

THE CAPITAL OBSERVER

October 2020



the technical analyst
AWARDS 2018
WINNER

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



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THE CAPITAL OBSERVER

A Monthly Macro and Asset Review
Featuring MJT's Timing Methodology

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*The desire of gold is not for gold.
It is for the means of freedom and
benefit.*

Ralph Waldo Emerson

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12 / Gold's fundamentals and primary price factors show some crosscurrents for Q4 but improve thereafter - Gold has been consolidating since early August, something that promoters of the yellow metal have struggled to explain. That decline has happened despite the rise in COVID-19 in Europe and elsewhere, as well as the threat of a "contested election" in the US presidential races within a month or so. That decline has taken hold despite spotty employment prospects of the US labor force. In much of this situation, that gold price decline has been due to the fundamentals of gold, and its relationship with interest rates and the US Dollar. Those aspects need to be addressed. It is the delta of the year-over-year gold production, which has been driving the major changes in gold price trends since at least the 1970s. In the final analysis, gold is impacted by systemic liquidity as much as the US Dollar is. Gold is known as the anti-Dollar, and it does make sense that there is a tight inverse correlation between Gold and the US Dollar (DXY as proxy). Moreover, both instruments are driven by changes in liquidity flows, especially those coming from the US Treasury's account at the Federal Reserve, popularly known as Treasury Cash Balance (TCB). Gold shows almost perfect inverse covariance between it and the DXY. Our take from this liquidity model is that the Dollar (DXY) has found a temporary bottom, and is now bound for higher levels in Q4 2020.

15 / Timing and Tactical Insight - Gold's uptrend probably extends into next Spring - Gold's strong uptrend since August 2018 reached an important intermediate top mid Q3. It has since been consolidation down in the 2'000 – 1'800 USD/oz range. This counter-trend move may continue into early/mid November, yet should hold above 1'800 USD/oz. Gold then resumes higher again towards year-end and then next Spring as US long term Treasury yields and the US Dollar remain under pressure. Upside targets over the next couple of quarters are probably towards the 2'200 – 2'400 USD/oz range. Silver is following similar dynamic, yet with more volatility. It should also continue to consolidate down and underperform Gold into November. We believe levels around 21 USD/oz will hold, and by mid/late November, Silver should start to rise again into next Spring and towards levels in the mid 30's USD/oz. Gold and Silver mines are following similar dynamics and could still see strong upside potential from mid Q4 into next Spring. As for Platinum and Palladium, they could continue to lag into early/mid Q1 but could then offer an interesting alternative.

22 / Equities resume the bull phase after a short correction as the next liquidity drought brings more significant pain until late November - The seasonality of the equity indices has been remarkably consistent until early this year, when the COVID-19 panic threw all historic patterns out of the window. However, we have noticed that the markets are starting to groove back to their historic norms. The Treasury Cash Balance (TCB) liquidity flows that we featured above is actually just a single component of the liquidity flows that emanate from the Federal Reserve and the US Treasury. A broader measure of liquidity flows (which includes government budget outlays) adds more dimension and details to what can be expected from the price of risk assets in the near-term. Equity markets may start correcting lower toward late October, as bond yields fall on disappointing outlook of further COVID-19 stimulus and less than stellar tech stocks earnings. The US Elections may also play a part in this correction process. The next episode of seasonal liquidity drought could bring lower risk assets prices until late November – early December. At The Capital Observer, we have made it a point to explain how the largess from the Fed and the US Treasury makes equity and bond markets tick. We continue with that objective in this month's articles.

25 / Timing and Tactical Insight - Equities could see some retracement into November, but then rise into next Spring - Supported by the huge liquidity injections since March, equity markets have probably started a new long term uptrend. We expect them to rise into next Spring and then perhaps into 2022. Both the S&P500 and the EuroStoxx 50 may reach above 4'000 over the next 18 to 24 months. In the meantime, however, a first leg up is currently probably being completed and we would expect some consolidation, probably at high levels (3'200 support of the S&P500, 3'000 on the EuroStoxx50) into mid/late November. Following that, the uptrend probably resumes into year-end and then next Spring. The pattern on VIX seems to confirm this scenario with a series of declining highs since March, and a possible further rebound (yet below previous ones) into mid/late November. It then resumes lower into early next year and probably to below 20. On the factor and sector front, breadth and cyclical sectors such as Financials remain weak into mid Q1 at least. Growth consolidates vs Defensive profiles into mid/late Q4, but then outperforms towards year-end and into next Spring. Vs more Cyclical profiles, this outperformance is already starting and could extend into early, perhaps Spring next year.

33 / China bounces back strongly – what that means to the Rest of The World - Many observers think that the COVID-19 virus is something that the global economy will never recover from. Even if US GDP recovers (most recent estimate has US GDP rising to circa 36% in Q3 2020-- just 3% short to get back to where the economy was pre-COVID-19. Many people believe that there's an awful lot of pain suffered by the economy which will manifest as companies run out of capital or struggle to recover under the new debt loads. However, one may also believe in the contra factual – that modern economies are robust, and even if there are problems going forward, we will be able to work through them. One can be too optimistic, but if one looks at China, maybe we all have reasons to be optimistic, after all. ? We're interested in China for several reasons, one of which is the description of that possible future path for the rest of the world. The other is that it's the second largest economy on the planet currently has increased demand, and that will help boost the global economy. Finally the importance of the China growth data is that it serves as proof that economic recovery from the ravages of COVID-19 is not impossible.

5/ Executive Summary

35 / Timing and Tactical Insight - China outperforms into year-end as equities consolidate, yet also remains strong on an absolute basis into late next year - The MSCI China Index could rise a further 10 to 20% into next Spring, while the Shanghai Composite may reach up to 4'000 or 10 to 15% above current levels. In the meantime, however, we expect Chinese equity markets to consolidate at high levels into mid/late Q4, yet, they will probably prove more resilient than Global markets, and outperform them during this period. Some of this outperformance may then be given up into the Spring, but, more generally, Chinese equity markets remain strong into late next year. On the currency front, we expect USD/CNY to bounce slightly over the next month or so as the Dollar is probably more defensive than the Yuan, but then to resume lower into next Spring, and to below 6.5. Within China, we would favor more domestic indexes during Q4, as they are more counter-cyclical (e.g. the CSI 300 Index or the SME ChiNext100 Index)- We would then switch back to more pro-cyclical ones from late this year / early next year, and probably towards next Spring (e.g. the MSCI China Index, the CSI 300 Information Technology index or the MSCI Consumer Discretionary Index).

42 / Copper prices will continue to rise on the back of better global economic prospects, led by China - US interest long-term interest rates declined to the levels seen in the aftermath of the 2008 global financial crisis during Q1 and Q2 – that is very good for copper prices. Fiscal and monetary policy stimulus rose to unprecedented levels since March. The Fed's willingness to tolerate inflation above the 2% target rate, or any further weakness in the US dollar, and the tidal wave of liquidity were very positive factors for the price of copper and other commodities. We believe this will continue. Furthermore, if the 2008 GFC provides an example for the copper market, we could see far higher prices for the red metal in the coming months and quarters. China's economic recovery (discussed in another article) is also a bright spot for copper and other commodities. Copper and other base metals should continue to trade higher over the next few quarters even if we see some short term correction in November.

44 / Timing and Tactical Insight - Dr Copper is seeing a promising recovery since March. Will it maintain its momentum into next Spring? - Copper has performed a strong rebound since April and has made it above our Corrective resistance levels to the upside, i.e. into Impulsive territory on our Weekly graph. It has now probably reached an intermediate top and could correct vs other less cyclical industrial metals and Gold into late this year. Copper mines have also been quite dynamic, should also correct during Q4, yet could resume their uptrend from late this year into next Spring and new highs. Some doubts persist as to the strength of this cyclical recovery from late Q4 / early Q1 into Spring next year. Indeed, on a relative basis, the Copper to Gold ratio, or the ratio of Copper mines vs Goldmines may take some time before resuming their uptrend during Q1. This may imply that our expectations of further upside momentum into next Spring on these ratios may be deceived, and that they could continue to underperform for much of 2021. On an absolute basis, however, we expect Copper and Copper mines to tag along other risk assets at least, and following some retracement into Q4, make new highs towards next Spring.

50 / Splicing the markets - The US Dollar may bounce during November, yet probably drops again thereafter into the Spring - The USD may bounce from late October into the November. EUR/USD could reach back to the 1.16 – 1.15 range, while Cable could fall back to between 1.27 and 1.23. If these dips materialize, we believe these could be interesting Buy the Dips opportunities (probably towards late November / early December) as the following leg-up could travel into the Spring with EUR/USD reaching the mid/high 1.20s, while GBP/USD approaches 1.40. Vs more defensive currencies such as the Yen, the US Dollar may bounce slightly during November, but then also drops back to new lows into early next year in first instance.

6/ Mapping the markets

Last month, we expected risk assets and equities to stabilize towards late September and initiate a recovery / upside retest rally into mid October. This has pretty much been the case. We also expected a short bounce on yields and cyclical themes (which did hold up), a further upside extension on EUR/USD, potentially towards 1.22, and a resume uptrend situation for Gold and Silver (a rebound did materialize on these, yet it was weaker than what we had anticipated). We then expected a new period of retracement on risk assets from mid/late October into November. It may have just started, but for now is still waiting to be confirmed.

Going forward, we do indeed expect a more defensive environment into early, perhaps mid November. Equity markets and most risk assets could retrace down to their late September lows, perhaps marginally below them. Downside risk on the S&P500 is potentially slightly below 3'200, while the EuroStoxx 50 could revisit the 3'000 – 2'900 range. Defensive sectors seem to outperform both Growth and Cyclical themes until then, while geographically China, as a countercyclical play, probably outperforms developed markets and other emerging markets. Gold and Silver could also retrace down towards their late September lows, yet Gold probably holds above 1'800 USD/oz and Silver above 21 USD/oz. EUR/USD could retest down towards the 1.16 – 1.15 range and USD/JPY should manage to hold up in the 105 – 107 range. Long term Treasury yields should roll-over again and potentially approach their March lows.

From mid/late Q4, we then expect risk assets to gradually recover and resume their uptrend, probably from mid/late November, perhaps December. Yet, yields could remain under pressure until early, perhaps late Q1 next year. This, we believe, could initially be an environment for Growth trades once again, as well as for Gold and precious metals, or the Yen. EUR/USD may then follow suit and from late this year may attempt a new leg up, potentially towards new highs in the mid 1.20s next Spring. More cyclical themes could then also begin to recover, but will probably lag until yields gradually bottom out during Q1.

Main Equities & Government Bonds

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Main Equities	US S&P500	Following its recent bounce, the S&P500 may retrace down into early/mid November towards 3'200 - 3'100 and then gradually resumes its uptrend into year-end.	From late Q4, we expect the S&P500 to resume its uptrend towards next Spring and towards 3'800 - 4'000.
	Europe EuroStoxx50	Following its recent bounce, the EuroStoxx 50 may continue to retrace down into early/mid November towards 3'000 - 2'900 and then gradually resumes its uptrend into year-end.	From late Q4, we expect the EuroStoxx 50 to resume its uptrend towards next Spring and towards its February highs.
	EMs MSCIEM USD	Following their recent upside retest, Emerging Markets could retrace down into early/mid November with 10% risk and then gradually resume their uptrend towards year-end.	From late Q4, we expect the MSCI Emerging Markets index to resume its uptrend towards next Spring and to above its early 2018 highs.
Treasury	US10Y Bond prices	The US10Y Treasury yield probably continues to roll-over again, from late October at the latest and into year-end.	The US10Y Treasury yield could remain under downside pressure into early next year, perhaps into mid/late Q1 and make new lows.
	Germany 10Y Bund prices	The German 10Y Bund yield is rolling over again and this leg down continues into year-end in first instance.	The German 10Y Bund yield could remain under pressure into early next year, perhaps even mid/late Q1 and approach its March lows.

Legend: Strong Underweight Underweight Neutral Overweight Strong Overweight

Main Equities

p 22-24, 25-27

Following their bounce since late September, we expect a new period of retracement on equity markets, probably into early/mid November. Depending on markets, we expect downside risk towards, and perhaps marginally below, the late September lows. Equity markets then recover from mid/late November and rise into next year.

Main Regional picks

US equity markets may outperform European ones in US Dollar terms into early/mid November as the US Dollar rebounds. During this period, European markets may hold up in nominal terms, but the effect of a stronger US Dollar will lead them to underperform in US Dollar terms. From late Q4, EUR/USD could then gradually resume its uptrend and European markets with it, on a relative basis in US Dollar terms at least.

Emerging markets

Emerging Markets will probably retrace into November and, except for China, which is rather countercyclical, underperform developed markets. They should then recover from late Q4 and during Q1 next year.

Volatility

p 28

VIX could bounce into November, but probably doesn't break above previous spikes (yet could approach the levels of its late September one around 35). It then resumes lower from mid/late November into year-end and early Q1. It may break below 20 by then.

Government Bonds

US & European Benchmarks

p 15, 17-18

Treasury and Bund yields have probably started to roll-over again, first into November and potentially towards early next year.

Equity to Bond Ratios, Fixed Income Dynamics & Commodities

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Equity / Bonds	US	The US Equity to Bonds ratio (S&P500 vs 10Y Treasuries) could now retrace down into mid/late November and then gradually resume its uptrend into year-end.	From late Q4, the ratio then continues to rise into next Spring.
	Europe	The European Equity to Bonds ratio (EuroStoxx 50 Futures vs Bund Futures) could now retrace down into mid/late November and then gradually resume its uptrend into year-end.	From late Q4, the ratio then continues to rise into next Spring.
Duration		US Yield Curve Spreads could top out and start retracing between now and late October, probably towards year-end.	US Yield Curve spreads should continue to consolidate into early next year.
Credit		US Investment Grade Credit spreads could bounce again into early/mid November, before gradually starting to roll-over again towards year-end.	From late Q4, Credit spreads should continue their downtrend into next Spring.
TIPs/Treasuries		Inflation Expectations could also retrace into November, but then gradually recover from mid/late November and rise into year-end.	From late Q4, Inflation Expectations should resume their uptrend into next Spring.
Oil		Oil probably retraces down into November and the mid 30s on Brent. It then gradually builds a base into December.	From late Q4, perhaps early next year, Oil could attempt to resume its uptrend again.
Industrial metals		Industrial Metals could also see some retrace into early/mid November, but then resume their uptrend towards year-end.	Industrial Metals then continue to rise into next Spring.
Gold		Gold may continue to consolidate into early/mid November, but then resumes higher into year-end.	Gold probably continues to rise in Q1 and may top 2'300 USD/oz by next Spring.

Legend: Strong Underweight Underweight Neutral Overweight Strong Overweight

Equity to Bond Ratios

US & Eurozone Market

Equity to Bond ratios should follow equity markets up and down as the equity side is clearly more volatile than the bond one (i.e. they could retrace down into mid/late Q4 and then rise into year-end and early next year).

Fixed Income Dynamics

Duration (10Y - 3Y/3M)

With short term yields now near zero, the yield curve will mainly follow the direction of long term yields. Yield curve spreads should hence start to roll-over / flatten again into mid/late Q4 in first instance, and perhaps until early/mid Q1.

Credit	Credit Spreads in the US and Europe are back-stopped by the FED's and the ECB's massive buying programs. Hence, their downtrend seems very resilient. They may bounce slightly into November, but from mid/late Q4 should then resume their downtrend into early, perhaps Spring next year.
Rate Differentials	The rate differential between the US and Europe should follow US rates up and down as US rates are more volatile than European ones. The spread may hence also roll- over again into mid/late Q4 in first instance.
Tips	The TIPs / Treasury inflation breakeven ratio could also retrace from late October into November. It then resumes its uptrend into year-end and potentially Spring next year.
Commodities	
Oil	Brent Oil probably corrects down starting between now and late October, probably into mid/late November, perhaps December. It may drop back to the mid 30s USD/barrel. It then attempts to bounce again in Q1.
Industrial metals p 42-46	Copper and Industrial metals could also retrace from mid/late October into November. Copper could drop back down to the lower 6'000s, and then resume its uptrend towards year-end and then next Spring.
Gold & PMs p 12-15, 17-19, 21	Gold and Silver have been consolidating at high levels since early August. Following a bounce from late September, they may retrace once again into early/mid November. They will not necessarily make new lows. If so, previous support levels around 1'800 USD/oz for Gold and 21 USD/oz for Silver, should hold. Thereafter, both metals should resume their uptrend towards year-end and potentially new highs. By next Spring, Gold could reach the 2'200 – 2'400 USD/oz range, while Silver may top out in the mid 30s USD/oz. Platinum and Palladium do look weaker than Gold into early, perhaps mid Q1, but then probably outperform into the Spring.
Agriculture	Agricultural Commodities have rallied over the last few months and broken out of their accumulation range since 2018. They may be approaching intermediate tops and could correct down slightly into November. Thereafter, we expect them to resume their uptrend with 10 to 20% upside potential into the Spring, thereby confirming their upside breakout.

Foreign Exchange

		Next 2 months	3 to 6 months ahead
USD vs	EUR	EUR/USD probably retraces down into mid/late November and the 1.16-1.15 range. It then resumes its uptrend towards year-end and the 1.19 - 1.22 range.	EUR/USD continues higher towards next Spring and could reach the 1.27 - 1.34 range.
	GBP	GBP/USD retraces back to the 1.27 - 1.23 range by mid/late November. It then resumes its uptrend into year-end (towards 1.30).	GBP/USD continues higher towards next Spring and could reach above 1.40.
	JPY	USD/JPY holds up around 105 - 106 until mid November and then drops towards year-end and 102.	USD/JPY could push lower into next Spring, potentially in the 101 - 97 range.
	CHF	USD/CHF may bounce back once again towards 0.92 - 0.93 into mid/late November. It then drops towards year-end and below 0.90.	USD/CHF could continue to slide towards the 0.88 - 0.86 range.
EUR vs	GBP	EUR/GBP could rise towards 0.93 - 0.94 into mid/late November. It then drops back towards the low 0.90s by year-end.	EUR/GBP may break down into the high 0.80s into the Spring.
	JPY	EUR/JPY could drop towards the low 120s by mid/late November, but then bounces back to current levels by year-end (i.e. 123 - 124).	EUR/JPY may push slightly higher, perhaps to above 125 by next Spring.
	CHF	EUR/CHF could drop to 1.06 by mid/late November. It then climbs back to above 1.07 by year-end.	EUR/CHF could then rise to above 1.10 by next Spring.
GBP vs	JPY	GBP/JPY drops towards the 132 - 130 range by mid/late November. It then rises back to current levels by year-end (circa 136).	GBP/JPY may push slightly higher into the high 130s by next Spring.
	CHF	GBP/CHF could drop back towards 1.15 by mid/late November. It then rises back to current levels by year-end (i.e. to above 1.18).	GBP/CHF could rise to the low/mid 1.20s by next Spring.

Legend: Strong Underweight Underweight Neutral Overweight Strong Overweight

US Dollar
p 16

The US Dollar (i.e. the Dollar Index) could bounce again into mid/late November, potentially to the 0.94-0.95 range. It then probably resumes lower towards 0.91 by year-end and then perhaps towards the 0.88 – 0.84 range by next Spring.

Euro
p 50

EUR/USD could see another period of retracement into mid/late November, potentially towards the 1.16 – 1.15 range, It then rises again into year-end towards the 1.19 – 1.22 range and may continue higher to above 1.25, perhaps up to the 1.27 – 1.34 range by next Spring.

Yen
p 51

The Yen may hold up around 106 – 105 into mid/late November, but then drops towards 102 by year-end. It may push deeper into the 101 – 97 range towards next Spring. EUR/JPY and GBP/JPY could drop towards mid/late November in the low 120s on EUR/JPY and the low 130s on GBP/JPY. They then bounce back towards year-end and current levels (123 – 124 on EUR/JPY, towards 136 on GBP/JPY) and could continue slightly higher into next Spring.

Sterling
p 51

Cable could retrace down again into mid/late November and the 1.27 – 1.23 range. It then resumes its uptrend into year-end and towards 1.30. It then continues higher into next Spring and could break above 1.40.

Swiss Franc

USD/CHF may bounce back towards the 0.92 - 0.93 range by mid/late November. It then resumes lower towards 0.90 by year-end and could reach into the mid 0.80s by next Spring. EUR/CHF drops back to 1.06 by mid/late November. It then bounces back to above 1.07 by year-end and may continue to above 1.10 by next Spring. Similarly, GBP/CHF could drop down towards 1.15 by mid/late November. It then reaches back above 1.18 by year-end and could break into the 1.20s by next Spring.

Oil & Commodities currencies

Commodity currencies (our equal weighted portfolio containing AUD, BRL, CAD, NOK, NZD, RUB, CLP and ZAR) should retrace down again vs both the US Dollar and the Euro into mid/late November, perhaps December. They should then gradually resume their uptrend vs the US Dollar into next Spring and achieve new highs, but could remain weak vs the Euro into mid Q1 at least.

Asian currencies
p 37-38

Our Asian Growth equal weighted portfolio (CNY, INR, KRW, THB and TWD) is more defensive than the Commodity portfolio above. Vs US Dollar, it could retrace slightly into mid/late November and then rise to new highs into next Spring. Vs the Euro, these may continue to bounce into mid/late November and then probably resume lower into next Spring (i.e. the Euro is more pro-cyclical than them).

Equities Markets Segmentation

Core Sector Weightings

Next 2 months

3 to 6 months ahead

US Sectors - S&P500 (general comment)			Into December we will favour Growth and Defensive profiles					From early next year, we would underweight Defensive profiles and favor Growth and gradually increase Cyclical.				
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)			Into December we will favour Growth and Defensive profiles					From early next year, we would underweight Defensive profiles and favor Growth and gradually increase Cyclical.				
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 20, 30-32, 47-49

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

On the sector front, we expect a rather defensive environment from mid/late October into November and then a resume uptrend situation into year-end. This recovery will probably be led by Growth profiles. Hence, until December, we would favor a mix of Defensive and Growth profiles.

Thereafter, from late Q4 / early Q1, we would underweight Defensives, keep Growth overweight and gradually enter the stronger / less value cyclical profiles. Energy probably remains weak until rates bottom out at some point in Q1.

Countries allocation

Core Countries Weightings			Next 2 months					3 to 6 months ahead				
All World Country Index Currency hedged (general comment)			Into December, we would neutralize the US and Europe, Underweight Canada, Japan and the UK and Overweight China and Switzerland.					From late Q4 / early Q1, we will probably underweight the US and Switzerland and neutralize the rest.				
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 33-34, 35-41, 47

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

In US Dollar terms, US markets may bounce into mid/late Q4 vs the All Country World Index along with the US Dollar. They should then resume lower with it into next Spring.

Europe on the other hand could underperform in US Dollar terms, but in nominal terms (hedged for currency risk) hold up rather well, except for the UK which seems structurally very weak. Early next year, Europe may perform rather well despite a stronger EUR/USD as cyclical trades gradually pick up. We will hence probably neutralize the region into Q1 next year.

Japan probably suffers from a weaker USD/JPY into year-end and into Q1. Yet, a weaker Yen vs European currencies may neutralize this effect from Q1.

We Overweight Switzerland as a defensive trade into late Q4 and will then reverse this position into next Spring.

The MSCI China is also quite counter-cyclical and we will hence Overweight it into year-end. It may then continue to perform on par with other markets early next year.

