6/ Mapping the markets

General comment

As we enter 2018, we believe that the business cycle is maturing and that the secular Equity Bull market since 2009 is reaching the last stages of its ascension. Reflation trades, which have been on the rise since early 2016 (commodities, interest rates, credit, emerging markets) are also approaching an important inflexion point. Indeed, and as we have been forecasting throughout 2017, we expect an important top to materialize on all risk assets between late Q1 and the middle of this year. The following correction could be substantial, and may probably last towards mid/late 2019.

Yet, in the meantime, we would warn on turning too negative too early. Indeed, we expect more positive surprises during Q1 2018, and even envisage the possibility of a potential late stage Commodity, Emerging markets and Growth assets blow-off (positive acceleration towards a final top) in Q2. A more conservative scenario would be that Equity markets top-out late Q1, and then distribute throughout the Spring, before they start moving lower in H2 2018. As often, the resultant will probably be a mixed outcome, with some risk assets making a last spike, while others gradually start to roll over.

That said, whatever the scenario we expect for Q2 and then for H2 2018, we are still very positive on the potential outcome for Q1. Especially, we see strong potential for European and Japanese equity markets, a trend that should be reinforced by the initial US Dollar bounce we expect until March (which may then be retraced if the blow off scenario materializes in Q2). These stronger Dollar dynamics in Q1 should be led by rising US long term yields, and possibly a steepening rebound in the yield curve. The macro factors to justify this move are abundant, ranging from the US tax plan, to the related repatriation of foreign earnings, or to a possible increase in near term US inflation perspectives. On the other hand , this mix, i.e. a rising Dollar, rising yields and steepening rebound in the yield curve, should be negative for Treasuries and Gold as well as all related Defensive assets. Other Commodities are more cyclical and should be more immune, Industrial Metals should consolidate at high levels, while Oil may even carry on up slightly higher. Finally on the sector front, we would favor value and industrial profiles, such as the Banks, Industrials and Energy.

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Main Equities	US S&P500	The S&P500 may carry on beyond 2'800 towards early March, or 2 to 4% above current levels	The S&P500 starts to distribute and could top out netween late Q1 and late Q2. Above 2'800, the upside potential is exhausted on all frequencies
	Europe EuroStoxx50	Strong performance potential towards 3'900 until early March or more than 10% potential	During Q2, the EuroStoxx 50 may carry on another 5 to 10% to above 4'000 and possibly even 4'400
	EMs MSCIEM USD	Global Emerging Markets top out in January and could retrace some of their recent gains until late February / March	From late Q1 and into Q2, Global Emerging markets accelerate up one last time to circa 5% above current highs
Treasuries	US10Y Bond prices	US Treasuries continue to correct until late February / March, US10Y Yield make marginal new highs between 2.6 and 2.8%	US Treasuries bottom out during Q2 as US10Y yields top out in the high 2s %. Strong performance expected in H2 2018 for very High Quality Bonds
	Germany 10Y Bund prices	Bunds consolidate down between 2 and 4% towards late February / March (towards 159-156 range)	Although a sell-off cannot be exlcuded during Q2 2018 (towards circa 151), this Dip should be bought as the Bund should perform strongly during H2 2018

Legend: Strong Underweight | Underweight | Neutral | Overweight | Strong Overweight

Main Equities

World markets
p 45, 46, 48
We are still positive on global equity markets, first into early March. Then, following and possible intermediate correction (during late March and April), still positive potentially until mid year.

Main Regional picks
p 45, 46, 47, 48
On a relative basis, Europe seems oversold and Japan could still deliver strong potential. We would favour these over US markets in Q1. The Dollar rebound, which we expect over the next couple of months, should also help these markets outperform in their local currencies (perhaps as much as plus 5% until March for European markets vs the US).

Emerging markets
p 49, 50
The USD rebound we expect during Q1 should weigh on Dollar denominated Emerging Markets Indexes. A correction to the downside on Commodities currencies could also have a negative impact. Emerging Markets could consolidate slightly or at best underperform rising global equity markets.

Volatility
p 52
Following several spikes to the upside on the VIX during November and December, the downtrend should resume, potentially towards March as Equity markets continue to rise.

Government Bonds

US & European Benchmarks
p 20
US 10 year yields should make new highs for this cycle in Q1, possibly reaching towards 2.8%, while German 10Y Bund prices may correct some 2 to 4 % until March.

