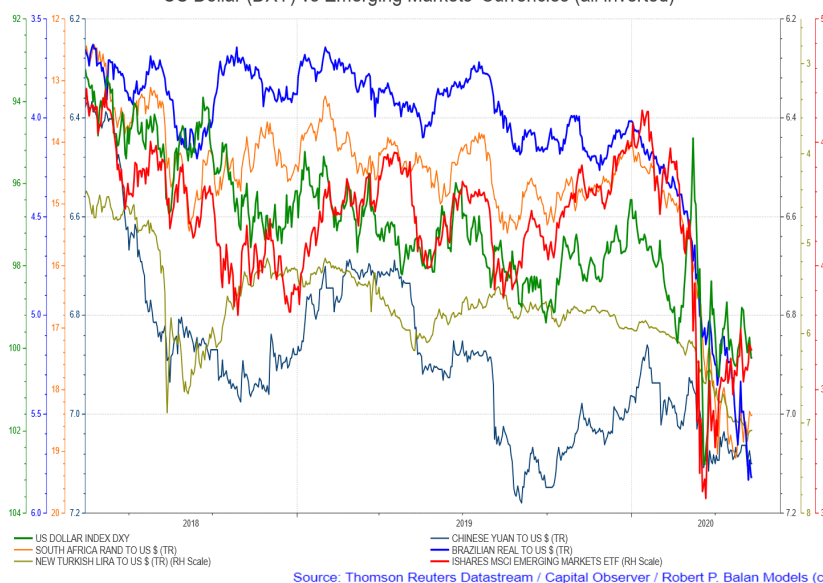
With the emergence of COVID-19 in China which reduced demand for nearly all commodities, all assets -- including emerging market debt -- have experienced heightened volatility in the first quarter of the year. The markets embarked on an avoidance of risk as the COVID-19 global epidemic was further exacerbated by issues in the oil market, including a breakdown in the OPEC+1 agreement to limit oil production. This sector has gotten so bad that we saw negative oil prices, for the first time in mankind's history.

When COVID-19 became a global pandemic after spreading beyond China, many investors began to sell all assets perceived as risky, including (and especially, emerging market debt and other assets). While emerging market economies have dramatically changed over the past couple of decades, many of the larger borrowers are still sensitive to commodity prices - oil in particular. Furthermore, government-enforced shutdowns significantly reduced economic activity, including tourism and trade, which are vital to many emerging markets.

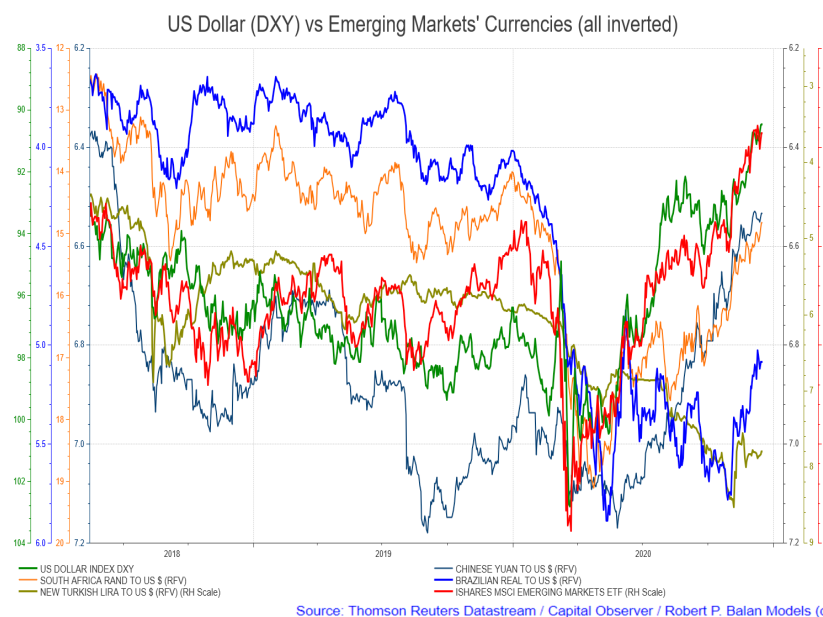
The worst aspect was that the US Dollar became again very strong as capital looking for safe haven flocked to the US currency. While it is true that EM economies have done a commendable job of redenominating their debts, it is not merely the Dollar strength (and EM currencies' weakness) that weighs heavily.

For instance, a rising dollar not only limits the ability of emerging countries to assume U.S. dollar denominated debt -- it increases the credit risk of

Original chart in the May 2020 edition of The Capital Observer
US Dollar (DXY) vs Emerging Markets' Currencies (all inverted)



This is how the graph above looks today



most of these countries. As the dollar continued to rise, emerging markets found it difficult to service their dollar denominated debt, which provided another reason for investors to go short emerging market securities or flee that market for the safety of US-based dollar denominated assets. Also, a stronger US Dollar encourages capital flows from EM capital base itself, and the US gets flows which could be destined for EM economies. That, primarily, is how a strong US Dollar undercuts EM economies and assets.

What a difference seven months can make!

In May, (see 1st graph on this page) we saw the impact of a strong US Dollar on EM debt -- at that time, hard currency sovereign credits have been worst affected, followed by local currency sovereigns which have done marginally better. While some of the local assets themselves performed quite well, local currencies have been negatively impacted versus the US dollar, and the over-all result was an unmitigated disaster for EM assets.

The strong US Dollar downtrend since then has turned around the fortunes of the Emerging Markets. It was the forceful intervention of the Federal Reserve and the US Treasury which laid the foundations for a significantly weaker US Dollar. The Fed led in terms of developed markets, with a range of strong policy measures that even encompass asset purchases, including exchange-traded funds and high-yield securities. The Fed has delivered, and not only for the US markets, but also for EM.

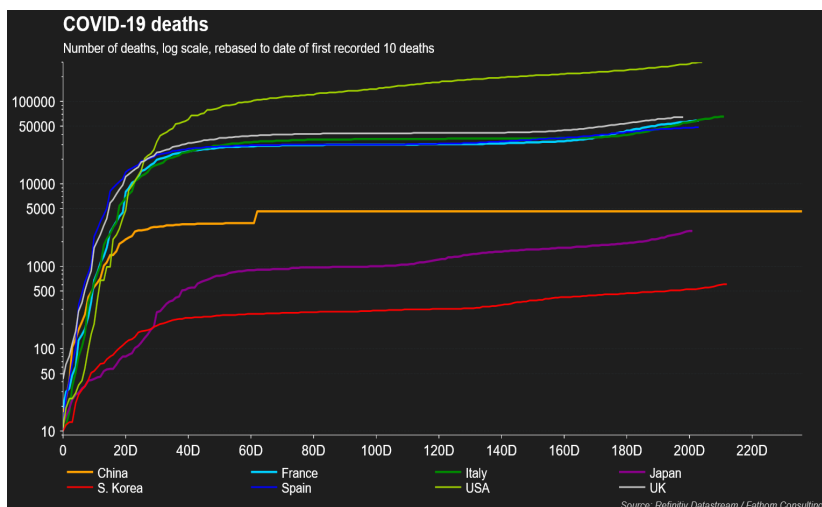
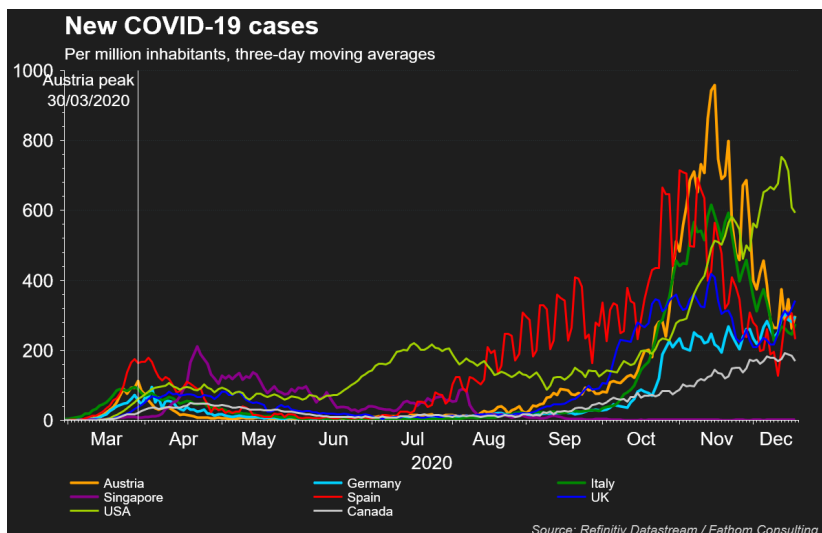
There has been a trickle-down effect on emerging market debt as well in terms of keeping the financial system buoyant. Above all, that Fed largess undercut the exchange rate of the former almighty US Dollar. That has allowed the resurgence of the Emerging Markets.

Global economy picks up – even as the COVID-19 situation stabilizes

The longer-term growth outlook for the global economy continues to improve. Most recently, the news that a number of vaccines are proving effective at preventing COVID-19 has bolstered the case for a strong year of global growth in 2021. EM has been held back by COVID-19, limited policy flexibility and has fostered weak capital flows to these regions.

To be sure, the recent pickup in hospitalizations and fatalities related to the most recent wave of COVID-19 infections will likely slow global growth somewhat and may cause a slight decline in activity in the fourth quarter of this year. This will likely contribute to uncertainty and market volatility in the quarter, but does not impact the longer-term prospects for growth or the basic underpinnings of Emerging Market rise, in our view.

However, we remain in critical watch on the pandemic situation, for if there is any one single factor that can upend the EM resurgence story, it is a resurgence of COVID-19 cases, Wave 3.



Overall, negative implications from the global economic impact of COVID-19 should fade as the data continues to improve. Even in the US, which saw a late spike up, cases have started to trend lower (see 1st chart above).

The best part is that the fatality rate in global basis has remained stable (see 2nd chart above).

As these global macro factors change, and as the pandemic data change for the better, EM has room to move higher, in our view. We continue to favour a pivot from developed markets to the Emerging Markets.

However, there are caveats we need to sound off.

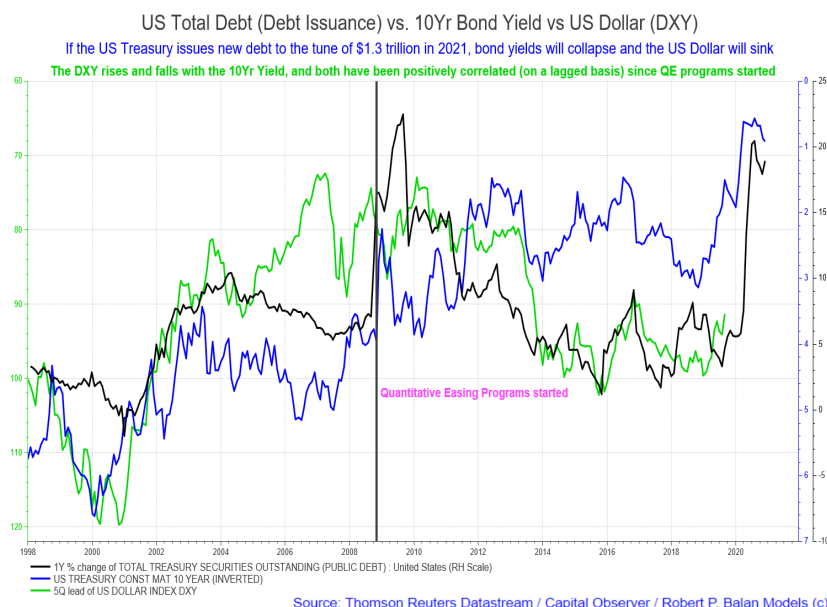
Expectations for policy in the near term have become less certain. The US Federal Reserve (Fed) has continued to buy US Treasuries and mortgage-backed securities, but has not committed to any longer-term

quantitative easing (QE) plan. The European Central Bank (ECB) will likely increase the Pandemic Emergency Purchase Program (PEPP), but any large new easing is unlikely. Fiscal support has stalled, as it has been caught up in the political process in the US and Europe, and politicians seem to have lost some of the urgency. Our expectations are for further fiscal support, although it is unlikely to be as much as originally expected.

These developments will not derail EM's resurgence in the near-term at least. What could augment the chances of the EM's is the published plan of the new US government to flood the US economy with at least \$1.3 trillion in new money. That can only hurt the US Dollar, and improve the odds of capital flowing into EM currency denominated assets next year.

If the US Treasury issues new debt to the tune of \$1.3 trillion in 2021, bond yields will collapse and the US Dollar will sink. The point here is that the US Dollar (proxy: DXY) rises and falls with the 10Yr Yield, and both have been positively correlated (on a lagged basis) since QE programs started in November 2008 (see 1st chart on this page).

A declining US dollar should ease EM financial conditions and provide support to EM. Asia, and particularly China, which is ahead in managing the spread of COVID-19, still looks particularly attractive, from the currency-exchange point of view. The Chinese bond market is a large, liquid market that provides significant yield pickup versus the US and Europe. Judging by balance of payments performance, we view the CNY and other EM currencies as arguably still cheap and potentially well-supported in the medium term.



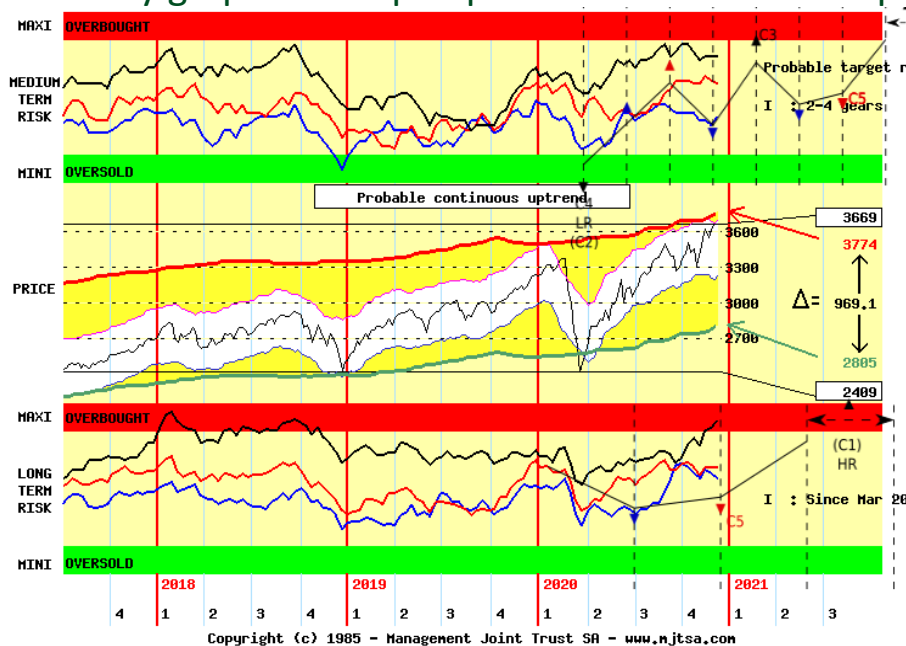
26 / MJT - TIMING AND TACTICAL INSIGHT

EM markets could lead into mid Q1, DM markets and China could then extend the rally into late Q1

Following a high level consolidation from early September into late October, equity markets have since broken out to upside again. Fiscal stimulus hopes and the promise of widespread vaccination are currently fueling their rise. As we explain in our article on US Yield in this edition of The Capital Observer, we expect these reflationary forces to fade from mid Q1. Yet, monetary policy may come to the rescue and help extend the rally into late Q1. Given these dynamics, we will attempt in this article to map the rotation from Emerging Markets back into Developed Markets, probably from mid/late Q1.

S&P500 Index

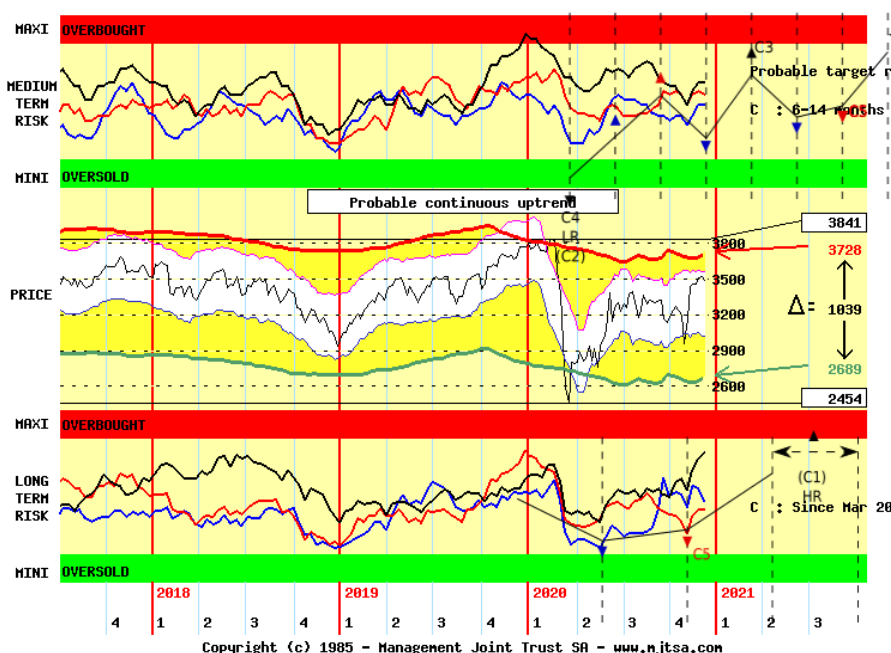
Weekly graph or the perspective over the 2 to 4 quarters



On our medium oscillators (upper rectangle), the S&P500 did reach Overbought conditions this Summer. These were followed by a high level consolidation during September and October. Since early November, the S&P500 is now back in a strong uptrend. On both oscillator series (lower and upper rectangles), we expect the current leg up to continue into mid/late Q1 and perhaps even the Spring. According to our I Impulsive targets to the upside (right-hand scale), the S&P500 may reach up to the 4'000 mark over the next couple of quarters.

EuroStoxx50 Index

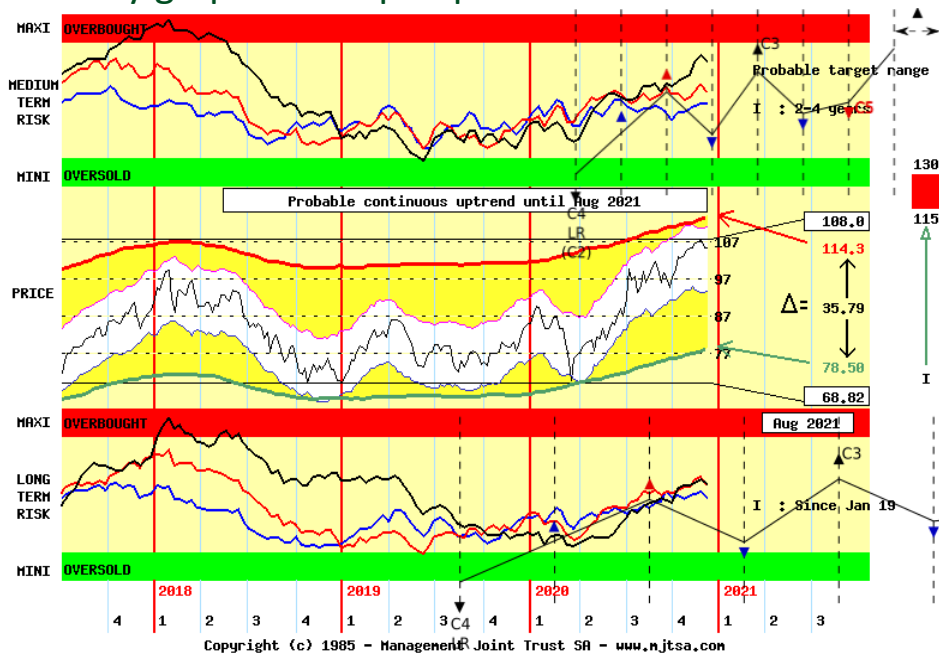
Weekly graph or the perspective over the next 2 to 4 quarters



The EuroStoxx50 did confirm a strong resume uptrend signal early November following a consolidation period which had lasted from June into late October. It has since broken out above its Summer range as well as above the resistance of our C Corrective targets to the upside around 3'300 (right-hand scale). On both oscillator series (lower and upper rectangles), we would now expect this uptrend to continue into late Q1, and perhaps the Spring, and do believe that the EuroStoxx 50 could challenge its February highs by then.

MSCI China Index

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

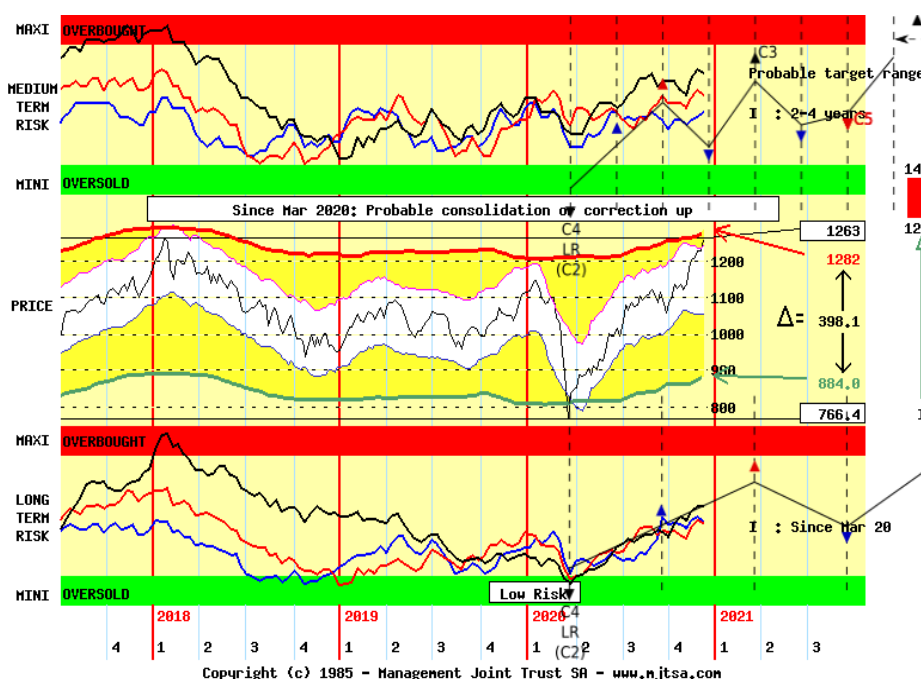


Switching to Emerging markets, we first consider the MSCI China Index. It has staged one of the most impressive rallies this year, and since August has been making new all-time highs. While we are wary of the price configuration, which may have just completed an impulsive leg up, our oscillator series (lower and upper rectangles) seem to indicate **further upside into late Q1 and perhaps next Spring**. Upside targets over the next few quarters, as estimated by our I Impulsive targets to the upside (right-hand scale), may be as high as the 115 – 130

range, or 10 to 25% higher than today. In the meantime, we would probably remain prudent over the next couple of months (into mid Q1) as suggested by the consolidation period shown on our long term oscillators (lower rectangle).

