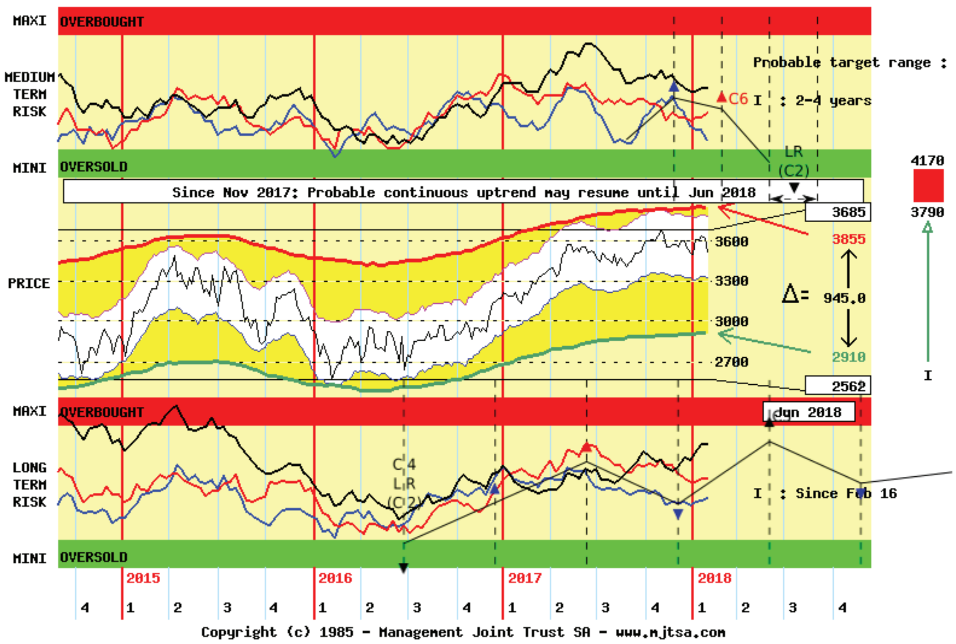
Strong potential, yet will it be fulfilled? Financials still look strong at least

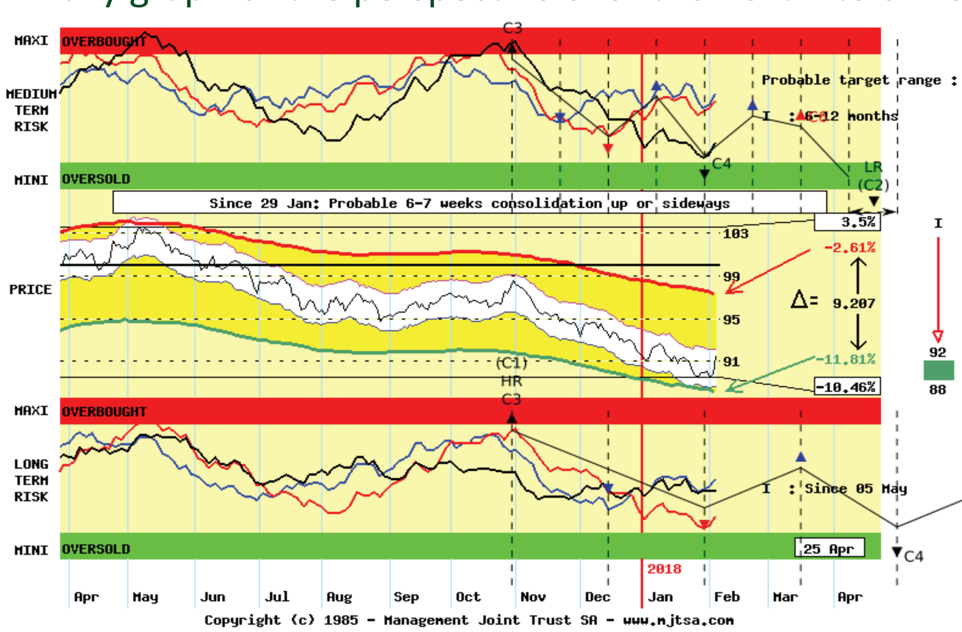
Depending on which European index you look at, over the last few days, prices have dived below or held at our Daily C Corrective targets down. Holding these levels is what we would usually expect from an intermediate correction down. August 2017 lows have pretty much been retested everywhere. Below that, the next support levels are towards the January 2017 highs, some 3 to 6% lower than today. In this article, we will consider the business case for European Equities, try to assess if they will manage hold up, and if so, how much untapped upside potential they may have left, and what countries or sectors to favor in Q1 and/or in Q2 2018.

EuroStoxx 50 Fut (Mar)
Weekly graph or the perspective over the next 2 to 4 quarters



As we write, the EuroStoxx 50 Future is holding around 3'400, or towards the lower end of the August 2016 retracement range. Although these levels cannot be seen yet on this Weekly graph, **the uptrend on our long term oscillators** (lower rectangle) **is still in place, for now, possibly until June according to our Automatic messaging (message box in middle rectangle). The I Impulsive up price potential could still reach towards the 3'800 – 4'200 range or 10 to 20% higher than today. That said, the current sell-off (provided it halts) has weakened the picture**. It took out the early January lows, which theoretically served as a base for the upside move towards June. **In order to reconfirm our positive projection, the EuroStoxx will probably need to bounce back quite strongly over the next few weeks**. If not, a sequence of declining highs could materialise on our medium term oscillators (upper rectangle) during Q1, a configuration which is usually quite negative.

