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12 / **The peak of risk asset prices for 2018 could take place in late July - August period -** The purpose of this recent series of articles about systemic liquidity is to prepare the readers of Capital Observer to the eventuality of a peak in many of the risk asset markets this summer. This view is still not a part of the mainstream sentiment profile.
The last bull market phase should last until a late July-August top, with intermediate pauses .The ensuing sell-off should last until late September, after which we could see some temporary recovery in asset prices. But by and large, the trough in this forthcoming sell-off may only be seen by early spring 2019. Consequently an exit strategy from risk asset and defensive strategy should now be prepared to be implemented over the next 2 months. Therefore, if this forecast actually takes place, the impact on asset prices will be significantly worse than otherwise. We urge readers to take measures to minimize the impact of a sharp break in risk asset prices very soon.

16 / **Timing and Tactical Insight - UP and OUT, one a last rally on equities into the 2nd half of July, use it to take profit and reduce your risk** - This is not a market for Buy and Hold equity investors anymore. Indeed, over the medium term (next quarters), we believe that the risk/reward has very much deteriorated: the risk of a substantial correction seems strong, while the remaining upside potential we calculate is pretty much exhausted. On the timing front, our view is that the S&P500, for example, could soon enter into a period of correction to the downside, which may last between 12 and 18 months and possibly bring the index lower by 20 to 35%. Shorter term, the support points we were expecting end June seem to have held, and we would now expect a last push higher on most developed markets, possibly making new highs on some during the 2nd half of July (such as the Nasdaq 100 or the CAC40). That said, from late July, we would strongly suggest to opportunistically start reducing risk quite substantially on equity positions given the more negative developments we expect from August into year-end and 2019.

23 / **The US Congressional Budget Office Forecasts Growth Recession In Late 2018, Then GDP Falls Further In 2019, Bottoms In 2020 -** One of the recent projections of the Congressional Budget Office that caught our attention is that they have shown a forecast of a top in growth in 2018, and a subsequent growth recession from late 2018 to 2020. The reason for the recession (from this construct) is that, at the end of 2018, private tax relief clauses expire. All of a sudden, tax rates rise and extract billions of dollars out of the economy where they will appear on no measure of the money stock, not M1, M2, M3. What is especially relevant and telling, in our opinion, is the sharp decline in fiscal discretionary spending from late 2018 to 2020. It resonates with us because the changes in this data lead the changes in GDP and changes in risk asset prices. The sharp fall in fiscal discretionary spending after 2018 could lead to growth recession in 2019-2020. Furthermore, a monetary policy tightening in the entirety of 2018, and fiscal consolidation in by late 2018, extending into 2019-2020, are scary prospects, as they would be happening at the same time. A more difficult environment for risk assets is on the horizon.

25 / **Timing and Tactical Insight - As the economy starts to decelerate, Treasuries, Defensive sectors and Gold should outperform equities, probably into 2019/2020 -** We believe the asset environment will soon turn defensive, probably not quite yet, but from the end of this month. The yield curve should start to flatten quite aggressively, long term yields should soon top out in the US, while in Europe they will continue lower, Equity to Bond ratios are also topping out, Credit spreads should continue to accelerate up, while Defensive equity sector should start to outperform the market. Finally, Gold may take a bit more time to reverse up as the US Dollar remains strong, yet from late Summer, we expect it to turn up, and gradually gather momentum towards year-end and then possibly throughout 2019.

32 / **CNY devaluation: China got what it wants, and dealt The Donald a stunning riposte; Mr. Xi will not use the devaluatin route any further as weapon in the trade spat** - Many China observers say CNY devaluation was a weapon-- to us, it is an admission that the economy is in dire straits, which Mr. Xi, et al, expect it to get worse. China needed to do it to kickstart a flagging economy. It was an opportunity too juicy to ignore or waste. "
China got what it wants-- a devaluation of its currency, and a chance to shove a shiv up Mr. Trump's figurative behind. There is a reason why China cannot lower the value of CNY too much too soon. Weaker CNY will negatively impact FDI inflows-- and for China incoming FDI is even more important than higher trade balances. Moreover, Chinese corporates have a huge overhang of USD-denominated external debts, so a sharp CNY devaluation is driving those companies witless-- hence the collapsing Shanghai Index has been an expression of these corporate fears. Therefore, a stable CNY is desired to make sure the fallout from slowing FDIs will not go out of control. The Chinese are also now leery of a repeat of the early 2016 partial CNY devaluation which triggered a large amount of capital flight from China. We believe that the Chinese will not use this "weapon" again in the trade spat with The Donald.

