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featuring MJT timing methodology



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DIAPASON COMMODITIES & CURRENCIES





DIAPASON COMMODITIES AND CURRENCIES MACRO ANALYSIS

A Monthly Macro and Asset Review
Featuring MJT Timing Methodology

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The shift towards more reflationary policies by many growth-starved countries around the world is still largely an aspirational one, offset in many instances by slowing trade, poor demographics, weak productivity, and heavy debt burdens. As such, we think that the cross-currents of near-term reflationary stimulus juxtaposed against the aforementioned structural macro headwinds likely mean more volatility lies ahead for investors again in 2017.

KKR GLOBAL INSTITUTE

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Inflation is breaking out everywhere, but it may not be the rewarding strategy to go for reflation trades during H1 2017

The latest inflation data from the Eurozone indicate a substantial jump in inflation in Europe's largest economy in December, eliciting calls, especially from Germany, that the European Central Bank president Mario Draghi end his ultra-loose monetary policy and raise the ECB's policy rate. Draghi once more faces the wrath of Germans fearful that savers face devastation due to zero or even negative interest rates, and fretting that the supposed "guardian of price stability" will let them down. This reaction is natural in Germany, where people have been conditioned to fear inflation. But the situation is complicated by the fact that the ECB sets monetary policy not only for Germany, but for the whole euro area.

On a eurozone-wide view, the numbers are more benign -- CPI growth in the currency bloc is at 1.1 percent in December, almost twice as fast as the previous month but still well below the goal of just under 2 percent. The ECB predicts euro-area inflation won't reach that target until at least 2019. ECB policymaking in the past several years has been conditioned by the slow economic growth in the eurozone and the actual fear of deflation, driving the central bank to adopt radical measures, like negative interest rates, in efforts to underpin growth. The ECB's drive towards zero and even negative rates has been the biggest single factor that has kept the EUR lower against the US Dollar over the past several quarters.

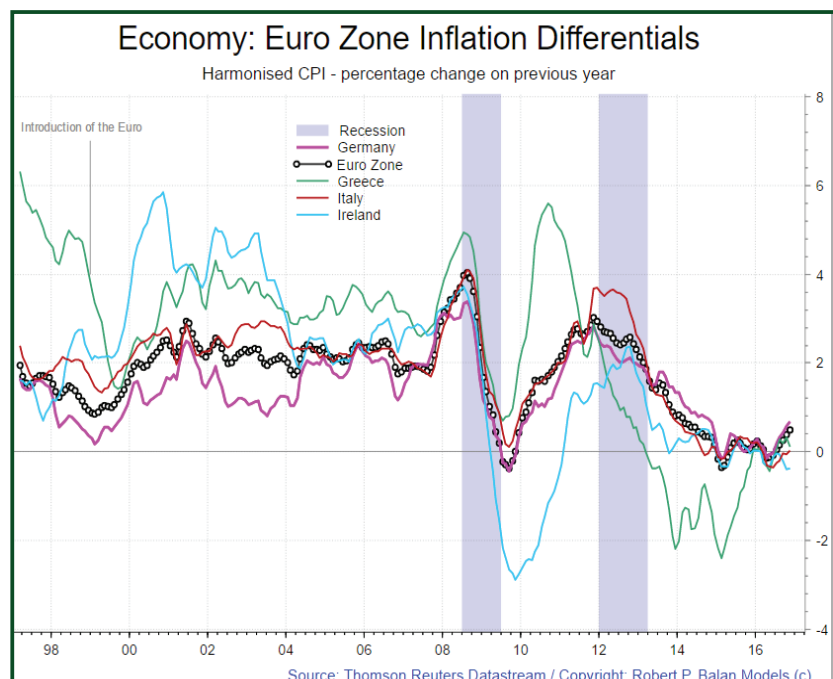
However, the first inflation data in the new year brings a reminder

of just how strong the German economy has become during this time. The number of jobless fell more than forecast in December; the unemployment rate remains at a low of 6 percent, and inflation (boosted by higher energy, food and goods costs) increased a record 1.7 percent from 0.7 percent (see graph below).

The reaction to the data was immediate and predictable -- Clemens Fuest, president of the respected Munich-based Ifo research institute, called on the ECB to consider ending its bond-buying program in March, which the ECB Governing Council decided just last month to extend until at least the end of 2017. Germans have always been leery of the ECB's bond buying program, and the low interest rate regime that comes with it. Bild, Germany's most-read newspaper, in an opinion

piece wrote that people "are seeing a net devaluation of their savings while governments in euro countries can continue borrowing at historically low costs," in a regime of rising inflation while deposit accounts' interest rates are at near zero. The Handelsblatt newspaper reported that Germans could lose tens of billions of euros a year on the real value of their savings under those conditions, which Bavarian Finance Minister Markus Soeder told the paper would be "devastating."

The reality is that with energy costs rising quickly in the past few months, the strong disinflationary pulse that the globe had seen in 2015 and during the early part of 2016 is all but neutralized. The deflation meme, as we stated before, is dead. Inflationary expectations have jumped up in Europe, and along with rising inflationary

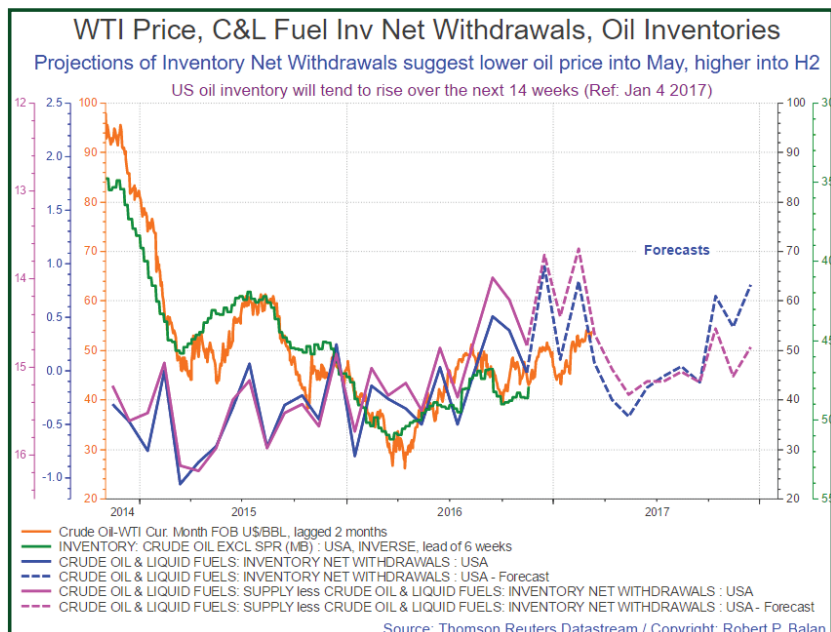
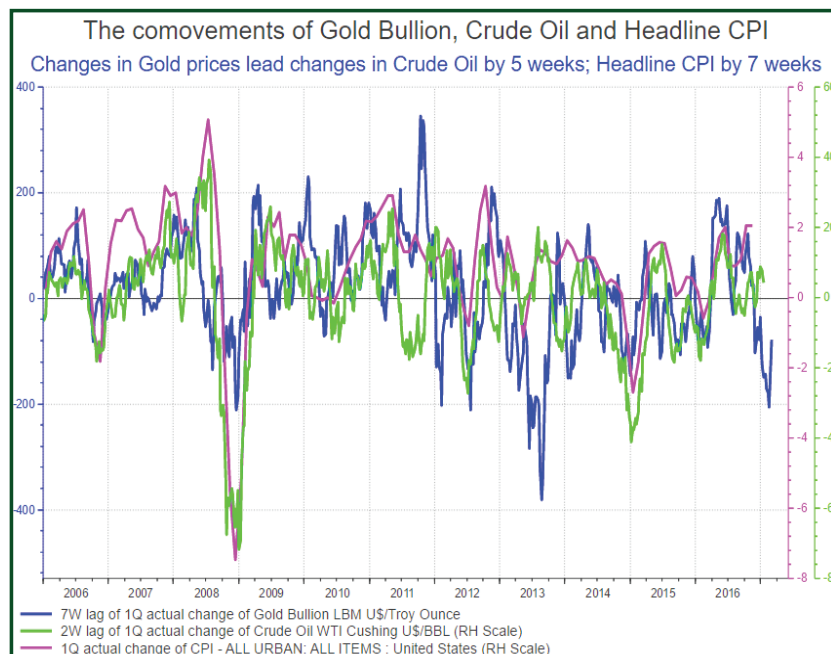
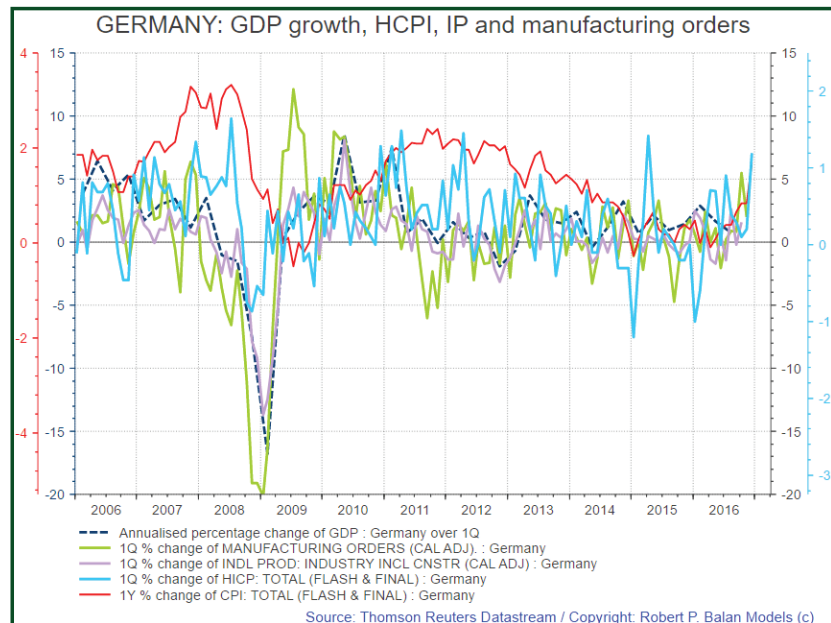


expectations in the United States, the picture emerging is one where inflation may become an issue again for investors and central banks across the globe in the near future. So far, we see that rising inflation in the US is being driven by the rapid rise in energy costs in the past four quarters of 2016.

But we also see some indications of lower energy prices during the early parts of H1 2017, as energy prices moderate somewhat. This may be illustrated with the comovements of gold, crude oil and Headline CPI as illustrated on the graph 2 on this page. Gold has the tendency to lead crude oil prices by almost two months, and oil prices lead the CPI by about a month. The weakness in gold prices in the past few weeks (among other things, including the oil term structure) is signaling lower oil prices, and therefore lower Headline CPI during Q1 2017 or even in Q2.

Most economic and asset price projections for the first half of 2017 do not include this kind of picture for energy prices (see graph3), and therefore for inflationary expectations and actual inflation, making assumptions that US President-elect Donald Trump's fiscal initiatives will carry on lighting up reflation trades, with devastating implications of sharply rising interest rates. The kind of interest rate displacement pundits are talking about, if it comes to pass, may just spell the end of the bond bull market.

However, we have issues with the timing element of those assumptions. Let's just say that Mr. Trump will become president by January 20, 2017 but those initiatives will definitely take some time before we arrive at the get-go moment. In the meantime, interest rates will likely continue to be impacted by the evolution of energy prices, which determine the path of Headline CPI, which in turn, significantly influences the trajectory of interest rates.

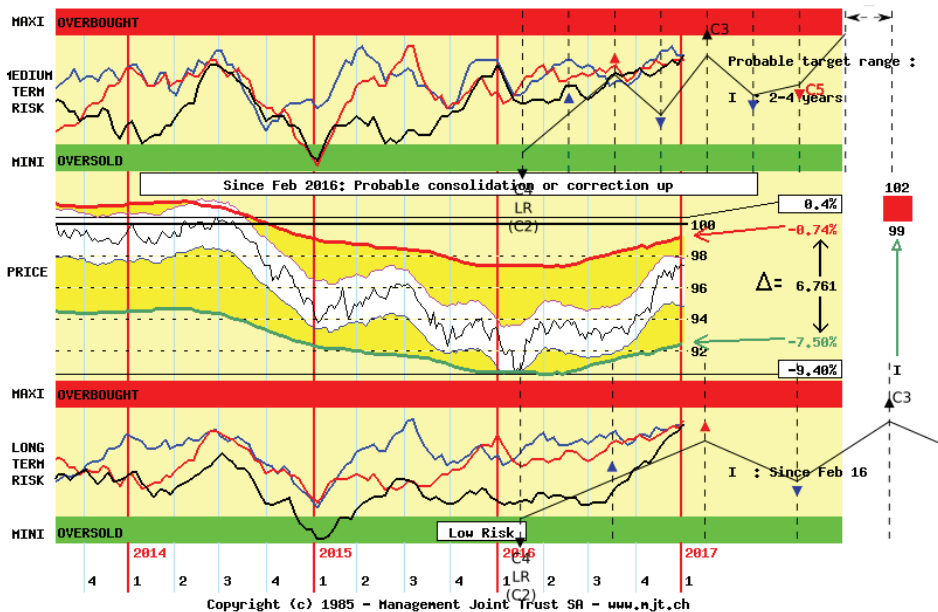


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Reflation trades should top out and start to retrace during Q1 2017:

Globally, reflation linked assets are also due for several months of retracement once they top mid Q1.

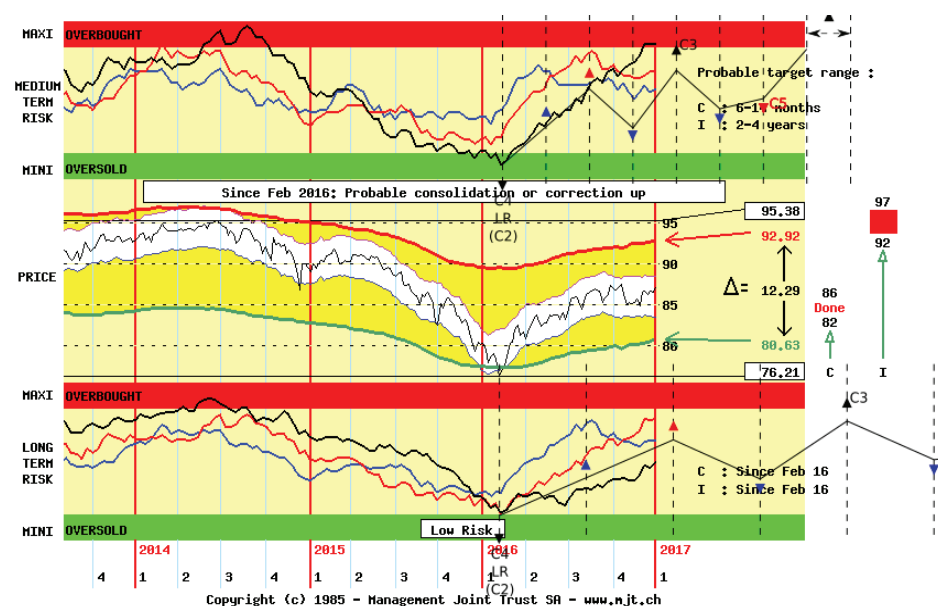
TIP - iShares TIPS Bond ETF vs IEF - iShares 7-10 Year Treasury Bond ETF (Weekly graph or the perspective over the next 2 to 4 quarters)



The TIP to IEF ratio is a proxy for investors appetite in seeking inflation protection. Both ETFs show similar duration, which allows for an adequate comparison. The ratio usually moves when inflation surprises materialize. Both the sharp rebound in Oil in Q1 2016 as well as the election of Mr Trump provided such situations. Our oscillators series (upper and lower rectangles) suggests than the

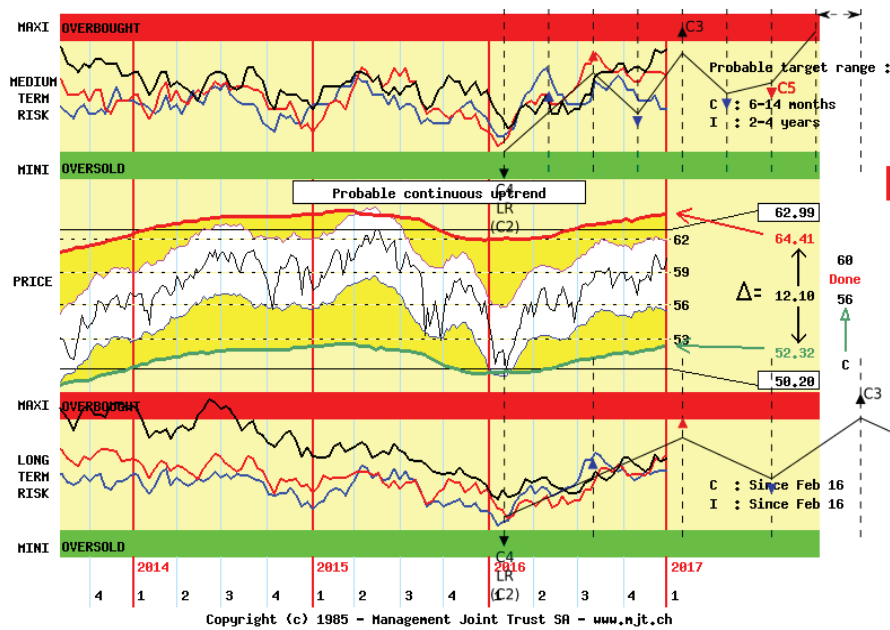
inflation surprise effect should subside as we enter 2017 and that the ratio should start to consolidate down for 3 to 6 months on an intermediate top mid Q1 2017. Following that, the uptrend should resume probably announcing more inflation surprises but only for H2 2017.

