6/ Mapping the markets

When we last published on the 13th of November, we expected a further bounce in risk assets during the 2nd half of November. We considered it as another exit opportunity, and warned that by late November / early December, risk assets and equities should resume their downtrend, probably towards February / March. These projections have proven correct for now.

Going forward, we expect the risk-off environment to continue, probably into the 1st half of January in first instance. Until then, the S&P500 may dip below 2500, while the EuroStoxx 50 could reach below 2900. Following that, some risk assets may start to rebound, yet further retests to the downside may still materialize on many risk assets into February, and perhaps even until early March. Then, from mid/late Q1, we intend to gradually turn more pro-cyclical given the strong bounce on equities and risk assets we currently expect into the Spring.

In the meantime, over the next 2 months, we believe the US Dollar should resume its uptrend. Some Emerging Markets and Commodity currencies have already started to weaken again (e.g. BRL, ZAR, INR, KRW, TWD, AUD, CAD), others, as well as Majors such as the Euro and the Yuan, could soon follow suit. Indeed, we expect the US Dollar to perform a last leg up vs most currency towards late January / February (except for the Yen, which at some point may start to strengthen on risk-off considerations). Following that, the US Dollar probably retraces into the Spring.

Given this strong Dollar scenario and the risk-off environment we expect into January at least, we would continue to favour the US over other regions. Indeed, over the next few weeks, we believe the negative newsflow could shift back to China and Emerging Markets, while Europe also remains under pressure given the many political issues which are still outstanding. These risks abroad could reignite the positive feedback loops seen this Summer on the US Dollar, as funds flow back to the US from Equity and Credit markets in Europe and Emerging markets. More generally, given the risk-off environment we anticipate, Flight to Safety flows could intensify once more, out of Corporate and Sovereign Credit, out of Equities, out of Commodities, and more generally out of risk assets, and into Treasuries, Confs, JGBs or the Bund. Benchmark bonds yield should hence continue to retrace, possibly by another 20 to 30 basis points on the US 10 Years, thereby briefly leading to inversion at some point during Q1. By then, the FED rhetoric may soften an additional notch, laying ground to the strong risk assets rally and possible yield curve steepening we expect during the Spring.

Main Equities & Government Bonds

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Main Equities	US S&P500	Since early December, US Equity markets have entered a new leg down, possibly into February/March, and the 2'500 - 2'370 range on the S&P500.	US Equity markets may find support during February/March. A bounce could then materialize into the Spring.
	Europe EuroStoxx50	European markets have also been resuming lower since early December, probably towards mid Q1 and potentially towards the 2'900- 2'850 range.	European Equity markets may find support during February/March. A bounce could then materialize into the Spring.
	EMs MSCIEM USD	EMs have started to resume down early December, probably towards February/March. We would expect new lows, probably 10% below current levels.	Emerging markets may find support towards February/March, and initiate a bounce into the Spring
Treasuries	US10Y Bond prices	Treasuries have been accelerating up since early November on Flight to Safety flows. 10Y Treasury yields may retrace towards 2.6 - 2.4% into mid Q1.	From mid/late Q1, however, we expect Treasury yields to bounce along with risk assets, probably into mid 2019.
	Germany 10Y Bund prices	Bund Futures have been accelerating up since early November, and should continue higher into February / March. We expect 10Y Bund yields to move back below 0% by then.	From mid/late Q1, however, Bund yields may bounce into the Spring along with risk assets.

Legend:	Strong Underweight	Underweight	Neutral	Overweight	Strong Overweight

Main Equities

World markets
p 15, 16, 17, 18, 48

Following a choppy and volatile correction up between late October and late November, Equities have since resumed their downtrend, probably towards the first half of January, and then possibly again into February and perhaps March.

Main Regional picks
p 15, 16, 17, 18, 48, 51-55

Most equity markets seem Oversold on a relative basis vs the US, yet over the next 2 to 3 months, the US should continue to benefit from positive inflows from Europe and Emerging Markets while the US Dollar remains strong. From mid/late Q1, this situation may reverse temporarily as the US Dollar probably retraces into the Spring.

Emerging markets
p 15, 16, 17, 18

Emerging markets are probably resuming their downtrend towards mid Q1 both on an absolute and relative basis. Indeed, they could also suffer from negative feed-back loops triggered by a stronger US Dollar.

Volatility

Volatility probably continues higher, potentially into early Q1 as risk assets continue to correct. We expect a first peak during the 1st half of January and then possibly a second one in February.

