THE CAPITAL OBSERVER

JULY / 2017

A DC&C publication,
featuring MJT's timing methodology

DC&C
Diapason Currencies & Commodities

MJT

DIAPASON CURRENCIES AND COMMODITIES MACRO ANALYSIS

A Monthly Macro and Asset Review

Featuring MJT's Timing Methodology

CONTENTS

"Comparing recent prices with their very long-term averages (most commodities are trading well below their average prices over the last 10 years) and choosing exposure to a broad range of markets, seeking diversification into and within commodities, that is a long-term measure of value that should put you on the right side of the trade,"

Scott E. Wolle, Chief investment officer for global asset allocation at Invesco

"The stock market as a whole looks expensive to us but commodity stocks look like they're trading at a bit of a discount, relative to where they have traded historically, and there's a diversification benefit."

Matt Kadnar, asset allocation specialist for GMO

4/ Executive Summary

7/ **It could get worse before it gets better: allow for risk asset prices to fall in August-early September before Reflation Wave II gets underway** - The QE programs, and the surfeit of systemic liquidity it unleashed, also skewed the relationships between and among financial variables, especially as it pertains to inflation, bond yields, yield curves and even the US Dollar. Case in point – M2 money supply (after having been impacted by QE) has become an important variable in the determination of equity prices since November 2008, when the first QE program was launched. Prior to November 2008, the relationship between M2 and the stock market (with S&P 500 Composite as proxy) was episodic and often, seemingly random. But after November 2008, the correlation became much tighter -- whenever the quarter-on-quarter growth of M2 goes to zero, equity prices crumble several weeks thereafter. Note that after any sell-off triggered by liquidity-related issues, the subsequent counter-trend move is powerful and decisive. This was the case in all the equity episodes post-Nov 2008, and it should be the case again this year. We expect a sharp recovery in equities and risk assets after a sell-off in late August-early September (if it happens), and the rally could extend until late in the year or even until mid-Q1 2018.

10 / **Timing and Tactical Insight - 10 Daily charts to summarize our current tactical outlook**: Risk/reward is stretched on our Daily charts for so called risk assets. We hence expect some consolidation to the downside into the 1st Half of August for the S&P500, the Eurostoxx 600, EUR/USD, USD/JPY or EUR/JPY. At the same time, reflationary asset should make their final sell-off, while defensive assets could bounce. From mid August/early September, risk and reflation assets should resume their uptrend towards October and then early 2018.

16 / **All that you know before Nov 2008 is now all wrong: understanding how QE skewed the relationship of financial variables** - The Fed will raise its policy rate of interest just one more time this year, and will begin to reduce the size of its securities portfolio later this year -- September being the best guess for the initial reduction of the Fed's balance sheet.
So inevitably "Quantitative Tightening" is in the pipeline , but let's be careful with the semantics here. Central banks, courtesy of the Eurozone and Japan, are still buying financial assets with both hands, despite impressions of Mr. Draghi about to turn off the tap. The fact is that global monetary authorities have snapped up a record amount of financial assets in the year to date, in addition to the previous 8 years of cumulative stimuli.
However, the blessings come with some cleverly disguised, insidious pit-falls. The first Quantitative Easing program, initiated by the Fed on November 2008, altered the relationships and correlations among financial variables, and those skewed relationships will probably stay with us for as long as global systemic liquidity remains very high.
So, to summarize, one should understand that the relationships among financial variables prior to November 2008, are now all wrong and you should update one's analytical tool kit.

20 / **Timing and Tactical Insight - Yields and the Yield Curve remain soft until September, yet the downside is limited from here**: US 10 Years Treasury Yields have started to react up in June, yet they may still retest during the Summer probably within their recent range. From late August / September onwards, we expect them to accelerate up until early next year. German Yields are stronger, yet quite well synchronized and confirm this positive picture following some retracement into August. Finally, the US Yield curve has probably reached a "Low Risk" situation that should see it rebound into next year.

28 / **Oil is still susceptible to a last decline/setback in August-September but this will be followed by sharp gains during the rest of H2 2017 -** The next tactical move may still be a last sell-off that we have been flagging for some time, a last decline toward the lower part of this year range, which we have always said will happen in late Q3 2017. It should act like some kind of reset -- and a new upcycle should commence thereafter. This may be a spoiler for the bullish surge which has been going in the past 4 weeks in the back of favourable oil news flow.
US oil inventories also respond to lower oil prices by building (after a 2-month lag), and so it is just at this time that inventories should start rising soon due to this factor. Oil inventories continue to draw however, as demand from refineries enabled some spectacular weekly drawdowns in recent weeks. However, although the inventory decreases paint a seemingly bullish picture, several of the contributing variables are not necessarily indicative of global supply and demand rebalancing, and will likely be confronted by increasing U.S. production.
This is the confluence of events which we believe could trigger a last sharp decline in oil towards the $45/40 level. However, the adverse situation should not last long. All those factors would quickly realign so that global production will decline, supply will fall and inventory withdrawals will accelerate during the last quarter of the year. That would be extremely price-friendly and we expect a surge in oil prices which should challenge the $60.00 level by year-end.

The Capital Observer editors team, London / Geneva, July 28th 2017
to view previous issues, please visit our website at: http://www.thecapitalobserver.com

31 / **Timing and Tactical Insight - Oil is building a base, late Summer could see it rising again**: Oil may have already reached its retracement low. Yet we are weary of possible retests into the Summer as well as of the downside risk we still calculate on our Daily graphs (towards USD 40 a barrel). That said, the dynamics, which we have been considering since late last year (retracement into the Summer, re-acceleration towards year-end and early 2018) still appear to be valid. Sectors, Countries play and Commodities currencies seem to confirm this view. On our Daily graphs, we see quite a few indications that investors should probably wait until mid / end August for a better opportunity to enter Oil and its promising related plays.

35 / **Is it time to allocate funds away from equities to commodities? An opportunity of a lifetime to do that may be close at hand**

At no other time in the history of commodities has financial interest in the asset class been as weak as it is today. Over the past 50 years, commodities have never been cheaper relative to equities than they are at present. The good news is that the correlation between commodities and equites is highly cyclical -- the history of US stock and commodity prices has been characterized by recurring super cycles that last several decades. Similar extremes were seen in the early 1970s, in 1986 and in 1998, leading up to the dot-com equity bubble. Of course, the ratio can fall further from here, and this year may not be the time when the reversion begins. But with talks of equity markets being in a bubble, and the Fed making noises about wanting to reduce the level of its balance sheet, which has been significantly responsible for pushing up equity prices, the elements that could trigger a reversion to the mean are starting to get into their proper places. Those relationships are due for a major change soon, as soon as next year, and we look forward to a radical change in regime, when commodities will again outperform equities. Asset classes inevitably take turns in outperformance, and sometime next year commodities should switch over to the driver's seat.

38 / **Timing and Tactical Insight - There will be multiple opportunities in H2 2017 for commodities**: Most commodity play are expected to resume their uptrend from mid Summer to Spring next year. The outperformance potential for both commodities and their related equity sectors is substantial. Shorter term, the bounce which materialized from mid June will probably be retraced somewhat into mid August. Our view is that it will probably make higher lows already. We see this retracement as an opportunity to pick up Commodities before their prices really take-off.

43 / **Splicing the markets – The trend is now heading upwards on GBP/USD, Buy the Dips**: The uptrend, which started earlier this year on GBP/USD, now seems quite robust and we would expect it to continue towards next year. In the meantime, some retracement may materialize into August. We see this potential pull-back as a 'Buy the Dips' opportunity.

6/ Mapping the markets (part I)

General comment

Late last months, we were caught picking highs on EUR/USD. We had been bullish on the EUR/USD from at least late last February and considered that it was time to expect a counter-trend move. We did point to the possibility that EUR/USD would extend into early July and towards 1.15, yet the move continued a bit higher and a while longer than we had expected. Going forward, we still expect EUR/USD to consolidate some, probably into the 1st Half of August and the 1.13-1.12 area. This is less aggressive that the projections we had made last time. Yet, it matches quite well the more general retracement we expect on risk assets over the next few weeks. Indeed, while Equities, EUR/USD, USD/JPY and Treasury yields consolidate to the downside into the 1st Half of August, we would expect Energy and Commodities to make a last re-test / sell-off towards their recent lows. This should finish the important retracement period that reflation assets have experienced since the Spring. Following that, from mid August, or at the latest, early September, we would expect Risk assets and the Euro vs the Dollar to resume their uptrend, probably into H1 2018. At the same time, Energy and Commodities should be bottoming out (also between mid August and early September) and we believe this constitutes a strategic "Buy the Dips" opportunity for them with large potential into next year.

Equity markets

Volatility

VIX is approaching an intermediate Daily low. We would expect 3 to 4 weeks of rebound, possibly 1.5 months.

World markets
p 11, 21, 28, 29

The S&P500 is nearing an intermediate top, while the EuroStoxx 600 is eyeing another leg down. Generally, we would be prudent on equity markets over the next several weeks, possibly into mid August.

Regional picks

The relative performance of Europe and Japan vs the US has recently been suffering from the weaker Dollar. Although, we do expect a measured consolidation on EUR/USD, its influence should be limited. At the same time, a stronger Yen over the next few weeks should weigh on Japanese stocks.

Emerging markets

These markets are at risk of several weeks of consolidation to the downside going into August as global equity markets correct some and the Dollar makes a slight rebound (vs the Euro especially). Over the next few months, we remain constructive on China, yet are also focused on re-entering commodity and energy related plays towards end August / early September for a strong rally into year-end.

Relative Sectors

Cyclical sectors and Financials should retrace some of the early gains they've achieved since they bounced in June. Following that, from end August / early September, we would expect them to confirm their nascent uptrend and start outperforming until year end and early 2018.

Profiles/Themes

Value vs Growth should align with the sector dynamics above as growth outperforms value one last time into August.

Interest rates

US rates and Yield curve
p 19, 20, 22

US 10 Year yields have bounced back since early June. Yet, they may retrace once more, probably towards late August / early September. The yield curve spread (10Y-3M) should be bottoming out over the next couple of months. Following that, we expect it to bounce into year-end.

Other countries
p 12, 22, 23, 32, 33

Yields and Yield curves in other developed countries are following similar dynamics as in the US, yet with a more positive tilt. For example, German 10 year yields have recently made new highs and we would expect some mild retracement into August (no strong sell-off expected)

Credit

High yield has reached intermediate tops and could consolidate mildly into the Summer before resuming its uptrend into year-end

Rate Differentials

The US yield curve has recently flattened more than elsewhere. Hence, while the US vs Eurozone and Japan short term rates differentials (2 years tenures) are still holding up, longer term US yields (10 year tenures) are still sliding vs their US and Japanese counterparts. They may rebound slighlty into August, yet should retrace again into the Fall.

Tips

TIPs are still in a downtrend vs US Treasuries of the same tenure, potentially until late August / early September. This reflects continued pressure on inflation expectations in the US as reflation assets and commodities finish off their retracement from the Spring.

7/ Mapping the markets (part II)

Commodities

Oil
p 26, 27, 28, 29, 31

Oil did bounce from the 3rd week of June into July, yet we would expect one last retest into the 1st Half of August before it stabilizes and starts to resume its uptrend from late August / early September, possibly into the 1st Half of next year.

Base metals
p 37, 38, 39, 40, 41

These should also be retracing into August before they resume their uptrend late August / early September potentially into early next year

Gold & PMs
p 13, 15, 38, 42

Gold is eyeing a continuation trade into the Summer during the risk-off period we expect during August. Previous highs in the higher 1'200s USD/oz should offer strong resistance to the upside though. Following that, from late August / early September, Gold should retrace again as reflation assets, inflation expectations and most importantly longer term interest rates resume their uptrend. Silver should also be bottoming vs Gold around that time, reflecting its higher cyclicality.

Agriculture
p 39

Agricultural commodities did also bounce in June, yet they should also be retracing into late Summer. In general, these remain weaker than other commodity segments into year-end.

Foreign Exchange

Dollar Index

The Dollar will probably remain under pressure into later this year. That said it may be reaching an intermediate bottom, which could see it consolidate slightly to the upside into August

Euro
p 14

EUR/USD remained strong during July, yet may now be temporarily topping out. We would expect it to consolidate slightly into August before it resumes its uptrend possibly from mid August into late this year.

Yen
p 14

The Yen is firming against the Dollar and could also do so over the next several weeks vs the Euro. Yet, from mid/end August, we would expect it to weaken again quite substantially, possibly until year-end.

Sterling
p 43, 44

Sterling extended to new yearly highs in July. Against the Dollar, it now seems to be following the Euro up towards year end. As with EUR/USD, we would expect GBP/USD to consolidate into August before it resumes is uptrend into the Fall

Commodities currencies
p 33, 34

Oil and Commodity currencies are still retracing from their tops early this year. Along with Commodities, they should start to resume their uptrend from late August / September, possibly into year-end.

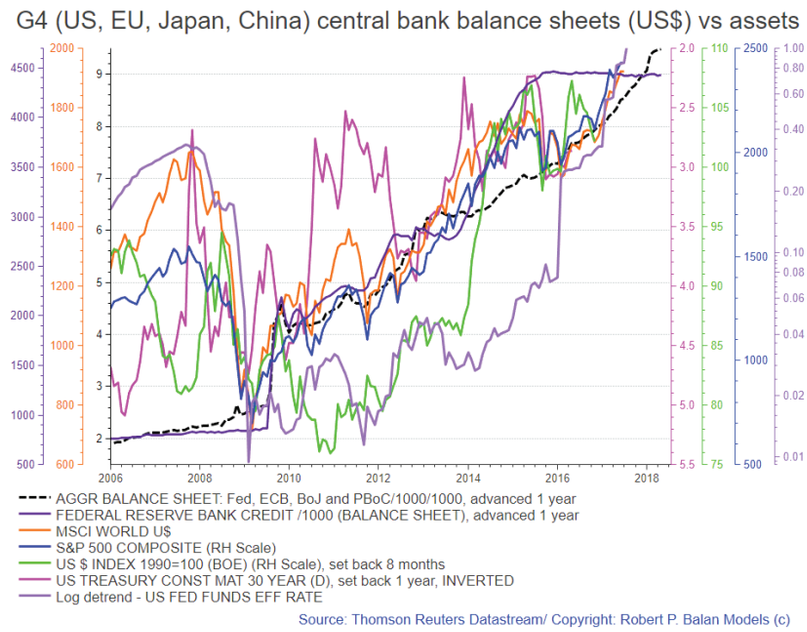
Asian currencies
p 14

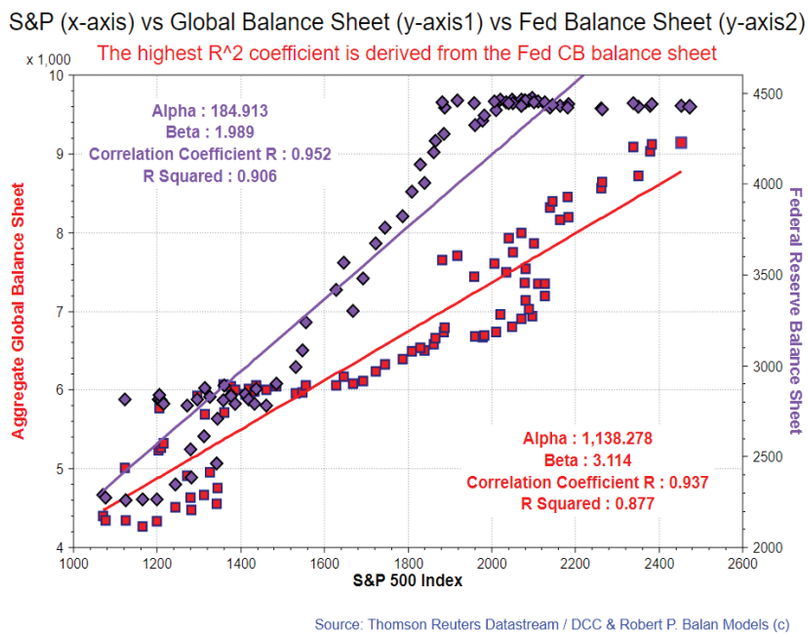
INR, KRW or TWD are weaker yet similar to the Euro vs the US Dollar. They may hence consolidate to the downside during August, possibly early September, before they resume their uptrend towards year-end.

8 / It could get worse before it gets better: allow for asset prices to fall in August-early September before Reflation Wave II gets underway

During the Quantitative Easing (QE) programs conducted by the US Federal Reserve, the central bank created new electronic money in order to buy government bonds and other financial assets, thus raising the prices of those financial assets and lowering their yield, while simultaneously increasing the money supply. The express purpose was to stimulate the economy by trying to increase private-sector spending and return inflation to the Fed`s target. **The QE programs were an unconventional form of monetary policy, which was used when standard monetary policy had become ineffective at combating a falling money supply.** Another side benefit the Fed wanted from QE was to push long-term rates lower, while keeping short-term rates close to the zero-bound.

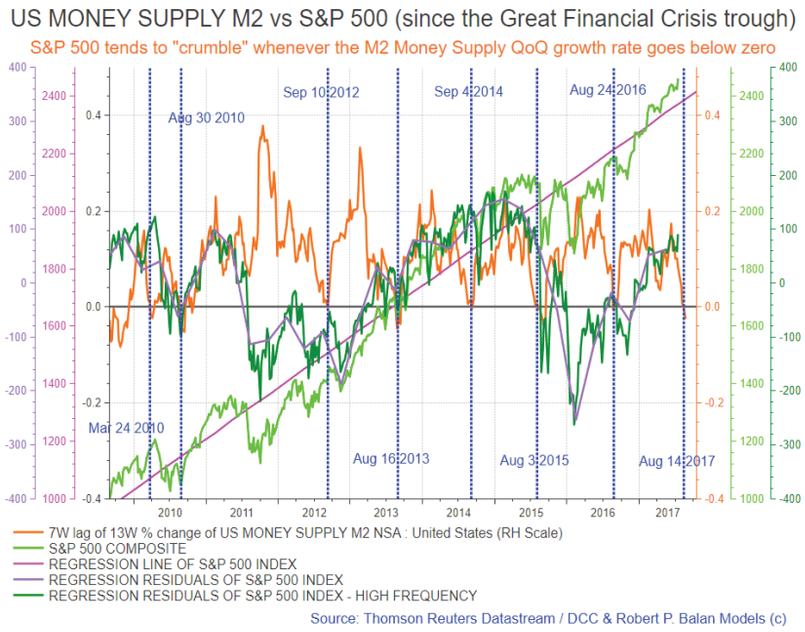
We have become familiar with the refrain that the QE programs did nothing much to stimulate the "real" economy, but that they provided the juice that pushed asset prices (especially equities) to stratospheric heights. And it was not just the Federal Reserve feeding the asset markets – the aggregate balance sheets of the Big Four central banks (Fed, ECB, BoJ and PBoC) are still pushing up the prices of major asset classes, short and long-term US rates, and the US Dollar up to this time. **However, the Fed failed in its side objective to manipulate the yield curve – long terms rates did fall, but short term rates rose, flattening the curve – not what they expect**. Working with the first derivatives of the G4 aggregate balance sheet and asset prices, their coeficient of determination (R^2) was found to be satisfactorily high ***(see two charts on this page):***



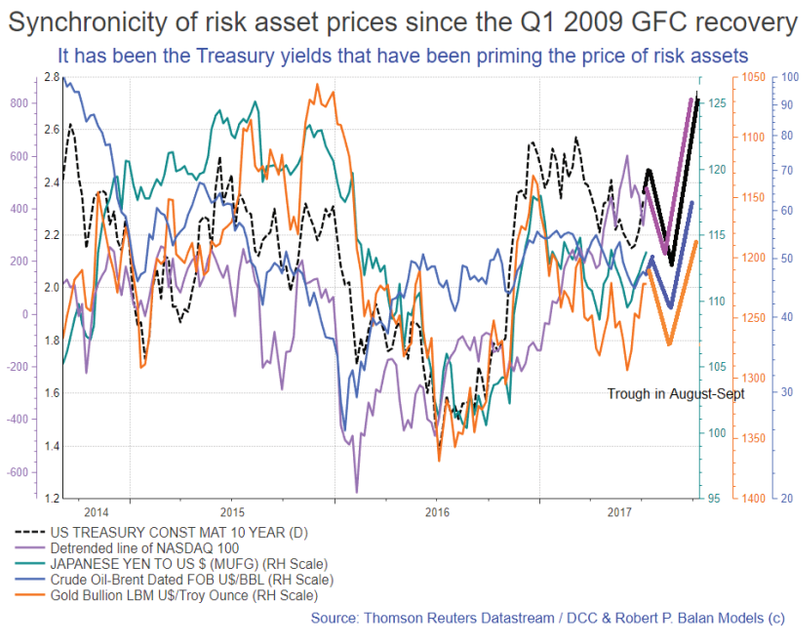


The QE programs, and the surfeit of systemic liquidity it unleashed, also skewed the relationships between and among financial variables, especially as it pertains to inflation, bond yields, yield curves and even the US Dollar. Case in point – M2 money supply (after having been impacted by QE) have become an important variable in the determination of equity prices since November 2008, when the first QE program was launched. Prior to November 2008, the relationship between M2 and the stock market (with S&P 500 Composite as proxy) was episodic and often, seemingly random. **But after November 2008, the correlation became much tighter -- whenever the quarter-on-quarter growth of M2 goes to zero, equity prices crumble several weeks thereafter**. We have documented such events and presented them in the ***1st graph of the next page***. Note that it is not the level of M2 money supply that matters – it is its quarterly change rate that shows the relationship between the change in the money supply and the S&P 500 Index. .

This phenomenon has underpinnings which are similar to economists` and Business Cycle Theory, in that when the amount of money in an economy stops expanding after a period of credit expansion, boom turns to bust. Since the stock market reflects developments in the real economy, then the boom-bust effect gets to be seen in the asset markets as well, after a lag. Since January 2009 (post-GFC trough), the M2 qoq growth fell to and below zero seven times, and we got six equity sell-offs of various degrees during those times. If we get an equity decline in late August, it will be successful event No. 7, out of 8 times the M2 quarter-change made a trip to the zero-bound.



The significant development at this time is that the the M2 qoq growth rate had already hit the zero level. Pushing out that event by 7 weeks brings us to Aug 14 this year as likely inflection point for an equity sell-off. Our presumption is that equity prices will fall during that time, or not long after. The degree of the equity price adjustment has some bearing on the extent of M2 growth below zero. At this time, the M2 quarterly change rate is still falling -- we won`t be able to make an estimate as to how severe a decline in equity prices will be until the M2 growth rate reverses and starts rising again.

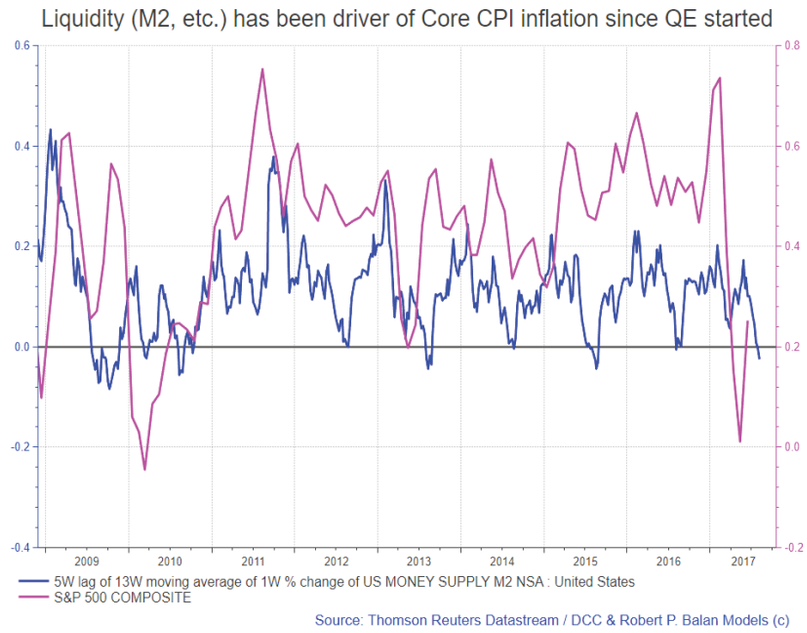


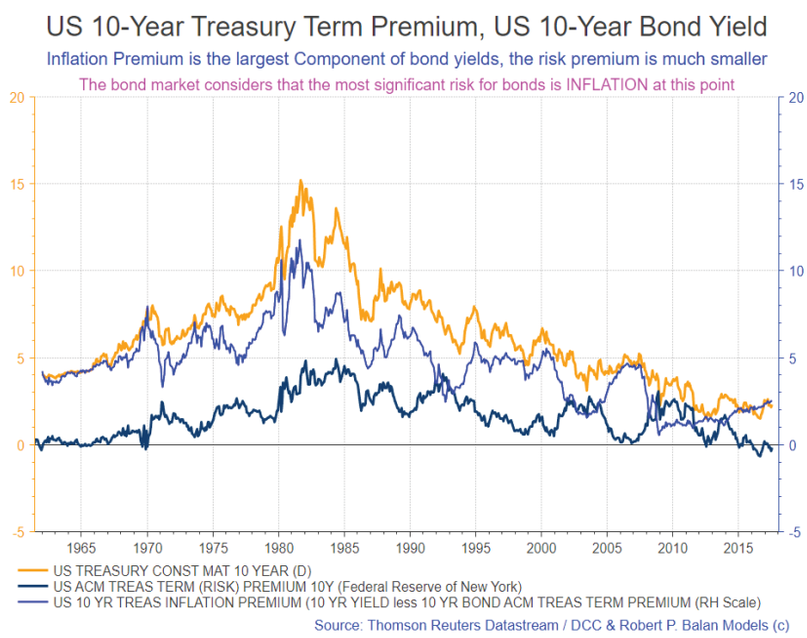
If you believe this hypothesis (and we do), now is the right time to implement protection strategies for long equity market exposures, or benefit from falling equity prices if you could. This phenomenon was actually first observed by one of us 11 days before the August 24 2015 Black Monday flash crash. A similar warning from the M2 growth rate was seen on August 24 last year (2016), and true enough a subsequent equity decline took place not long after. There seems to be seasonal elements involved, as most of the M2-powered market crumbles happen in late August-early September each year. And if a stock market sell-off does happen during or after August 14 this year, then this strategy has the potential to be repeated next year.

A more detailed study of the M2 database yields some interesting aspects, which support the seasonality flavor. Whether a sell-off will occur in mid-to-late August in any year, depends on the Federal Reserve's H.6 Money Stock Measures report for the first week of July. The first week of July, reported on a 10-day lag by the Fed, almost always shows a monetary growth spurt. Since 2008, that growth spurt has been between 0.7% and 1.5% growth from the previous week's not seasonally adjusted one-week average. With the 13-week average during that period this year growing week-to-week below the norm, stocks should be in trouble in due time. If conditions obtaining by the first week of any July would have been otherwise, then a stock market sell-off is unlikely to happen, under the defined circumstance. But there was M2 sub-par growth, so we prepare for a putative sell-off in the equity markets sometime soon.