HYG - iShares iBoxx \$ High Yield Corporate Bond ETF (Weekly graph or the perspective over the next 2 to 4 quarters)



High Yield bonds show a similar dynamic to oil and are also positioned for an intermediate top during Q1 2017 on both our oscillator series (lower and upper rectangles). More generally, a relative chart of Corporate Bonds vs Government Bonds with the same maturity, would show a similar picture (i.e. appetite towards Credit is also eyeing an intermediate top during Q1 2017).

ACWI – iShares MSCI ACWI Index Fund (All Country World Index) (Weekly graph or the perspective over the next 2 to 4 quarters)

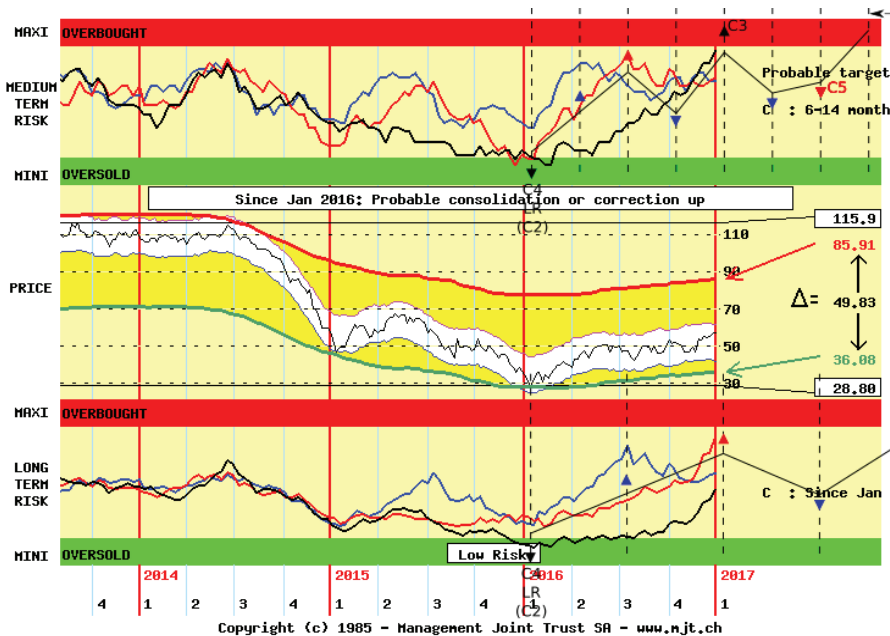


From its lows in February last year, ACWI has initiated an uptrend sequence on both our long term and medium oscillator series (lower and upper rectangles).

During Q1 2017, an intermediate top should materialize (prospective timing towards mid Q1 2017), which could trigger 3, possibly 6 months of retracement (respectively on our medium term and long term oscillators).

Following than, the uptrend should resume in H2 2017 with a further 10 to 15% upside from current levels ("I" Targets, i.e. "Impulsive Targets"; right hand scale).

Brent Oil (Weekly graph or the perspective over the next 2 to 4 quarters)



As a key reflation asset, Oil is showing a similar dynamic, we expect it to top out during the first half of Q1 2017 on both our long term and medium term oscillator series (lower and upper rectangles). The correction down could last into early Q2 2017 (medium term oscillators, upper rectangle), in worse cases towards mid year (longer term oscillators, lower rectangle).

Following that, the uptrend in Oil prices should continue towards

the higher end of our corrective targets up (higher \$60s, lower \$70s; right hand scale). Above that, the next resistance levels are towards the \$100 mark. These could probably be reached towards end 2017, early 2018.

Concluding remarks:

The main drivers of the reflation trade all seem to point to an important intermediate top ahead during Q1 2017. The correction that follows could last 3 to 6 months depending on assets and could retrace all of the gains since the US election, for some, possibly more, into the levels traded mid 2016.

As US growth is at risk of decelerating, possible roadmap through a distribution period for key assets.

Inflection point may happen by mid Q1

As mentioned above, we have several issues with the market perception that the Donald Trump effect will continue to be the most significant market and economic driver during H1 2017.

The first issue, as we said earlier, has something to do with the timing of the impact of whatever salubrious measures the administration of Mr. Trump may take in restructuring regulations, cutting taxes and rebuilding public infrastructure.

Despite Republican Party control of both houses of Congress and a majority of State governorships, passage of Mr. Trump's agenda does not appear to be a slam dunk insofar as Congress is concerned. We seriously doubt some market participants' characterization of the Republican-controlled Congress as a rubber-stamp entity, as even now some Republican politicians look like having cold-feet with regards to the size of the budget deficits that Mr. Trump's infrastructure projects entail, during a time when taxes will be cut as well. Massive budget deficits, in the scale proposed by Mr. Trump during his election campaign, do not go well with the natural, conservative bent of many Republican congressmen and senators. In fact, it was this miserly attitude which may contribute to the growth hiccup that we expect during H1 2017 and possibly for most of the year

thereafter, until early 2018. Simply put, the US economy was starved of sufficient funds by trimming down the budget deficit as from 2012, even as the economy struggled to reach take-off velocity. Lower deficits reduce systemic liquidity, and that does impact the economy after 8 to 12 quarters -- there is some sense of proportionality between the size of the deficit that was trimmed and the size of subsequent dislocations in growth (see graph 1 next page).

Therefore, it appears that problematical growth issues that have already been "baked in the cake" due to the very significant reduction of the US budget deficit over the past 4 years. We do not really expect a full-blown recession, just a "technical" growth recession over the next two or three quarters of the new year. If Mr. Trump does what he said he will do, and assuming the Republicans who control the Congress and Senate go along, then the worse scenario case may be avoided. But the economy will nonetheless battle the negative impulses that have already been set into motion. And there is indeed a non-trivial risk that slower growth will keep inflation subdued, an environment which suggests that longer term interest rates may still revert to the mean and could hypothetically retrace sharply the recent rise.

We believe that if these events come to pass, we should see better levels and better timing for reflation trades sometime in the second quarter of the new year.

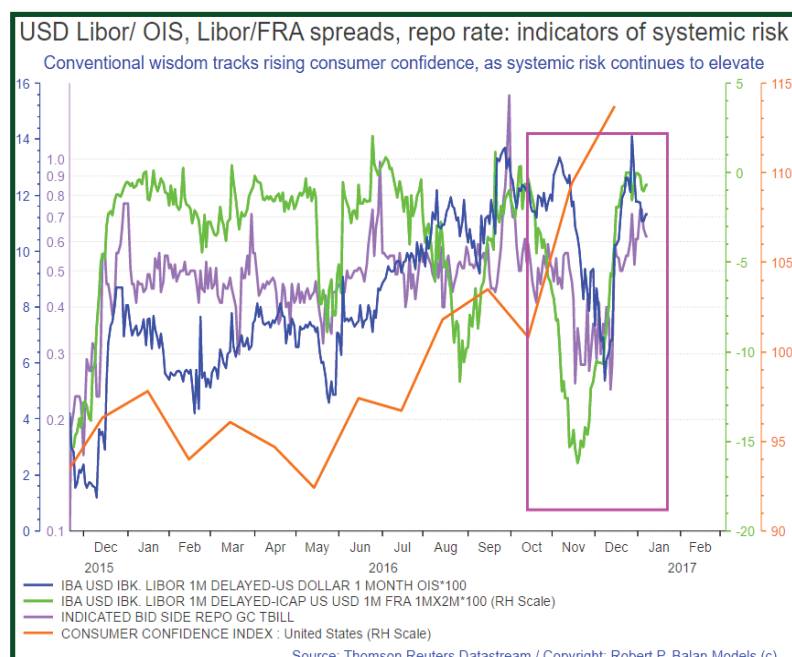
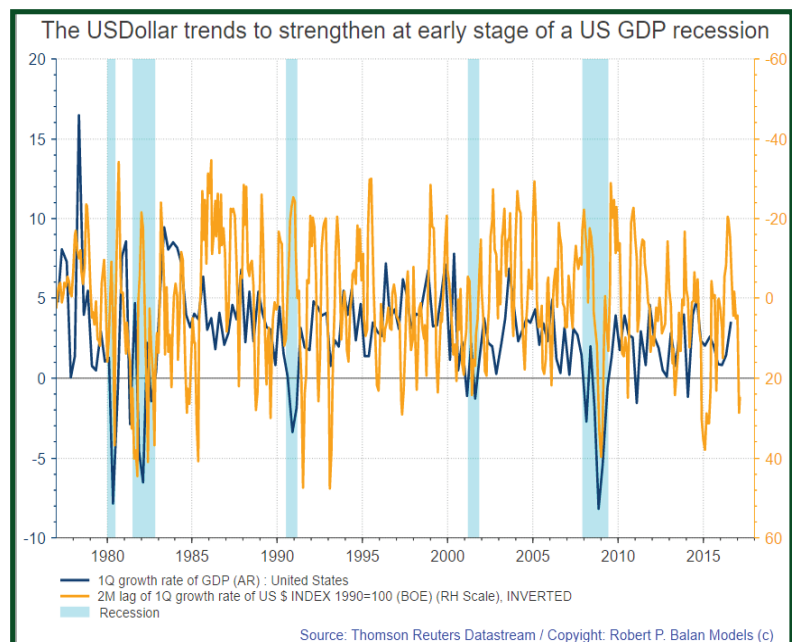
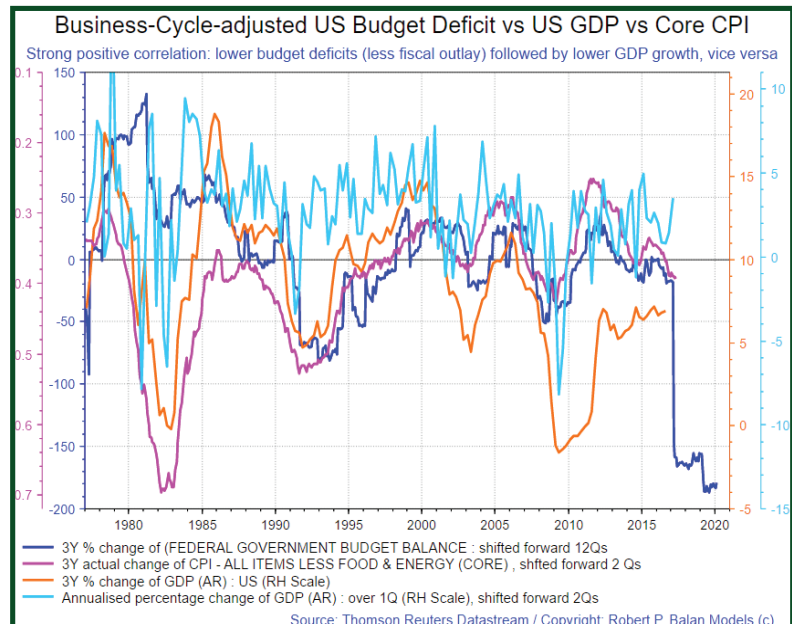
Bad as the "baked in the cake" growth issues emanating from miserly budget allocations, the recent Fed tightening of monetary policy, on top of a sharply higher US Dollar and long term rates added to the long list of negative factors which may indeed tip the economy over to at least a technical growth recession (of two consecutive quarterly GDP declines).

For one, there is a strong negative relationship between a strong US Dollar and a subsequent growth slowdown 2 to 3 months thereafter. The transmission mechanism in the relationship is probably the next exports component of GDP (see graph 2 next page). This outlook does not hew to what is considered today as conventional wisdom about the markets and the economy. The accepted mode is a continuation of the robust growth seen in Q3 2016, bolstered by the positive implications of a rising equity market, and a confirmation coming from rising bond yields -- all of these being de rigueur in an environment of rising growth and activity. However, market-based leading indicators of systemic risks are flashing unwelcome signals -- spreads between the market price for LIBOR and FRA pricing, and the spread between Libor and OIS are widening again.

We think those widening spreads spell rising systemic risk, even as consumer confidence elevates, tracking conventional wisdom (see graph 3 next page). Half of the world's \$300 trillion in total debt and derivatives is denominated in US dollars. It is therefore not unreasonable to call the US dollar LIBOR as the single most important daily market rate posted globally, and moreover because it is a reference for money managers of US dollar denominated fixed-income portfolios. One basis-point shift (a basis point is 1/100th of 1%) in LIBOR amounts to an annual transfer of \$15 billion from lenders to borrowers or vice versa. The Libor spot price is the interest rate the banks are charging for unsecured loans to each other. Commercial borrowers and institutional agents that transact with those banks also usually structure their transactions at a spread above a LIBOR benchmark.

It is the spreads that are discussed and negotiated, and therefore what makes the difference, in the transaction world of high finance. Therefore, changes in the spreads are lead indicators of rising or falling market-based risk perceptions -- an early warning system, so to speak. In the current context, that risk may be coming from the sudden sharp rise of US rates, the consequent sharp ascent of the US Dollar, putting billions of USD denominated EM loans in danger, or the outlook of higher energy prices could push inflation (actual and expected) higher, further providing a tailwind to rising rates globally. Or it could be a recognition of the "baked in the cake" future growth angst embedded in the US growth structure – nobody can say.

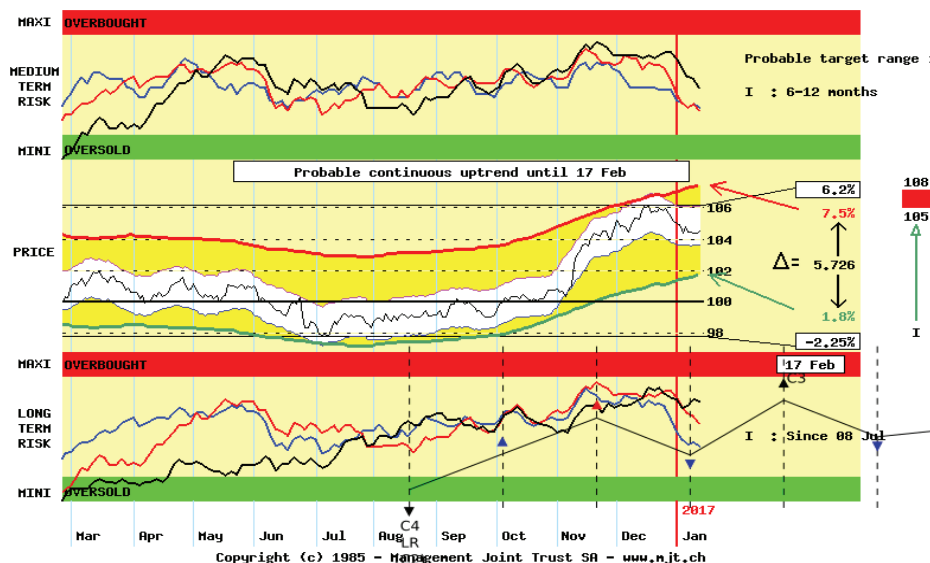
But the early warning emanating from the rising Libor spreads should be heeded. We believe it is premature to stay heavily into reflation trades during H1 2017.