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

Core factors and Themes

Core Factor/Themes Weightings

Next 2 months

General Comment	We would Overweight Growth into year-end, neutralize Defensive trades and Underweight Cyclical ones					From late Q4 / early Q1, we would keep Growth Overweight, gradually add some of the more dynamic Cyclical themes and Overweight Mining.				
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 20, 29

On the factor front, Cyclical plays could underperform until late this year, while Growth outperforms. Goldmines could reaccelerate up from early/mid November, following further consolidation until then.

Then, from late Q4 / early Q1, we would gradually add some of the more dynamic Cyclical themes to the mix (e.g. small caps, Diversified Mining), but would probably stay away from Value themes well into Q1. Goldmines remain Overweight.

12 / Gold's fundamentals and primary price factors show some crosscurrents for Q4 but improve thereafter

Seldom have the media and pundits been more bullish on gold's prospects, especially after the recent publication of global central bank official gold holdings, which surprised some investors to the upside. That has added to the bullish sentiment for the yellow metal.

However, gold has been consolidating since early August, something that promoters of the yellow metal has been struggling to explain. That decline has happened despite the rise in COVID-19 in Europe and elsewhere, as well as the threat of a "contested election" in the US presidential races within a month or so. That decline has taken hold despite spotty employment prospects of the US labour force. In much of this situation, that gold price decline has been due to the fundamentals of gold, and its relationship with interest rates and the US Dollar. Those aspects need to be addressed, and that is what we intend to do with this edition of The Capital Observer article. We decided to go use a few graphs to illustrate those relationships better.

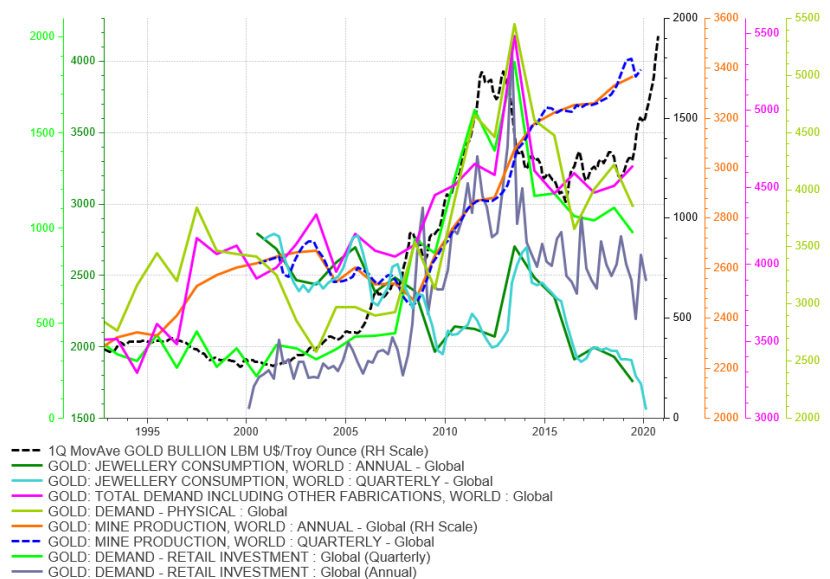
This is the current state of gold's price-demand-supply fundamentals (see 1st chart on this page): (1) gold demand, consumption, have all been sideways or have been falling in the past several years, following the peak in gold price in late 2013; (2) mine production and supply are still rising. Despite these fundamental impediments, the price of gold has risen sharply (see 1st chart on this page).

We do understand that there is a peculiar sequence in gold's price-demand-production dynamics, one that is also seen in some commodities (you also see this in crude oil, which has a slightly different twist): the prime mover of gold price is exogenous (coming from elsewhere, usually interest rates and

the US Dollar), then changes in the price positively impact the changes in demand (total and physical, including jewelry use), and changes in the supply.

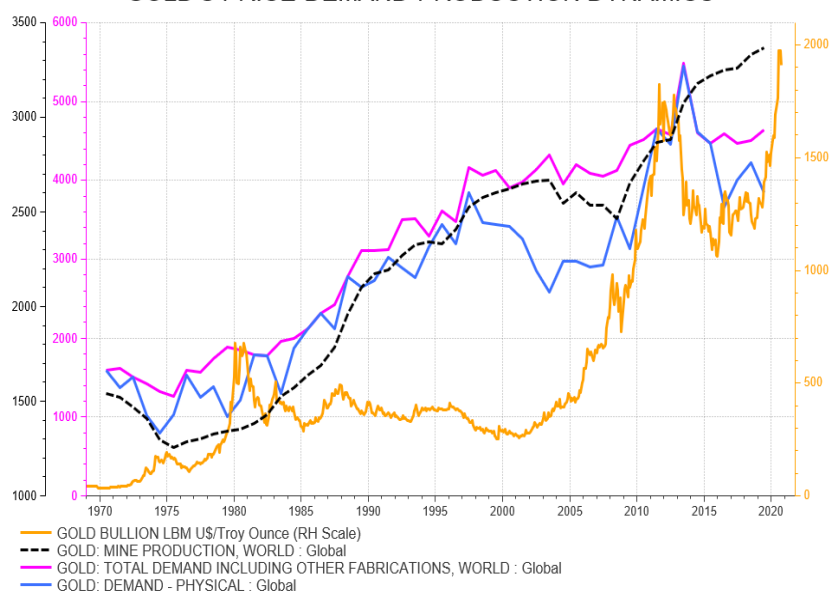
Changes in price also positively impact the pace of mine production, although there is a long-acting feedback loop between production and price, which seem to offer interesting avenues to gold price forecasting. (see 2nd chart on this page)

INTERPLAY OF GOLD'S CONSUMPTION-SUPPLY FUNDAMENTALS



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

GOLD'S PRICE-DEMAND-PRODUCTION DYNAMICS



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

The peculiarity is that ALL of the above variables are POSITIVELY correlated with the price of gold - when the price of gold falls, demand (total, physical, jewelry) falls, supply declines as well, and eventually, mine production slows down. It is clear that expectations of lower prices further out have been the recent key driver in deterring purchases among physical buyers, and the same expectation is fostering a similar mentality in retail demand.

This looks like a violation of the so-called "law of demand" in economics, which says that there is a negative relationship or correlation between the quantity demanded of a good and its price. Said another way, the law suggests that when gold prices fall, the demand for it should go UP, not DOWN (other pertinent things, e.g. income, remaining the same).

This is maybe why gold violates the "law of demand": there is strong evidence that demand for gold is relatively elastic, that is, changes in price have a relatively large effect on the quantity of a gold demanded. **And the elasticity is positive - gold is a Veblen good.** As such, the higher the price of gold goes, the higher the demand (and the rest of the "fundamentals") rise as well.

The lag between the changes in price and the changes in these variables can be very long, from 3 quarters to as long as 10 quarters. That has been true for the pace in current mine production - production at high rates is still going on as the miners are encouraged to go all out and take advantage of the rising gold price. **In essence, rising production is NOT a negative factor to the price – it is just following Gold's price's uptrend.**

Simply put, it's the direction of the changes in gold price that essentially determine the direction of the response of many of the considered "fundamentals" inherent in the gold trade (see 1st chart on this page).

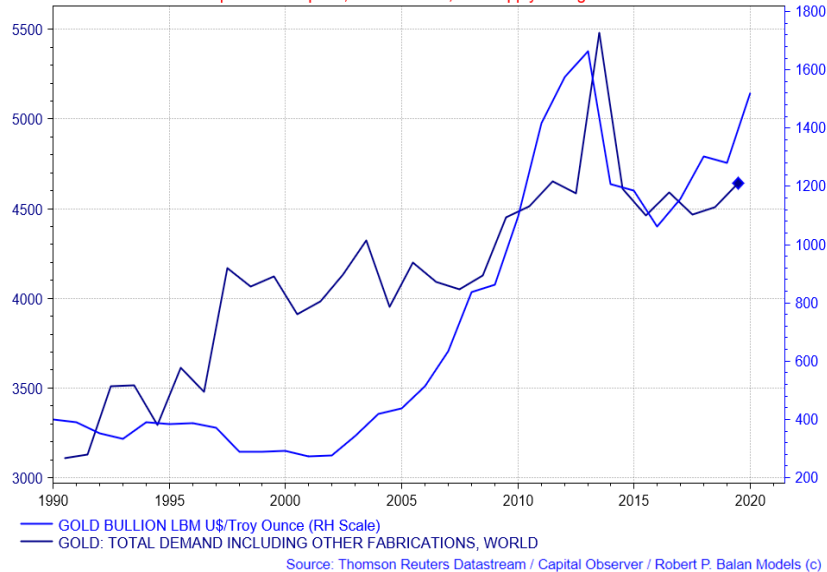
The comovements are all positive and seriously lag. *What this means is that what we think of as gold's fundamental supply-demand-price balances and linkages are USELESS in forecasting the future price of gold.*

That is not to say that Gold's "fundamentals" are completely useless in forecasting the long term prospects of the yellow metal. Mine production is such data: mine production adds only about 1 percent to the total world supply each year. That amount is equal to less than 1-week turnover in the

Correlations between Gold price vs demand and supply (time series)

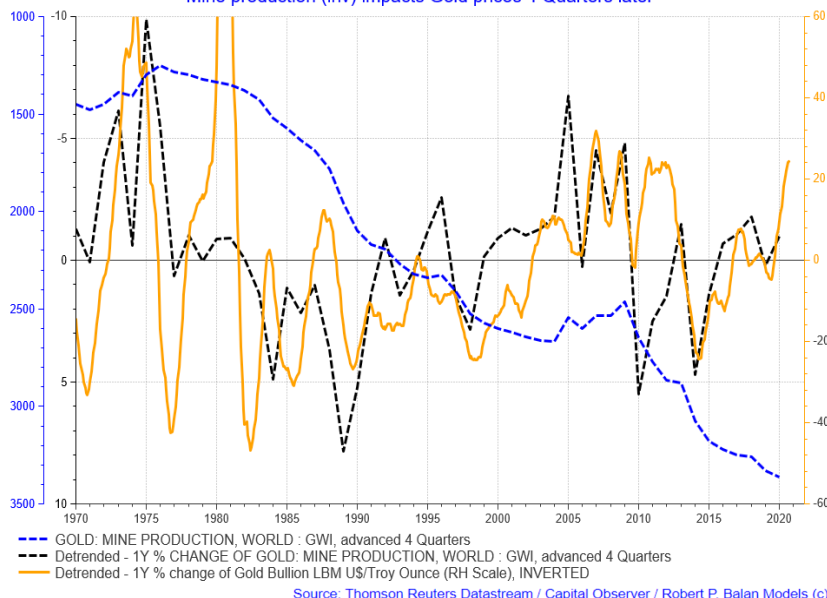
Changes in the gold price trend is ahead of the changes in demand and supply trends

The temporal order: price, then demand, and supply changes come last



GOLD'S BEST LEADING FUNDAMENTAL: MINE PRODUCTION

Mine production (inv) impacts Gold prices 4 Quarters later



world's gold markets. Therefore, many analysts claim that there should only be a limited impact from yields in mine production to the overall price of gold. But that does not hold true.

It is the delta of the year-over-year gold production, which has been driving the major changes in gold price trends since at least the 1970s (see 2nd chart above):

But mine production is not granular at all, when we want to know how the price of gold will perform in the near- and medium-term, which is what concerns most gold investors. In the final analysis, gold is impacted by

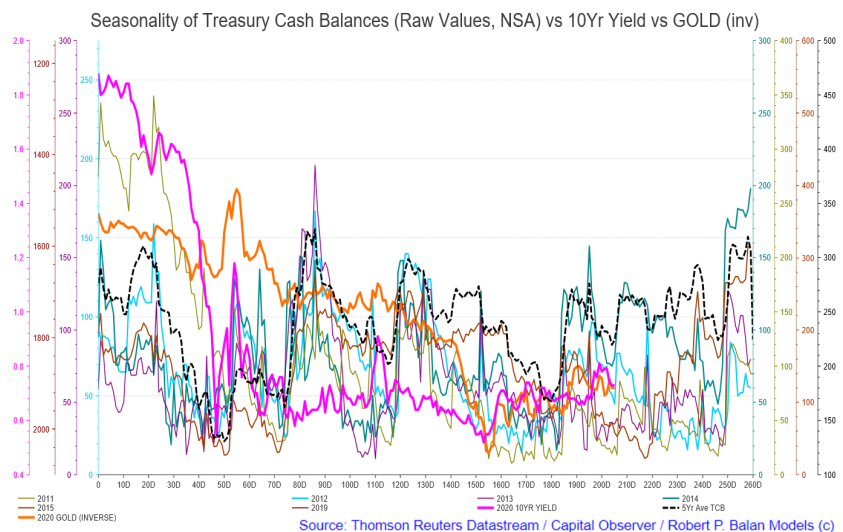
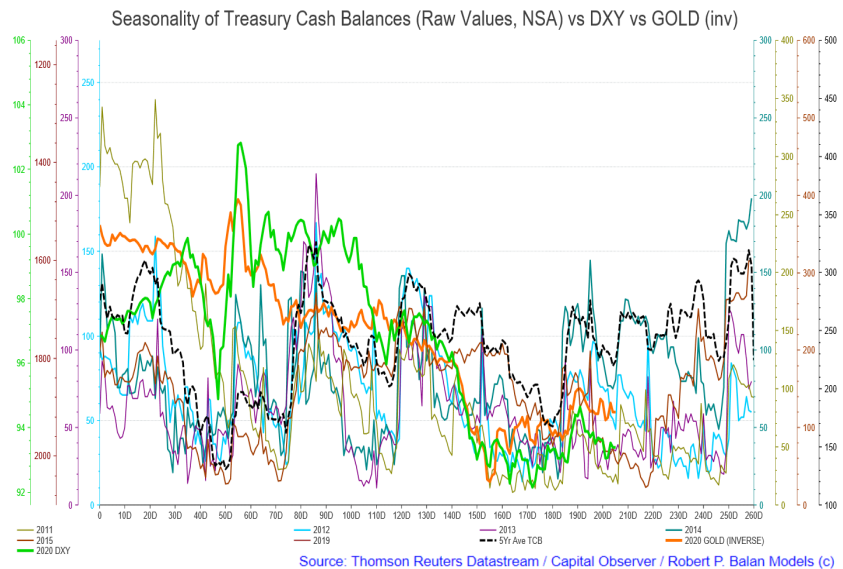
systemic liquidity as much as the US Dollar is. Gold is known as the anti-Dollar, and it does make sense that there is a tight inverse correlation between Gold and the US Dollar (DXY as proxy). Moreover, both instruments are driven by changes in liquidity flows, especially those coming from the US Treasury's account at the Federal Reserve, popularly known as Treasury Cash Balance (TCB).

Gold shows almost perfect inverse covariance between it and the DXY. Our take from this liquidity model is that the Dollar (DXY) has found a bottom, and is now bound for higher levels in Q4 2020, with intermittent weakness caused by systemic liquidity outflows. In that environment, Gold will struggle. We expect consolidation in gold prices, going into the end of the year on that basis. (see 1st chart on this page)

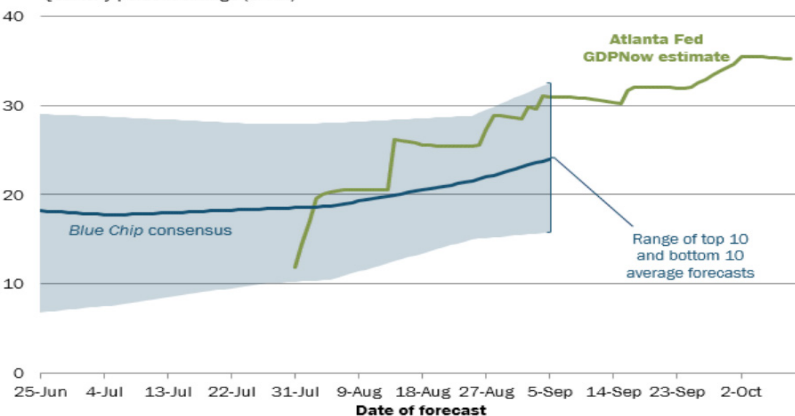
Gold is also negatively correlated with long bond yields (10yr yield as proxy). We also expect long term yields to stay firm over the course of Q4 2020 for various reasons, one primary factor being good Q3 GDP numbers to be released in late October. **With GDP rising, rates should stay firm, as well as the US Dollar. This environment is not usually the most supportive for gold.** (see 2nd and 3rd chart on this page)

Latest estimate: 35.2 percent — October 9, 2020

The GDPNow model estimate for real GDP growth (seasonally adjusted annual rate) in the third quarter of 2020 is 35.2 percent on October 9, slightly down from 35.3 percent on October 6. After this morning's wholesale trade report from the U.S. Census Bureau, the nowcast of third-quarter real gross private domestic investment growth decreased from 48.9 percent to 48.4 percent.



Evolution of Atlanta Fed GDPNow real GDP estimate for 2020: Q3
Quarterly percent change (SAAR)



Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

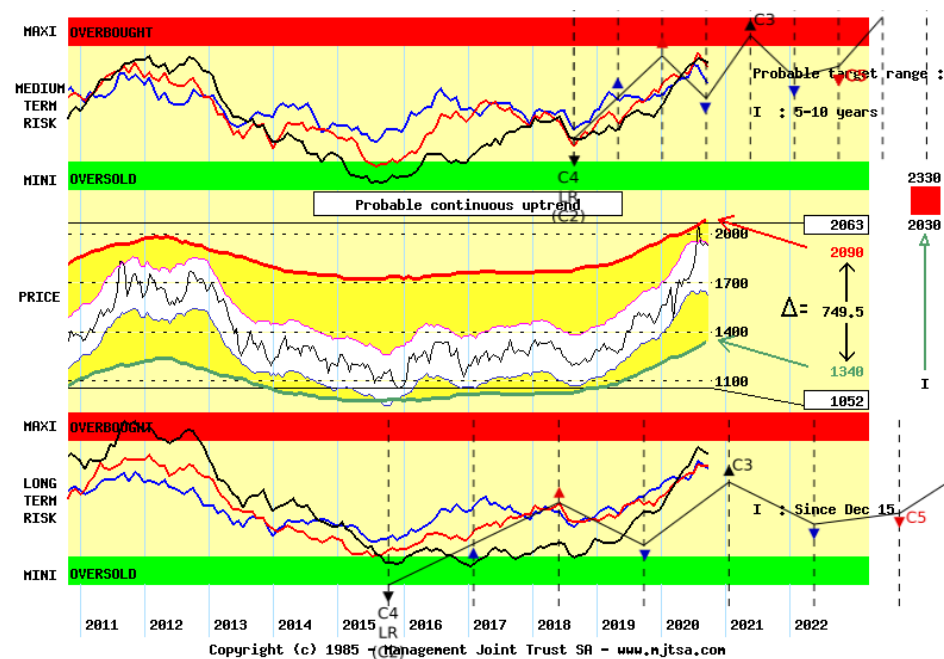
15 / MJT - TIMING AND TACTICAL INSIGHT

Gold's uptrend probably extends into next Spring

We have maintained a bullish call on Gold over the last couple of year. Yet, given this year's acceleration to our initial targets around 2'000 USD/oz and the correction period we have seen over the next couple of months, it is now probably time to review the case. For now, we believe that the conditions which have led to Gold's acceleration to the upside this year are still in place. Indeed, we expect further monetary and fiscal stimulus, yet an economy which recovers slowly, keeping a cap for now on interest rates, while the US Dollar remains under downside pressure into the Spring at least. We hereby review these cross asset drivers and Gold with a 6 months investment horizon.

Gold Spot (USD/oz)

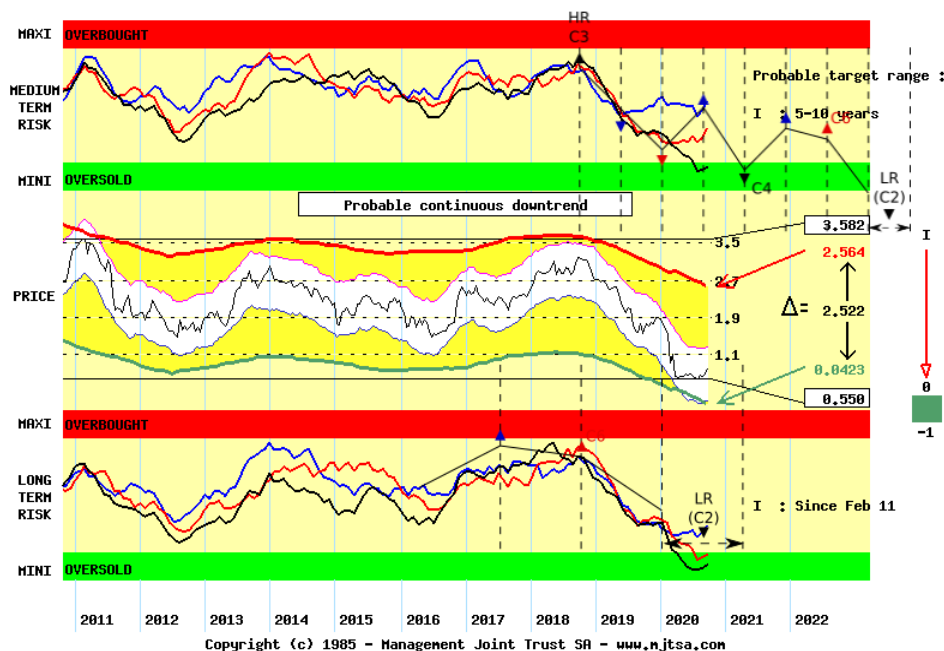
Bi-monthly graph or the perspective over the next 1 to 2 years



Gold has now made new highs and its 2011-2015 retracement period is now history. On our long term oscillators (lower rectangle) the current uptrend since 2015 may be approaching an important intermediate top. It could weigh on Gold prices from H1 2021 into 2022. For now, however, **we still expect one push higher in the current leg-up, probably into next Spring** as shown on our medium oscillators (upper rectangle). **By then, Gold may reach the higher end of our I Impulsive targets to the upside around 2'300 USD/oz.** Thereafter, it could start to retrace into late 2021 in first instance.

US10 Year benchmark Bond yield

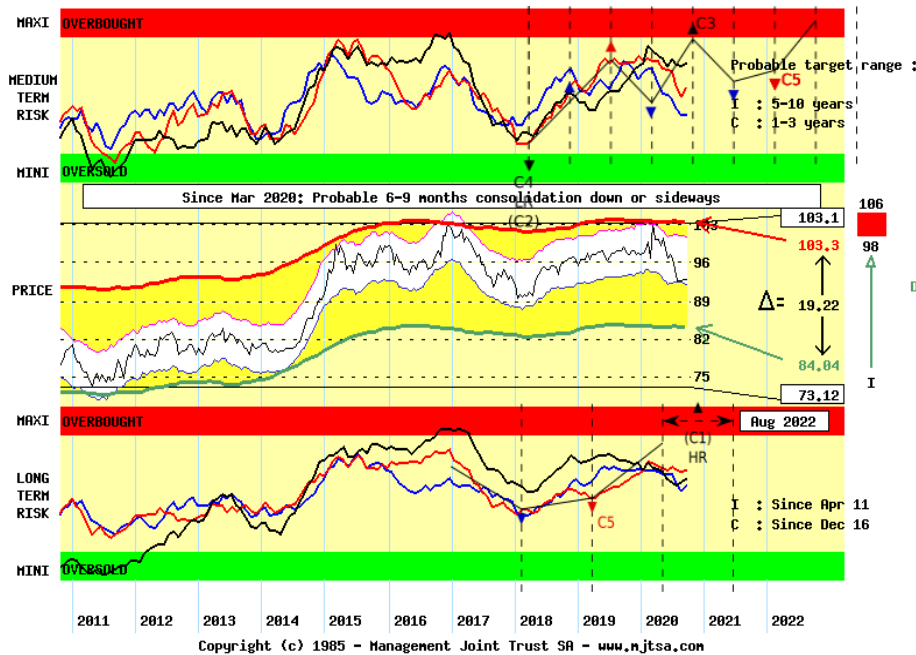
Bi-monthly graph or the perspective over the next 1 to 2 years



Declining long term yields have been a strong tailwind for Gold over the last couple of years. Not only do declining yields improve the opportunity cost of holding Gold, they also tend to push real interest rates in negative territory. On our long term oscillators (lower rectangle), the US10Y Treasury yield may have reached a Low Risk zone. We hence expect it to stabilize over the next few quarters. Yet, on our medium term oscillators (upper rectangle), **the downside move since late 2018 doesn't seem quite finished yet and may extend lower into next Spring.** This should provide further support for Gold prices until then.