MSCI Emerging Markets

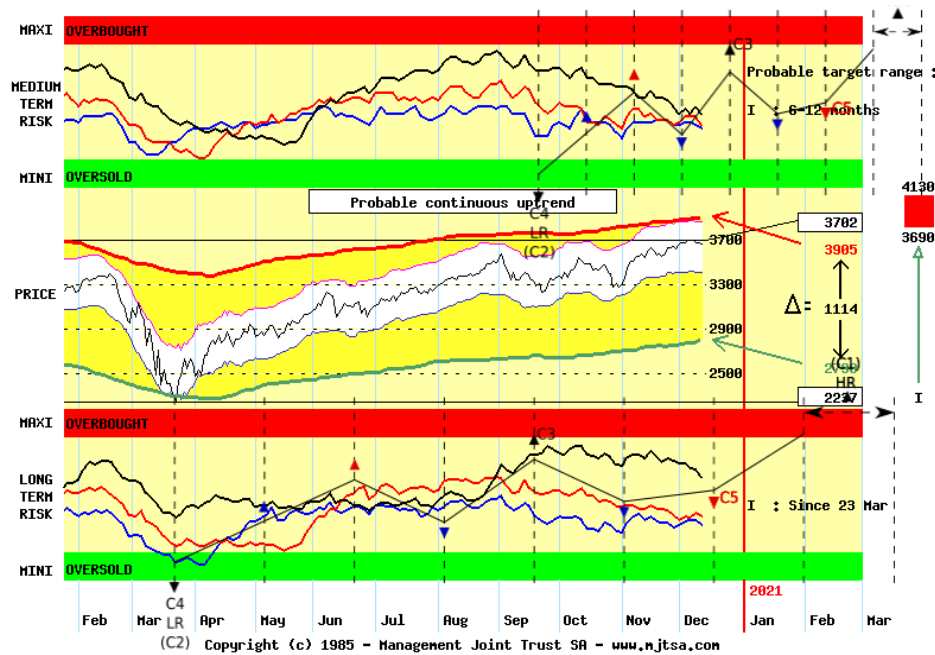
Weekly graph or the perspective over the next 2 to 4 quarters



The wider Emerging Markets index on the other hand (which does include a circa 40% weighting on China) appears more straightforward with an **uptrend that probably extends into late Q1 and towards our I Impulsive targets range between 1'280 – 1'440 (right-hand scale), or up to 15% above current levels over the next few quarters**.

S&P500 Index

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

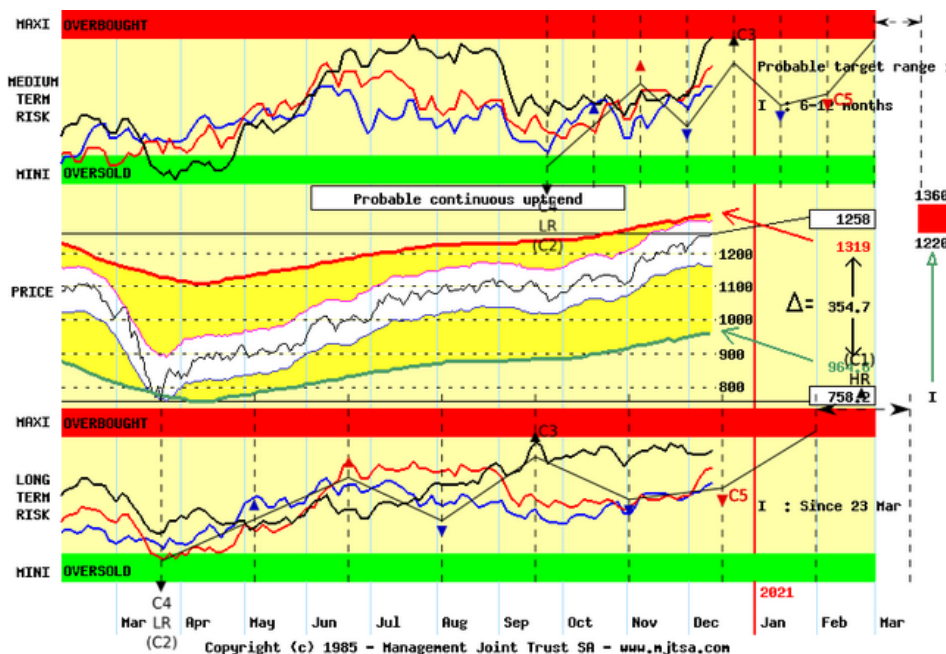


Shorter term on its Daily graph, the S&P500 does seem quite extended short term. Indeed, both our envelopes are touching each other (usually a sign of exaggeration). Yet, for now, it remains in a strong uptrend, and our long term oscillators (lower rectangle) are probably approaching a new resume uptrend situation. On our medium term oscillators (upper rectangle), we expect some volatility into year-end and early January, but the uptrend then also probably resumes higher into late Q1, at least. On the target front

(right-hand scale), our I Impulsive targets to the upside (right-hand scale) are also pointing to upside potential above 4'000 over the next few months.

MSCI Emerging Markets

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

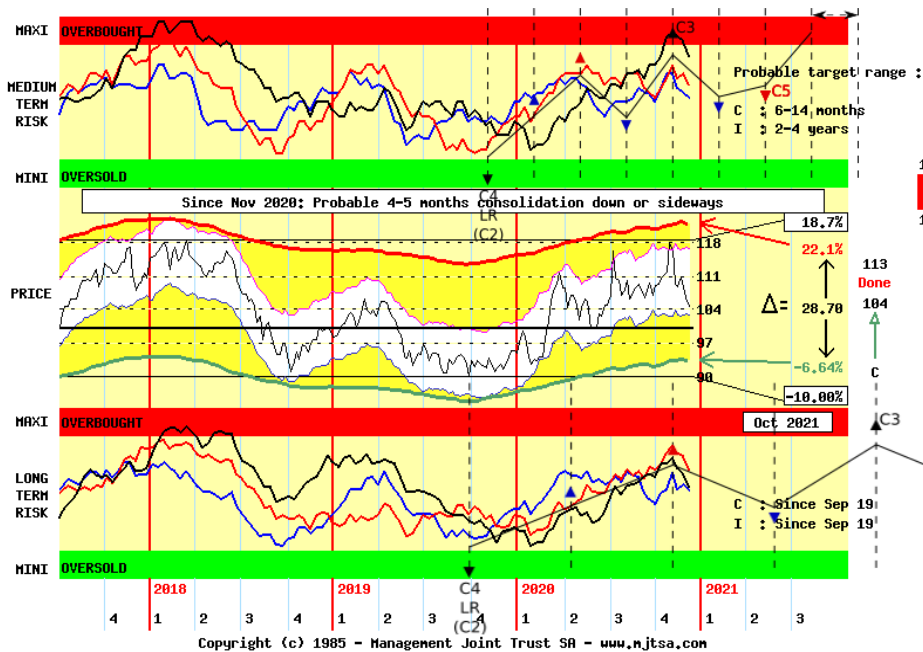


The MSCI Emerging Markets Index is showing similar dynamics than the S&P500 on this Daily graph. Here also, our long term oscillators (lower rectangle) do support further upside into mid/late Q1, while our medium term ones (upper rectangle) could make an intermediate top late this year, correct down into early January, and the rise again into late Q1. Upside targets as calculated by our I Impulsive targets to the upside (right-hand scale) still suggest interesting potential over the next few months, probably up to the mid/high

1'300s, or 5 to 7% above current levels.

MSCI China vs All Country World Index

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

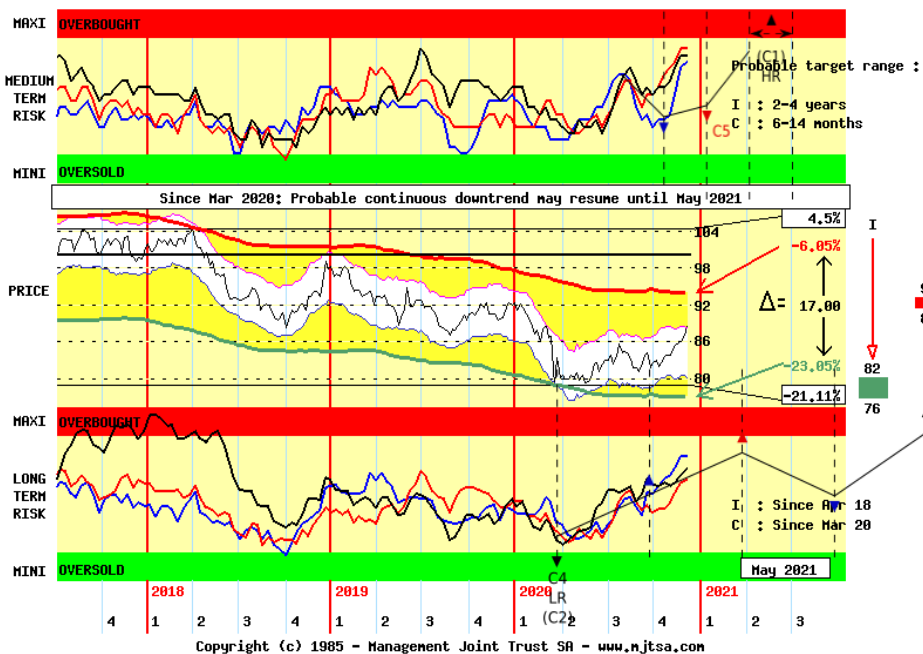


The MSCI China is in a long term uptrend vs the All Country World Index. This is what both our oscillator series are suggesting (lower and upper rectangles). Yet, **China is also very counter-cyclical and indeed since markets have reaccelerated up from late October /early November, it has been underperforming.** We expect this countertrend to find initial support towards mid Q1. The ratio should then gradually stabilize during late Q1 / early Q2, before China eventually outperforms again into late next year. Since

midyear, the ratio has been working around the resistance of the upper end of our C Corrective targets to the upside (right-hand scale). The ratio did break above these levels quite markedly during its October spike. We would hence now expect further upside potential over the next 12 months, probably towards the 127 – 139 range, or between 25 and 40% above current levels. Hence, the next few months may provide an opportunity to re-enter China, on a relative basis at least, probably from mid Q1.

Next 6 Emerging Markets (after China) vs All Country World Index

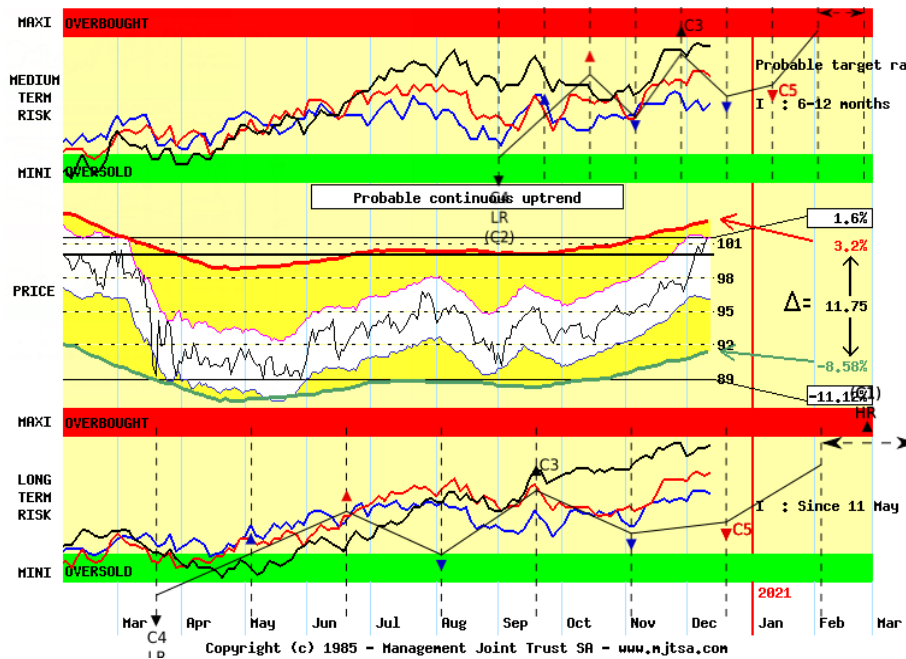
Weekly graph or the perspective over the next 2 to 4 quarters



Other large Emerging markets are more cyclical than China. In this graph, we compare a cap weighted portfolio (using the weights of the MSCI Emerging Markets index) of the six largest Emerging Markets ex China (i.e. South Korea, Taiwan, India, Brazil, South Africa and Russia). And compare it to the All Country World Index. **The ratio is in a strong recovery, which probably continues into late Q1** on both oscillator series (lower and upper rectangles). Until then, it will probably challenge the resistance of the upper end of our C Corrective targets to the upside circa 5% above current levels (i.e. 92, right-hand scale), perhaps more if these levels are broken through.

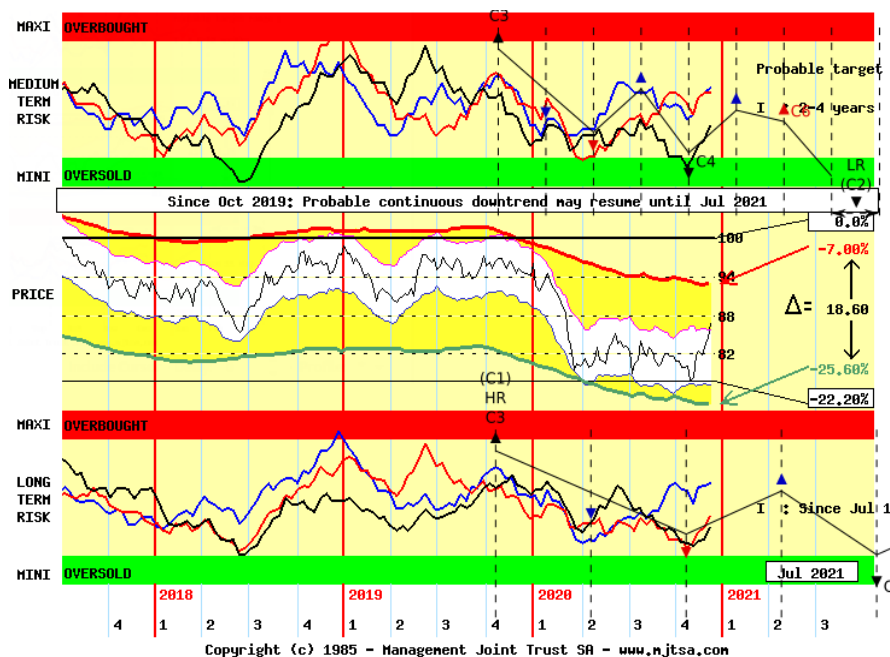
corrective targets to the upside circa 5% above current levels (i.e. 92, right-hand scale), perhaps more if these levels are broken through.

Next 6 Emerging Markets (after China) vs All Country World Index Daily graph or the perspective over the next 2 to 3 months



We consider the same ratio on a Daily basis. On our long term oscillators (lower rectangle), the uptrend is resuming higher and probably extends into February with 5 to 10% of upside potential according to our I Impulsive targets to the upside (right-hand scale). Shorter term, on our medium term oscillators (upper rectangle), we do expect some consolidation into early/ mid January (as equities markets could also retrace slightly) although the pace of the current acceleration will probably imply that this countertrend remains quite short and shallow.

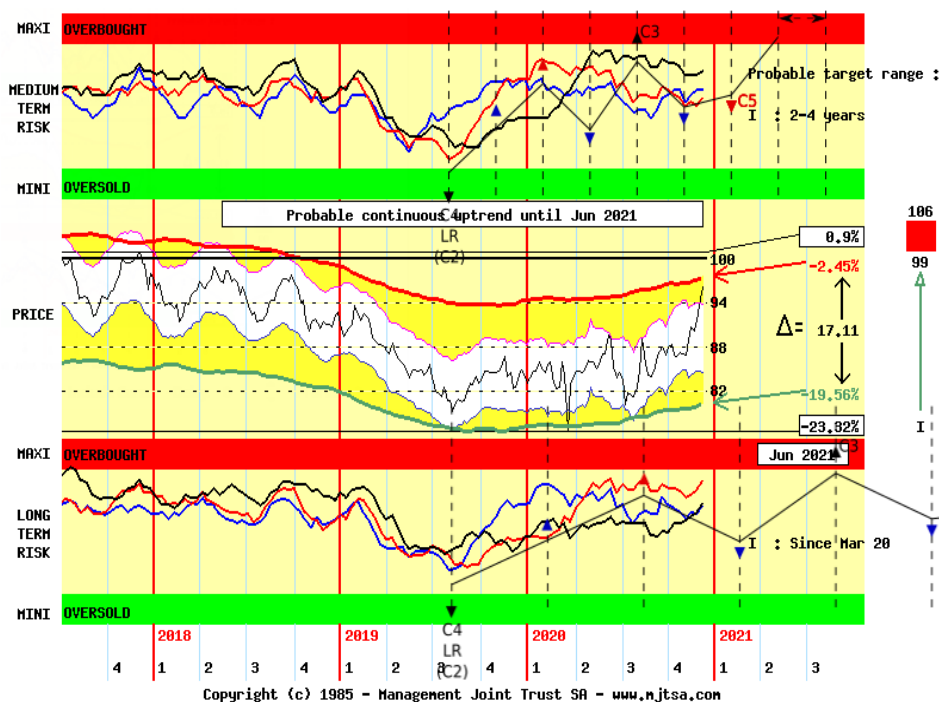
MSCI Emerging Markets vs MSCI China Index Weekly graph or the perspective over the next 2 to 4 quarters



We now compare both profiles by looking at the ratio of the MSCI Emerging Markets Index vs the MSCI China. Early Q4, both our oscillator series (lower and upper rectangles) were quite Oversold and a bottom did materialize. The bounce is well underway and according to our medium term oscillators (upper rectangle) should continue into early/ mid Q1 at least. We believe this rebound is however countertrend and then expect that during late Q1 and Q2, the ratio gradually re-

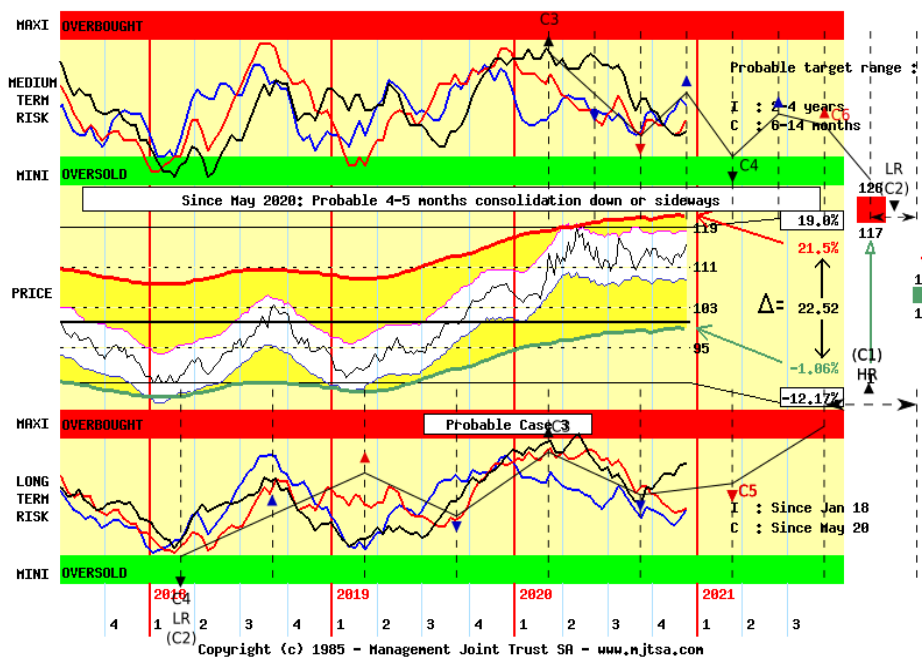
verses down. Perhaps, it could then even drop into late next year. Our I Impulsive targets to the downside (right-hand scale) are suggesting that it may then make new lows.