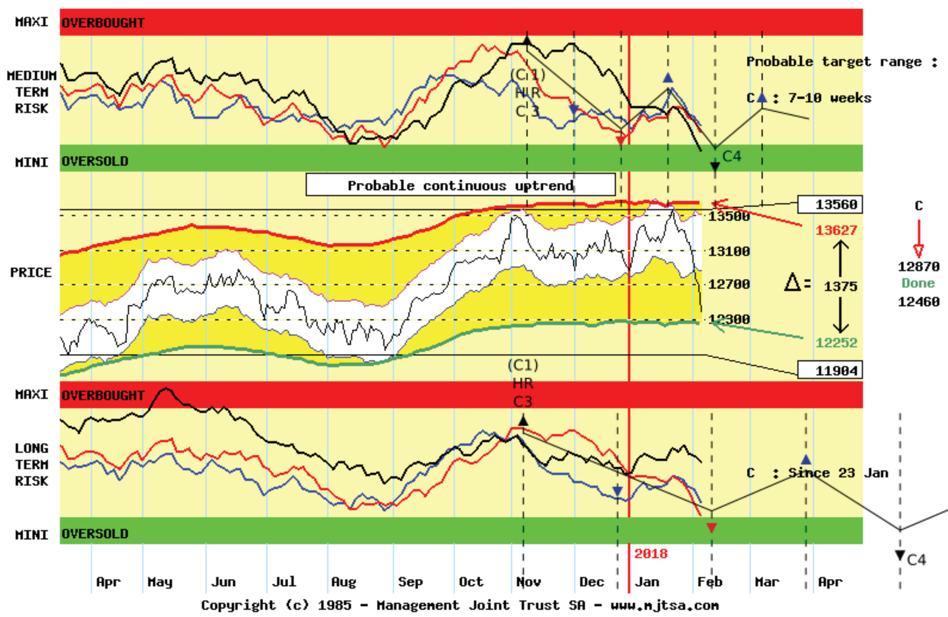
EuroStoxx 600 vs MSCI World (hedged for currency risk)
Daily graph or the perspective over the next 2 to 3 months



On a relative basis **the EuroStoxx 600 has systematically underperformed world markets since the Euro accelerated up in May.** This ratio is hedged for currency risk and hence does not take the Euro appreciation into account. Indeed, usually, the stock market with the stronger currency underperforms. On both our oscillator series (lower and upper rectangles), **the ratio is now positioned to bounce, possibly over the next 3 to 6 weeks.** Its downside I Impulsive price potential down (right-hand scale) is also exhausted. **This rebound, if it materialises, will certainly be linked to a rebound in the US Dollar. Will it happen as Equity markets continue to fall (flight to quality towards the US Dollar), thereby cushioning European markets, which may fall, but less that others, or will Equities and the Dollar rise together on reduced inflationary pressures as a result of the consolidation we expect on commodities.**

Dax Index

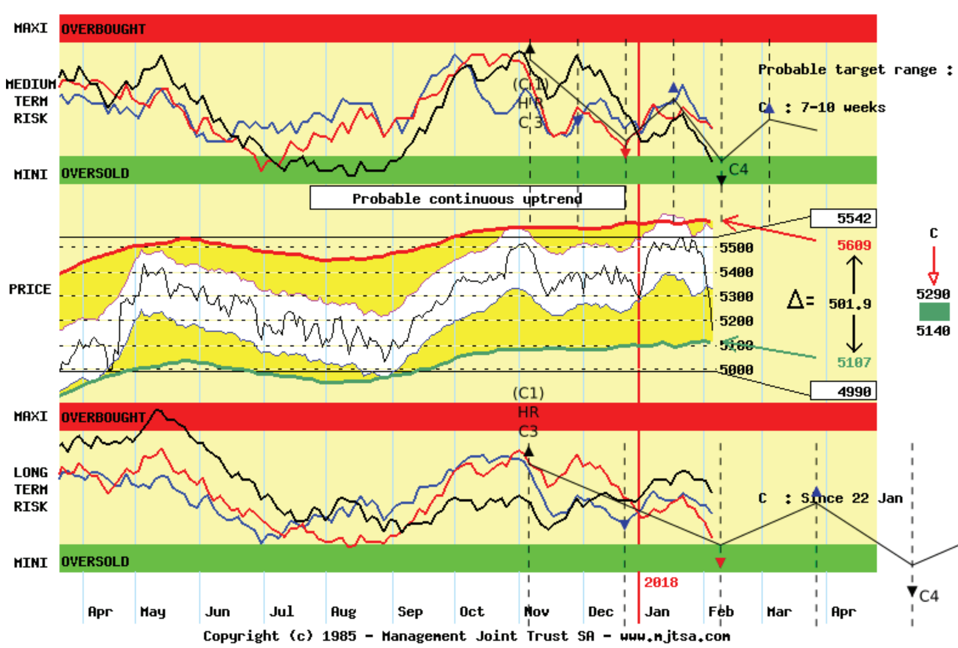
Daily graph or the perspective over the next 2 to 3 months



Yet, it may be slightly early to cheer up completely. Indeed, the time window for the current sell-off is not quite closed yet, i.e. the intermediate low we think could halt the sell-off may still be a few days away as shown on both oscillator series (lower and upper rectangles). **That said, prices have pretty much held above or at the lower end of our C Corrective targets down on an End of Day basis (around 12'460, right-hand scale). If they can continue to do so, this may lay the ground for a rebound that could last into March. This projection is weighted against a 6% downside risk, if these C Corrective down levels break and prices move towards our I Impulsive targets down** (top of the graph at 13'560 minus 1.3 times our historical volatility measure "Delta" at 1'375 equals circa 11'780, or the levels reached 12 months ago during January 2017)