Dollar Index – DXY

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

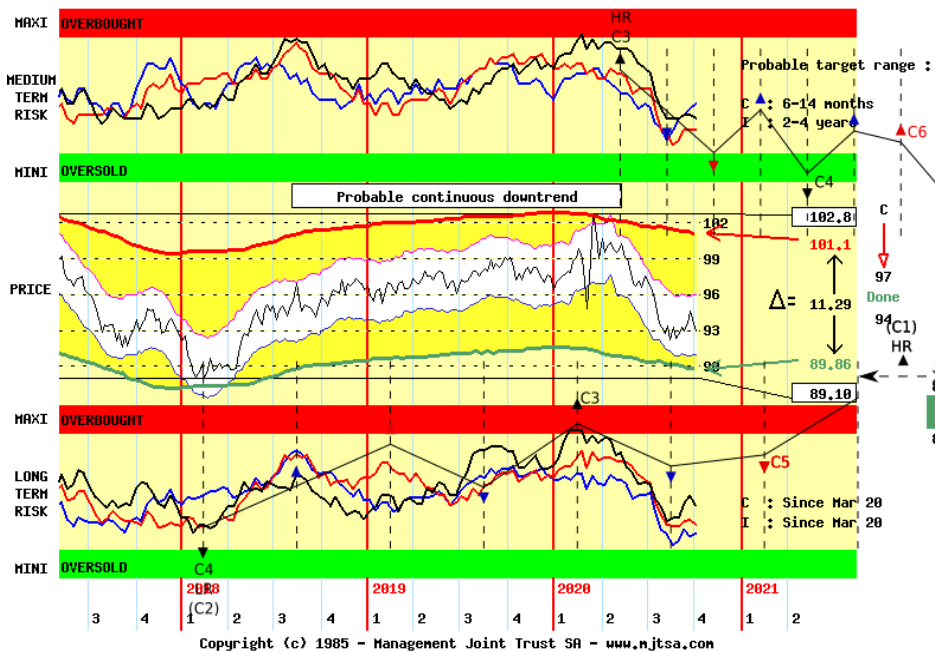


Gold is denominated in US Dollar and hence a weaker Dollar usually supports higher Gold prices. This is especially the case, when the US Dollar is dropping on the back of strong monetary stimulus. This was the case in 2019, from mid 2010 to mid 2011, in H1 2016 and recently. During all these periods, Gold performed strong rallies. On our long term oscillators (lower rectangle), the Dollar Index was approaching a High Risk zone earlier this year. These can usually trigger 1 or 2 years of consolidation to the downside, if not

a secular reversal. On our medium term oscillators (upper rectangle), the Dollar Index did start to turn down slightly early, but this move down is now finding confirmation as these oscillators are currently reaching an important intermediate top. We believe it should put further downside pressure on the US Dollar over the next couple of quarters. **We hence expect the Dollar Index to remain weak into next Spring and probably test down to our C Corrective support around 88** (right-hand scale).

Dollar Index – DXY

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

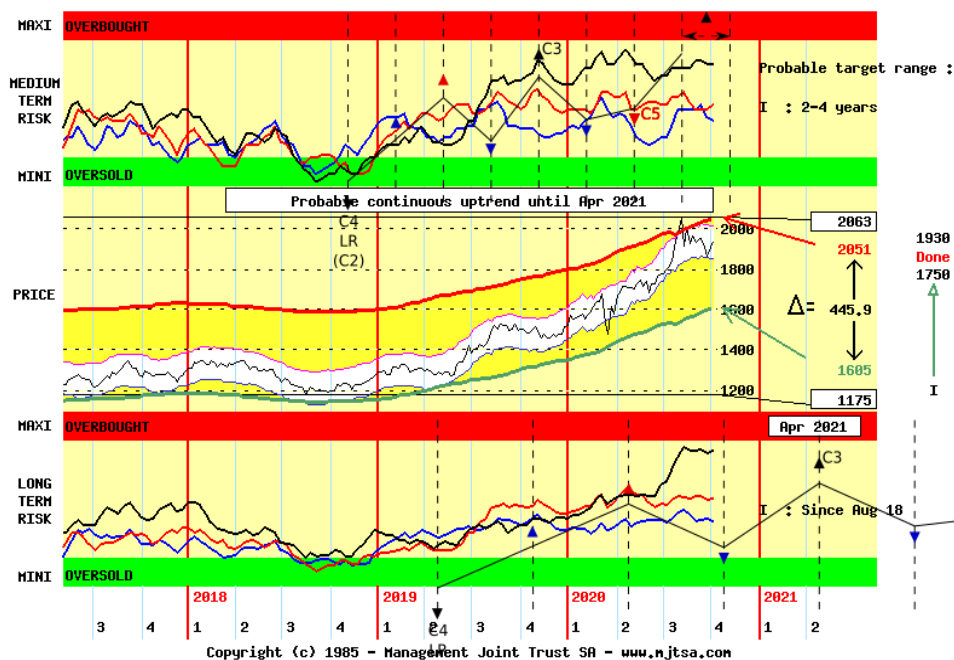


On the Weekly graph, the Dollar Index may have reached an intermediate bottom mid Q3 on our long term oscillators (lower rectangle). It is currently attempting to bounce and could continue to do so for another month or so. It then probably retraces / retests down again into mid/late Q1 (with higher or lower lows) before rising again into next Summer. This scenario is rather constructive on the US Dollar, yet fails to consider that we have recently broken (although marginally) below the support of the lower end of

our C Corrective targets to the downside around 94 (right-hand scale). This break suggest that the Dollar Index may now be in an impulsive move down, which could last several quarters. This is the more negative scenario, and our preferred scenario, which we show on our medium term oscillators (upper rectangle). **The Dollar index may still bounce towards mid/late Q4, but then from late Q4 / early Q1 should resume its downtrend to lower lows into next Spring. Our I Impulsive targets to the downside (right-hand scale) indicate that it could reach into the 88 – 84 range by then.**

Gold Spot (USD/oz)

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

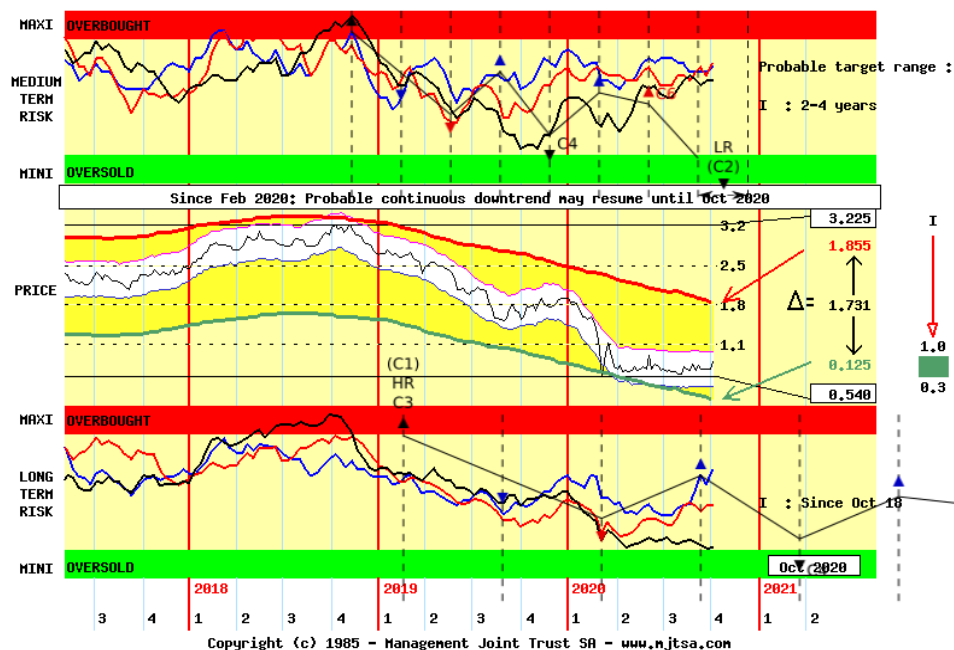


Inversely, Gold should head higher once again into next Spring. It had indeed reached an important top this Summer on our medium term oscillators (upper rectangle) as well as our I Impulsive targets to the upside (right-hand scale). However we do believe that this top is of intermediate nature and that Gold should soon resume **its uptrend, probably between now and mid Q4** as shown on our long term oscillators (lower rectangle). **It could rise into next Spring, probably towards our next level of targets, our I2 Impulsive 2**

extended targets to the upside, which we calculate in the 2'200 to 2'380 range (or 2.3 to 2.7 times our historical volatility measure "Delta", here at 445.9 – middle rectangle, right-hand side – added to the graph's lowest point at 1'175).

US 10Y Benchmark Bond Yield

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

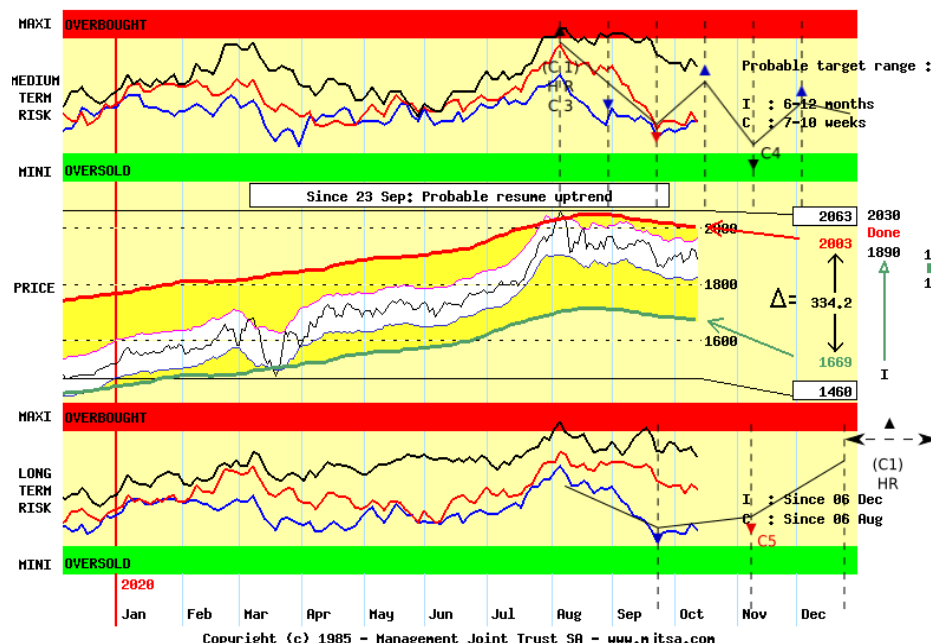


Inversely, we expect the US10Y Treasury yield to retest down into the Spring. On our medium term oscillators (upper rectangle), it may have also reached a Low Risk position. Yet, these oscillators are still very much in the middle of the range highlighting a rather risky position, while the rebound on yields since March has been insignificant (risk has risen, while prices have stayed low). We would hence favor, the sequence we show on our long term oscillators (lower rectangle), **where the US10Y Treasury yield probably made**

a new intermediate bottom late Q1, and following a weak bounce, is now getting ready to resume its downtrend into late Q1. Our I Impulsive targets to the downside (right-hand scale) may justify further downside potential towards 0.3% until then, i.e. towards new marginal lows. This again, should help Gold rally to new highs.

Gold Spot (USD/oz)

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

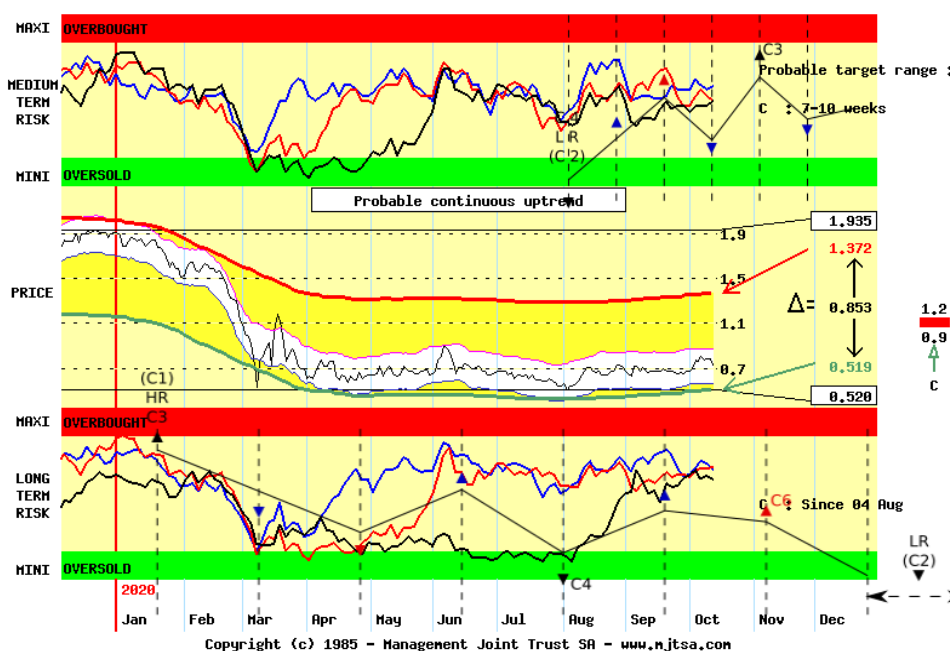


On a Daily basis, Gold has been consolidating down since early August, and did reach an initial support point late September. It has since been attempting to rebound. According to our medium term oscillator's (upper rectangle), **this rebound may come to an end of the next few days and Gold could then retest down once more into early/ mid November** on both oscillator series (lower and upper rectangles). We don't believe it will make much lower lows that the ones seen late

September, could even hold above those levels, and if worse comes worse, **the lower level of our C Corrective targets to the downside around 1'800 (right-hand scale) should then provide support.** Following that, from mid/late November, we expect Gold to resume its uptrend, probably retesting its August highs by late this year / early next year and continuing higher into next Spring.

US 10Y Benchmark Bond Yield

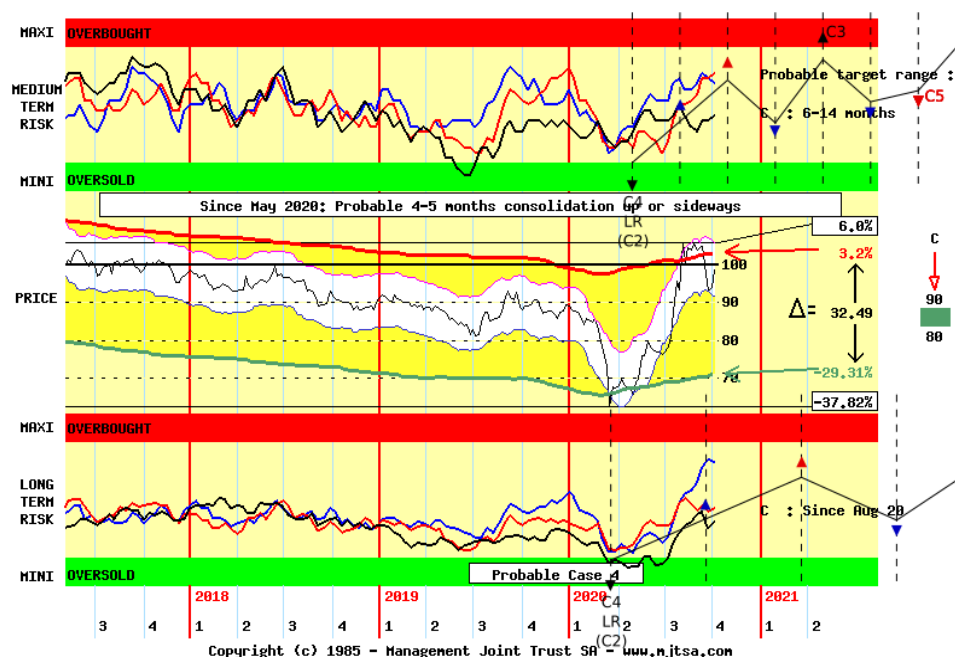
Daily graph or the perspective over the 2 to 3 months



The US10Y Treasury yield has also been in a countertrend move (i.e. a weak bounce) since early August. While on our long term oscillators (lower rectangle), it may already be rolling over, on our medium term ones (upper rectangle), **it may still surprise to the upside into late October / early November.** Thereafter, we expect the US10Y Treasury yield to resume lower on both oscillator series (lower and upper rectangles), **probably into late this year / early next year in first instance.** This again we believe should be supportive for Gold prices until then.

Silver to Gold ratio

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

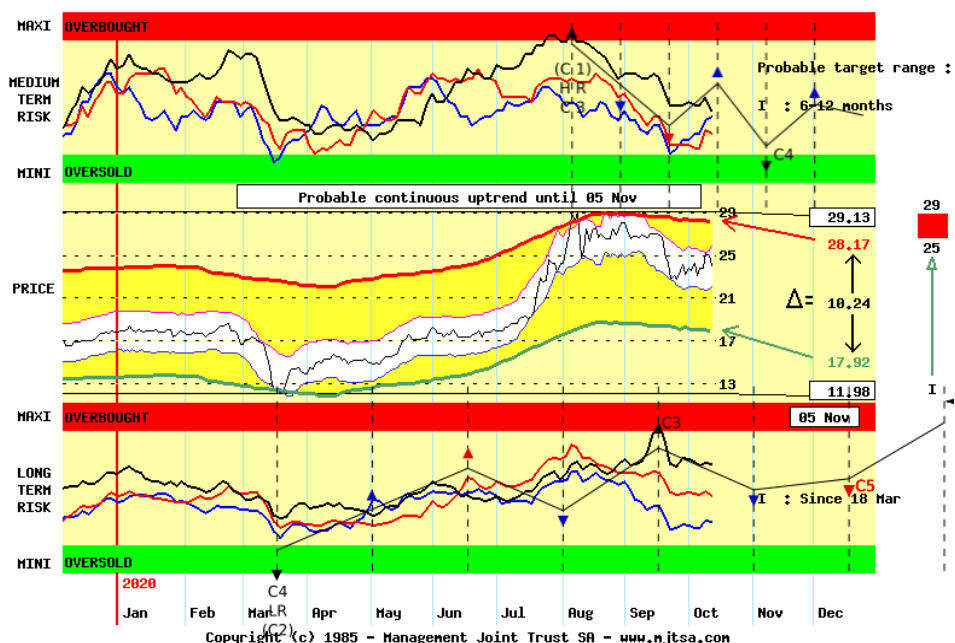


We now consider the Silver to Gold ratio, which had been in a downtrend for many years and did reach historical lows in March. It has since been rebounding impressively, a move which correspond to the aggressive monetary stimulus measures, which have since been pushed through by the FED and other Central Banks. This correlation between the Silver to Gold ratio and monetary stimulus is not new and was also very strong between 2009 and 2012 following the Great Financial Crisis, and to a lesser

extend in H1 2016. Silver is indeed more volatile than Gold and more reactive than it to monetary stimulus. **We expect the ratio to continue its current consolidation into late this year, perhaps early Q1, but then rise again strongly into next Spring and towards new highs.**

Silver Spot (USD/oz)

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

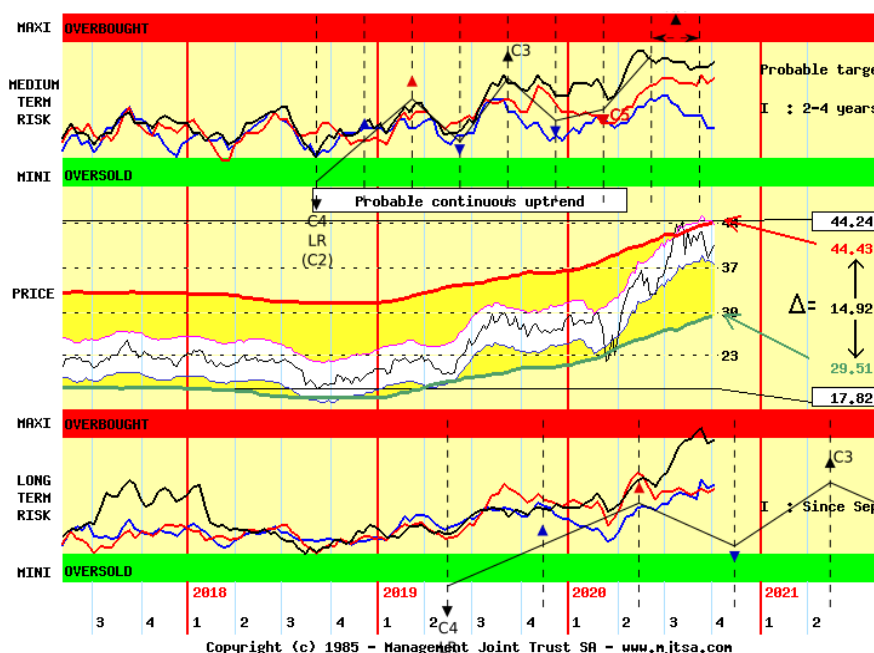


Considering Silver itself, it topped out with Gold in early August and has since been retracing. Similarly to Gold, it found support late September and has since been attempting to bounce. We expect **this bounce to die out over the next few days** on our medium term oscillators (upper rectangle) and **Silver should then retrace / retest down again into early/mid November** on both oscillator series (lower and upper rectangles). **By then, it could make new marginal lows, but probably hold above the**

lower end of our C Corrective targets to the downside, which we calculate towards 21 USD/oz (0.8 times our historical volatility measure "Delta", here at 10.24 – middle rectangle, right-hand side – subtracted from the graph's highest point at 29.13). This is also where it found support late September on an intraday basis. **Thereafter, we expect Silver to gradually stabilize during late November / early December and then rise again towards early next year and then next Spring. We expect it to make new highs towards the mid 30s USD/oz by then.**

Goldmines

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

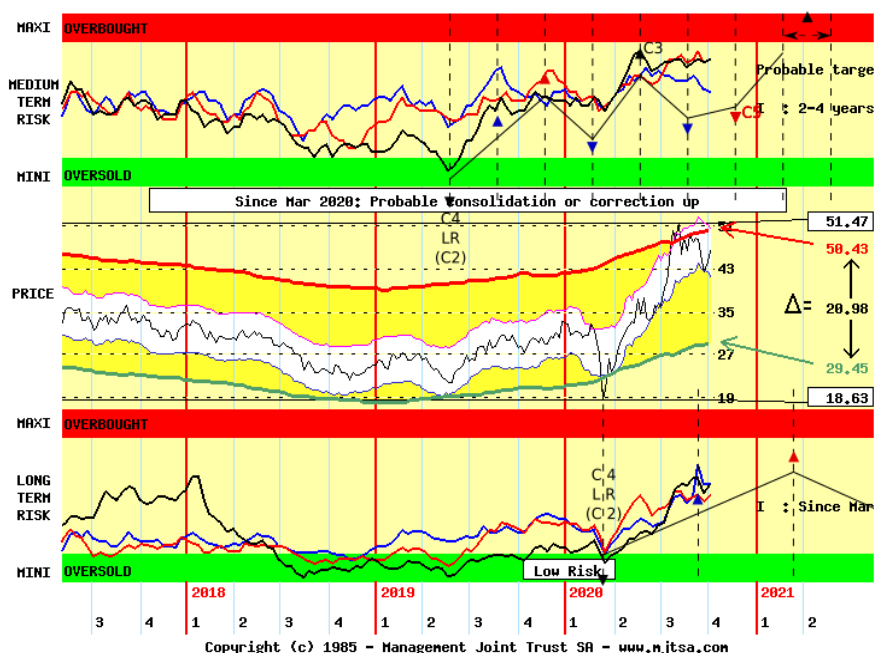


As with Gold itself, Goldmines (GDX ETF) may have reached an important top zone this Summer, i.e. a High Risk zone, on our medium term oscillators (upper rectangle). Yet, here also, a new move up with strong momentum seems underway. It made an intermediate top early Q2 on our long term oscillators (lower rectangle) and is now approaching a resume uptrend situation, probably over the next month or so. It should then lead prices higher (from circa

mid Q4) and into Spring next year. On the target front, our I Impulsive targets to the upside were achieved on the move up towards this Summer (right-hand scale). The next level of targets we can calculate, our I2 Impulsive 2 extended upside targets would point to the 52 – 58 (or 2.3 to 2.7 times our historical volatility measure “Delta” – middle rectangle, right-hand side – added to the graph’s lowest point at 17.82). This is between 25 and 40% above current levels, i.e. Buy the Dips on Goldmines towards mid Q4.