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



We now move on to consider the other large Emerging markets vs MSCI Emerging markets Index. South Korea does indeed look very promising on a relative basis. **The ratio is currently accelerating out of a base, and could continue to do so on both oscillator series (lower and upper rectangles) until the Spring. Our I Impulsive targets to the upside indicate that it could outperform the MSCI Emerging Markets Index by 5 to 10% by then.**

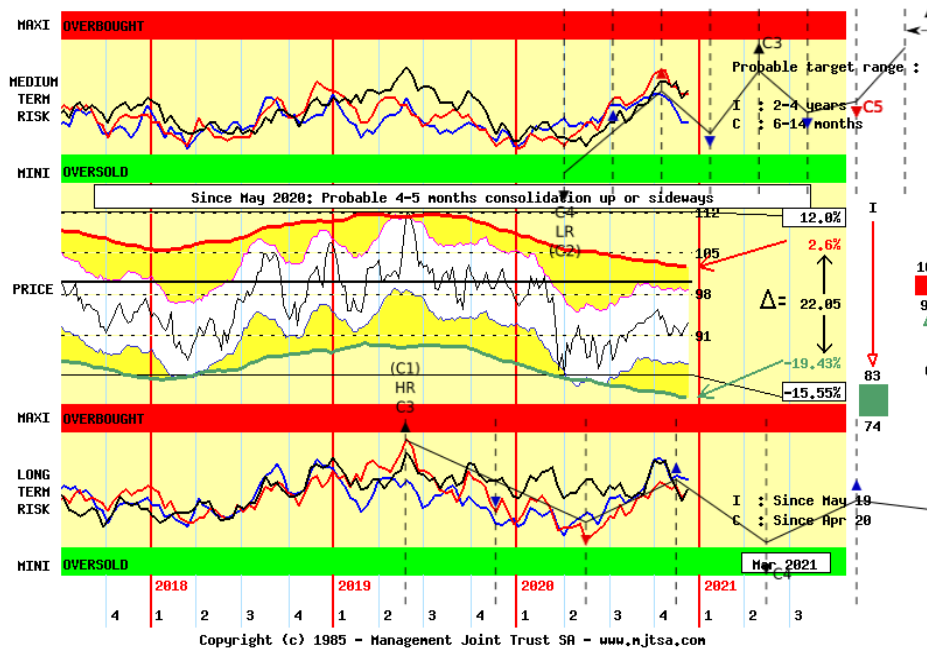
Weekly graph or the perspective over the next 2 to 4 quarters



Taiwan is traditionally more defensive than South Korea. Indeed, it did outperform other Emerging markets during the March sell-off, and since mid Q2 has been underperforming. On both oscillators series (lower and upper rectangles), **we expect its consolidation to continue probably into mid/late Q1 as more cyclical Emerging markets will probably outperform. Thereafter, the ratio could rise into the mid next year** as the environment could turn more defensive, probably making new highs. For the more risk averse investors, Taiwan may provide a way to play Emerging Markets with a more defensive profile.

MSCI India vs the MSCI Emerging Markets Index

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

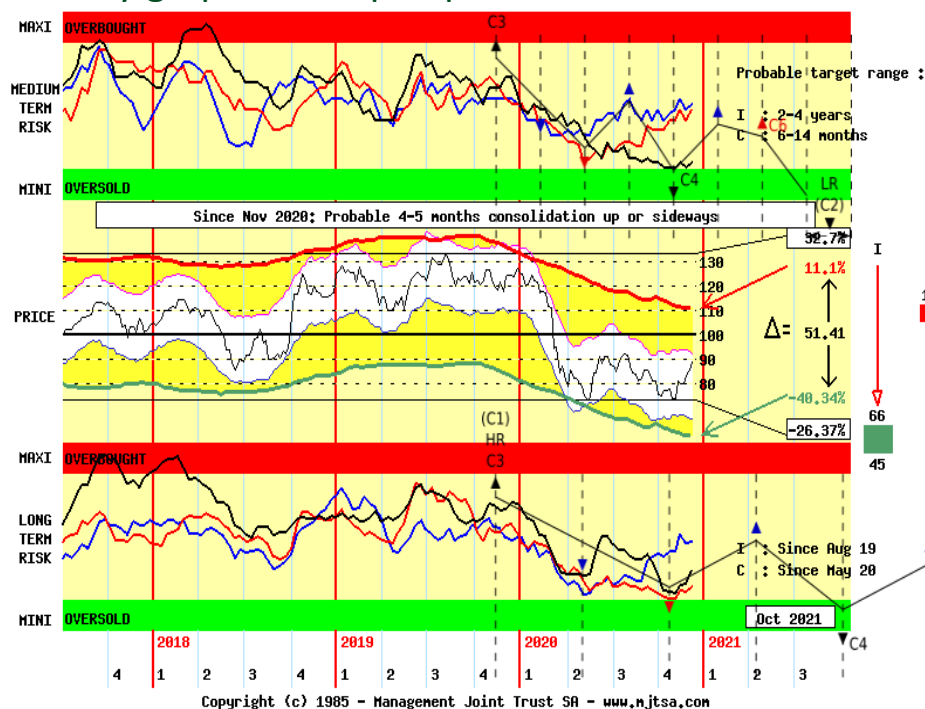


India did see a very sharp sell-off in Q1 compared to other Emerging markets. It has since recovered circa half of these losses on a relative basis vs them. Our long term oscillators (lower rectangle) suggest that the outperformance since March was just a bounce and that India could soon resume lower vs other Emerging Markets, probably into next Spring. Yet, since March, **our medium term oscillators (upper rectangle) have started to create a new uptrend sequence.** These developments are rather promising, and could

justify a reversal of trend to the upside. The sequence is currently in a correction, probably into early Q1, but we are on the look out for any strength early next year that could confirm this more positive scenario (or not).

MSCI Brazil vs the MSCI Emerging Markets Index

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

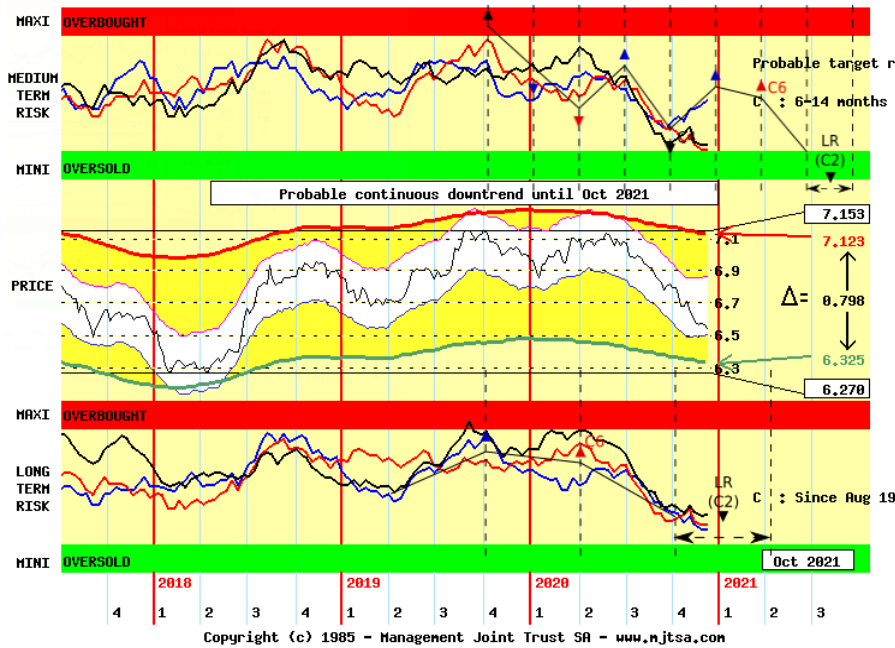


Brazil is quite cyclical. Its relative weakness from April into October and its recent bounce vs the MSCI Emerging Markets Index, does position it as a Value/High Beta play among Emerging Markets. On both oscillator series (lower and upper rectangles), the late October low did mark an intermediate bottom. On our medium term oscillators (upper rectangle), **the bounce may continue into mid Q1**, while on our long term ones (lower rectangle) it may extend into next Spring. **Following that, Brazil could then retest**

down into late next year vs other Emerging markets. Hence, given this uncertainty, we would probably consider Brazil as an interesting short term play, i.e. into mid Q1 in first instance.

USD/CNY

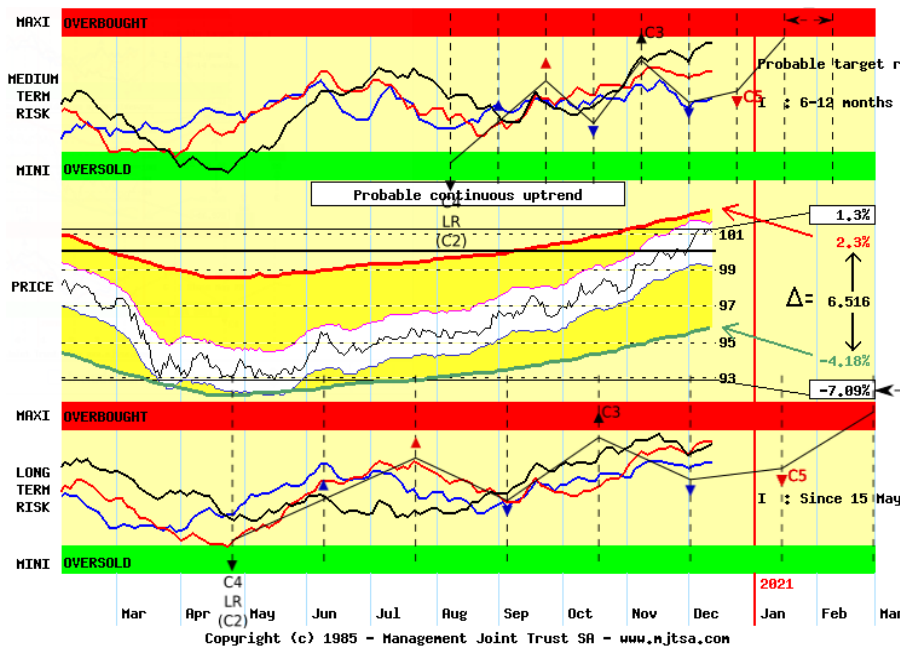
Weekly graph or the perspective over the next 2 to 4 quarters



We finish off this article by considering Emerging Markets currencies. We first turn to USD/CNY. It was one of the first US Dollar pairs to top out in late Q3 last year. Since this Spring, it has seen a strong sell-off. While the move does seem rather Oversold, and may have reached important support around 6.5 (right-hand scale), we expect that following a slight bounce into early/mid Q1, it should then continue lower into next Spring, perhaps even next Summer. We are hence still negative on USD/CNY over the next couple of quarters, and hence still bullish on China vs developed markets until then.

Next 6 EM Currencies vs US Dollar

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



We also consider the next 6 largest Emerging market currencies vs the US Dollar (a cap weighted portfolio comprising of KRW, TWD, IND, BRL, ZAR and RUB). The uptrend since the Spring has been quite dynamic. According to both oscillator series (lower and upper rectangles), it may consolidate slightly into late this year / early January, yet then continues higher into February/March with up to 4 - 5% of further upside potential (right-hand scale). This should provide further tail wind for Emerging markets ex China over the next couple of months.

Concluding remarks:

We are still positive on most equity markets into late Q1. We expect the S&P500 to reach up to the 4'000 mark, while the EuroStoxx50 could retest its February highs. Emerging Markets seem even more dynamic and could add a further 15%, despite China, which is traditionally more countercyclical and could lag (China represents circa 40% of the Index). Hence, other Emerging markets could be strong outperformer over the next couple of months. Shorter term, the current rally on both the S&P500 and the MSCI Emerging Markets could make an intermediate top just after Christmas and retrace down into early January. Both should then rise again into late Q1. Within Emerging Markets we would favor South Korea, Brazil, South Africa or Russia into mid Q1, we would then gradually shift to more defensive profiles such Taiwan and China as equity markets could start to top out towards mid/late Q1 and may then retrace into the Spring.

34 / Crude oil prices are due for another correction late in the year, but things are looking up for oil in the years ahead

The last time The Capital Observer wrote about crude oil was in September 2020. At that time, there were some supply build headwinds and we suggested marking time until those were resolved. We headlined the article, thus: **Oil supply begins to build: the expected large pullback in oil prices is happening and that may last until late October – early November.** This is what we said then:

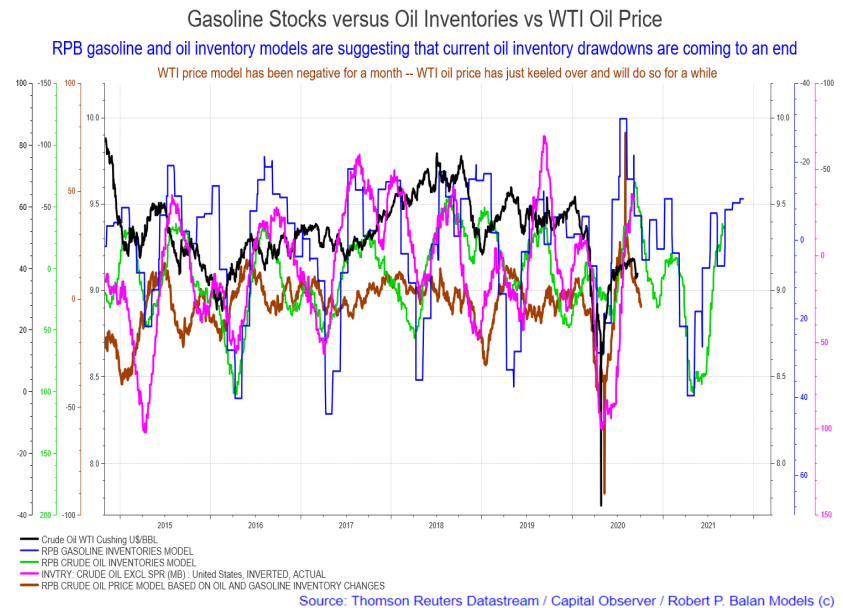
WTI price model has been negative for a month -- WTI oil price recently keeled over and will do so for a while. This suggests to us that WTI and Brent Oil prices will be under pressure from here until late October – early November (see 1st chart on this page). US oil inventories tend to start picking up in late November, but oil prices tend to front run the data, and we could oil prices start to pick up by late October – early November. That price rally may last until early February, but a downturn comes next, again anticipating a reversal of inventory withdrawals, and the start of a new cycle of inventory build-up.

From there, we do not expect a reversal of crude oil price weakness until mid-April 2021, when lower inventory trends by early May next year become clear to inventory modelers. Price could be higher going into winter of next year.

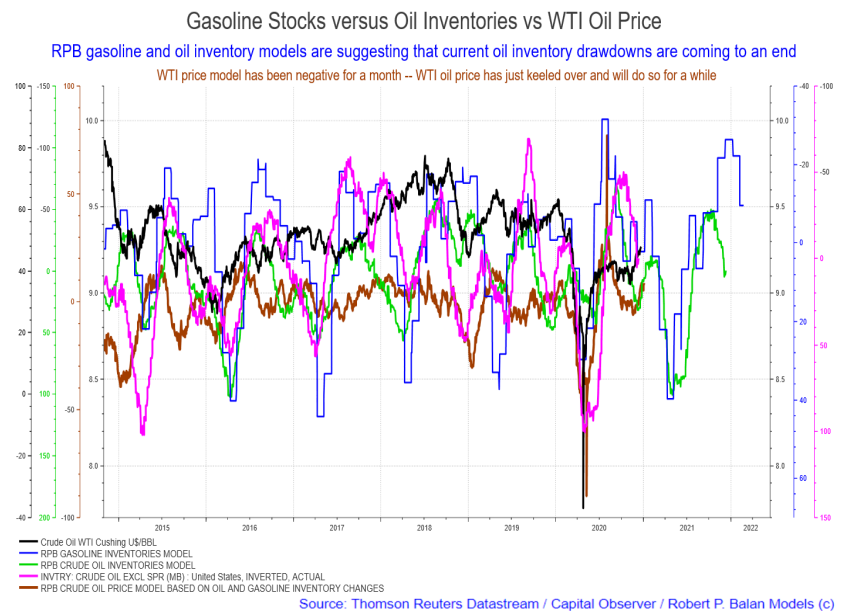
Indeed, the modelled reaction function of WTI crude oil price to US-centric gasoline and crude oil inventories is still going per the models' forecasts. But we need to apply this analytical paradigm to a global level, which we did with the 3rd graph in this page.

The global outlook near-term outlook is essentially the same as its US counterpart. We can expect several weeks more of Oil modest price gains, but the more significant feature of the two models show above is a price decline into April 2021 thereafter. Higher US and global prices are shown to manifest in Q2, but based on global

Original chart from Sept 2020 Capital Observer

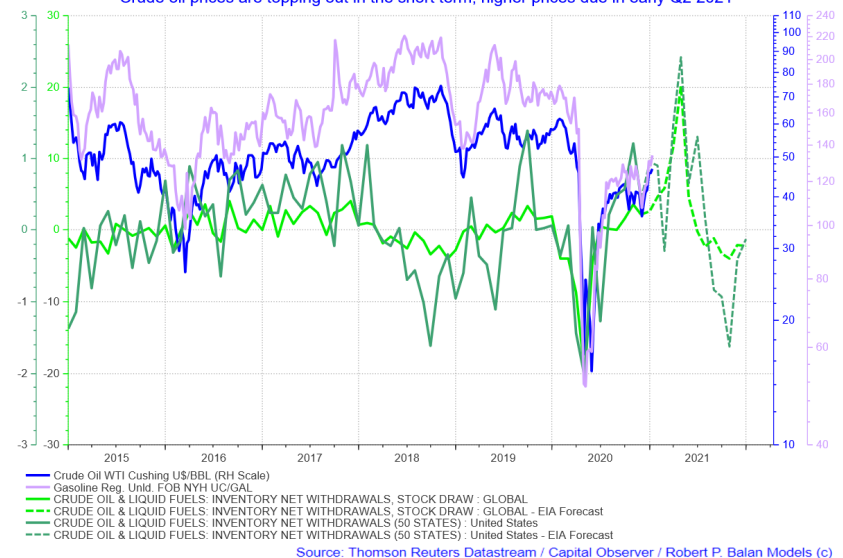


This is how the chart above looks now.



Reaction function of Crude and Gasoline to CO&LFuels inventory net withdrawals

Crude oil prices are topping out in the short term; higher prices due in early Q2 2021



outlook of CO&LF inventory withdrawals there might be trouble in H2 next year (see 3rd chart on previous page).

Near-term outlook

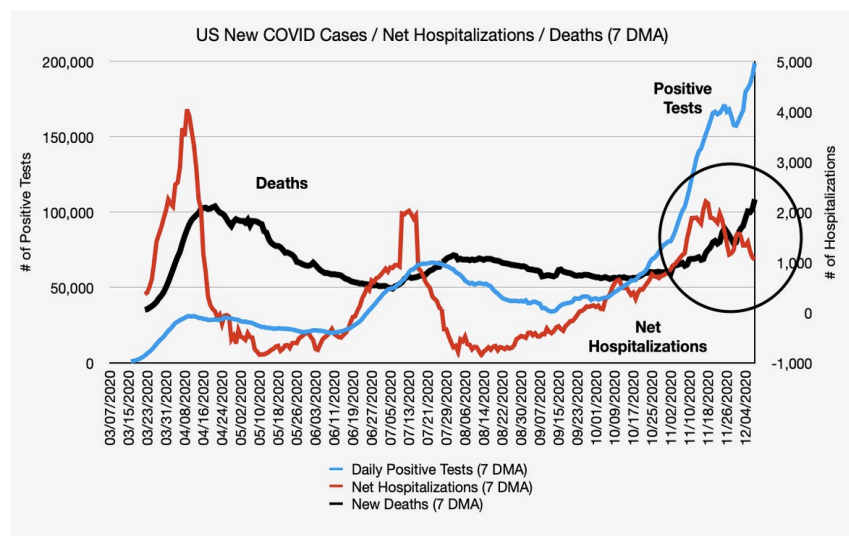
Western countries continue to suffer from rising COVID-19 case counts as renewed lockdown risks pose the biggest threat to higher oil prices in near term. **Synchronized demand recovery will be needed for oil prices to trend higher from here.**

Germany announced over the weekend that the current lockdowns will likely last into January. This alongside the rest of Europe likely remaining in lockdown territory poses the biggest risk to oil price recovery in the near term. This comes as the Pfizer vaccines are now being made available, but the oil market balance will have to assess just how much weight it wants to put on near-term oil balances versus what's coming on the horizon. The market is also trying to weigh the impact of lockdowns near term with the visibility of demand recovery on the horizon arising from the vaccine rollout.

Net hospitalizations (see 1st graph on this page), a leading indicator, have been falling which likely points to a peak in US COVID case counts over the coming weeks. This combined with the initial rollout of COVID vaccines will help with the demand outlook, albeit slow and tepid recovery still.

We can't forecast COVID-19 cases, but we can look at oil market data to see how the oil universe perceives the supply-demand situation as reflected by data. **Synchronized demand recovery will be needed for oil prices to soundly push above \$50/bbl. Consider this: despite potentially new lockdown restrictions in the US, the 3-2-1 crack spread or the proxy for refining margins is now trending higher again.**

This was very intriguing, especially considering the fact that last week saw total liquids build close to ~20 million bbls. And despite all the new lockdown announcements, oil and gasoline prices are up again, signalling to us that the market is trying to look past the near-

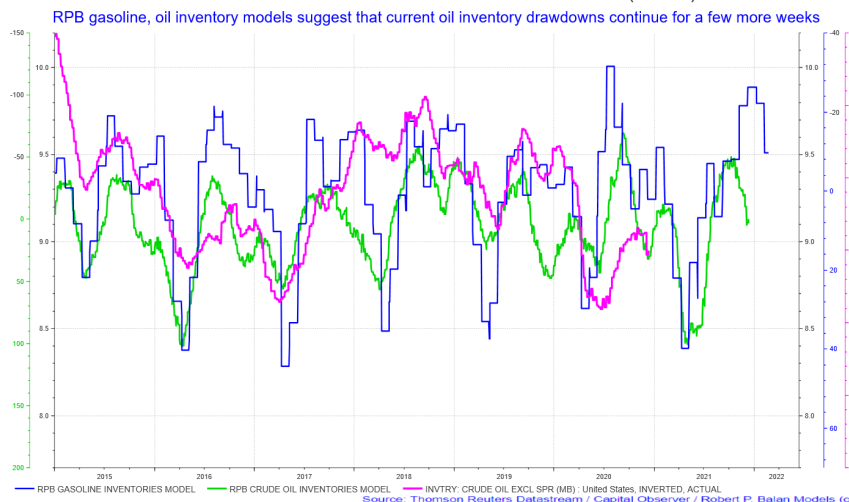


Crack Spread 321: the impact of gas consumption vs production



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

Gasoline and Oil Stocks Models vs Oil Inventories (Actual)



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

term bearish COVID-19 headlines (see 2nd chart above).