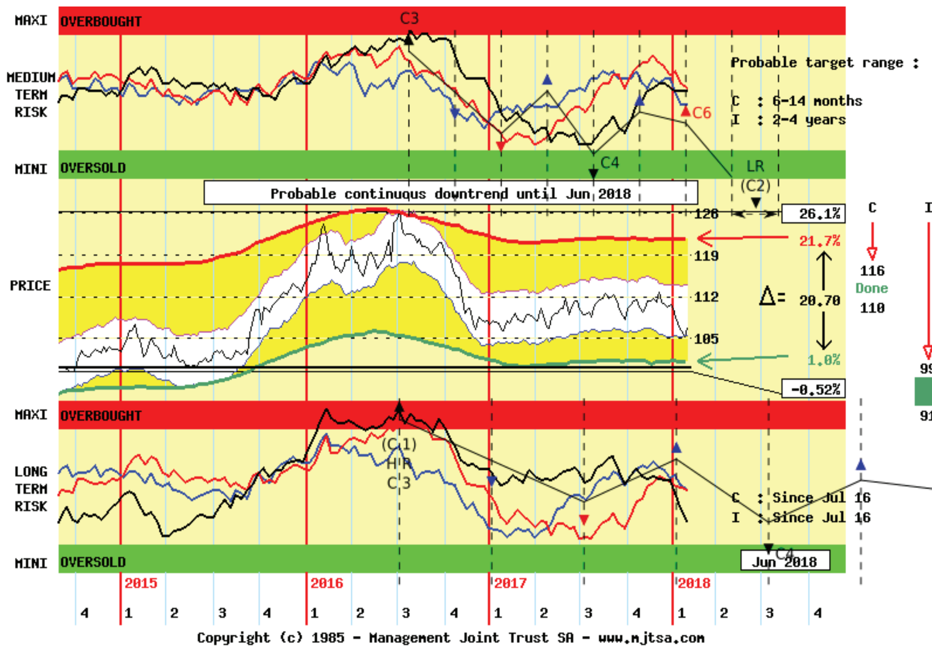
CAC40 Index

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



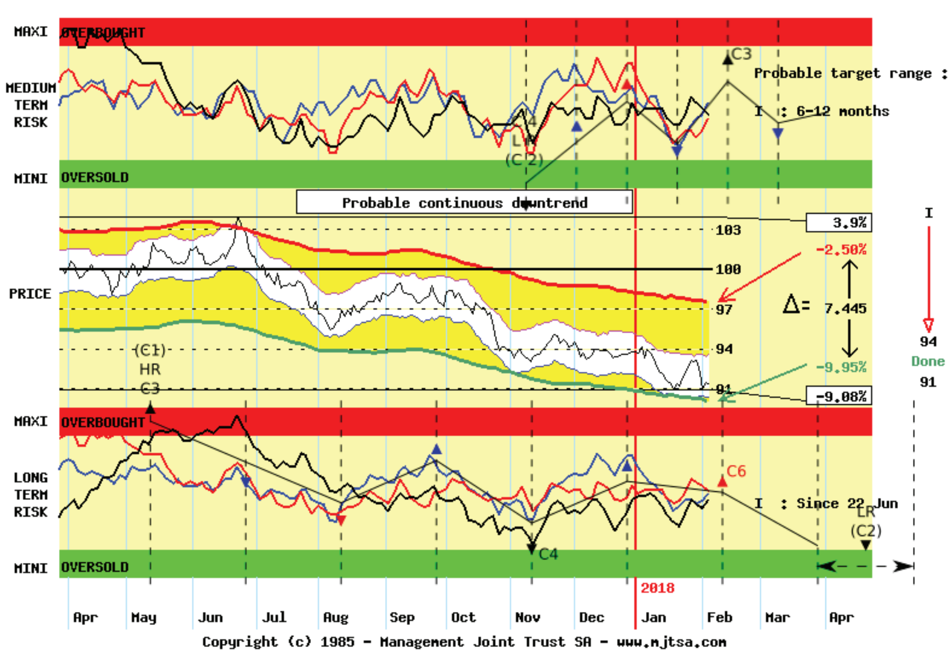
The picture on the CAC40 is more positive. The intermediate low that could stop the sell-off is theoretically only a day or so away as shown on both our oscillator series (lower and upper rectangles), and **even on an intraday basis (overnights), the lower end of our C Corrective targets down (right-hand scale) has pretty much held overnight** (at or around 5'150). Provided these support levels continue to contain the sell-off, **the CAC40 could start to rebound soon, possibly towards early / end March. Theoretically it may even move back up to retest its highs.**

Food & Beverage sector Europe Stoxx 600 vs Europe Stoxx 600
Weekly graph or the perspective over the next 2 to 4 quarters