The very low-end growth for the first week of July this year was very close to the conditions obtained prior to the August 2015 equity sell-off. This strengthens our belief that a significant equity market sell-off may happen during the second half of August this year. The impact will not be exclusive to the equity markets. We expect bond yields to fall sharply as well, and that event may provide the linkage with other risk assets, like USD/YEN and gold, as illustrated below ***on 2nd graph previous page.***

It is not a stretch to link bond yields with the M2 money supply, if we ran the linkage through Core CPI. It is easy to show that since the QE programs started, Core CPI has had good comovements with M2, and we even surmise that some sort of cause-an-effect runs from M2 to Core CPI, and that is exceedingly critical at this point, as inflation has become the most critical element in bond pricing at this time, as ***the graphs illustrate on this page.***





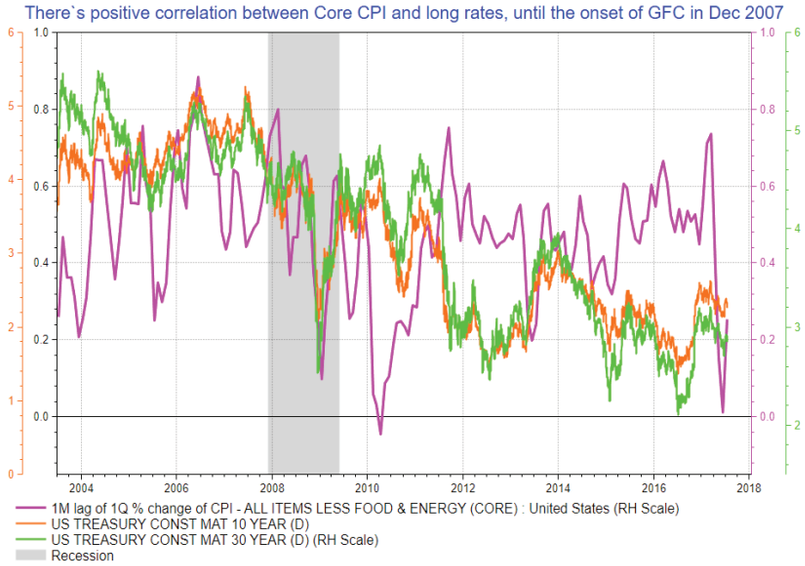
The impact of Core CPI on bond yields, and by extension, on yield curves, can not be over-emphasized. There was a historic, positive correlation between Core CPI and long rates – higher Core CPI is accompanied by higher long rates, after a slight lag. But this relationship started to go awry after the onset of the Great Financial Crisis in December 2007; the correlation started to break down in earnest after QE from the global central banks unleashed a tsunami of global systemic liquidity. ***(see 1st chart on this page)***

Since the onset of the tsunami of systemic liquidity unleashed by the global central banks, starting with the Fed`s QE1 program in November 2008, the historic correlation between Core CPI and long bond yields broke down. By 2011, the correlation between the two variables completely flipped, and the relationship turned negative, and the effect lags by as long as 6 months. Put simply, lower Core CPI is now followed by higher long yields, and vice versa. Given this new set of relationship, it is conceivable that we could see a sharp decline in yields sometime very soon, followed a sharp rise towards the year-end, following the previous lead of the lagged (advanced) Core CPI as illustrated in the ***2nd chart of this page***.

Note that after any sell-off triggered by liquidity-related issues, the subsequent counter-trend move is powerful and decisive. This was the case in all the equity episodes post-Nov 2008, and it should be the case again this year. We expect a sharp recovery in equities and risk assets after a sell-off in late August-early September (if it happens), and the rally could extend until late in the year or even until mid-Q1 2018. And we as well expect long bond yields (proxy: 10yr yield) to rise to a peak in the current up-phase until sometime in Q4 this year. These moves are all consistent with the Reflation Wave II themes to come that we have been discussing in articles published in issues of this publication.

Historic correlation between Core CPI and long-term bond yields

There`s positive correlation between Core CPI and long rates, until the onset of GFC in Dec 2007

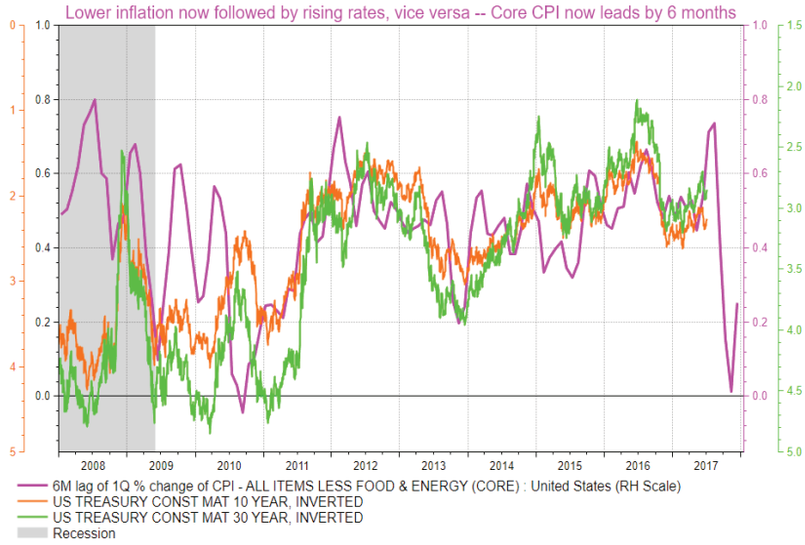


Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

Correlation between Core CPI and long-term bond yields, post-Dec 2007

After the QE programs in Nov 2008, the relationship between Core CPI vs long rates inverted

Lower inflation now followed by rising rates, vice versa -- Core CPI now leads by 6 months



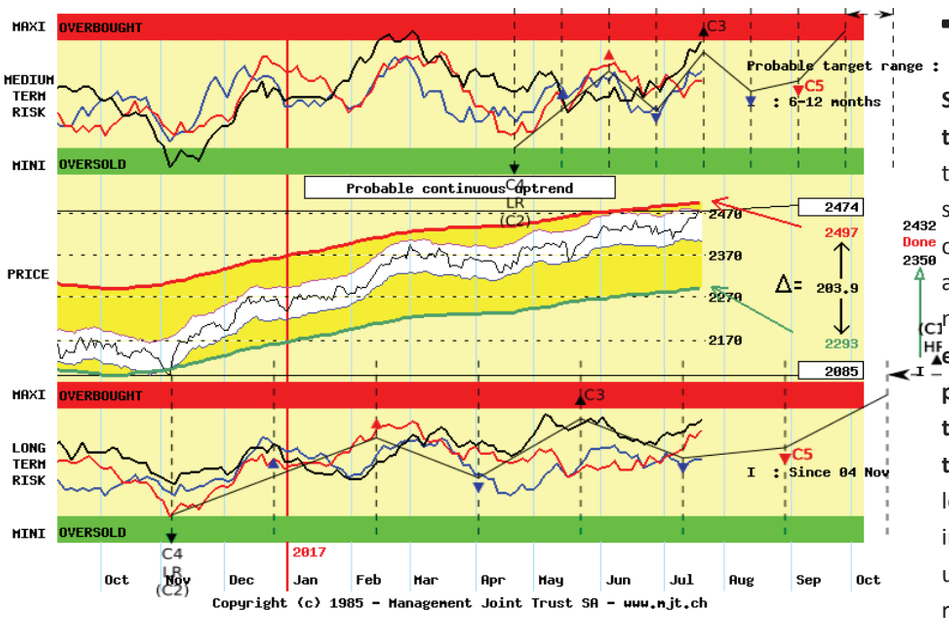
Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

12 / MJT - TIMING AND TACTICAL INSIGHT

10 Daily charts to summarize our current tactical outlook

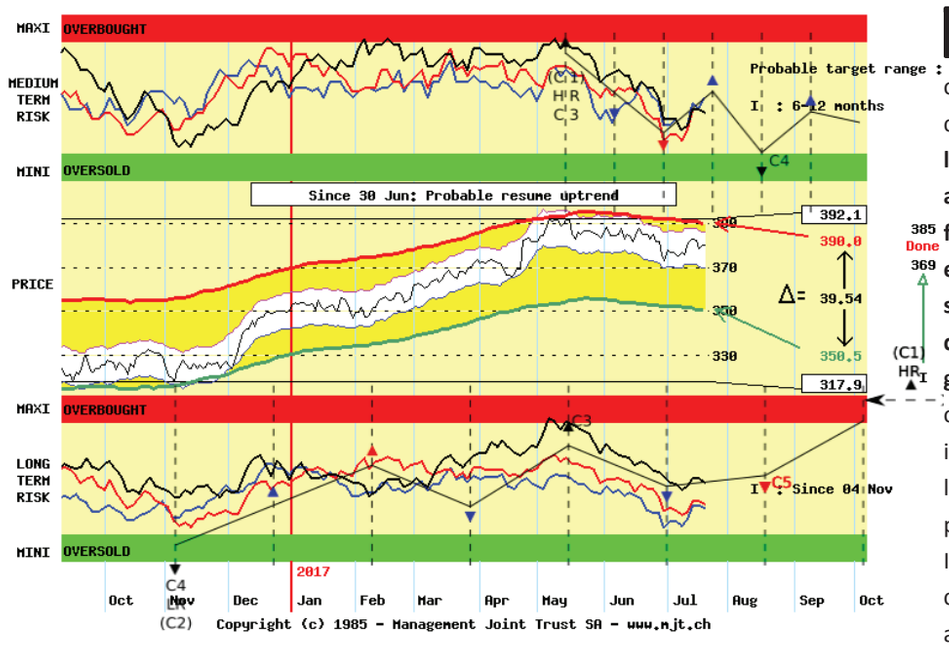
We expect some consolidation into August as risk assets correct to the downside and reflation trades bottom out. Following that, these trends should resume up possibly until October and then early next year.

S&P500 Index
Daily graph or the perspective over the next 2-3 months



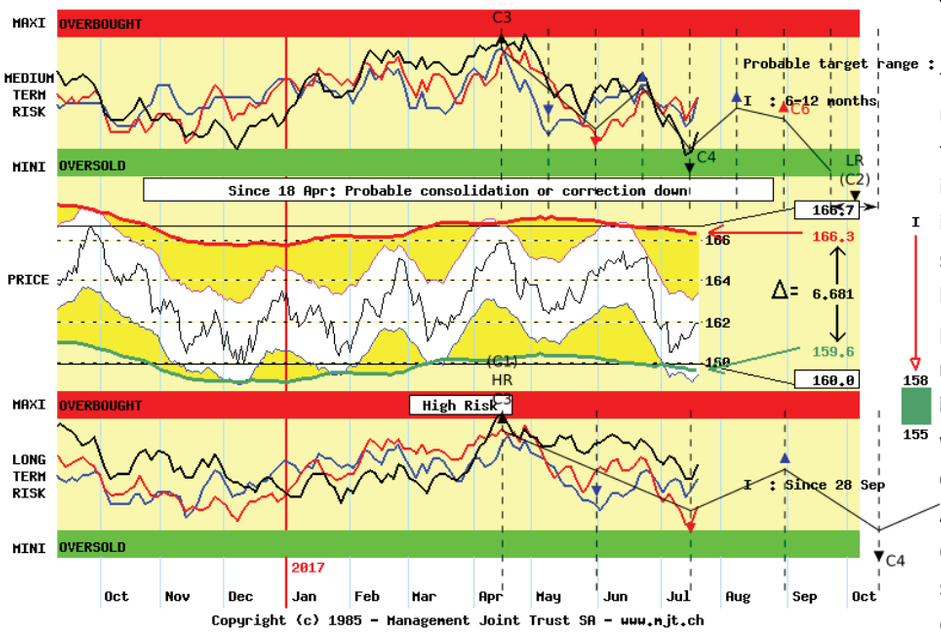
The Risk/Reward on this Daily graph of the S&P500 is stretched at this stage ('I' Impulsive up targets "done"; right-hand scale) and on our medium oscillators (upper rectangle) an intermediate top is imminent. **We would hence expect that a consolidation period materializes over the next 3 to 4 weeks into the 1st Half of August.** Following that, the S&P500 index should resume its uptrend, although another retest to the downside is still possible towards early September as shown by both our oscillator series (lower and upper rectangles). The consolidation potential is somewhere between 0.5 and 0.8 times our historical volatility measure "delta", currently at 205.0 (middle rectangle, right-hand side), i.e. between 100 and 160 points.

EuroStoxx 600
Daily graph or the perspective over the next 2-3 months



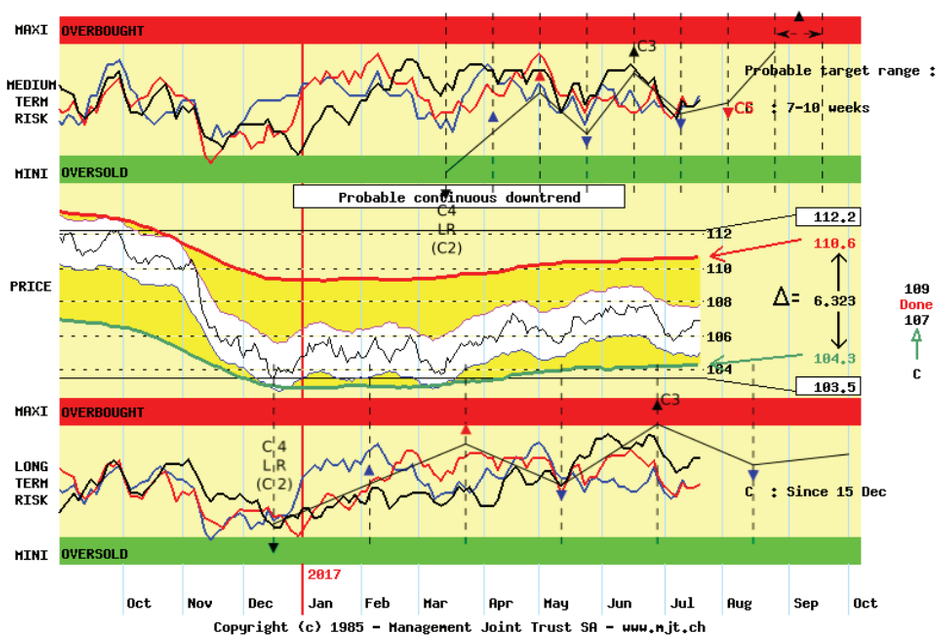
European Markets have been weaker than US ones since the Euro re-accelerated mid June. **On our long term oscillators (lower and upper rectangles), a first bottom was made end of June. We expect a second one to materialize during the 1st Half of August.** Our medium term oscillators (upper rectangle) indicate a slightly lower low, which would be our preferred scenario for now. It syncs quite well with the consolidation period we await on the S&P500 and would correspond to a 'mild' consolidation on EUR/USD. Following that, the EuroStoxx 600 should resume its uptrend. The corrective price potential to the downside we can calculate using our historical volatility measure 'delta', currently @ 39.54 (middle rectangle, right-hand side) is between 372 and 360 (or 0.5 to 0.8 our 'delta' subtracted from the early May top @ 392). **This would lead us back to the lows made end of June and possibly 3% lower.**

Bund Future (Sep)
Daily graph or the perspective over the next 2-3 months



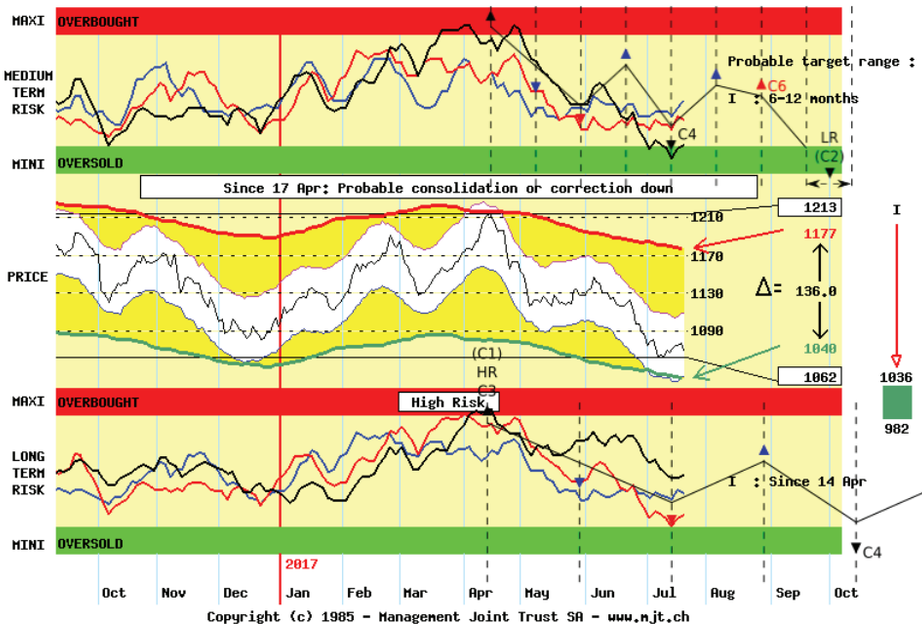
The Bund has been particularly hard it by the upward revision in Eurozone inflation perspectives. Over the last week, it has probably reached an intermediate bottom as shown on both our oscillator series (lower and upper rectangles). **We would now expect it to continue its bounce over the next 3 weeks, towards the 1st Half of August in first instance.** At best, this rebound could extend into end August as shown on our long term oscillator series (lower rectangle). Following that, the Bund should resume its downtrend and make news lows towards October. **We believe that the potential for this rebound is quite limited (towards 163-164),** while the downside risk into October is still substantial, possibly towards 158 – 155 as shown by our 'I' Impulsive targets to the downside (right-hand scale).

IEF - iShares 7-10 Year Treasury Bond ETF
Daily graph or the perspective over the next 2-3 months



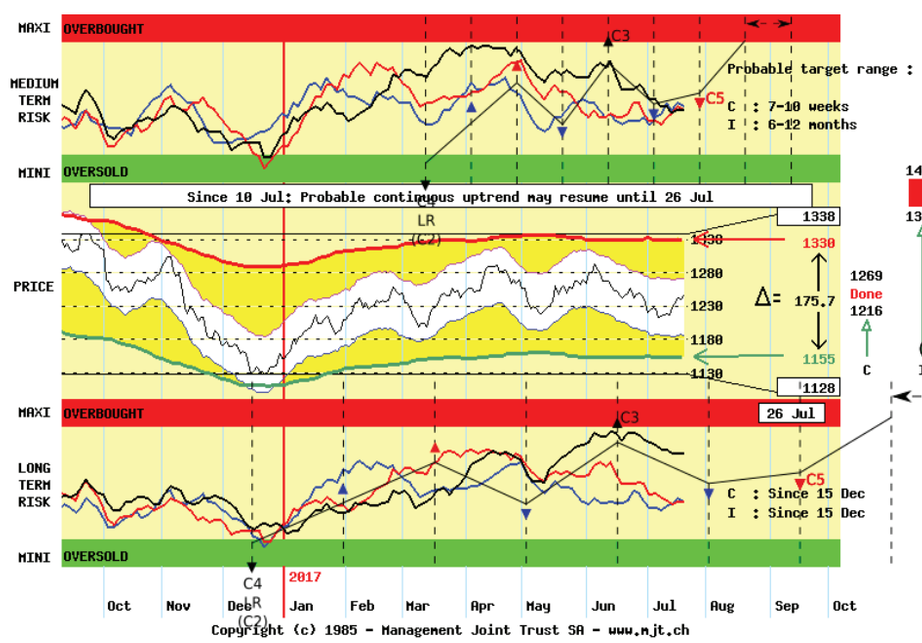
Treasuries in the US have shown more resiliency that in Europe as lately inflation expectations in the US have been revised down rather than up. Nevertheless, on this Daily graph, Treasuries did reach a top end June has shown by on our long term oscillator series (lower rectangle). We believe that the whole progression to the upside since December is just a correction: it never made it above our 'C' corrective targets to the upside (right-hand scale). On our medium term oscillators (upper rectangle) **a continuation trade may be envisaged into August.** This would correspond to the consolidation to the downside we expect on equities. **Yet, Bottom line, we see little upside potential on US Treasuries from here (they should remain below our corrective targets to the upside) and we would expect them to start resuming their downtrend at the latest by end August / early September.**

Gold in Euros
Daily graph or the perspective over the next 2-3 months



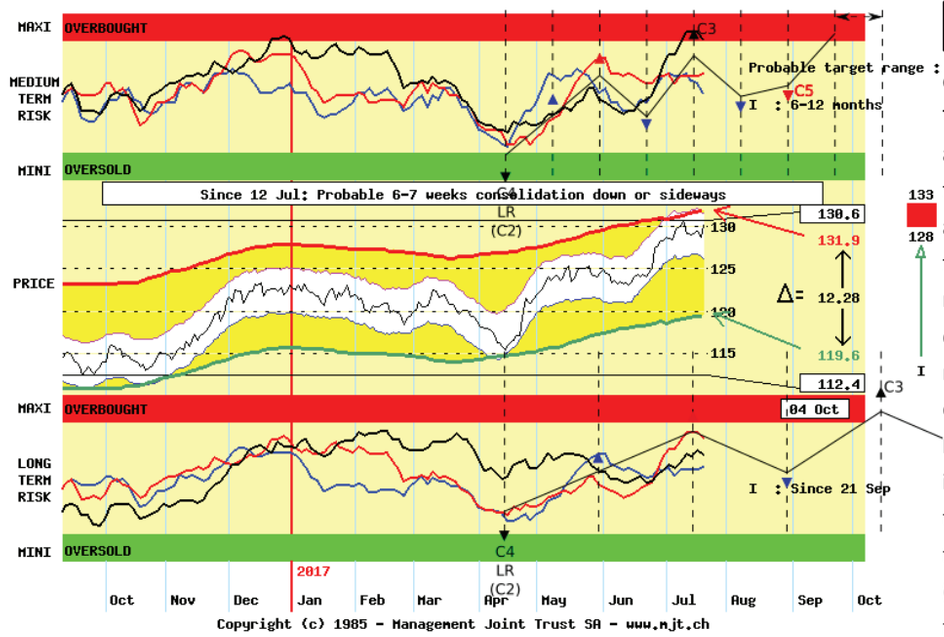
The Daily graph of Gold in Euros is very similar to the one of the Bund above. **It recently reached an intermediate bottom and could be ready to bounce into the 1st Half of August** as shown on our medium term oscillators (upper rectangle). In the best of cases, this bounce could extend into end August (our long term oscillators; right-hand scale). **Following that, Gold in Euros, should resume its downtrend towards October.** We believe the potential for the bounce is probably into the lower/mid 1'100s, while the downside potential towards October is still quite substantial (our 'I' Impulsive targets down; right-hand scale).

Gold in USD
Daily graph or the perspective over the next 2-3 months



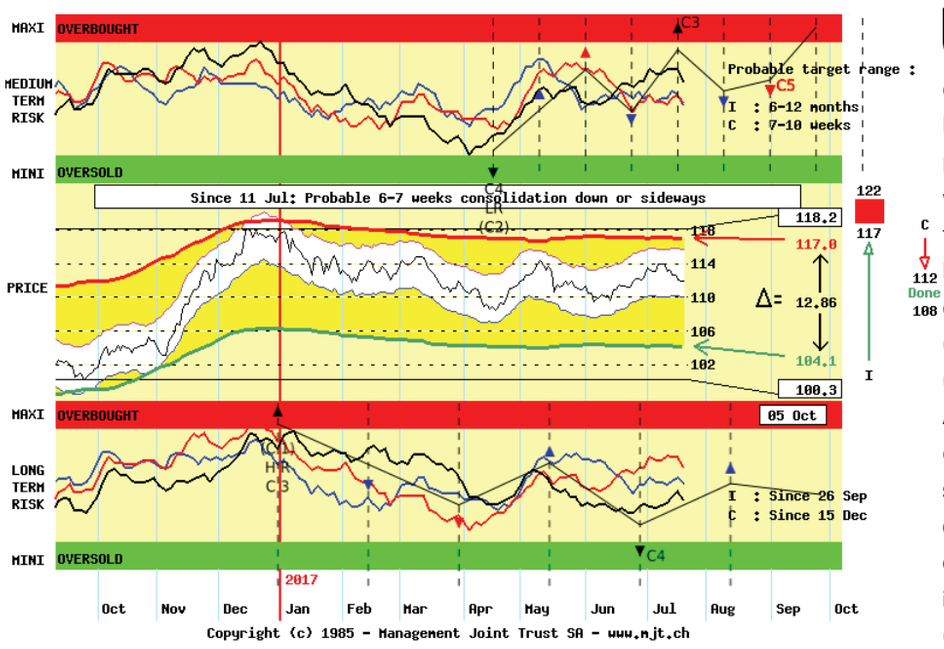
Similarly to the US Treasury graph above, Gold in USD shows a stable progression up since December. Gold in USD is also less volatile than Gold in Euros as it is less distorted by the strong moves in EUR/USD we have seen since December. Since June, both our oscillator series have entered a consolidation period to the downside (upper and lower rectangles). On our long term oscillators (lower rectangle), **we believe that this consolidation period could last into late September. In the meantime, as with Treasuries or Gold in Euros, Gold in USD may bounce to the upside into August (as shown on our medium term oscillators; upper rectangle), yet we expect the potential to be limited** as Gold in USD should meet strong resistance towards the upper end of our 'C' Corrective targets up (right-hand scale) and previous 2017 highs, i.e. between 1'270 and 1'300.

EUR/JPY
Daily graph or the perspective over the next 2-3 months



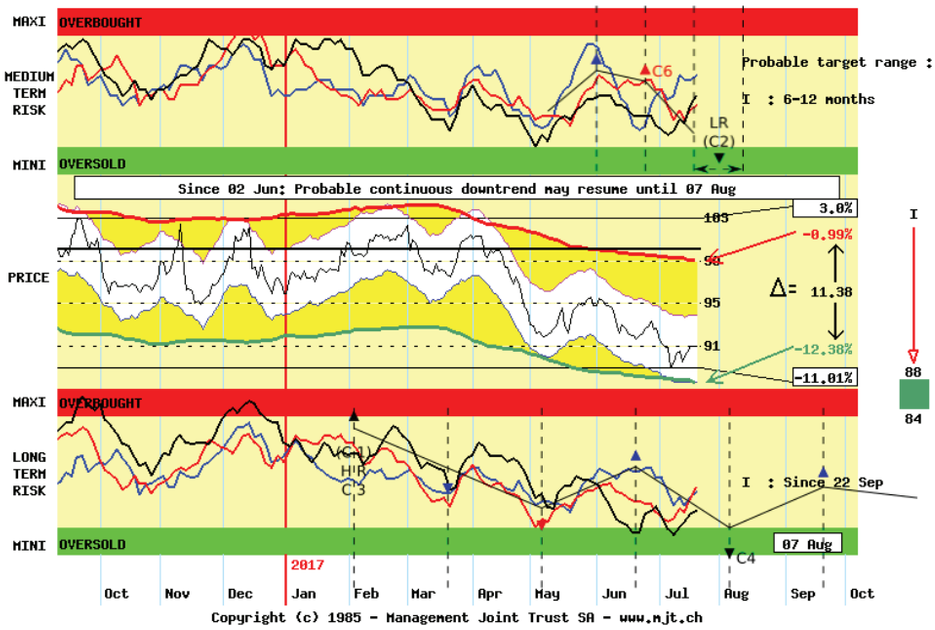
Euro vs Yen shows a similar picture than the Bund or Gold in Euros, in reverse. The graph also looks like an exaggerated version of the S&P500 graph further above. On both our oscillator series (upper and lower rectangles), **an intermediate top is currently being made. We would now expect EUR/JPY to consolidate to the downside into the 1st Half of August** towards the higher end of the corrective targets down (circa 124). Following that, from mid, at the latest end August, we expect EUR/JPY to resume its uptrend towards October.