One thing that is important to note: as we enter this period of the recovery phase in demand, destocking storage will be the number 1 priority, so as demand does start to normalize in the coming months, the market will need to see storage drawdown to get comfortable with where prices are.

For the US inventory projections, last week's large crude build will prove to be one-time in nature due to imports coming in while exports were artificially low. Over the next several weeks, we see the entirety of that 15 million bbl crude build being eliminated, and more (see 3rd chart above).

Based on our models, we do see drawdown continuing until January 2021, but the year-end US crude storage figure is coming in at the top-end of our forecast range due to COVID-19 demand recovery stall. (see 1st chart on this page).

Longer-term outlook

We have been focusing on the short to near-term outlook in crude oil, but we believe we have to start looking at the energy universe post COVID-19 pandemic.

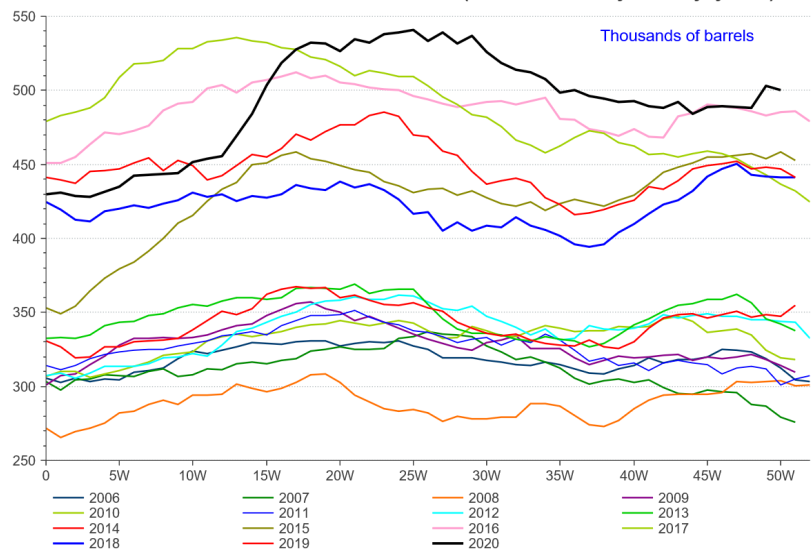
Energy is a cyclical business. The larger the swing to the downside, the larger the swing back up. Everything in business and industry moves in a cyclical pattern. And the only way for the world to avoid a future, massive energy price on the swing up is for some type of miracle invention that stops us from using oil. And as far as I know, there's nothing like that even remotely on the horizon.

Hydrogen fuel cells have been cast in that role as a saviour, but portable fuel cells (movie-style) may still be a decade away.

We mentioned this in previous issues of The Capital Observer. **Structural supply deficit will be a key theme over the coming years as the delta created by COVID will be too large to overcome.** Right now, the market is still fixated on how oil demand is impacted by the COVID pandemic, but eventually, once demand normalizes, it will look to the other side of the equation, and realize that there may be just not enough supplies to go around.

For energy investors, the 2014-2020 bear market has been incredibly brutal – that we know first-hand at the Capital Observer. But as the old adage goes, **"Low commodity prices is the cure for low commodity prices."** Our understanding of US shale and other oil market fundamentals leads us to believe that we are finally entering a **multi-year bull market**. And that may not just be in oil, but in other commodities as well.

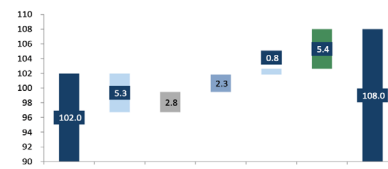
US CRUDE OIL INVENTORIES (Jan to Dec, year by year)



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

Exhibit 4: We estimate a 5.4 mln b/d call on OPEC between 2020 and 2025 to meet IEA 'current policies' demand forecasts...

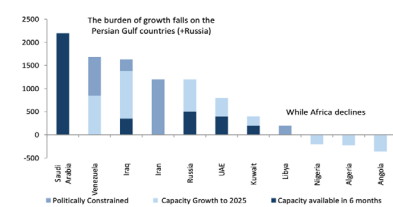
Key variables in the global supply and demand forecast out to 2025 (mln b/d)



Source: IEA, Goldman Sachs Global Investment Research

Exhibit 5: ...which would utilize most of OPEC+ current 3.7mln b/d of capacity, 2.5mln politically constrained and planned growth of 2.4mln b/d to 2025

OPEC + Russia spare capacity in kb/d by date of availability



Source: IEA, Goldman Sachs Global Investment Research

This eventuality has been long in coming.

Consider this: In October 2019, Goldman Sachs published a report titled, **"The End of Non-OPEC Growth."** At the end of 2019, Goldman expected US shale to grow another ~1 mb/d in 2020. Instead, we have decreased by ~2 mb/d. This creates a delta of ~3 mb/d versus the original forecast. (see 2nd graph above)

And using this forecast, the call on OPEC then was 5.4 mb/d by 2025, which was a figure unachievable. So now you have to add an additional ~3 mb/d to that figure from just the US alone.

Therefore, if we rewind, look at the oil market balance at the end of 2019 and project out global oil supplies, we were still in a supply crunch even with the US producing ~12.8 mb/d.

Now? The outlook suggests an even worse supply crunch on the horizon.

Every one of those Goldman key points in 2019 saw their impact magnified due to COVID-19 in 2020. The decrease in US shale versus the projected increase. The scrutiny on reserved-based lending and the inability to access capital. The oil majors curtailing capex in shale regions and projecting no growth for the incoming years. The shale treadmill resulting in material declines in the production base. And finally, the massive capex cuts resulting in international activity to drop to historic lows.

All of these things are magnifying the oil bull thesis. The price gains after October have been very comforting and reassuring – but don't miss the forest for the trees. The central themes we've talked about in October remain true. There will be a crude oil (and a commodity boom) in the years ahead.

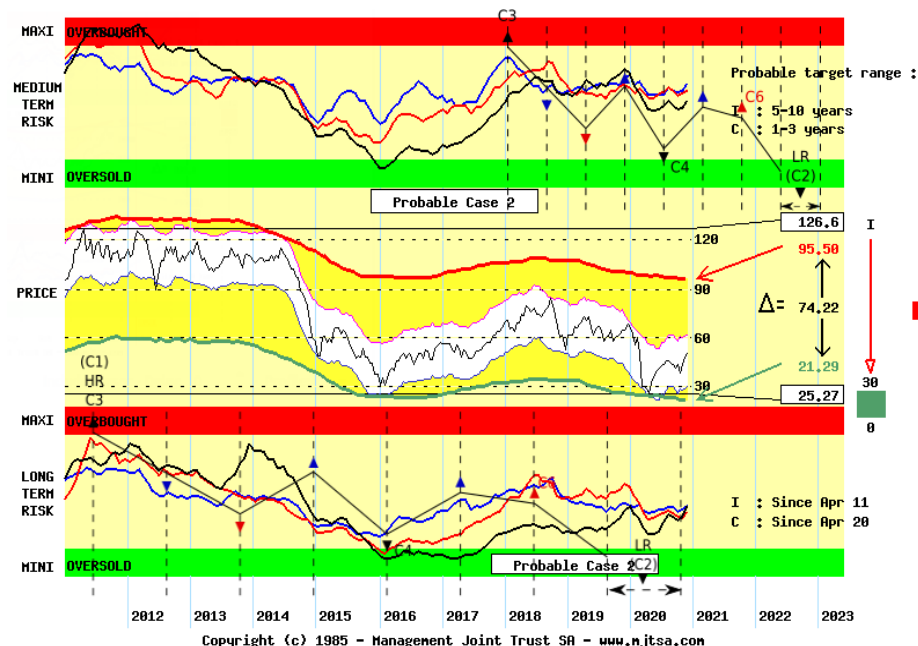
37 / MJT - TIMING AND TACTICAL INSIGHT

Oil – the Recovery continues into mid/late Q1

Last month Oil broke out above the resistance of our Daily Corrective targets to the upside and is now back in an impulsive uptrend with targets towards 60 USD/barrel on Brent over the next few months. The move was fueled by hopes of economic recovery as several vaccine candidates had been announced. Going forward, vaccine and recovery news will probably be offset by the lockdowns which are currently been planned in the US and Europe over the Christmas Holidays and perhaps still during large parts of Q1. Under these circumstances, which still requires a leap of faith, we will review Oil, related Trades and the Energy sector's relative performance.

Brent Oil (USD/barrel)

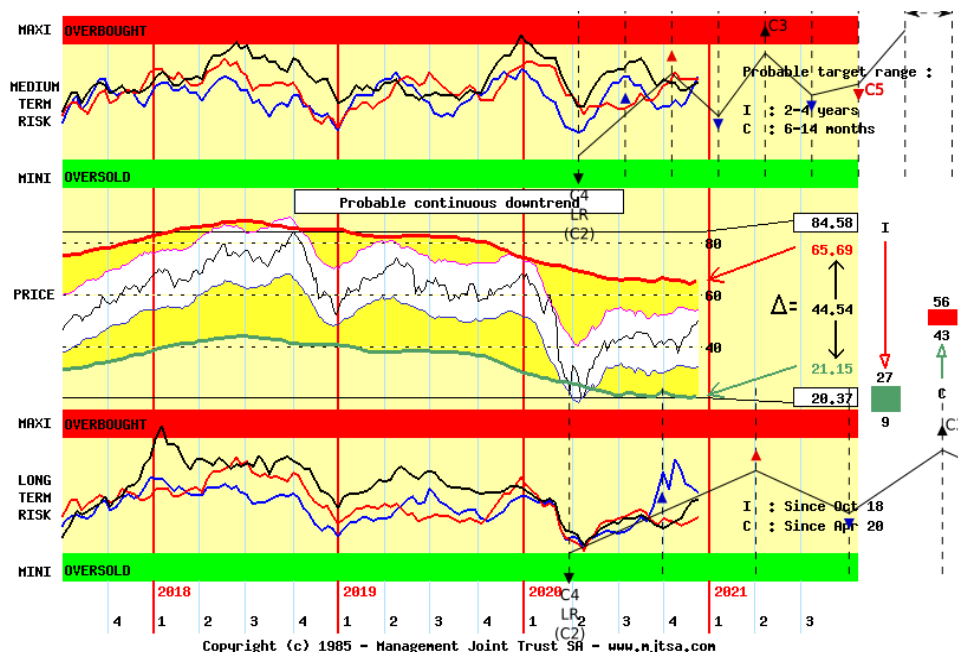
Bi-monthly graph or the perspective over the next 1 to 2 years



Oil did reach a Low Risk position on our long term oscillators (lower rectangle) last April. It has since been bouncing strongly. Usually, such Low Risk situations can trigger 1 to 2 years of correction to the upside at least. On our medium term oscillators (upper rectangle), it is too early for now to call for a full upside reversal, yet **the current bounce should last into mid/late Q1 at least. Corrective targets to the upside over the next few quarters would justify that Brent could make it back to the 62 – 85 USD/barrel range, i.e. the long term upside reversal is still uncertain, yet, the Low Risk situation on our long term oscillators is very promising.**

Brent Oil

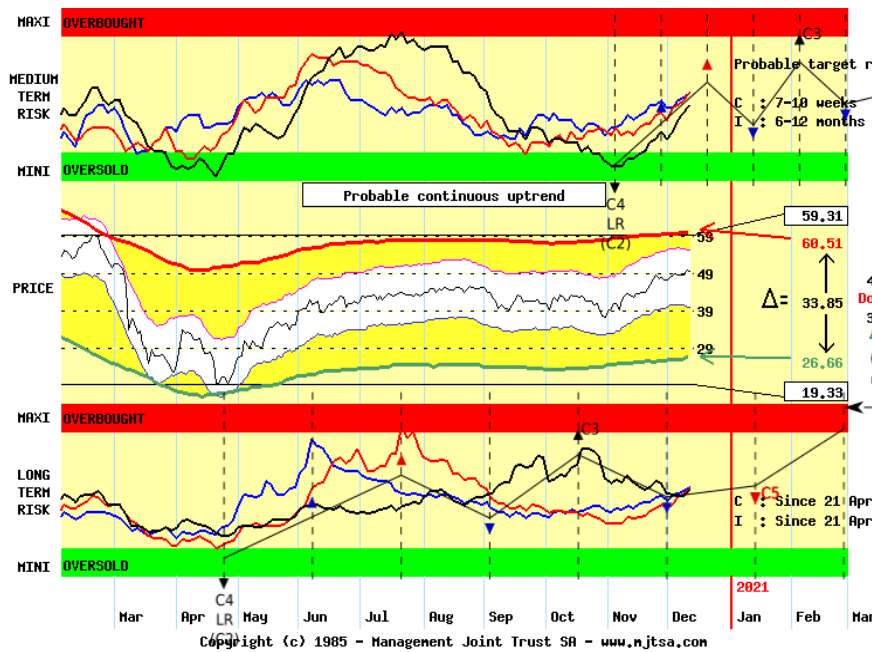
Weekly graph or the perspective over the next 2 to 4 quarters



On the Weekly graph, Brent has now reached our C Corrective targets to the upside (right-hand scale). A break above these levels (i.e. above 56 USD/barrel) would then confirm **further upside into the Spring, probably into the 60s USD/barrel.** In the meantime, the sequence we show on our medium term oscillators (upper rectangle) may still suggest some retracement into early Q1, before a resume uptrend situation is confirmed. Both oscillator series (lower and upper rectangles) then indicate **a continuation of the uptrend into late Q1 / early Q2 next year. The Spring could then see some retracement.**

Brent Oil (USD/barrel)

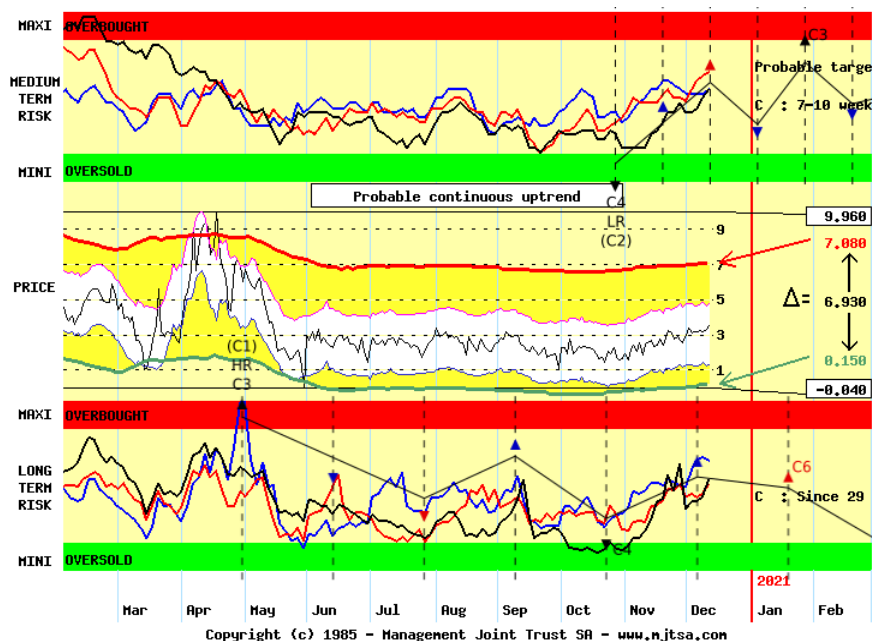
Daily graph or the perspective over the next 2 to 3 months



Brent broke above the resistance of the upper end of our C Corrective targets to the upside last month (i.e. above 46 USD/barrel, right-hand scale). It is now eyeing our I Impulsive targets to the upside over the next few months. These point to the 63 – 77 USD/barrel range. Both oscillator series (lower and upper rectangles) are now uptrending, probably until February and perhaps even into March. In the meantime, a short countertrend may materialize from late this year to early January on our medium term oscillators (upper rectangle).

Brent to WTI spread

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

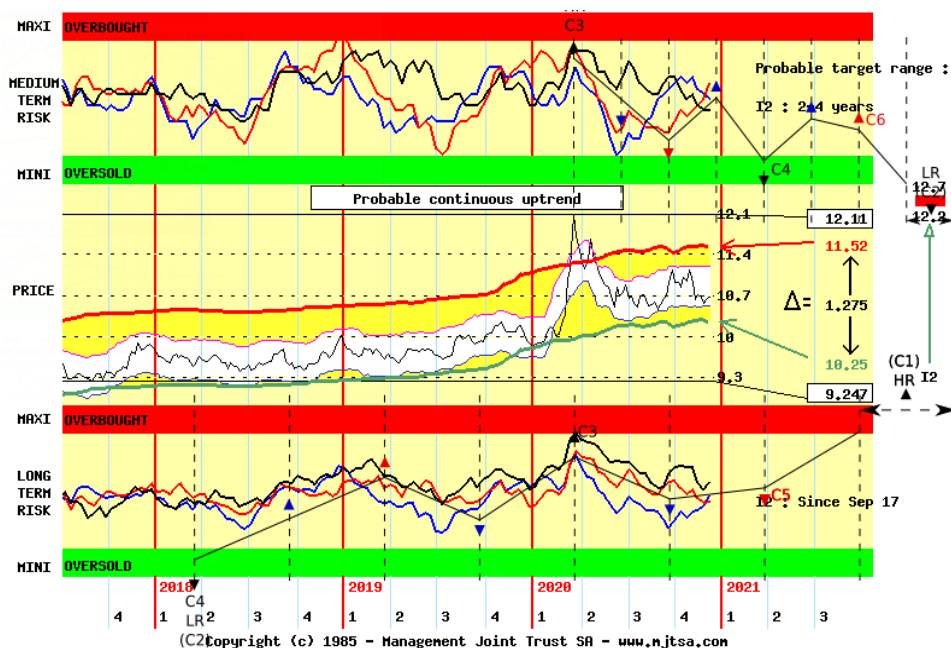


The Brent to WTI spread is in recovery mode suggesting a tighter international market. Chinese demand for Brent may be fueling this rise. The relation between the spread and Oil prices is rather shaky, yet since early November, the rise in the spread has accompanied a strong resume uptrend situation for both Brent and WTI. We will hence consider the spread to be positively correlated to Oil prices in the near future. As with Brent above, we believe it may be approaching an intermediate top. We cannot exclude that it could be

the beginning of a reversal to the downside (as show on our long term oscillators – lower rectangle), but would favor the more positive outcome shown on our medium term oscillators (upper rectangle), where **the spread probably retraces into early January with Brent and WTI, and then rises into February / March.** It may be interesting to note than during the 2016 – 2017 reflationary recovery, the spread was positively correlated to rising Oil prices.