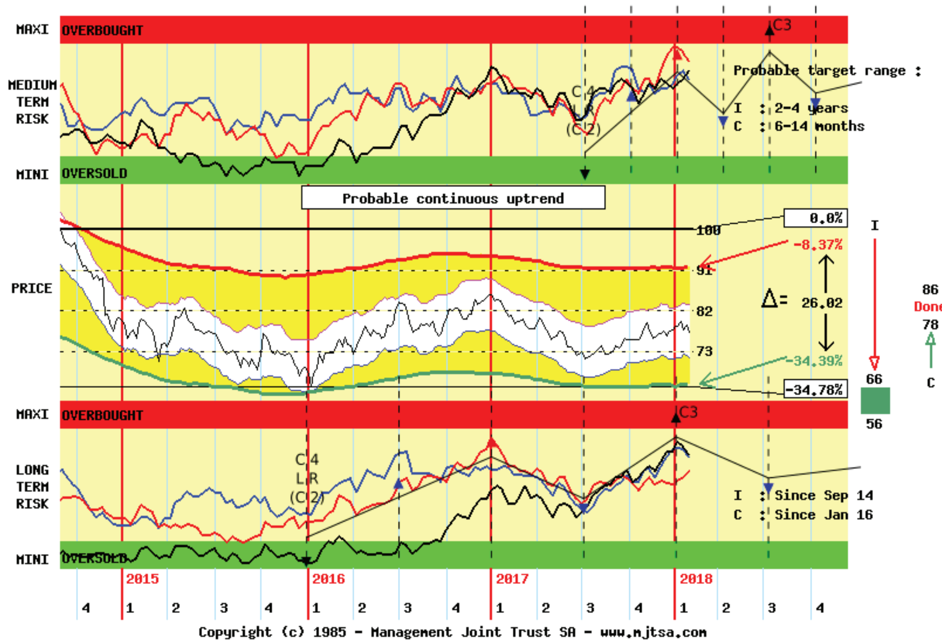
We now focus on the long term picture of our Weekly graphs, where the sell-off early this week is not yet integrated, and will first look at Defensive sectors. In this graph, we will compare the Europe Stoxx Food & Beverage index vs the Europe Stoxx 600 (the sector is a good proxy for defensive profiles). According to both our oscillator series (lower and upper rectangles), **Food & Beverage should continue to underperform the market, possibly until June. Our I Impulsive targets down (right-hand scale) would suggest a further 5 to 15% of underperformance potential until then, and hence continues to justify our risk-on bias towards mid year.**

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



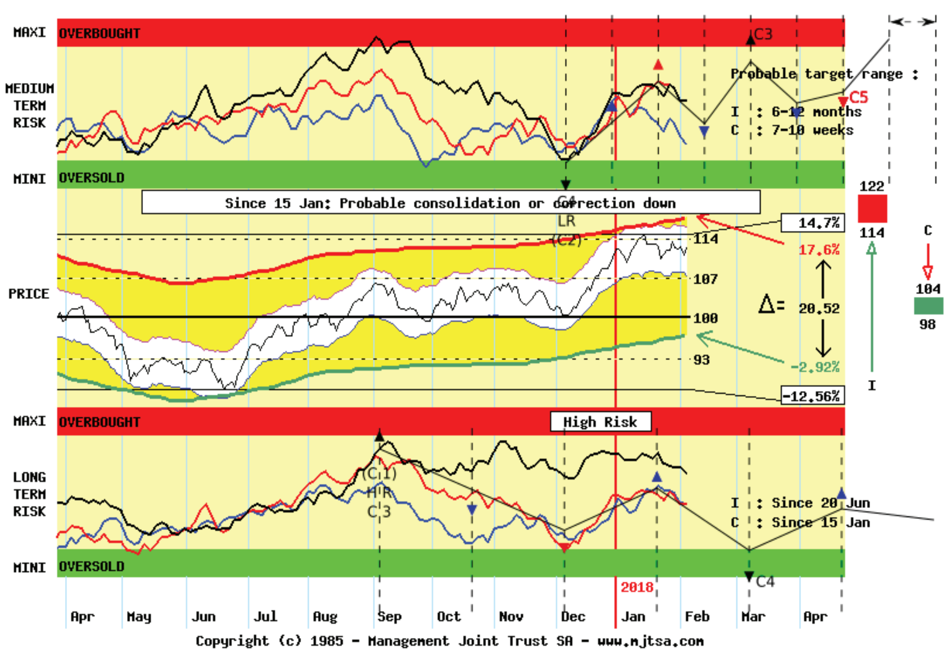
Looking at another European Defensive sector, yet on a Daily graph, we turn to the European Healthcare sector vs the Europe Stoxx 600. On both our oscillator series (lower and upper rectangles), **the slight rebound since mid January is coming to an end over the next few days. Healthcare should then resume down vs the market**. Over the next month or so, the underperformance potential is somewhat exhausted (our I Impulsive targets down have been reached; right-hand scale), yet on a longer term basis (on our Weekly graph, not shown here), Healthcare could underperform the Stoxx Europe 600 index by a further 8 %. This again, confirms **that the risk-on environment probably resumes during Q1, possibly until mid year.**

Energy sector Europe Stoxx 600 vs Europe Stoxx 600
Weekly graph or the perspective over the next 2 to 4 quarters