USD/JPY
Daily graph or the perspective over the next 2-3 months



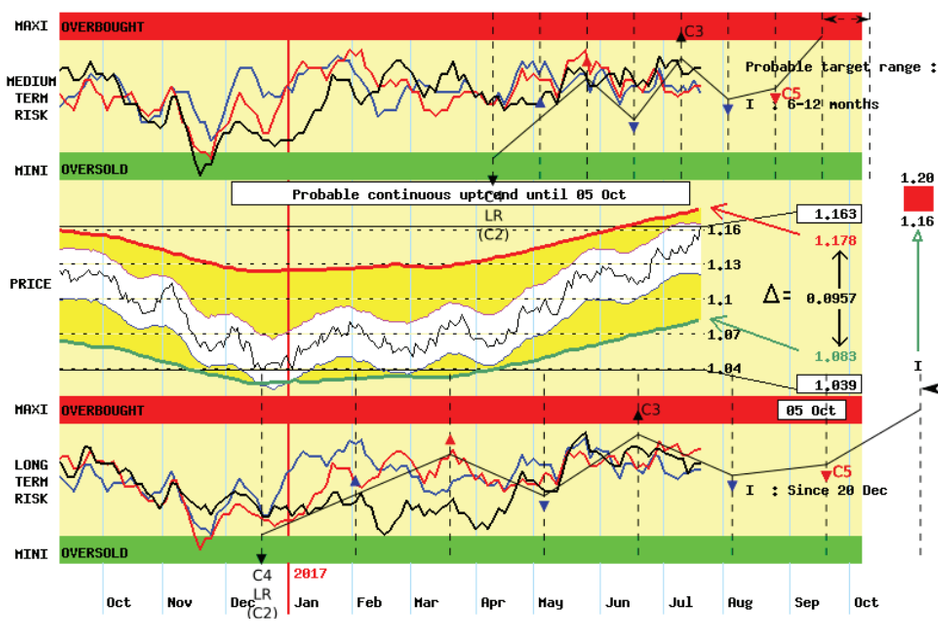
USD vs Yen is weaker than EUR/JPY. Yet, over the next months, we believe it shows a similar picture (yet again, a bit weaker). The consolidation to the downside has probably found a low point on our long term, oscillators (lower rectangle), while the uptrend, which started in April on our medium term oscillators (upper rectangle) **should first correct to the downside into the 1st Half of August and then resume its uptrend until October** (as with EUR/JPY). We believe the consolidation down from December into April was just a correction in a larger uptrend. Indeed, it has held above the lower end of our 'C' Corrective targets down (right-hand scale). The correction to the downside we expect into August should also hold above these levels. Following that**, the potential to the upside ('I' Impulsive targets up; right-hand scale) into October is in the low 120s.** This view is similar to Gold in USD in reverse, yet more positive for the Dollar vs Yen. It would justify our reticence to be too aggressive to the upside for Gold as we move into August.

Silver to Gold ratio
Daily graph or the perspective over the next 2-3 months



We like to use the Silver to Gold ratio as a proxy for reflation trades. It translates the more cyclical bias Silver has over Gold. Over the last 18 months, it was also nicely correlated with Oil. On both our oscillator series (lower and upper rectangles), **the current downtrend could extend into the 1st Half of August.** That said, 'I' Impulsive targets down (right-hand scale) have almost been met. **We believe the Silver to Gold ratio could be bottoming over the next 3 to 4 weeks and we do not see much downside potential left. This is positive for reflation trades in general from mid August onwards.**

EUR/USD
Daily graph or the perspective over the next 2-3 months



We conclude this section with EUR/USD. Last month, we were awaiting the USD to bounce and EUR/USD to start correcting to the downside. We had however laid out the possibly that EUR/USD could extend into early July and 1.15. That said, EUR/USD has lingered on a bit further and a bit longer than expected. This would confirm our strong views since earlier this year, that EUR/USD will probably remain strong throughout 2017. In first instance, both our oscillator series (lower and upper rectangles) would suggest **further highs into October possibly towards the 1.20 mark. In the meantime, as with other assets mentioned above in this section, we still expect a counter-trend move into the 1st Half of August**. We would be more conservative than last time however on its potential to correct to the downside: towards the higher end of the corrective targets to the downside we can calculate (circa 1.13-1.12).

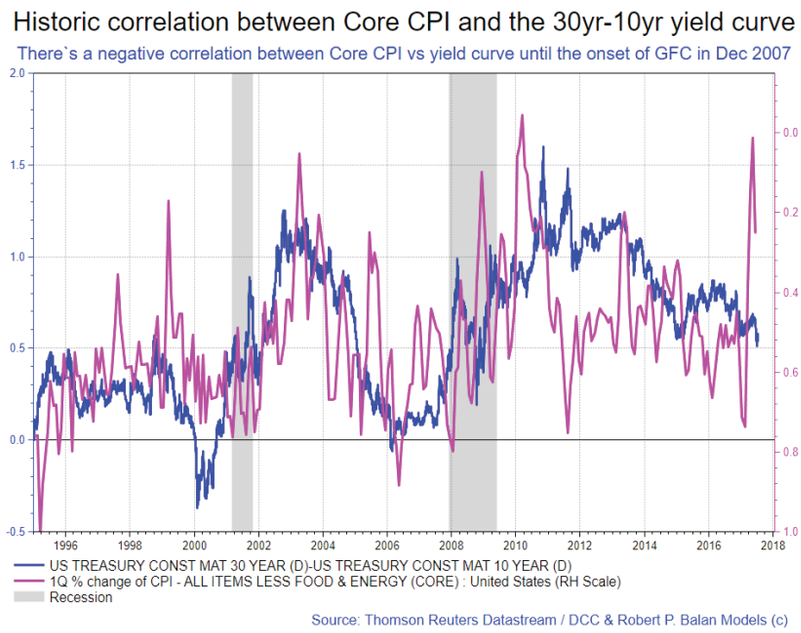
Concluding remarks

Risk/reward is stretched on our Daily charts for so called risk assets (S&P500 and EUR/JPY especially) and intermediate tops seem to be in the making. We hence expect some consolidation to the downside into the 1st Half August for these assets as well as for EUR/USD, USD/JPY or the Eurostoxx 600. At the time, defensive assets should make a comeback and Treasuries, the Bund and Gold could indeed bounce. **During this risk off period, reflation trades may see their final lows for the year following their strong retracements Year to Date.** From mid August (at the latest end August/early September), we believe risk assets should resume their uptrend possibly in first instance towards October, then into early 2018. In the meantime, reflation assets would have made their lows and started to move up again.

17 / All that you know before Nov 2008 is now all wrong: understanding how QE skewed the relationship of financial variables

Fed Chair Janet Yellen testified before the US Congress and basically confirmed what pundits have been saying for some time -- that **the Fed will raise its policy rate of interest just one more time this year, and will begin to reduce size of its securities portfolio later this year -- September being the best guess for the initial reduction of the Fed's balance sheet**. And the market is also waiting for indications from ECB president Mario Draghi if the central bank's monetary stimulus will finally end, and when. Pundits are raising alarm that these attempts to reduce global systemic liquidity may finally usher in the end of the equity bull market. Some alarmists even speculate that with these moves to reduce global systemic liquidity, the almost 4 decades of bond bull markets will end as well. This presents an awkward situation where both the equity and bull markets are supposed to shudder to a halt, as global central banks take away the proverbial «punch bowl».

So, is «Quantitative Tightening» in the pipeline? Inevitably, that will happen, but let's be careful with the semantics here. Central banks, courtesy of the Eurozone and Japan, are still buying financial assets with both hands, despite impressions of Mr. Draghi about to turn off the tap. The Bank of Japan made it clear that the stimulus will go on, until the central bank has figuratively seen the whites of domestic inflation`s eyeballs. In the part of the Federal Reserve, the central bank has spent over eight years, since it began the movement to spur on the economic recovery, not to make any error that could destabilize the banking system or the financial markets and bring to a halt the economic rebound.



The Catastrophe of 1937-1938 looms large in the minds of Federal Reserve officials. It prolonged the Great Depression which started in 1929. The U.S. made the mistake of a premature fiscal consolidation in 1937, when then US Treasury Secretary Henry Morgenthau argued that the modest budget deficits Roosevelt ran in his first term were exacerbating the economy's problems, rather than being part of the cure. In 1937, Morgenthau was successful in getting Roosevelt to raise taxes and cut spending, and in convincing the Fed to tighten monetary policy because prices were finally starting to rise. This was, of course, absolutely the wrong policy. The actual federal budget deficit was in fact much too small in every year of the Great Depression to power the economy towards escape velocity.

And, of course, it was disastrous for the government to try and run a surplus in 1937. Economists are unanimous in their view that this was one of the greatest economic mistakes in history. **The result was an immediate economic setback, and unemployment started rising again, prolonging the Great Depression by another two years**. The Fed, we can all be sure, does not want to commit the same mistake, or if they want to emulate the self-immolation, they will do it slowly.

But the fact is that global monetary authorities have snapped up a record amount of financial assets in the year to date, in addition to the previous 8 years of cumulative stimuli. That's despite all the focus on the Federal Reserve's plan to begin winding down its balance sheet and speculation the European Central Bank could be nearing the end of its bond-buying spree. **The ECB in December extended its bond-buying program to December 2017 from March, but said it would reduce the size of monthly purchases from 80 billion euros ($85.6 billion) to €60 billion beginning in April 2018. Until then, we believe that the «punch bowl» would remain filled close to the brim**. And this matters a lot. Many analysts (including us) believe that it is the "only one flow that matters," and that $1 trillion of financial assets bought by the European Central Bank and Bank of Japan year-to-date would equal a $3.6 trillion annualized pace, which would

be the strongest since 2007. This is our main argument: that this surfeit of liquidity has been the prime mover of global stocks and bonds which are hitting annualized double-digit gains, year to date, despite Trump, Russian-Gate, and macro miscues over the past six months.

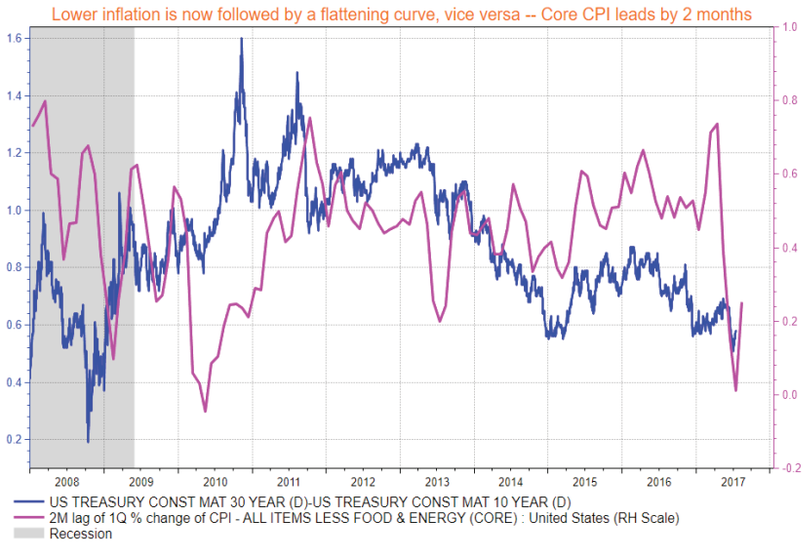
However, the blessings come with some cleverly disguised, insidious pit-falls. The first Quantitative Easing program, initiated by the Fed on November 2008, altered the relationships and correlations among financial variables, and those skewed relationships will probably stay with us for as long as global systemic liquidity remains very high. Since we believe that the global monetary authorities will be loath to make a redo of the Catastrophe of 1937-1938, high liquidity levels will be a feature of the global financial landscape for a long while. Therefore, learning what has been changed in those decades-old relationships need to be internalized. **As a starter, we will illustrate that the old relationships between inflation and yield curves, and yield curves and bond yields have been profoundly altered**.

Case in point: there was a historic, negative correlation between Core CPI and long yield curve, the 30Yr-10Yr spread. Historically, lower Core CPI was accompanied by a steeper yield curve. However, this relationship started to get skewed after the onset of the Great Financial Crisis in December 2007. Then, the correlation started to significantly break down after stimulus from the global central banks unleashed a flood of global systemic liquidity *(see graph on previous page)*

Correlation between Core CPI and 30yr-10yr yield curve, post-Dec 2007

After the QE program in Nov 2008, correlation between Core CPI and yield curve became positive

Lower inflation is now followed by a flattening curve, vice versa -- Core CPI leads by 2 months

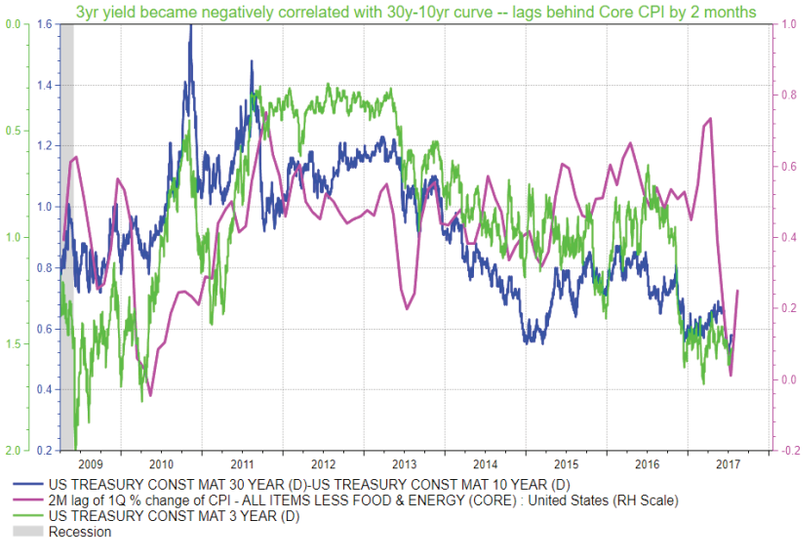


Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

Correlations: Core CPI, 30yr-10yr yield curve, 3yr yield post-Dec 2007

After the QE program in Nov 2008, correlation between Core CPI and yield curve became positive

3yr yield became negatively correlated with 30y-10yr curve -- lags behind Core CPI by 2 months

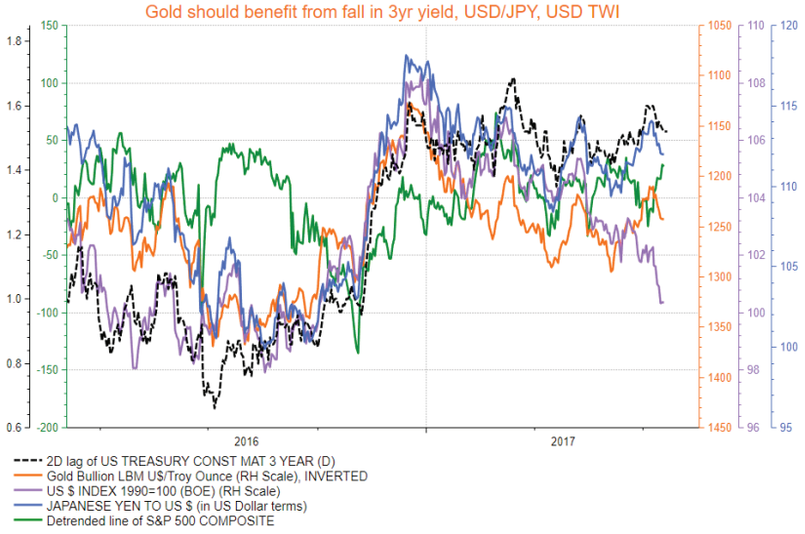


Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

3yr bond yield: the direct mover of risk-on, risk-off assets

Equities diverging with the pack, but will likely fall with further fall in yields and USD/JPY

Gold should benefit from fall in 3yr yield, USD/JPY, USD TWI



Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

The skew in the relationship progressively got worse as global central banks created more electronic money. By 2011, the correlation between the two variables have completely reversed – the relationship turned positive. And now changes in the Core CPI leads the yield curve by 2 months (the lag was marginal pre-November 2008). **Put another way, lower Core CPI is now followed by a flattening of the yield curve, and vice versa.** Given this new set of relationship, it is conceivable that we could see a steepening of the 10Yr/30Yr yield curve soon, following the lead of the Core CPI qoq change, and in the back of our analysis that Core CPI will rise in Q3 2017 ***(see first graph on previous page).***

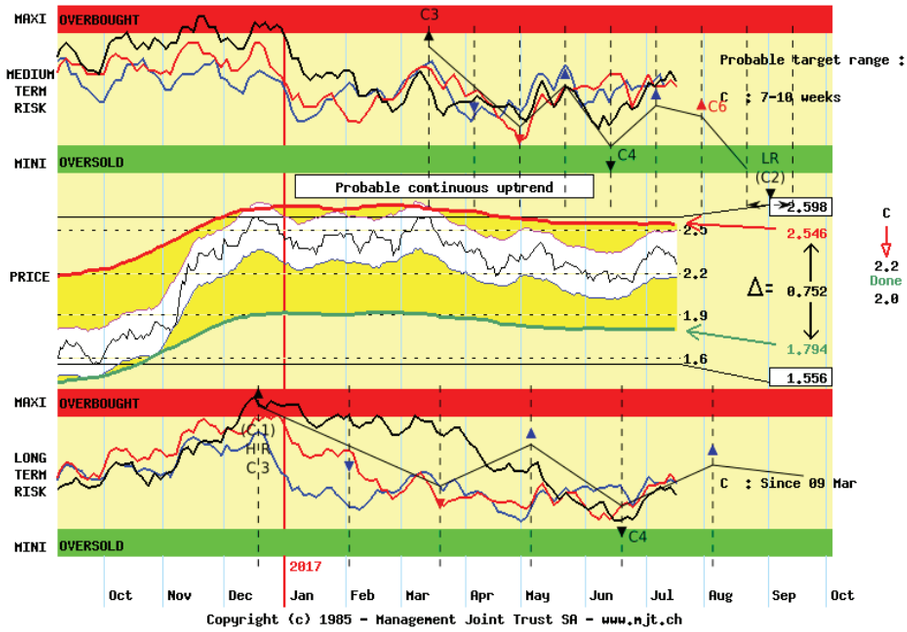
In and of itself, that new relationship is valuable because we now have a way of anticipating changes in the long yield curve, especially as this spread has been a traditional harbinger of long term inflation trends. **There is nothing more significant than the long bond spread being led by changes in the actual inflation measure, itself.**
(see first graph on previous page)

But that is not all – liquidity offers another gift. Since November 2008, the spread between the 30yr and 10yr yields, has become a long-end proxy of the 3yr bond yield, in its inverse. The spread and the inverse of the 3yr yield move lock-step, and more importantly, both variables lag behind the Core CPI's qoq reading by 2 months. So, following the current trajectory of the quarterly Core CPI, we know that the spread will be widening, and the 3yr yield will be declining over the next two months ***(see 2nd graph on previous page)***.

It is already a significant blessing if the manna from global liquidity stops falling from there – but no, there is more. You see, **the 3yr bond yield is the direct mover of many risk assets, and it does so with a 2-day advance notice. The USD/JPY and USD TWI rise and fall with it, and gold sinks when the 3yr yield rises. Most importantly, during most periods, the 3yr and S&P 500 have positive comovements, underlining how critical the 3yr yield should play in timing your strategies.** Currently, the S&P 500 index goes against the trend of the pack (lower, with Gold higher – (***see 3rd graph on previous page***), but eventually we believe that SPX will decline (this analysis is the subject of another article in this same issue of the Capital Observer). **So, to summarize, one should understand that the relationships among financial variables prior to November 2008, are now all wrong and you should update one's analytical tool kit.**

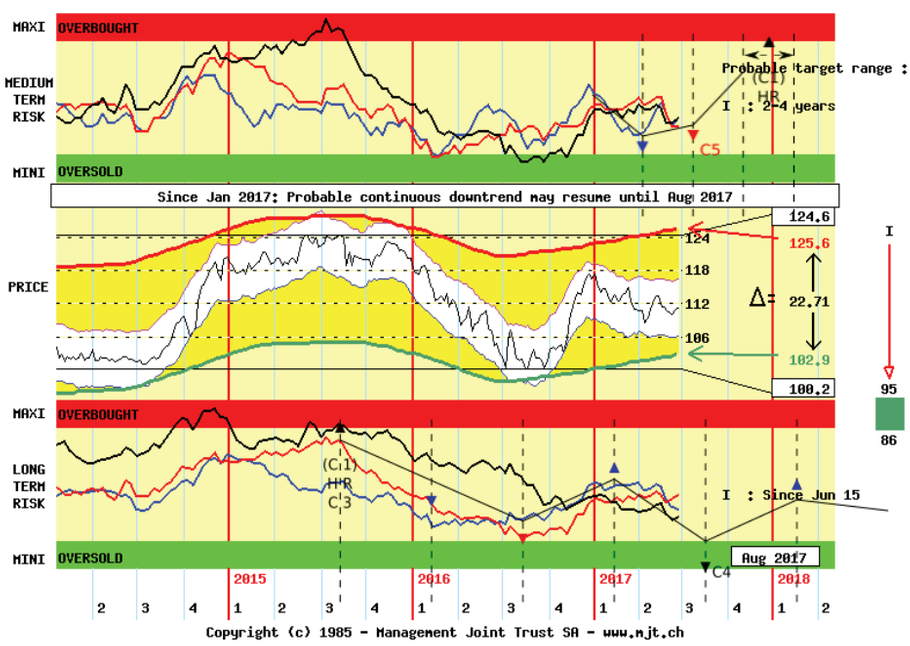
Yields and the Yield Curve remain soft until September, yet the downside is limited from here

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



On both our oscillator series, US 10 year Treasury yields made an important low in June. While, on our long term oscillators (lower rectangle), this low may mark the end of the correction to the downside since the December/March double top, on a medium term oscillators (upper rectangle), the sequence we project would suggest a further downside retest into late August / early September. We would hence remain **defensive for now on rates although we believe that our 'C' Corrective targets to the downside, between 2 and 2.2% (right-hand scale), should continue to provide support as they have done since the Spring.**

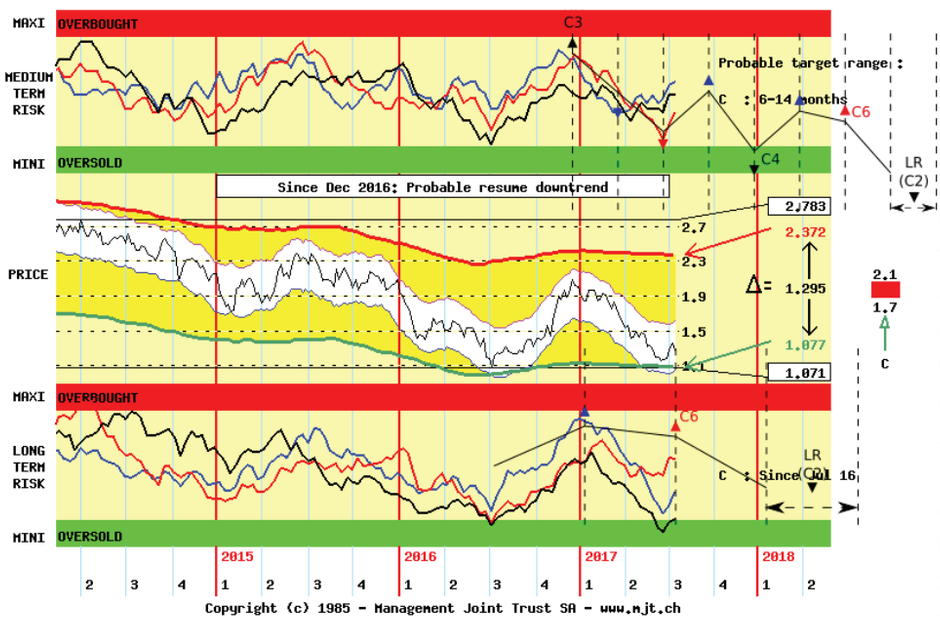
US 10 years Benchmark Bond Yield
Weekly graph or the perspective over the next 2 to 4 quarters



On our Weekly graph of 10 Year Treasury yields, we expect a higher low (compared to the lows made mid 2016) to be confirmed during the Q3 2017 (this would be very positive). The sequence we show on our long term oscillators would position it pretty much now (lower rectangle). On our medium term oscillators (upper rectangle), and in light of the Daily graph above, we would expect **a retest to the downside later during the Summer** before yields start accelerating to the upside again. Also, as mentioned above, we believe the 2% mark is, and will continue to be, the crucial support point that justifies this positive view. From late Q3 2017, we expect Treasury yields to start accelerating up again towards next year and our 'I' Impulsive targets up between 2.9% and 3.4% (right-hand scale).

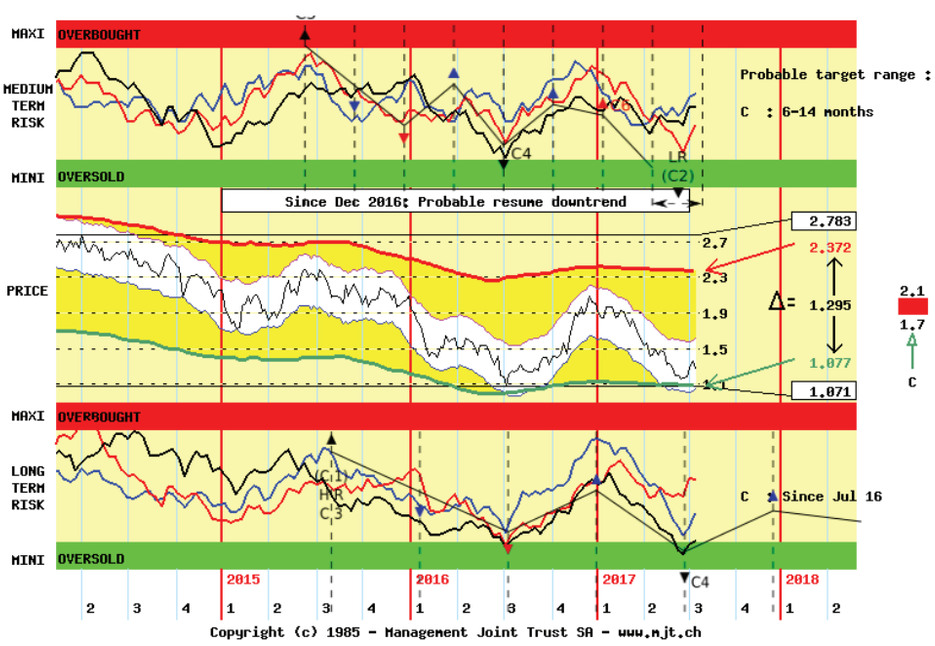
US Yield curve: 2 scenarios, one negative, one positive. We weigh towards the positive one.

US 10 years - 3 months Benchmark Bond Yields (NEGATIVE SCENARIO)
Weekly graph or the perspective over the next 2 to 4 quarters



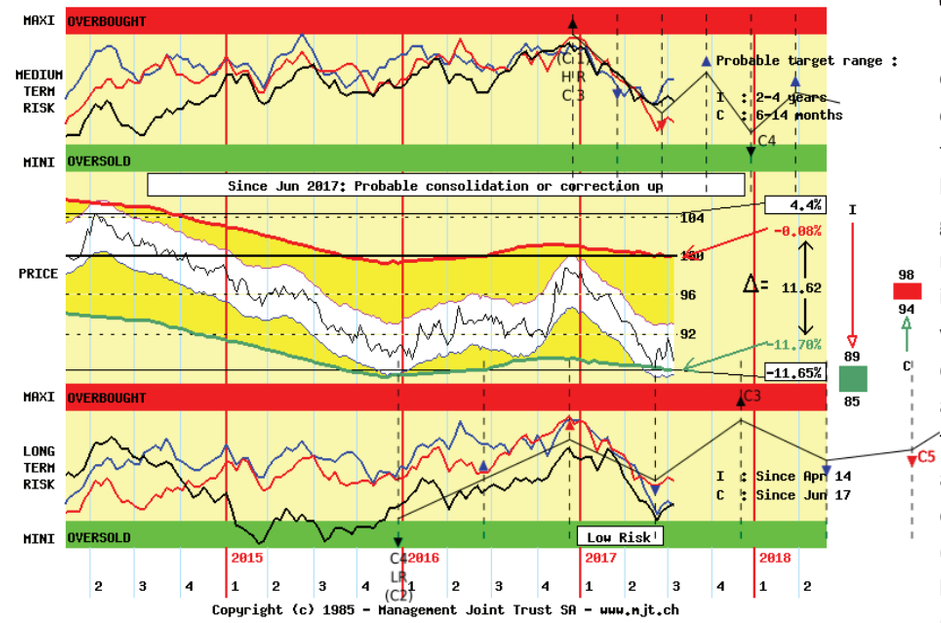
The flattening since December has been impressive and is closely linked to the FED's rate hike schedule. As shown, on both our oscillator series (lower and upper rectangles), the low made in June and its short rebound may justify the negative sequences we project (declining tops: one in December 2016, the other in June 2017 on our long term oscillators). It would imply a limited reaction during the Summer and further lows towards year end (further flattening of the curve). This scenario would be quite negative for reflation trades, and possibly for risk assets in general, suggesting that the FED would be expected to continue its sustained rate hike schedule, while the long end of the curve (and inflation perspectives) remains subdued.