EUR/NOK

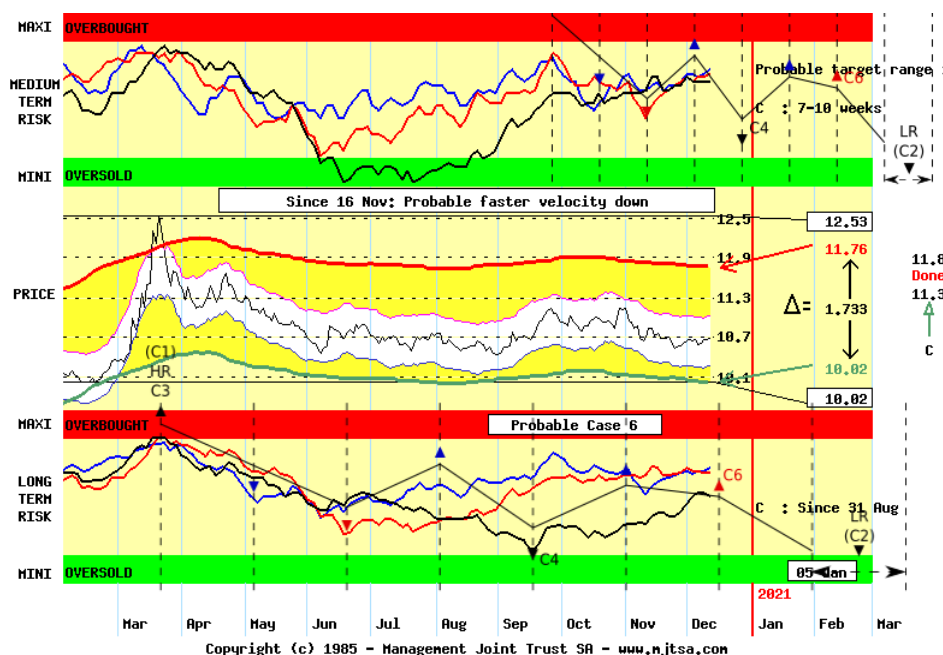
Weekly graph or the perspective over the next 2 to 4 quarters



Seeking confirmation for this positive view on Oil prices, we turn to the currency market and the EUR/NOK exchange rate. Indeed, the pair is usually inversely correlated to Oil prices given that the EuroZone is a net importer of Oil, while Oil is Norway's strongest exporting industry. Since March, the pair has come down as most Major currencies have underperformed more cyclical ones. It did bounce between September and October as risk assets and Oil consolidated, but has since been resuming lower. **We expect it to continue to do so on both oscillator series (lower and upper rectangles), probably into late Q1. These dynamics should provide a bullish confirmation for Oil prices.**

EUR/NOK

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

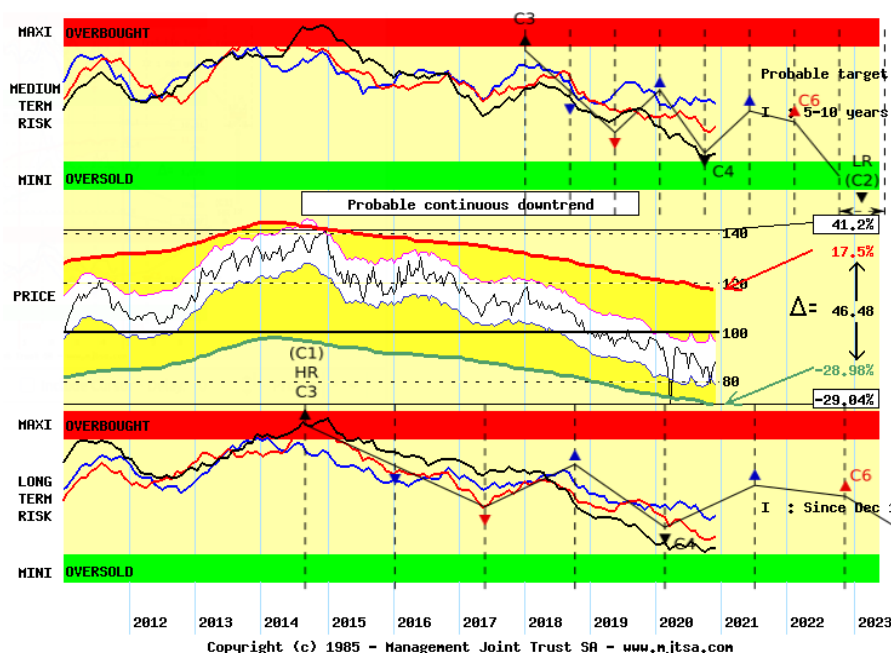


On the Daily graph, it is clearer to see how the pair follows risk-ON / risk-OFF periods in reverse. It was indeed, weakening into the early June cyclical spike and just recently, since early November. Inversely it had strengthened during the March sell-off, the mid/late June retrace period or as already mentioned above, during the September and October market consolidation period. Both oscillator series (lower and upper rectangles) confirm that it probably **continues lower into February, perhaps March**. In the meantime, a short countertrend

may materialize late December / early January on our medium term oscillators (upper rectangle). **Downside targets we can calculate for the pair over the next few months are towards the 10.3 – 9.6 target range** (1.3 to 1.7 times our historical volatility measure "Delta", here at 1.733 – middle rectangle, right-hand side – subtracted from the graph's highest point at 12.53), **or another 4 to potentially 11% below current levels. This is quite compelling.**

S&P US Energy sector index vs the Europe Stoxx Energy sector (currency hedged ratio)

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

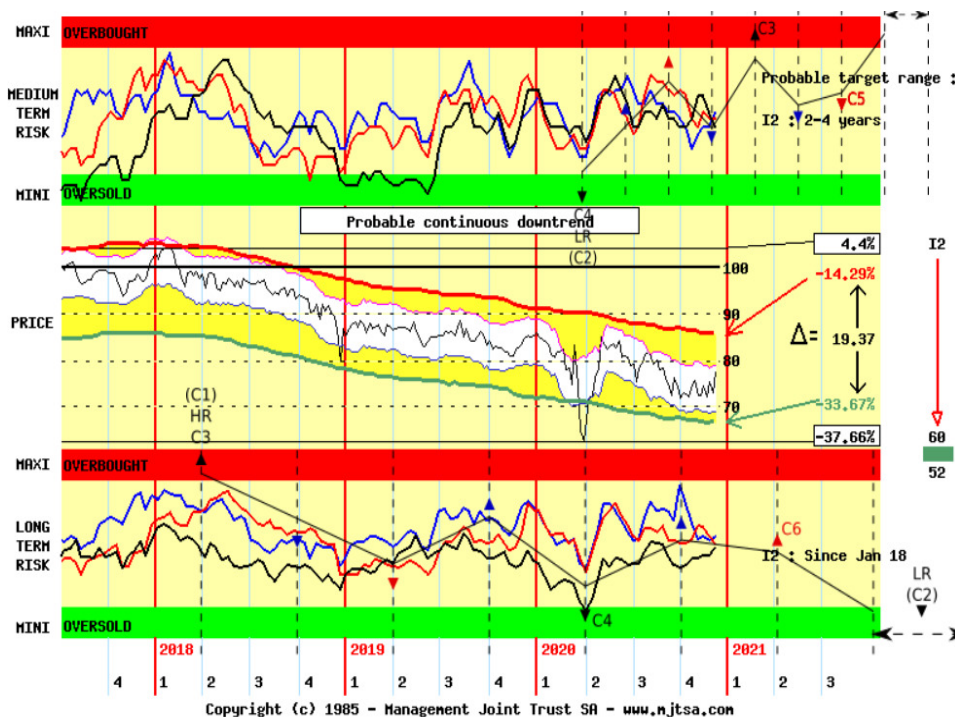


We now turn to the Energy sector and first to a comparison of the US vs the European Energy sector on a hedged currency basis. Indeed, the ratio is a good proxy to capture any Value bounce in the Energy sector, which usually translates into a stronger performance by US Energy stocks. Indeed, the US index is more focused on pure play exploration and production Oil companies, while Europe's Energy sector mostly features large integrated Oil Majors. Since March, the ratio

has been bouncing. It did retest down into late October with most Value plays, and has since been attempting to bounce again. According to both oscillator series (lower and upper rectangles), the Value/Energy sector bounce may hold up into the Spring, perhaps even into H2 2021.

S&P US Energy sector index vs the Europe Stoxx Energy sector (currency hedged ratio)

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

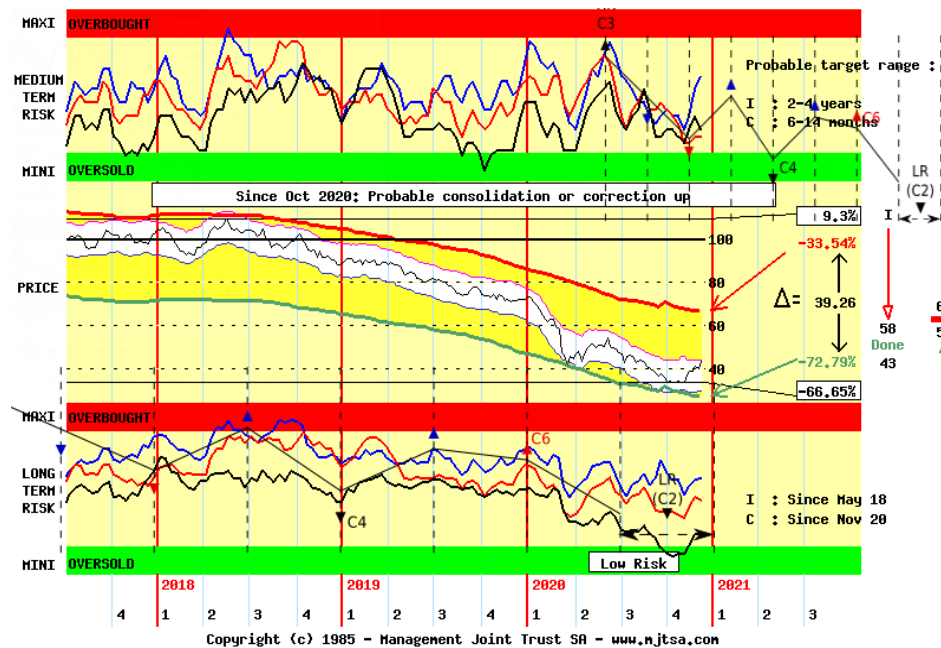


We now focus on the Weekly graph of this ratio to refine the timing of this bounce. On our long term oscillators (lower rectangle) we are still in a persistent downtrend, yet the ratio could hold up until late Q1 before resuming lower again. On our medium oscillators (upper rectangle), we are considering the bounce since March as a possible uptrend. According to this sequence, the ratio potentially rises into mid Q1, then retraces during the Spring and could then see a further period of strength into H2 2021. If so, it would imply that Energy and more generally Value plays could

continue higher over the next couple of months, then retrace into late Q2, but then bounce again later next year. Note: during such bullish periods, it is worth overweighting US Energy plays vs European ones, yet investors would probably want to hedge the US Dollar as it is currently inversely correlated to Oil and the Energy sector.

S&P US Energy sector index vs the S&P500 index

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

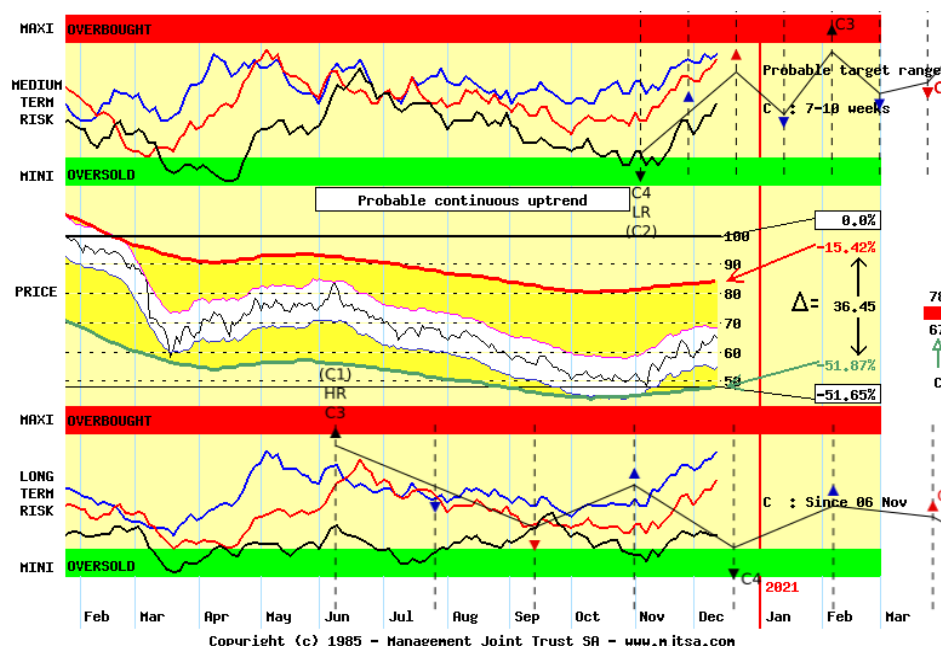


We now consider the more classic relative ratio of the US Energy sector vs the S&P500 Index. On our long term oscillators (lower rectangle), it has reached a Low Risk position, a situation that usually results in 6 to 12 months of counter-trend, and in some cases even in a reversal of the trend. **The sequence we show on our medium term oscillators (upper rectangle) is more negative as it implies that the current bounce probably dies out towards mid Q1, that the**

ratio then retests down into the Spring, before eventually bouncing again with lower highs during H2 next year. For now, we would probably go with this more prudent scenario.

S&P US Energy sector index vs the S&P500 index

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

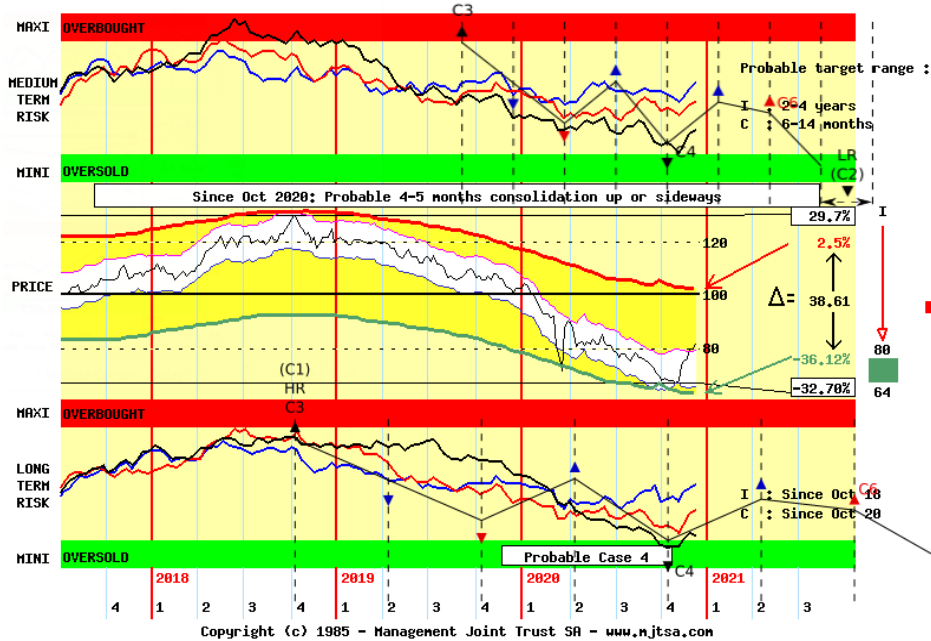


On the Daily graph, the initial sequence up to mid Q1 (i.e. into February) is shown on our medium term oscillators (upper rectangle). It could see a slight period of retracement over the next few weeks, and from early/mid January should then rise again into early / mid February. Upside potential for this corrective move is probably towards the resistance of the upper end of our C Corrective targets to the upside around 78 or circa 10% above current levels for US Energy vs

the S&P500. This is positive, although it does imply that most of this Value bounce is probably behind us. Our long term oscillators (lower rectangle) do also feature a further bounce into February and then possibly a gradual roll-over situation during late Q1 ending with a drop into Q2.

European Energy sector vs the Europe Stoxx 600 Index

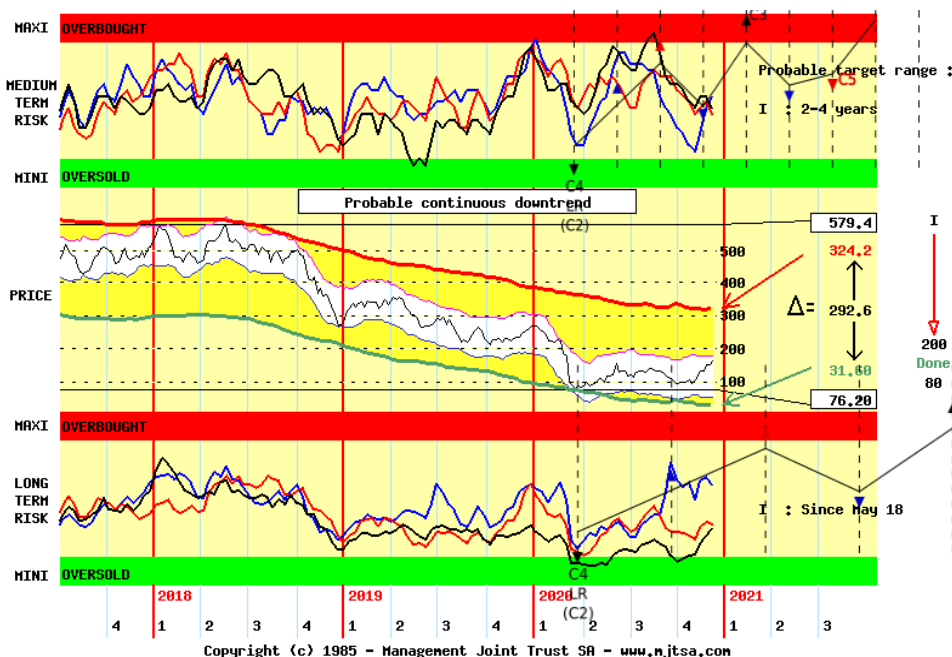
Weekly graph or the perspective over the next 2 to 4 quarters



Considering Europe, the ratio of the European Energy Sector vs the Europe Stoxx 600 may have also made an important intermediate low on our long term oscillators (lower rectangle). It may suggest a bounce that continues into the Spring and then perhaps another bounce during the Summer. Yet, for now, we would probably remain rather risk averse on this relative trade and favor the sequence shown on our medium term oscillators (upper rectangle). It suggests that the Europe Energy sector could continue to bounce vs the Europe Stoxx 600 into late January / February, but than it then probably starts to roll over again.

US Oil Services

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



We finally focus on Oil Services the deeper value segment of the US Energy sector (OIH ETF) on an absolute basis. The rebound since March has been quite compelling (up 140%), yet still pales in comparison with the drop down from Spring 2018 (i.e. a more than 85% drop). On both oscillator series (lower and upper rectangles), we expect the bounce to continue, probably into mid Q1 at least. Initial upside targets we can calculate are around 220 or towards the lower end of our C Corrective targets to the upside (0.5 times our historical volatility measure "Delta", here at 292.6 – middle rectangle, right-hand side – added to the lowest point of the graph at 76.2). This

is potentially another 35% above current levels, though, as with other Energy plays, we would probably wait for some retracement into early January. Thereafter, we would expect a downside retest into the Spring, and perhaps another bounce later on, towards the end of next year.

Concluding remarks:

Oil may have made a secular low in April. Shorter term, it is now back in an impulsive uptrend on our Daily graph as it recently broke above resistance around 46 USD/barrel on Brent. We would expect some retracement of the recent rally into early January, perhaps back to the high 40s on Brent, and then a further leg up into February, perhaps even into late Q1. Upside targets do point to levels around 60 USD/barrel until then. Thereafter, Oil could correct down into the Spring. Since early November, the Energy sector has also been bouncing quite aggressively along with most Value plays. We expect this bounce to extend into mid Q1 (late January / February) before starting to roll over again and then reverse down into the Spring. This scenario is similar to the one we have on US long term yields. H2 next year could then see another bounce.

43 / The precious metal may consolidate a bit more but by early January 2020, gold presents a tremendous buying opportunity

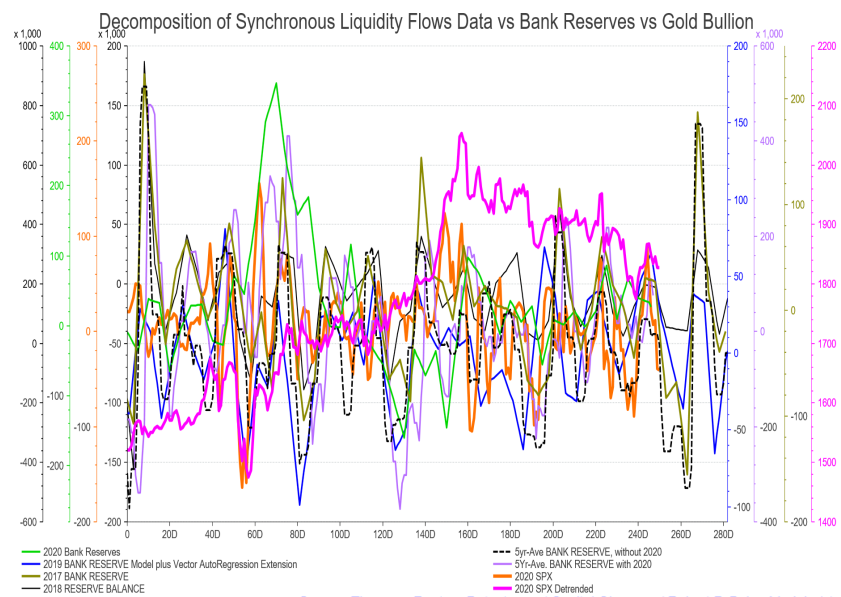
The last time we wrote about Gold was in October 2020, when we headlined at that month's Capital Observer: **Gold's fundamentals and primary price factors show some crosscurrents for Q4 but improve thereafter.** We explained then:

Gold has been falling since early August, something that promoters of the yellow metal has been unable to explain. That decline has happened despite the rise in COVID-19 in Europe and elsewhere, as well as the threat of a "contested election" in the US presidential races within a month or so. That decline has taken hold despite spotty employment prospects of the US labor force. In much of this situation, that gold price decline has been due to the fundamentals of gold, and its relationship with interest rates and the US Dollar.

Gold is also negatively correlated with long bond yields (10yr yield as proxy). We also expect long term yields to rise over the course of Q4 2020 for various reasons, one primary factor being good Q3 GDP numbers to be released in late October. With GDP rising, rates should rise, as well as the US Dollar. Gold does not fare very well in that environment.

Gold price changes are driven, in the short-term, by changes in liquidity flows, especially those coming from the US Bank Reserves under the safekeeping of the Federal Reserve, popularly known as BRs. Those BRs fall, historically speaking, fall going into year-end. That's why we expect systemic weakness in gold prices, going into the end of the year.

It's the end of the year, in two weeks. And gold has been struggling since the middle of October, as we saw it then. And changes in the current (2020) data on Bank Reserves have not deviated much from historical seasonality –



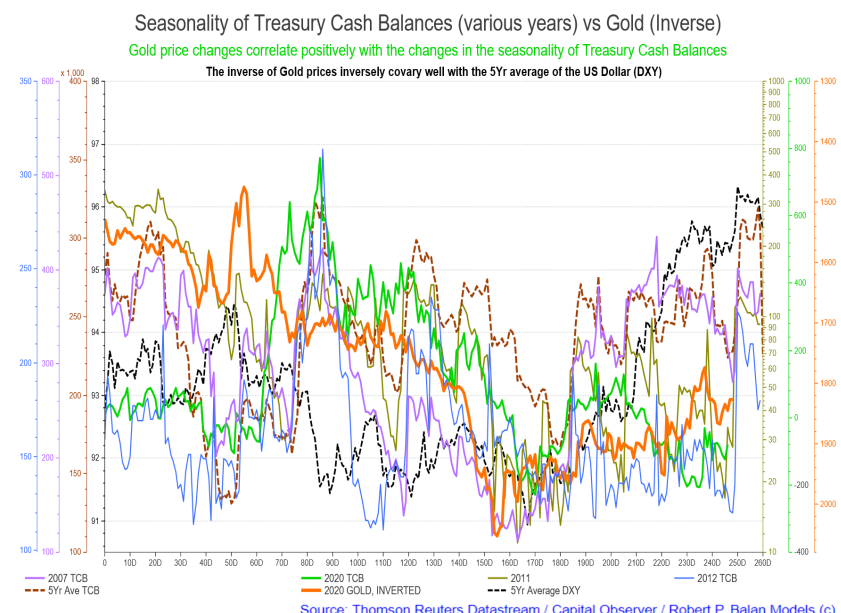
Source: Thomson Reuters Datastream / Capital Observer / Robert P. Balan Models (c)

hence we still expect Gold Bullion prices to still consolidate, along with equities -- Gold and equities have been correlating positively in recent days. **In fact, Gold and equities may bottom together sometime in early January 2021 (see graph above).**

The timing of this prospective trough is also corroborated by the counterpart of Bank Reserves in the Fed's asset and liabilities spreadsheet – the Treasury Cash Balance (TCB) – BRs being the asset, and TCB the liability. The BRs and TCB have a yin-yang relationship – their general trend

goes towards the same direction, but the high frequency fluctuations have opposite polarities.