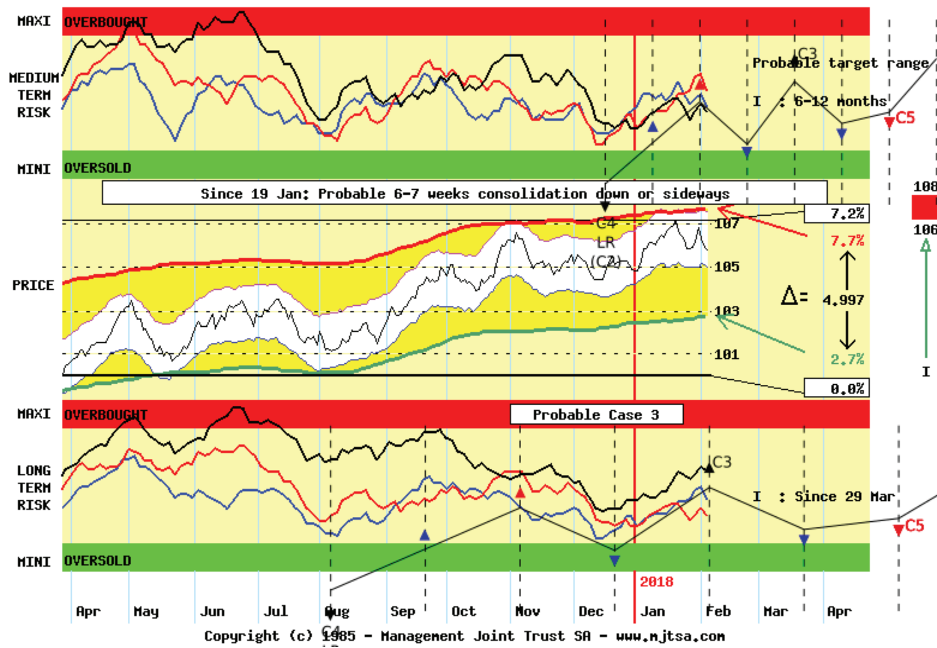
We now look at sectors linked to commodities and first at the European Energy sector vs the Europe Stoxx 600 Index. Since 2016, our long term oscillator series (lower rectangle) have worked perfectly in timing the inflection points of the sector vs the market. **Energy has now reached an important intermediate top on a relative basis (similar to Oil and other Commodities). We expect it to consolidate down during Q1, yet would still expect one last rebound from early Q2 until year end. This is shown by the sequence on our medium term oscillators (upper rectangle).**

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



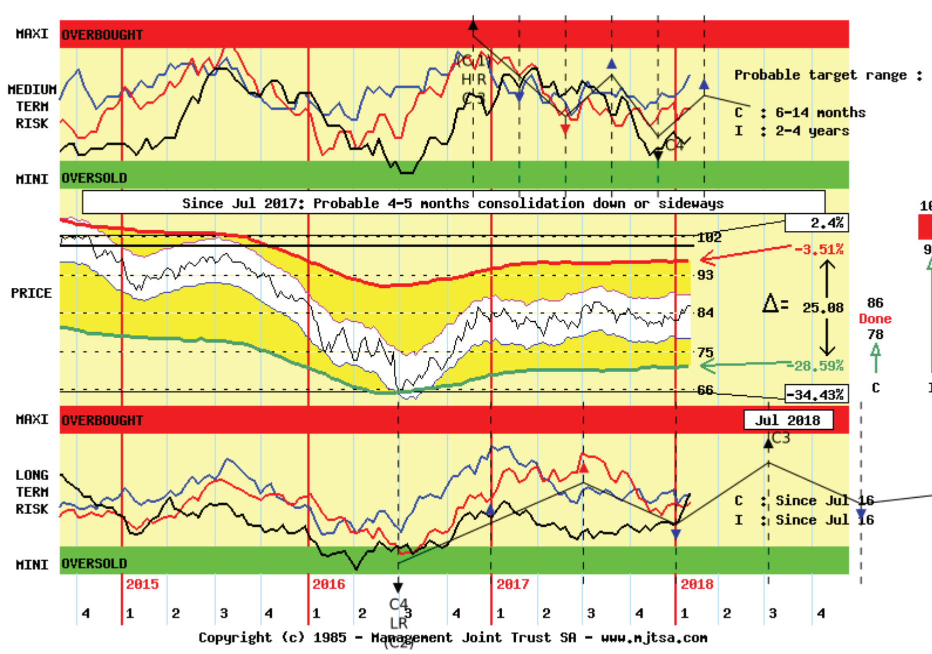
On this Daily graph, we look at European Basic Resources vs the market. The sector is also very much linked to Commodities. As mentioned by our Automatic Messaging (lower rectangle), the sector as now reached a High Risk position vs the market. At best, we would now expect a high level consolidation towards late Q1 as shown on our medium term oscillator series (upper rectangle). Yet, our favored scenario (shown on our longer term oscillators; lower rectangle) would rather point to **a correction into March, before the sector gradually startst to rebound towards the Spring. The C Corrective potential to the downside (right-hand scale) is pointing to possibly 10 to 15% underperformance for the sector vs the market over the next 1 to 2 months (indeed, Basic Resources are quite volatile).**

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



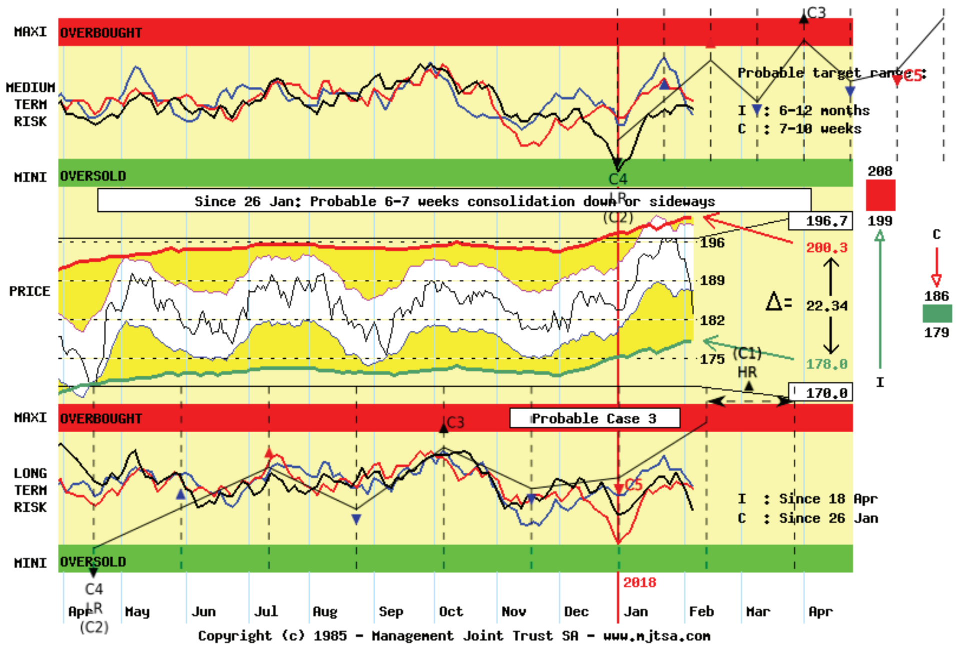
We also look at Industrials, another sector, which has performed strongly during H2 2017. On both our oscillators series (lower and upper rectangles), it has **probably reached an intermediate top and should correct during 3 to 6 weeks into March**. Following that, it may resume up from late March/April into mid year. We can also note that for now its outperformance potential has been fulfilled. Indeed, our I Impulsive targets up (right-hand scale) have been reached.