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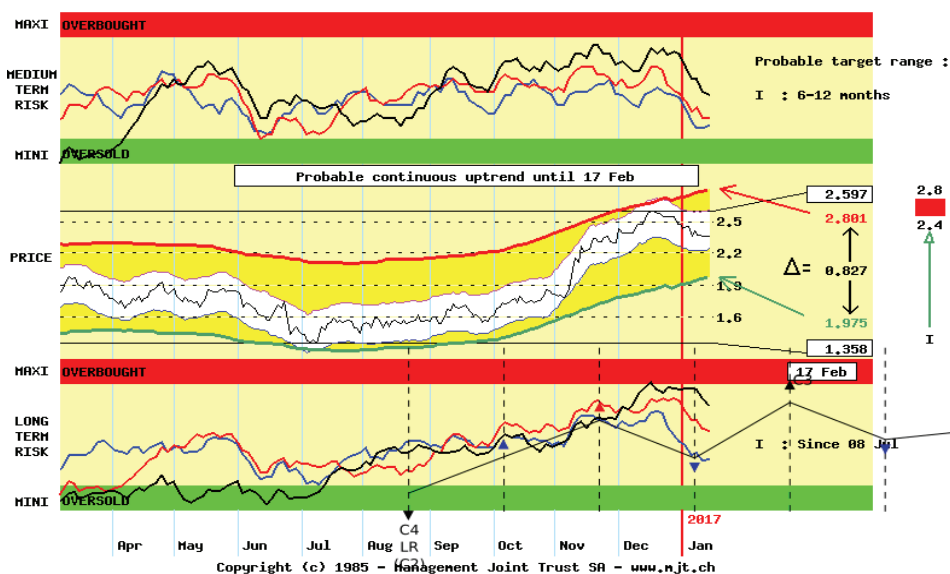
As the economy decelerates, Bond Yields should top and start to retrace

SHY - iShares 1-3 Y Treas. Bond ETF / IEF - iShares 7-10 Y Treas. Bond ETF
(Daily graph or the perspective over the next 2 to 3 months)



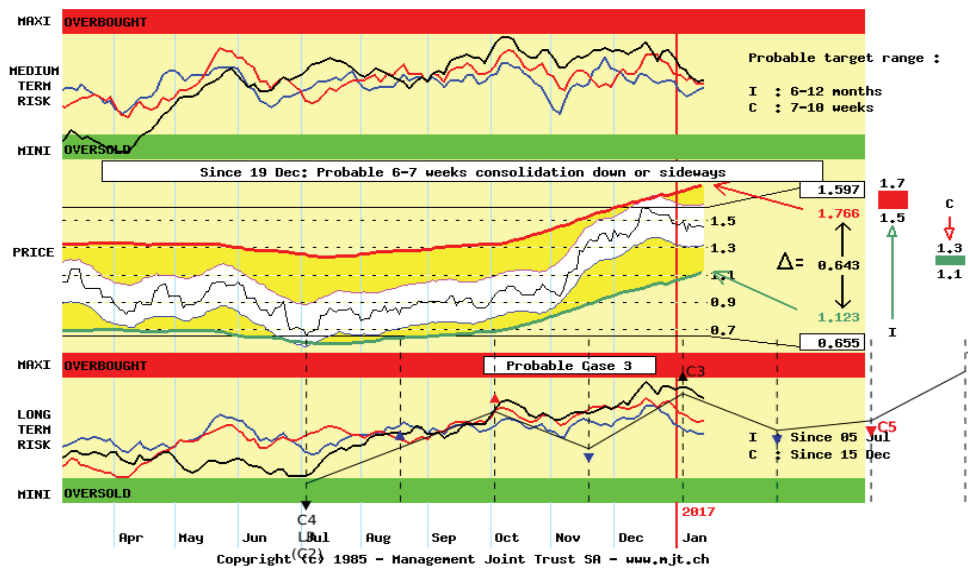
We simulate the yield curve by comparing this short term treasury ETF (SHY) to the longer term one (IEF). According to our long term oscillators (lower rectangle), the pair could soon resume its uptrend towards an end of February top (yield curve should steepen further). From a targets perspective (right hand sale), the move has little potential left.

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



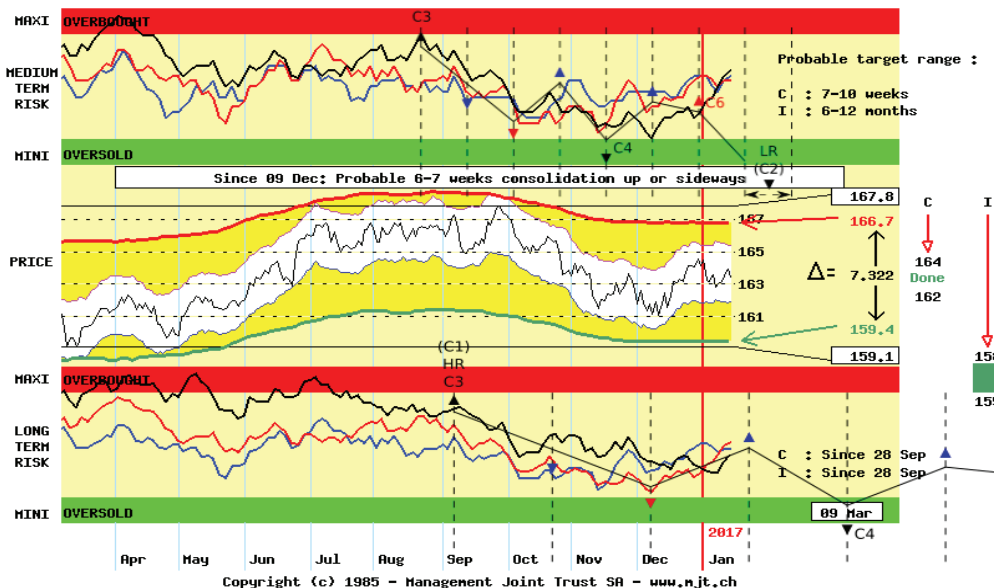
The steepening move described above is mostly the result of a further rise in long term interest rates: the 10Y US benchmark yield also tops towards end February on our long term oscillator sequence (upper rectangle). The potential up is limited (right hand scale), yet it could make new highs. Our current measure of historic volatility (our Delta = 0.827 bps shown on the right portion of the chart) suggests that once it corrects, the 10Y yield could retrace 40 to 70 bps.

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



Indeed, the 3Y US benchmark yield may find it more difficult to push higher now: a Case 3 top has also been identified on our long term oscillator sequence (lower rectangle). It usually triggers several months of consolidation. Our corrective targets down ("C"; right hand scale) suggest that this correction could retrace 20 to 40 bps.

Bund Futures (March) (Daily graph or the perspective over the next 2 to 3 months)



In Germany, the yield curve has also recently been mostly influenced by its long end. Indeed, tenures below the 5 years are still retesting lows, while the 10Y has moved up rapidly. The correction down on the Bund could resume during January towards a Case 4 low in early March (lower rectangle). Alternatively, based

off the intermediate low made mid November, a late February bottom could also be envisaged on our medium term oscillators (upper rectangle).

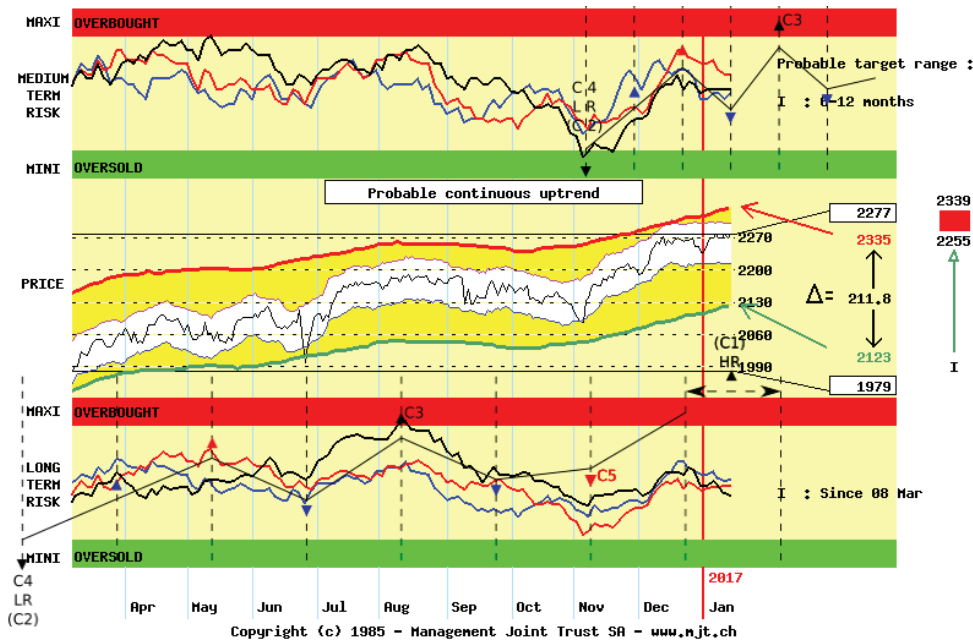
Concluding remarks:

The rise in interest rates since mid last year is nearing the end of a first leg up. There seems to be limited potential left on short term tenures, yet, the long end could extend into late February / early March resulting in the yield curve steepening a bit further.

As Equities top and Oil fades, Gold may shine again

S&P500 Index

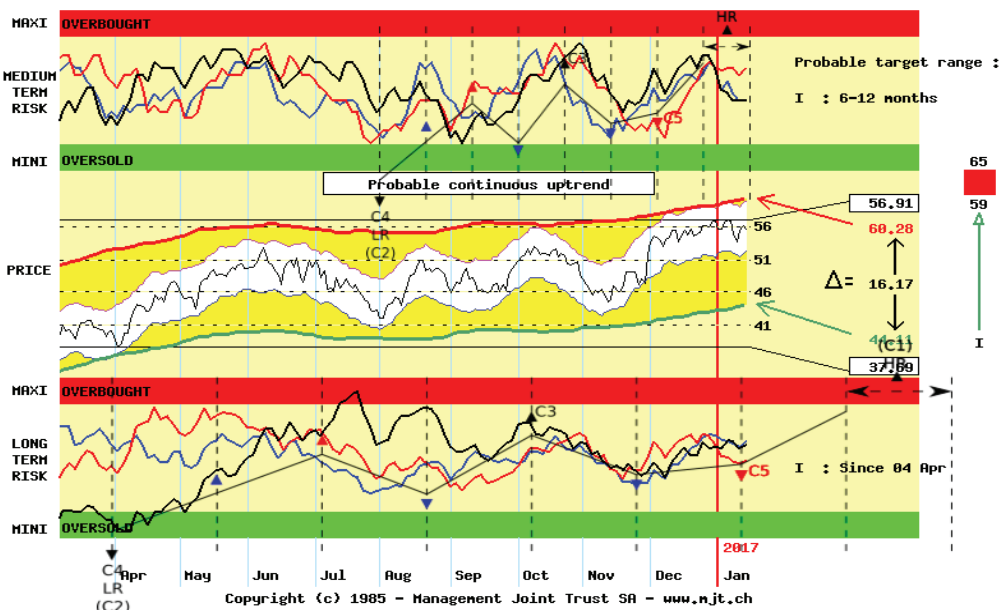
(Daily graph or the perspective over the next 2 to 3 months)



Following our classical uptrend model, our long term oscillators have now entered a High Risk zone ("HR", lower rectangle). On our medium oscillators however, one last sequence is still underway until early February (upper rectangle). The potential up is limited (2 to 3%; right hand scale). Following that prices could correct down towards the low 2'100s ("C" correction down; right hand scale)

Brent Oil

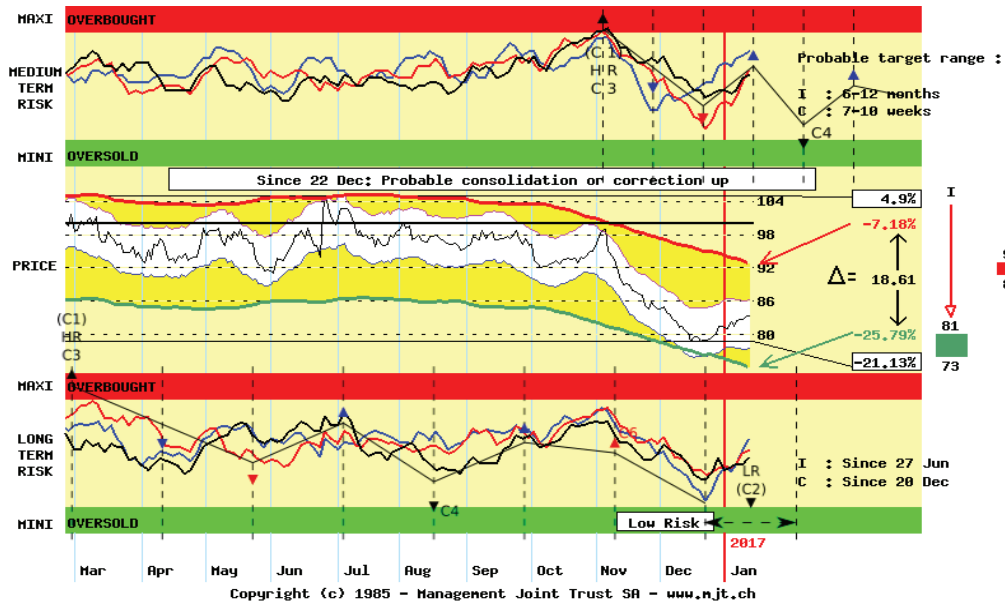
(Daily graph or the perspective over the next 2 to 3 months)



In line with our Weekly chart, a High Risk situation has materialized on our medium term oscillators early January ("HR"; upper rectangle). Yet, we would warn on turning too negative too quickly as a Case 5 set-up may be developing on our long term oscillators (lower rectangle). It would set the scene for a continuation trade into February, possibly into the lower \$60s (right hand scale).

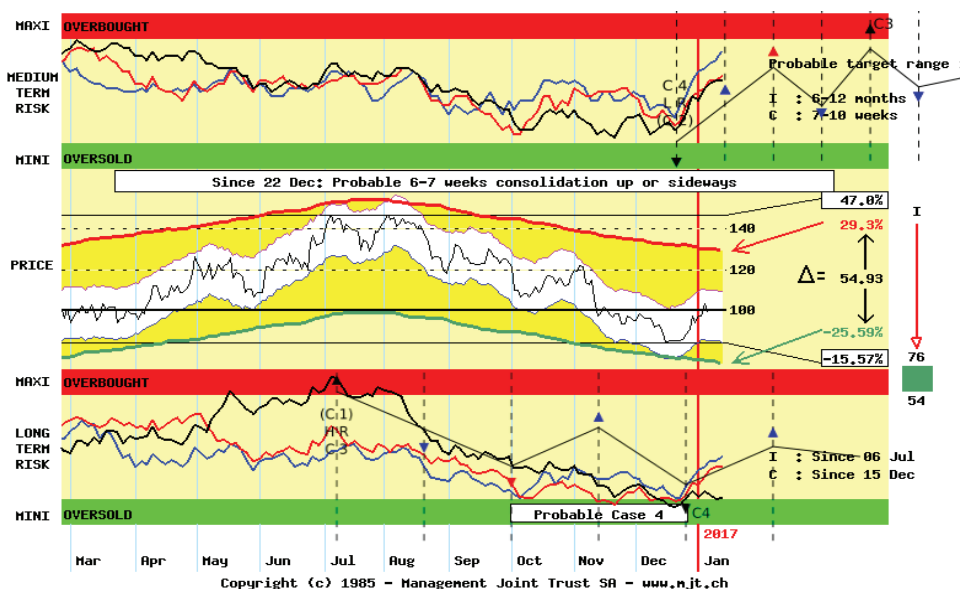
The risk/reward ratio is however extended: if we calculate the corrective potential down (not shown), it would imply a correction down of \$8 to \$13 per barrel based on "Delta" our historical volatility measure (calculated here at 16.53 US Dollars). Once the top is confirmed, we would expect this type of correction into Q2 2017.

Gold vs the S&P500 Index (Daily graph or the perspective over the next 2 to 3 months)



The ratio has reached a Low Risk zone on our long term oscillators (lower rectangle). As with the S&P500 Index, we expect a continuation trade on our medium term oscillators (upper rectangle); i.e. one last retest down towards early February

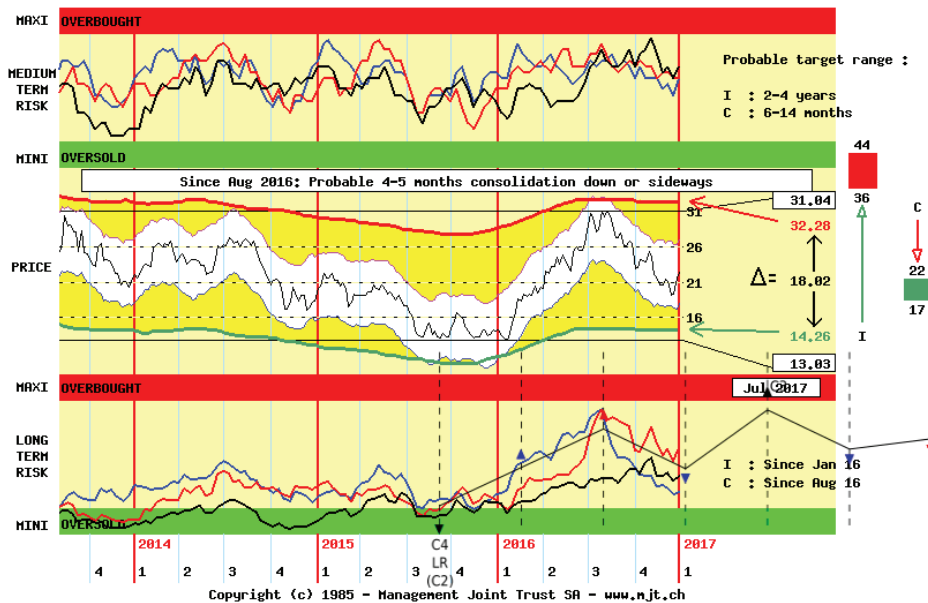
GDX - Market Vectors Gold Miners ETF / SPY - SPDR S&P 500 (Daily graph or the perspective over the next 2 to 3 months)



Gold Mines have also moved substantially in recent weeks. They may have already made their lows in anticipation of the reversal in the deflation trade. Indeed, on our long term oscillators (lower rectangle), a Case 4 bottom has been confirmed, and, our medium term oscillators (upper rectangle) may have started an uptrend sequence.