US 10 years – 3 Months Benchmark Bond Yields (POSITIVE/ PREFERRED Scenario)
Weekly graph or the perspective over the next 2 to 4 quarters



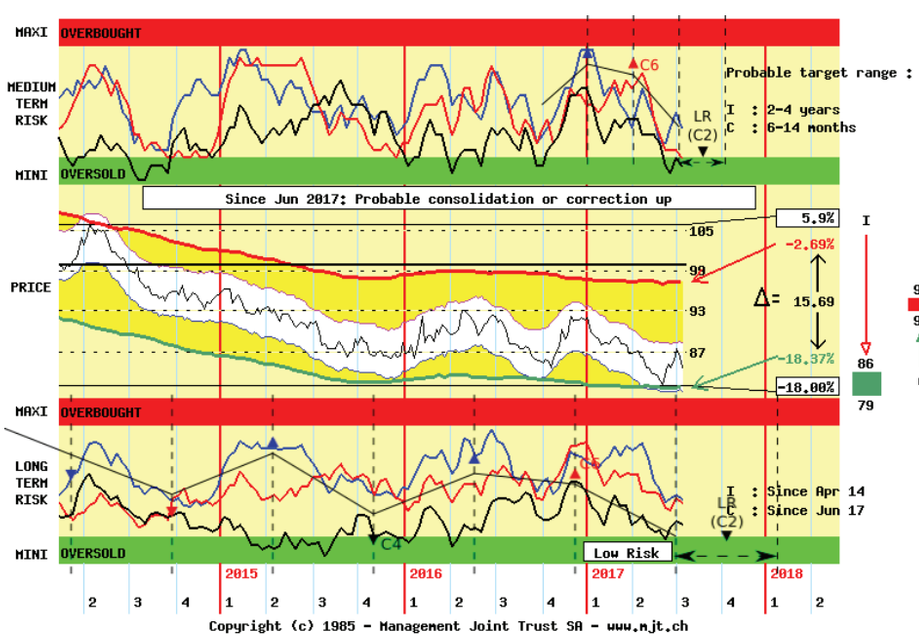
This scenario suggests that the yield curve is making a double bottom. The sequence we project on our medium term oscillators (upper rectangle) would have reached **a "Low Risk" position,** while the one we show on our long term oscillators (lower rectangle) **suggests that a base is currently being made so that the yield curve could start to steepen again in H2 2017.** This base appears quite comfortable, with our long term longer oscillator (the black one) in an Oversold position as well as our standard deviation envelopes (middle rectangle) touching each other to the downside (i.e. this shows a temporary exaggeration). **This scenario would suggest that reflation trades and inflation expectations make a come back in H2 2017, while the FED momentarily tames its rate hike ambitions (i.e. appears somewhat more dovish). It is our preferred scenario.** Let's see why in the following pages.

IVE - iShares S&P 500 Value ETF vs IVW - iShares S&P 500 Growth ETF
Weekly graph or the perspective over the next 2 to 4 quarters



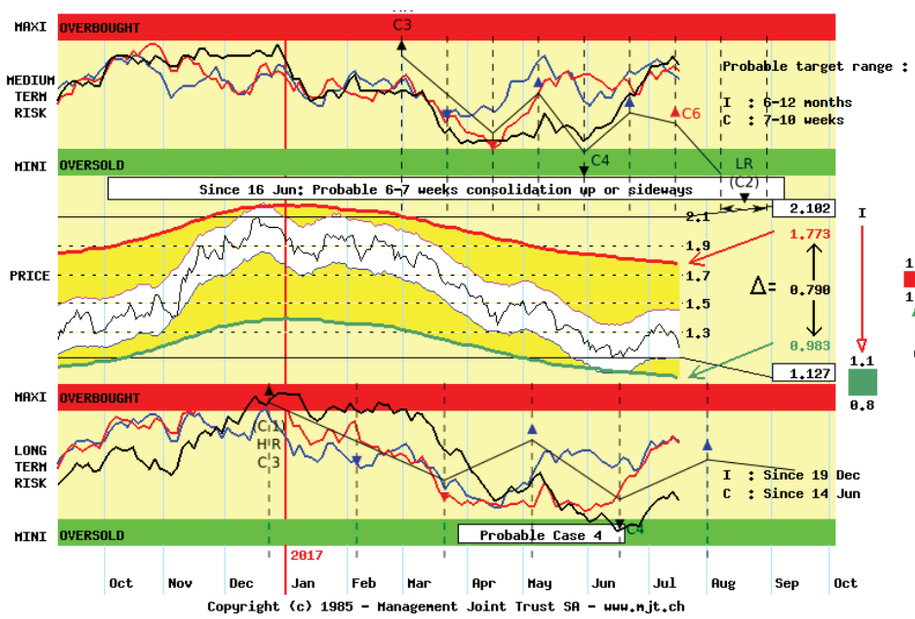
The Value vs Growth relationship in the US is closely linked to the shape of the yield curve. It arbitrages cyclical, often low value stocks vs long duration, growth plays. The configuration on this relative graph is indeed very similar to the yield curve one above, yet it did start to move up earlier at the beginning of 2016. This allows us to show an ascending sequence on our long term oscillators (higher highs during 2016; lower rectangle). Furthermore, **the recent sell-off has created a "Low Risk" situation** on our long term oscillators as mentioned on the graph. We caveat this view with the sequence we show on our medium term oscillators (descending into year-end; upper rectangle), yet would expect the reaction during Q3 2017 to gradually shift the sequence to a more positive outcome. So, this is no a clear cut situation yet, however **Value vs Growth seems quite Oversold at this stage**.

Dow Jones Industrial Index vs QQQ - PowerShares Nasdaq100 ETF
Weekly graph or the perspective over the next 2 to 4 quarters



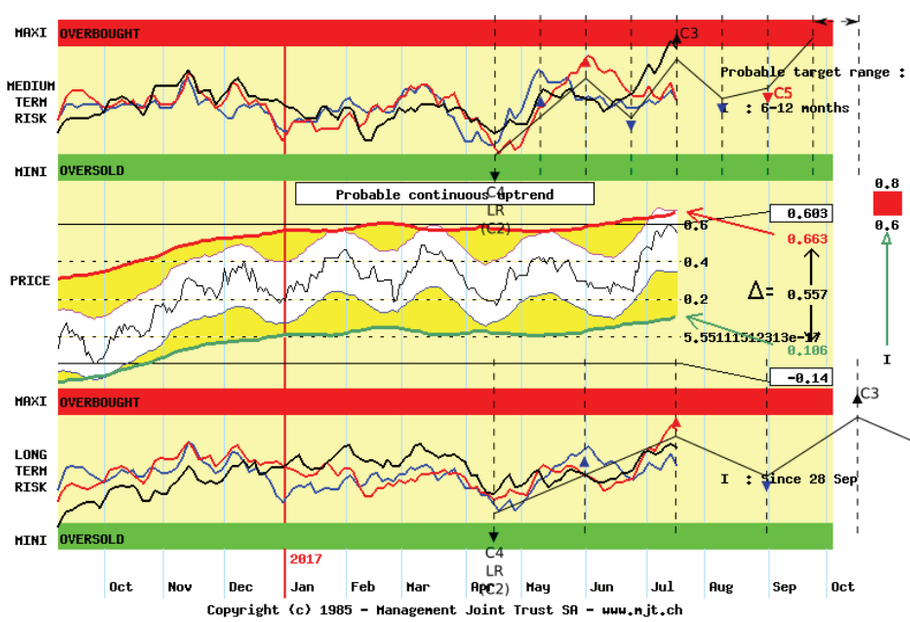
Taking the Value vs Growth relationship to the Index levels and echoing our risk parity article from our last newsletter ("The secular trends favoring Risk Parity strategies could take a pause until early 2018"), we compare the Dow Jones Industrial Index (a price weighted index with little Tech exposure) with the Nasdaq skewed towards Growth and Big Tech. **The Dow Jones has reached a "Low Risk" position on both our oscillators series vs the Nasdaq (lower and upper rectangles) and could rebound to the upside during H2 2017.** Our 'I' Impulsive targets to the downside had been met on the lows made in June (right-hand scale). Hence, again, cyclicality seems to be bottoming out vs Growth.

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



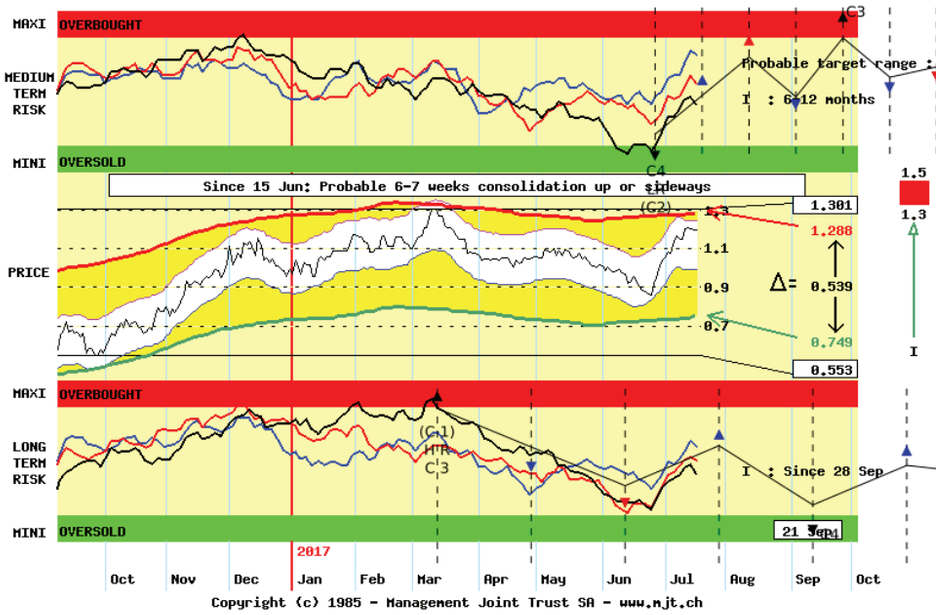
We now consider the Daily graph of the US yield curve to understand how a reversal could materialize over the next few months. As with US treasury yields, the sequence down we show on our long term oscillators (lower rectangle) **has reached an important bottom in June.** That said, on our medium term oscillators (upper rectangle), **we would expect one last retest of lows into late August.** There is still some risk for new lows as our 'I' Impulsive targets down have not quite been met yet (right-hand scale). Does this jeopardize our rather bullish scenario above? Well, we believe not, and **would consider it as part of the bottoming process.** Over the following pages, we also look at yields in Europe for more comfort.

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



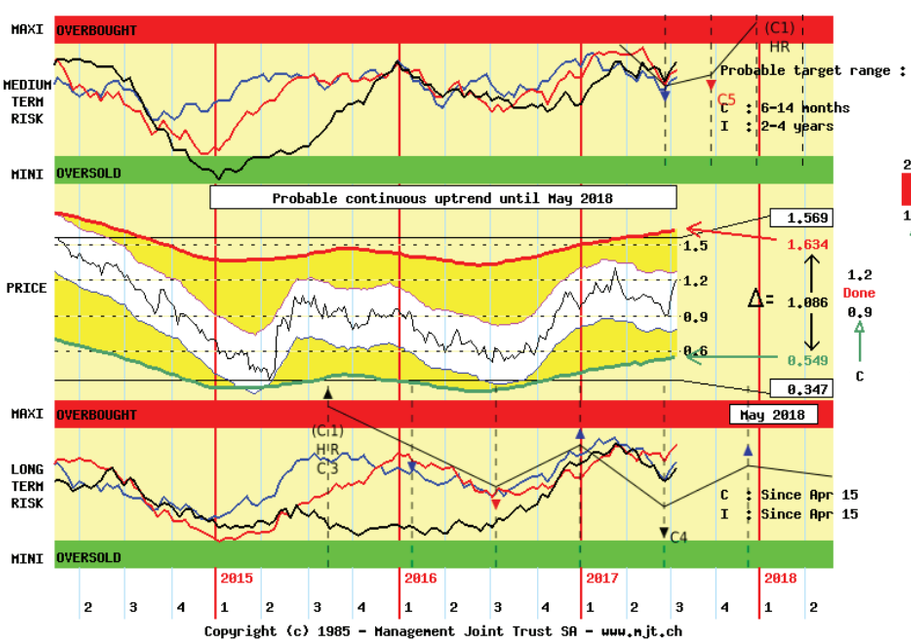
German 10Y Government yields have also been consolidating since last December (a rather flattish consolidation). By and large, they remain well synchronized with US yields, just with a more positive twist. Just recently, in July, they broke out to new territory. In our view, this **confirms their medium term uptrend (towards early next year).** The sequence we show on both oscillator series (lower and upper rectangles) is very similar to the one we describe further up in this document on the S&P500 or EUR/JPY. It is one where risk assets continue their uptrend towards October at least. In the meantime, however, as with other risk-ON proxies, **German benchmark bond yields should see a correction into the 1st Half of August,** at the worst into late August. This should indeed put some downside pressure on US yields, yet a short lived one (as discussed above).

Germany 10 years – 2 years Benchmark Bond Yields
Daily graph or the perspective over the next 2 to 3 months



Looking at the yield curve in Germany, which had been flattening since March, the sequences we show on both our oscillator series (lower and upper rectangles) have probably bucked their downtrend consolidation. On our medium term oscillators (upper rectangle), we show an **nascent uptrend sequence with a possible correction to the downside in August.** On our long term oscillators (lower rectangle), we expect that the curve could flatten again into early September. We believe that **any retracement into August / September should find support within our corrective targets to the downside**, which given our current volatility measure "Delta" would calculate around the 1.05 – 0.90 area (minus 0.5 to 0.8 times our delta of 54 basis points substracted from the graph highs; middle rectangle, right-hand side) or slightly above the lows made in June. **This would deliver a nice set-up for renewed steepening of the European curve into the Fall and possibly year-end.**

Germany 10 years – 2 years Benchmark Bond Yields
Weekly graph or the perspective over the next 2 to 4 quarters



Scoping out to the Weekly graph of the European Yield curve, it seems that the higher low just made in June (following the one made mid 2016) confirms the set-up we expect on our long term oscillators (lower rectangle). **This is a good base to move higher into year-end. On our medium term oscillator, a retest may still materialize towards late Summer, but the sequence we show is clearly positive (upper rectangle).** On the price targets front, we are currently working through our 'C' Corrective targets up above 1.20%. Once this spread clearly manages to break above these levels, the 'I' Impulsive up targets potential is substantial, i.e. towards the 2% mark.

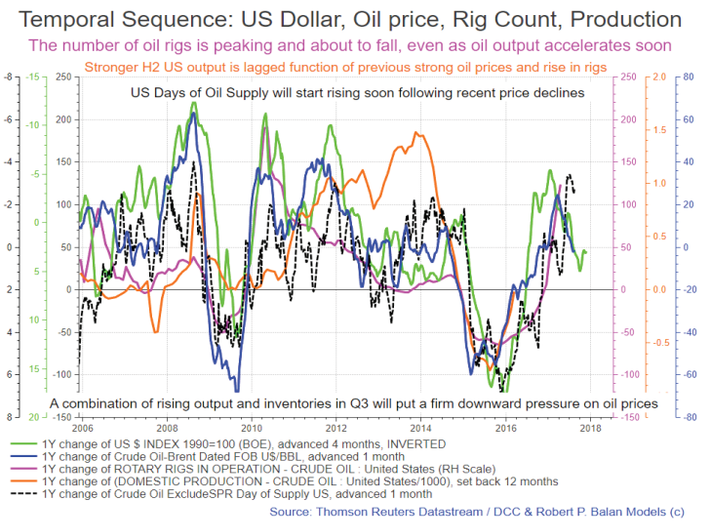
Concluding remarks

US 10 Years Treasury Yields have started to react up in June, yet they may still retest during the Summer probably within their recent range. From late August / September onwards, we expect them to accelerate up until early next year. German Yields are stronger, yet quite well synchronized and confirm this positive picture following some retracement into August. The US 10Y – 3M spread has flattened aggressively since December and is currently testing last year lows. We believe that it has reached a "Low Risk" situation that should see it rebound into next year. **Value vs Growth, Cyclicals vs Long Duration or the European yield curve seem to confirm this view.**

25 / Oil is still susceptible to a last decline/setback in August-September but this will be followed by sharp gains during the rest of H2 2017

The first half of the year has pushed back on the bulls in the oil market, and the time window for oil to take off may not be in August. **The next tactical move may still be a last sell-off that we have been flagging for some time, a last decline toward the lower part of this year range, which we have always said will happen in late Q3 2017. It should act some kind of reset -- and a new upcycle should commence thereafter. This may be a spoiler for the bullish surge which has been going in the past 4 weeks in the back of favorable oil news flow**. Just last week (July 19), oil prices were significantly higher on news of an OPEC/non-OPEC in Russia this coming Monday. The price bid was based on talks of production caps on Libya and/or Nigeria, and or a unilateral cut by Saudi Arabia coming (which we believe is a non-starter). The news flow has been friendly to oil prices in the past month, as we saw the following developments:

(1) IEA publish its July oil market report on Thursday where the agency raised 2017 global oil demand growth forecast from 1.28 million b/d to 1.41 million b/d. The IEA upwards revision suggests global demand will expand this year by 1.5 million barrels per day (mb/d), or a jump of 0.1 mb/d from the agency's estimate in the previous month. The agency says demand is rising faster than expected, particularly in Q2 relative to Q1, which suggests the H2 2017 may lead to stronger inventory declines (all other things remaining the same). The demand figures from the IEA were backed up by recently released data from China showing that refinery demand in June was the second strongest on record. And because China's domestic production has contracted substantially over the last few years, it has had to step up imports.



(2) The US rig count, while still increasing, is expanding at a slower pace. Last week the rig count only increased by 2, a minuscule number in the context of the 14-month-long expansion since the spring of 2016. In the past three weeks, the oil rig count has only increased by 7; in the prior three-week period the rig count jumped by 25. Lower oil prices have started to deter shale drillers from jumping back into the field too aggressively.

(3) US oil inventories posted two consecutive weeks of strong declines. The EIA reported inventory drawdowns of 7.5 and 6.3 million barrels in the past two weeks, respectively, after several weeks of remaining flat. This two-week sequence was actually the largest drop in 10 months. There was a similarly significant drop in total product inventories, of -3.8 million barrels, above the 5-year average build for the week of 2.4 million barrels.

4) OECD inventories (of which the U.S. comprises ~17% of excluding SPR), are also trending down. OECD inventories have fallen relative to the 5-year average since January. They are currently 240 million barrels above the 5-year average. Most of this decline in OECD inventories has ended up in China, which has been experiencing significant storage builds. As Chinese Teapot refineries have recently been granted further import quotas, this transfer of stocks should continue, leading to a decline in visible US and OECD inventories.

(5) Hedge funds and other money managers, having built up an extraordinary level of short positions in June, began liquidating two weeks ago (couple of weeks after the price bottomed in mid-June). Large investors staked out more bullish positioning in each of the last two weeks as price continued to rise.

Unfortunately, we believe that this run of good fortune is ending soon. We start with US-based oil fundamentals. We begin by showing the temporal sequence among the US Dollar, the price of oil, the US rig count and production, as illustrated in ***the graph above***.

The US Dollar has an impact on the crude oil prices, which in turn, has tremendous impact on the oil rig count and US oil production, both on a lagged basis. We now have evidence that the US rig count rise has significantly slowed, and will soon peak or take a pause after a frenetic one-year rise, as the recent decline in oil prices made shale drillers more cautious. But even if get an actual slowdown in the number of rigs, it is highly likely that US oil production will continue to accelerate for some time, at least for the rest of the 3rd quarter.

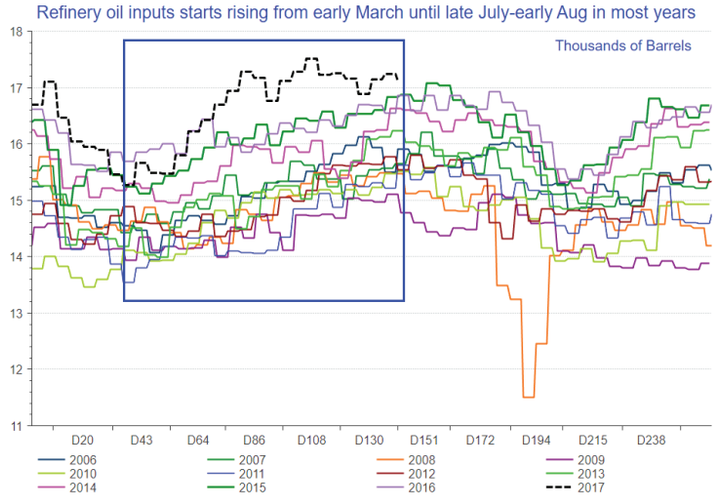
This sequence of events is dictated by the temporal ordering among these variables: oil prices lead changes in the rig count by 4 months, and changes in the oil rig count leads oil production by 8 months. **Put another way: sustained fall in oil price will negatively impact the oil rig count 4 months later, and oil production will slow down only 8 months later.** We therefore forecast domestic production to continue climbing to record highs, which could cast a dark shadow over continued inventory draws and the effectiveness of OPEC cuts. U.S. oil production is forecast to increase 373,000 bpd year-on-year in 2017 despite lower crude prices in the last month. Production increases are expected to continue beyond this year.

US oil inventories also respond to lower oil prices by building (after a 2-month lag), and so it is just at this time that inventories should start rising soon due to this factor. Oil inventories continue to draw however, as demand from refineries enabled some spectacular weekly drawdowns in recent weeks. However, although the inventory decreases paint a seemingly bullish picture, several of the contributing variables are not necessarily indicative of global supply and demand rebalancing, and will likely be confronted by increasing U.S. production. Moreover, by early August, the seasonal demand from refineries will start to taper, removing the biggest single factor that would prevent inventories from building up again ***(see 1st & 2nd graph on this page)***

There is also a distinct comovement among global oil data, especially among consumption, supply, and net inventory withdrawals. Aligning or synchronizing the quarterly changes among these variables is not particularly difficult. The point is that there are periods when these variables align so that oil prices get the benefit or the ill effects of such alignment. One such alignment will occur in late Q3 when global consumption and net inventory withdrawals are forecast to fall, at a time that global supply is expected to increase. **This is the confluence of events which we believe could trigger a last sharp decline in oil towards the $45/40 level. However, the adverse situation should not last long. All those factors would quickly realign so that global production will decline, supply will fall and inventory withdrawals will accelerate during the last quarter of the year. That would be extremely price-friendly and we expect a surge in oil prices which should challenge the $60.00 level by year-end. The entire sequence of the down-and-then-up movement is illustrated in the *last graph above*.**

US Refinery Crude Oil Input Seasonality (Jan to Dec. year by year)

Refinery oil inputs starts rising from early March until late July-early Aug in most years

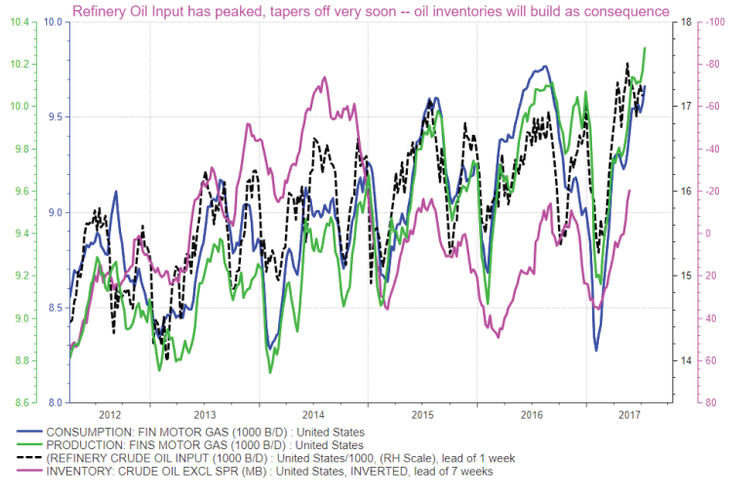


Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

Gasoline Consumption and Output, Refinery Oil Input and Oil Inventory (inverted)

Oil inventory is lagged response to the scale of Refinery Oil Input that goes into Gasoline production

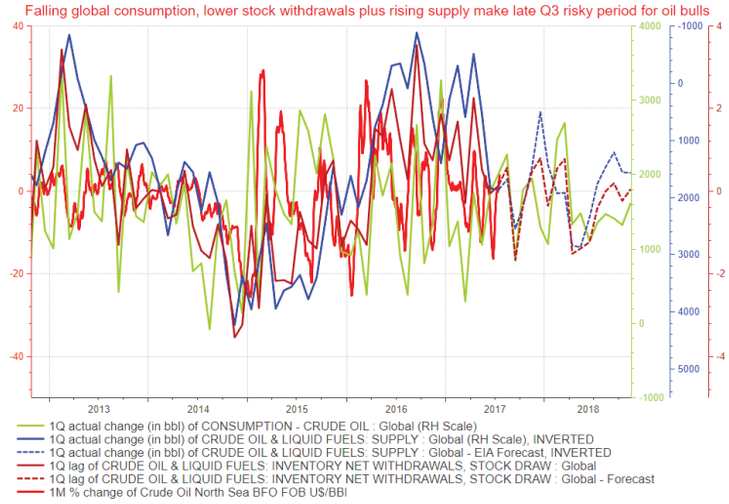
Refinery Oil Input has peaked, tapers off very soon -- oil inventories will build as consequence



Source: Thomson Reuters Datastream / Copyright: Robert P. Balan Models (c)

Comovements: Global Oil Demand vs Inventory Withdrawals vs Price

Falling global consumption, lower stock withdrawals plus rising supply make late Q3 risky period for oil bulls



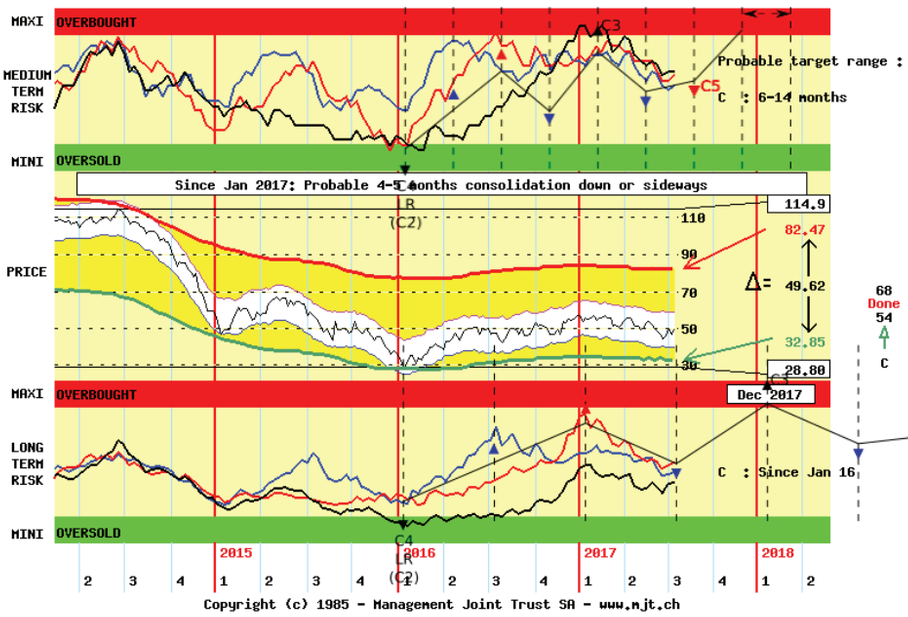
Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