Banking sector Europe Stoxx 600 vs Europe Stoxx 600
Weekly graph or the perspective over the next 2 to 4 quarters



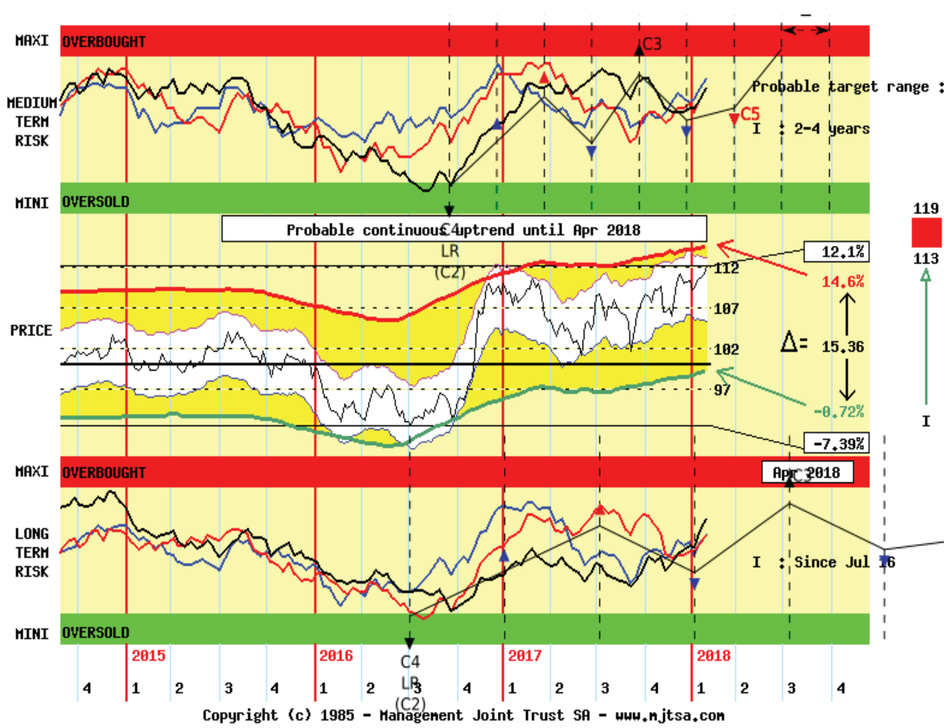
One sector, we've been promoting over the last few months is Financials, and especially European Banks. Indeed, their Weekly graph vs the Europe Stoxx 600 still looks favorable, possibly until mid year: our medium oscillators (upper rectangle) have finished their retracement, while our long term oscillators (lower rectangle) are suggesting the resurgence of a strong uptrend. It could last into mid year, and its upside potential is compelling, possibly towards our **I Impulsive relative price targets 15 to 20% above current levels (right-hand scale). Financials is a typical sector that performs well late in the cycle. They should remain strong until equity markets top out sometime later this year.**

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



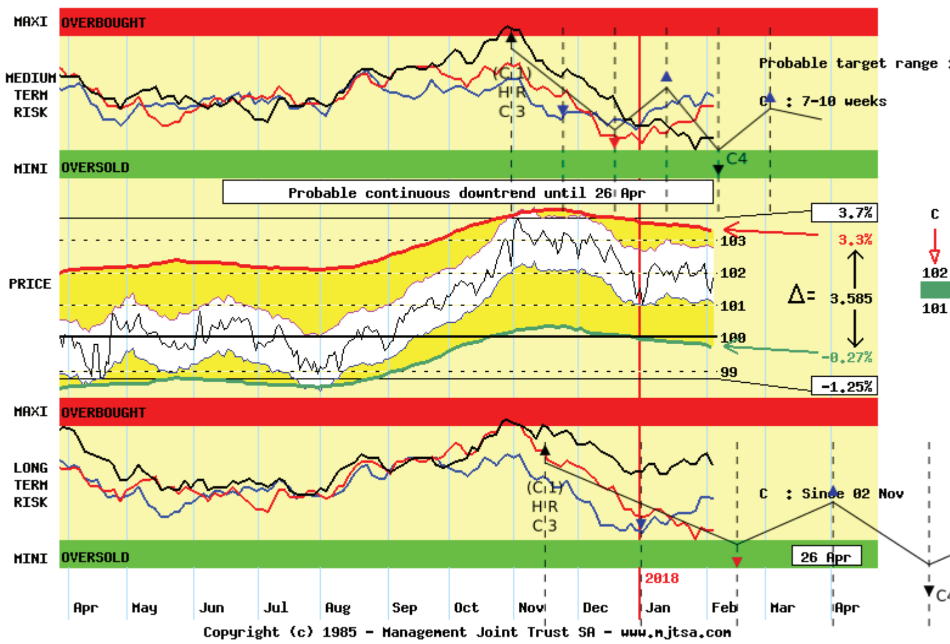
We now lookat the European Banking sector on a standalone basis, On both our oscillator series, **the sector is still uptrending and shows potential I Impulsive potential up above 200 (right-hand scale)**. That said, following the recent correction, **prices are now within our C Corrective targets down. Although, we will worry some if they break below these (below 179), retracements into Corrective price targets often deliver interesting Buy the Dips opportunities.**