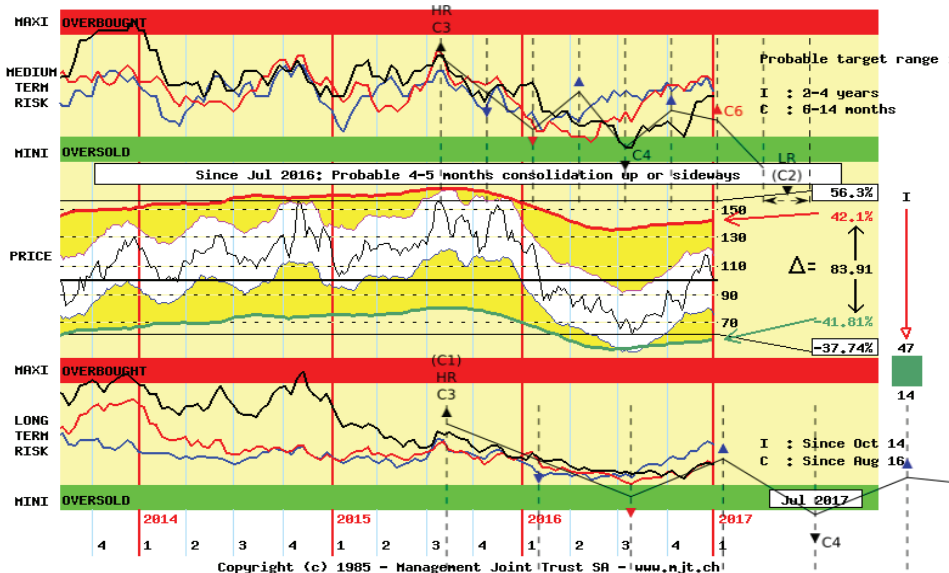
A retracement towards February is still likely and new lows cannot be excluded, yet this graph is promising for Gold Mines.

GDX - Market Vectors Gold Miners ETF (Weekly graph or the perspective over the next 2 to 4 quarters)



The weekly chart of GDX is indeed ending a correction down and could soon reverse up towards mid 2017 (model on our long term oscillators: lower rectangle). Price potential is substantial as Gold Mines could double again as per our Impulsive targets ("I"; right hand scale). We find additional comfort in the fact that our corrective targets down ("C") provided support during the H2 2016 (i.e. the sell-off is theoretically still only a correction within a prevailing uptrend).

VDE - Vanguard Energy ETF / GDX - Market Vectors Gold Miners ETF (Weekly graph or the perspective over the next 2 to 4 quarters)



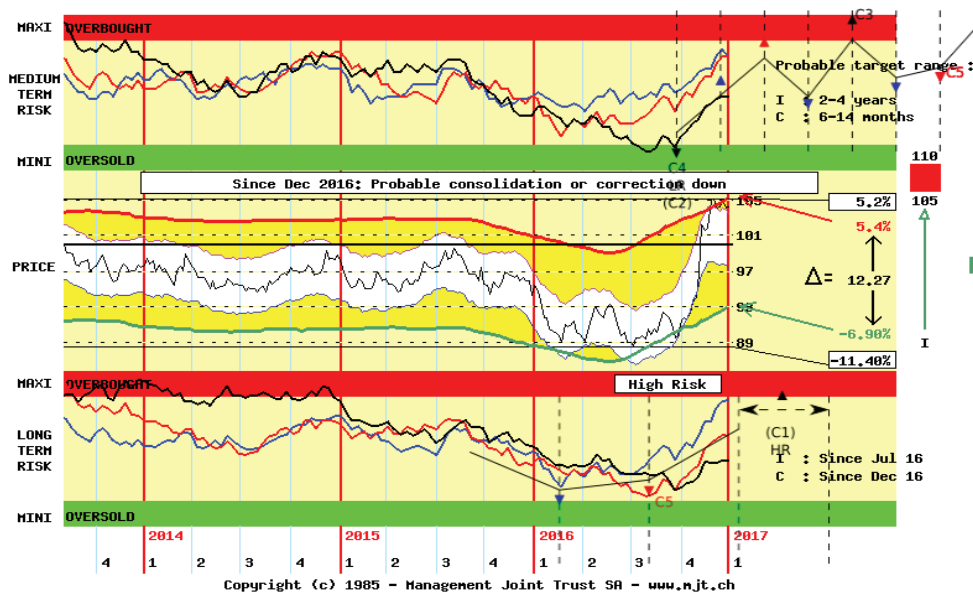
From mid last year and the bottom in interest rates, the Energy sector and Gold Miners have followed opposite paths. Indeed, while the Energy sector climbed another 10%, Gold Miners followed the yellow metal down and lost 40% of their value. This trade may be ready to reverse: the correction up on both our oscillators series (lower and upper rectangles) is close to completion and the previous downtrend may resume towards mid 2017. Downside risk is significant for Energy vs Gold Miners as shown by our impulsive targets down (right hand scale).

Concluding remarks:

Following some consolidation since late December, the S&P500 Index, and possibly Oil, are eyeing a continuation trade towards February. Gold vs the S&P500 Index should follow a similar schedule down. Yet, Gold mines may have already started their ascent. We see substantial potential for Gold Mines into H1 2017 on an absolute basis, but also, for example, versus Energy, a key reflationary sector.

A switch back to Defensive and Growth assets during H1 2017

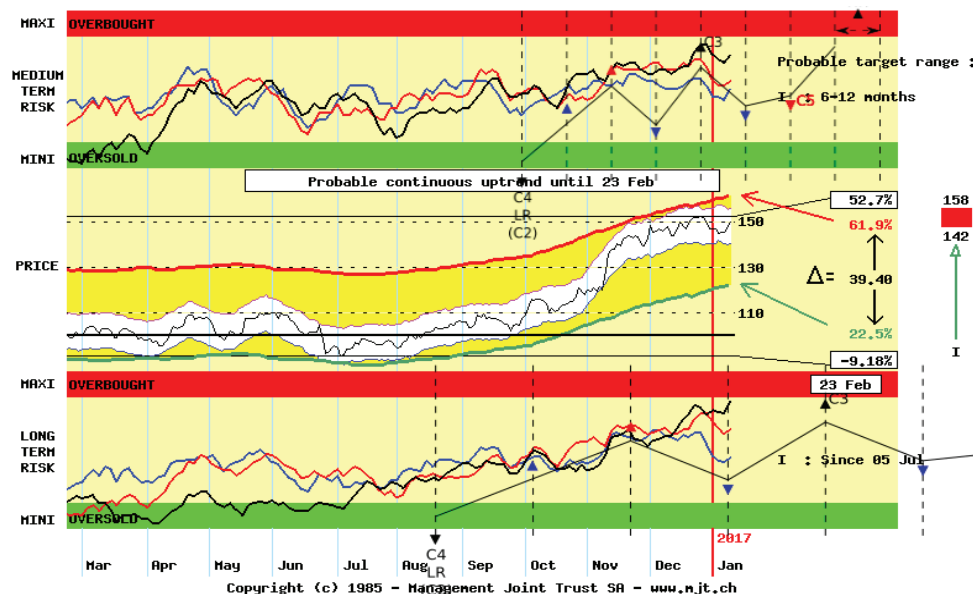
XLFF - Financial Sector SPDR Fund / SPY - SPDR S&P 500 (Weekly graph or the perspective over the next 2 to 4 quarters)



The rise in interest rates along with the steepening of yield curves since mid 2016 have provided for a stunning relief rally for US Financials vs the S&P500. Our long term oscillators have entered a High Risk situation (lower rectangle). The sequence on our medium oscillators could push into February or March to effectively confirm a top (upper rectangle).

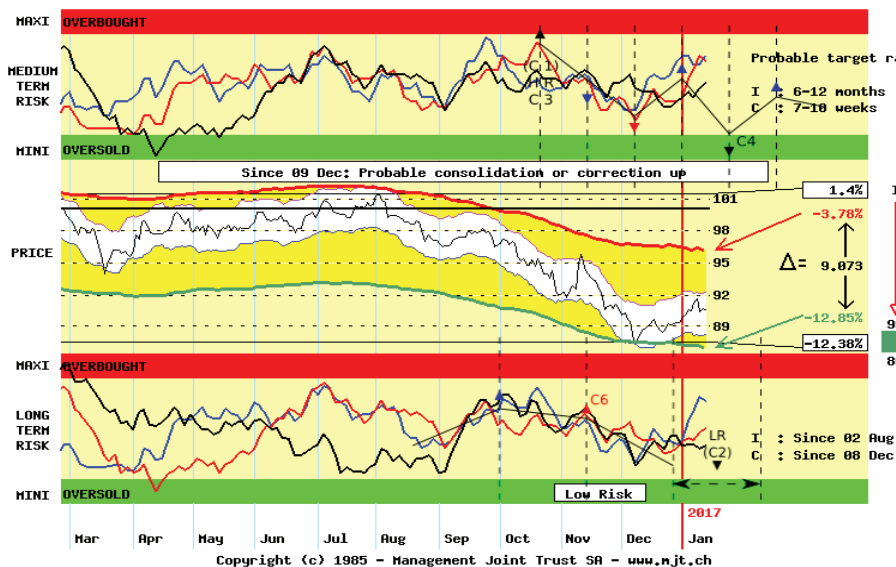
The Risk/Reward has however deteriorated as shown by our targets (right hand scale), i.e. the corrective potential down ("C") is now larger than the impulsive potential up "I".

KRE - SPDR S&P Regional Banking / RWR - SPDR DJ Wilshire REIT (ETFs) (Daily graph or the perspective over the next 2 to 3 months)



Taking this relation a bit further, we look at outperformer "US Regional Banking" vs REITs (opposite sides of the reflation trade) on a Daily basis. The current move up could extend to late February on both our oscillators sequences (lower and upper rectangles). The potential up for this pair trade is however nearing exhaustion ("I" Impulsive up targets; right hand scale)

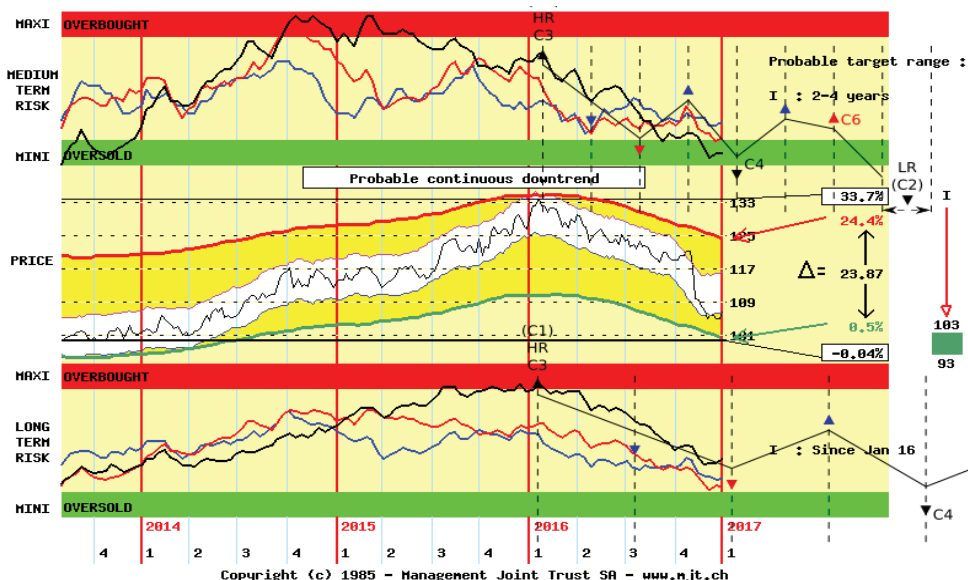
XLV - Health Care Select Sector SPDR Fund / SPY - SPDR S&P 500 (Daily graph or the perspective over the next 2 to 3 months)



Focusing on Defensives, US Healthcare is another sector that on a relative basis may be anticipating a slowdown in reflation.

The downtrend sequence on our long term oscillators (lower rectangle) has reached a Low Risk zone and Impulsive targets down have been achieved ("I"; right hand scale). The medium term oscillators (upper rectangle) could still justify a last sell-off into late January, yet there is little time left to achieve new lows.

IVW - iShares S&P 500 Growth ETF / Russell 2000 Value Index (Weekly graph or the perspective over the next 2 to 4 quarters)



Value has had a tremendous run vs Growth in 2016 (the chart shown is inverted, i.e. Growth vs Value). We believe Growth is also due for some rebound during H1 2017: intermediate bottoms are expected in mid Q1 2017 on both our oscillator series (lower and upper rectangles). These could trigger 3 to 6 months of rebound. In this chart, we've taken the S&P500 Growth ETF vs the Russell 2000 Value Index as an example, yet the analysis also holds for the Nasdaq vs the S&P500, the S&P500 vs the Russell 2000 (larger caps vs small caps) or larger Technology companies (e.g. the XLK Technology ETF) vs small caps, value or the general market (and any iteration of these).

Concluding remarks:

As reflationary assets and trades retrace during H1 2017, Defensive and Growth stocks should outperform again, possibly from February to late Spring / early Summer 2017.

17/ Inflation and its implications for the US Dollar and Euro relationship

Will the inflation uptick be sustainable if energy prices are taken down a notch, as we expect in Q1 2017? Given the single universal price of crude oil, will inflation rise faster in Europe relative to the US, or is it the other way around? These questions are being asked as comparative inflation rates often plays large roles in the USD-EUR relationship. During certain periods in the immediate past, inflation differentials were instrumental in driving the valuation of the USD versus the euro, as much as interest rate differentials did (see graph 1 next page).

Inflation has been relatively higher in the US since early 2015, but the lower EU inflation rate since then did not help the common currency as swap and yield spreads predominantly favored the US Dollar over the euro at that time, a condition which still persist today. But as the chart above shows, relative inflation rates played a major role in the EUR-USD relationship during the period up to Q2 2014. During those earlier periods, the higher inflation rates in the US were part of the reasons why the US currency was weaker versus its EU counterpart (see graph 1 next page).

Then by late 2014, the interest rate spreads turned massively in favor of the US Dollar as the ECB aggressively eased monetary policy. In fact, it was the sharp decline in inflation (actual and expected) which drove the ECB to engineer a rapid decline in interest rates, which subsequently brought about a persistent decline in the valuation of the common currency. Nonetheless, there is

now a growing gap between the inflation rates of the two regions as US inflation rates rise sharply. Although inflation as valuation factor has been overshadowed by the overwhelming impact of rate differentials favoring the US unit, there would come a point where significantly higher inflation rates in the US would start to hurt the USD and weaken its valuation against the euro. It also helps that with domestic inflation rising quickly, the change rate of Germany's bond yields is stabilizing. Germany CapitalAccount is also starting to rise, suggesting that investment capital which fled the Eurozone is starting to be repatriated, and should help strengthen the common currency in the near future (see graph 2 next page).

There is this persistent belief in the markets that higher long term interest rates (the 10yr yield as proxy) pushes up the value of the US dollar. This belief is misguided. That has not been true since global finance came out of the Great Financial Crisis (GFC) of 2007/2008 during Q2 of 2009. Since then, changes in the US Headline CPI have been ahead of the changes in the 10-year yield and the US dollar. The new comovements: changes in CPI are positively correlated with, and lead the changes in the long bond yield, and changes in both CPI and 10yr yield lead the negative changes in the US dollar. These relationships have held true even in the periods before, during, and after the Fed tightened policy in December 2015; it remained the case until late August 2016, when the US Dollar started to strengthen even as the CPI and the 10yr yield rose (see graph 3 next page). The inflation situation

in the US is, and has been, significantly different from that of the eurozone's. US Core CPI has been sideways since February last year, after a sharp push in most of 2015, bringing the index above 2.0%. The Fed targets the Core PCE's change rate, which is still slightly below the Fed's target of 2%, but the recent high energy prices will soon percolate into the PCE, and we expect the Fed's inflation target to be met by 3Q 2017. This outlook contrasts sharply with that of the Eurozone – the ECB predicts euro-area core inflation won't reach their 2% target until at least 2019. Normally, we do not invoke the Fed's and ECB's inflation targets in a discussion of relative currency valuations, as both central bank's core inflation targets have been similar in recent years.

But the recent schism shown in the US Headline CPI-long bond yield-US Dollar relationships may have its origin in developments in the core inflation universe. It turned out that there is a new player in the inflation Index, long-term rates, and US Dollar triangle – the US Core PCE Index (less Food and Energy components).