27 / MJT - TIMING AND TACTICAL INSIGHT

Oil is building a base, late Summer could see it rising again

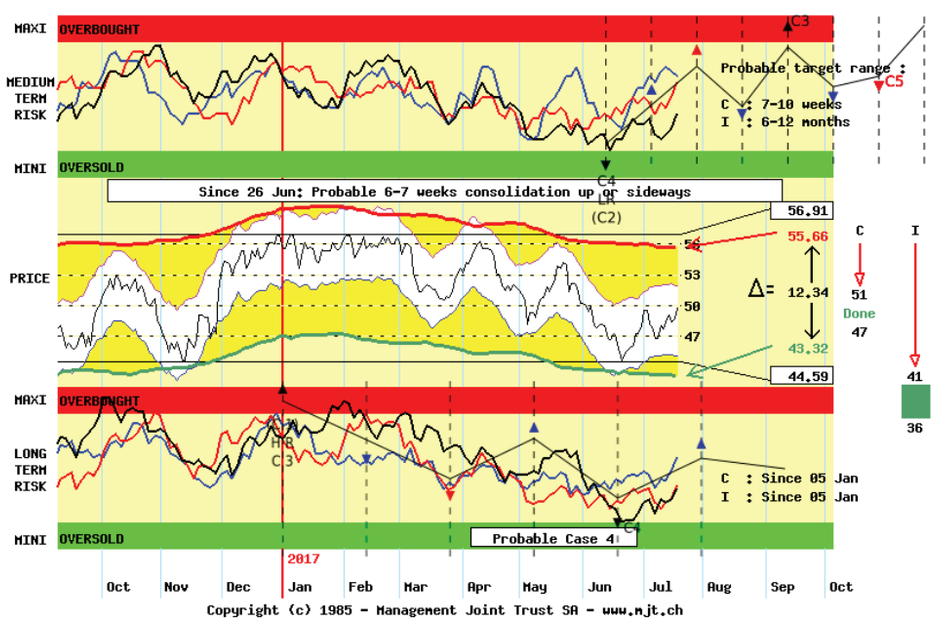
Late April, we wrote an article for Raoul Pal's real Vision website where we forecast oil to possibly bottom towards late June (precisely the 22nd of June). Oil did indeed make an important low on the 21st of June and has since been reacting up. When that scenario fitted our views at the time, we now consider **that following the nice rally it just had, oil could retest into August, possibly early September. It is difficult at this stage to evaluate if it will make new lows, yet we will be looking to pick it up during August, at the latest early September. The Energy sector and related trades seem to confirm this view.**

Brent - Weekly graph or the perspective over the next 2 to 4 quarters



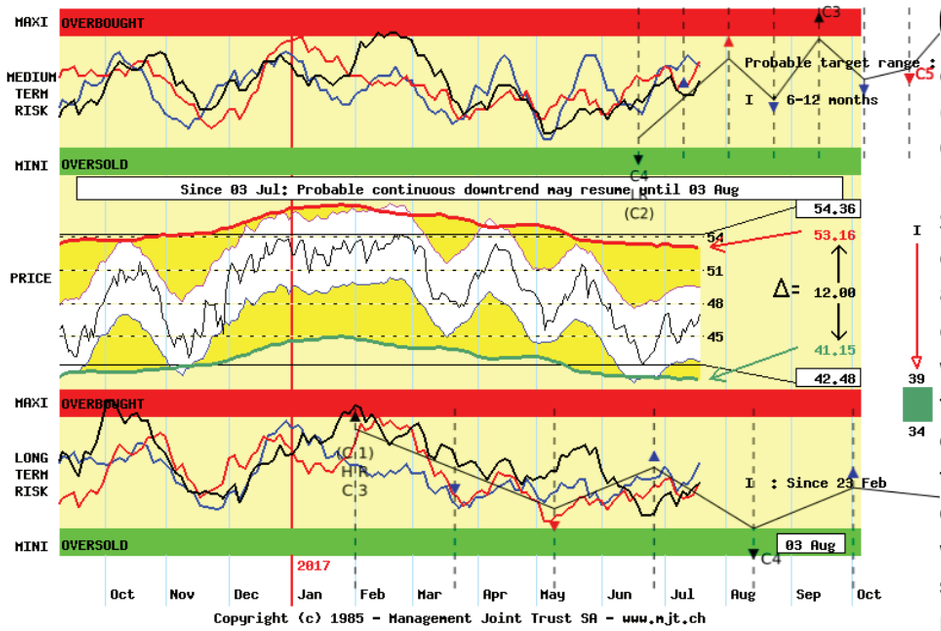
On both our oscillator series, Brent is approaching the end of the retracement period we had anticipated to materialize from mid Q1 2017. While on our long term oscillators (lower rectangle), the bottom may have already been made, our medium term oscillators (upper rectangle) would suggest more work into the Summer. Following that, we expect Brent to resume its uptrend into year-end and early next year, possibly reaching into the high 60s USD a barrel. This forecast is not consensual, yet our model since early 2016 has seen oil move up to Q1 2017 and retrace down to today. We are hence confident in following this sequence through towards year-end.

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



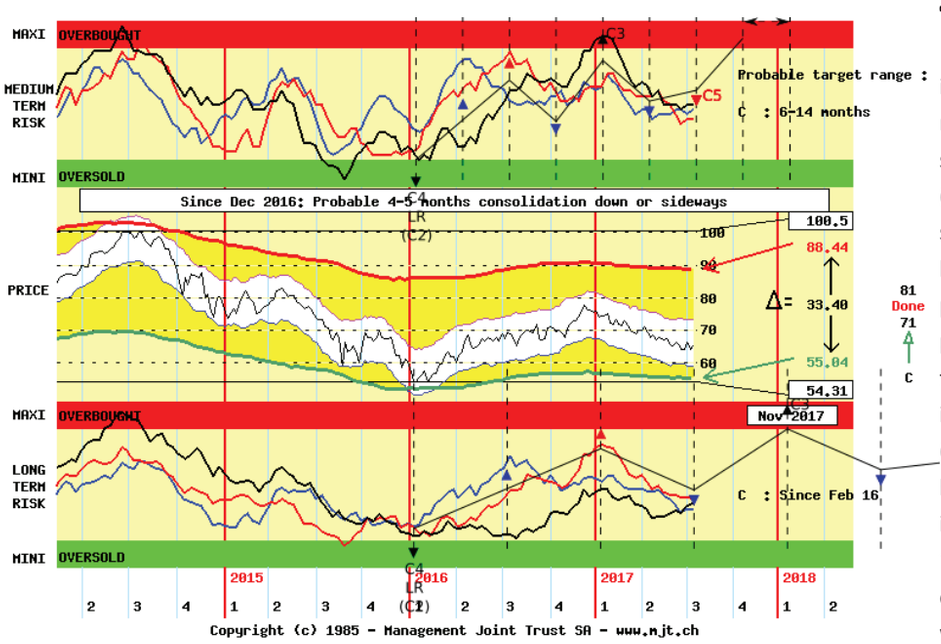
On our both our oscillators series (lower and upper rectangles), Brent made a low on the 21st of June, it has since been reacting to the upside and could theoretically continue to do so over the next couple of weeks before it softens some into August. **The uptrend we expect into year-end and early 2017 may have already started. Yet, what is also quite clear, is that there is still significant risk**. Indeed, in June, Brent broke through the support of our 'C' Corrective targets to the downside (right-hand scale). This has opened the door to our lower 'I' Impulsive down targets towards USD 40 a barrel and below. Hence, despite a rather favorable reaction on our oscillators, we would remain quite prudent for now, especially given the retracement to the downside we expect in August. Any price action below the lower boundary of our 'C' Corrective targets down (a.k.a USD 47 a barrel) would imply even more prudence.

WTI Oil - Daily graph or the perspective over the next 2 to 3 months



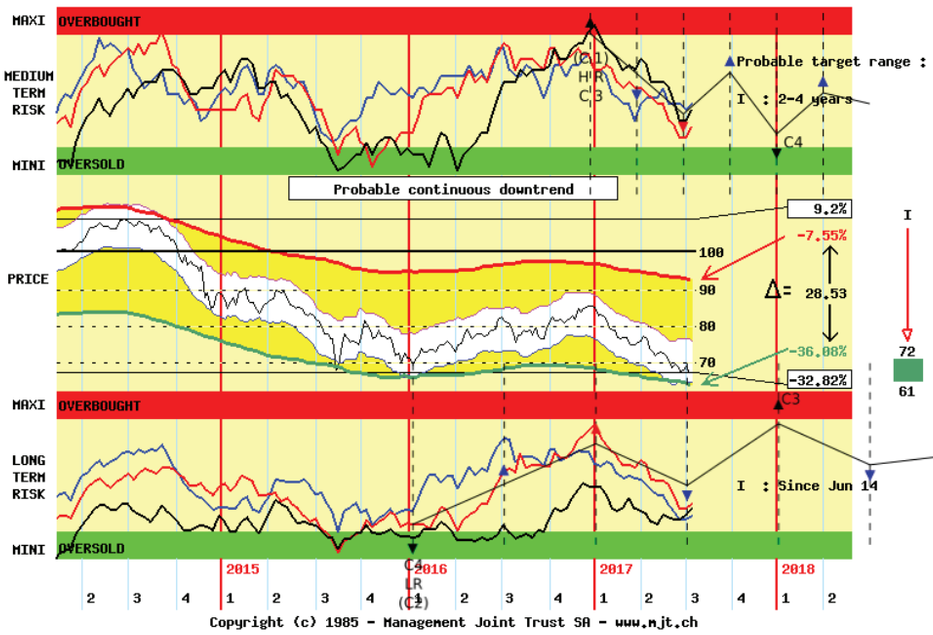
On WTI Oil, the sequence that we project down on our long term oscillators (lower rectangle) expects Oil to bottom during the 1st Half of August (not in June). So even if our medium term oscillators (upper rectangle) are probably already in the early stages of an uptrend, **we would remain prudent for now, especially when considering our targets to the downside ('I' Impulsive down; right-hand scale), where the risk remains significant.** Over the next pages, we will review many Oil / Energy related trades and although some also extend down into August, **the general picture is that a bottom, if not already done, is not far away.**

XLE - Energy Select Sector SPDR Fund
Weekly graph or the perspective over the next 2 to 4 quarters



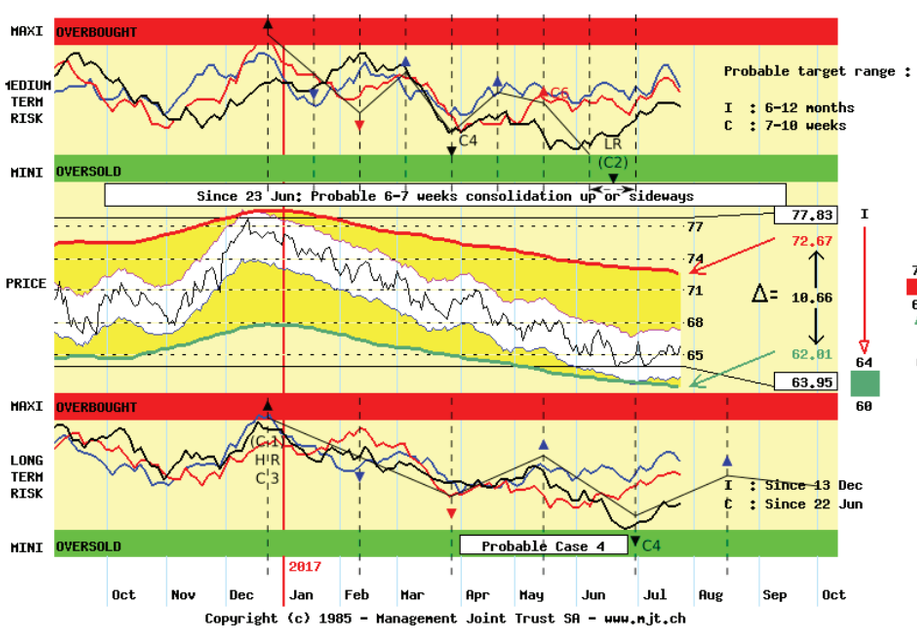
The US Ernergy sector confirms that we are in the later stages of the retracement period which started in early December (a few weeks before oil started to stall). Both oscillator series (lower and upper rectangles) expect a low point to be confirmed over the next few weeks. The initial price target potential ('C' Corrective up; right-hand scale) for the sector into year-end is between 10% and 20%. Above that, our 'I' Impulsive targets up would lead us back into the 2014 highs.

MSCI World Energy vs MSCI WORLD INDEX
Weekly graph or the perspective over the next 2 to 4 quarters



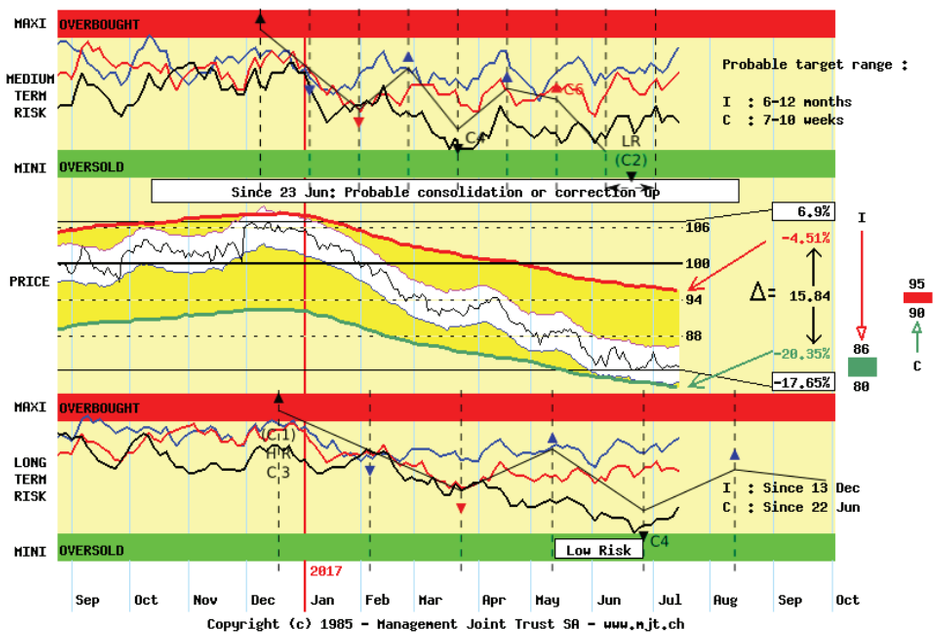
Looking at the ratio of the World Energy sector vs its reference index, the picture is more challenging. Indeed, Energy recently made lower lows against the benchmark. That said the sequence we project on our long term oscillators (lower rectangle) is still valid and would imply a bounce into year-end. We do caveat this view somewhat on our medium term oscillators (upper rectangle) and would first need to confirm a bounce into the Fall before we can envisage more. Finally, we can note that our 'I' Impulsive targets down have pretty much been achieved (right-hand scale) and that both our envelopes are currently touching each other, a sign of exaggeration (middle chart). This adds comfort to the base which is potentially being made. **Energy vs the market on a worldwide basis is still in a downtrend, yet it may be ready to bounce, to the least.**

XLE - Energy Select Sector SPDR Fund
Daily graph or the perspective over the next 2 to 3 months



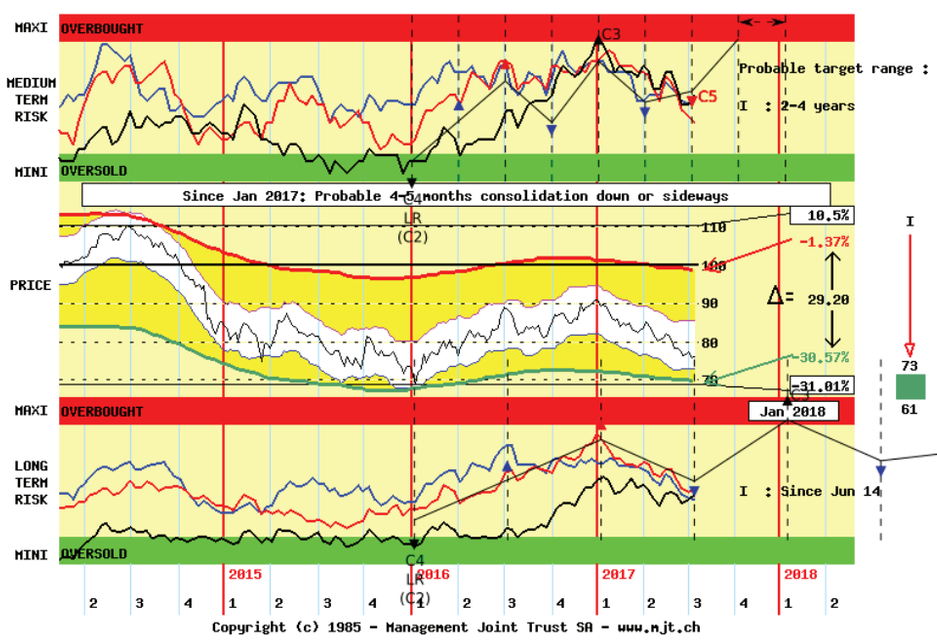
On the Daily graph of the US Energy sector, we can note that on both our oscillator series an important bottom has been made in June (lower and upper rectangles). For now, we would remain prudent as we are still bouncing off lows. Also, our 'I' Impulsive price targets down (right-hand scale) show that there could still be another 10% of downside risk. So, **US Energy is quite Oversold, just the situation is not comfortable enough yet.**

XLE - Energy Select Sector SPDR Fund / SPY - SPDR S&P 500
Daily graph or the perspective over the next 2 to 3 months



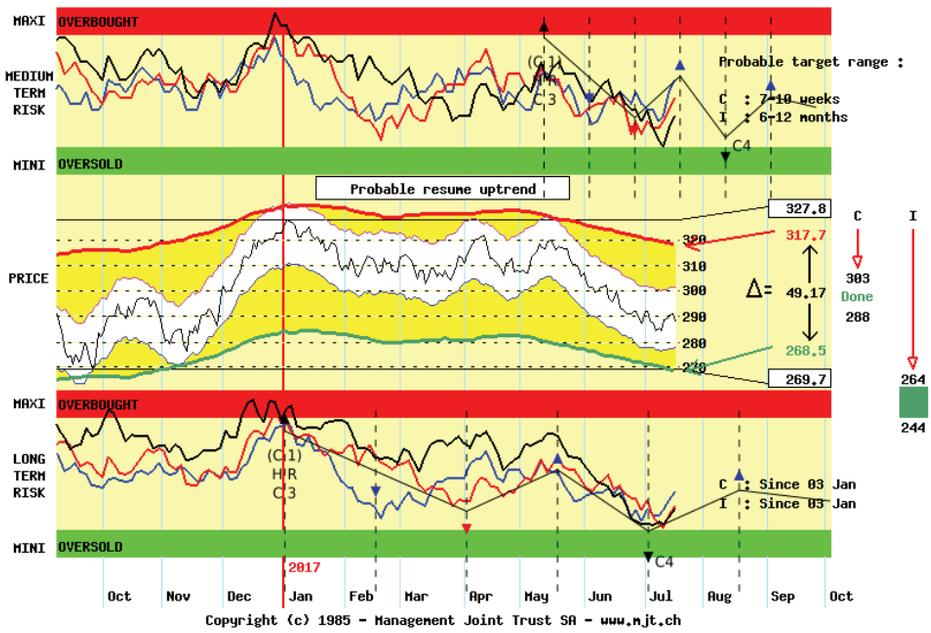
On a relative basis, US Energy vs the S&P500 is also Oversold with an important low being confirmed on both our oscillator series (lower and upper rectangles). Although, it is also still retesting lows, the 'I' Impulsive targets down (right-hand scale) have now been reached. This relative picture is a bit more promising that the Energy sector above on a standalone basis. **It may be that the consolidation we expect more generally on equities into the 1st Half of August materializes and that Energy holds ground vs the Index. This could be a further confirmation of the bottoming process of the Oil nexus.**

ENERGY - Dow Jones STOXX vs Dow Jones STOXX 600
Weekly graph or the perspective over the next 2 to 4 quarters



In Europe, the situation is more positive. The sector has retraced substantially, yet it has been able to hold above its early 2016 lows. 'I' impulsive targets down are still menacing (right-hand scale), yet the sequences on both our oscillators series (lower and upper rectangles) seem to point to a bottom that could mark the end of the retracement period. **European Energy seems ready to outperform again towards year-end / early 2018.**

ENERGY - Dow Jones STOXX
Daily graph or the perspective over the next 2 to 3 months



On the Daily graph of the European Energy sector, our long term oscillators (lower rectangle) would confirm that an important low has been made. Yet, the sequence on our medium term oscillator (upper rectangle) does extend down into August. **The risk to the downside may still be significant** (10% to 15% lower according to our 'I' Impulsive targets to the downside; right-hand scale). This seems like a big fall if it materializes, even in an environment where we would expect European equity markets to consolidate a bit into the 1st Half of August. **We would hence remain prudent until August on the European Energy sector.**

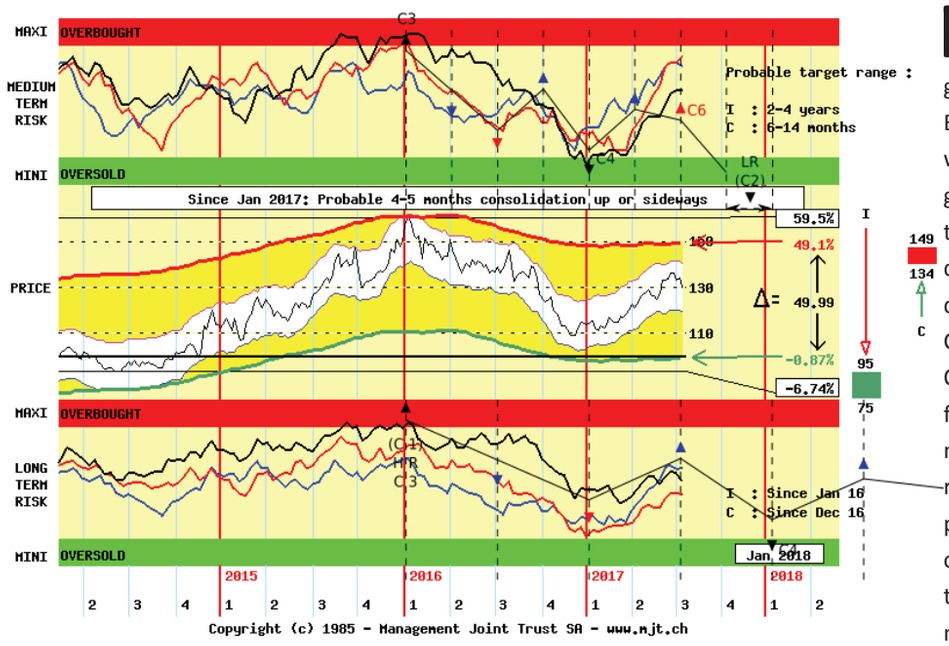
Initial remarks

While Oil made an important low towards the 3rd week of June, it may still be a bit early to call the end of its retracement period since the Spring. Indeed, our Daily graphs would still warrant caution, probably towards mid August and their 'I' Impulsive targets down still show some important Risk, possibly into the lower 40s and higher 30's. That said, many of our Weekly charts on the Energy sector are either Oversold and forming a base, or ready to resume their uptrends towards year-end. **Weakness into August (retest of lows or strong sell-off) may provide great entry points to the strong uptrend we expect globally on Energy towards year-end.**

Oil related plays – is it time to buy them back?

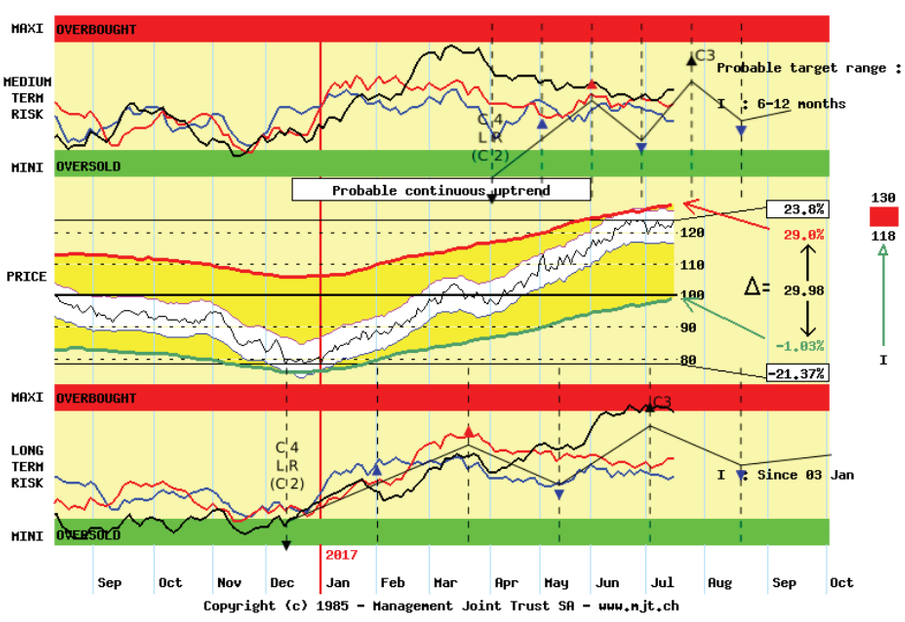
Considering our remarks above on timing the actual low on Oil and the Energy space (building a base between now and mid August), we review below the trades that we put forward in our February letter (when we believed Oil was ready to retrace to the downside, dated the 22nd of February). We would now highlight that these trades are potentially getting ready to reverse.

Copenhagen SE All-Share Price Index vs Norway Oslo Obx Index
Weekly graph or the perspective over the next 2 to 4 quarters



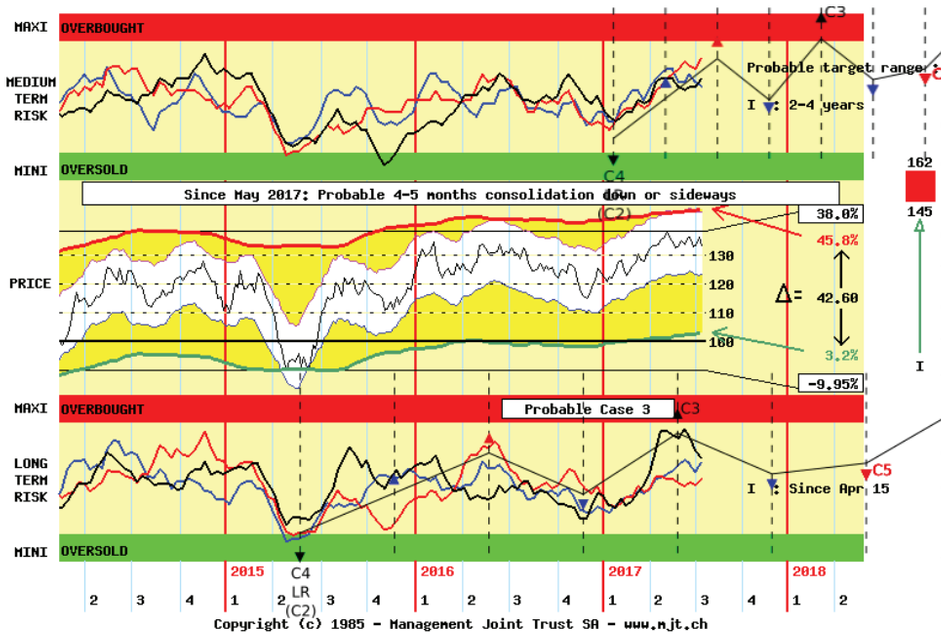
Back in February, we wrote that as Oil was getting ready to correct, Energy related countries would probably suffer. The graph above represents the Copenhagen Main Index (mostly skewed towards Healthcare, Banks and Consumer Goods) vs the Oslo Index (very much focused on Oil and Commodities). At the time, we recommended to buy Copenhagen vs Oslo (circa 15% outperformance including the currency effect). Five months down the line, both our oscillator series (lower and upper rectangles) would now suggest to reverse this trade **as the downside potential for Copenhagen vs Norway into early 2018 is now calculated between 25% and 40% underperformance** ('I' Impulsive targets down; right-hand scale).