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35/ **Timing and Tactical Insight - Chinese equities and the Yuan may find support towards mid Summer, yet their reflationary momentum is broken, further downside is expected towards year-end and early 2019** - Chinese Equity markets along with the Yuan have taken a strong hit since mid June. We believe they will take some time to stabilize, probably until mid/late August. Shorter term, we expect a short bounce over the next couple of weeks, and then a new downside retest. In the initial Yuan sell-off, probably 70 to 80% of the downside potential has been achieved. Hence, the remaining risk from today's levels into mid August is probably limited. Following that, from mid/end August, we expect Chinese equities and the Yuan to bounce again into the Fall, but believe that they will resume lower once more from early/mid Q4 towards year-end and 2019.

41 / **The US Dollar pulls back at a resurgence of financial risk appetite in July, but the ongoing uptrend continues thereafter** - The US Dollar ascent has been accompanied by rising long-term rates, as well as short-term rates, due to the published intention of the Federal Reserve to raise policy rates three times this year. This triple whammy situation presents risks, not only to Emerging Markets, but to the US and global economies as well – a fear which we expressed at various issues of Capital Observer as early as February this year. The US dollar is now winning the FX "beauty contest. Almost all the macro factors remain in favour of the US currency, especially those that matter in FX currency valuation. We also pinpointed that the US dollar's continuing strength is, and will be, coming from the steady improvement of the US Capital Account Balance. Continuing strength of the US Dollar during most of 2018 will have repercussions to a lot of assets and asset classes. Further US dollar strength may contribute further to stresses in the Chinese economy, the rest of the Emerging Markets have also been devastated by the recent US Dollar strength and are reeling again from new blows from the US currency's recent appreciation. Finally, distress in financial assets also tends to drive the valuation of the US currency even higher, as many investors seek the safety of US Treasuries, with concomitant capital inflows, which strengthens the US Dollar.

44 / **Timing and Tactical Insight - The first leg up in the US Dollar is probably not finished yet** - Over the next couple of weeks, we expect the US Dollar to resume higher vs the Euro possibly until mid/late August (EUR/USD towards the 1.14-1.10 range). This move will probably be concomitant with a sharp correction in risk assets during August. Following that, the Euro and Asian Growth currencies could rebound vs the US Dollar. This environment is not dissimilar to the one that prevailed in H1 2017 (a Growth extension). Yet, we do not expect it to be as strong and last as long as it did back then. Indeed, from early/mid Q4, the US Dollar should resume its uptrend, possibly well into 2019 as the risk asset environment further deteriorates and the US Dollar regains its Flight to Safety status. We would back this view by the fact that Commodity Currencies seem to be the weakest link as we move into H2 2018 and 2019. This would conclude the 2016-2017 reflationary period, leading to an economic deceleration that may last well into 2019, perhaps even 2020. In this context, USD/JPY may attempt a last push higher into late July /early August, but will suffer thereafter, probably until late next year as a more risk-off environment gradually takes hold.

50 / **Splicing the markets - What do to with your favorite Growth stocks ? -** The important equity market top we are expecting is approaching, potentially towards late July / early August. We believe that during this period, Big US technological stocks may also top out on a relative basis vs the market. Indeed, the general market correction to the downside we expect over the next 3 to 5 quarters could be relatively serious, and these Big Tech stock could be hard it given their traditionally "high beta" features. On the other hand, BioTech stocks may offer an interesting alternative. They are more defensive that Big Tech ones, as part of the Healthcare sector. They usually perform well very late in the cycle. Following some correction into late August, we expect them to extend up, possibly towards October/November with interesting upside potential.

The Capital Observer editors team, London / Geneva, July 10th 2018
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