Unlike the leading function of the US Headline CPI on US rates and the US Dollar, the Core PCE tends to lag behind developments in rates and the US currency. But that changed starting in July when the Core PCE monthly changes started to fall sharply even as corresponding monthly changes in rates and the US Dollar rose sharply. The divergences we saw in the Headline CPI relationships, and now in the Core PCE comovements, led us to believe that the long bond yield rally was driven primarily by the sharp rise

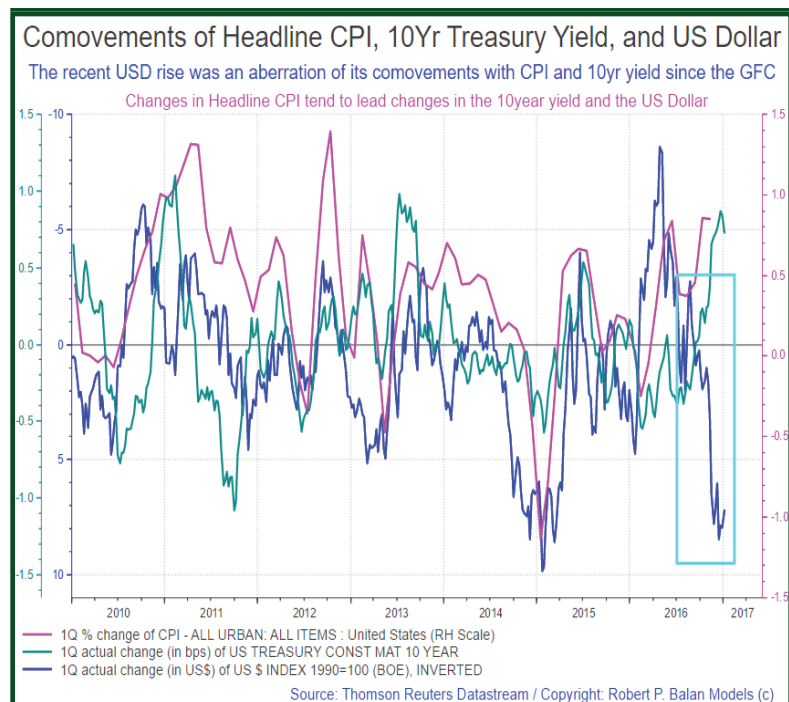
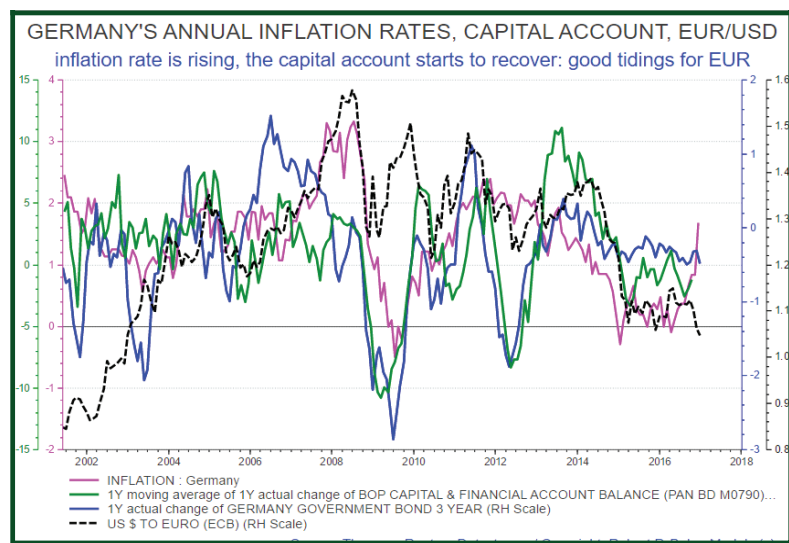
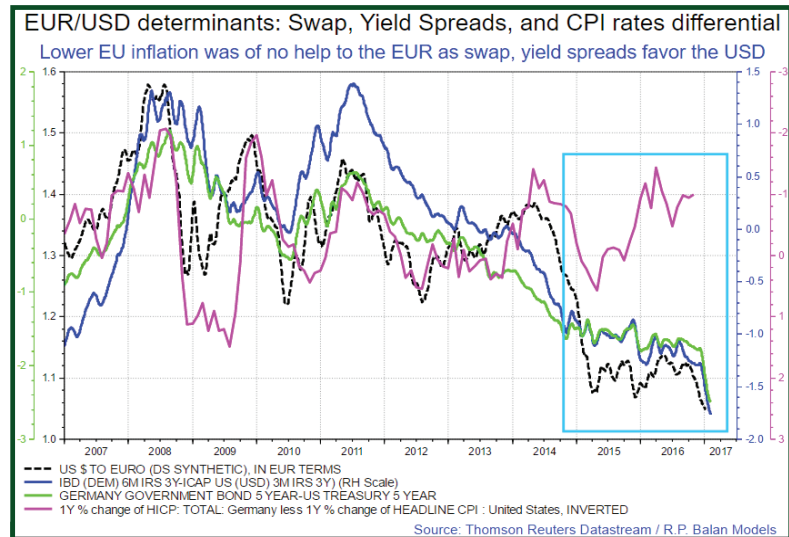
in CPI, while the sharp ascent in the US Dollar was impelled primarily by the aggressive decline in Core PCS inflation. Those developments make sense if considered separately, but based in the context of recent relationships, they don't if taken together. The most puzzling of all – the positive correlation between the long bond yield and the Core PCE has completely broken down

Conclusion:

There is evidence from academic work that the negative correlation between crude oil and the US Dollar flows from the former to the latter. We can also show empirical evidence that this is indeed the case, and we have shown that in previous publications. In fact, we believe this is the linkage leading to the negative correlation between the US Dollar and CPI inflation, headline or core. As we showed in previous charts, inflation negatively leads the US Dollar, and since crude oil leads CPI, then the proper conclusion is that higher oil produces higher inflation which tends to weaken the US currency.

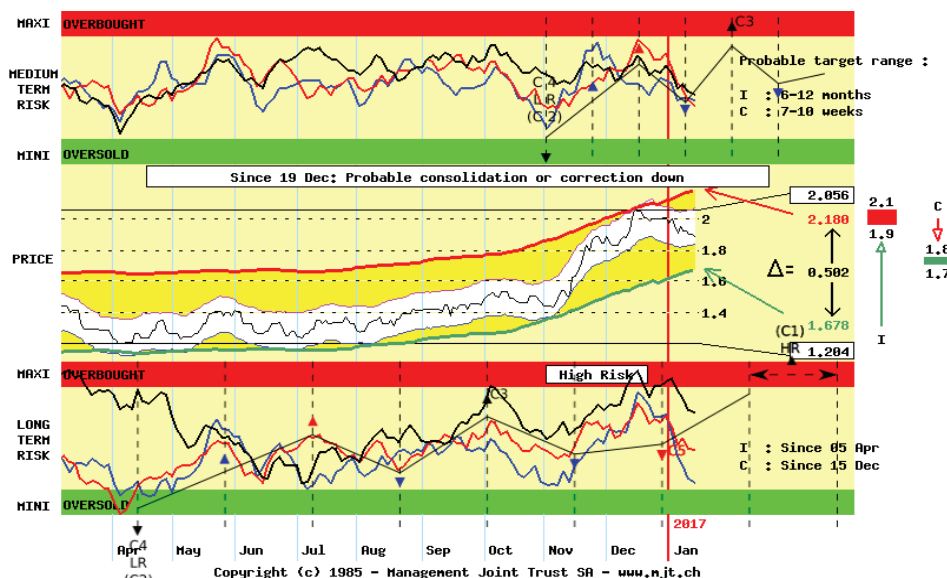
The outlook for near-term oil prices, on account of the OPEC and Non-OPEC agreements to cut oil production, is significantly bullish, as can be expected. However, we believe that there are short-term negatives in the oil fundamentals which may depress oil prices in early Q1 2017, but by mid-year, the production cuts should start to push prices higher. It may also be that severe Capex cuts in the past two years, and over the next coming years (up to 2020) should prime higher oil prices, with negative consequences to the US currency for some time.

Therefore, our outlook is for the US Dollar to strengthen until mid-February, after which the US currency should weaken significantly against the euro and other major currencies.



The Dollar could be topping out, hedging US assets could lead to outperformance

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

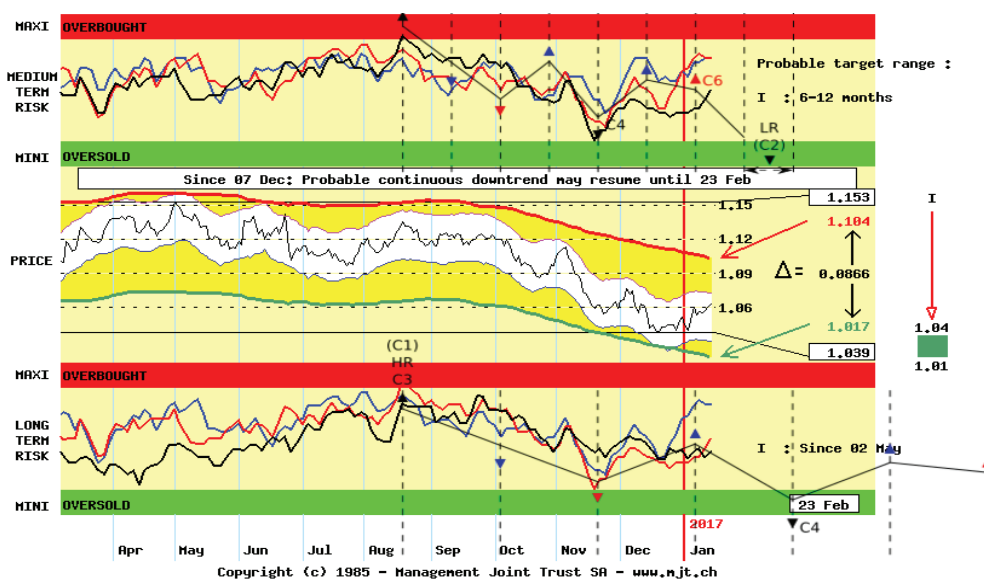


Short term US rates could start to correct down while German ones continue to bounce off lows, i.e. the uptrend for this spread may be nearing exhaustion. Indeed, "I" Impulsive up targets have been achieved (right hand scale) and our long term oscillator sequence is calling for a High Risk situation (although it comes a bit early according to our model; lower rectangle). Indeed, our medium term

oscillators are showing a last push up towards early February (upper rectangle), yet the potential is limited. In recent years, this US vs German short term yield spread has been fairly well correlated to the USD strength vs the Euro: once it reaches exhaustion, EUR/USD usually start to corrects up.

EUR/USD

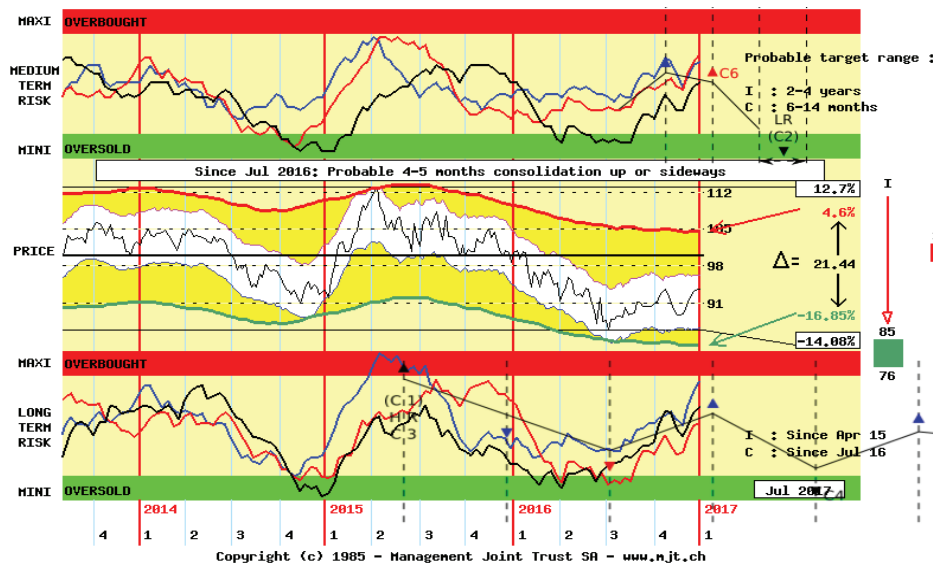
(Daily graph or the perspective over the next 2 to 3 months)



On EUR/USD, the sequences on both oscillators series are calling for a new low in the second half of February (lower and upper rectangles). Hence the weak bounce that we've seen since November / December, could soon be coming to an end. Our price targets down (right hand scale) suggest

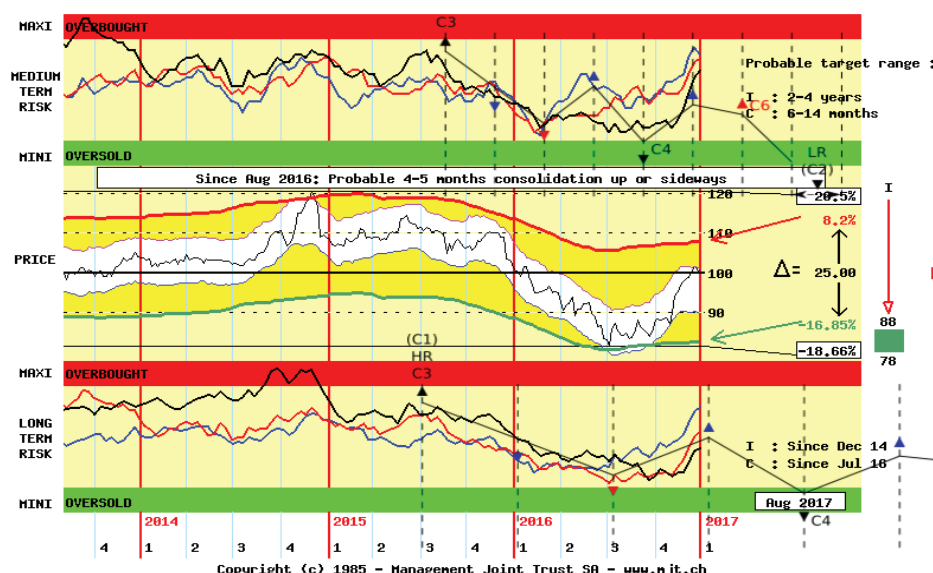
that it could make new lows, yet the potential left is somewhat limited now (1.01, i.e. close to parity). Following that, EUR/USD could start at least several months of correction up.

Dow Jones EURO STOXX (EPI) vs SPY - SPDR S&P 500 (hedged for currency) (Weekly graph or the perspective over the next 2 to 4 quarters)



Bouncing off the EUR/USD story, we compare the performance of Eurozone markets like to like with the S&P500 i.e. hedged for currency). During H2 2016, the US has been a clear leader in inflation. It led the correction up in interest rates resulting in the strong USD rally we've seen. Concomitantly, Eurozone markets outperformed US ones when hedged for currency. Both our oscillator series (upper and lower rectangles) suggest that this dynamic is about to reverse down, possibly until mid next year: in H1 2017, US markets could provide an interesting defensive trade on a relative basis when hedged for currency risk.

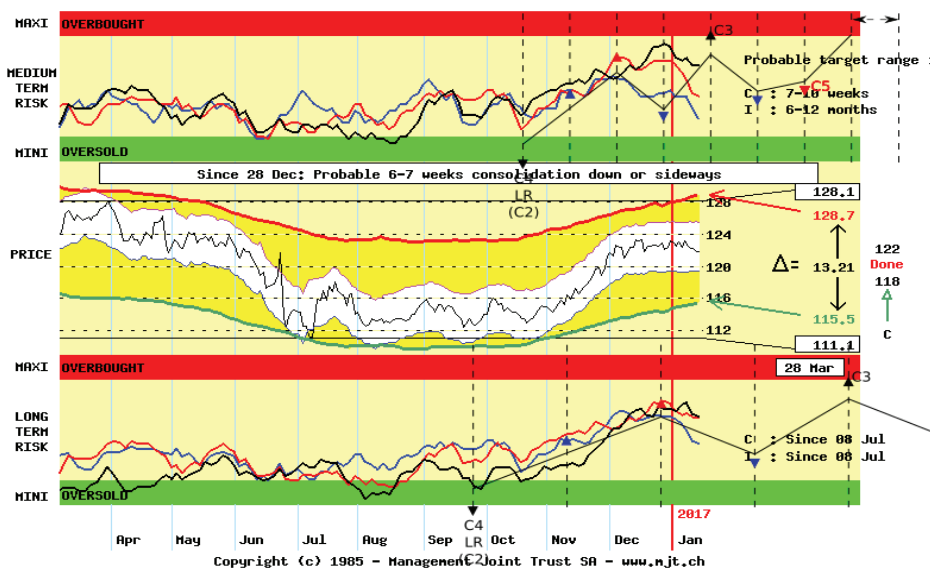
DXJ - WisdomTree Jap. Hedged Eq. Fund / EWJ - iShares MSCI Jap. Idx Fund (Weekly graph or the perspective over the next 2 to 4 quarters)



Similarly, we compare the exporter laden, currency hedged DXJ Japanese ETF vs the broader EWJ Japanese ETF. The pair is also due to resume its downtrend on both our oscillator sequences during Q1 2017 (lower and upper rectangles), possibly into Summer 2017. Hence, during Q1 2017, it might be judicious to switch from DXJ to EWJ if one is looking for exposure to Japanese equities.