We see TCB seasonality as normally rising into year-end, and the current 2020 TCB data is no exception – it has been keeping pace with historical TCB seasonality, so there is no reason that this year will see deviations of 2020 data and years prior. Rising TCB Also suggests weaker Gold until the year end at least, (see chart below). To add further vectors to the analysis, we also added the 5-yr average of the US Dollar (DXY), and true enough



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

– DXY seasonality also rises through to the year-end.

Gold weakness which started in October has been partly caused by pressure from previously rising bond yields. The yield on the 10-year Treasury has been on the upswing (until two weeks ago), and as we have explained a number of times before, this can have a huge impact on the direction of gold prices. **Gold hit its all-time high of nearly \$2,070 an ounce on August 6, when the 10-year yield traded as low as 0.5%.** Remember, this is the nominal yield. That can be easily shown by a simple regression study (see 1st graph on this page).

Gold bullion prices also have distinct seasonality. Gold experiences seasonal weakness between in September and typically ending in December. **November has been the weakest month for gold over the past five years.** There are a few reasons for this weakness. Firstly, the weakness is typically associated with the beginning of the Indian wedding season. Jewelers typically stock up on their gold going into the wedding season and sell into the event.

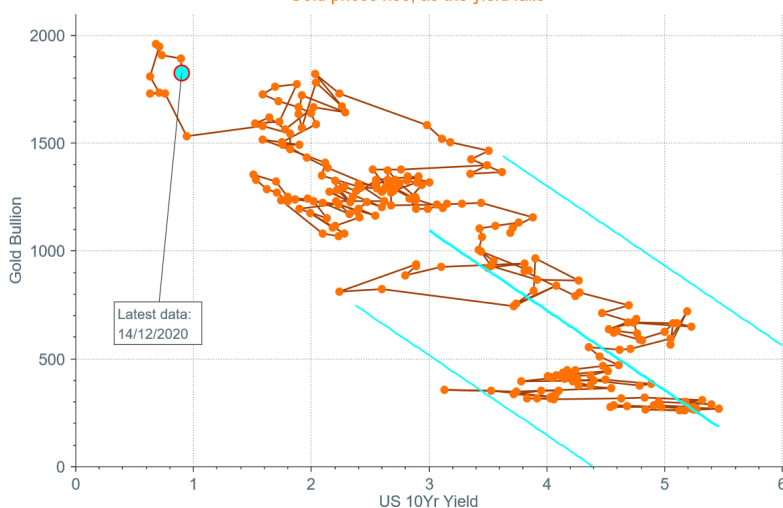
Historically, broader equities enter a period of seasonal strength in December, which is associated with a decline in volatility (VIX). Gold prices have a positive correlation with equity volatility. Naturally a decline in equity volatility also produces transitional weakness in gold. **However, that relationship and seasonality have changed since August this year to the current period (see 2nd graph on this page).**

As the graph above shows, Gold and volatility have become **negatively** correlated; hence gold and equities took on a positive covariance. With volatility (VIX). If equities fall in December (as we expect), then VIX should rise, and Gold prices should fall. **Therefore, we take it as a given that Gold prices may consolidate until early January 2021.**

But what could change the trend

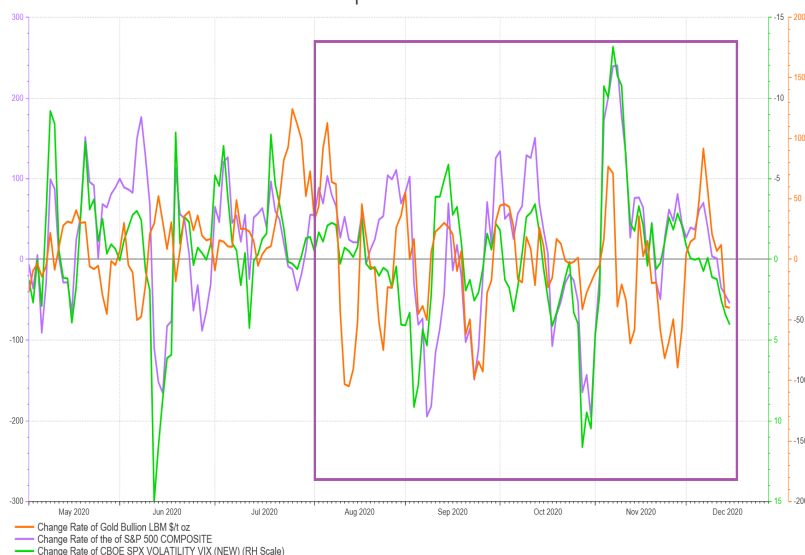
The negative correlation between 10yr yield and Gold price

Gold prices rise, as the yield falls



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

Numerical Decomposition of SPX vs VIX vs Gold



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

for the yellow metal next year?

There are several factors. **One of them is the almost certainty that bond yields will not be rising anytime soon. Why?**

Treasury Secretary-designate Janet Yellen will unleash \$1.3 trillion in new debt issuance in 2021 alone. It never ceases to amaze us how some economists and pundits say that will push interest rates to the moon casually without any shred of justification, or evidence (often both). The reality is that if the Biden government unleashes that much (in a year), bond yields will collapse (especially at the front end). Look at it from the demand side (with the Fed buying most of it) -- not the supply: there is no way "bond

vigilantes" will be able to remonstrate all that issuance, and push rates higher. The days of these vigilantes ended in November 2008 when the Fed started Quantitative Easing. We can easily show those relationships as well (see 1st graph on the next page).

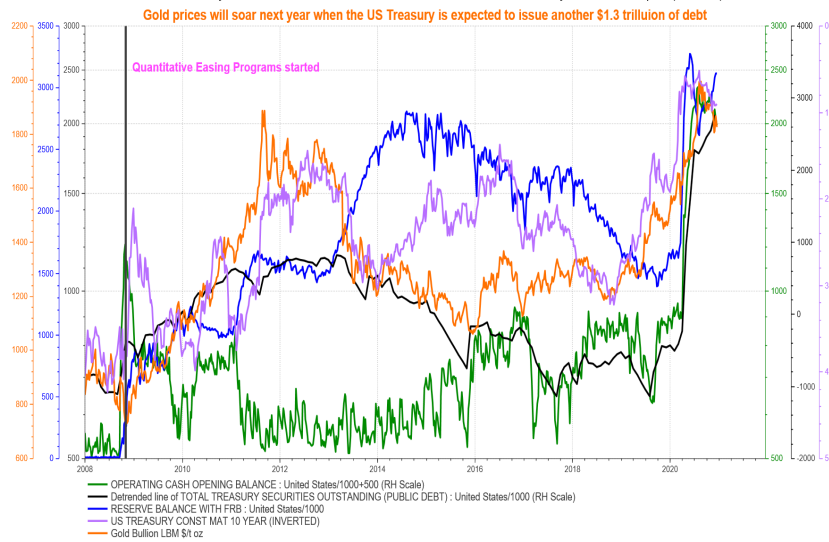
Gold prices will soar next year when the US Treasury is expected to issue another \$1.3 trillion of debt. If the Biden government issues more, we could see US front rates going negative, and gold will soar even higher.

Then there is also the subject of likely “double-dip” recession next year. It is being flagged by the Citit US Economic Surprise Index. If GDP falls sharply, then bond yields will also fall, and Gold prices will soar (see 2nd chart on this page).

Summary:

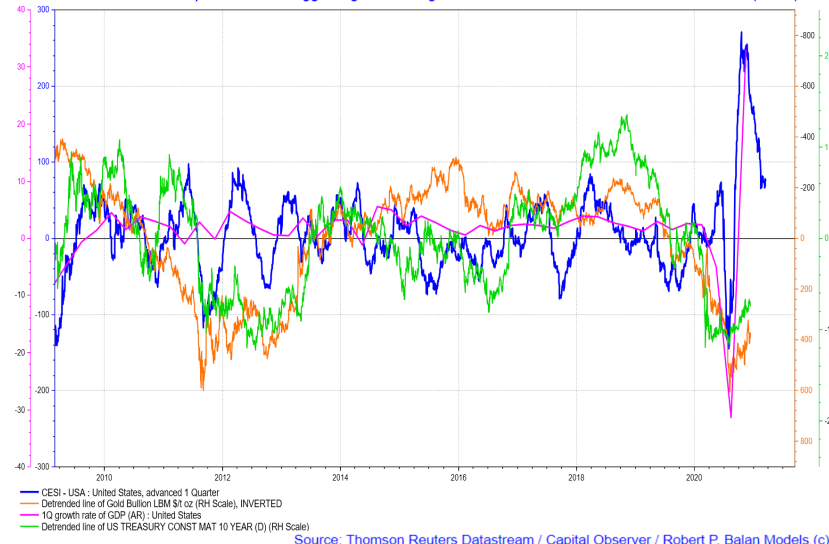
We expect further short-term struggle in Gold prices, as per our October outlook, likely until early January 2020. But the longerterm prospects of gold are very bright. Therefore, gold investors should only hunker down a little bit longer, and by early next year, we will be presented with a tremendous buying opportunity. Stay tuned to The Capital Observer for our next gold update.

US Total Debt (Debt Issuance) vs. Treasury Cash Balance, Bank Reserves vs 10Yr and 2Yr Yields
If the US Treasury issues new debt to the tune of \$1.3 trillion in 2021, bond yields will collapse (not rise)



CESI USA vs US GDP Growth vs 10Yr Yield vs Gold

The Citi Economic Surprise Index is suggesting that GDP growth will weaken until at least mid-March 2020 (so far)

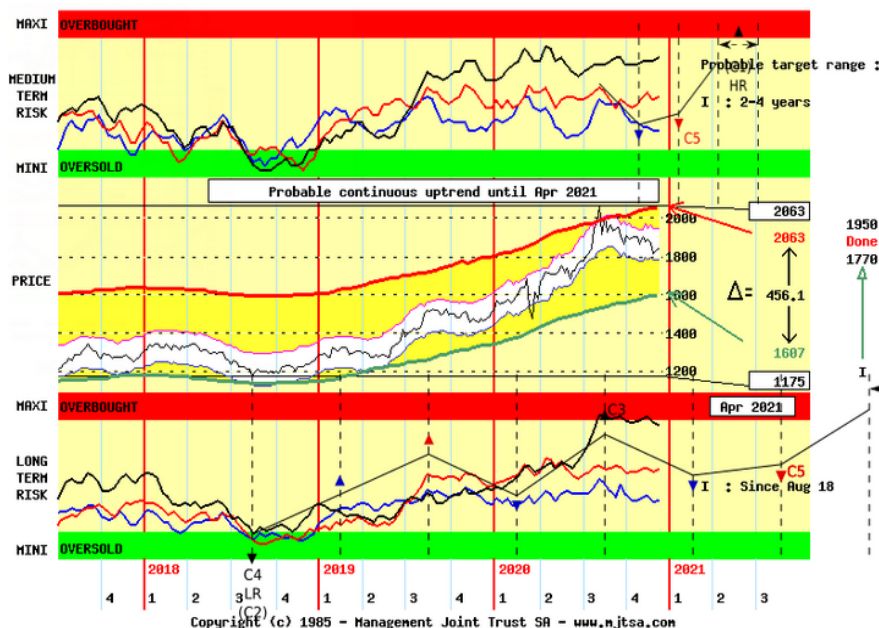


A bit more patience is probably required until Gold rises again into the Spring

Gold Spot (USD/oz)

Gold could still reach up towards 2'300 USD/oz over the next few quarters. Thereafter, it then probably corrects down towards next Spring/Summer. Longer term, however, over the next few years, its secular uptrend will probably persist.

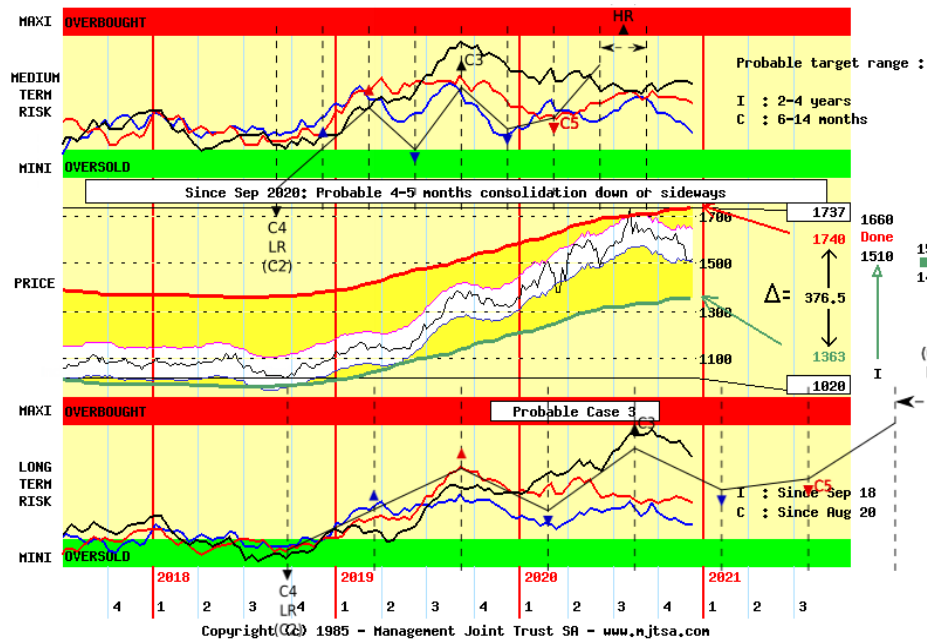
Weekly graph or the perspective over the 2 to 4 quarters



upside) would point to a target range between 2'224 and 2'406 (or 2.3 to 2.7 our historical volatility measure “Delta”, here at 456.1 – middle rectangle, right-hand side – added to the graph’s lowest point at 1'175).

Gold Spot in Euros (EUR/oz)

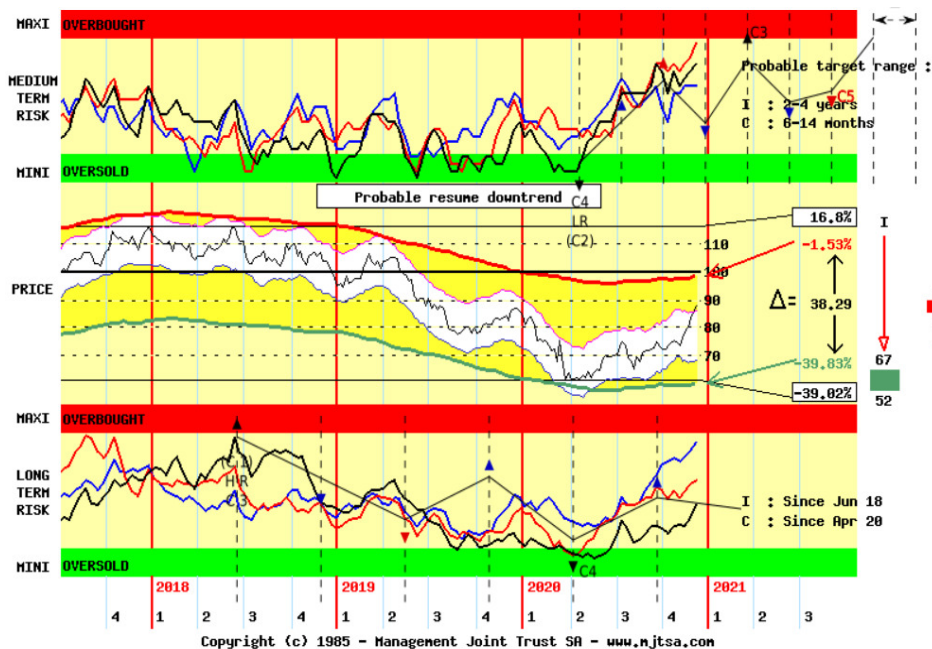
Weekly graph or the perspective over the next 2 to 4 quarters



Gold in Euros made an important intermediate top in August on both oscillator series (lower and upper rectangles). **The current correction period probably extends into early Q1 in first instance with some downside risk remaining towards the lower end of our C Corrective targets to the downside in the mid 1'400s (right-hand scale).** Following that, according to the sequence we show on our long term oscillators (lower rectangle), Gold in Euros could rise again into next Spring. Thereafter, it may then retrace once more towards mid next year/next Summer and then rise again towards 2022.

Copper/Gold ratio

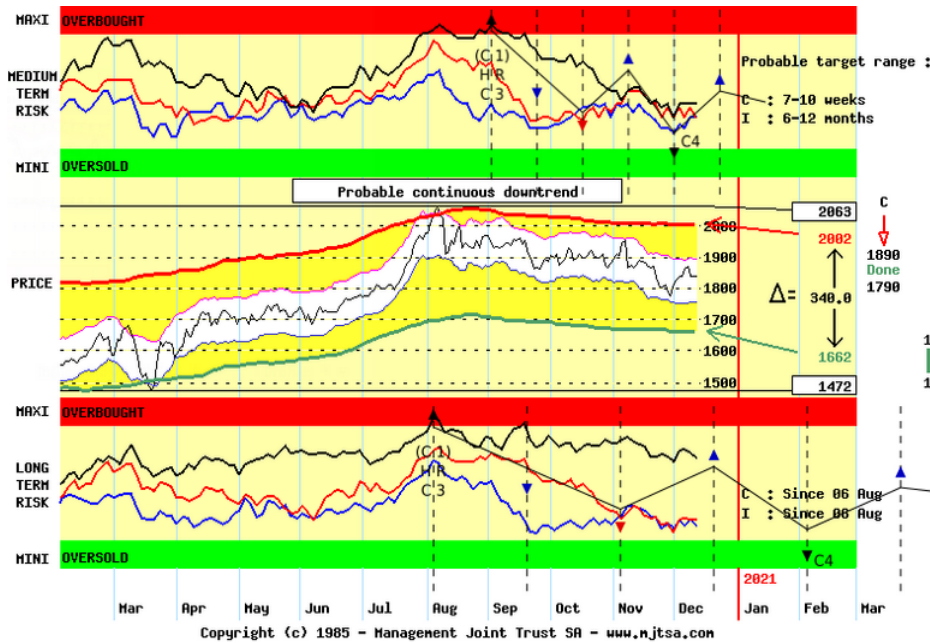
Weekly graph or the perspective over the next 2 to 4 quarters



While Gold may start to resume higher from early Q1, it could continue to lag more cyclical metals until mid/late Q1. This is what the Copper to Gold ratio is suggesting. On our long term oscillators (lower rectangle), a first intermediate top did indeed trigger only limited retracement and the uptrend hence probably continues. The sequence we now show on our medium term oscillators (upper rectangle) is then pointing towards mid/late Q1 as a further intermediate top. **Our view is that both**

metals probably rise as the US Dollar continues to weaken into mid/late Q1. Gold could then prove more resilient as the US Dollar gradually stabilizes and attempts to bounce from mid/late Q1.

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

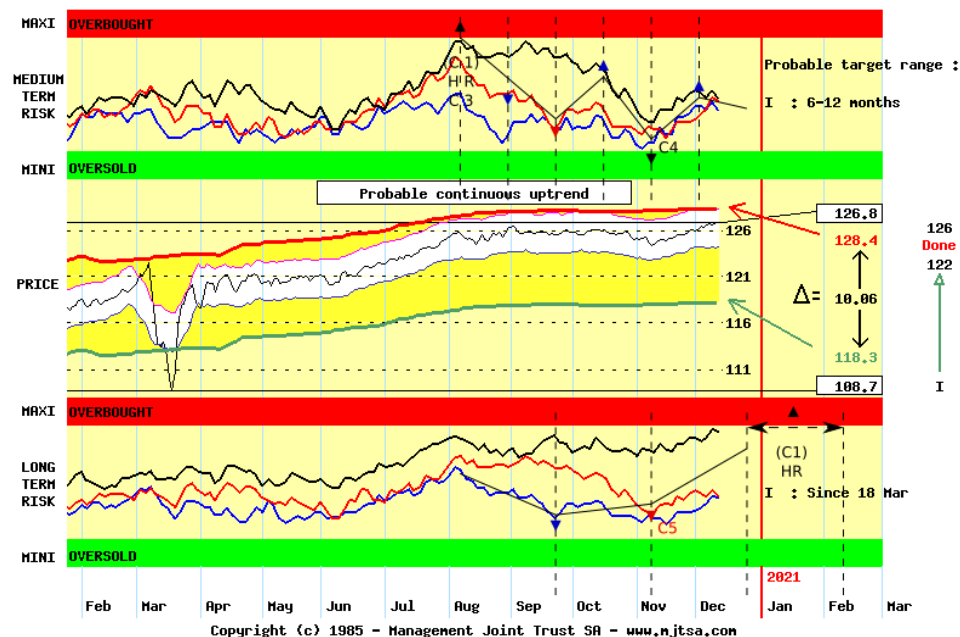


On the Daily graph, Gold seems to have plugged an important bottom late November. It did briefly break below our C Corrective targets to the downside around 1'790 USD/oz (right-hand scale), but then rapidly recovered. For now, we would favor a rather constructive scenario as shown on our medium term oscillators (upper rectangle), where **Gold probably remains in its recent range into mid/late January, and then probably resumes higher in line with our Weekly graph above.** Yet, we cannot exclude

a more damaging scenario (although we don't favor it), where Gold could see another strong sell-off into late January / early February and towards our Impulsive targets to the downside in the 1'620 – 1'490 range (right-hand scale). We would probably consider this risk as rather unlikely and would only consider it if Gold was to break down again below its recent support range, i.e. below 1'770 USD/oz.

