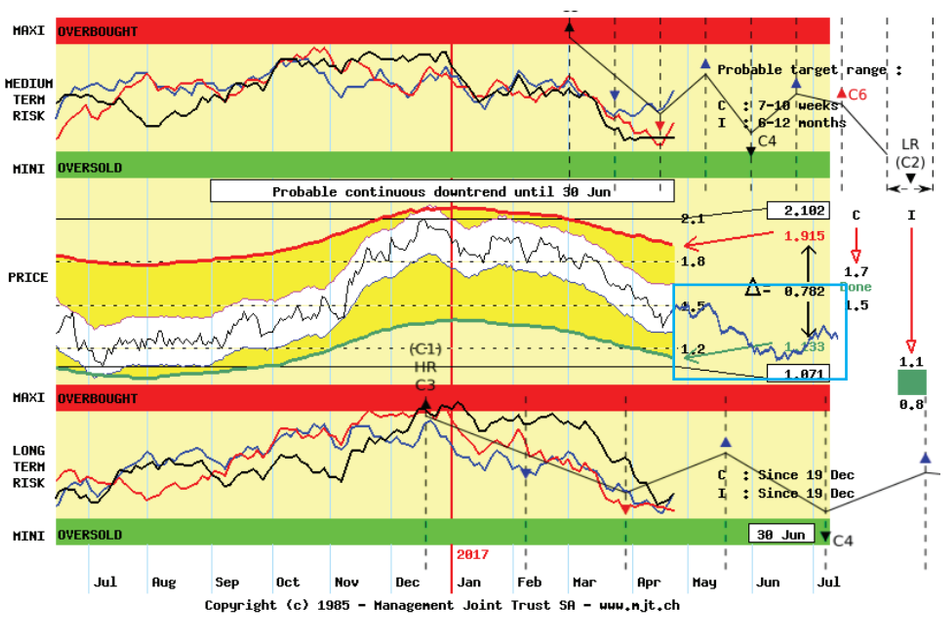
41 / TIMING AND TACTICAL INSIGHT

The yield curve may flatten further before it bounces later in H2 2017

In light of the article above on IOR, Fed Fund rates and their negative correlation with the yield curve, we consider the yield curve, rates and the US equity to bonds ratio in an attempt to map the upcoming risk-off period we expect during May and June.

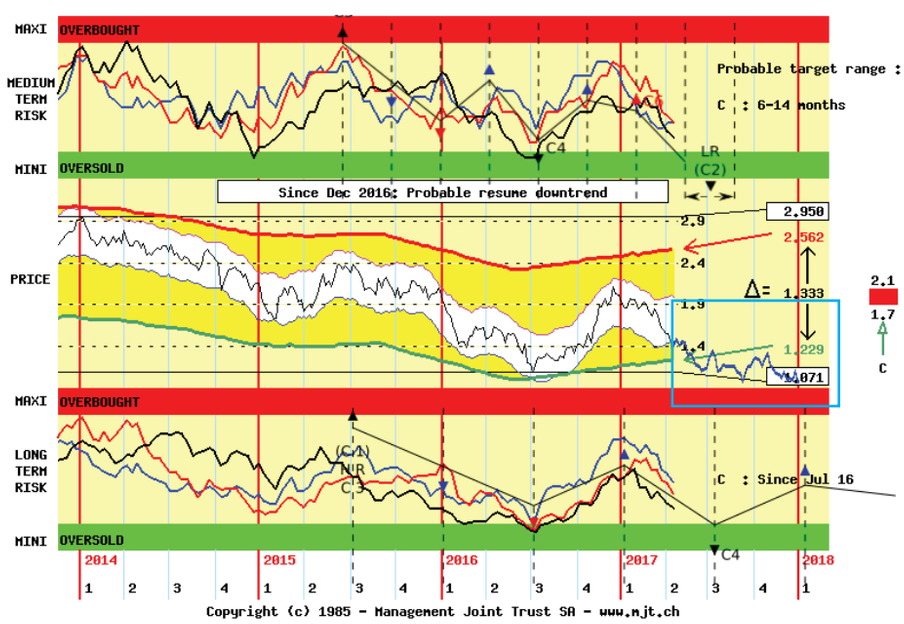
US 10 years Benchmark Bond Yield - US 3 Months benchmark Bond Yield (Daily graph or the perspective over the next 2 to 3 months)