EUR/JPY

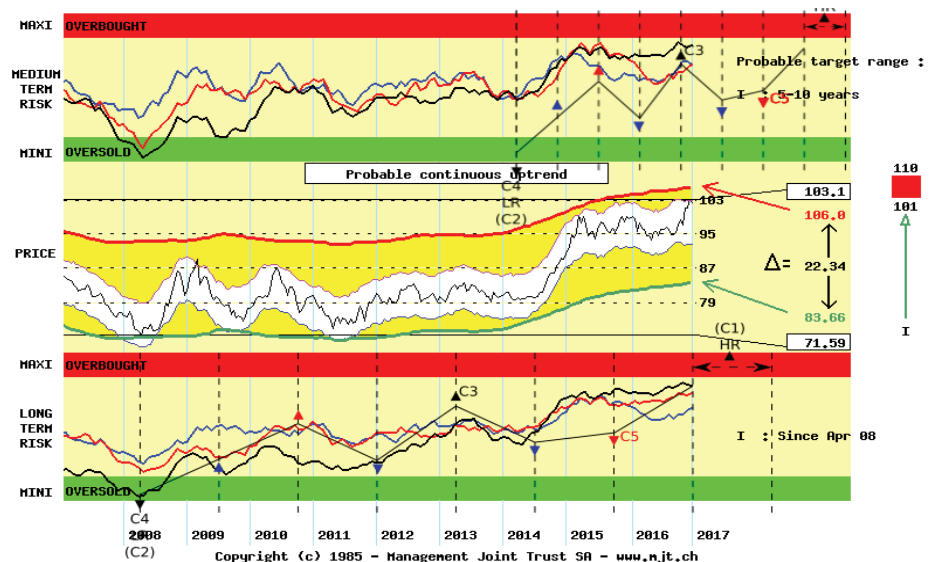
(Daily graph or the perspective over the next 2 to 3 months)



It is interesting to note the slight discrepancy in the timing of the two relative charts above: the Europe/US comparison seems to top out earlier than the Japanese one. This Daily chart of EUR/JPY may go some way to explain this shift. Indeed on both our oscillator series EUR/JPY is seen as topping out towards end March, rather than mid February for EUR/USD suggesting that the Euro may bottom sooner than other currencies vs the US Dollar.

DXY – Dollar Index

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



Finally, we broaden our scope to the wider Dollar Index and consider it on a long term bi-monthly basis. Following an uptrend, which has now lasted almost a decade, our long term oscillator series (lower rectangle) have entered a High Risk zone, while our "I" Impulsive targets up have been achieved (right hand scale). Although the top on our medium term oscillators (upper rectangle) may be of intermediate nature only, it potentially provides an important inflexion point down (i.e. this is a bi-monthly chart) into H1 2017.

Concluding remarks:

The spread on short term rates between the US Dollar and the Euro confirms our daily chart analysis that a top in EUR/USD may materialize during February, while our cross asset analysis (different geographical regions or segments of the market) suggests that the correction could last well into the Spring, possibly the Summer 2017.

22/ China and Base metals

Lately, it has become popular, even chic (to the point of becoming consensual) for market analysts to express concerns about the Chinese economy. The market fear has risen so dramatically that there was a ascending chorus projecting financial and economic collapse.

We have always said that with a heavy corporate debt burden, far heavier than it should, it will take a while for the Chinese economy to gain escape velocity, but we never thought that a financial crisis, much less an economic collapse, was likely. Heavy debt burden encumbers and slows the economy, but it need not lead to a financial crisis. We cited the case of the US which has been battling onerously heavy debt load since the 1970s but had never experienced a financial crisis directly emanating from the consequences of such high level of debt. The concern from a heavy debt load arises from the belief that insolvency is inevitable consequence -- the example being cited by concerned analysts was the case of Greece.

But China is a sovereign currency issuer (unlike Greece), so solvency is never an issue -- the issue is, and always has been, inflation if China decides to print money to pay for debts in avoiding defaults. China has not shown signs that it was going this way, and in fact it as just recently came out of PPI deflation. The basic problem of China, just like the rest of the world, is that there is low aggregate demand. Moreover, fiscal policy has been erratic, spending executed in fits and starts, and government net borrowing change rate has been falling since late 2010. Apparently, it is not the level of borrowing (stock) that makes the difference in generating growth, it is the rate of change (flow) in government borrowing that correlates to growth rates (see graph 1 next page). The conclusion is that China's economy has been starved of needed funds, if this criterion is used as measure. China has taken this issue by

the horns, so to speak, and the government's new focus is on growth in consumption-related and «new economy» sectors. If these sectors continue growing at current rates -- and we expect this to be the most likely outcome -- President Xi Jinping's administration can soon replace the old, contracting sectors of the economy as the main source of demand that will drive economic activity and will keep growth rates high.

The key in understanding the future growth outlook in China is to focus less from what looks like abysmal macro conditions (heavy corporate debt load) and pay more attention to the more optimistic picture at micro level. It has been too easy to be «too pessimistic» about the Chinese economy given the debt load backdrop, but that holds less water if one looks at the «unlimited demand» for everything from entertainment to healthcare sectors, which are growing at double-digit rates and will continue to do so in the foreseeable future. And of course, investment in infrastructure is going strong again.

Nonetheless, many analysts decry China's renewed growth in investment. They say it must be reversed because a large and growing portion of this investment is not productive enough to justify the spending, the result of which is that the value created by the investment is less than the cost of the investment.

However, for us, the argument to abandon investments is a politically inept solution and threatens the primacy of the Communist Party. Investment is such a large share of China's GDP; the growth in investment have pulled China's GDP growth behind it for most of the past 30 years, so abandoning it when the other sectors of the economy are not ready to take over the job, will have politically disastrous consequences -- a factor that is not taken in clinical economic analysis of the Chinese economy. Consumption growth must

accelerate and ultimately drive GDP growth if the role of investment is to be reduced without causing GDP growth to stall. That will not happen in a quarter or two -- it may take another two years before consumption can take over as a primary growth driver. Investments in infrastructure will be a feature in the Chinese economy for a while, and will continue to underpin commodity prices.

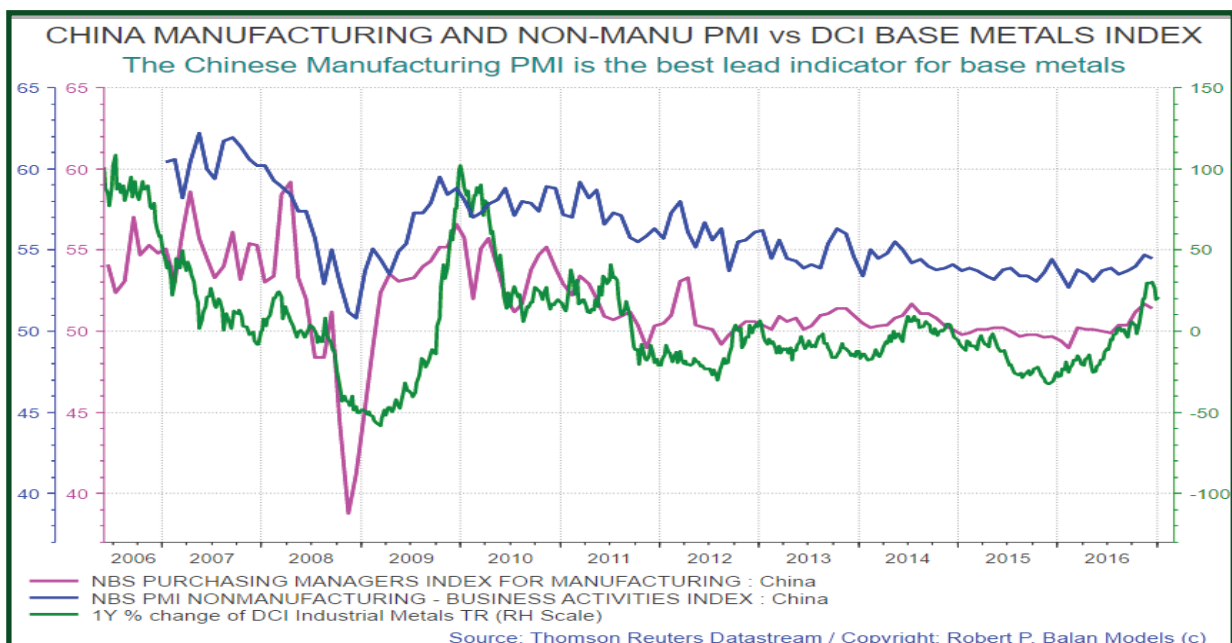
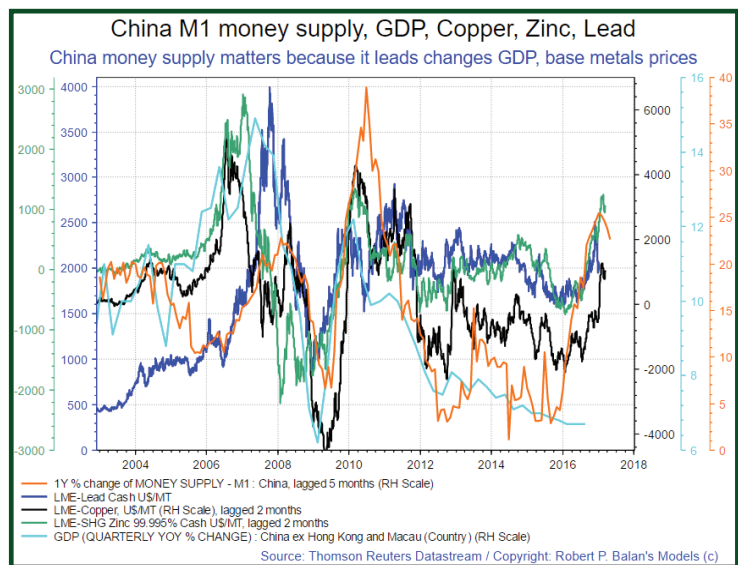
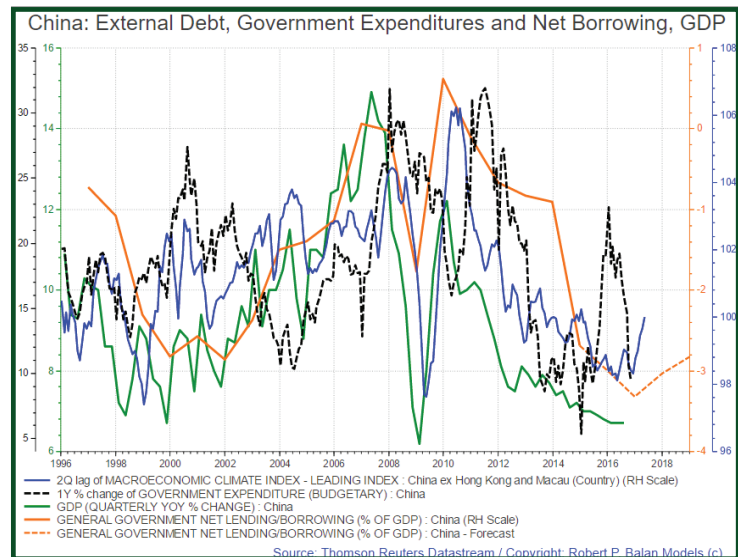
One sign that the government is trying to underpin consumption has been the tremendous growth in money supply in China. China money supply growth not only has domestic, but also international ramifications in that it influences the prices of commodities, especially base metals (see chart below). We believe that the Chinese government will continue to invest in infrastructure because they will not risk the primacy of the Communist Party leadership, until such time as aggregate demand can fully take over the job.

This brings us to the state of the economy at the start of the new year. Chinese business conditions have further improved at year-end 2016, and sustains the significant upturn seen at the start of Q4 2016. The China Composite PMI Output Index, rose from 52.9 in November to 53.5 in December, the highest mom growth since the start of 2011. The latest reading signaled an acceleration in the pace of business activity growth. The average PMI reading for the past three months picked up to 53.1 from 51.7 in the third quarter -- the strongest quarter in almost six years. The composite data was lifted by stronger expansions in both manufacturing and services in December. Manufacturing growth now broadly in line with that seen in the service sector, dispelling stories about weak manufacturing conditions amid ongoing economic restructuring; this goes a long way in rebalancing the Chinese economy. For a government seeking to reduce excess capacity in the industrial

economy, this is welcome news. But the shift towards a consumption-based economy is far from done. Growth in the service sector, a proxy for domestic consumption, remained below its long-run series average. And modest job creation at service providers failed to offset the losses in manufacturing payrolls. Hiring in the service sector slowed marginally in December, while manufacturing jobs remained in decline. Further expansions in activity and new business in 2017, which we expect, could help reverse the current contraction in China's workforce in coming quarters.

However, although the stronger composite expansion helped to limit job cuts, the upturn was accompanied by a further sharp rise in commodity and raw material prices. The fact is, the Chinese Manufacturing PMI is the best leading indicator for future base metal prices. Prices for raw materials and commodities in China surged, exacerbated by the costs of US\$-denominated imports as the CNY weakened. Manufacturing input prices are now at the highest since March 2011. In contrast, cost inflation in the service sector remained comparatively muted despite picking up to the quickest in almost two years.

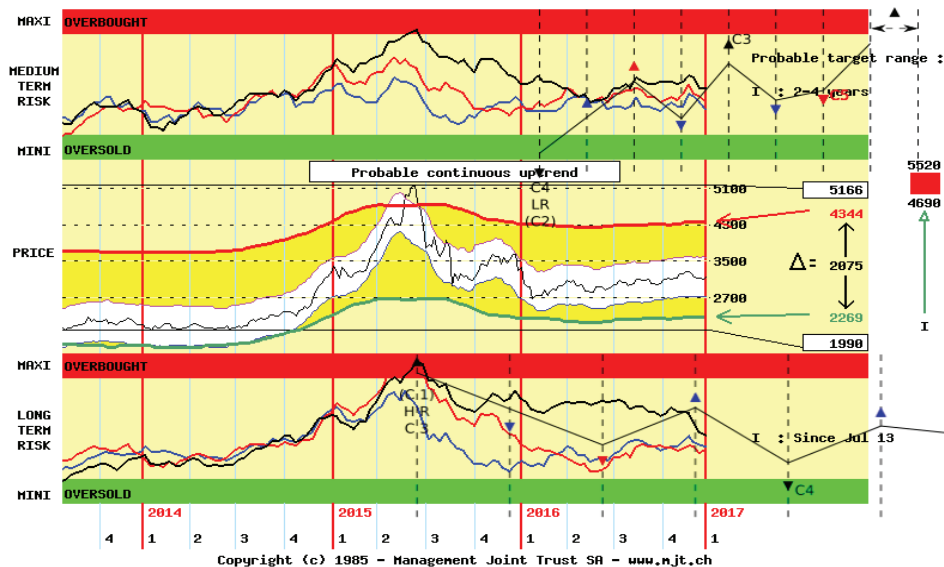
But make no mistake, inflation is about to pick up significantly in China, a phenomenon that is being seen globally, as higher energy costs percolate into domestic price structures. That should put the economy on normal footing, as disinflationary tendencies are neutralized, and should encourage companies to invest again. This should help hasten China's transition to a consumption economy – but until then, infrastructure spending will continue to underpin the prices of raw materials.



24 / MJT TIMING INSIGHT

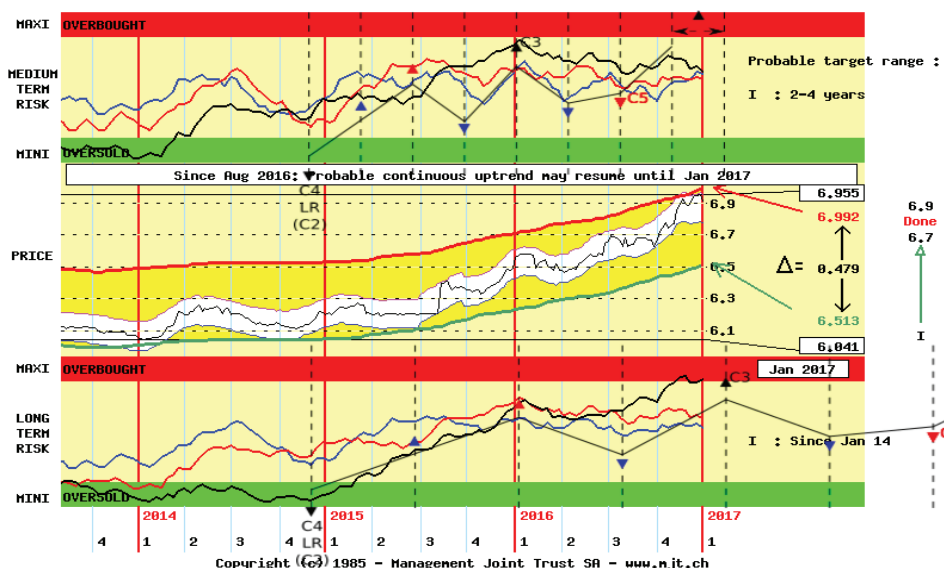
China is still in a period of transition

Shanghai Composite Index (Weekly graph or the perspective over the next 2 to 4 quarters)



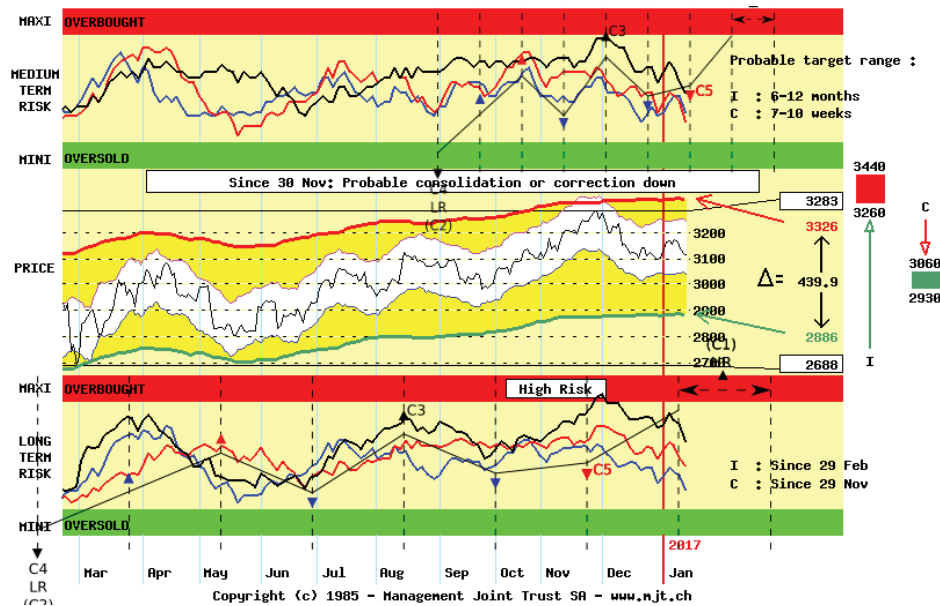
Depending on how you look at it, the Shanghai Composite Index is either is a weak uptrend (our medium term oscillators; upper rectangle) or in a downtrend, which is taking time to resume (our longer term oscillators; lower rectangle). Both sequences could synchronize again once a Case 3 top ("C3") is made towards the mid/end of Q1 2017 on our medium term oscillators. The correction down, as shown on both oscillator series, could last until late in Q2 2017.