Poland Wig vs RTS Moscow Index
Daily graph or the perspective over the next 2 to 3 months



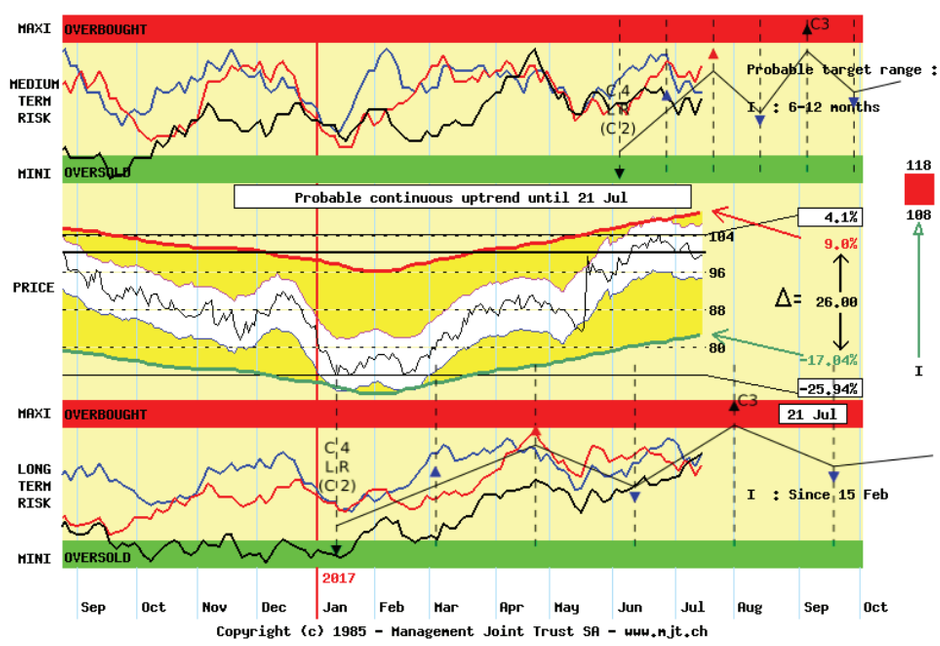
Another call, we suggested at the time was to buy Poland vs Russia. The resulting outperformance (circa 25% since the 22nd of February, including currency movements) is represented on this Daily graph comparing both markets. On both our oscillator series (lower and upper rectangles), the sequences up we show seem to be coming to an end between now and the end of the month. The remaining upside potential as shown by our 'I' Impulsive targets up is possibly another 5% max (right-hand scale). **An opportunity to take profit is neigh.**

INDY – iShares S&P India Nifty 50 Index Fund vs FXI – iShares FTSE China 25 Index Fund
Weekly graph or the perspective over the next 2 to 4 quarters



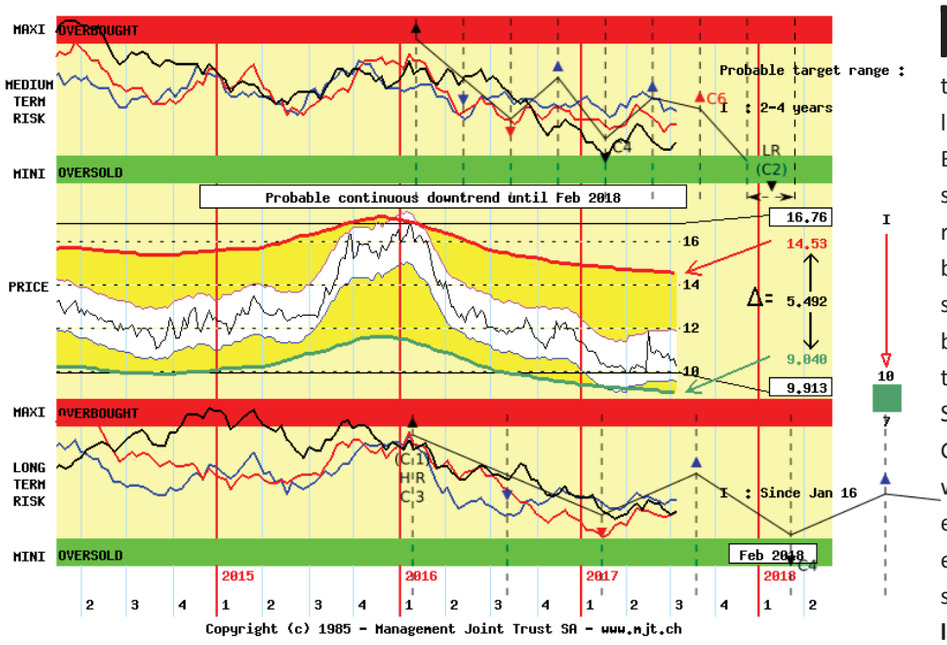
Another trade we did put forward was to buy India vs China. Indeed, **India is younger than China as an Industrial nation and is hence more dependent on oil prices** (i.e. "It will be the fastest-growing crude consumer in the world through 2040, according to the IEA, adding 6 million barrels a day of demand, compared to 4.8 million for China" - Bloomberg, April 2016). India has outperformed China by circa 8% since we published back in February including currency moves (down from 13% a few days ago). Oil is certainly not the only driver of this outperformance, yet this relative performance has sync-ed quite well with the dynamics we expected. On our long term oscillators (lower rectangle), we would expect this outperformance to be retraced until mid Q4 2017, while on our medium term oscillator (upper rectangle), **India could hold its stance until mid Summer before it also retraces into Q4 vs China. This would also work relatively well with our scenario for Oil.**

EWW - iShares MSCI Mexico Capped Investable Market Index Fund vs EWZ - iShares MSCI Brazil Capped Index Fund
Daily graph or the perspective over the next 2 to 3 months



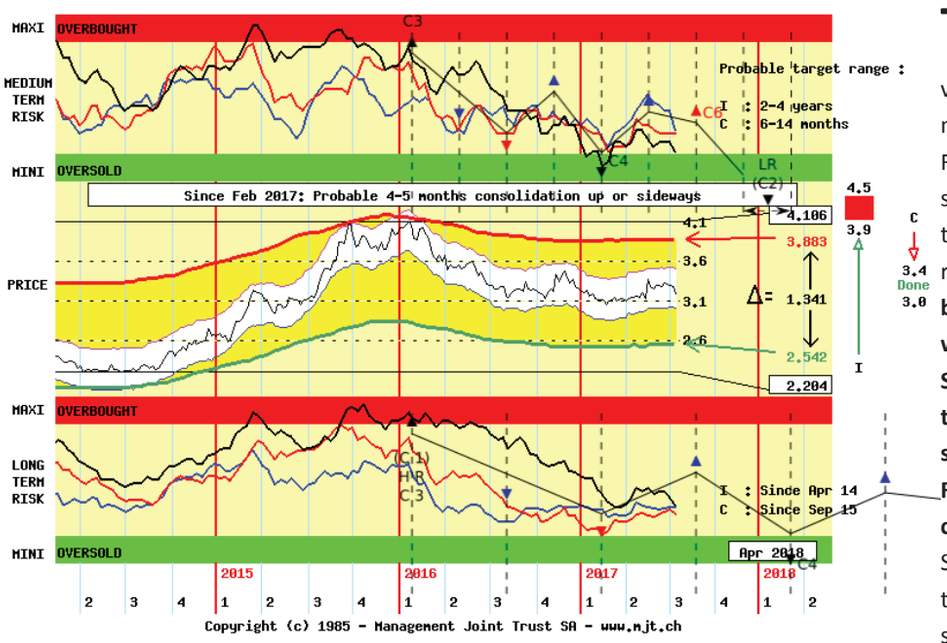
Another pair trade, we put forward at the time was to buy Mexico vs Brazil. While Mexico had been battered by the polemics around the Trump wall, Brazil was heavily sensitive to oil prices, which we believed were getting ready to correct. The outperformance of Mexico vs Brazil has been circa 30% including the cross currency effect. On both our oscillator series, **the trade is now well advanced, yet we would call for a bit of patience before reversing it.** On our long term oscillators (lower rectangle), we would expect it to top out sometime towards the end of this month. On our medium term oscillators however (upper rectangle), it could continue upwards towards early September. The 'I' Impulsive potential up (right-hand scale) is still substantial (between 8% and 18%), possibly a reminder that Oil may surprise one last time to the downside in August (or is it Brazilian politics?) Following that, the Weekly graph (not shown here) suggests similar perspectives as the Copenhagen vs Olso pair trade (a few pages up): **from end Summer to early 2018, Brazil may outperform Mexico by more than 30%.**

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



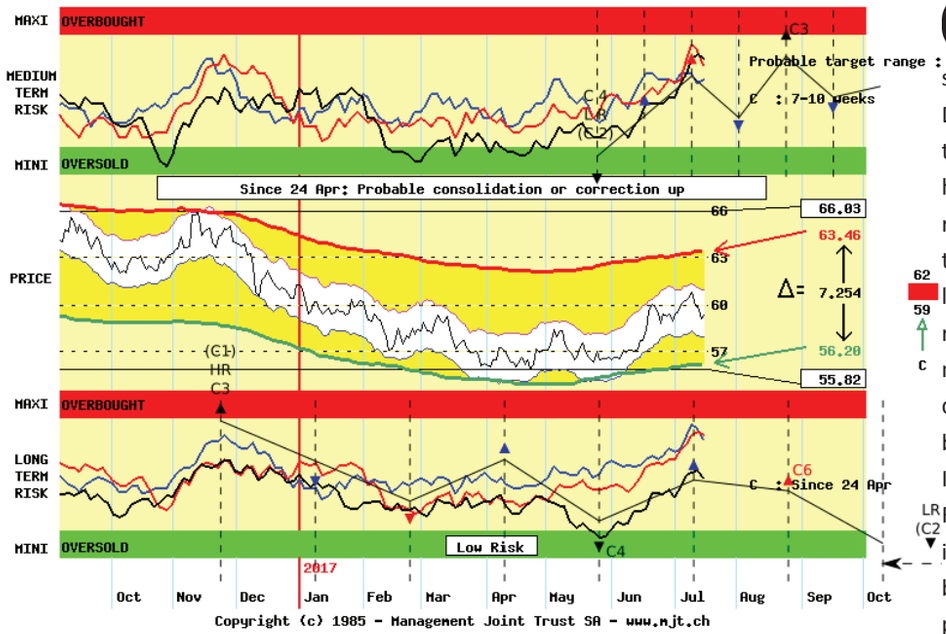
If you were looking for a bond market where interest rates are still falling, you might consider Brazil. On both oscillator series (lower and upper rectangles), we would probably suggest that you should wait a while longer before you enter (probably towards end August / early September). Yet, Brazilian Government Bonds are still well positioned towards early 2018. The move since early 2016 has already been substantial. **We nevertheless calculate that another 300 basis points to the downside are possible on our 'I' Impulsive down yield targets (right-hand scale). That is circa 20% price potential on a 10Y tenure, plus the coupon.**

Brazilian Real per U.S. Dollar
Weekly graph or the perspective over the next 2 to 4 quarters



The Brazilian Real also seems well positioned vs the USD (as most commodity currencies are). From the sequences we show on both our oscillator series (lower and upper rectangles), **we would probably recommend to wait a while longer (mid August / September). Yet, following that, the Dollar should resume its downtrend vs the Real (up for the Brazilian currency)**, possibly into next Spring. Our 'C' Corrective targets down (right-hand scale) show strong support around their lower boundary towards the 3.0 – 3.1 levels. **Making it below them would open the door to our 'I' Impulsive targets to the downside, which we would calculate between 2.36 and 1.82** (not shown), an aggressive projection, which will be very profitable if only half of it comes true.

Russian Ruble per U.S. Dollar
Daily graph or the perspective over the next 2 to 3 months



On a similar note, we also look at the Russian Rubble on a Daily graph. Despite, the strong correction down on oil we have had since the Spring, it has remained fairly resilient vs the USD. On both our oscillator series (lower and upper rectangles), we expect the next inflexion point to the downside (up for the Rubble) towards end August. Ideally, until then, USD/Rubble will remain below its 'C' Corrective targets up between 59 and 62 Rubble per USD (right-hand scale), justifying that the move since April was only a bounce. The Weekly graph (not shown here) shows similar dynamics as the Real per USD graph above: **USD / RUB could accelerate to the downside (Rubble up vs USD) between end August and early next year with significant price potential.**

Concluding remarks

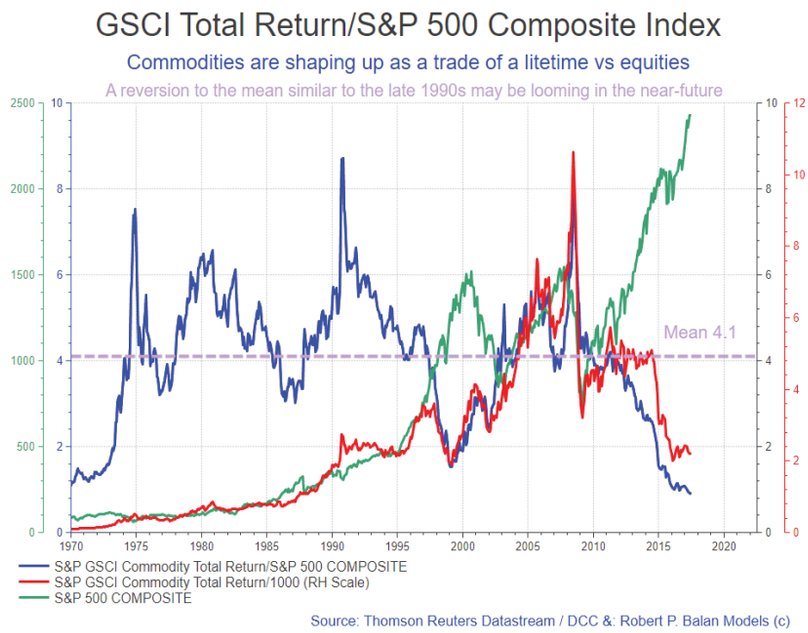
As mentioned above in our initial remarks, Oil may have already reached its retracement low. Yet we are weary of possible retests into the Summer as well as of the downside risk we still calculate on our Daily graphs (towards USD 40 a barrel). That said, the dynamics, which we have been considering since late last year (retracement into the Summer, re-acceleration towards year-end and early 2018) still appear to be valid. Sectors, Countries play and Commodities currencies seem to confirm this view. **On our Daily graphs, we see quite a few indications that investors should probably wait until mid / end August for a better opportunity to enter Oil and its promising related plays.**

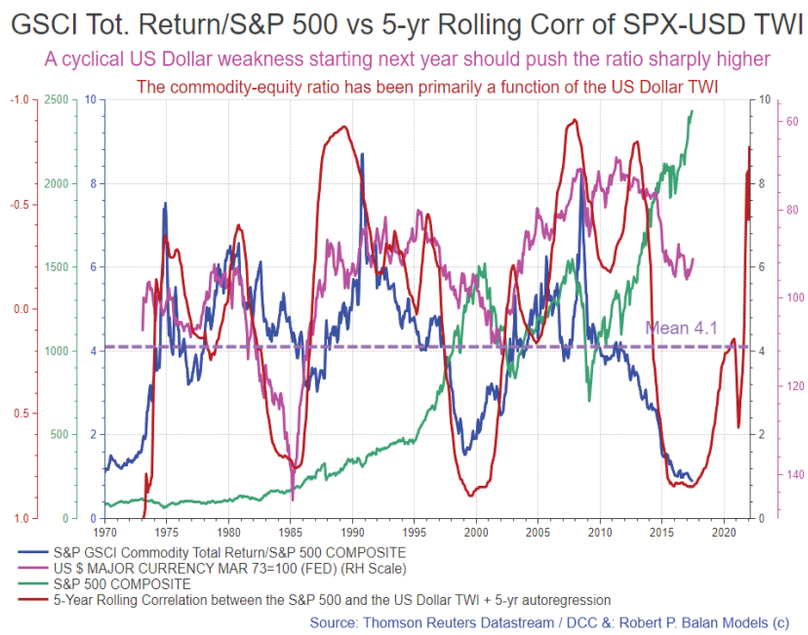
36 / Is it time to allocate funds away from equities to commodities? An opportunity of a lifetime to do that may be close at hand

At no other time in the history of commodities has financial interest in the asset class been as weak as it is today. Over the past 50 years, commodities have never been cheaper relative to equities than they are at present. Even as equities continue to make new highs, a disconcerting calm pervades the commodity trading exchanges -- there`s never been a more lackluster period for commodities than in the last couple of years. The commodities underperformance is even more stark when compared to equities. The divergence has reached historic levels in the back of a 246%-plus move on the S&P Index (SPX) since the trough of the Great Financial Crisis in Q1 2009, compared with a 31.2% decline for the Goldman Sachs Commodity Total Return Index over the same period.

The good news is that the correlation between commodities and equites is highly cyclical -- the history of US stock and commodity prices has been characterized by recurring super cycles that last several decades. Similar extremes were seen in the early 1970s, in 1986 and in 1998, leading up to the dot-com equity bubble. In all of those cases, of course, stocks eventually crumbled, which led to commodities outperformance. At present, the commodity (proxy: S&P GSCI Total Return Index) ratio over equities (proxy: S&P 500 Composite Index) is at its lowest point since June 2008, 0.895 this week versus 8.249 in June 2008 ***(see 1st chart on this page).***

The relationship is at the lowest point in recent history, and had some analysts talking about the ratio`s reversion to the mean, which is at 4.1, taking into stock the somewhat spotty prices available during the late 1960s. Some analysts (us included) reason out that the divergence in the commodity-equity relationship is so extreme, therefore a snap back into more reasonable levels looks inevitable.





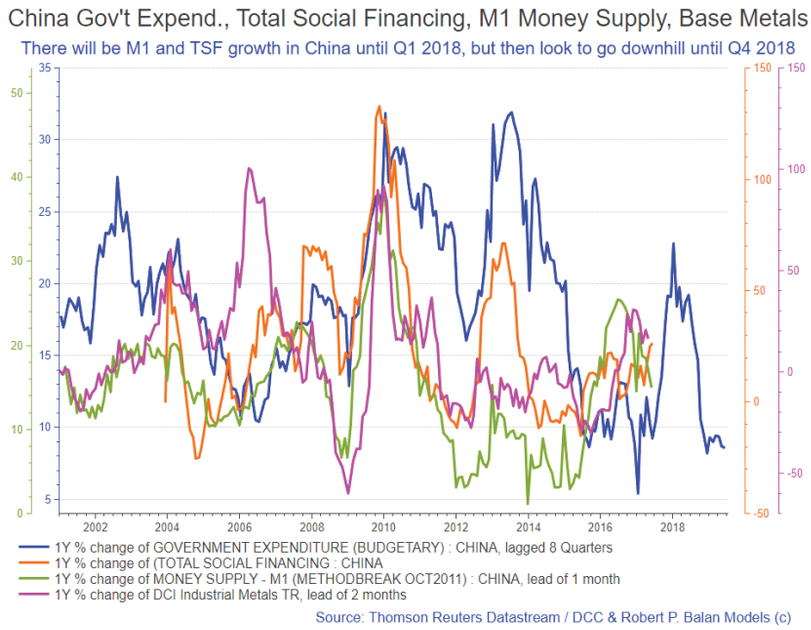
Of course, the ratio can fall further from here, and this year may not be the time when the reversion begins. But with talks of equity markets being in a bubble, and the Fed making noises about wanting to reduce the level of its balance sheet, which has been significantly responsible for pushing up equity prices, the elements that could trigger a reversion to the mean are starting to get into their proper places. Further analyses provided below suggests that the trough or inflection point could be next year ***(see 2nd chart on this page).***

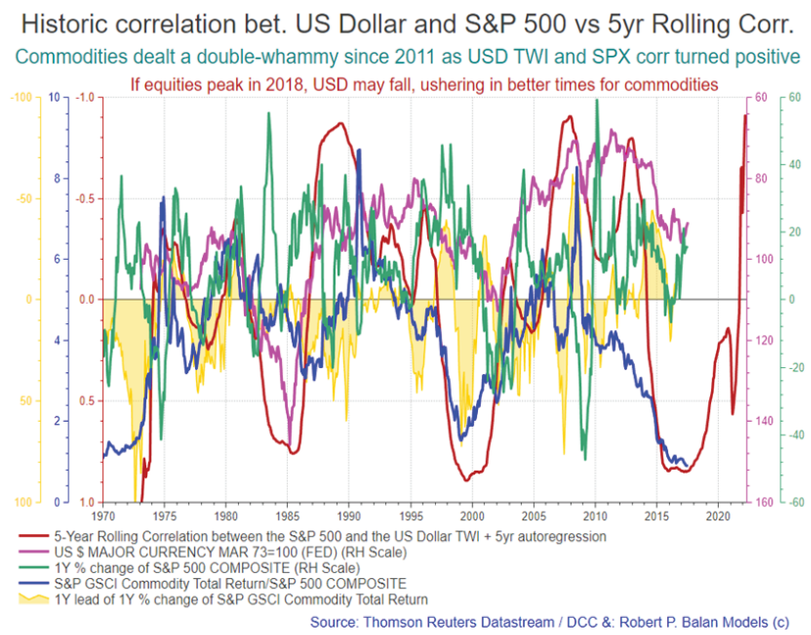
It also helps that China has not imploded, and the country in fact is starting to surprise in the growth and activity sectors -- that could add to factors that could arrest further declines in the ratio. China, and its travails over the past few years, in retrospect, has played a large part in the severe underperformance of commodities versus equities. Fear of a Chinese economy blow-up had severely handicapped commodity prices since 2011, as China, after all, is the largest consumer of commodities in the world, specifically base metals.

But China has been on the mend, and growth surprises during Q2 2017 suggest that macro conditions in that country have stabilized *(see 1st chart on this page).*

In the final analysis, the ratio has been driven less by the relative strength of commodities, but mostly by a variable that impacts both commodities and equity markets – the US Dollar Trade Weighted Index. ***As the 2nd graph of this page*** illustrates, commodity underperformance vs equities have always happened during episodes of USD strength. **This makes complete sense as commodities are the antithesis of the US currency. The reality is that commodities simply cannot prosper during periods of US Dollar strength.**

The weak episode for commodities from 2011, and for that matter, all weak periods in the historic commodity/equity relationship, came at a time when equities and the USD were rallying together – a veritable double whammy for commodities***(see 2nd chart on this page)***. The synchronous movement between equities and the dollar suggests to us that there is a third macro variable involved in the equation. Therefore, this is also why the ratio looks cyclical and has cyclical characteristics. Finding that third macro variable will be the subject for a future report in this publication.





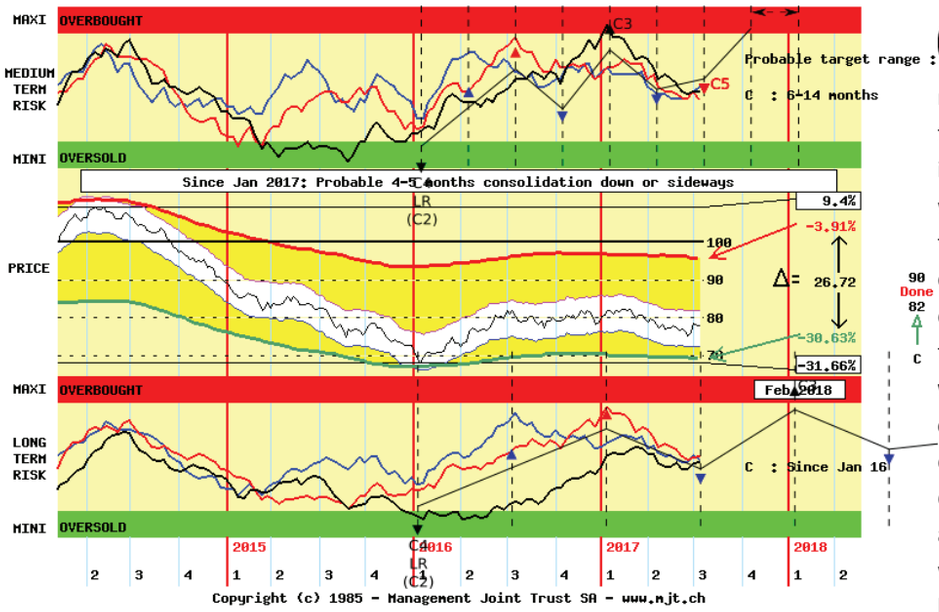
For now, we are satisfied that the relationships described in this article explains many, if not all, of the weakness and strength that the commodity/equities ratio has shown over the years. **Those relationships are due for a major change soon, as soon as next year, and we look forward to a radical change in regime, when commodities will again outperform equities. Asset classes inevitably take turns in outperformance, and sometime next year commodities should switch over to the driver's seat.**

38 / MJT - TIMING AND TACTICAL INSIGHT

There will be multiple opportunities in H2 2017 for commodities

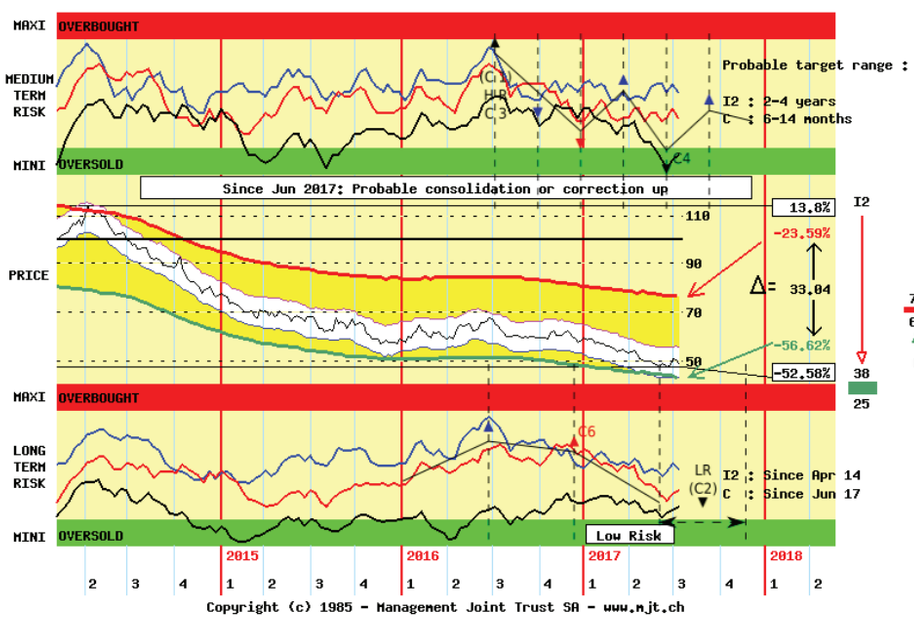
As with Oil and Energy, most Commodities and their related sectors have retraced since earlier this year. We would soon also expect them to resume their uptrend, possibly during the Summer and probably towards early next year. Some have already started to move and we believe it's time to review the space.

Equal Weighted Commodity Index (a portfolio we created) Weekly graph or the perspective over the next 2 to 4 quarters



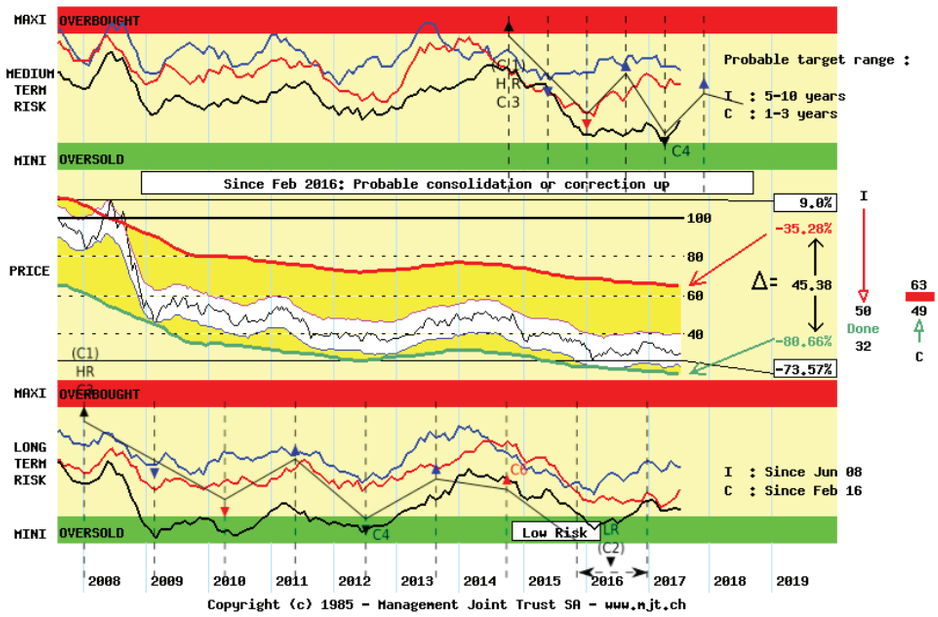
Often when considering commodity indexes, it might be difficult to escape the predominance of Oil in its composition. We also wanted to view commodities through a wide base of constituents. Hence, using our portfolio simulation tool, **we created an equal weighted portfolio of 28 commodities** including Energy related, Soft Commodities as well as Precious and Industrial Metals. The weight of Energy was quite low (slightly above 10%), yet that was the whole point. Looking at the results on this Weekly graph, **it is amazing how similar its dynamics compare to Oil.** On both our oscillator series (upper and lower rectangles), we can notice the upside progression last year and the subsequent retracement into midyear. **We would now expect it to move up again towards early 2018.** On the targets side, our 'C' Corrective targets up (right-hand scale) show 5 to 10% additional potential to the upside. If, however, the portfolio manages to accelerate above our corrective targets, the next levels of targets ('I' Impulsive up targets; not shown here yet) are possibly 15 to 25% higher or 20 to 40% higher than today. A worthwhile trade if it materializes.