XLF - Financial Sector SPDR Fund vs SPY - SPDR S&P 500
Weekly graph or the perspective over the next 2 to 4 quarters



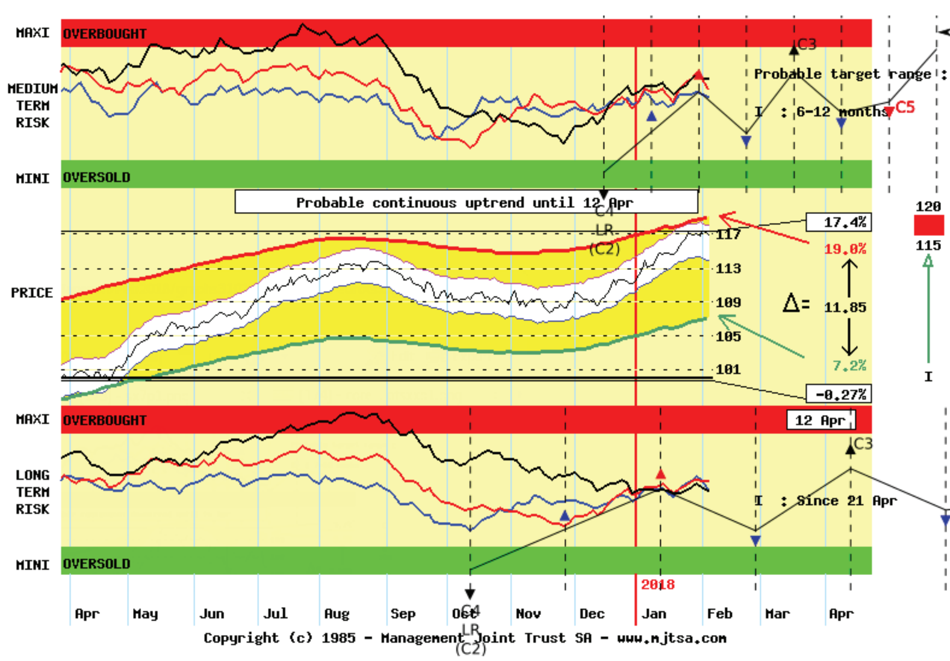
We also take this opportunity to reiterate our positive opinion on the **US Financials sector vs the market**. Although in terms of price potential the trend seems more advanced than in Europe, it may still deliver **5 to 10% outperformance until mid year** (right-hand scale). Both our oscillator series are also showing that the trend should continue up until then, possibly even into the Summer.

Europe Core (equal weighted CAC40 + DAX Kurs Index) vs Europe Stoxx 600
Daily graph or the perspective over the next 2 to 3 months



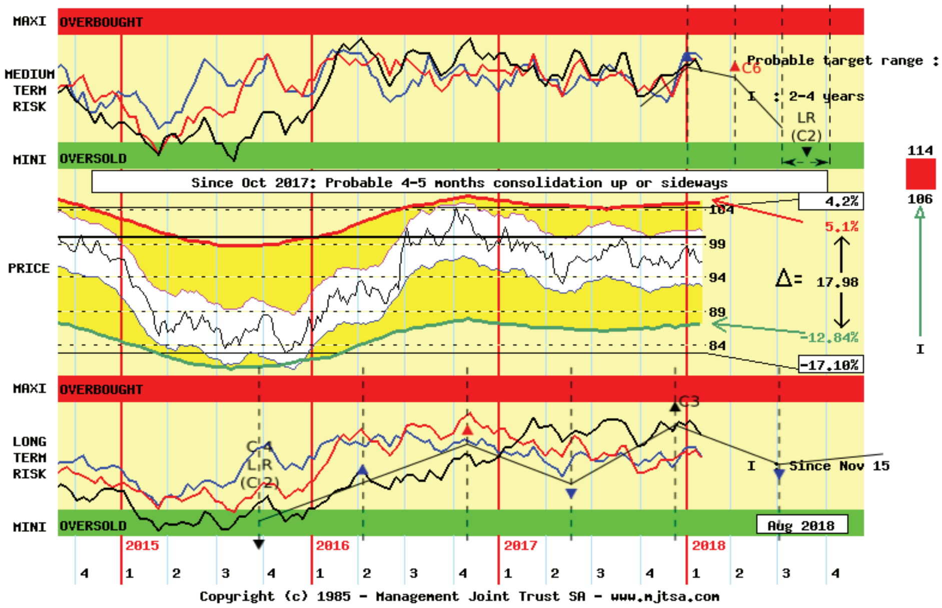
We now compare a Core Eurozone portfolio to the Europe Stoxx 600. The Core EuroZone portfolio is simply equal weighted between the DAX and the CAC40. **Historically, the DAX and the CAC40 are slightly more defensive than the general index (large markets), and are also more sensitive to changes in the EUR/USD exchange rate than the general European index**. Indeed, their constituents are often large, international companies, which on a relative basis benefit during periods of EUR weakness. On both our oscillator series (lower and upper rectangles), **we are expecting them to outperform the rest Europe, from now into March. This may indirectly confirm that the USD could rebound over the next 3 to 6 weeks.**