Yuan Renminbi per USD (Weekly graph or the perspective over the next 2 to 4 quarters)



Recently, there's been a lot of talk about the weakening of the Chinese currency vs the USD Dollar. Yet, USD/CNY is still mostly a loose adjustment mechanism to compensate for the strength or weakness of China's trade partner currencies vs the USD (and de facto CNY's own strength or weakness against these). That, said, both our oscillator series (upper and lower rectangle) anticipate a top for USD/CNY during Q1 2017, which may confirm the correction down we anticipate on the US Dollar vs most currencies.

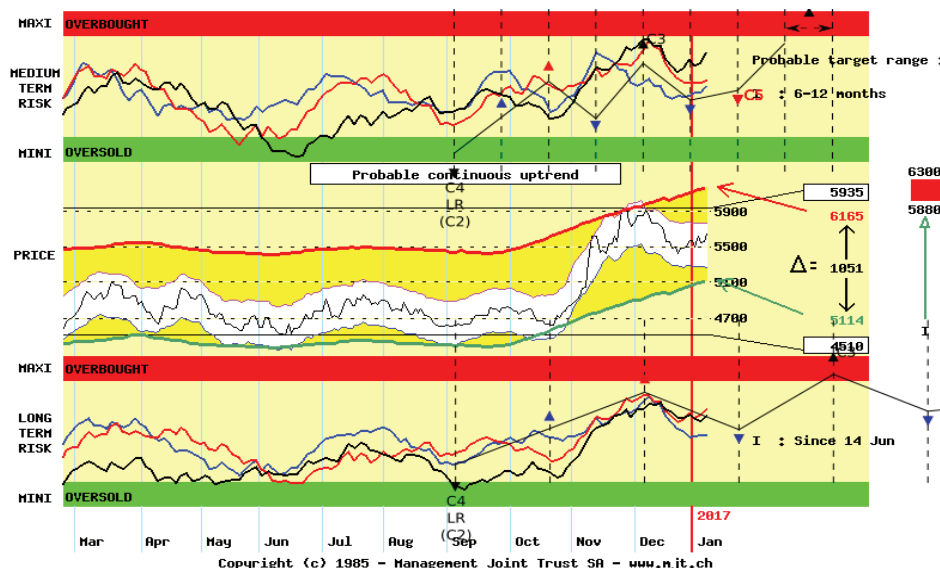
Shanghai Composite Index (Daily graph or the perspective over the next 2 to 3 months)



On the Shanghai Index Daily chart, the uptrend in place may have reached a High Risk zone on our long term oscillators (lower rectangle). Yet, a further uptrend sequence on our medium term oscillators (upper rectangle) justifies that a continuation trade up could materialize into late February / early March. "I" Impulsive targets up could be revisited (right hand scale), while "C"

corrective targets down would provide some support (and possible Stop/Loss levels) in case of a sell-off. Given both target levels and the extended nature of this trend, Risk/Reward is at best neutral.

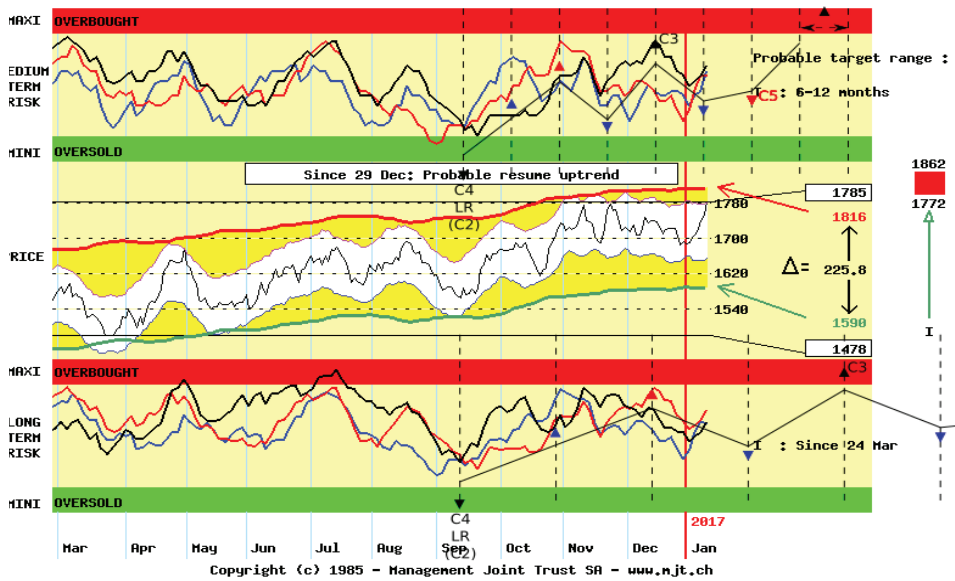
Copper Spot (Daily graph or the perspective over the next 2 to 3 months)



Copper, which is widely influenced by the strength of China's infrastructure and manufacturing industries, is however eyeing this trend with more confidence. It made an intermediate top early December on both our oscillator series (lower and upper rectangles) and, following some retracement, could now be resuming its uptrend towards late February / early

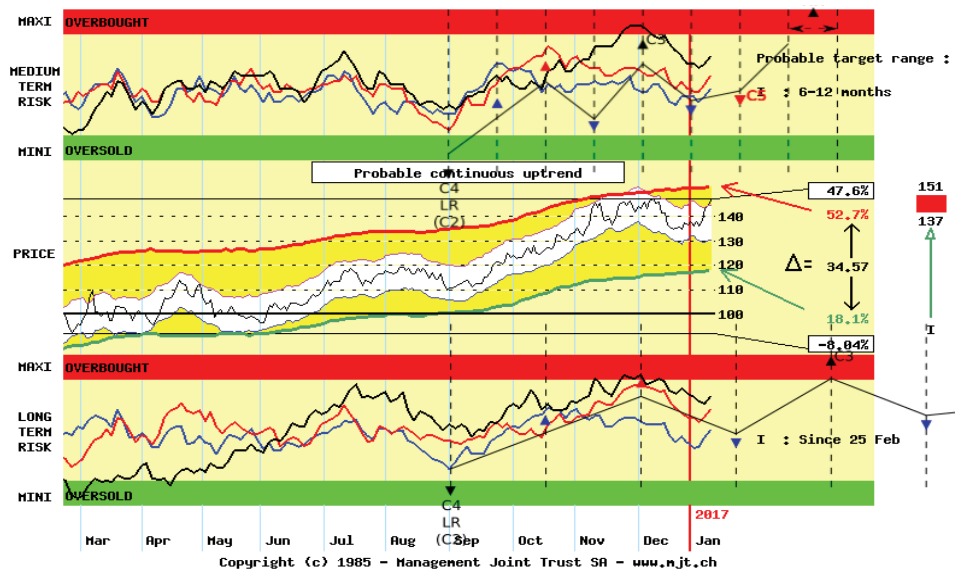
March. It could revisit its recent highs and according to our "I" Impulsive targets up (right hand scale) even push above the 6'000 mark.

Aluminium Three Months (continuous Future) (Daily graph or the perspective over the next 2 to 3 months)



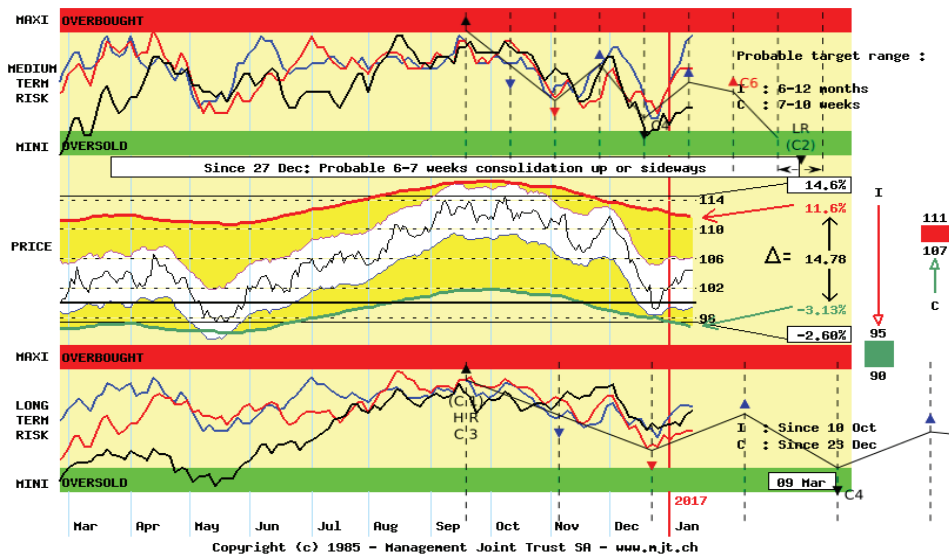
The continuation trade is also very clear on Aluminium, where both our oscillator series (lower and upper rectangles) show that prices could continue to accelerate towards March 2017. The lower boundaries of our "I" Impulsive targets (right-hand scale) have been reached, yet prices could extend into the 1'800 USD/t. possibly above 1'850.

MSCI UK Materials Index vs FTSE 100 Index (Daily graph or the perspective over the next 2 to 3 months)



For further confirmation, we look at the MSCI UK Materials Index vs the FTSE 100. The MSCI UK Index is one of the purest plays when it comes to large diversified miners (unlike the World, US and European Materials indexes, which include a large portion of Chemicals). The extension we've been monitoring on Copper and Aluminium is also clearly visible here on both our oscillator series (lower and upper rectangles)

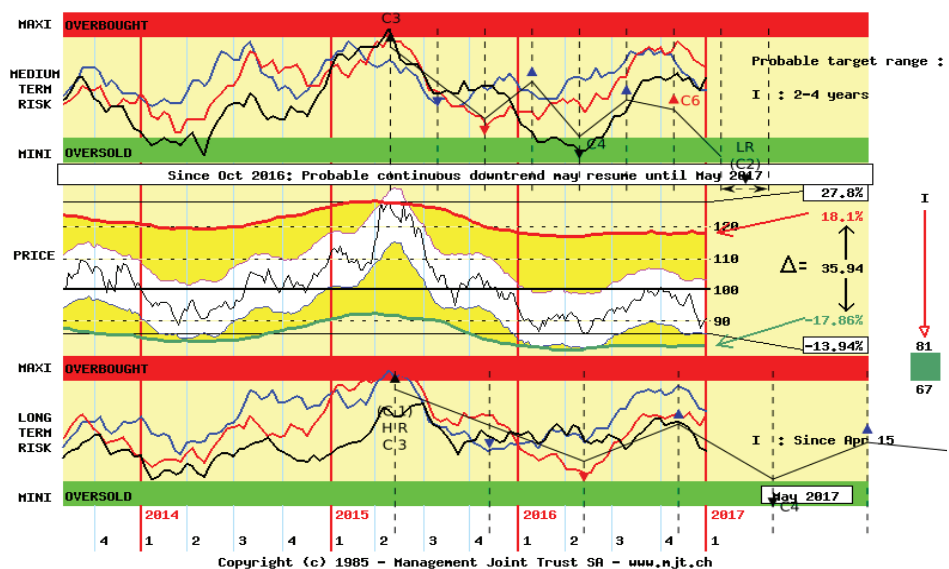
FXI - iShares China 25 Index Fund / ACWI - iShares MSCI ACWI Index Fund (Daily graph or the perspective over the next 2 to 3 months)



On a relative basis, the China large cap index fund has recently been underperforming the world index. The sell-off in December coincides with the correction down in base metals. Now that these are resuming their uptrend, China's underperformance has started to retrace up.

On both oscillators series (lower and upper rectangle), the bottom which was just made is probably intermediate: China vs ACWI could correct up for most of January, probably into February before resuming its downtrend towards March.

FXI - iShares China 25 Index Fund / ACWI - iShares MSCI ACWI Index Fund (Weekly graph or the perspective over the next 2 to 4 quarters)



The above charts on China have been quite benign, yet the Weekly relative chart vs ACWI is more concerning. The current short term correction up can be identified, but on both our oscillators series (lower and upper rectangles), the sell-off that follows could persist into Q2 2017 with substantial downside potential ("I" Impulsive down; right hand scale).

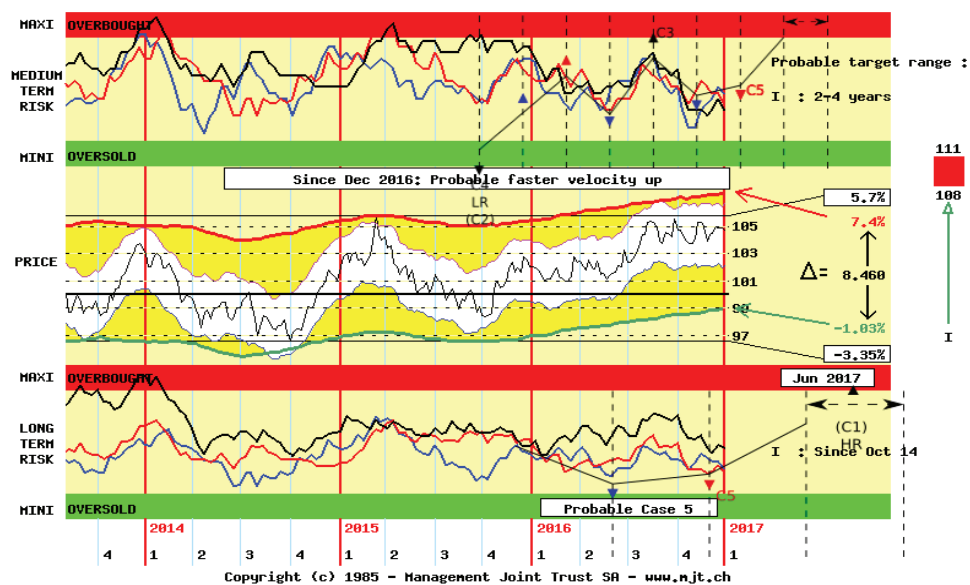
Concluding remarks:

Last year, the Chinese stock market outperformed the ACWI well into Q3 2016, before starting to correct. Considering its correlation to Copper, which seems set to continue up into early March, China could bounce and retrace some of its recent underperformance into February. Following that, we would call for caution: both the absolute and relative charts signal a correction down into May.

Disparities in the Eurozone worsen during H1 2017

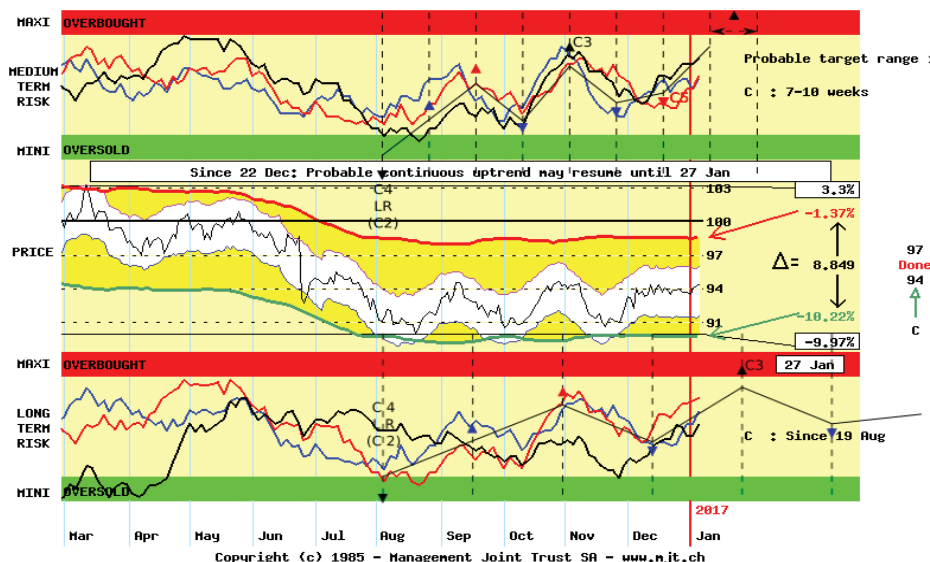
Bouncing off the introductory comments in this document and using stock markets performances as a proxy for economic prospects and investors confidence, we note that the reflationary revaluation of the South vs the North of Europe has been limited in H2 2016. Worse, in H1 2017, Germany should resume its outperformance, while PIIGS (Portugal, Italy, Ireland, Greece and Spain) start lagging again. These divergent developments will result in continued hefty monetary policy ring-fencing discussions inside the Eurozone in H1 2017.