Government Bonds

US & European Benchmarks
p 41, 42, 43

US Treasury yields topped-out early October as planned and have since been correcting down rapidly on Flight to Safety flows. We expect them to move lower over the next couple of months, probably by another 20 to 30 basis points. German Bund yields also topped out in October, on lower highs than the ones achieved in Q1 this year and could move back to negative territory over the next couple of months.

Equity to Bond Ratios, Fixed Income Dynamics & Commodities

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Equity / Bonds	US	The ratio should continue to correct down until February/March. Equities should underperfom by 5 to 10%.	From mid/late Q1, the ratio could bounce during the Spring along with equities and yields.
	Europe	The ratio should continue to correct down until February/March. Equities should underperfom by 5 to 10%	From mid/late Q1, the ratio could bounce during the Spring along with equities and yields.
Duration		US and European yield curve spreads should flatten once more into mid Q1, while long term yields retrace	From mid/late Q1, Yield curves could start to steepen. Long term yields could bounce again into mid-year.
Credit		Corporate spreads are resuming higher, probably towards February/March. Sovereign spreads should follow soon.	Credit spreads retrace during next Spring, yet the Credit Cycle has probably turned down and we expect to see much higher Credit Spreads towards end 2019.
TIPs/Treasuries		Inflation expectations (TIPs vs Treasuries ratio) probably continue to drop towards February/March.	The TIPs vs Treasury ratio could bounce into the Spring, yet then probably continues lower until end 2019.
Oil		Oil continues to sell-off, probably towards January, and perhaps towards February/March. Brent could reach down into the mid 50s.	Oil could stabilize towards mid Q1 and start to bounce into the Spring.
Industrial metals		Industrial metals should resume their downtrend, probably towards February/March. They may move 10% below current levels by then.	From mid/late Q1, Industrial metals could see a bounce during the Spring
Gold		Gold could retrace back down to its Sunmmer range, at or slightly below 1'200 USD/oz, as the US Dollar strengthens into mid/late Q1.	From mid/late Q1, Gold should resume higher into the Spring as the US Dollar retraces.

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

Equity to Bond Ratios

US & Eurozone Markets

The further declines we expect on equities over the next couple of months and the retracement we expect on treasury yields should depress the Equity to Bond ratios and we expect the former to underperform the latter by 5 to 10% during this period.

Fixed Income Dynamics

Duration (10Y - 3Y/3M)
p 38-41

Longer term treasuries in the US and Europe are correcting down, while yields curves should flatten once more towards mid Q1. This should favor duration over the next couple of months.

Credit
p 27-32

The Credit cycle has turned. Corporate spreads have started to resume lower with equities in October, while Sovereign spreads should soon follow suit as the US Dollar enters one more leg up, probably towards early/mid Q1.

Rate Differentials

The US rate differential vs other regions is quite extended, and may have started to retrace since early November, yet we expect it to retest up, at worst hold, until mid/late Q1.

Tips

TIPs have started to correct up from early November, yet they may retest down once more during January and February as real interest rates may retest their recent highs (not the case for nominal rates, which should continue to correct). Indeed, the TIP vs Treasuries breakeven ratio is retracing quite quickly and should continue to do so into January / February.

Commodities

Oil
p 56, 57

Oil topped out as expected early October and has since been retracing quite aggressively. We expect it to continue lower, probably towards early/mid January, when it could start to bounce. A further retest down into February / March is also possible. We expect Brent to reach below 57 USD/barrel by then, possibly extending into the low 50s. On WTI, we are eyeing levels below 50 and possibly down to the mid 40s.

Industrial metals
p 21

Industrial Metals are also resuming lower. We expect them to continue this downtrend into early 2019, possibly towards February (5 to 10% of additional price risk). Copper could reach back down below its Summer lows and settle between 5'800 and 5'400 USD/ton (LME) before it stabilizes and starts to bounce during the Spring.

Gold & PMs
p 22

We are still prudent or Gold and Precious Metals despite the risk-off environment we are in and despite their decent bounce since August. Indeed, we believe that Gold and PMs are still very sensitive to any US Dollar strength going forward. Hence, we expect Gold for example to retest down below 1'200 USD/oz over the next couple of months, possibly testing important support towards 1'150 – 1'130. If these levels were to break, we see little support until Gold reaches the symbolic 1'000 mark. Although, this negative scenario is rather unlikely, we would continue to avoid Gold and Precious Metals for now on risk vs reward considerations.

Agriculture
p 22

Agricultural Commodities are typical late cycle commodities. They usually outperform other more cyclical commodities such as Oil or Industrial Metals in a cycle downturn. This has been the case since October. On an absolute basis, however, we believe they may retest down one last time with other commodities towards mid Q1.