Equal Weighted Commodity Index vs QQQ - PowerShares Nasdaq100 ETF Weekly graph or the perspective over the next 2 to 4 quarters



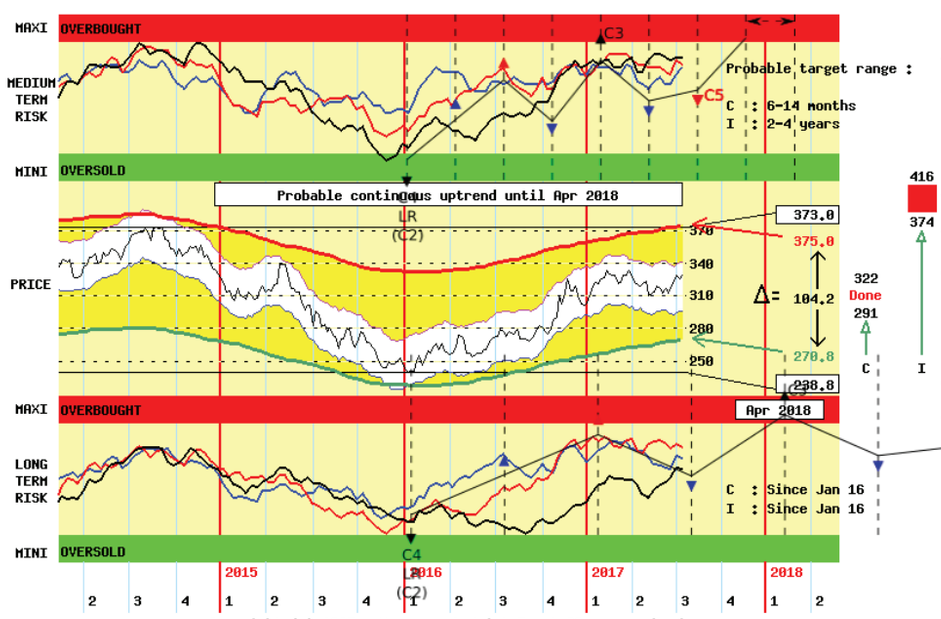
In our newsletter last month, we benchmarked cyclical assets vs long duration ones and concluded that Long Duration would probably underperfom during H2 2017 as yields started to rise again. In this chart, we do the same exercise with our commodity equal weighted portfolio and compare it to the Nasdaq100 (mostly Big Growth and long duration profiles). **Both our oscillators sequences (lower and upper rectangles) are currently making important lows (labeled 'Low Risk' on the graph) and should correct to the upside possibly into early next year.** Our 'I2' downside targets still show some risk (right-hand scale), yet these are 'I2' Impulsive 2 downside targets, i.e. our most extreme level of targets. Furthermore, our envelopes are touching each other, signaling an exaggeration. **We hence believe that Commodities are getting ready to outperform.**

Reuters CRB Futures Price Index vs Gold Spot (USD/Oz)
Bi-monthly graph or the perspective over the next 1 to 2 years



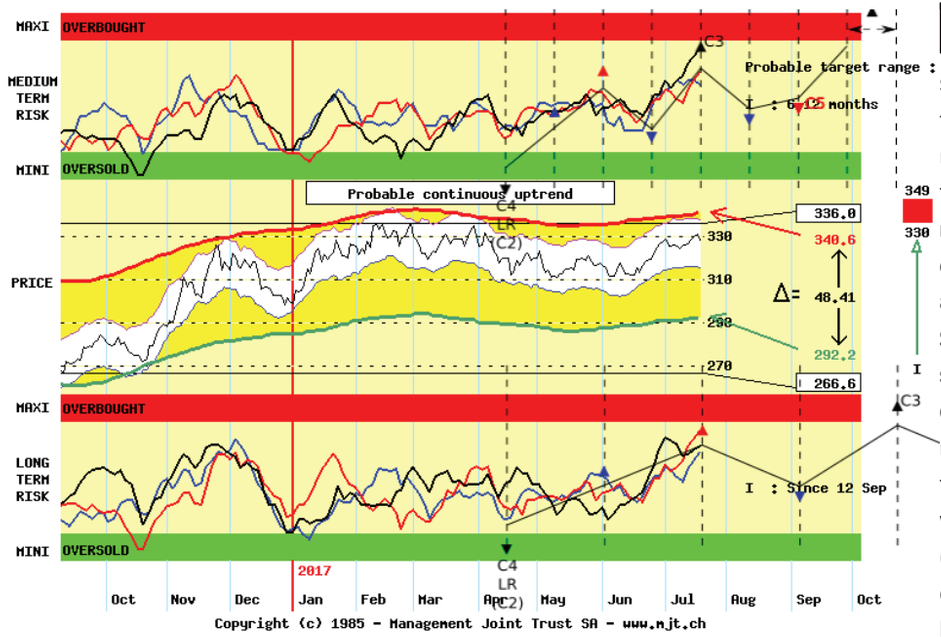
On this graph, we have used the Reuters CRB Futures Price Index (Energy accounts for 33%) where we have a long price history and compared it to Gold. This is like a reflation / deflation gauge in the commodity space. On both our oscillator series (lower and upper rectangles), Commodities have reached important lows (labeled "Low Risk"). Although it is still early stages (this is a very long term graph), the 'C' Corrective potential up (right-hand scale) is quite substantial, while the 'I' Impulsive downside risk had previously been achieved (labeled 'Done'). **Hence, Commodities vs Gold are in a "Low Risk" situation with an advantageous Risk/Reward position.**

Goldman Sachs Industrial Metals Index
Weekly graph or the perspective over the next 2 to 4 quarters



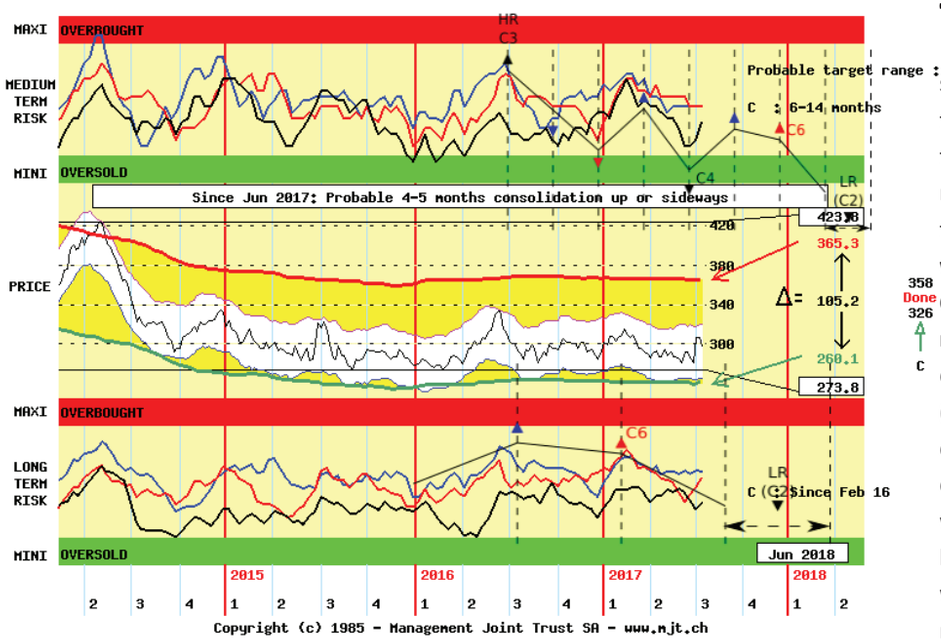
As for the different segments in the commodity space, we've already looked at Oil and Gold several times in this document, we will move on to Industrial Metals. On both our oscillator series (upper and lower rectangles), the dynamics are similar to other commodities. Yet, as with Oil, following the recent bounce, **we would probably expect some retracement during the Summer.** Indeed, prices are currently testing the upper end of our 'C' Corrective targets up (right-hand scale), which often provide some resistance. **Following that, once the breakout is confirmed, Industrial Metals could accelerate towards their 'I' Impulsive targets up, some 15 to 25% higher.**

Goldman Sachs Industrial Metals Index
Daily graph or the perspective over the next 2 to 3 months



Looking at this Daily graph, the sequences we show on both our oscillator series (lower and upper rectangles) would suggest that **Industrial Metals could retrace into the 1st Half of August in first instance, and then possibly into early September, before they resume their uptrend towards October.** The downside risk we calculate, is circa 0.5 to 0.8 times our historical volatility measure "Delta" (currently at 48.29; middle chart, right hand side) or between 7 and 11%.

Goldman Sachs Agriculture Index
Weekly graph or the perspective over the next 2 to 4 quarters

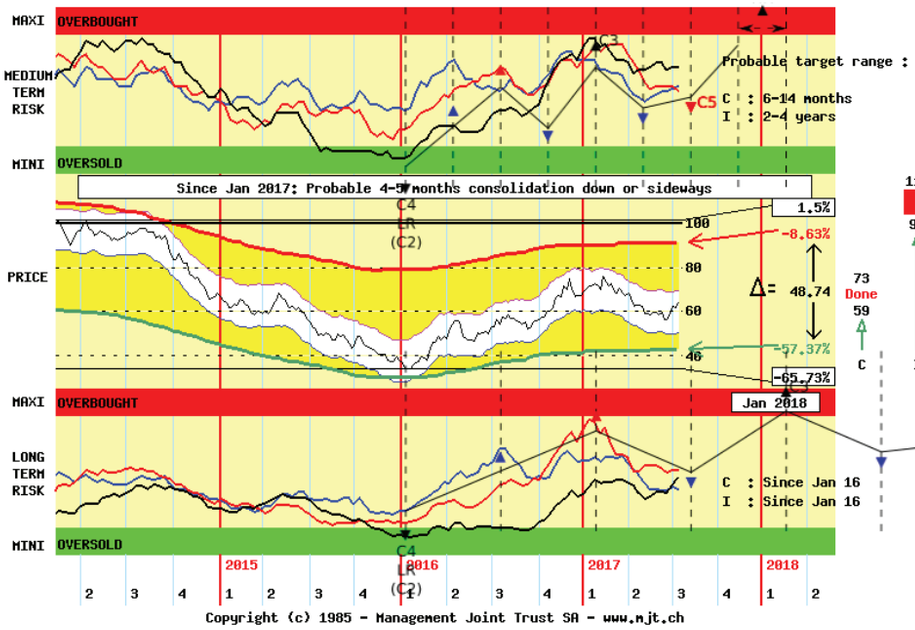


The prices of Agricultural Commodities have been subdued for quite some time. Within the segment, their individual price dynamics may differ quite substantially. Yet, in general, **we would expect Agricultural Commodities to remain range-bound for now.** Indeed, our long oscillators (lower rectangle) show a downside sequence which doesn't seem over yet, while, on our medium oscillators (upper rectangle), we would expect a rather short rebound. We would remain defensive for now on Agricultural Commodities and would look to the individual segment constituents for opportunities.

Initial remarks

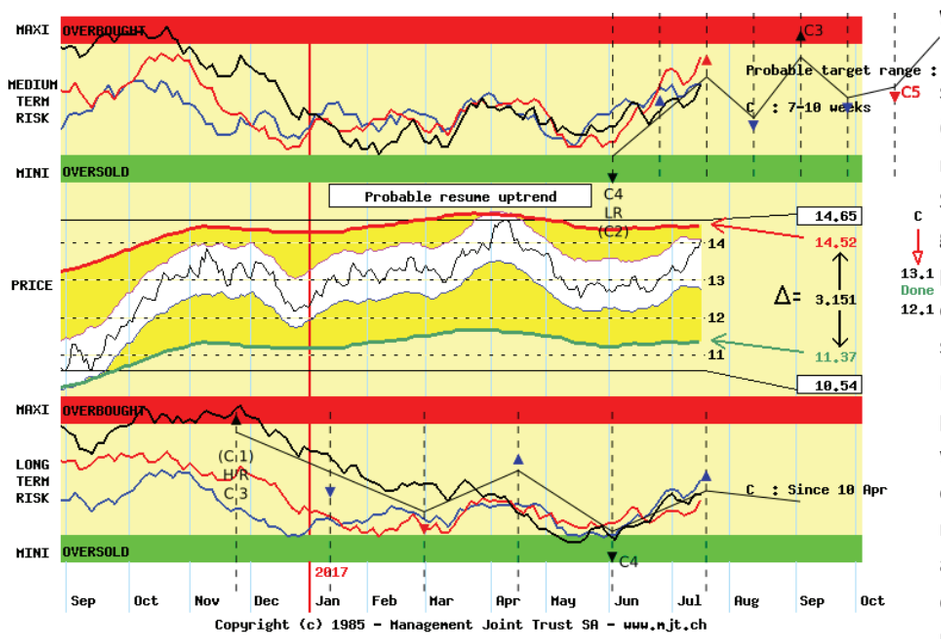
On an absolute basis, Commodities seem to be finishing off the retracement started in the Spring. As with oil, following the recent bounce from mid June, we would expect some retracement into August. Longer term, Commodities are in "Low Risk" situations vs Gold (defensives) and Growth assets. Towards year-end, we would favor Industrial Metals over Precious Metals and Agricultural Commodities. We now go on to review related equity sectors worldwide.

STEEL - Steel Index (NYSE Arca) vs SPY - SPDR S&P 500
Weekly graph or the perspective over the next 2 to 4 quarters



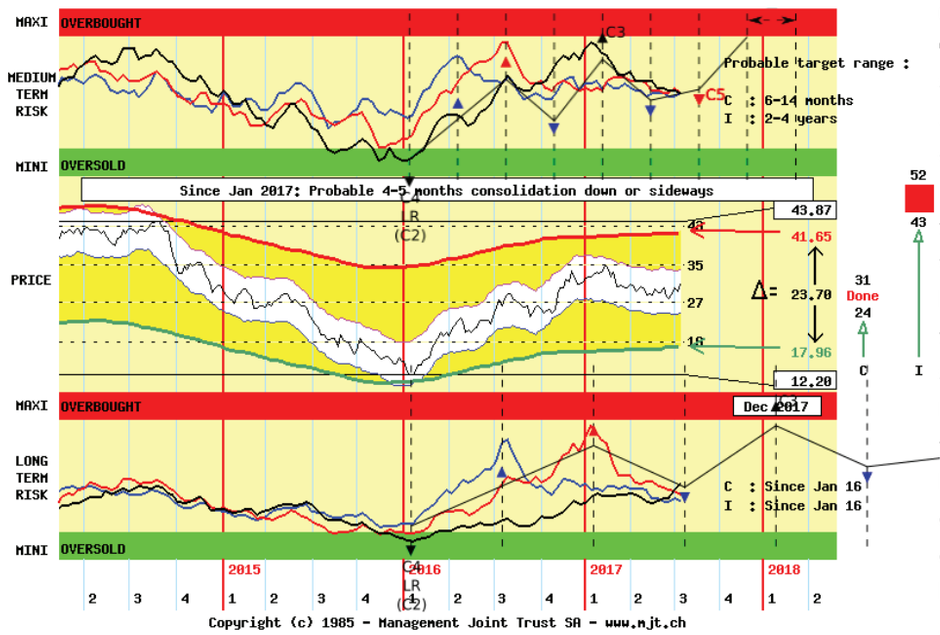
The Steel sector in the US vs the S&P500 is also getting ready to resume its uptrend on both our oscillator series (lower and upper rectangles). **An oscillator low is indeed awaited mid Summer. Hence, the recent bounce has come a bit early and we would expect some retracement into August.** Price would first need to make it above our 'C' Corrective targets up (circa 15% higher). Above that our 'I' Impulsive targets up show tremendous potential. **The Steel sector is very volatile (lots of price amplitude up or down) and we believe that over the next 6 months, it's going up.**

KOL - Market Vectors Coal ETF
Daily graph or the perspective over the next 2 to 3 months



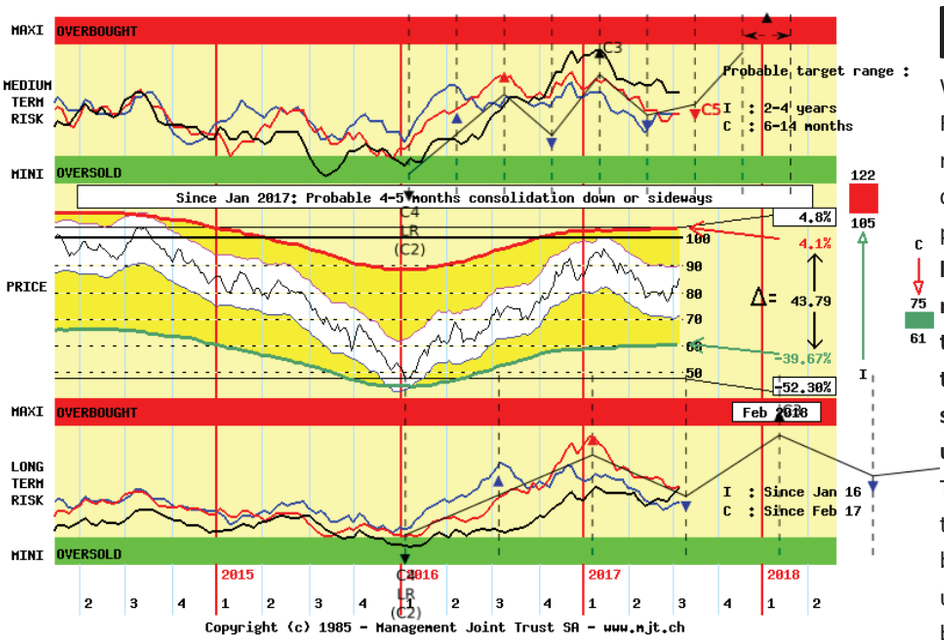
We now switch to the neighboring Coal sector. On its Weekly graph (not shown here), the dynamics are very similar to Steel. Similarly, the Daily graph of Coal is also a good proxy to monitor Steel. On our long term oscillator series (lower rectangle), KOL has reached an important low in May / June, which marked the end of its consolidation period. It is now moving to the upside again as shown on our medium term oscillators (upper rectangle). **We would expect some retracement into the 1st Half of August before the trend resumes to the upside.**

XME - SPDR S&P Metals & Mining ETF
Weekly graph or the perspective over the next 2 to 4 quarters



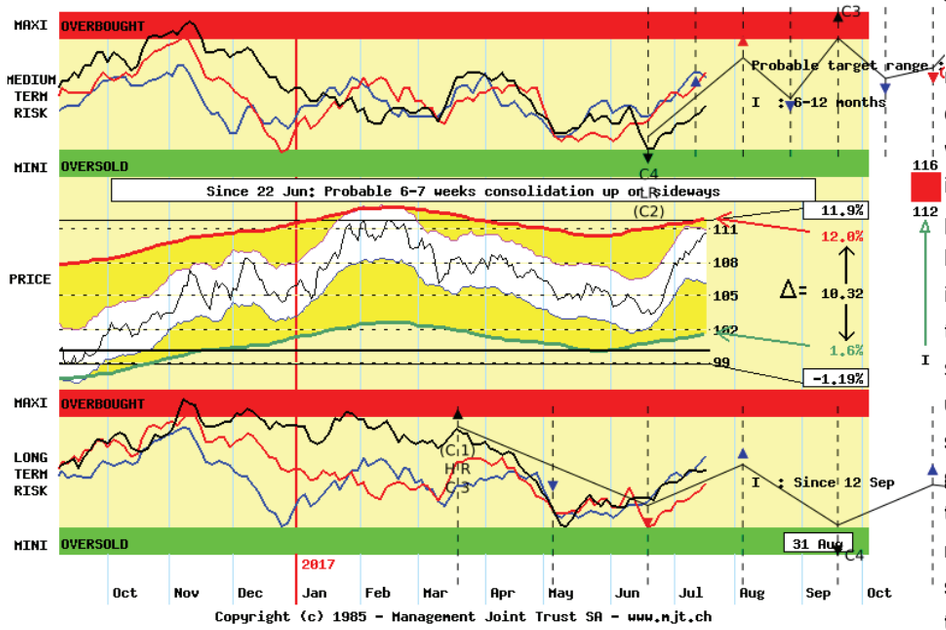
Similarly to Steel or Coal, the US Metals & Mining sector is due to **resume its uptrend from mid Summer** on both our oscillator series (lower and upper rectangles). Price are currently working through the higher boundary of our 'C' Corrective targets up (right-hand scale). Following that the 'I' Impulsive target potential to the upside we calculate is between 35 and 70%. **Lots of volatility here too and over the next 6 months, we believe it's pointing to the upside.**

Basic Resources - Dow Jones STOXX vs Dow Jones STOXX 600
Weekly graph or the perspective over the next 2 to 4 quarters



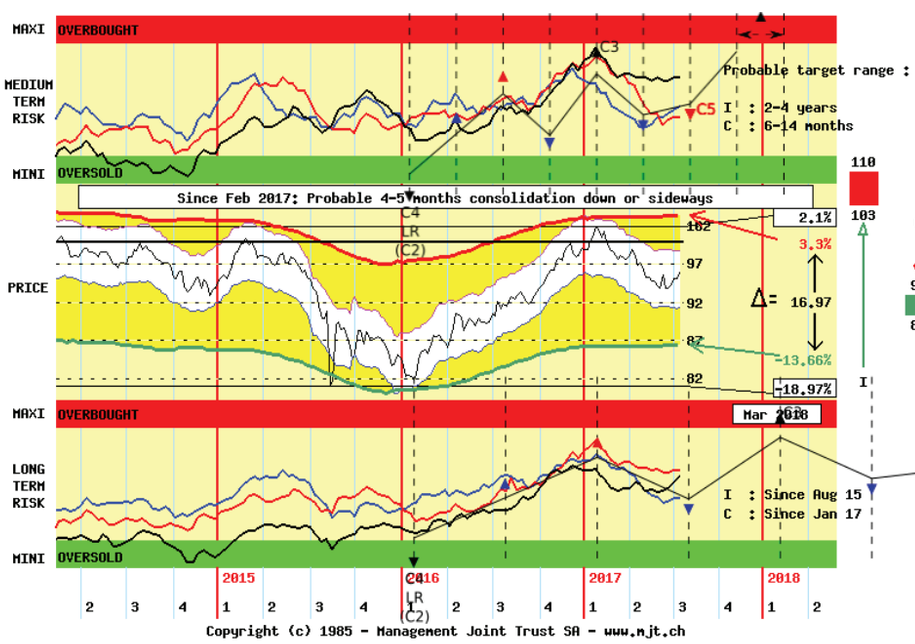
In Europe, the situation is similar as shown by this Weekly graph of the Basic Resources sector vs its reference index. On both our oscillator series (lower and upper rectangles), **we are also looking for some retracement into August (following the bounce since June) and then we would expect the sector to start accelerating up towards early next year.** The outperformance potential vs the index measured by our 'I' Impulsive targets up (right-hand scale) is between 20 and 45%.

MSCI Asia Pacific Materials vs MSCI Asia Pacific
Weekly graph or the perspective over the next 2 to 4 quarters



There's been a lot of talk recently that it is technology, rather than commodities, which is currently driving Emerging Markets up, in Asia especially. This graph proves that this is not exactly true as commodity sectors in Asia have already started to outperform aggressively since mid June. **This uptrend will probably see some retracement into August as shown our medium term oscillators (upper rectangle) and even possibly into September (long term oscillators; lower rectangle), before it accelerates up again into the Fall.** The retracement risk to the downside we can calculate using our historical measure of volatility 'Delta' (10.32; middle rectangle, right-hand side) is between 4 and 8% or 0.5 to 0.8 times 'Delta'.

MSCI World Materials vs MSCI WORLD INDEX
Weekly graph or the perspective over the next 2 to 4 quarters



We finally look at the world index for the Materials sector vs the MSCI World to confirm the dynamics mentioned above on the segments and regions we considered. As with most Weekly absolute and relative graphs we have seen in this section, **we would expect prices to accelerate up from mid Summer to year-end. In the meantime, the rebound from June may be retraced somewhat into August.** The outperformance potential here on this very board based sector index is between 7 and 15% according to our 'I' Impulsive targets up (right-hand scale).

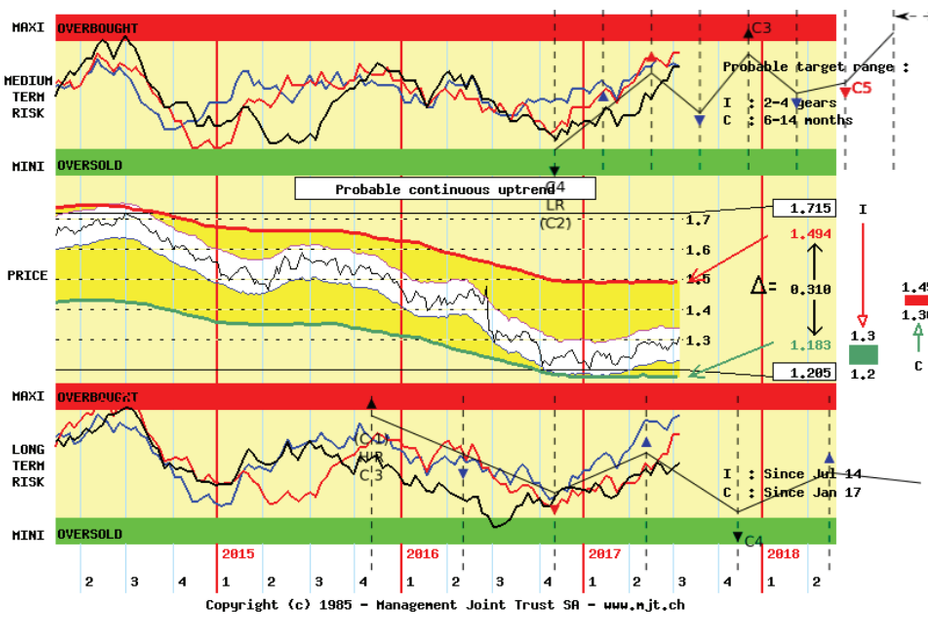
Concluding remarks

Most commodity play are expected to resume their uptrend from mid Summer to Spring next year. The outperformance potential for both commodities and their related equity sectors is substantial. Shorter term, the bounce which materialized from mid June will probably be retraced somewhat into mid August. Our view is that it will probably make higher lows already. We see this retracement as an opportunity to pick up Commodities before their prices really take-off.