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Equity / Bonds	US	Equities carry on, Treasuries continue to consolidate, 5-10% outperformance potential for equities	Equities start to distribute, Treasuries stabilize, the ratio gradually reverses and should then favour Treasuries over Equities in H2 2018
	Europe	Strong outperformance (10-15%) by European Equities while Bunds consolidate	European equities may carry on vs the Bund into May/June.
Duration		Yield Curve spreads in the US and Europe bottom out and bounce 20 to 30 bps towards March	The steepening bounce gradually dies out during Q2, yield curves then flatten again until end 2018.
Credit		High Yield, Corporate, EM and Sovereign Credit Spreads attempt a last move down with marginal new lows towards late February/March	Credit Spreads bottom out between late Q1 and mid Q2, and start to move up towards end 2018/2019
TIPs/Treasuries		TIPs re-accelerate up vs Treasuries until end February/March as investors seek inflation protection	TIPs start to top-out and gradually reverse vs Treasuries, from mid year, inflation expectations worldwide start to fall
Oil		Oil extends up slightly further towards 65 USD/barrel on WTI and 71 USD/barrel on Brent	A last push higher during Q2 2018 cannot be excluded. From mid year, Oil should start to reverse down
Industrial metals		Industrial Metals may consolidate at high levels until early/mid February. Retracements should be bought	Industrials Metals extend up from mid Q1 to mid year. Copper reaches above 8'000 USD/ton on the LME
Gold		Gold retraces back down into late February/ March, retesting below 1'250 USD/oz and possibly even droping below 1'200	From late Q1, Gold gradually starts to move up again. It may reach 1'500 USD/oz by year-end. Accumulate!

Legend: Strong Underweight | Underweight | Neutral | Overweight | Strong Overweight

Equity to Bond Ratios

US Markets
p 18

The S&P500 may carry on another 2 to 4 % to the upside until March, while US 10Y Treasuries may correct down between 2 to 3 %. we expect between 5 to 10 % outperfomance for US Equity vs US Treasuries until March.

Eurozone Markets
p 19

Strong performance by European and Eurozone Equity markets, while the Bund corrects, could deliver more than 10 % outperformance for European equities vs the Bund until March.

Fixed Income Dynamics

Duration
p 21

Yield Curves are oversold, they could make a steepening bounce in the US during Q1 and resume their steepening in Europe. The move happens mostly on the long end and could add 20 to 30 bps to yield curve spreads in both regions (10Y- 3Y).

Credit
p 23

In the rising long term interest rates environment we expect during Q1 2018, Corporate debt should be less sensitive than Treasuries, and should continue to outperform. High Yield should also make a comeback, yet its uptrend and relative performance vs Investment Grade may be already rolling over for this cycle. At the moment, we believe High Yield is probably the weakest link in the reflation trade.

Rate Differentials
p 22

Rate differentials in favour of the US (vs Europe, Japan or the UK) continue to climb on all tenures, until March at least.

Tips
p 22

TIPs should follow Gold and the whole fixed income space lower until March at least, considering the rising interest rates environment we expect. That said, inflation expectations are rising and the inflation break-even ratios (TIPs vs Treasuries) should continue higher until March at least.

Commodities

Oil
p 41, 42

Oil is approaching the targets we have been projecting for Q1 2018 since early 2016 (70$/barrel on Brent). Our daily graphs could suggest that its uptrend may carry on towards February/March and possibly add some marginal additional performance. Following some consolidation in late Q1, early Q2, a blow-off (strong acceleration before a major top) cannot be excluded in Q2 towards mid year.

Industrial metals
p 35, 36, 42

Following their strong rally in H2 2017, and more recently in December, they could consolidate at high levels until late February/March. Following that, we expect them to resume up towards mid year and potentially accelerate in a typical late cycle Commodity blow-off.

Gold & PMs
p 38, 39, 40, 53

In the rising interest rates, rising USD environment we expect over the next 2 months, we expect Gold and Precious Metals to sell-off once more (for Gold possibly back to below 1'250 USD/oz or even below 1'200 USD/oz until March). We will then be positive for Gold for the rest of the year, which could possibly reach 1'500 USD/oz by year-end.

Agriculture

Agricultural Commodities as a whole are still lingering lower, possibly until mid year.