Foreign Exchange

		Next 2 months	3 to 6 months ahead
USD vs	EUR	We remain bullish on the Dollar over the next 2 months, and believe EUR/USD should soon resume lower, probably towards 1.11 or slightly below.	From mid/late Q1, the US Dollar should make an intermediate top and start retracing down into the Spring, EUR/USD rebound target: 1.15- 1.19.
	GBP	Cable should continue lower over the next couple of months, probably towards 1.23 in first instance, perhaps below.	GBP/USD may remain under pressure into late Q1 and even early Q2, theoretically it could test 1.20 by then.
	JPY	USD/JPY could continue to consolidate down, probably towards early Q1 next year, possibly down to the 111-109 range.	During Q1, USD/JPY may find support and attempt a retest up of recent highs into the Spring.
	CHF	During December, USD/CHF may initiate a last move up, possibly towards early/mid Q1 and towards the 1.00 - 1.02 range.	During Q1, USD/CHF could top out and enter a consolidation down during the Spring, it may then find support towards 0.97.
EUR vs	GBP	EUR/GBP is resuming higher, the move should continue over the next couple of months, probably towards 0.93 in first instance.	EUR/GBP probably continues higher into late Q1 at least, probably even during the Spring.
	JPY	EUR/JPY resumes lower, probably towards January and 125, perhaps below.	EUR/JPY should find support towards mid Q1 and start to bounce during the Spring.
	CHF	EUR/CHF is resuming lower. It may reach below 1.10 over the next couple of months.	EUR/CHF should find support towards mid Q1 and start to bounce during the Spring.
GBP vs	JPY	GBP/JPY continues lower, probably towards January and the 140 - 135 range.	GBP/JPY remains under pressure probably until late Q1 and then bounces slightly during the Spring.
	CHF	GBP/JPY continues lower, probably towards January and the 1.24 - 1.20 range.	GBP/CHF remains under pressure probably until late Q1 and then bounces slightly during the Spring.

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

US Dollar

We believe the US Dollar has turned up for this cycle and that it will continue to strengthen in successive stages towards mid/late 2019. Shorter term, the Dollar Index is starting to resume higher. The move should continue probably towards January and perhaps into February, before it retraces down into the Spring.

Euro
p 49, 50

EUR/USD should continue to resume lower between now and late November. We expect it to move down towards January, perhaps February and initially test below the 1.11 levels. From mid/late Q1, it may then start to bounce into the Spring. Vs CHF, EUR clearly reversed down this Spring. Following its bounce since September, it is now resuming lower once again and could move to test support around 1.10 over the next couple of months. EUR/GBP has recently been resuming higher. We expect it to continue, possibly towards 0.93 by mid/late Q1. Obviously successful conclusion (or not) of Brexit negotiations, approvals are going to have a strong impact on the pair and its volatility.

Yen
p 50

USD/JPY has been consolidating at high levels since early October. We expect it to make another attempt to the downside between now and January, possibly testing into the 111 – 109 range. Following that, from mid/late Q1, it may bounce back into next Spring and could retest its recent highs. Vs the Euro and Sterling, the Yen has started to strengthen again and could continue to do so until early next year.

Sterling
p 55

The fate of Sterling is hanging onto the current Brexit process. Cable (GBP/USD) is currently accelerating lower, probably towards 1.23 and perhaps below over the next couple of months. At the same, EUR/GBP is resuming higher and could reach up to 0.93 over the next couple of months. Sterling also remains weak vs CHF or the Yen, probably towards mid/late Q1.

Oil & Commodities currencies
p 20

Commodity currencies (our equal weighted portfolio containing AUD, BRL, CAD, NOK, NZD, RUB, CLP and ZAR) rebounded vs the US Dollar between September and November. We believe they should now resume lower and possibly retest their late Summer lows, probably by mid Q1. We expect them to retrace vs EUR, CHF or JPY, although they may not make new lows vs EUR.

Asian currencies
p 19

Our Asian Growth equal weighted portfolio (CNY, INR, KRW, THB and TWD) shows a similar profile as our Commodity currencies portfolio above, yet with less volatility (i.e. it is more defensive on a relative basis). We also expect to resume lower vs EUR, CHF or JPY towards mid Q1. We however believe it will resist better and outperform our Commodity portfolio above during this period.