Silver mines

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

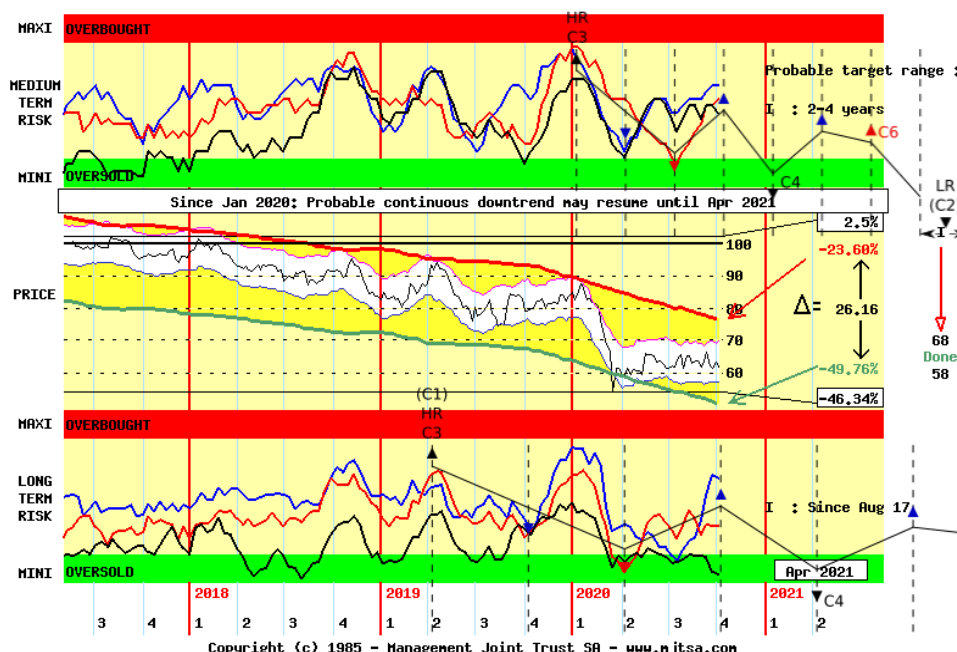


Silver mines appear even more dynamic (SIL ETF). The sequence we show on both oscillator series would also point to a continuation of their uptrends, which started this March (lower rectangle), or in Spring last year (upper rectangle) into late Q1 / early Q2 next year. As with Goldmines, the trend could resume from mid Q4, as shown on our medium term oscillators (upper rectangle). Our I Impulsive targets to the upside (right-hand scale) still show some upside potential towards 54

(15% above current levels). Calculating I2 Impulsive 2 extended targets to the upside, as we did with Goldmines, would point to even more upside potential into the high 60s / low 70s (i.e. more than 40% above current levels). We would hence also be looking to Buy the Dip on Silver mines towards mid Q4.

Platinum vs Gold

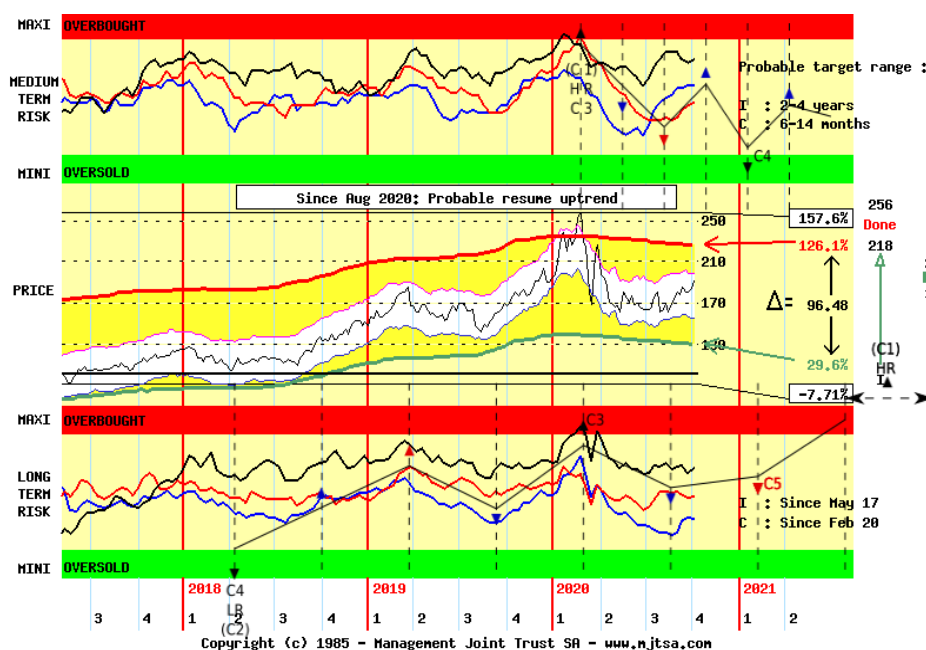
Weekly graph or the perspective over the next 2 to 4 quarters



We now compare Gold to other precious metals and first to Platinum. The ratio seems to be very much linked to US long term interest rates and has attempted to rebound with them since March. **This counter-trend move for now hasn't been very dynamic and probably resumes lower into early Q1 on our medium term oscillators (upper rectangle) and potentially towards early Q2 on our long term ones (lower rectangle).** We would hence wait until early next year to consider Platinum as an alternative to Gold.

Palladium vs Gold

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



Palladium is more cyclical than Gold and the ratio comparing both metals surged from mid Q3 last year into mid Q1. It then corrected sharply with the Covid-19 crisis and has since been slow to recuperate these losses. Both our oscillator series (lower and upper rectangles) suggest that **it may take more time before Palladium could start to reaccelerate up again vs Gold, probably from early/mid Q1.** Thereafter, we expect the ratio to rise strongly again into next Summer, probably retesting its early 2020 highs. As with Platinum, we would hence also wait

until Q1 to consider Palladium as an alternative to Gold.

Concluding Remarks:

Gold's strong uptrend since August 2018 reached an important intermediate top mid Q3. It has since been consolidation down in the 2'000 – 1'800 USD/oz range. This counter-trend move may continue into early/mid November, yet should hold above 1'800 USD/oz. Gold then resumes higher again towards year-end and then next Spring as US long term Treasury yields and the US Dollar remain under pressure. Upside targets over the next couple of quarters are probably towards the 2'200 – 2'400 USD/oz range. Silver is following similar dynamic, yet with more volatility. It should also continue to consolidate down and underperform Gold into November. We believe levels around 21 USD/oz will hold, and by mid/late November, Silver should start to rise again into next Spring and towards levels in the mid 30's USD/oz. Gold and Silver mines are following similar dynamics and could still see strong upside potential from mid Q4 into next Spring. As for Platinum and Palladium, they could continue to lag into early/mid Q1 but could then offer an interesting alternative.

22 / Equities resume the bull phase after a short correction until late November as the next liquidity drought could bring more significant pain on the back of uncertainties around the elections

The last time we wrote about the equity markets was in September 14, and we said then:

If our TCB models are correct, their implications being likewise bolstered by the seasonality of major indexes' 5-year averages, there could be further pain in the markets up ahead. The implications of these models: if there's recovery soon, and markets top by late in the month, the next trough may be seen by late October-early November (see 1st and 2nd chart on this page).

The seasonality of the major indices' 5-year averages (NDX and SPX as proxies) also provide support for this thesis: a recovery from here (September 14) for about a week or two, followed by more risk asset price declines until late October- early November.

The seasonality of the equity indices has been remarkably consistent until early this year, when the COVID-19 panic threw all historic patterns out of the window. However, we have noticed that the markets are starting to groove back to their historic norms. The Treasury Cash Balance (TCB) liquidity flows that we featured above is actually just a single component of the liquidity flows that emanate from the Federal Reserve and the US Treasury. A broader measure of liquidity flows (which includes government budget outlays) adds more dimension and details to what can be expected from the price of risk assets in the near-term (see 3rd chart on this page).

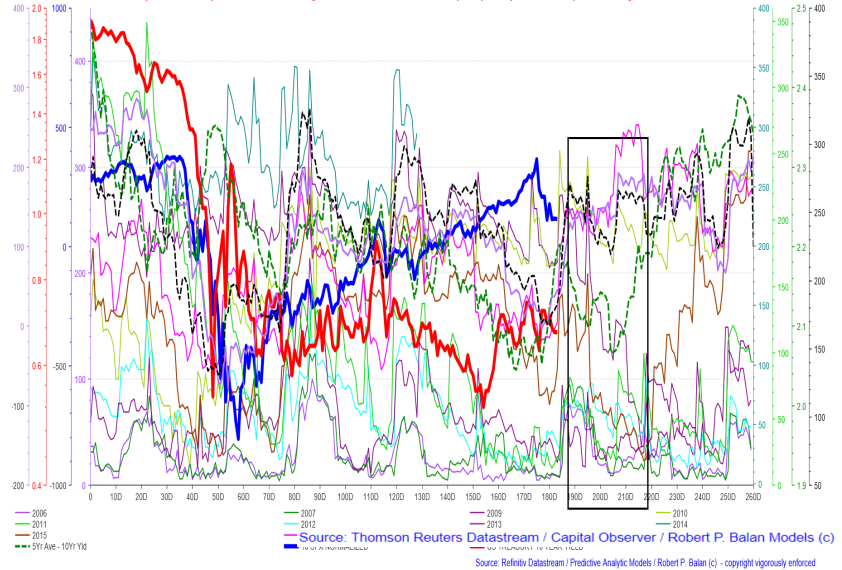
The historical average of liquidity aggregates and risk asset price flow follow monetary and fiscal flows. Changes in risk assets (equities) follow the changes in inflection points of liquidity ebb and flow after 4 weeks.

The August - September time frame is a seasonally dangerous period for risk assets because all the major sources of systemic financial liquidity (fiscal and monetary) are receding at that time frame, as shown by the 3rd chart on this page. This has been true for many

Original graph in the September edition of The Capital Observer

Seasonality of Treasury Cash Balances (Raw Values, NSA), January 2019 - December 2020

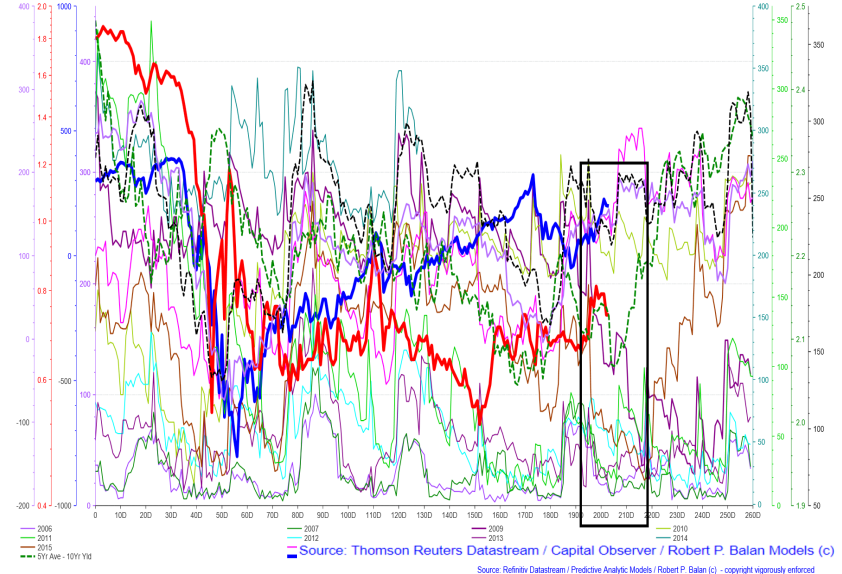
Seasonality in the 10Yr yield historical average, and in the TCB seasonality may see yields and equities falling over until TD 180-181



The chart above looks like this today

Seasonality of Treasury Cash Balances (Raw Values, NSA), January 2019 - December 2020

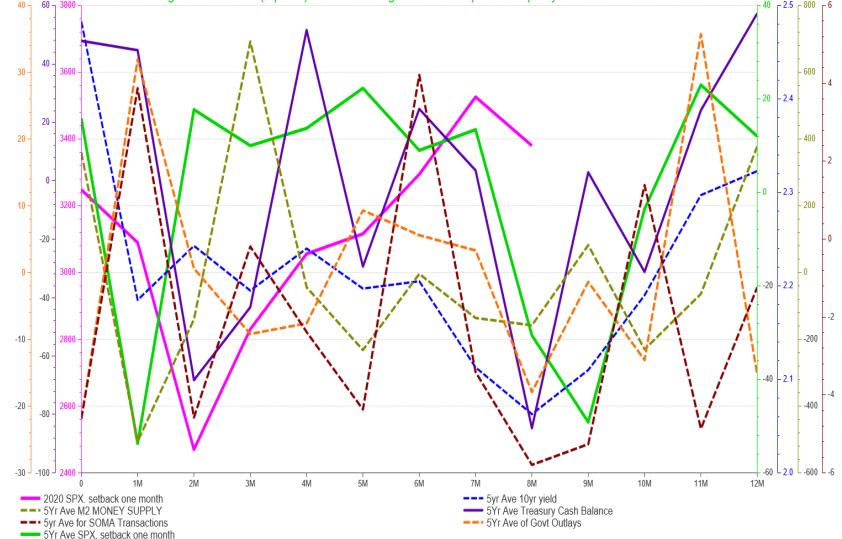
Seasonality in the 10Yr yield historical average, and in the TCB seasonality may see yields and equities falling over until TD 210



Seasonality of US Govt Budget Outlays (year to year) vs Liquidity Flows vs SPX

The historical average of liquidity aggregates and risk asset price flow follow monetary and fiscal flows

Changes in risk assets (equities) follow the changes in inflection points of liquidity ebb and flow after 4 weeks



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

years, and so the worst historical market performance has been seen during this period.

What is insidious is that the full impact of these changes in liquidity (monetary) flows take a month or longer, before the financial system has been sufficiently undercut - so the market loses sight of the factors that are bringing the market to its knees. It's worth underlining this fact -- changes in risk assets (equities) follow the changes in inflection points of liquidity ebb and flow after 4 weeks.

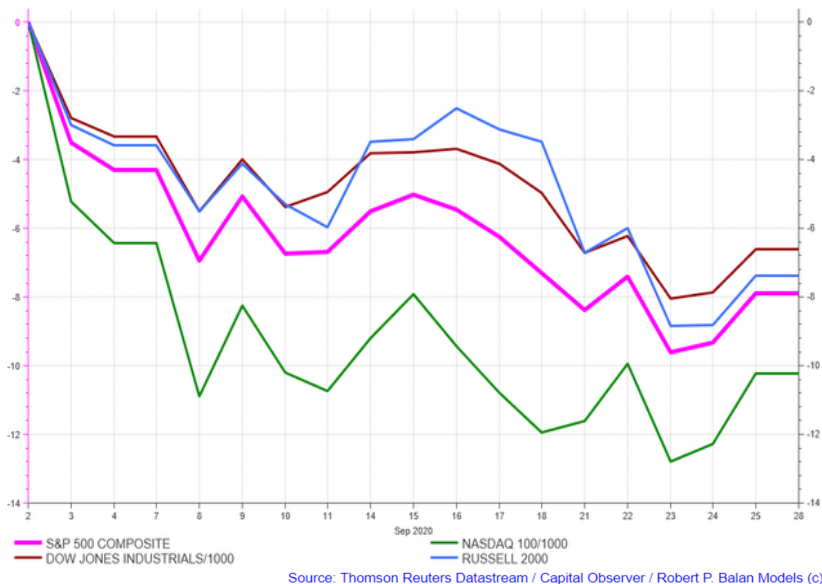
The equity market did inflect more pain to investors after we wrote the September article, finally making a bottom in late September. The Nasdaq went into an official bear phase falling more than 10 percent (the index declined as much as 12.8 pct on September 23), and the rest of the indices have fallen close to the 10 pct definition of a bear market (see 1st chart on this page).

The good news is that had brought market value destruction (liquidity outflows/drought), also brings forth market value resurrection (liquidity inflows/gusher). That happened after the September 24 equity market through marked by the brown vertical line (see 2nd chart on this page).

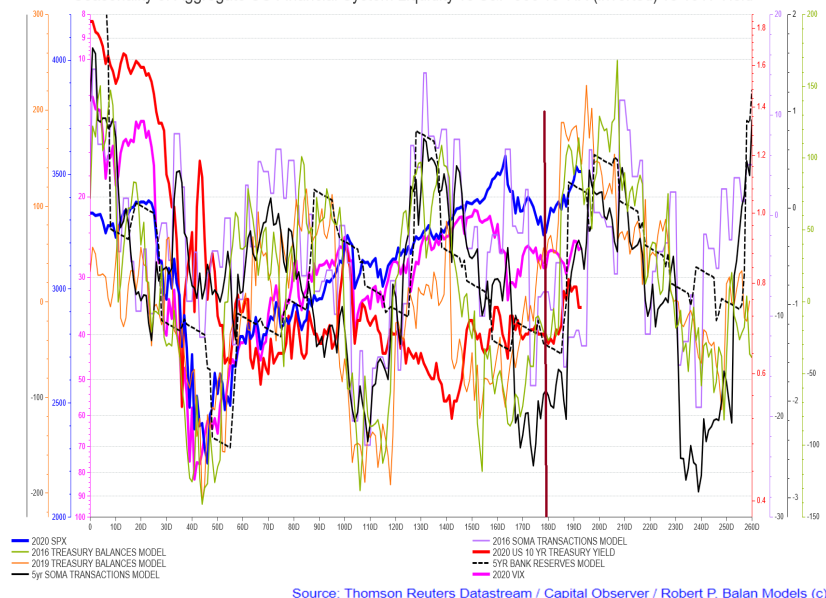
Equity markets may start correcting lower toward late October, as bond yields fall on disappointing outlook of further COVID-19 stimulus and less than stellar tech stocks earnings. The US Elections may also play a part in this correction process. The next episode of seasonal liquidity drought could bring lower risk assets prices until late November - early December (see 2nd chart on this page).

In drawing up these forecasts, we specifically focused on the historical seasonality of the 5yr averages of the Fed's SOMA transactions (balance sheet), the Fed's bank reserves and the US Treasury's cash balance at its account at the Fed. These variables were also juxtaposed with the 5yr average of the S&P 500 Index and some representative yearly performance.

Comparative Performance of Major Equity Indexes (Ref: Sept 2 top)



Seasonality of Aggregate US Financial System Liquidity vs S&P 500 vs VIX (inverted) vs 10Yr Yield



The aggregate data shown in the 2nd chart above provided some clues as to what could be expected in terms of higher risk asset prices in the short run, as the seasonal gusher in systemic liquidity during October period unsurprisingly coincided with the historical seasonal pattern of higher equity prices during the same period (with the former having prime-moved the latter).

As one will also note in the graph, there could be a rally circa month-end of October, which may arise after the publication of the Q3 US GDP.

The V-shaped recovery in highlighted indicators argue for much better Q3 GDP data than expected by analysts. That, in fact, is what is being flagged by the Atlanta Fed's GDPNowcast.

The variables that the Atlanta Fed track suggest a strong rebound in growth in Q3 2020.

Latest estimate: 35.2%-October 9, 2020

The GDPNow model estimate for real GDP growth (seasonally adjusted annual rate) in the third quarter of 2020 is **35.2 percent** on October 9, slightly down from 35.3 percent on October 6. After this morning's wholesale trade report from the U.S. Census Bureau, the nowcast of third-quarter real gross

private domestic investment growth decreased from 48.9 percent to 48.4 percent. (see 1st chart on this page).

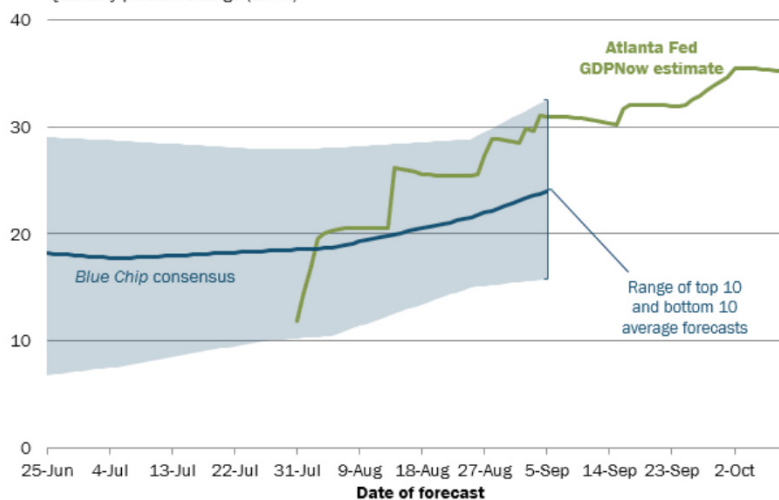
During the September market rout, there was something different in the Fed's behaviour. The central bank gave rise to conditions which around that time, made a bad seasonality feature a lot worse. The Fed started to tighten up Quantitative Easing (implementing Quantitative Tightening, in a sense). This situation was exacerbated by the fact that fiscal outlays were lower, and money supply also declined (illustrated in the 2nd chart of the previous page) -- in aggregate, a triple whammy for risk assets during September time window. This is what we showed at that time:

At that time, the Fed's assets were falling as the central bank implemented some mode of Quantitative Tightening (see 2nd chart on this page). When the markets started to misfire, the Fed quickly paused and reversed course, and asset levels started to climb back higher (see 3rd chart on this page). But the harm had been done. It cannot be undone, but the Fed did a mea culpa and stopped the balance sheets retrogress.