US TIPs – Inflation Protected Treasuries

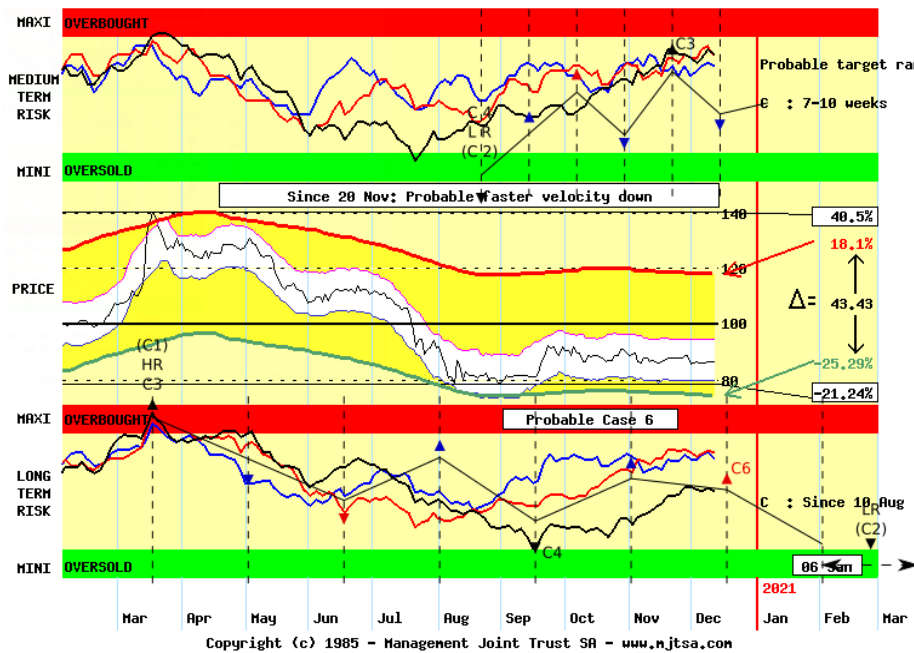
Daily graph or the perspective over the next 2 to 3 months



We find some comfort for the constructive scenario above on Gold in the Daily graph of US TIPs (TIP ETF). Indeed, while US nominal rates are rising, fueled by rising Inflation Expectations, **US real rates on the other hand still seem to be falling** as suggested by the persistence of the uptrend on US TIPs. We expect this trend to continue into early next year at least, perhaps into February. This uptrend in TIPs should help Gold prices as they attempt to resume their uptrend over the next month or so.

Gold to Silver Ratio

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



We now turn to the Gold to Silver ratio. Our base hypothesis is that the ratio usually falls when both metals are rising, i.e. Silver is more volatile / more cyclical than Gold, and is usually positively correlated to it. According to this Daily graph, **the ratio could soon resume its downtrend on our long term oscillators (lower rectangle), probably into mid/late Q1.** On our medium term ones (upper rectangle), the ratio may hold up into early January, but then probably also resumes lower. Hence, **by being negative on**

the ratio over the next few months, we are positive on both Gold and Silver.

Gold to Silver ratio

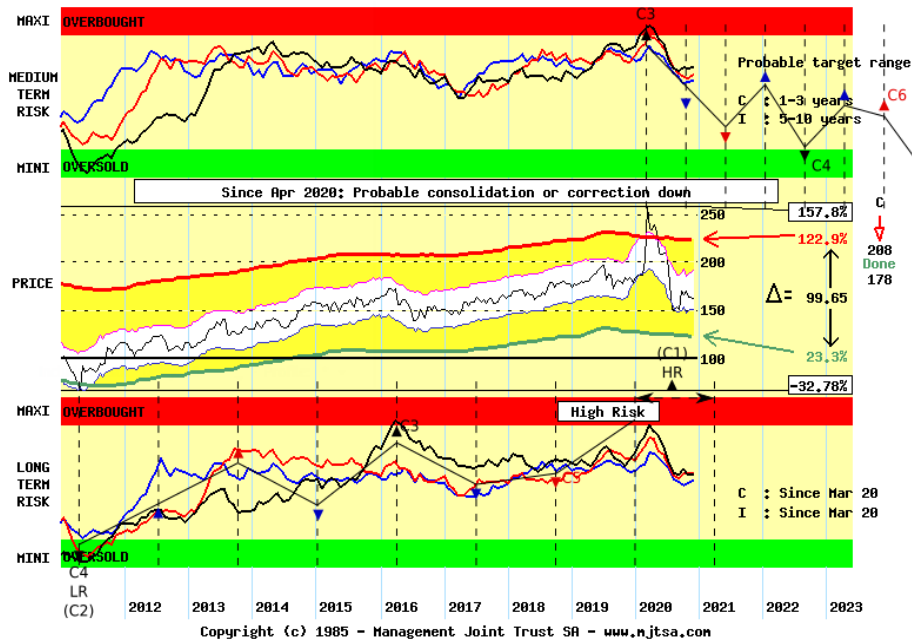
Weekly graph or the perspective over the next 2 to 4 quarters



Our long term oscillator series (lower rectangle) on this Weekly graph of the Gold to Silver ratio seem to confirm our scenario above on the Daily graph. **Indeed, according to this sequence, the ratio could soon resume lower into late Q1.** Our medium term oscillators (upper rectangle) may take a bit more time to confirm this resume downtrend situation, yet these will probably do so at the latest from early Q1. **At best, the ratio may hence hold up over the next month or so, before it then resumes lower into late Q1 / early Q2.**

Gold to Silver ratio

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

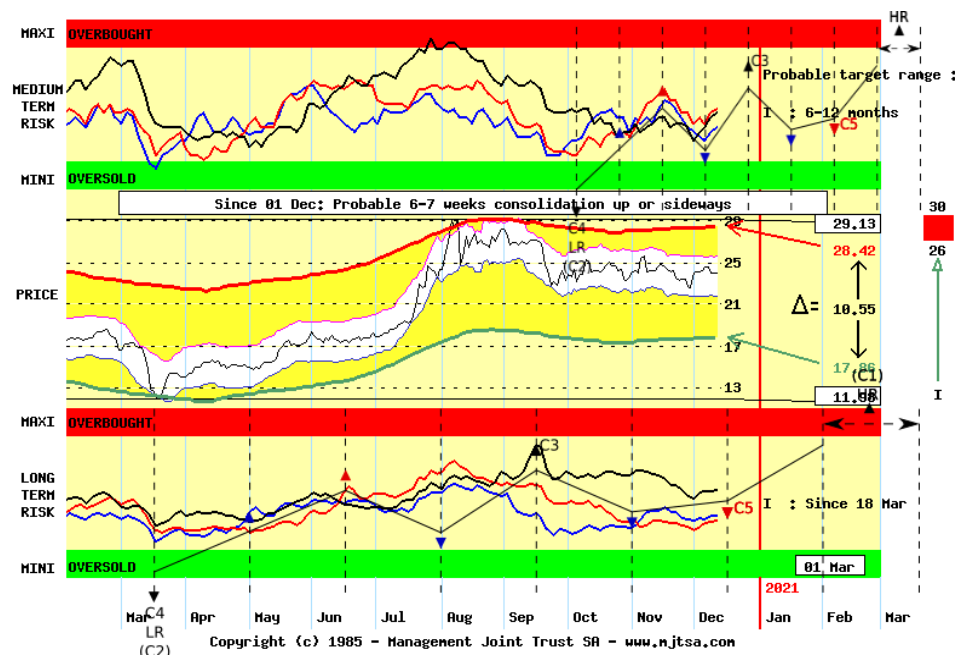


On the long term bi-monthly graph of the ratio, the spike in Q1 this year may have triggered a secular reversal. Indeed, the ratio had then reached its all-time highs, while topping out in a High Risk zone, according to our long term oscillators (lower rectangle). It has since dropped quite rapidly, and a strong upside retest is now probably unlikely. Indeed, the ratio recently made it below the support of our C Corrective targets to the downside (right-hand scale), and is now potentially

eyeing our much lower I Impulsive targets to the downside over the next couple of years. We will hence consider this new downtrend sequence, which we show on our medium term oscillators (upper rectangle), as the reference for our forward looking scenario. It suggests **further downside on the ratio into the Spring, then a rebound into H2 2021 before renewed weakness in 2022. We believe this is long term positive for both metals into 2022.**

Silver Spot (USD/oz)

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

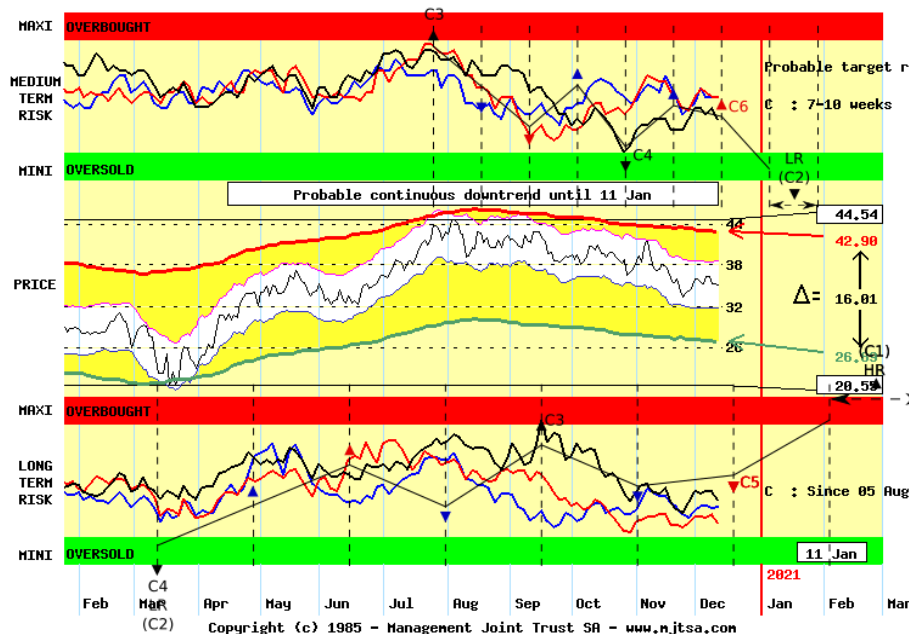


Similarly to Gold, Silver is still stuck in its recent Corrective range between 21.5 and 26. Both oscillator series seems to be positively positioned into mid/late Q1 (lower and upper rectangles). Yet, as with Gold, Silver probably still continues to consolidate in a range into early/mid January (upper rectangle). **Downside support is still** around 21 USD/oz (20.7 to be more precise, or 0.8 our historical volatility measure "Delta", here at 10.55 – middle rectangle, right-hand side –

subtracted from the graph's highest point at 29.13). A break below these levels would lead us to reconsider our positive scenario. In the meantime, **we remain constructive and believe that during Q1, Silver may make new highs, probably into the mid/low 30's USD/oz** (i.e. which would correspond to our I2 Impulsive 2 extended targets to the upside)

Goldmines

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

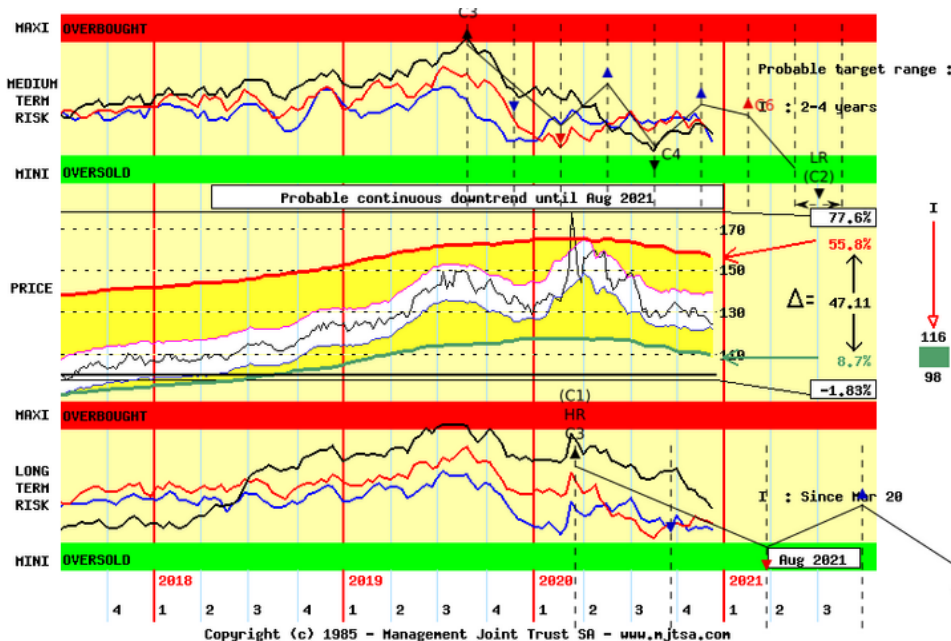


We now turn to equities and consider Goldmines (GDX ETF). Similarly to Silver, these usually follow Gold prices, yet with a higher beta. Here also, we suspect that the lows made late November may hold as these do coincide with the end of a potential correction period on our long term oscillators (lower rectangle). The model is not perfect as it indicates a top mid September (while the price top was made early August), yet the configuration theoretically corresponds to a

resume uptrend situation, probably into mid/late Q1. Alternatively, on our medium term oscillators (upper rectangle), a downtrend sequence could still be underway. It may extend into mid/late January. **Our view is that Goldmines will probably work around their current range until early/mid January, and then finally resume higher again. We would validate this rather constructive scenario as long as the support of our C Corrective targets to the downside around 32 (right-hand scale) continues to hold.**

Goldmines vs Silver Mines

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

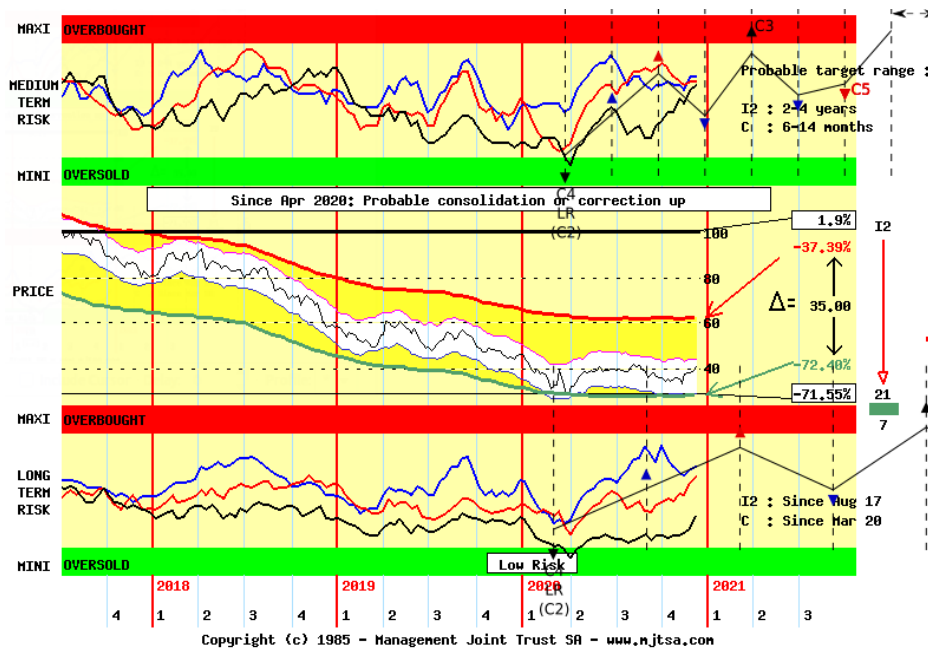


We also look at the ratio of Goldmines (GDX ETF) vs Silver Mines (SIL ETF), which not surprisingly, is showing similar dynamics than the Gold to Silver ratio analyzed above. While we need to distinguish the oscillator tops (in Q3 2019) and the price top (in March this year), both oscillator series (lower and upper rectangles) seem to point to **further underperformance of Goldmines vs Silver Mines into late Q1 / perhaps even next Spring.**

Downside targets, according to our I Impulsive targets to the downside (right-hand scale) are between 10 and 25% over the next few quarters. Here also, we will make the hypothesis that a falling ratio is a positive sign for both Gold and Silver mines.

Platinum vs Palladium

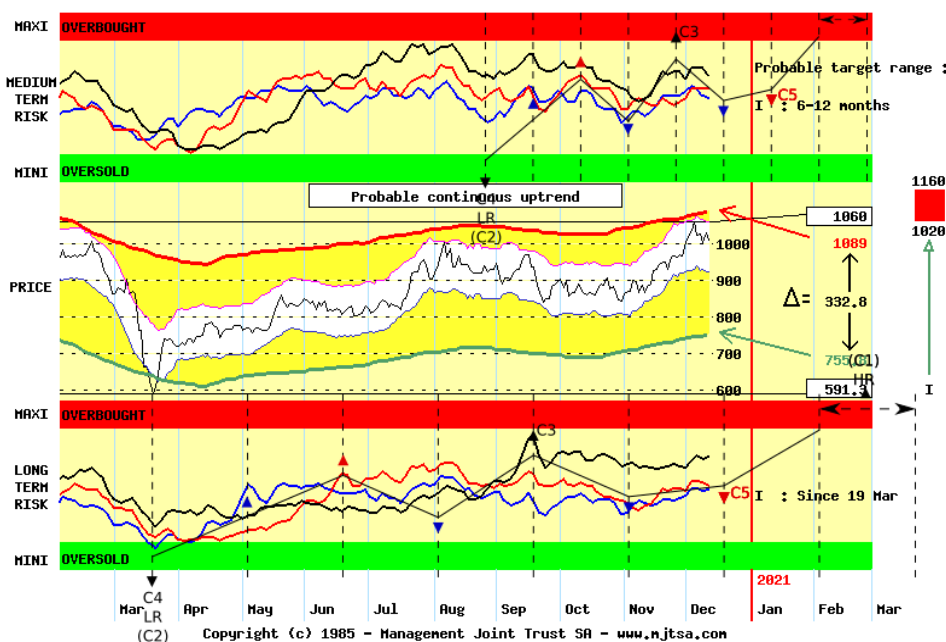
Weekly graph or the perspective over the next 2 to 4 quarters



Platinum is usually more cyclical / more value driven than Palladium. Since March, the ratio has indeed been rising. Both our oscillator series (lower and upper rectangles) seem to indicate that **this uptrend probably continues until mid/late Q1**. Platinum may then reach the resistance of the upper end of our C Corrective targets to the upside (i.e 56, right-hand scale), 10 to 15% above current levels.

Platinum Spot (USD/oz)

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



While Gold sold off in November, Platinum performed a strong rally. The dichotomy between the two metals is quite amazing as up until then, they had been following similar paths, although Platinum had been more value / more cyclical driven. According to both oscillator series (lower and upper rectangles), **Platinum may see some retracement over the next few weeks, but then probably rises again into mid/late Q1, potentially into the mid 1'100s by then (right-hand scale) or up to 15% above current levels.**

Concluding remarks:

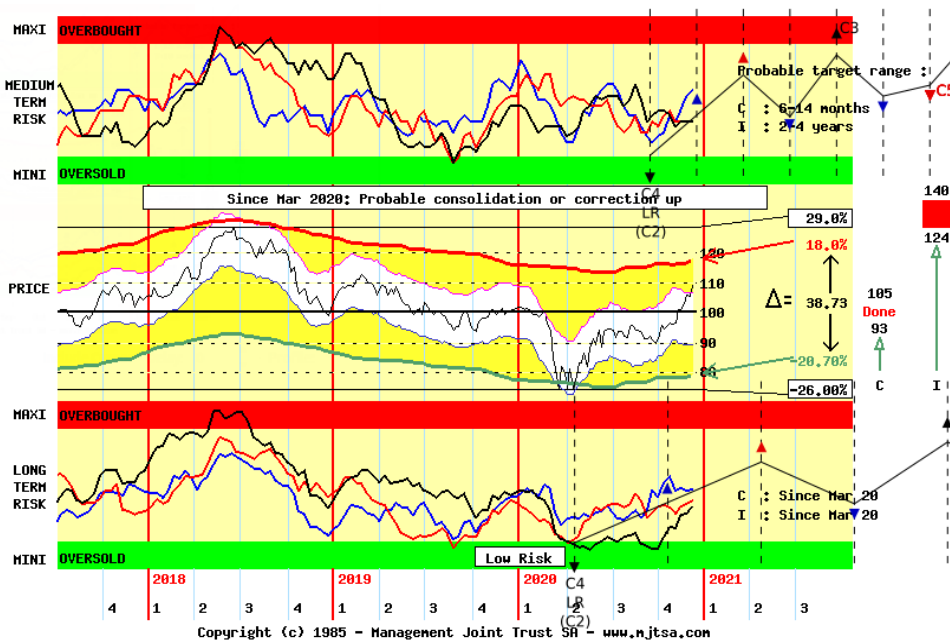
Despite its recent correction, the long term uptrend on Gold is probably still underway. We expect it to continue higher into late Q1 / early Q2 in first instance. By then, Gold may make new highs and reach into the 2'200 – 2'400 USD/oz range. Shorter term, the sell-off in November may have plunged an important bottom. Indeed, it briefly fell through support, around 1'790, but then rapidly stabilized above it again. Over the next month or so, we expect further work in the mid/low 1'800s, but believe that Gold probably holds. It then finally resumes higher at some point in January, along with Silver and Goldmines. The Gold to Silver ratio seems to confirm these dynamics as it probably continues to drop into mid/late Q1. Indeed, historically, a drop in the ratio is usually positive for both Gold and Silver as Silver, which is more volatile, outperforms. We expect Silver to reach up to the low/mid 30s USD/oz by the Spring. Finally, considering other precious metals, Platinum seems to be breaking out to the upside vs Palladium. We expect this nascent uptrend to continue into mid/late Q1 in first instance. Similarly to Silver outperforming Gold, Platinum will hence probably outperform Palladium. Both Silver and Platinum hence have our favors in the precious metals space into February at least.