Equities Markets Segmentation

Core Sector Weightings			Next 2 months					3 to 6 months ahead				
US Sectors - S&P500 (general comment)			**A very Defensive allocation probably until the 1st half of January**					**From mid January we will neutralized some positions, yet will remain rather defensive. We will gradually add risk towards mid/late Q1**				
Sectors	Proxy ETF symbols	Benchmark-weights	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Technology	XLK	21%										
Healthcare	XLV	15%										
Financials	XLF	14%										
Discretionary	XLY	10%										
Communication	XLC	10%										
Industrials	XLI	10%										
Staples	XLP	7%										
Energy	XLE	6%										

			Next 2 months					3 to 6 months ahead				
European Sectors - Europe Stoxx 600 (general comment)			**A very Defensive allocation probably until the 1st half of January**					**From mid January we will neutralized some positions, yet will remain rather defensive. We will gradually add risk towards mid/late Q1**				
Sectors	Index symbols	Benchmark-weights	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Banks	SX7P	13%										
Industrials	SXNP	12%										
HealthCare	SXDP	11%										
Pers. & HH Goods	SXQP	9%										
Food & Beverage	SX3P	7%										
Insurance	SXIP	6%										
Energy	SXEP	6%										

Main Sectors Allocation
p 21, 33, 44, 52, 54, 57

Please read the detailed allocation comments in our time frame boxes above.

Until the first half of January, we will remain very defensive given the risk-off environment we expect. We will also avoid Financials given the retracement we expect on interest rates, and the further credit deterioration we foresee, as well as Energy given that we expect the current Oil sell-off to continue, probably into early next year.

From mid January, we will neutralize most of our underweight positions, yet will keep a defensive bias. Indeed, we believe that further downside retests are possible during February and perhaps even March. Gradually towards mid/end Q1, we will start adding risk again to our sector allocation in order to position for the equity market bounce we expect into the Spring.

Countries allocation

Core Countries Weightings			Next 2 months					3 to 6 months ahead				
All World Country Index Currency hedged (general comment)			**Until January, we will overweight the US and underweight other markets, EMs and China especially (Defensive + positive USD)**					**From mid January, we will neutralize many of our underweight positions, yet will keep a defensive bias, probably until mid/late Q1**				
Countries	Index symbols	Benchmark-weights	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
US	S&P 500	52%										
Canada	TSX	3%										
Europe	SXXP	21%										
-UK	FTSE	6%										
-France	CAC40	3%										
-Germany	DAX	3%										
-Switzerland	SMI	3%										
Japan	N225	8%										
China	MSCICN	3%										

Main Country Allocation
p 15-18, 48, 51-55

Please read the detailed allocation comments in our time frame boxes above.

Until the 1st half of January, our allocation remains risk-off and focused on USD strength. We are hence overweighting US markets vs the All Country World Index in US Dollar terms and underweighting most other markets against them. China and Emerging markets could be particularly impacted by the new leg up we expect in the Dollar.

From mid January, we will start neutralizing some of these positions, bringing most markets back to neutral. We do expect some downside retests on risk assets, possibly during February, perhaps even March, and would hence continue to overweight the US and perhaps Switzerland (the EUR/CHF weakness we expect may be behind us by then). Gradually, towards mid/end Q1, we will rotate back into other regions in order to participate in the rebound we expect for risk assets into the Spring.

Note: the country and regional allocations in the table above are considered hedged for currency risk, ie. the relative performances are anticipated in local currency (except for the S&P500 vs the All Country World Index as both are denominated in US Dollars).

Core factors and Themes

Core Factor/Themes Weightings	**Next 2 months**					**3 to 6 months ahead**				
General Comment	**Our Factors and Themes Allocation continues to avoid high beta risk into the 1st half of January.**					**From mid January, we will neutralize some of our underweight positions, yet will keep a defensive bias, probably until mid/late Q1**				
Themes	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Nasdaq 100 (vs S&P500)										
DJ Industrial (vs S&P500)										
Russell 2000 (vs S&P500)										
Wilshire REITs (vs S&P500)										
US Value (vs US Growth)										
Southern EuroZone (vs Stoxx EZ 600)										
EuroZone Small Cap (vs Stoxx EZ 600)										
Japanese Small Cap (vs N225)										
GDX - Goldmines										
XME - Diversified Mining										

Core factors and Themes
p 43-44

Into the 1st half of January, we will continue to avoid high beta plays and overweight defensive factors such as REITs vs the S&P500. We will also avoid trades which are countertrend to the US Dollar such as Commodities.

From mid January, we will neutralize some of our underweightings, will remain overweight defensive (REITs) as we expect some downside retests on risk assets during February, perhaps March, and will remain prudent on Southern Europe and Commodities. Gradually, from mid/late Q1, we intend to turn more risk prone and pro-cyclical in order to participate in the bounce we then expect into the Spring.