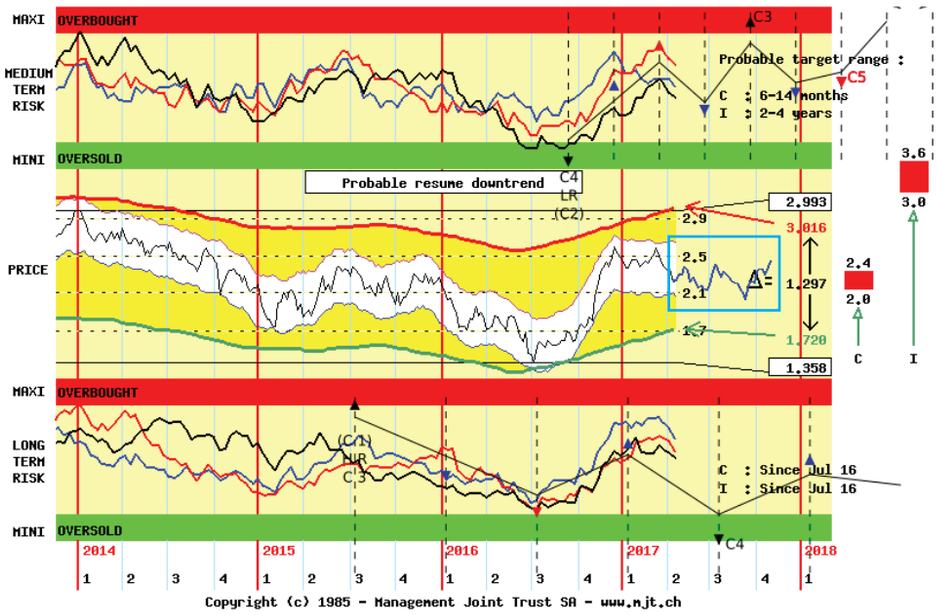
During April, the US 10Y – 3M treasury spread dipped below its corrective targets down (below 1.5%, right-hand scale). The spread is now in an impulsive downtrend with "I" impulsive targets which could justify a retest of the 2016 lows (towards 1.1% or even 0.8%). Both our oscillator series would suggest that **this downtrend developes into June at least, possibly making a low towards late June, July or even August**. In the meantime, we would expect a slight and late bounce into early May before the spreads starts accelerating down again.

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

Looking for further confirmation of this scenario, we turn to the Weekly chart of the same US 10Y – US 3m spread. Indeed, following a strong move up in H2 2016 and a test of our "C" corrective targets up between 1.7% & 2.1% (right-hand scale), the spread is rapidly retracing towards its 2016 lows. On both our oscillator series (lower and upper rectangles), **we expect this downtrend to continue probably into early Q3 2017**.



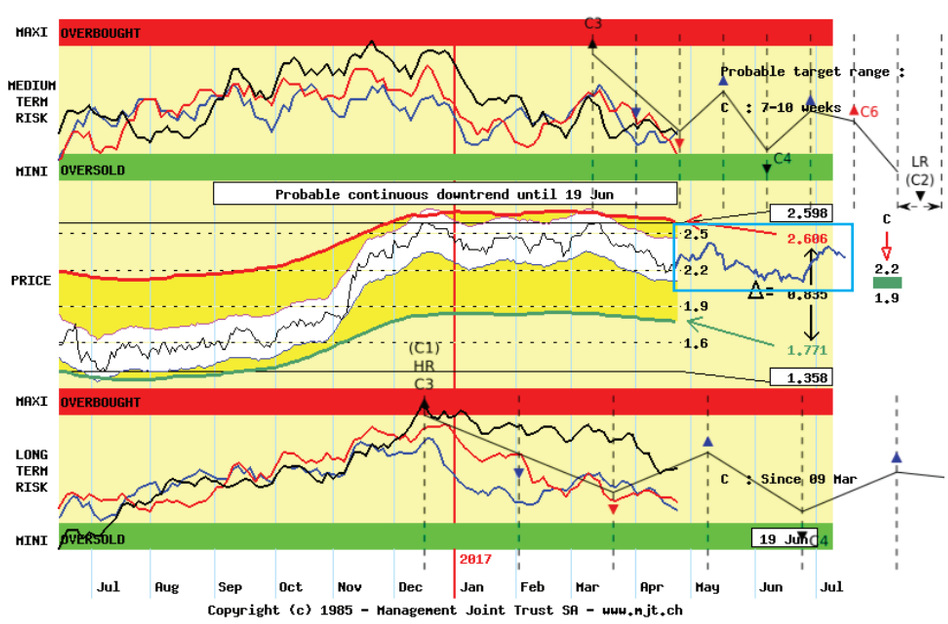
US 10 years Benchmark Bond Yield
(Weekly graph or the perspective over the next 2 to 4 quarters)