If we look at the lagged impact of liquidity flows from the Fed on the S&P 500 (by setting back the SPX price data by one month), recently rising Fed assets should continue to generate a strong recovery in the equity markets as a consequence (see 3rd chart on this page). That lagged market reaction is what blinds many investors to the effect of Fed and Treasury supplied liquidity on the markets.

This should not be the case. At The Capital Observer, we have made it a point to explain how the largess from the Fed and the US Treasury makes equity and bond markets tick. We continue with that objective in this month's articles.

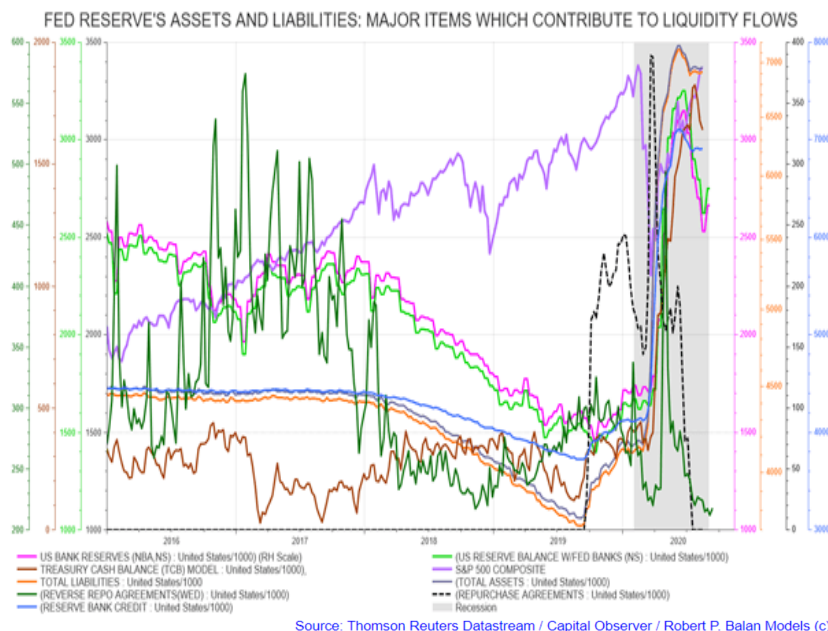
Evolution of Atlanta Fed GDPNow real GDP estimate for 2020: Q3
Quarterly percent change (SAAR)



Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

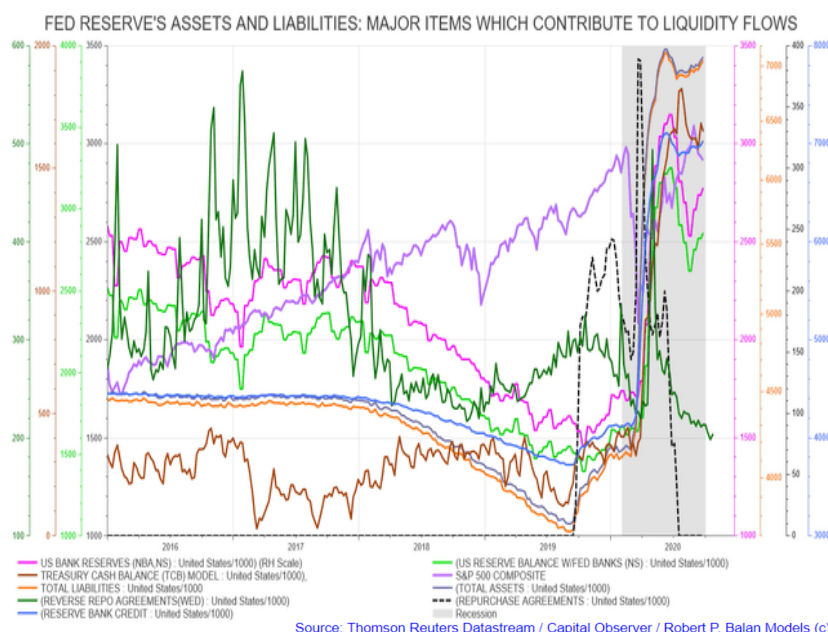
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

This is what we showed at that time



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

This is how this chart looks like now



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

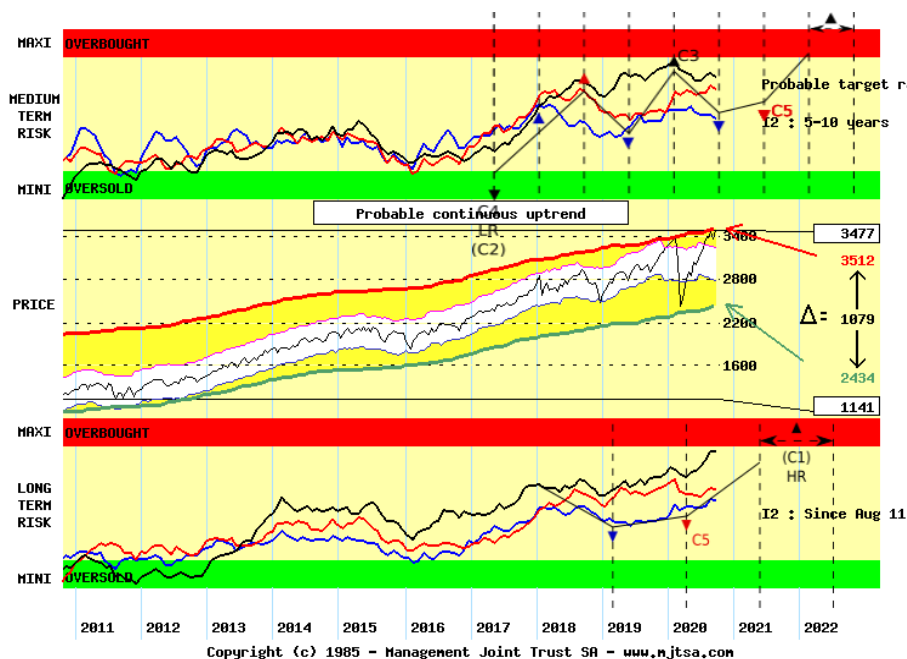
25 / MJT - TIMING AND TACTICAL INSIGHT

Equities could see some retracement into November, but then rise into next Spring

General background: Equities have been in a strong liquidity led rally since 2009. From its lows below 700 in March 2009, the S&P500 has indeed more than 5 folded. Yet, the COVID-19 crisis probably marks the beginning of a new blow-off phase in this Bull market, one where fiscal stimulus programs are north of 10% of GDP, and where liquidity provision by Central Banks is even larger. This flight forward could perdure for another few years, until the system eventually loses credibility. Intermediate setbacks along the way will represent further opportunities to enter this nominal frenzy.

S&P500 Index

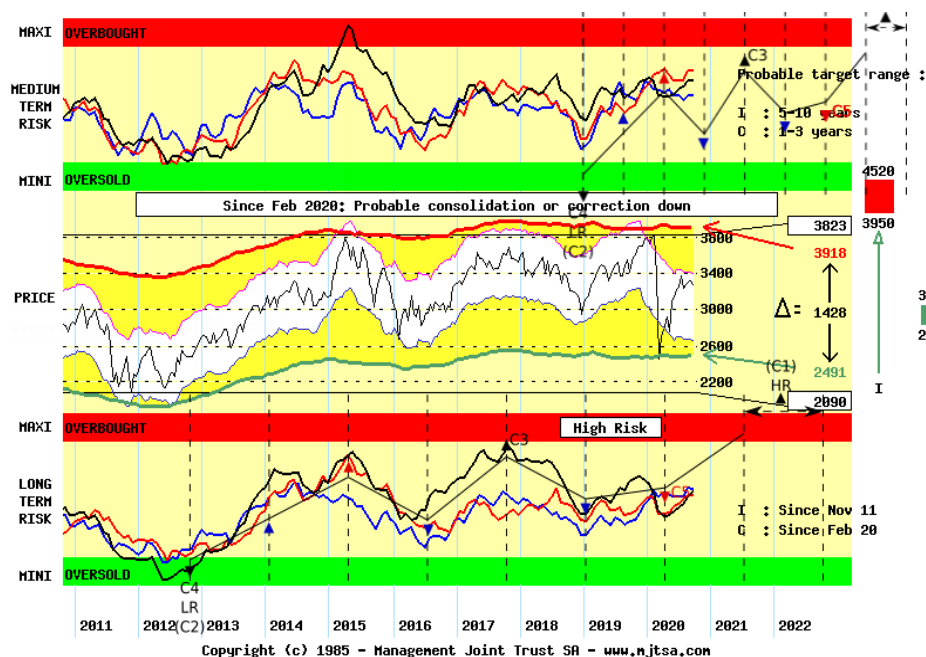
Bi-monthly graph or the perspective over the next 1 to 2 years



Following its strong inflationary rally since early 2016, the S&P500 Index entered a widening consolidation pattern with a series of higher highs and lower lows between early 2018 and March this year. During this period, many other markets didn't make new highs and corrected down, along with cyclical factors. **We are now back in uncharted territory on the S&P500, and although intermediate setbacks will materialize along the way, both oscillator series (lower and upper rectangles) suggest further upside into 2022 at least. On the price target front (right-hand scale), our I2 Impulsive 2 extended targets to the upside suggest that the S&P500 could reach to above 4'000 by then.**

EuroStoxx50 Index

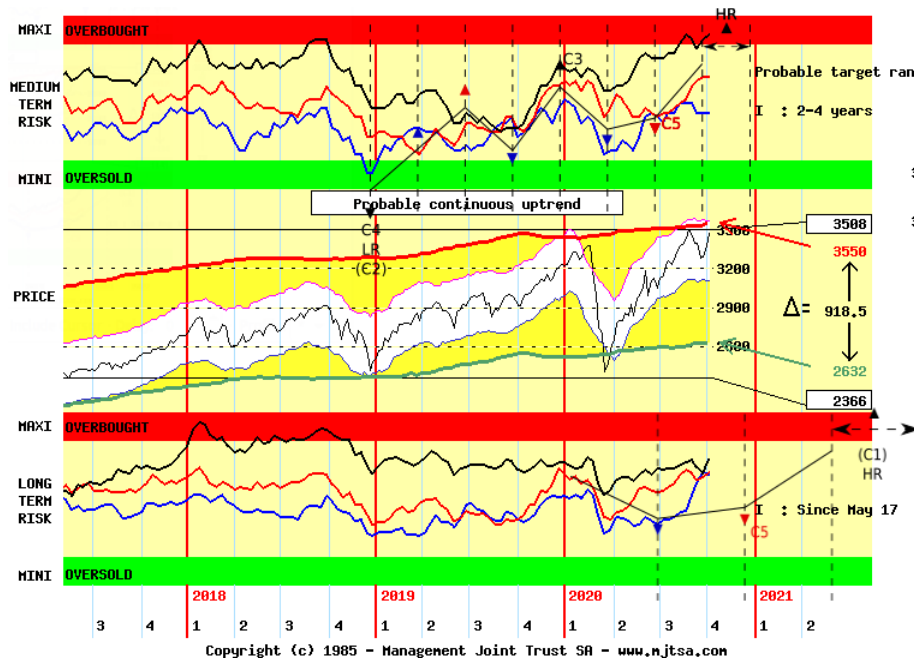
Bi-monthly graph or the perspective over the next 1 to 2 years



In Europe, the EuroStoxx50 Index has been consolidating down since 2015 or since the ECB's expanded QE program fueled a strong yet temporary rally in early 2015. This 5 years period seems to represent a large corrective pattern, which may have found a climax low in March. This is what our long term oscillators (lower rectangle) may be suggesting. **We now expect a recovery into late 2021, probably 2022 and would hope for some upside momentum with new highs until then. Indeed, our I Impulsive targets to the upside (right-hand scale) are suggesting that the EuroStoxx 50 index could reach towards the 3'950 – 4'520 range over the next couple of years. In the**

meantime, our medium oscillators (upper rectangle) seem to indicate some retracement into year-end and then a new rally towards mid next year.

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

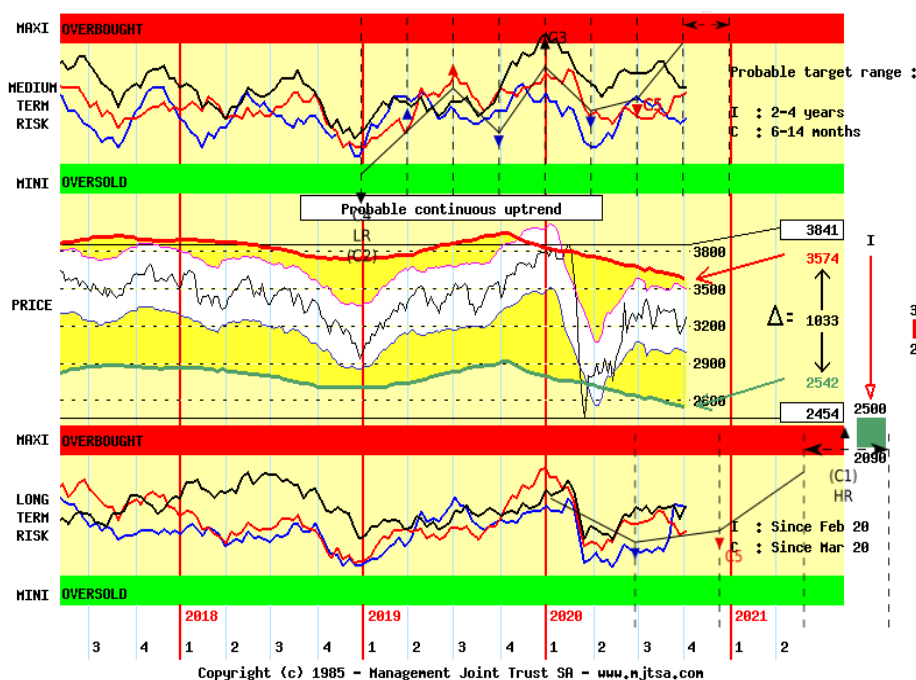


3'900 over the next couple of quarters.

Medium term, on the Weekly graph, the S&P500 has probably reached an intermediate High Risk zone on our medium term oscillators (upper rectangle). It could trigger **some retracement during Q4, until the S&P500 Index finds a new support points towards mid/late Q4** on our long term oscillators (lower rectangle). The rally then probably extends into next Spring in first instance. Our Impulsive targets to the upside (right-hand scale) suggest that the S&P500 could reach to above

EuroStoxx50 Index

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

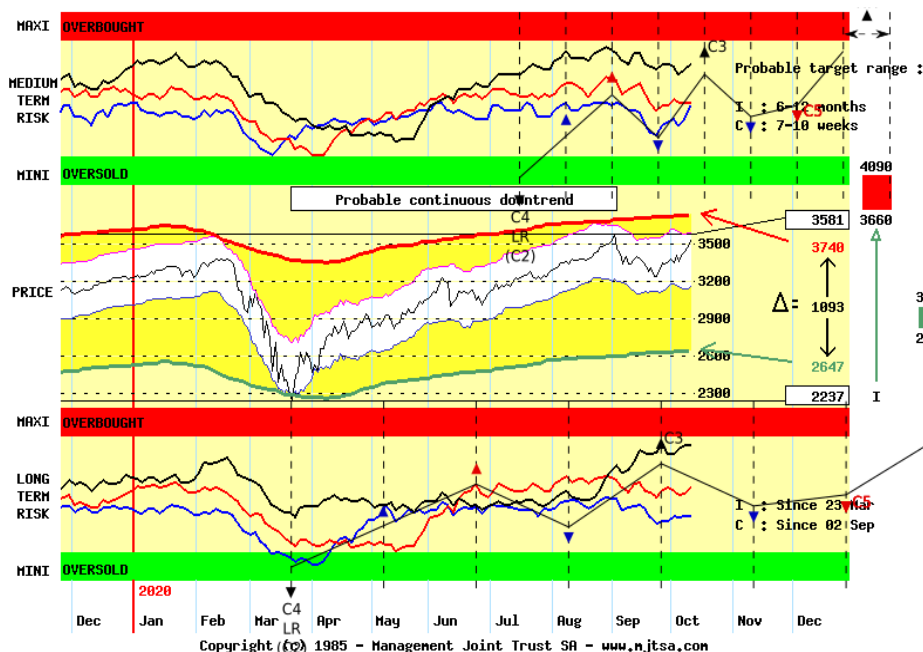


sible challenge of this year's February highs.

The EuroStoxx 50 is in a similar pattern, yet weaker. It has probably also reached an intermediate High Risk position on our medium term oscillators (upper rectangle) and **further consolidation / retracement may materialize into mid/late Q4. It should then find a support point on our long term oscillators (lower rectangle) and could rise into next Spring, finally clearing above 3'300 – 3'400** or above the resistance of our C Corrective targets to the upside (right-hand scale), **and opening the door to a pos-**

S&P500 Index

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

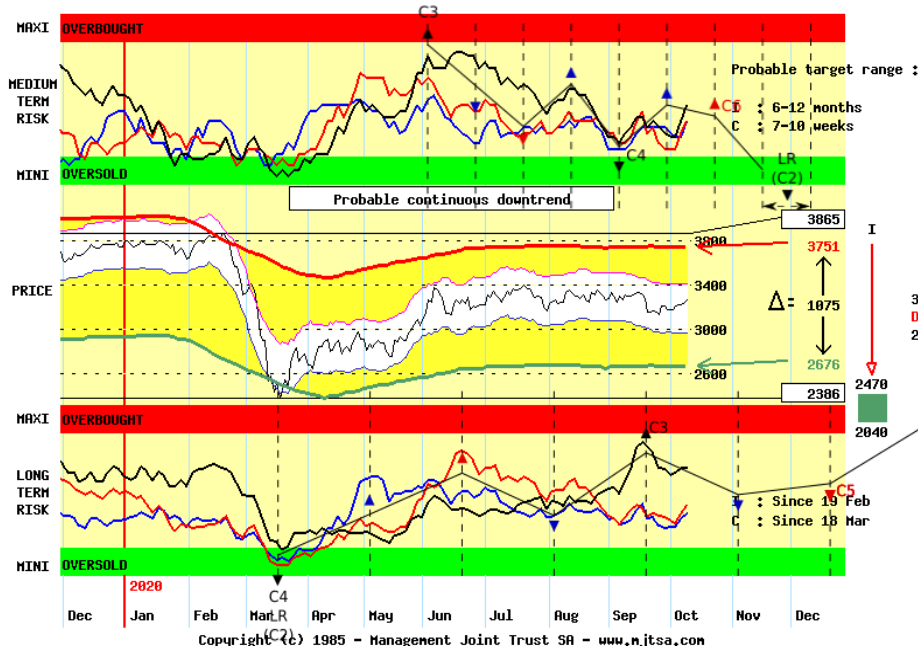


Shorter term, on the Daily graph, the S&P500 has been in a high level consolidation pattern since early September. It did start slightly early when our long term oscillators (lower rectangle) are considered. Nevertheless, this corrective pattern probably extends into early/mid November, perhaps December. In the meantime, **the current upside retest doesn't seem quite over yet, but then probably also retraces down again into November** (upper rectangle). **Downside risk is probably limited to the late September**

lows around 3'200, although our C Corrective targets to the downside (right-hand scale) point to the 3'030 – 2'710 range. We believe this is probably too aggressive given the intermediate nature of the current consolidation period. **Thereafter, from mid/late November, we expect the S&P500 to gradually resume its uptrend towards new highs in the 3'660 - 4'090 range (right-hand scale) and into next Spring.**

EuroStoxx 50 Index

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

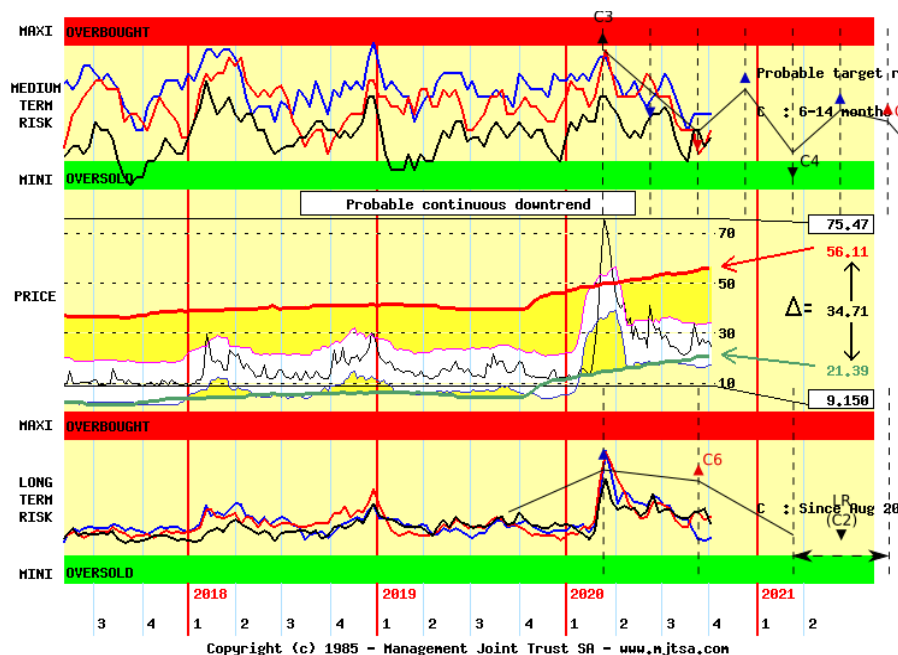


On the EuroStoxx50 Index, our medium term oscillators (upper rectangle) also suggest that the **index holds up another week or so, but then retraces down again into mid/late November**. Our long term oscillators (lower rectangle) are also in a consolidation pattern over the next month or so. **Thereafter, from mid/late November, we expect the EuroStoxx50 to gradually resume its uptrend, probably breaking above its recent 3'300 – 3'400 trading range into early next year and perhaps challenging this year's February highs by**

next Spring. In the meantime, the downside risk is probably much less damaging that what our I Impulsive targets to the downside are suggesting (right-hand scale). Indeed, price action into mid/late November is probably corrective, not in a new impulsive move to the downside. **Intuitively, we would expect the former resistance around the April highs (circa 3'000) to offer support over the next month or so.**

VIX CBOE Volatility Index

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

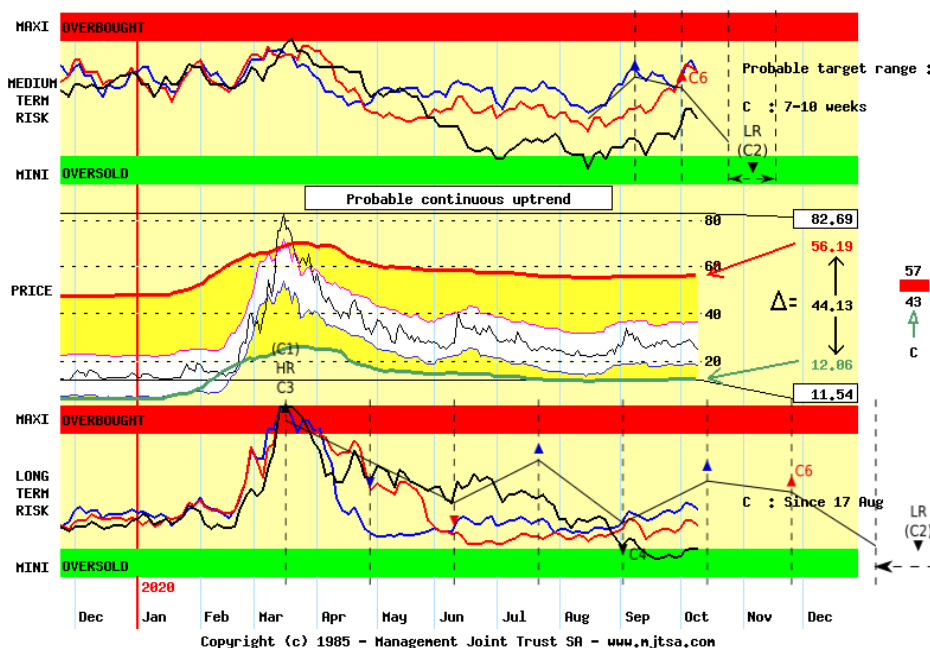


In March, VIX shot up to historical highs not seen since the 2008 Great Financial Crisis. It has since been making a series of lower highs in what appears to be a normalization process. While our medium term oscillators (upper rectangle) may suggest a further rebound during Q4, our long term ones (lower rectangle) seem to be well engaged to **continue lower into next Spring**. We would probably watch the two aftershocks made in June and early September as crucial resistance points to confirm this downtrend, i.e. as long as VIX

remains below 35 (and eventually below 45), equity markets remain well positioned into next year.