44 / Splicing the markets – The trend is now heading upwards on GBP/USD, Buy the Dips

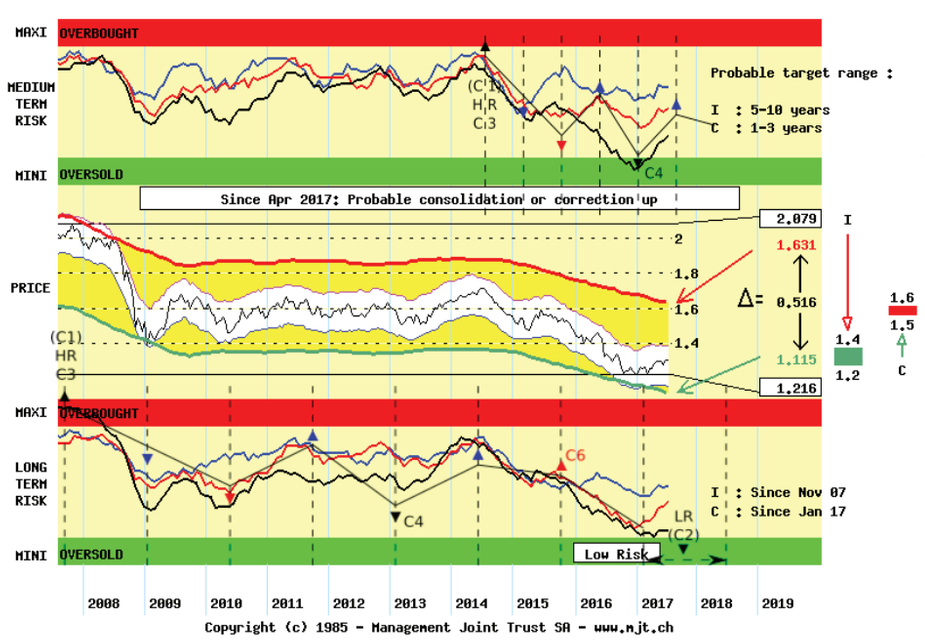
Hard to say I did not indulge myself into Brexit bashing over the last 12 months. Yet recently, the perspectives for a soft Brexit have been revised up and seem well received by the markets. As a result, **the Pound is now in an uptrend vs the USD.**

U.S. Dollar per British Pound
Weekly graph or the perspective over the next 2 to 4 quarters



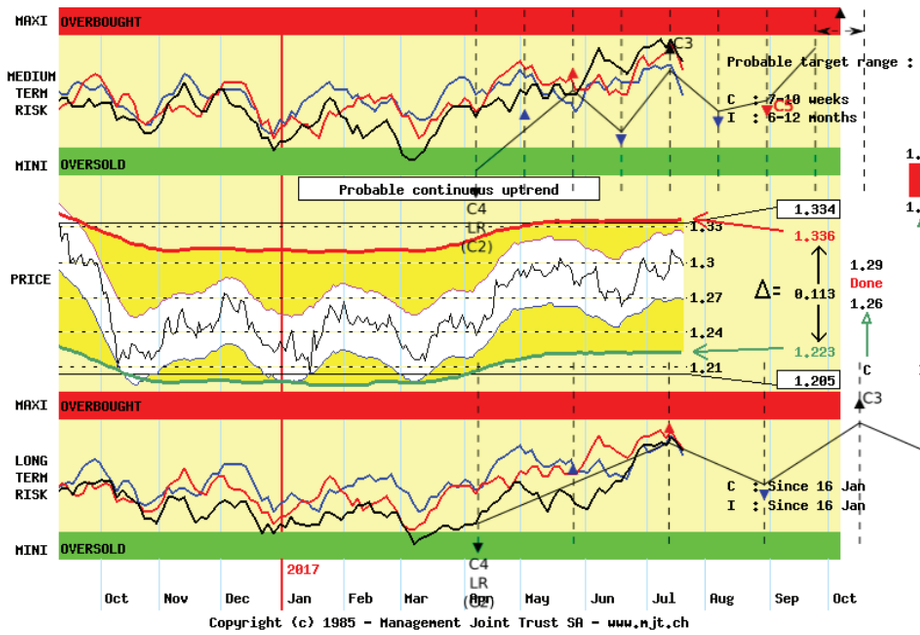
On our long term oscillator series (lower rectangle), there remains the possibly for a further retest to the downside on GBP/USD towards the Fall. Yet, our envelopes are now heading up and our medium term oscillators are in an uptrend sequence that seems quite strong (upper rectangle). Indeed, looking into the details of these medium term oscillators, we note that the intermediate top made in May has shown only a limited reaction to the downside and that since, prices have already broken out to new highs. On the price target side (right-hand scale), our 'I' Impulsive down targets had been achieved on the sell-off last Winter and our 'C' Corrective up targets are now showing potentials between 1.36 and 1.45 into next year. **Hence, shorting the Pound is now probably playing against the trend. Going forward, we would probably favor a Buy the Dips strategy.**

U.S. Dollar per British Pound
Bi-monthly graph or the perspective over the next 1 to 2 years



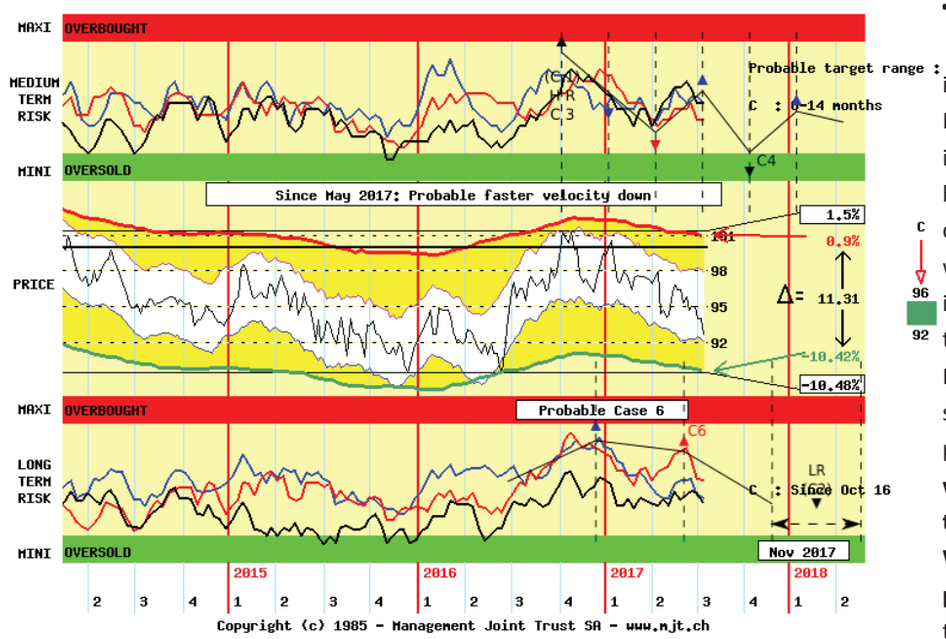
To gain more confidence, we confirm this view with the long term graph of GBP/USD. On our long term oscillator series, **GBP/USD is now in a "Low Risk" situation** (lower rectangle), while on our medium term oscillators (upper rectangle), it may have made a strong intermediate low at least. 'I' Impulsive targets down (right-hand scale) had been achieved late last year around 1.20. The 'C' Corrective up potential on this long term graph is now towards 1.50-1.60 or towards its previous 2009 – 2014 range.

U.S. Dollar per British Pound
Daily graph or the perspective over the next 2 to 3 months



Last October to April saw a large accumulation pattern on GBP/USD. According to the sequences we project on both our oscillators series (lower and upper rectangles), **GBP/USD is now in an uptrend and has probably reached an intermediate top. We would expect it to retrace down during the 1st Half of August before it starts moving up again towards the Fall and our 'I' Impulsive targets up between 1.35 and 1.40** (right-hand scale). This is not dissimilar to the scenarios we foresee on EUR/USD and other 'riskier' assets. Over the next few weeks, the potential for the retracement is probably towards 1.27-1.26 or circa 0.5 times our historical volatility measure 'delta' (middle rectangle, right-hand side) subtracted from the tops just made.

FTSE 100 Index vs MSCI WORLD INDEX (Currency hedged)
Weekly graph or the perspective over the next 2 to 4 quarters



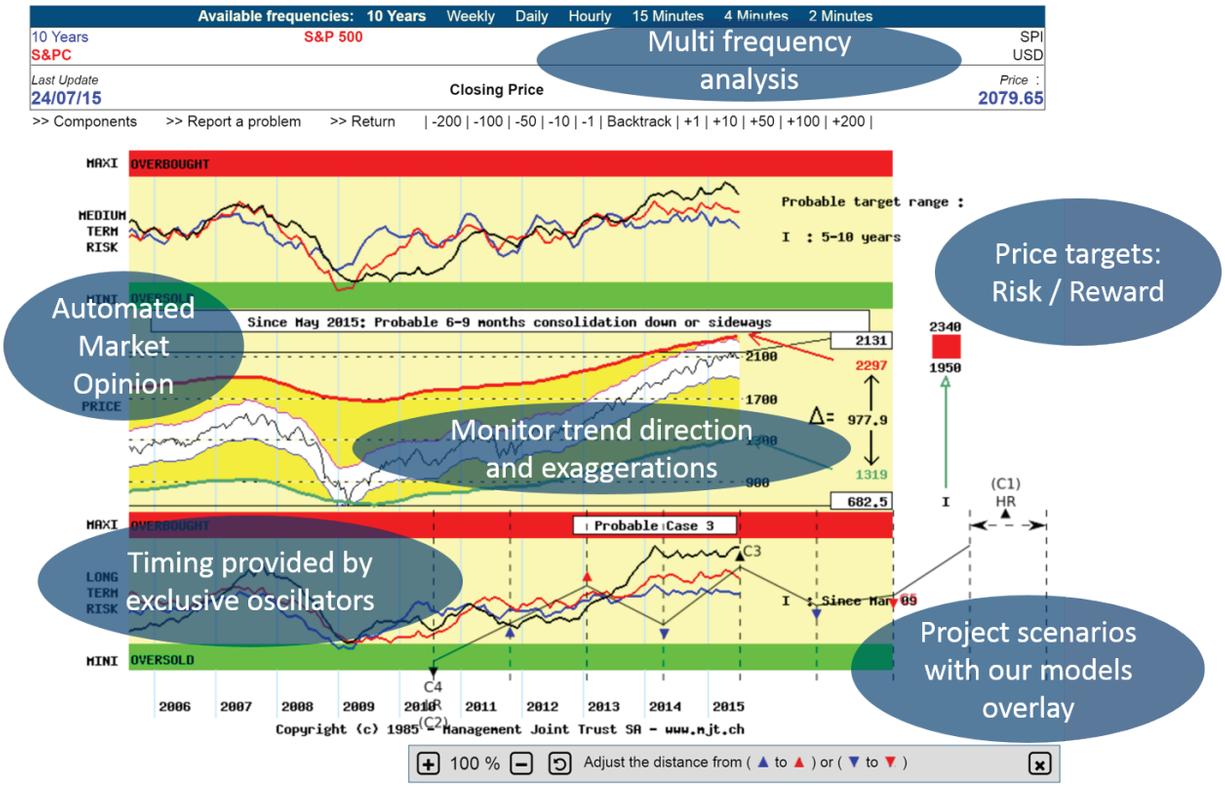
The positive trend for GBP/USD translates into a negative trend for the FTSE vs other markets. This is shown on this currency hedged ratio (like to like comparison of the graphs, where the currency effect is not taken into account) of the FTSE vs the MSCI World Index. On both the oscillator sequences we project (upper and lower rectangles), **we would expect the FTSE to underperfom the MSCI World into Q4 2017 and possibly H1 2018.** On the target side the ratio is currently working through the lower boundaries of our 'C' Corrective targets down (right-hand scale). Below that, it will turn impulsive to the downside. The 'I' Impulsive targets down we can calculate (not shown yet) using our historical volatility measure 'Delta' (here at 11.31 %; middle rectangle, right-hand side) would suggest **an underperformance of 5 to 10% towards year-end.**

Concluding remarks

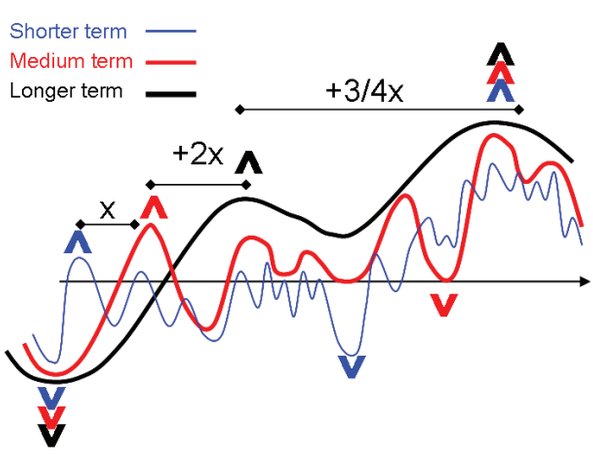
The uptrend, which started earlier this year on GBP/USD, now seems quite robust and we would expect it to continue towards next year. In the meantime, some retracement may materialize into August. We see this potential pull-back as a 'Buy the Dips' opportunity.

46/ METHODOLOGY

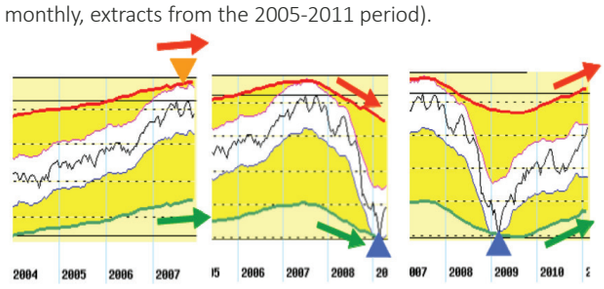
MJT's proprietary methodology uses Timing Oscillators to help investors position themselves either in an uptrend or downtrend. It will hence allow them to anticipate and project the future sequence of events. Coverage extends over 5'000 instruments, long term to intraday, across all asset classes. Relative 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.mjtsa.com)



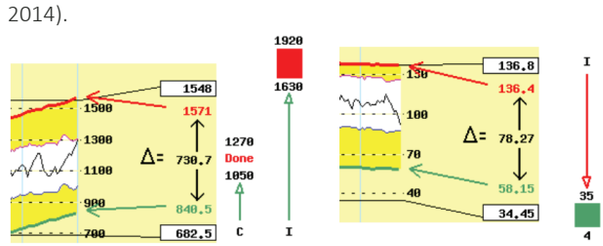
Timing oscillators: Different prices cycles are captured by our 3 Timing oscillators. Monitor how their relative positioning defines specific situations (Cases) to always know where you stand within the Trend (e.g. please see below the ideal Uptrend Case succession sequence)



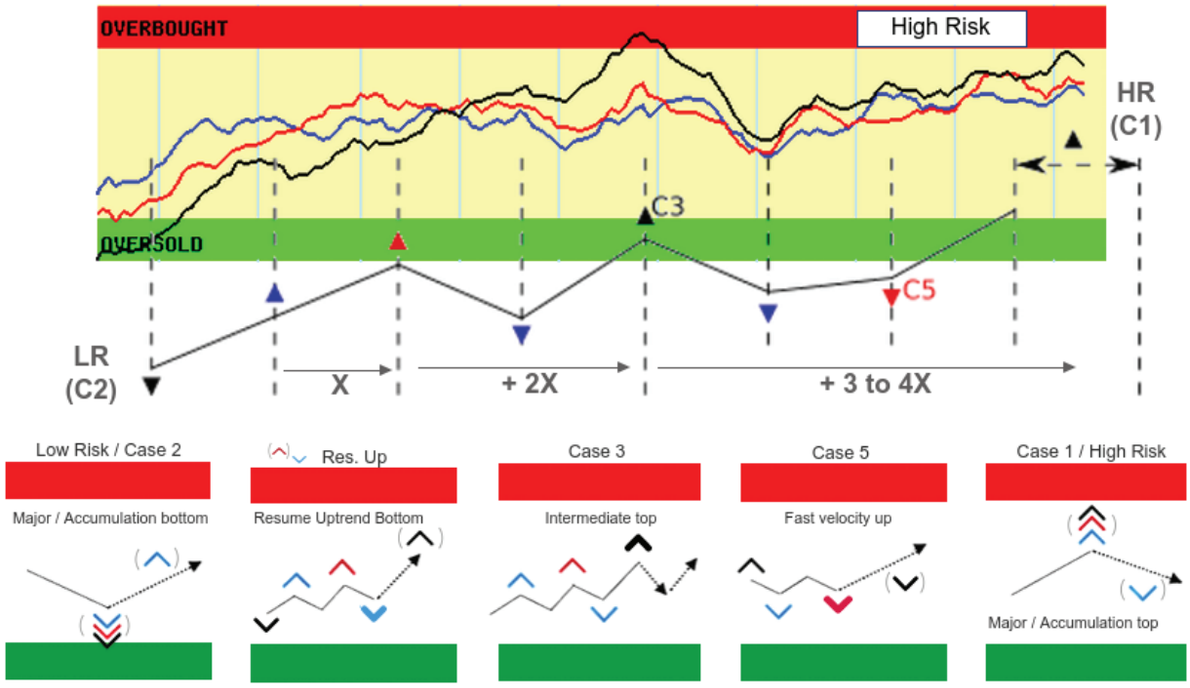
Trend direction: the direction of FinGraphs' large envelope will help you decide either to apply an uptrend or a downtrend model. Contacts between the wider and thinner envelopes will help you anticipate and confirm market turning points (e.g. S&P500 bi-monthly, extracts from the 2005-2011 period).



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).

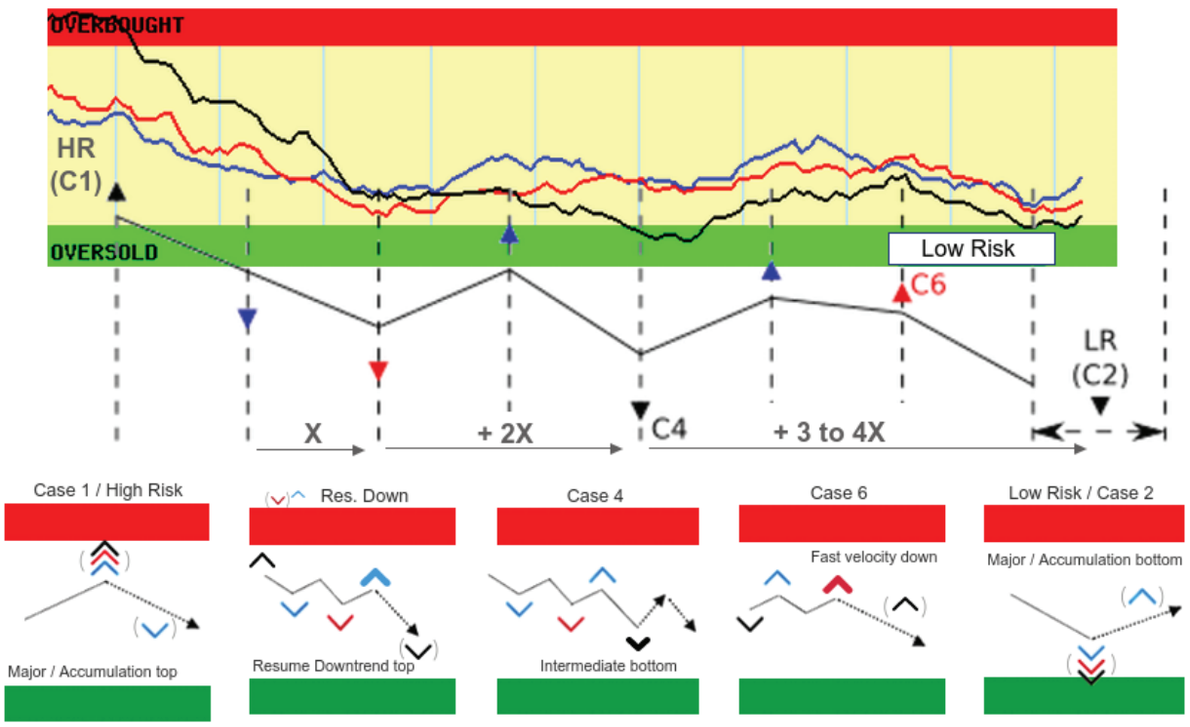


Ideal Uptrend Model



(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.

Copyright

MANAGEMENT JOINT TRUST SA

Disclaimer, No warranty, Copyright

Management Joint Trust SA is an editor of on-line financial graphics platforms as well as an independent research company. The information and graphics in this publication represent the opinion of Management Joint Trust SA and are not intended to be a forecast of future events and this is no guarantee of any future result. Nobody can predict the future and thus fluctuations of market prices (including market crashes). Past trends are not necessarily signs of future trends. Management Joint Trust SA warns you of the risks involved with any financial transactions (for example on stocks, bonds, raw materials). Derivatives or foreign exchange trades entail even greater risks. You need to be aware that chances of winning are in no way guaranteed and potential of losses may be very significant. As a reader of this publication or a user of our websites, you must take into consideration, as you select investments, of this uncertainty. This publication or any information provided through Management Joint Trust SA' s websites do not constitute a solicitation or offer, or recommendation to acquire or dispose of any investment or to engage in any other transaction. Any reference to a transaction, trade, position, holding, security, market, or level is purely meant to educate readers about our methodology as well as possible risks and opportunities in the marketplace and are not meant to imply that any person or entity should take any action whatsoever without first evaluating such action(s) in light of their own situation either on their own or through a professional advisor. To establish its statistical analysis, Management Joint Trust SA relies on data provided by first class outside providers; however, Management Joint Trust SA does not guarantee you the permanence of such supply, nor its content. More generally, Management Joint Trust SA, their members, shareholders, employees, agents, representatives and resellers or partners do not warrant the completeness, accuracy or timeliness of the information supplied in this publication or on its websites, and they shall not be liable for any loss or damages, consequential or otherwise, which may arise from the use or reliance of the any information or content in this publication or available on the Management Joint Trust SA's websites. Hence, neither you can nor may hold for certain analysis and interpretations provided in this publication or by our websites. Any financial transaction you may instruct is at your own risks. You can not claim nor obtain from Management Joint Trust SA compensation or indemnification for your damages (for example, incidental or consequential damages, losses, unrealised gains, liabilities, Management Joint Trust SA's service fee). If a person or entity does not believe they are qualified to make such decisions, they should seek professional advice. The prices listed are for reference only and are in no way intended to represent an actual trade. This information is not a substitute for professional advice of any nature, including tax, legal, and financial. While we believe the information contained herein to be accurate, all numbers should be verified by the reader through independent sources. Again, trading securities, options, futures, or any other security involves risk and can result in the immediate and substantial loss of the capital invested and every reader/recipient is responsible for his or her own investment decisions. The employees, officers, family, and associates of Management Joint Trust SA may from time to time have positions in the securities or commodities covered in its publications or on its websites. Corporate policies are in effect that attempt to avoid potential conflicts of interest and resolve conflicts of interest that do arise in a timely fashion. MJT is the owner of all its brands and websites (especially www.mjt.ch, www.mjtsa.com or any related websites). These are protected by intellectual property rights, among other copyright, trademark and competition rights. As reader of this publication or a user Management Joint Trust SA's websites, you acquire no rights on the various softwares, services, and information made available by Management Joint Trust SA. In particular, you do not acquire ownership rights. You undertake especially not to: a) Copy, save, reproduce, publish, post, transfer, transmit, exploit or distribute in any way data or components produced or any information or content made available by Management Joint Trust SA (including but not limited to its publications, its software, Internet pages and graphic displays); b) Mention or use in any non-purely private way the name Management Joint Trust SA or any of its trademarks, its or their logos, its or their texts and graphic displays; c) Interfere with or modify data or components published or edited by Management Joint Trust SA (including but not limited to its publications, software, Internet pages and graphic displays); d) Use Management Joint Trust SA in a way not consistent with its natural purpose; e) Access Management Joint Trust SA in an illegal way or without having filled the requested questionnaires, accepted these Terms and Conditions paid the requested fees. These Copyright and Trademark provisions mentioned above do not limit your right to print on paper, for your personal/private use only, pages of this publication or any other content produced by Management Joint Trust SA that you are interested in. Professional use of the printed pages is however strictly forbidden. Similarly you are forbidden to resell these pages. If you want to use any content produced and edited by Management Joint Trust SA not for your personal/private use, you must obtain in advance from Management Joint Trust SA a written authorization by writing to:

General Disclosure

This document or the information contained in does not constitute, an offer, or a solicitation, or a recommendation to purchase or sell any investment instruments, to effect any transactions, or to conclude any legal act of any kind whatsoever. The information contained in this document is issued for information only. An offer can be made only by the approved offering documentation, especially the prospectus of the Fund mentioned herein. The prospectus may only be distributed in accordance with the laws and regulations of each appropriate jurisdiction in which any potential investor resides. The investments described herein are not publicly distributed.

This document is confidential and submitted to selected recipients only. It may not be reproduced or passed to non-qualifying persons or to a non professional audience.

This document is issued by Diapason Commodities and Currencies (DC&C) / Diapason Commodities Management UK LLP ("Diapason UK"). Diapason UK is authorised and regulated by the Financial Conduct Authority.

This document is only made available to professional clients and eligible counterparties as defined by the Financial Conduct Authority. The services of Diapason may be restricted in some jurisdictions to persons who are professional clients and institutional investors. In such case, they are not available to retail clients and are not subject to the same protections afforded to retail clients. To the extent that this message concerns such products and services, then this message is communicated only to and/or directed only at professional clients and institutional investors and the information in this message about such services should not be relied on by any other person. For distribution purposes in the USA, this document is only intended for persons who can be defined as "Major Institutional Investors" under U.S. regulations. Any U.S. person receiving this report and wishing to effect a transaction in any security discussed herein, must do so through a U.S. registered broker dealer. The investment described herein carries substantial risks and potential investors should have the requisite knowledge and experience to assess the characteristics and risks associated therewith. Accordingly, they are deemed to understand and accept the terms, conditions and risks associated therewith and are deemed to act for their own account, to have made their own independent decision and to declare that such transaction is appropriate or proper for them, based upon their own judgment and upon advice from such advisers as they have deemed necessary and which they are urged to consult. Diapason disclaims all liability to any party for all expenses, lost profits or indirect, punitive, special or consequential damages or losses, which may be incurred as a result of the information being inaccurate or incomplete in any way, and for any reason. Diapason, its directors, officers and employees may have or have had interests or long or short positions in financial products discussed herein, and may at any time make purchases and/or sales as principal or agent. Certain statements in this presentation constitute "forward-looking statements". These statements contain the words "anticipate", "believe", "intend", "estimate", "expect" and words of similar meaning. Such forward-looking statements are subject to known and unknown risks, uncertainties and assumptions that may cause actual results to differ materially from the ones expressed or implied by such forward-looking statements. These risks, uncertainties and assumptions include, among other factors, changing business or other market conditions and the prospects for growth. These and other factors could adversely affect the outcome and financial effects of the plans and events described herein. Consequently, any prediction of gains is to be considered with an equally prominent risk of loss. Moreover, past performance is not a guide to future performance and investment may result in loss of capital. As a result, you are cautioned not to place undue reliance on such forward-looking statements. These forward-looking statements speak only as at the date of this presentation. Diapason expressly disclaims any obligation or undertaking to disseminate any updates or revisions to any forward-looking statements contained herein to reflect any change in Diapason's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The information and opinions contained in this document are provided as at the date of the presentation and are subject to change without notice.

Electronic Communication (E-mail)

In the case that this document is sent by E-mail, the E-mail is considered as being confidential and may also be legally privileged. If you are not the addressee you may not copy, forward, disclose or use any part of it. If you have received this message in error, please delete it and all copies from your system and notify the sender immediately by return E-mail. The sender does not accept liability for any errors, omissions, delays in receipt, damage to your system, viruses, interruptions or interferences.

Diapason Commodities and Currencies (DC&C)
17 Canvendish Square
London W1G OPH
UK
+44 20 7290 2260

Management Joint Trust S.A.
Rue de Hesse 1
P.O.Box 5337
1211 Geneva 11
Switzerland
+41 22 328 93 33

THE CAPITAL OBSERVER

JULY / 2017

A DC&C publication,
featuring MJT's timing methodology

DC&C
DIAPASON CURRENCIES & COMMODITIES

MJT