Dynamic Southern Europe basket vs Europe Stoxx 600
Daily graph or the perspective over the next 2 to 3 months



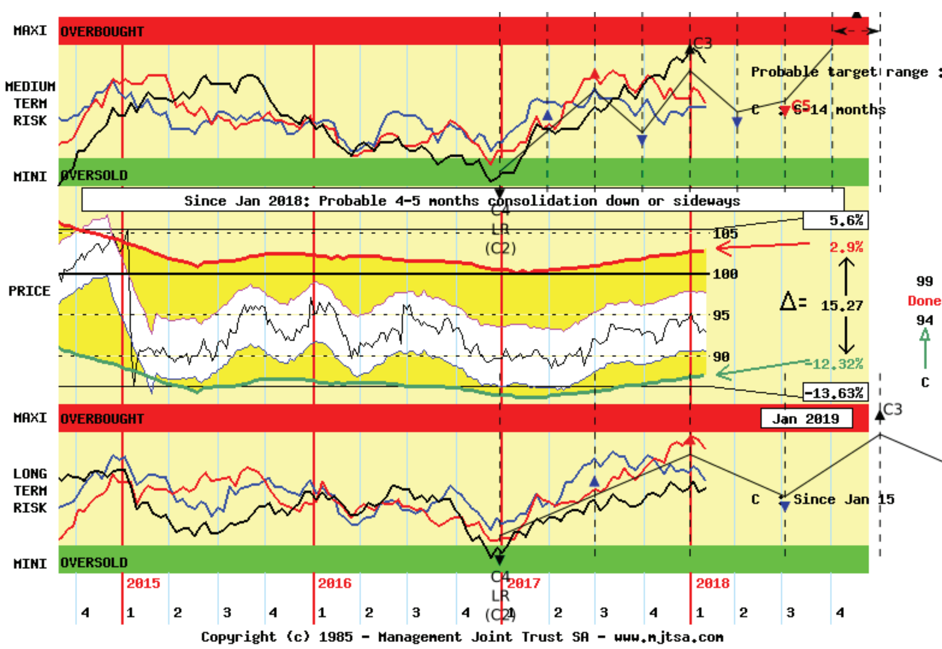
The possible outperformance of Core Europe above, may however be relatively short lived. **We now look a portfolio we label dynamic Europe, which includes Italy, Portugal, Greece and Austria. We have left out Spain, which has underperformed recently (the Catalonia events?) and included Austria, which is benefiting strongly from its exposure to Eastern Europe. These countries usually outperform the rest of Europe when the Euro is strong as their economic dynamics are less influenced by it. On Both our oscillator series, they may consolidate down into late February / early March, before they resume their uptrend from late Q1 into Q2**. Indeed, for now their outperformance potential seems a bit exhausted as they have reached our I Impulsive targets to the upside (right-hand scale). From this graph, we may tentatively conclude that the outcome of the Italian election should not be too disruptive after all.

UK FTSE Index vs Europe Stoxx 600 (hedged for currency risk)
Weekly graph or the perspective over the next 2 to 4 quarters



Turning outside the EuroZone, we first look at the FSTE vs the Europe Stoxx 600. Following a slight bounce into late Q1 (our medium term oscillators; upper rectangle), we expect to FTSE 100 to underperform, possibly until mid year on both oscillator series (lower and upper rectangle).** This may be explained by the EUR/GBP cross rate. We believe that as Commodities retrace a bit in Q1, and then accelerate up in Q2, EUR/GBP should do the opposite along with the FTSE to EuroStoxx 600 ratio.

Swiss SMI Index vs Europe Stoxx 600 (hedged for currency risk)
Weekly graph or the perspective over the next 2 to 4 quarters



Turning to Switzerland and the SMI vs the Europe Stoxx 600, both our oscillators series (lower and upper rectangles) would suggest that the SMI retraces down vs other European markets during Q1. During Q2, it then builds a base, before it accelerates up towards year end. The relative performance of the Swiss market is influenced by the EUR/CHF rates, but also by the fact that it is heavily weighted towards Defensive stocks. Its relative underperformance in Q1 may result from a retracement in the EUR/CHF cross rate (which is possible, especially during a Dollar rebound, as in Q4 2016), but could also happen on the back of a rather risk-on environment, which would penalize defensive stocks.

Concluding remarks

As we write, the current market sell-off could still be underway. That said, for now, European markets are holding onto the support of their August 2017 lows. Below that , the downside risk is probably towards the support of the January 2017 intermediate highs, 3 to 6% lower. This is non negligible, but not compelling. On a relative basis, European markets vs World markets are Oversold. We expect them to bounce back and outperform over the next 3 to 6 weeks. If the US Dollar manages to hold onto its recent short term gains, this may happen as global equity markets rebound. On the sector front, Defensives still look weak until mid year. Energy, Basic Resources and Industrials could retrace some of their recent outperformance during Q1 and then re-accelerate up towards mid year. Financials still look strong. Geographically, the DAX and the CAC could outperform over the next few weeks, as markets stabilize and the USD rebounds. Following that, our dynamic Europe portfolio (Italy, Greece, Portugal, Austria) should outperform again, probably towards mid year.