VIX CBOE Volatility Index

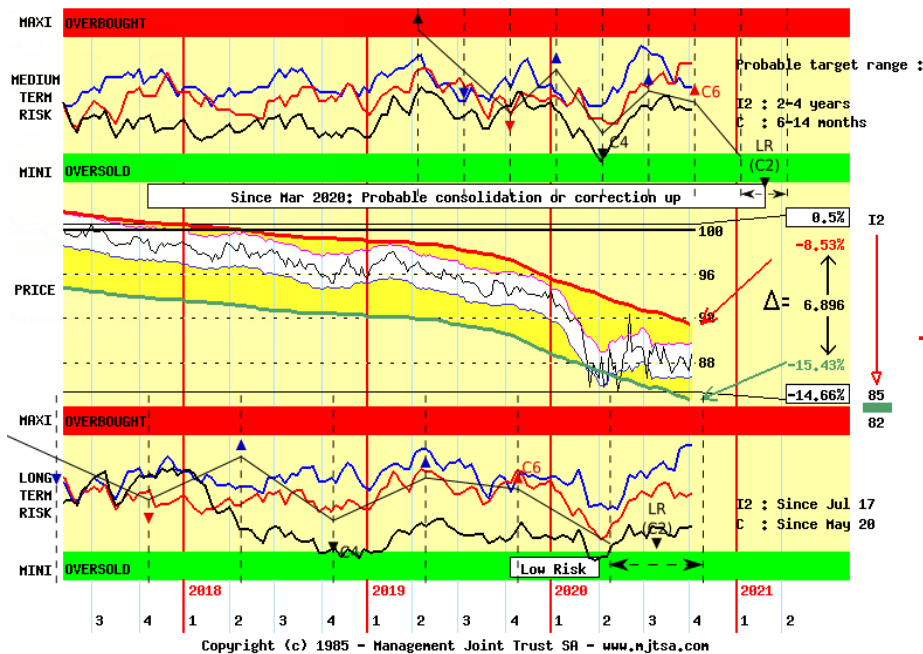
Daily graph or the perspective over the next 2 to 3 months



Shorter term, on the Daily graph, VIX remains under downside pressure, **A slight bounce is expected from late October into mid/late November, yet probably remains below the levels of its early September bounce**. Following that, from mid/late November, we would expect VIX to resume lower once again into early next year in first instance. Downside targets are probably towards the mid/high teens.

S&P500 equal weighted vs the S&P500 Index

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

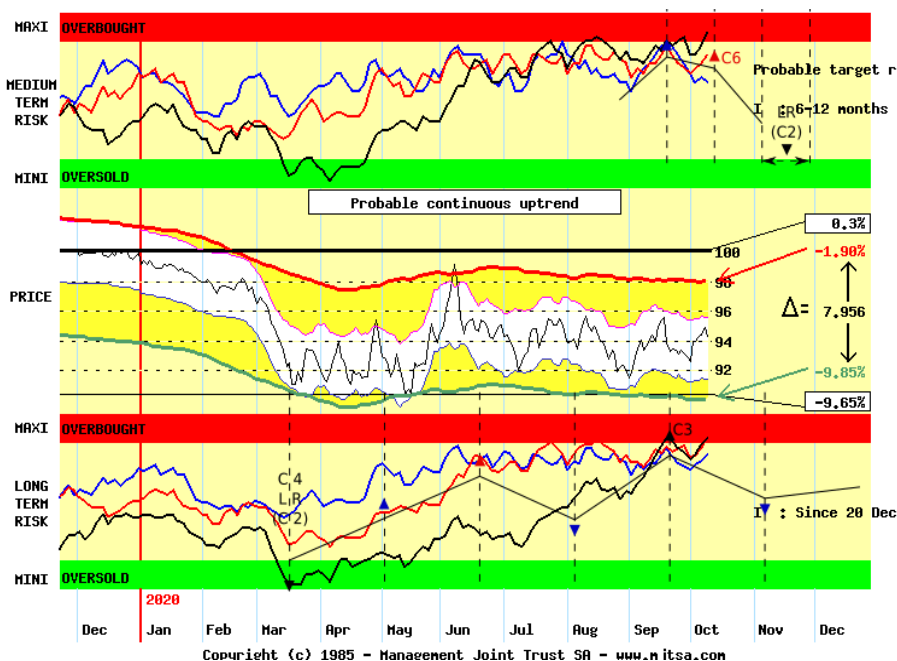


We now consider market breadth by comparing the S&P500 equal weighted ETF (RSP) to the one mirroring the S&P500 (SPY). The ratio is similar, yet less dynamic than the one comparing the Russell 2000 Small Cap index vs the S&P500. While our long term oscillators (lower rectangle) may have reached a long term Low Risk position, our medium term ones (upper rectangle) suggest a **downside retest** from now into Q1 next year. This may prove defensive, but could also be the result of further outperformance by Big

Growth profiles vs the others. Our view is that it is probably a bit of both, first defensive into mid/late Q4, and then Growth oriented, as these profiles probably lead again following the consolidation period we expect over the next month or so.

S&P500 equal weighted vs the S&P500 Index

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

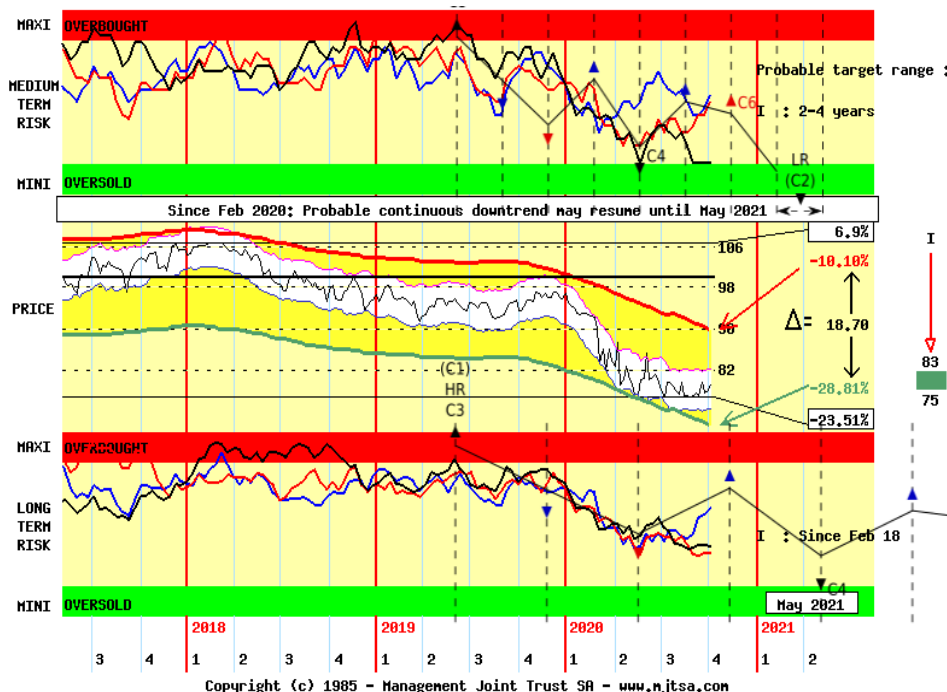


Shorter term, on the Daily graph, both our oscillator series (lower and upper rectangles) are in the Overbought zone, while prices have been rolling over again since their early June spike. This suggests a **further downside retest** initially into November, and perhaps further out into early next year. Our Impulsive targets to the downside (right-hand scale) are pointing to circa 5 to 7% of underperformance risk for the ratio over the next few months. This we believe is rather

negative for cyclical, value and medium and small cap profiles vs the Big Growth Mega Caps.

US Financials sector vs the S&P500 Index

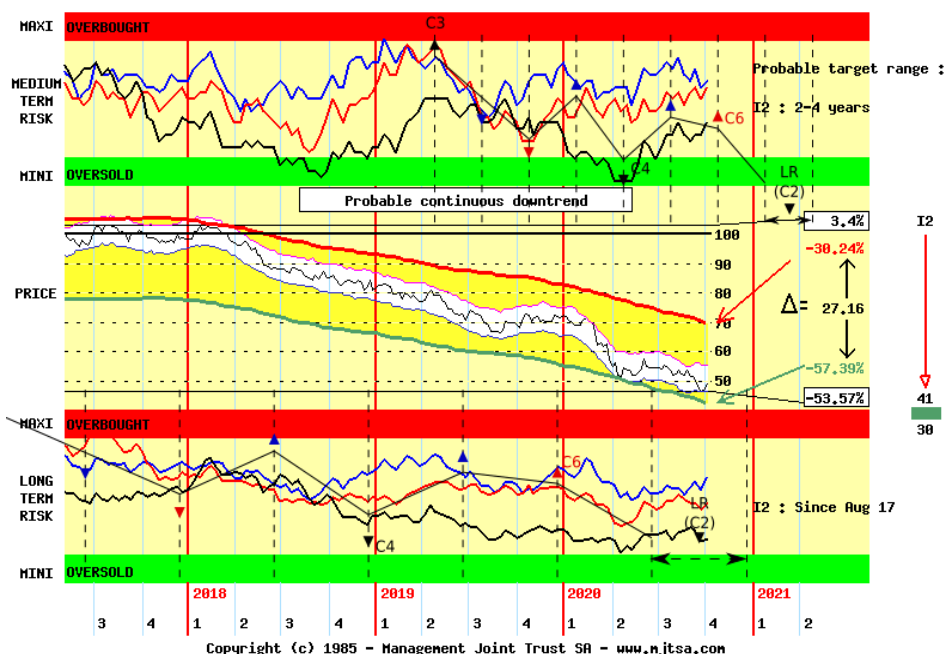
Weekly graph or the perspective over the next 2 to 4 quarters



We now consider more Value driven profiles and compare the US Financials sector vs the S&P500. The ratio has been in a downtrend from early 2018 and accelerated lower early this year. In terms of targets, the move may be quite exhausted as it has reached deep into our I Impulsive targets to the downside (right-hand scale). Yet, on both oscillator series (lower and upper rectangles), we would expect **a further retest down, probably from late this month into mid Q1, perhaps Spring next year.** This extension corresponds to the downside retest we also expect on Treasury yields until then.

European Banks sector vs the Europe Stoxx 600 Index

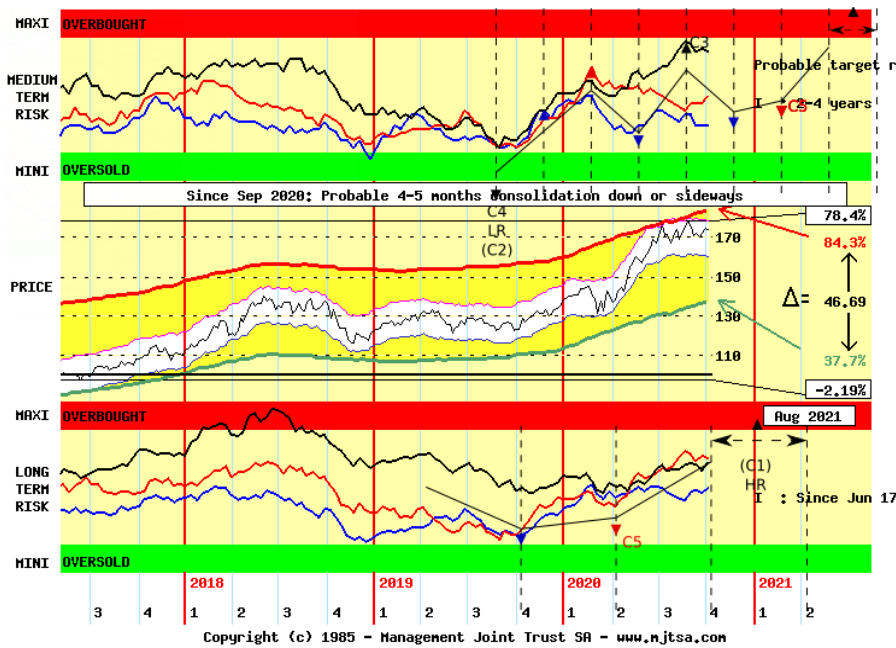
Weekly graph or the perspective over the next 2 to 4 quarters



Similarly in Europe, we consider Banks vs the Europe Stoxx 600 Index. The ratio has also reached a Low Risk situation on our long term oscillators (lower rectangle). Yet, our medium term ones (upper rectangle) are pointing **to further downside pressure into mid Q1, perhaps into next Spring.** On the price targets front, our I Impulsive targets to the downside have been achieved (i.e. the downtrend is already quite mature), yet, our I2 Impulsive 2 extended targets to the downside may be considered (right-hand scale). They suggest **at least 10% of further under-performance risk.**

Nasdaq100 index vs the US Staples sector

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

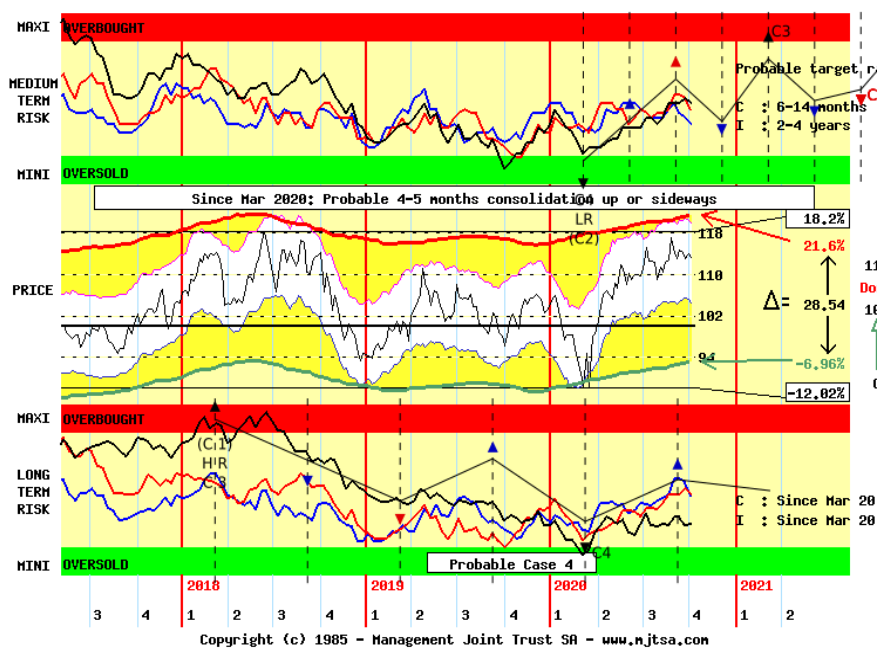


As we have done over the last couple of letters, we now revisit the ratio of the Nasdaq 100 index vs the US Staples S&P sector index. On this Weekly graph, it topped out late August on our medium term oscillators (upper rectangle) and **could remain in an intermediate consolidation phase into mid Q4**. Thereafter, both oscillator series (lower and upper rectangles) suggest **further upside into Q1**, perhaps Spring next year. We believe this indicate a rather risky environment into mid/late Q4 and then a more bul-

lish trend into next year.

European Technology sector vs European Utilities

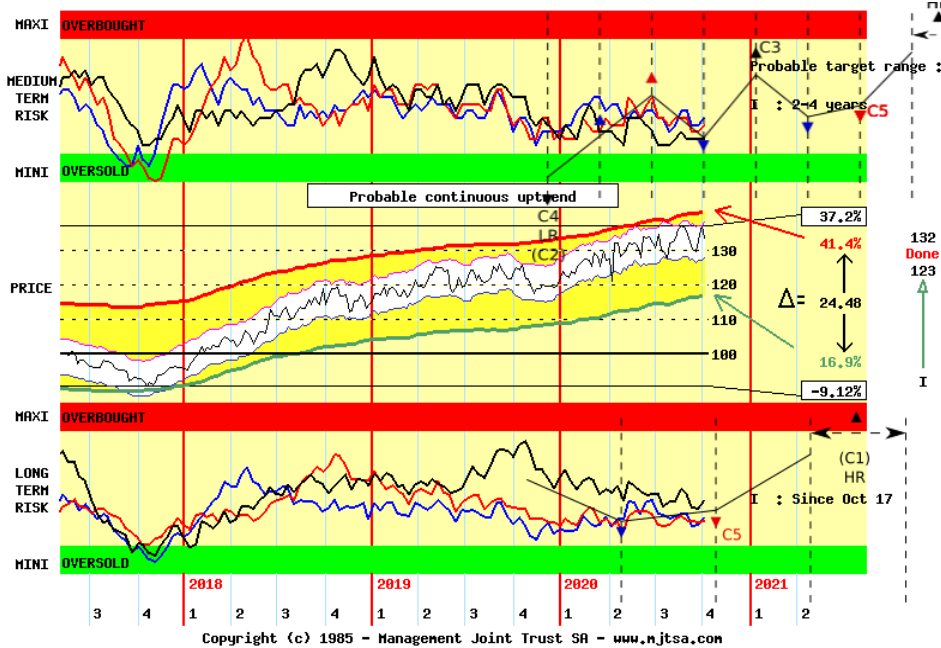
Weekly graph or the perspective over the next 2 to 4 quarters



In Europe, we perform a similar comparison by comparing the European Technology sector vs European Utilities. The ratio also made an intermediate top mid Q3, **probably corrects down into mid/late Q4**, and then should resume its uptrend into late Q1 at least. **Upside targets are still quite compelling, 10 to 20% above current levels** according to our I Impulsive targets to the upside (right-hand scale). This is also rather risk-ON into next Spring, following further consolidation into mid/late Q4.

US Consumer Discretionary sector vs US Materials

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

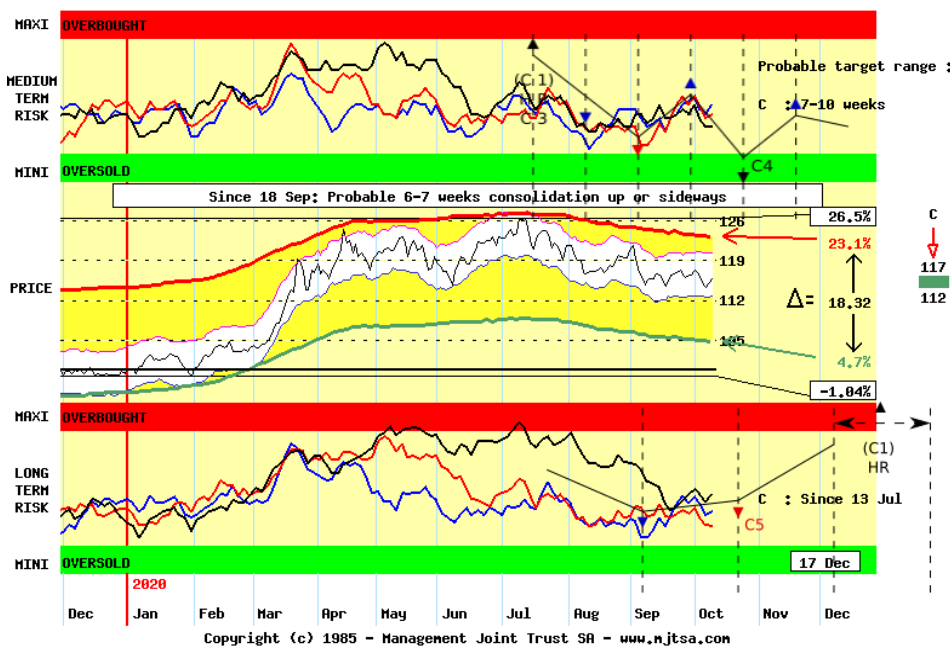


There is currently a strong debate about a change in leadership on the sector front. In fact, the battle has been going on since March and the beginning of the equity recovery rally. We hereby compare the US Consumer Discretionary sector (XLY ETF) to US Materials (XLB ETF). With US Industrials (XLI ETF), US Materials have indeed been the strongest cyclical sector in the US since March. US Consumer Discretionary (XLY ETF) and US Technology (XLK ETF) on the other hand had outperformed all other sectors, into August at least. **This Weekly comparison suggests that Growth themes remain in an uptrend vs cyclical ones, probably into early Q1 at least on our medium oscillators (up-**

per rectangle) and potentially into next Spring on our long term ones (lower rectangle).

European Technology sector vs European Industrials

Daily graph or the perspective over the next 2 to 3 quarters



Shorter term, in Europe, we consider the smaller European Technology sector vs European Industrials, i.e. the strongest European Cyclical sector since March. The ratio has been consolidating down since early July as cyclical sectors started a new rally following their early June sell-off. On both oscillator series (lower and upper rectangles), **we expect the ratio to find a new support point soon, into mid/late October, and then rise into November and probably early next year in first instance. This, we believe, could be rather risk-off into mid/late November, but then probably proxies renewed strength of Growth themes vs Cyclical ones.**

Concluding remarks:

Supported by the huge liquidity injections since March, equity markets have probably started a new long term uptrend. We expect them to rise into next Spring and then perhaps into 2022. Both the S&P500 and the EuroStoxx 50 may reach above 4'000 over the next 18 to 24 months. In the meantime, however, a first leg up is currently probably being completed and we would expect some consolidation, probably at high levels (3'200 support of the S&P500, 3'000 on the EuroStoxx50) into mid/late November. Following that, the uptrend probably resumes into year-end and then next Spring. The pattern on VIX seems to confirm this scenario with a series of declining highs since March, and a possible further rebound (yet below previous ones) into mid/late November. It then resumes lower into early next year and probably to below 20. On the factor and sector front, breadth and cyclical sectors such as Financials remain weak into mid Q1 at least. Growth consolidates vs Defensive profiles into mid/late Q4, but then outperforms towards year-end and into next Spring. Vs more Cyclical profiles, this outperformance is already starting and could extend into early, perhaps Spring next year.

33 / China bounces back strongly – what that means to the Rest of The World

Many observers think that the COVID-19 virus is something that the global economy will never recover from. Some doctors say that gaining herd immunity is not a slam dunk – unlike what happens when someone gets measles or chicken pox. Apparently, that is not the case with the coronavirus. If it really does come back after someone was exposed to it – that very bleak new for vaccines. And if true, that could be bad news for any economy that has been hobbled by the measures dealing with this virus.