Foreign Exchange

		Next 2 months	3 to 6 months ahead
USD vs	EUR	EUR/USD tops out again during January (1.21-1.22max). EUR/USD then moves back below 1.16	From late Q1 and during Q2, EUR/USD may attempt to retest its highs. It then weakens substantially during H2 2018
	GBP	GBP is more pro-cyclical than the Euro. It may correct a bit (1.33 - 1.31 range), but pretty much holds ground vs the Dollar in Q1	From late Q1 into Q2, GBP/USD moves up once more (high 1.30s). It then weakens substantially during H2 2018
	JPY	USD/JPY moves up towards end February / early March with prices targets towards 117 - 120	USD/JPY could extend into late Q2 and challenge previous 2015 highs above 125, even 130
	CHF	USD/CHF moves up towards late February / March. It may challenge its 2017 highs towards 1.015	The move up on USD/CHF could extend into late Q2 and challenge previous 2015 highs above 1.03
EUR vs	GBP	EUR/GBP weakens until late February / March: GBP is more pro-cyclical than EUR and cyclical assets should outperform in Q1 2018	From late Q1 and during Q2, asset rotation shifts to Growth and then Defensive assets, which should benefit EUR/GBP
	JPY	During Q1 EUR/JPY should continue up towards 140	Following some consolidation in late Q1 / early Q2, EUR/JPY extends towards 150 by mid year.
	CHF	EUR/CHF may consolidate at high levels until mid/late February.	From late February, EUR/CHF re-accelerates up into mid/late Q2, when it could top out in the mid 1.20s
GBP vs	JPY	During Q1 GBP/JPY extends up another 5% towards 159/160	GBP/JPY continues up during late Q1 / Q2, possibly towards 165/166.
	CHF	During Q1 GBP/CHF extends up another 3 to 5% towards 1.35 - 1.39	GBP/CHF continues up during late Q1 / Q2 and extends above 1.40

Legend: Strong Underweight | Underweight | Neutral | Overweight | Strong Overweight

US Dollar
p 27, 30

The Dollar should bounce in Q1 2018, probably between now and early March. It could add between 3 to 5 figures against the Majors. Then in Q2, it should retrace some of these gains and could even make new lows. From H2 2018, however, as risk assets start to correct, the Dollar should reaccelerate back up possibly into 2019.

Euro
p 28, 29, 30

The EUR may attempt to make new highs over the next week or so, yet, following that, it is more likely to correct down into March, possibly back towards the 1.16 – 1.13 range. During this period it could also correct down vs GBP, consolidate at high levels vs CHF, and continue to progress vs JPY. Following that, during Q2, it should re-test to the upside again vs the Dollar and the Pound, and accelerate up vs JPY and CHF. Longer term, we believe that the uptrend on EUR/USD since late 2016 is only a correction, that its upside potential is in the low 1.20s, and that its should die out during H1 2018. Thereafter, it resumes down quite aggressively during H2 2018, vs USD, JPY and CHF, while it remains strong vs GBP, which could be particularly vulnerable in a market downturn.

Yen
p 28

The Yen remains the ultimate defensive currency. During the late stages of the risk asset rally (expected until mid year), the Yen should weaken substantially, possibly towards 130 vs USD, and 150 vs EUR. It could then bottom out between mid year and the Summer, and recoup all of its losses, and perhaps more, until mid/end 2019.

Sterling
p 29

Sterling is pro-cyclical and still re-rating following the Brexit shock election. It should hence correct only moderately vs USD in Q1 (back to the 1.33 – 1.31 range). Following that, between late Q1 and early Q2, it could make new highs in the high 1.30s. Once risk assets top out, it should then weaken substantially vs most currencies into 2019. Indeed, we expect GBP to be particularly vulnerable in the important market downturn we are forecasting.

Oil & Commodities currencies
p 31

Commodity currencies (proxied by our equal weighted portfolio containing AUD, BRL, CAD, NOK, NZD, RUB and ZAR) have seen a strong rally vs the US Dollar since December. This performance should be retraced until early March as the Dollar rebounds. Following that, Commodity currencies should accelerate up again until mid year (a scenario that would confirm a possible Commodity blow-off in Q2). From mid year, they should then roll-over and underperform aggressively into 2019. The articulations we anticipate are similar vs EUR, yet with slightly less volatility.

Asian currencies

Our Asian Growth equal weighted portfolio (INR, KRW, THB and TWD) could consolidate slightly against USD until March. It then seems to resume up towards the Summer. This could be the case against all the Majors. From late Summer, at the latest from the Fall, they could start to correct down vs USD and JPY. They may however continue to outperform European currencies as their profile seems more defensive than them.