53/ Splicing the markets : While Cyclical remain strong, deep value is less convincing

The dual question currently rocking equity markets is to understand if the current rally extends into Q1 next year and if one should rather favor Cyclical, Value or Growth stocks. In this short article, we review the main equity profiles against each other with proxies for Cyclical equities, Growth, Defensive ones and for deep Value.

Russell 2000 vs the US Staples sector

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

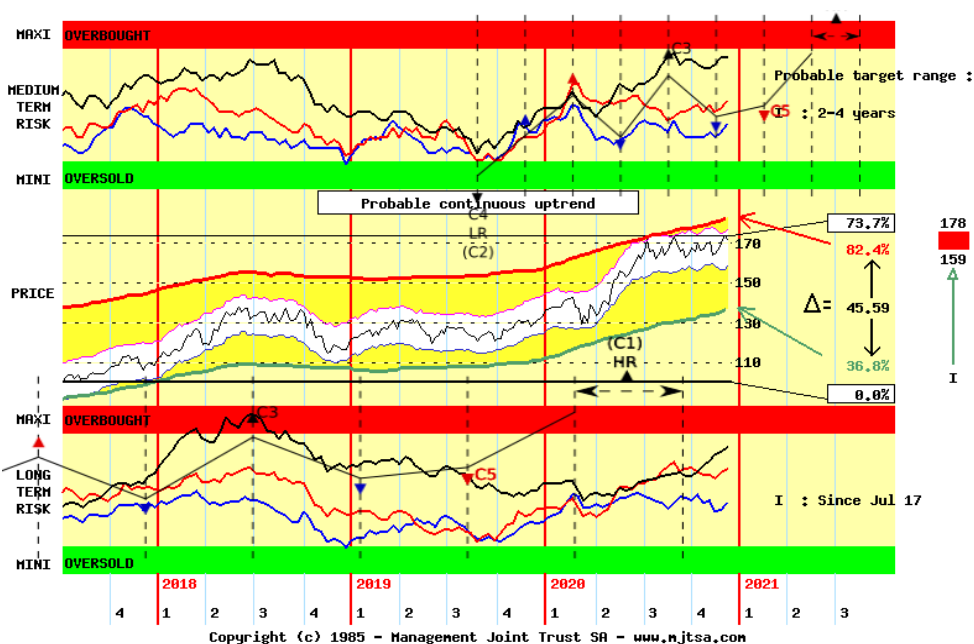


The ratio of the Russell 2000 index is still rebounding vs the defensive US Staples sector. The move recently turned impulsive making it above the resistance of our C Corrective targets to the upside (right-hand scale), thereby opening the door to much higher relative targets over the next 6 to 12 months (124 – 140 range, i.e. 15 to 30% above current levels). Hence, we are probably now in a strong new uptrend, which extends into late Q1 in first instance on both our oscillator series (lower and

upper rectangles) and then probably continue higher towards 2022, following some correction/ retracement this Spring. This is very promising for equity markets in general.

Nasdaq100 Index vs the US Staples sector

Daily graph or the perspective over the next 2 to 4 quarters

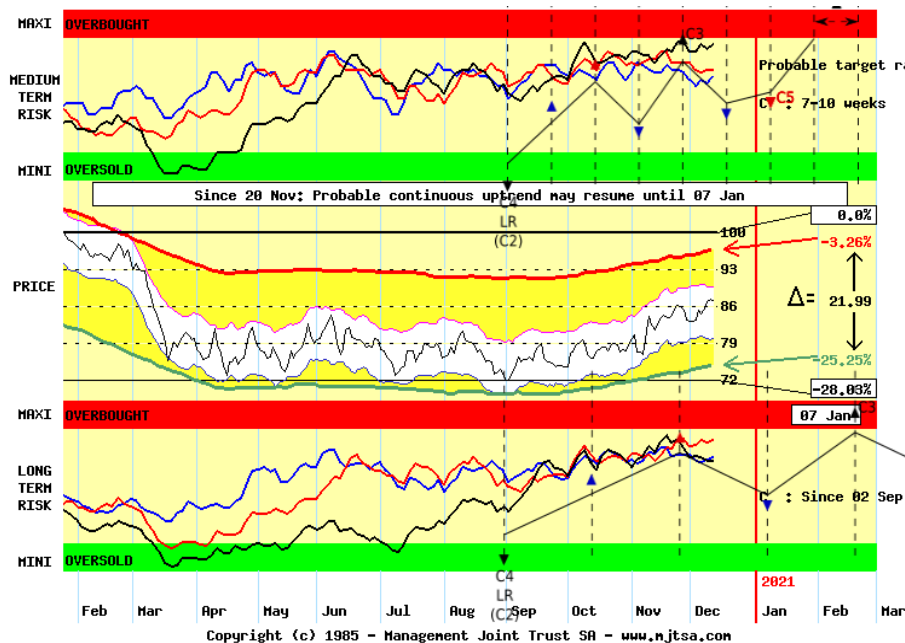


Obviously given the Nasdaq's strong performance over the last few years, the ratio of the Nasdaq100 vs the US Staples sector is more advanced in its uptrend (i.e. it recently reached a High Risk Zone on our long term oscillators – lower rectangle). Yet, this uptrend doesn't seem finished either. Indeed, as shown on our medium term oscillators (upper rectangle), we expect it to extend higher into Q1 and probably even into late next year. Upside targets (right-

hand scale) are showing some remaining upside potential although it isn't compelling. Nevertheless, this extension higher is also positive for equity markets more generally.

Russell 2000 vs the Nasdaq 100 Index

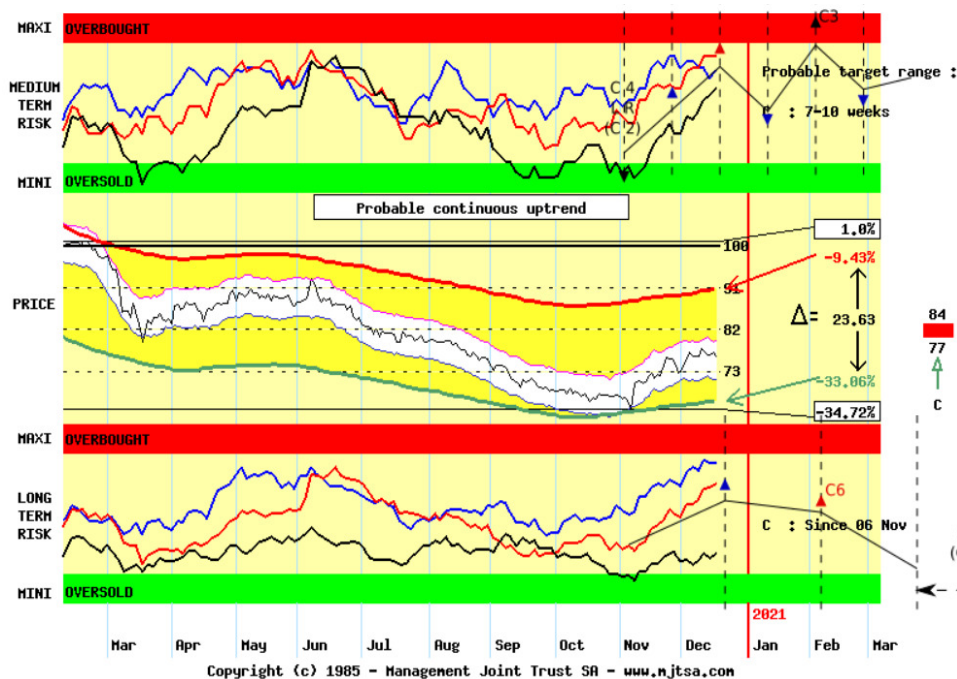
Daily graph or the perspective over the next 2 to 3 months



Shorter term, we now consider the ratio of the Russell 2000 vs the Nasdaq100. The more cyclical Russell 2000 has indeed been outperforming since early September while long yields have moved up. Similarly to our scenario on them, **we would expect the ratio to retrace down slightly into early January and then perform a further leg up into late January / February. Thereafter, it could start to roll-over / retrace into the Spring.** Our underlying understanding is that this shift may be due to a refocus on US monetary stimulus rather than current anticipations of a strong US fiscal push.

Deep Value US Cyclical sectors vs less Deep Value US Cyclical sectors

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



We finish this short article by comparing a portfolio of US Value sectors (equal weighted between US Financials and Energy) and compare it to less deep value cyclical sectors (equal weighted portfolio of US Industrials and Materials). Indeed, over the last couple of publications, we have been rather shy on promoting deep value preferring to focus on these less deep value cyclical sectors, as in our view, they offered a better risk/reward. In retrospect, this position was too risk averse. **Going forward, following the strong bounce of deep value sectors vs cyclical ones since November, we are still rather cautious.** On our medium term oscillators (upper rectangle), Deep Value could still outperform into February, probably following some underperformance

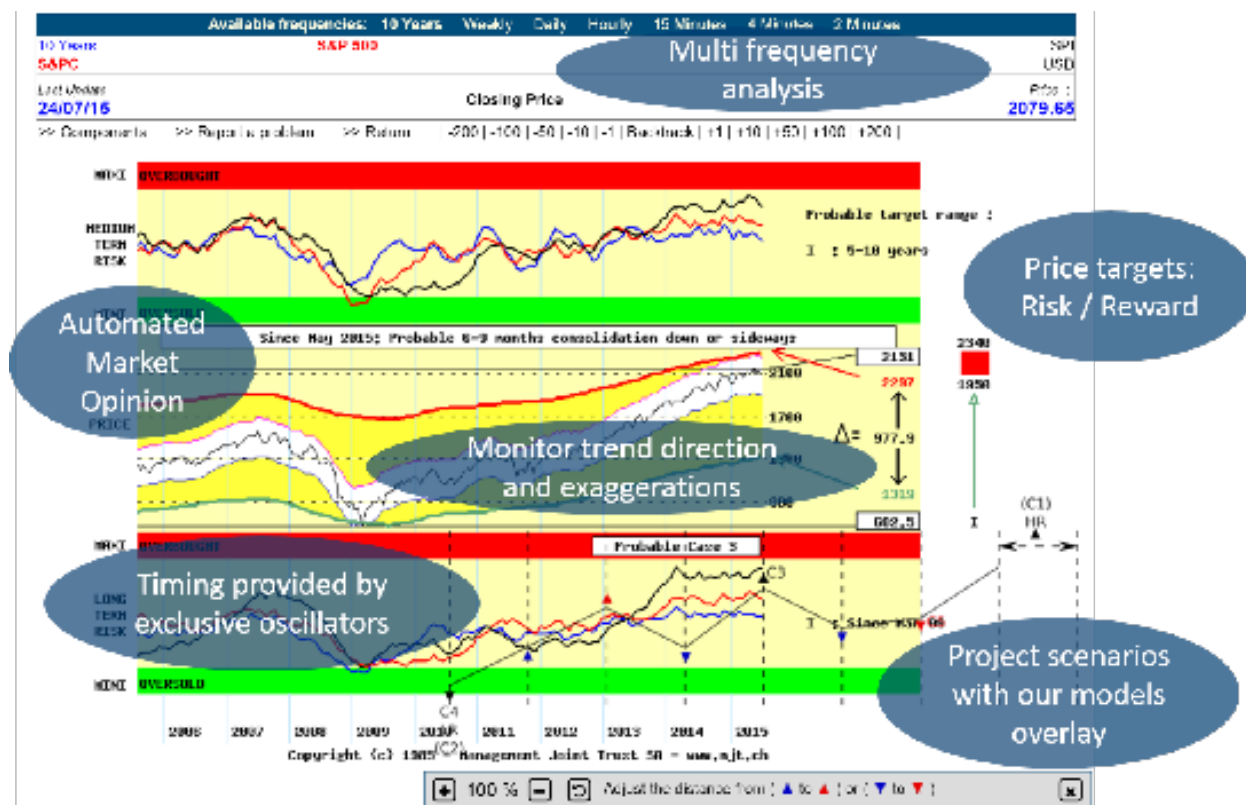
into early January. Upside targets could lead us up to the resistance of the upper end of our C Corrective targets to the upside, around 84 (right-hand scale). This is still 8% above current levels. On the other hand, the sequence on our long term oscillators (lower rectangle) suggests that the ratio could be already starting to roll-over.

Concluding remarks :

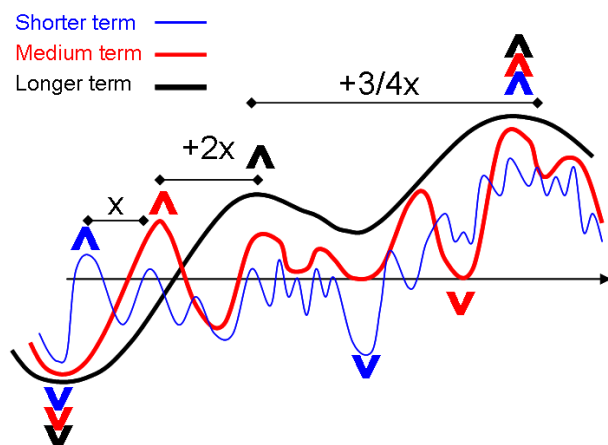
Both the Russell 2000 and the Nasdaq100 indexes are now in uptrends vs the defensive US Staples sector. These relative ratios do indeed show strong outperformance potential for the Russell 2000 into late Q1, and then again towards late next year. The uptrend of the Nasdaq 100 vs the US Staples sector is rather exhausted in terms of targets, yet, could still extend into Summer/late next year. Both suggest that the mood probably remains risk-ON over the next few quarters and probably into 2022, although an intermediate correction period is probably expected at some point this Spring. Short term, considering the ratio of the Russell 2000 vs the Nasdaq 100, the current cyclical rally seems to extend into late January / February, probably following some short term retracement into early January. As for deep value (e.g. US Energy or US Financials), the risk/reward in our view is still uncomfortable vs more intermediate cyclical plays (e.g. US Industrials or US Materials). Hence, although deep Value will probably hold up another month or so, perhaps even outperform slightly, we would continue to focus on the less deep value cyclical profiles, which anyhow also offers strong potential into mid/late Q1.

55/ 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)

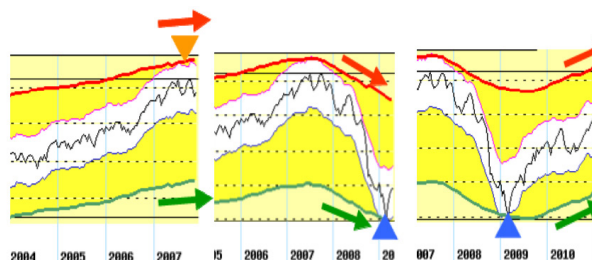


Timing oscillators: Different prices cycles are captured by our 3 Timing oscillators. Monitor how their relative positioning defines specific situations (Cases) to always know where you stand within the Trend (e.g. please see below the ideal Uptrend Case succession sequence)

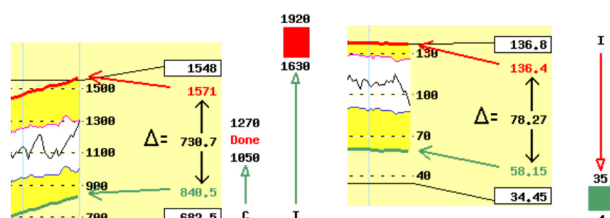


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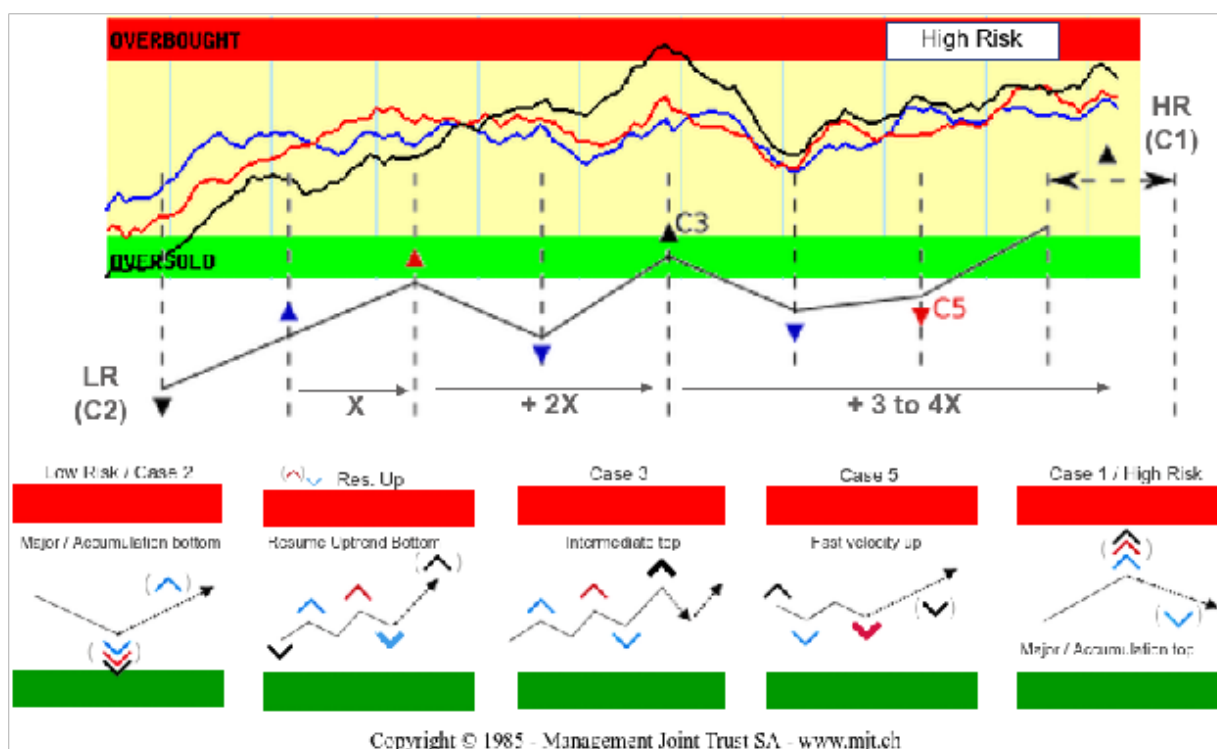
Trend direction: the direction of FinGraphs' large envelope will help you decide either to apply an uptrend or a downtrend model. Contacts between the wider and thinner envelopes will help you anticipate and confirm market turning points (e.g. S&P500 bi-monthly, extracts from the 2005-2011 period).



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).

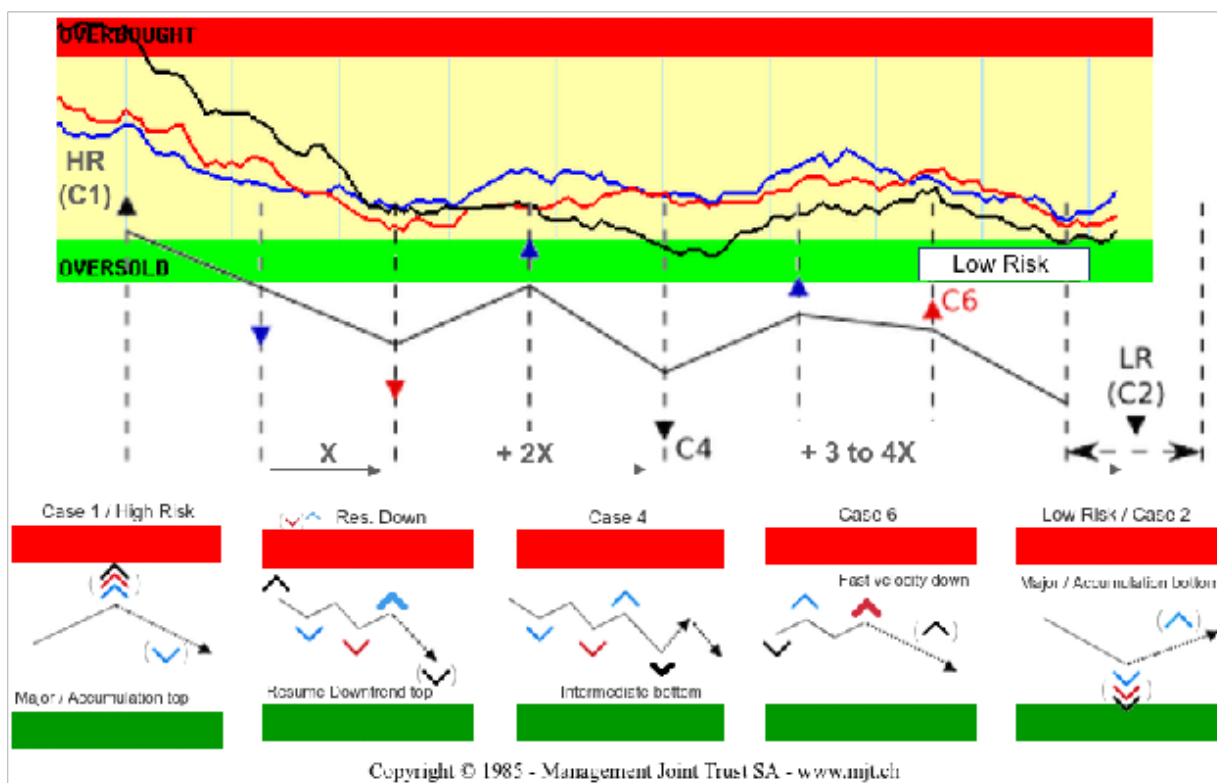


Ideal Uptrend Model



(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 $4X$.

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