DAX 100 Price Index vs EuroStoxx 600 Index (Weekly graph or the perspective over the next 2 to 4 quarters)



The sequence on our long term oscillators (lower rectangle) is calling for a re-acceleration of the DAX100 Price Index vs Eurostoxx 600 until mid 2017 (Probable Case 5). The outperformance potential is between 3 to 5% (right hand scale). Our medium term sequence (upper rectangle) would confirm that this acceleration could start from end January/early February.

PIIGS cap weighted estimated portfolio vs DAX 100 Price Index (Daily graph or the perspective over the next 2 to 3 months)

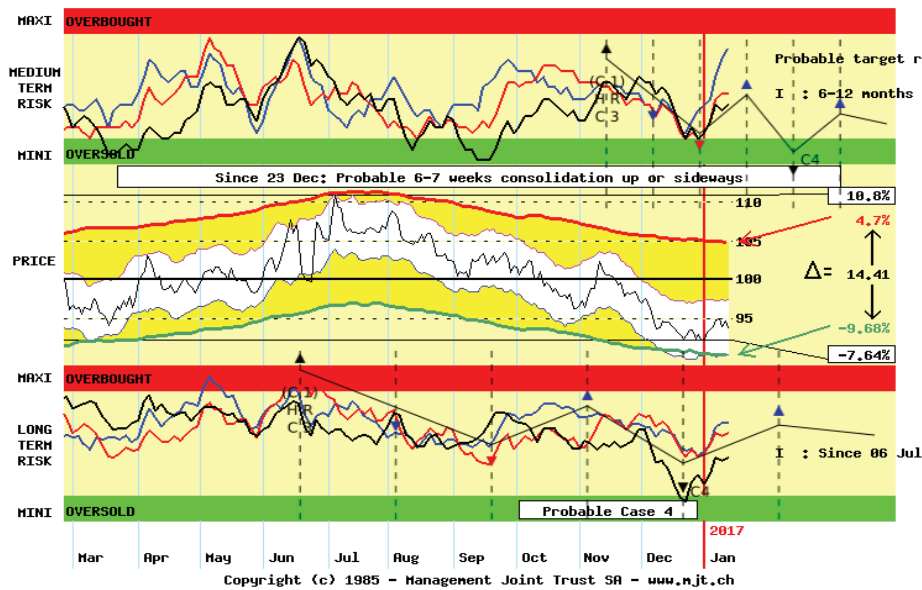


This weak uptrend for PIIGS vs Germany since August last year should top out towards end January as shown by both oscillator series (lower and upper rectangles). Our corrective targets up are pretty much done (1 to 3% outperformance left; right hand scale). Hence from February, the previous downtrend for PIIGS vs the DAX 100 Price Index is likely to resume.

Cross currency Defensive trades on both sides of the Atlantic

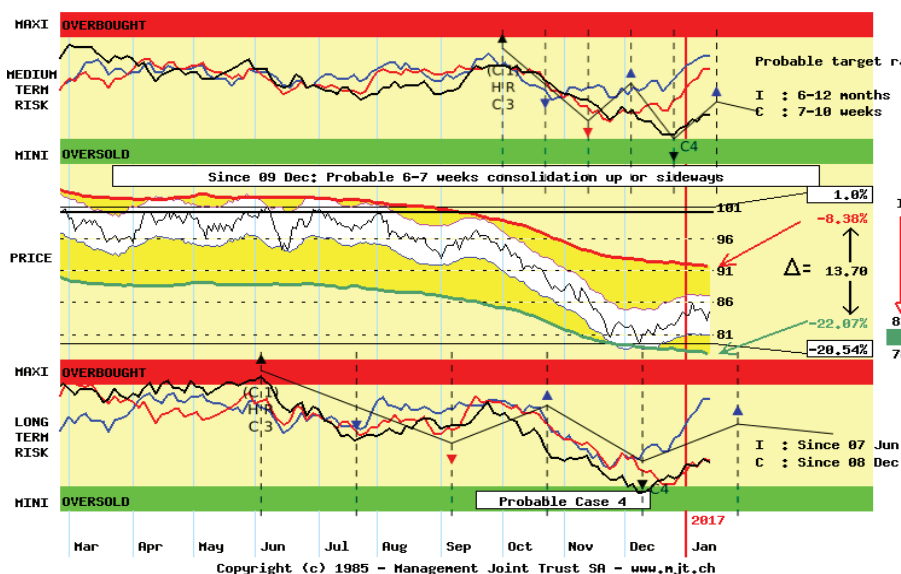
As detailed above, from February onwards, we expect the beginning of a risk-off period and a correction down in the US Dollar. Whether they are USD or European currencies based, investors may seize the opportunity to combine both trades. As detailed below, some of these may soon be ripe to consider.

XLV - Health Care Select Sector SPDR Fund vs Dow Jones STOXX (ccy hedged) (Daily graph or the perspective over the next 2 to 3 months)



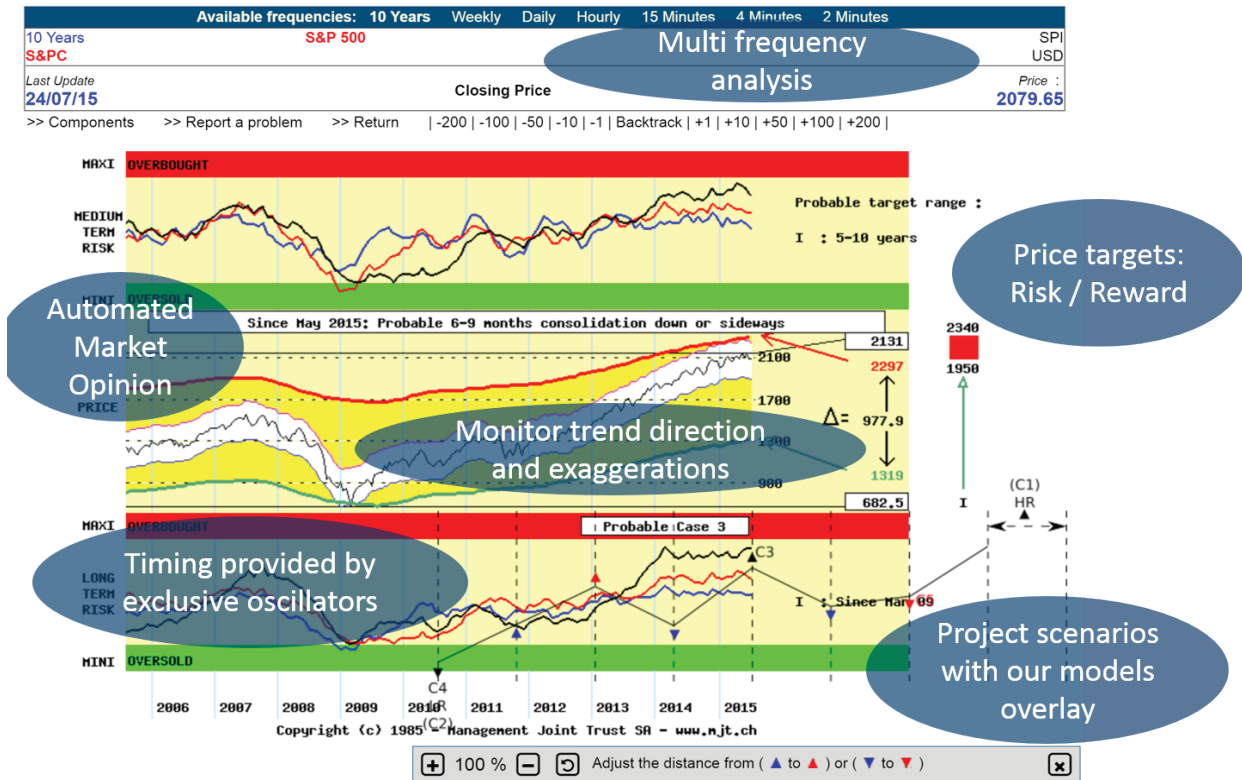
Theoretically, given the H1 2017 scenario above, European investors could outperform by buying defensive trades in the US hedged for currency risk. We've compared the XLV US Healthcare ETF (currency hedged) with the Dow Jones European STOXX Index. Although our medium term oscillators (upper rectangle) cannot exclude one last sell-off, our long term oscillators sequence has confirmed a Case 4 intermediate bottom while price targets down have pretty much been reached (right hand scale).

HEALTHCARE - Dow Jones STOXX / SPY - SPDR S&P 500 (not ccy hedged) (Daily graph or the perspective over the next 2 to 3 months)

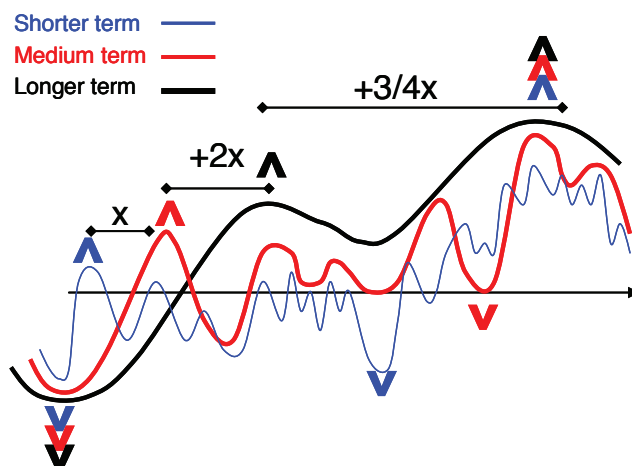


Invertedly, a US Investor may consider investing in European defensive stocks and retain the currency exposure. We've looked at the European Healthcare Index (SXDPA), which is particularly skewed towards Switzerland and Northern Europe and compared it to the SPY S&P500 ETF. Both our oscillators series (lower and upper rectangles) have made important lows during December within their "I" Impulsive price targets down and have started to correct up.

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.mjt.ch).

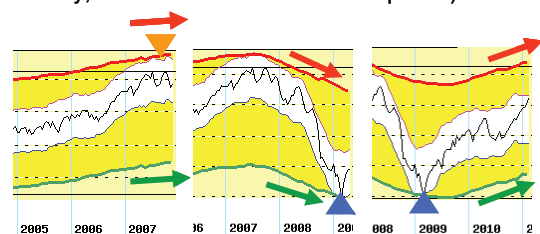


Timing oscillators: different prices cycles are captured by our 3 Timing oscillators. Monitor how their relative positioning defines specific situations (Cases) to always know where you stand within the Trend (e.g. please see below the ideal Uptrend Case succession sequence)

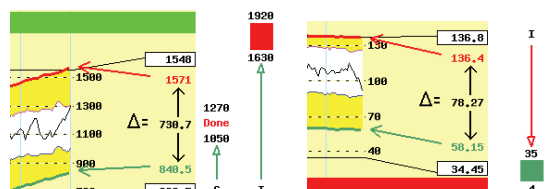


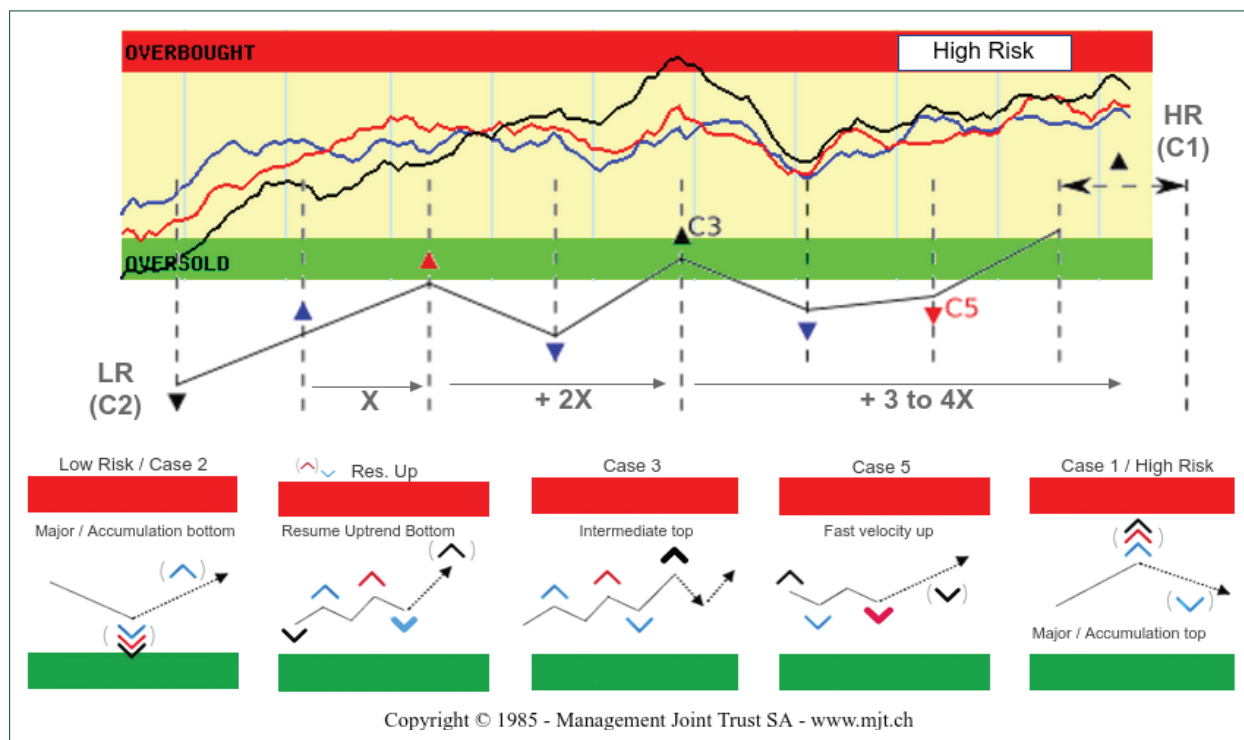
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Trend direction: the direction of FinGraphs' large envelope will help you decide either to apply an uptrend or a downtrend model. Contacts between the wider and thinner envelopes will help you anticipate and confirm market turning points (e.g. S&P500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



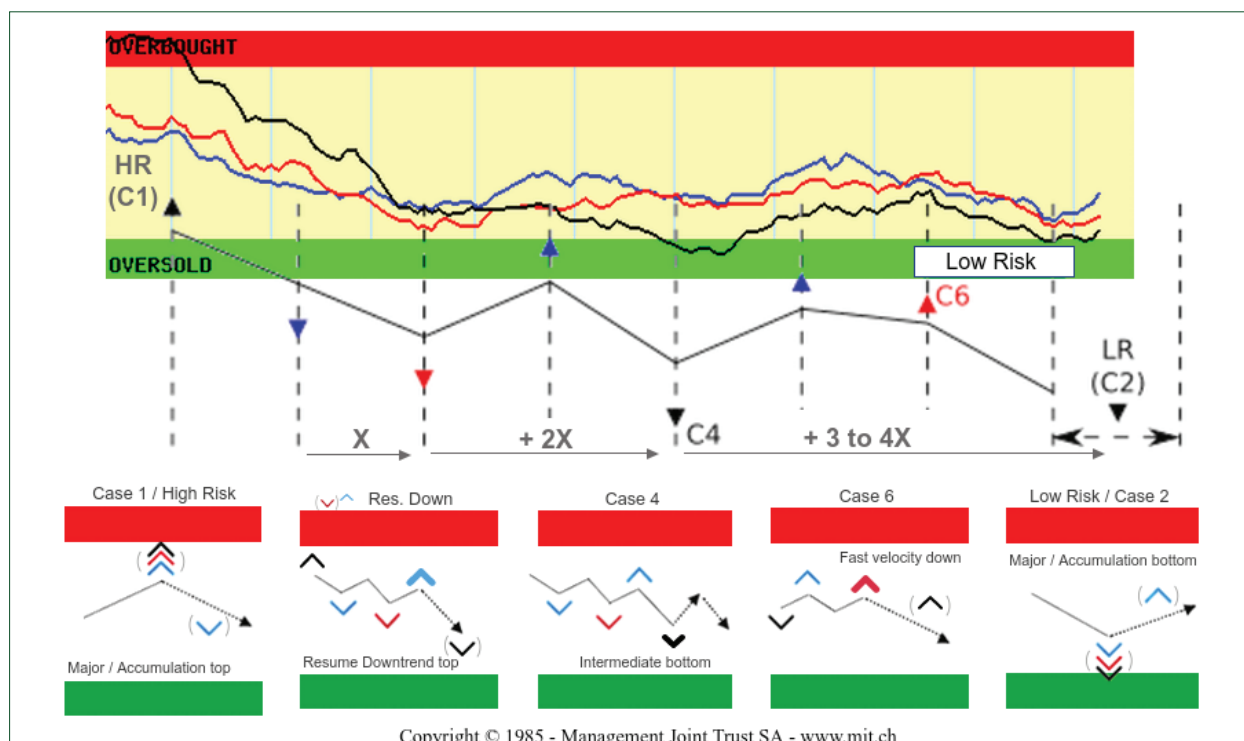
Price targets: based off historical volatility, they can highlight price potential or risk and, once achieved, define take profit or stop loss areas (e.g. below S&P500 in early 2011, Brent in October 2014).





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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