Equities Markets Segmentation

Core Sector Weightings **Next 2 months** **3 to 6 months ahead**

US Sectors - S&P500			From mid January, we expect pro-cyclical and Value sectors to outperform towards late February / early March					Equities may retrace a bit during late Q1 / early Q2, mid/late Q2 could see Growth and Commodity themes extend up				
Sectors	ETF symbol	Benchmark-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Technology	XLK	26%										
Financials	XLF	15%										
HealthCare	XLV	14%										
Discretionary	XLY	12%										
Industrials	XLI	10%										
Staples	XLP	8%										
Energy	XLE	6%										

European Sectors - Europe Stoxx 600			From mid January, a strong move up for European markets should benefit all pro-cyclical and high beta sectors, while Defensive sectors underpeform					Following some consolidation late Q1, in Europe, cyclicals seem to maintain momentum into late Q2				
Sectors	Index symbol	Benchmark-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Banks	SX7P	13%										
Industrials	SXNP	12%										
HealthCare	SXDP	11%										
Pers. & HH Goods	SXQP	9%										
Food & Beverage	SX3P	7%										
Insurance	SXIP	6%										
Energy	SXEP	6%										

Main Sectors Allocation

p 51, 52

Overall, our sector allocation for the next couple of months (until March) is skewed towards short duration equities (yield curve steepening rebound), value driven ones (in search of remaining price potential), Dollar sensitive ones (avoiding sectors inversely correlated to a Dollar rebound) and higher beta ones (light on Defensive profiles).

Looking forward towards Q2, we remain pro-cyclical for now, yet are split between a Global Equity distribution scenario and a more aggressive one where Commodities and Emerging markets, and possibly Growth profiles, could blow-off. We will aim to confirm one or the other of these scenarios over the next few months.

Satellite sectors and Segments

p 42

Deep value, in the Energy sector for example, looks quite promising in terms of profile and potential upside (oil services, natural gas).

Core Countries Weightings **Next 2 months** **3 to 6 months ahead**

All World Country Index Currency hedged			**European Markets are heavily Oversold vs World markets when hedged for currency risk. A US Dollar rebound in Q1 should benefit EuroZone markets from mid January**					**Following some consolidation late Q1 / early Q2, World markets reposition for a last rally into mid year. Growth and Commodity markets could then outperform**				
Sectors	Index symbol	Benchmark-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
US	S&P 500	52%										
Canada	TSX	3%										
Europe	SXXP	21%										
-UK	FTSE	6%										
-France	CAC40	3%										
-Germany	DAX	3%										
-Switzerland	SMI	3%										
Japan	N225	8%										
China	MSCICN	3%										

Main Country allocation

p51, 53

With the Dollar rebound we expect during Q1, we are clearly overweighting Europe and Japan, and within Europe, Core EuroZone countries such as Germany or France. Our view, indeed, is that EUR crosses could also correct some during Q1, which could result in slight UK and Swiss underperfomance vs Europe. Inversely, we would also underweight the US where we see less potential over the next few months. Canada is at risk given the correction we expect until Match on precious metals. China has had a great run in H2 2017 and its uptrend seems exhausted for now.

Going forward and looking into Q2, we will wait to confirm either a Global Market distribution or a potential Commodity blow-off scenario until mid year, but have tentatively penciled Canada and China as potential outperformance candidates.

Satellite Country allocations

Similarly to Canada, we would probably reduce risk on most commodity driven geographies, the ones focused on precious metals especially.

Note: these country and regional allocations are considered hedged for currency risk, i.e. performances are anticipated in local currency.

Core Factor/Themes Weightings **Next 2 months** **3 to 6 months ahead**

	Pro-cyclical, short duration and US Dollar friendly assets could outperform, while Defensive assets could lag or correct down					**Distribution starts in Global equity markets. Some cyclical assets may carry on into Q2, yet Growth assets are shifting to Market Neutral**				
Themes	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Nasdaq 100 (vs S&P500)										
DJ Industrial (vs S&P500)										
Russell 2000 (vs S&P500)										
Wilshire REITs (vs S&P500)										
US Value (vs US Growth)										
Southern EuroZone (vs Stoxx EZ 600)										
EuroZone Small Cap (vs Stoxx EZ 600)										
Japanese Small Cap (vs N225)										
GDX - Goldmines										
XME - Diversified Mining										

Core factors and Themes
p 37,39, 54

Over the next 2 months, we are underweighting Growth (Nasdaq100) and Defensive (REITs) themes, as well as Goldmines and Small Cap. profiles outside of the US. US Small Caps. and Value are overweight given our rebound scenario on the USD.

Additional Satellite Theme

Within Southern Europe, which is neutral on our table, we would favour Italy, which shows a strong profile as we approach the elections in March.