Even if US GDP recovers (most recent Estimate has US GDP rising to circa 36% in Q3 2020 -- just 3% short to get back to where the economy was pre-COVID-19). Many people believe that there's an awful lot of pain suffered by the economy which will manifest as companies run out of capital or struggle to recover under the new debt loads.

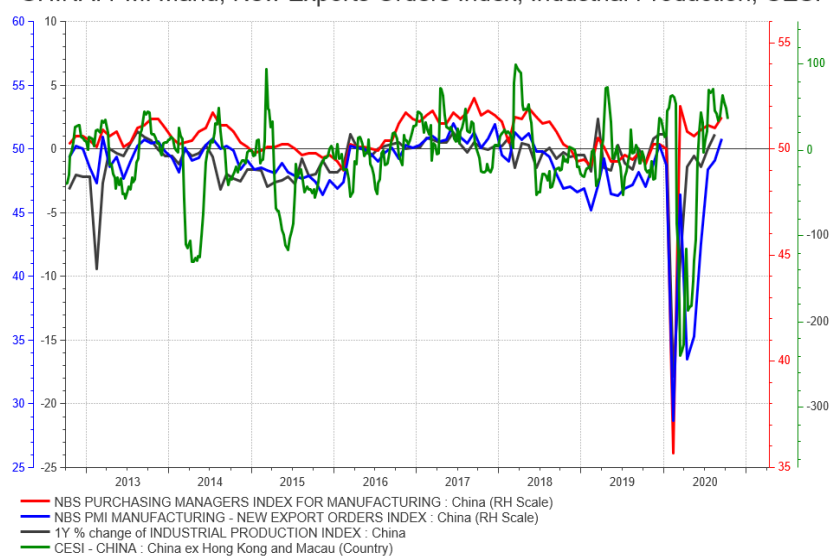
However, one may also believe in the contrafactual – that modern economies are robust, and even if there are problems going forward, we will be able to work through them. One can be too optimistic, but if one looks at China, maybe we all have reasons to be optimistic, after all.

The China case

China has couple of months ahead of the rest of the world in their experience with Covid-19. They got it earlier, locked down sooner, put some really draconian measures to prevent its spread, then opened up before any country did. The economic performance of China post COVID-19 is something to be envious about – their economic performance as providing an example of a path to recovery.

So, what's been happening in China then that is worth emulating? We're interested for several reasons, one of which is the description of that possible future path for the rest of the world. The other is that it's the second largest economy on the planet currently has

CHINA: PMI Manu, New Exports Orders Index, Industrial Production, CESI



increased demand, and that will help boost the global economy. They may indeed run a trade surplus but that means China would be buying stuff from the rest of the world.

China's industrial production

Industrial production isn't everything a modern economy has aplenty but it's a useful guide when discussing China's economy because that sector, for China, is proportionately very much larger than any economy in the West has. China industrial production has been booming after recovering during the dark days of Q1 2020. *(see first chart on this page)*

The recovery of China's industrial production accelerated in August with the total output growing at 5.6% y/y, up from 4.8% in July. Note that the data is year-over-year. It is not month on month calculation, where we see that production is rising from the post-coronavirus or lockdown depths. This is the rise on a year ago. And this rise is around and about the same as the rising production was a year ago. That is impressive, indeed.

The Chinese economy obviously has lost the production from lockdown -- but that shortfall has been made up for, and it's gone. Moreover,

the economy has recovered to not only the previous rate of production but also added the expected growth we would have looked for without that lockdown. That is, if we reckon in medium-term outlook (of 10 months and counting), the coronavirus has made no difference at all to Chinese industrial production.

The importance thing for the rest of the world is that here is the proof -- real world, empirical proof -- that extremely negative forecasts are not necessarily the only possible ones. China provides hard evidence that other, much better outcomes are possible, even after the worst that the COVID-19 pandemic has brought forth.

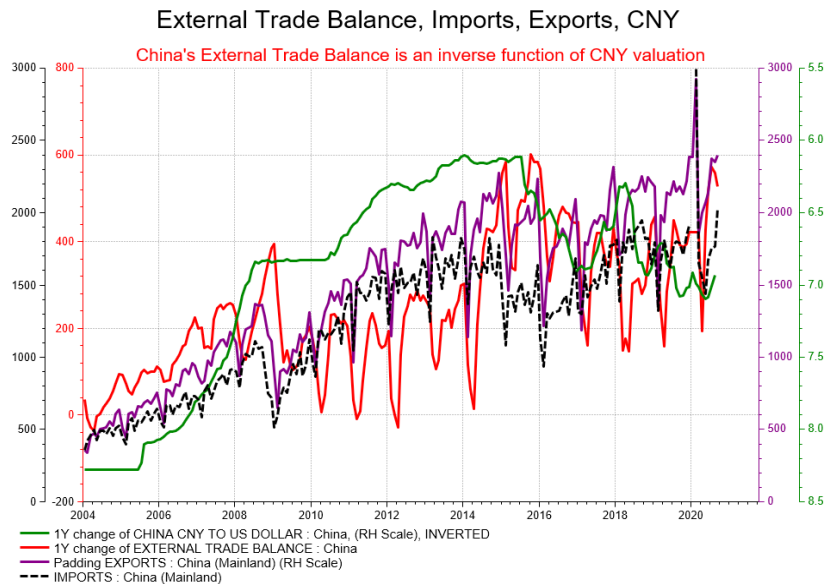
China trade

It was not only industrial production which prospered in China – trade was also a very bright spot. China posted a 9.9% y/y rise in exports, while imports surged 13.2% thanks to higher domestic demand. (see 1st chart on this page)

The size of the trade balance, either way, is not really an important metric at this time. But trade is obviously increasing on both the import and export side. This is an economy that really is growing, although it is easy for some to ascribe the data to some imaginary numbers concocted by China's data keepers. We do not believe so – those numbers do add up.

The importance of China's recovery

The importance of the China growth data is that it serves as proof that economic recovery from the ravages of COVID-19 is not impossible. If China can, then the Rest of the World can, too. So, yes, there're still further outbreaks to be managed, more stimulus needed and disbursed. But the existence out there of a major economy that has recovered, fully, not just to the starting point but making up the loss of 6 months of growth, tells us that global recovery is indeed possible.

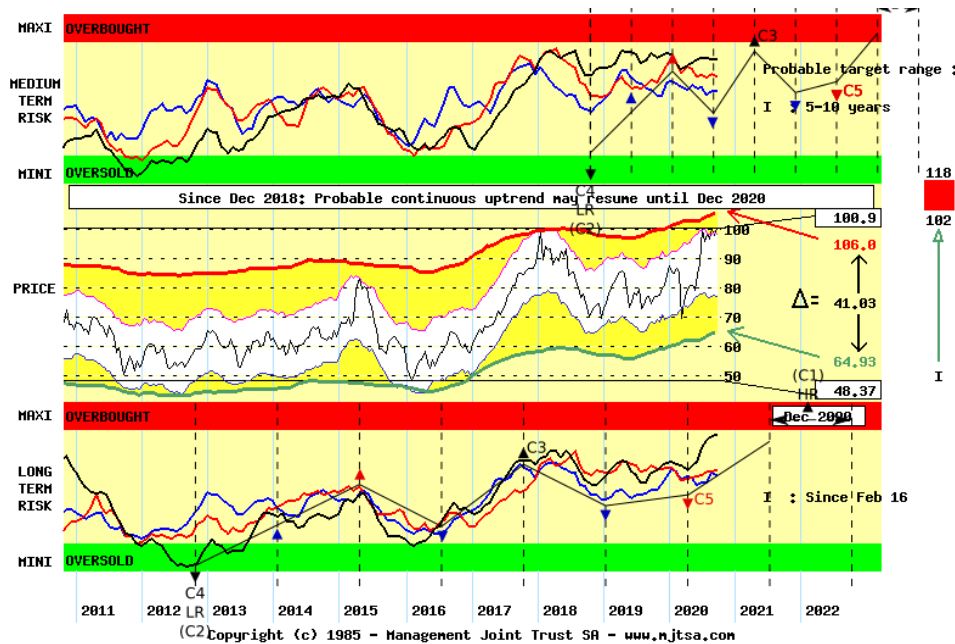


China outperforms into year-end as equities consolidate, yet also remains strong on an absolute basis into late next year

On a relative basis, Chinese equity markets have historically been counter-cyclical, and this year even more so. By definition, this is what you could expect from the world's second largest economy. As we anticipate some consolidation on equity markets during Q4, China may represent an interesting opportunity on a relative basis. More generally, in this article, we review the long term prospects for the MSCI China, the Shanghai Composite or the Yuan, and consider arbitrage opportunities between some of the main market/sector ETFs which are available on Chinese equity markets.

MSCI China Index

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

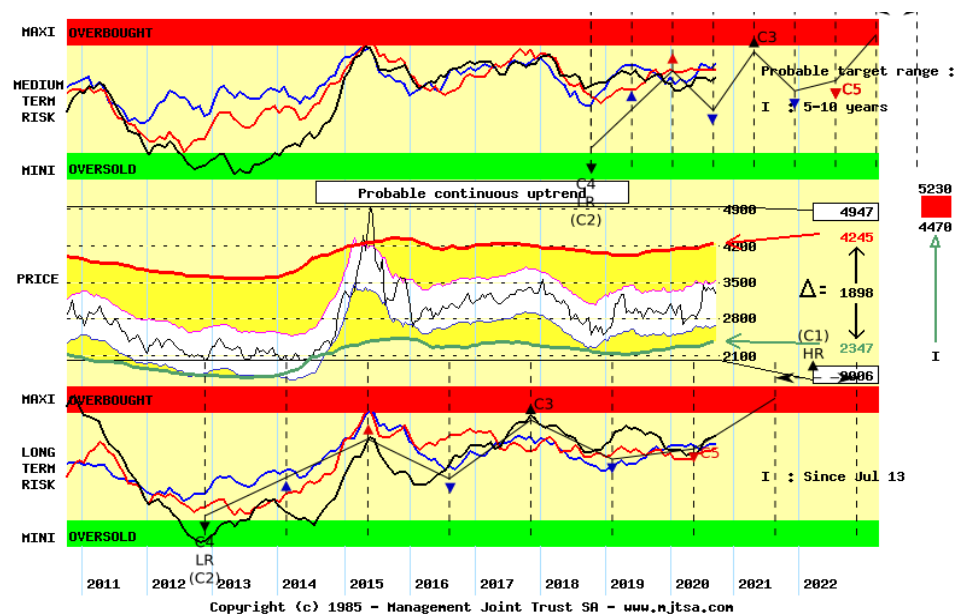


Following its strong recovery during the 2016 and 2017 reflation trade, the MSCI China entered a 2 years retracement period in early 2018, i.e. with the beginning of the trade war between the US and China. Since late 2018, it has built a base (at higher levels than the early 2016 lows) on both oscillator series (lower and upper rectangles), and since March has probably started a new acceleration phase to the upside. Our medium oscillators (upper rectangle) suggest that **the current move up may last into the Spring in first instance (probably towards an intermediate top)**, while our long term ones indicate further upside

into 2022. Our I Impulsive targets to the upside (right-hand scale) indicate 12 to 18% of additional potential until then.

Shanghai Composite

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

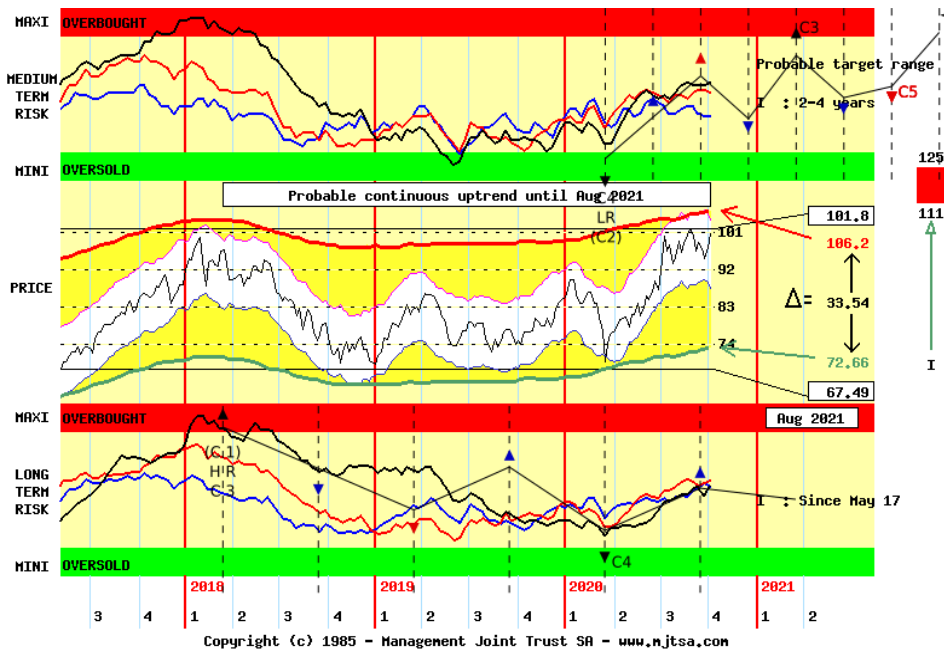


The Shanghai Composite is more value oriented. It is also probably still recovering from its 2015 spike and subsequent sell-off. Yet, the configurations we show on both oscillator series (upper and lower rectangles) are the same as the ones we expect on the MSCI China Index featured above. Here also, we expect **further upside towards an intermediate top next Spring** on our medium term oscillators (upper rectangle), **and thereafter a continuation of this trend into 2022** on our long term ones (lower rectangle). The I Impulsive targets to the upside on this bi-monthly graph are pointing to the 4'470 – 5'230

range over the next couple of years (right-hand scale). This may be aggressive considering that these targets are based off historical volatility and implicitly off the huge pump and dump move during the 2015 spike. If we consider these same I Impulsive targets on a Weekly basis (not shown here), they would point **towards the 4'000 mark. This level does seem achievable and a more reasonable target over the next few quarters.**

MSCI China Index

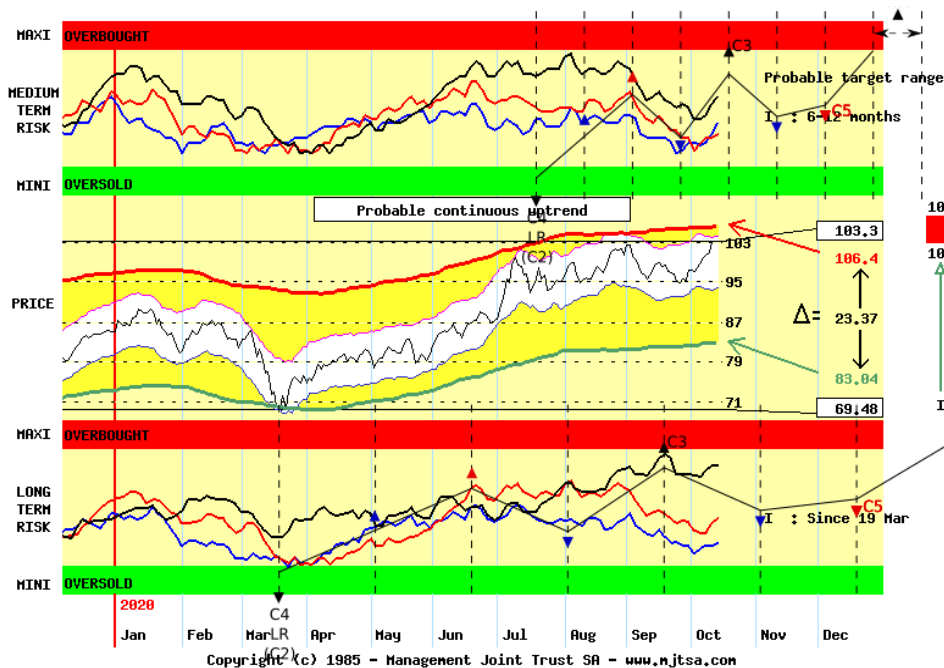
Weekly graph or the perspective over the next 2 to 4 quarters



On a Weekly basis, China has seen a very strong leg up since the March lows and has broken above its 2018 highs. It may have just reached an intermediate top on both oscillator series (lower and upper rectangles) and could see **some consolidation during Q4**. From mid/late Q4, it then resumes its uptrend into late Q1 in first instance. Our I Impulsive targets to the upside (right-hand scale) suggest that it could reach the 111 – 125 range by then, or 10 to 25% above current levels. Hence, we are still very constructive into the Spring on Chinese equity markets.

MSCI China Index

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

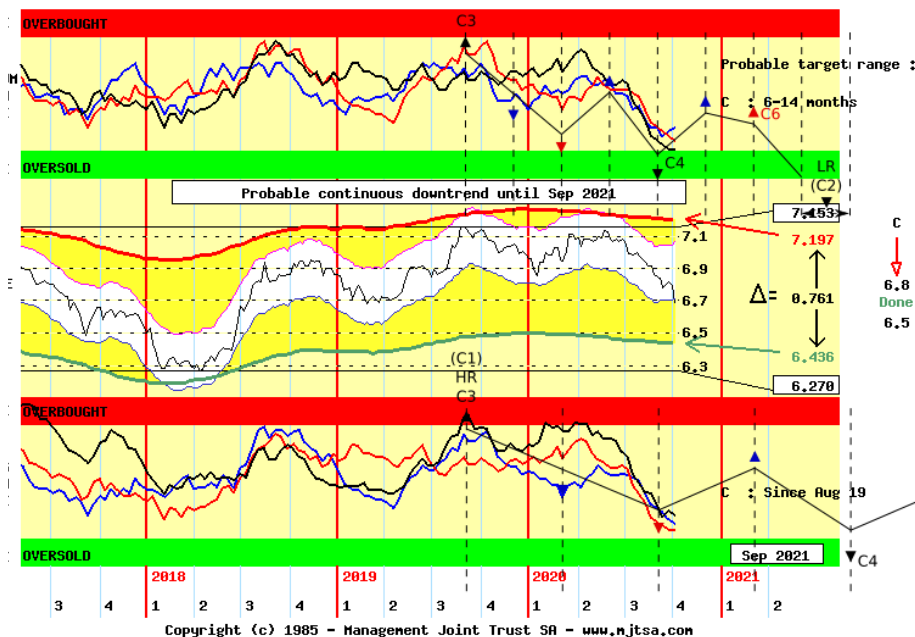


The MSCI China is currently retesting up, slightly above its early September highs. The move may continue another week or so on our medium term oscillators (upper rectangle), but then probably corrects down into mid/late November. Our long term oscillators (lower rectangle) are now **also in consolidation mode**, probably into early November at least. Thereafter from mid/late November, we expect both oscillator series to gradually resume their uptrend, first towards early next year and probably towards next Spring. On the target

front, the downside potential over the next month or so is probably limited (intuitively towards the low 90s). Thereafter, the upside potential is pointing to the 100 – 109 range (right-hand scale) or circa 5% above current levels towards early next year.

USD/CNY

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

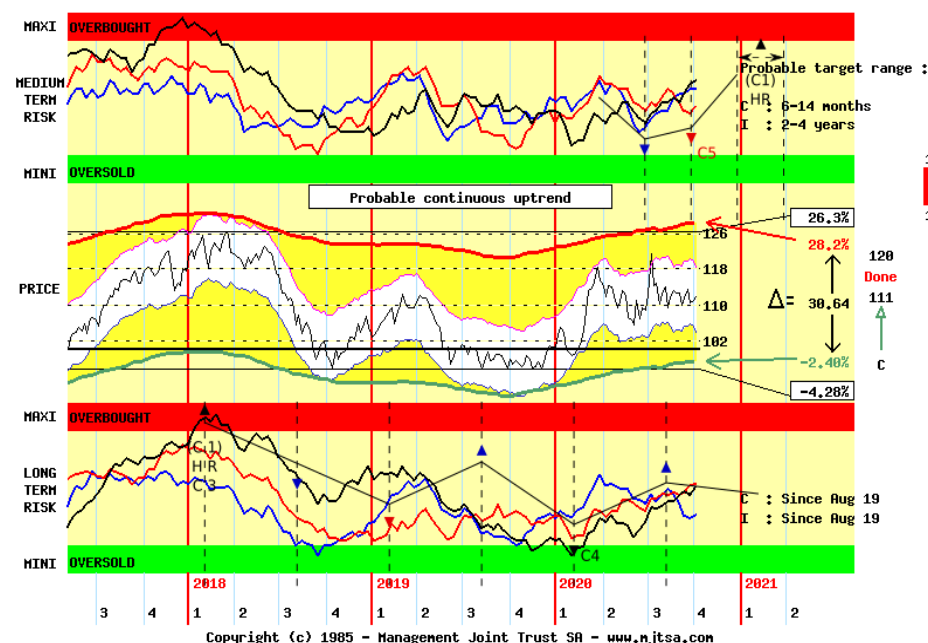


A stronger Yuan (a weaker USD/CNY) usually accompanies stronger Chinese markets on a relative basis. Yet, discrepancies lasting several months can often appear such as the Chinese outperformance in Q1 this year, while the USD/CNY was retreating up. Indeed, back then, both the US Dollar and Chinese markets were quite defensive, as the rest of the World was hit by the spread of the Covid-19. We believe a similar situation may materialize over the next couple of months as equity markets consolidate into mid/late Q4. Indeed, on both oscillator series (lower and upper rectangles), **we would expect USD/CNY to bounce**

during Q4. This bounce however shouldn't be very strong, neither last too long, and, as shown on our medium oscillators (upper rectangle), we believe that from late Q4, USD/CNY probably resumes its downtrend into next Spring, perhaps even until mid 2021. The support of the lower end of our C Corrective targets to the downside around 6.5 could be challenged by then.