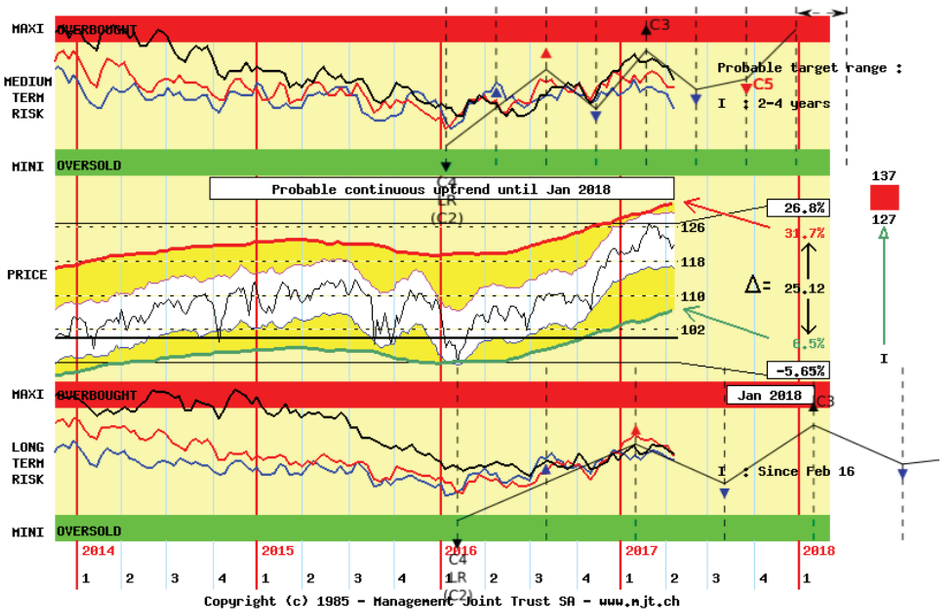
We look for further indication of this rather negative scenario and now consider the Weekly chart of the 10Y US Government bond yield. On the positive side, the strong move up during H2 2016 did briefly make it above or "C" corrective targets up (or above 2.4%; right-hand scale). This break-out would theoretically justify that the 10Y US Government Bond yield could resume its uptrend during H2 2017 to reach our "I" impulsive targets up above 3% sometime in late 2017 / early 2018. This scenario is highlighted by the model we project on our medium term oscillators (upper rectangle). That said, in the meantime, **the 10Y yield should correct further to the downside, possibly into mid year** as shown by the sequence we project on our longer term oscillators (lower rectangle). The fate of the 10Y yield during H2 2017 will probably depend on how deep the correction to the downside into mid year is likely to be. We consider the Daily chart below for further clues.

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

On this daily chart, we note that the 10Y US Government bond yield made a double top configuration between mid December and mid March. From the December top, we project a downtrend sequence on our longer term oscillators (lower rectangle). This would justify possible lows into late June. Similarly, from the March top, we project a downtrend sequence on our medium term oscillators (upper rectangle), which point to a low point towards mid June. Both are fairly close to our automatic messaging, which expects a tentative low the 19th of June. In the meantime, both oscillator series could justify a slight bounce into early May. On the price target front (right-hand scale), **it will be crucial to hold the support of our "C" corrective targets down (i.e. above 1.9%)** as a breakthrough these levels to the downside would open the door towards the next level of downside targets we calculate between 1.5% and 1.2% (i.e. towards their 2016 lows).



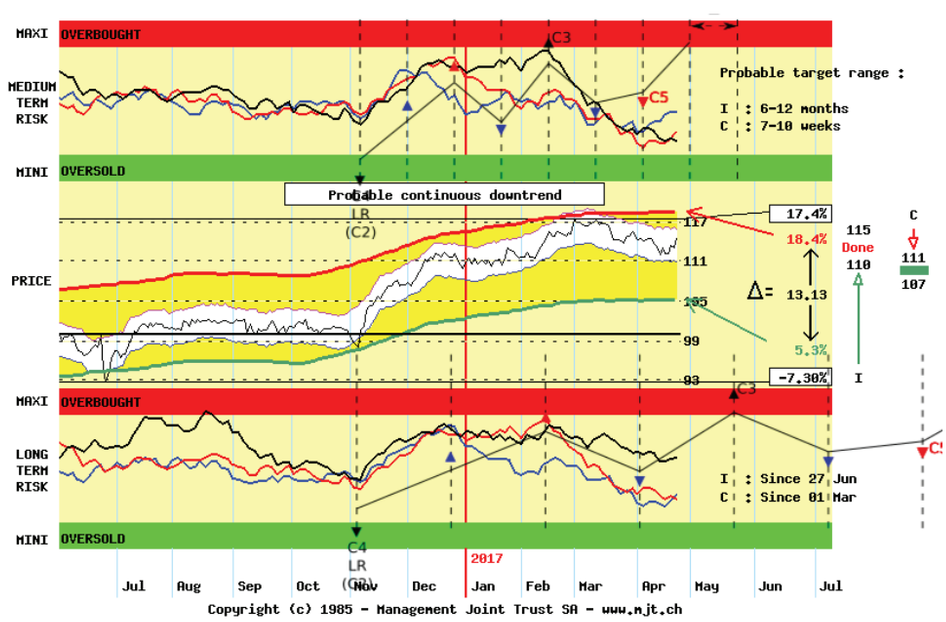
S&P 500 / Treasury Notes 10 Years Contract (Jun)
(Weekly graph or the perspective over the next 2 to 4 quarters)



We now focus on the US equity to bond ratio for further clues of the risk off period which may lie ahead. On both our oscillator series (upper and low er rectangles), we can identify intermediate tops, which were made early March 2017. These would justify **a correction period to the downside, which could last until June (upper rectangle) or possibly July** (lower rectangle). Following that, the ratio should resume its uptrend in H2 2017, towards early 2018 as mentioned by our automatic messaging (middle rectangle).

S&P 500 / Treasury Notes 10 Years Contract (Jun)
(Daily graph or the perspective over the next 2 to 3 months)

Turning to the Daily chart of this US equity to bond ratio, **we can expect a last move to the upside towards early/mid May** on both our oscillator series (lower and upper rectangles). It might retest its recent highs, yet our "I" impulsive targets up have already been achieved (I up "done"; right-hand scale), i.e. the risk/reward is quite stretched. **Following that a correction to the downside should materialize into late June** towards our "C" corrective targets down. The correction to the downside of US Equity vs Bonds during this period could reach circa 10% from the highs made in March ("C" down; right-hand scale).



Concluding remarks:

The FED's recent rate hikes seem to have been counter-productive once again. Indeed, the yield curve has reversed course (now flattening again) and we would expect that it continues this rapid flattening into midyear. US 10Y yields are holding up slightly better, yet they need to hold 1.9% to justify a linear continuation of the uptrend initiated last year. Both point to a new risk-off period ahead, which according to the US equity to Bonds ratio, could start between early and mid May and extend into late June. In the meantime, we expect a bounce on these 3 items (yield curve, 10Y yields, US Equity to Bonds ratio) which could last a week to 10 days (a further exit opportunity before the risk-off period actually starts).