MSCI China vs the All Country World Index

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

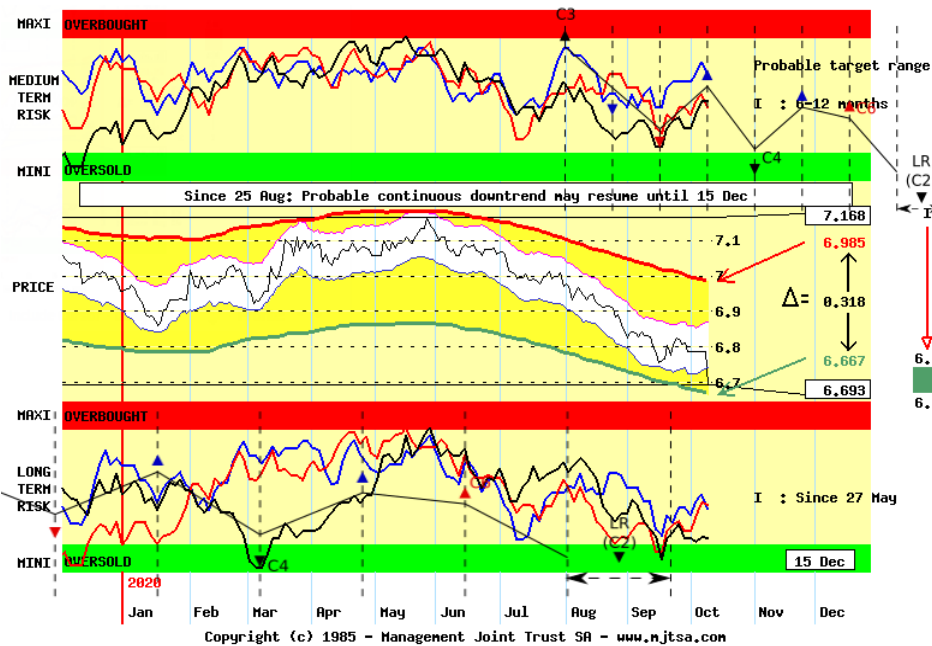


The ratio of the MSCI China index vs the All Country World Index may have reached an intermediate top in March on our medium term oscillators (upper rectangle) and in early July on our long term ones (lower rectangle). Both were then followed by a 2-3 months consolidation period, with higher lows however between late May and today. Indeed, **we believe that the complex sideways pattern since March constitutes a base**, and that, as shown on our medium term oscillators (upper rectangle), **the ratio could now be getting ready to accelerate to**

the upside again into late this year / early next year. By then, it may challenge the upper end of our C Corrective targets to the upside around 120 (right-hand scale), perhaps opening the door to **further Chinese outperformance during 2021 (i.e. towards our I Impulsive targets to the upside in the 136- 140 range).**

USD/CNY

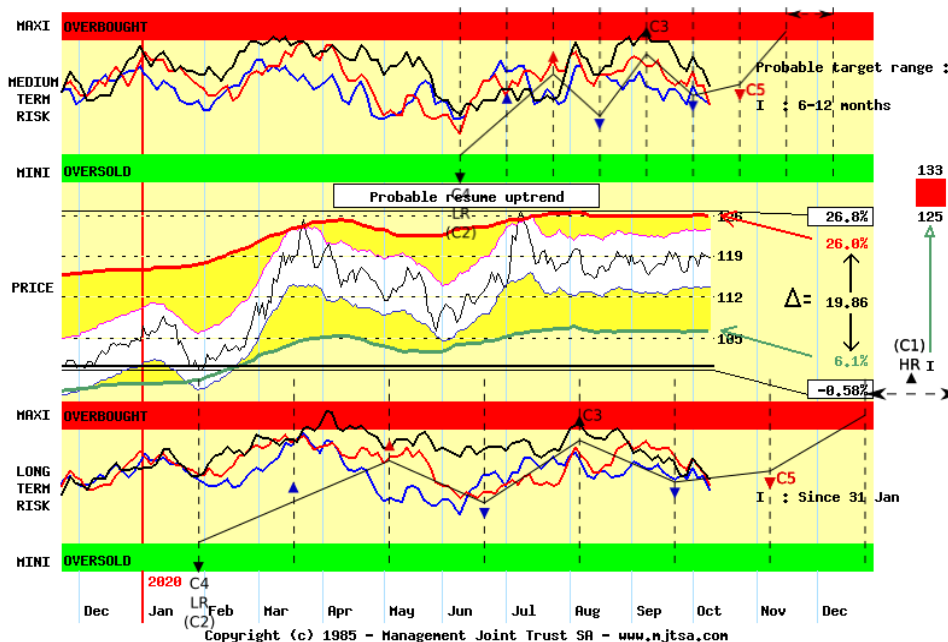
Daily graph or the perspective over the next 2 to 3 months



Shorter term on the Daily graph, USD/CNY may attempt to bounce from late October into mid/late November. Yet this bounce should remain rather weak and the pair should then resume its downtrend from late November / early December into next year.

MSCI China vs the All Country World Index

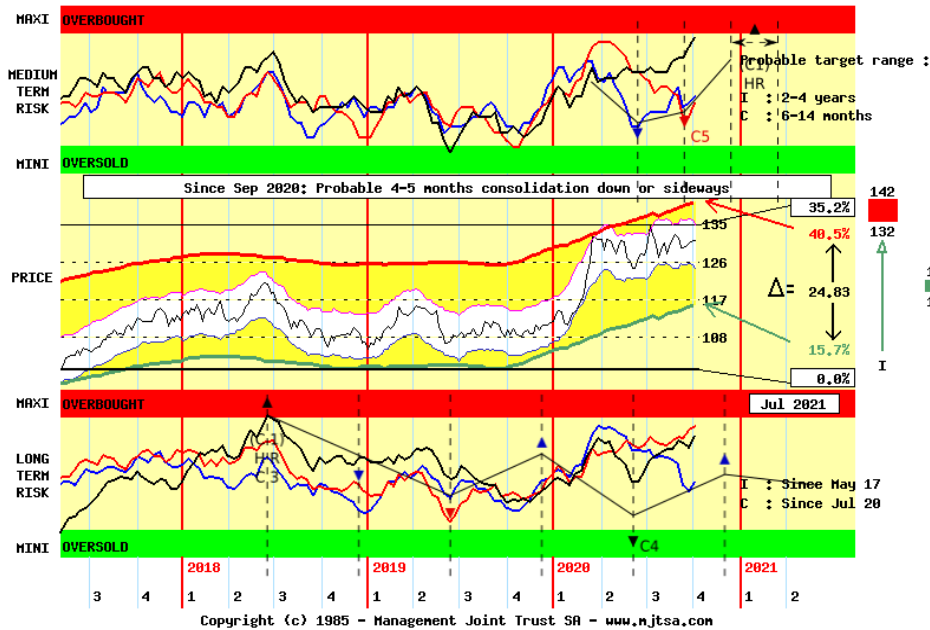
Daily graph or the perspective over the next 2 to 3 months



As for the ratio of the MSCI China vs the All Country World index, we expect it to find support on both oscillator series, from mid/late October on our medium term oscillators (upper rectangle), perhaps from early November on our long term ones (lower rectangle). It could then rise into late November / December and potentially into early next year. According to our I Impulsive targets to the upside (right-hand scale), the upside potential is towards the 125 – 133 range or circa 6 to 14% above current levels on a relative basis.

MSCI China vs the MSCI Emerging Markets Index

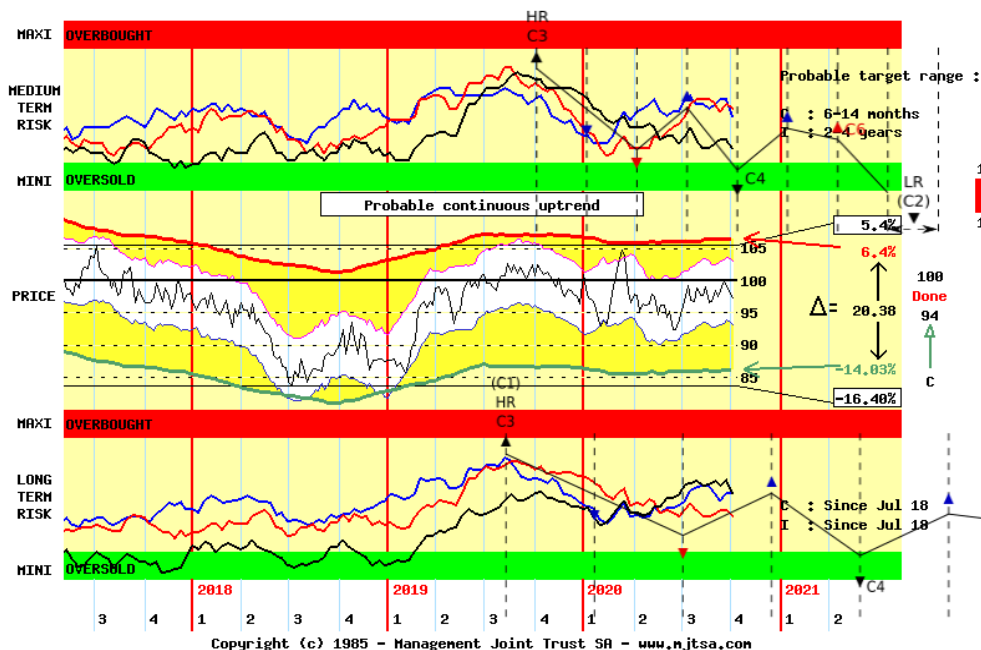
Weekly graph or the perspective over the next 2 to 4 quarters



Vs the global Emerging markets index, China shows a more defensive / less cyclical profile, and on both oscillator series (lower and upper rectangles), we would expect **the ratio to rise into late this year / early next year**. Our Impulsive targets to the upside (right-hand scale) suggest that **it could reach the 132 – 142 range by then or potentially 10% above current levels on a relative basis**.

CSI 300 Index vs the MSCI China Index

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

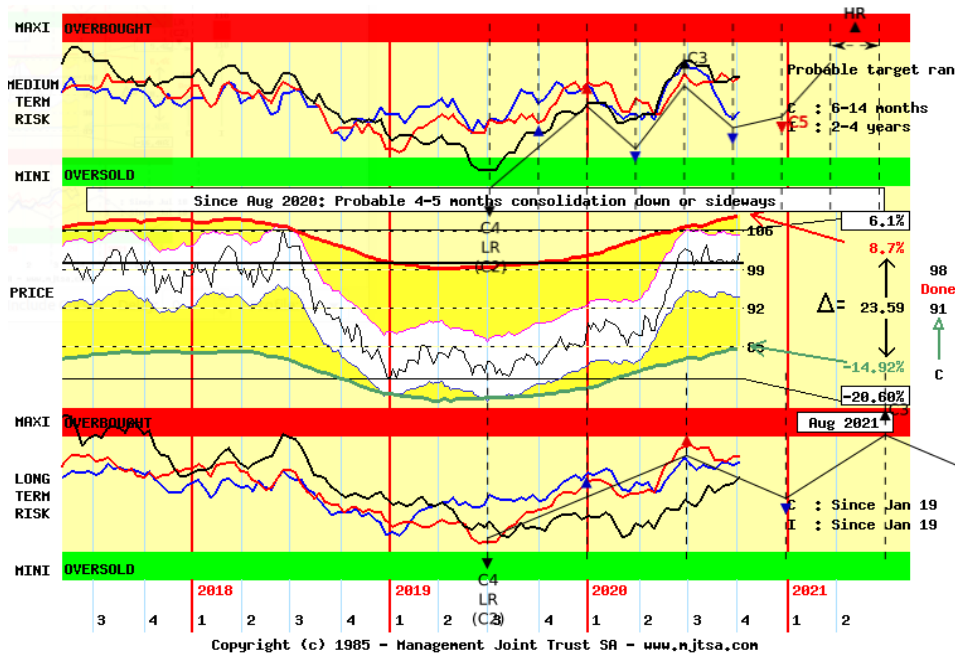


We now compare various Chinese Indexes and sectors, and first the more domestic CSI 300 index (ASHR ETF) vs the MSCI China Index (MCHI ETF). **Over the next few months, i.e. into late this year / early next year, the more domestic CSI 300 index may continue to bounce vs the Chinese MSCI Index**, as shown on both oscillator series (lower and upper

rectangles). Indeed, it is more countercyclical, as the price action this year would attest (e.g. the March and June/July bounces in the ratio). **From early next year, we then believe that the CSI 300 could underperform again into next Spring as the more international MSCI China index follows global markets in a strong further leg up.**

CSI Information Technology vs the MSCI China Index

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

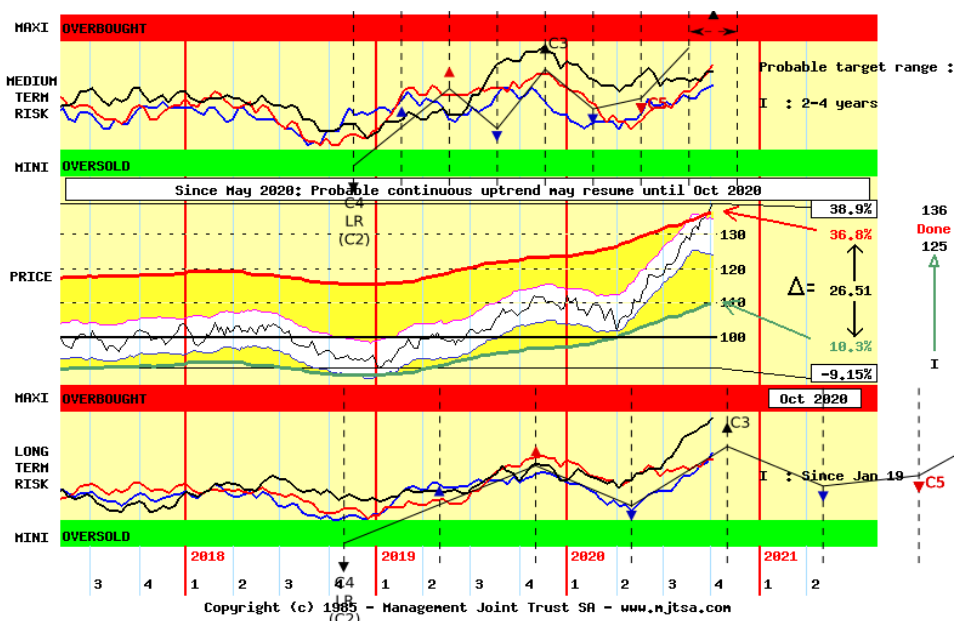


The Chinese CSI Information Technology Index (KWEB ETF) is rather high beta vs the MSCI China index. It is also more Growth oriented. Hence, similarly to the ratio of the Nasdaq100 vs the S&P500 index, this comparative has been rising this early 2019. Recently, during Q2, it accelerated to the upside and above the resistance of our C Corrective targets to the upside around 98 (right-hand scale). It has since been consolidating at high levels, but **could soon resume its uptrend on our medium oscillators (upper rectangle), and at the latest**

could do so from late Q4 on our long term ones (lower rectangle). It then rises into Spring next year with 10 to 20% of further outperformance potential, as indicated by our I Impulsive targets to the upside (right-hand scale).

MSCI China Consumer Discretionary vs the MSCI China Index

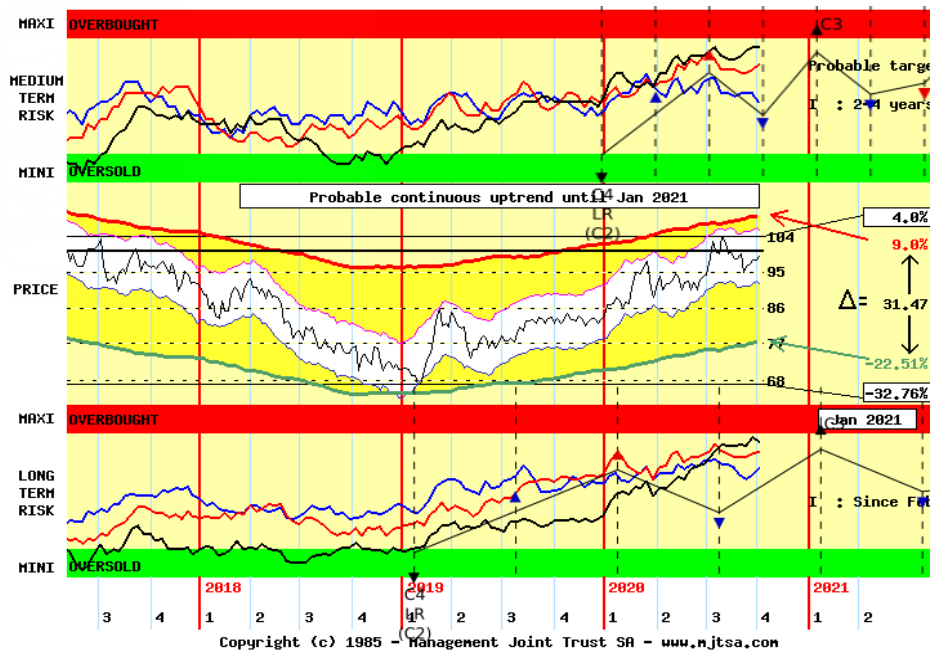
Weekly graph or the perspective over the next 2 to 4 quarters



The MSCI China Consumer Discretionary index (CHIQ ETF) has been a stellar outperformer this year vs the MSCI China (MCHI ETF). On both oscillator series (lower and upper rectangles), **it could now be reaching an intermediate top. We hence expect the ratio to correct down during Q4 as the environment turns more defensive.** We will then look for a new entry point on the ratio from early next year, at the latest from next Spring.

SME ChiNext 100 Index vs the MSCI China

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

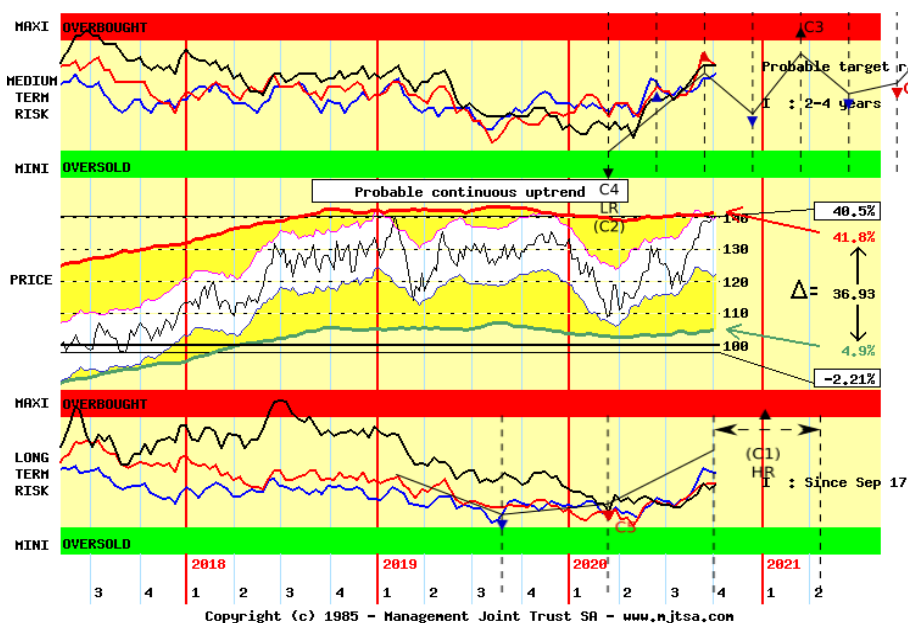


The ChiNext100 Small and Mid Cap index (CNXT ETF) is domestic oriented, but also high growth. It is similar to what the German Neuer Markt was a couple of decades ago. Since early 2019, it has outperformed the MSCI China (along with most Growth trades), but does appear more countercyclical than the MSCI Information Technology index analyzed above (i.e. strong outperformance in March as well as in June/July this year). On both oscillator series (lower and upper rectangles), we expect its ratio vs the MSCI China to **outperform into late this year / early next year.**

Upside potential over the next few quarters is also interesting according to our Impulsive targets to the upside (right-hand scale), possibly between 8 and 20% higher than today.

MSCI Consumer Discretionary vs the SME ChiNext 100 Index

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



We conclude our analysis of various Chinese equity profiles by comparing the pro-cyclical MSCI Consumer Discretionary Index (CHIQ ETF) with the more domestic, yet also Growth oriented, SME ChiNext100 Index (CNXT ETF). Since late last year, the ratio has followed a risk-ON profile. **We expect it to consolidate down during Q4 along with most equity markets (we would favor CNXT during this period), and then from late this year / early next year, resume its uptrend towards the Spring (we would then switch back to CHIQ).** Upside potential over the next few quarters could extend up to 161 according to our Impulsive targets to the upside (right-

hand scale), or **circa 10 to 20% above current levels in favor of CHIQ.** This, we believe, is rather risk-ON into next Spring.

Concluding remarks:

The MSCI China Index could rise a further 10 to 20% into next Spring, while the Shanghai Composite may reach up to 4'000 or 10 to 15% above current levels. In the meantime, however, we expect Chinese equity markets to consolidate at high levels into mid/late Q4, yet, they will probably prove more resilient than Global markets, and outperform them during this period. Some of this outperformance may then be given up into the Spring, but, more generally, Chinese equity markets remain strong into late next year. On the currency front, we expect USD/CNY to bounce slightly over the next month or so as the Dollar is probably more defensive than the Yuan, but then to resume lower into next Spring, and to below 6.5. Within China, we would favor more domestic indexes during Q4, as they are more counter-cyclical (e.g. the CSI 300 Index or the SME ChiNext100 Index)- We would then switch back to more pro-cyclical ones from late this year / early next year, and probably towards next Spring (e.g. the MSCI China Index, the CSI 300 Information Technology index or the MSCI Consumer Discretionary Index).

42 / Copper prices will continue to rise on the back of better global economic prospects, led by China

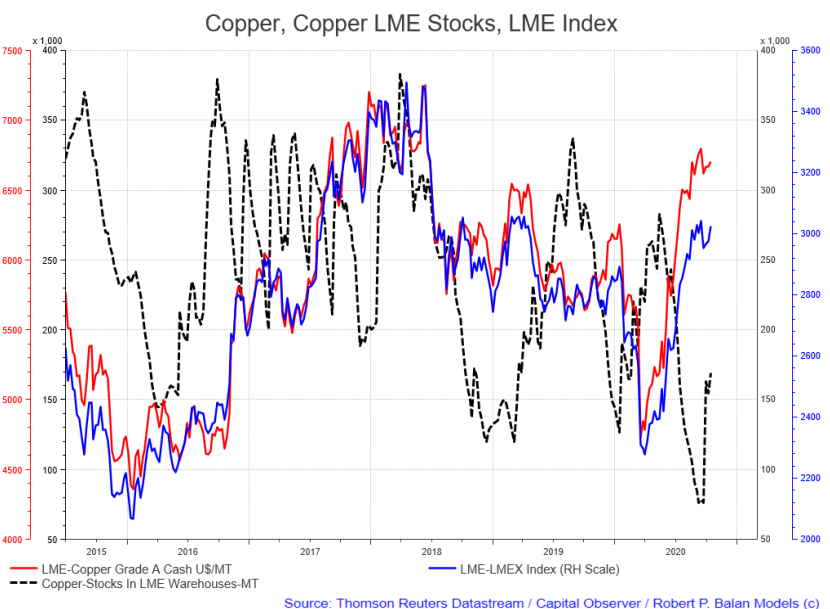
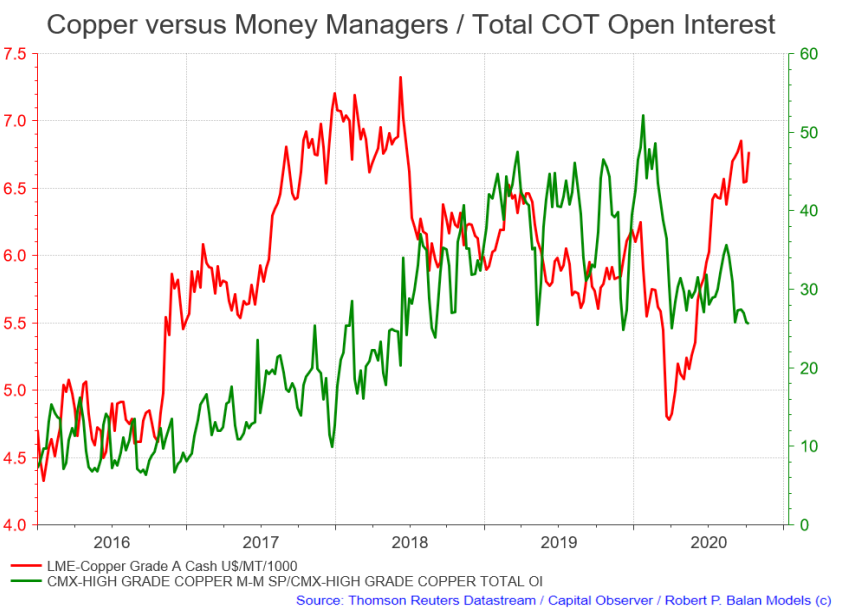
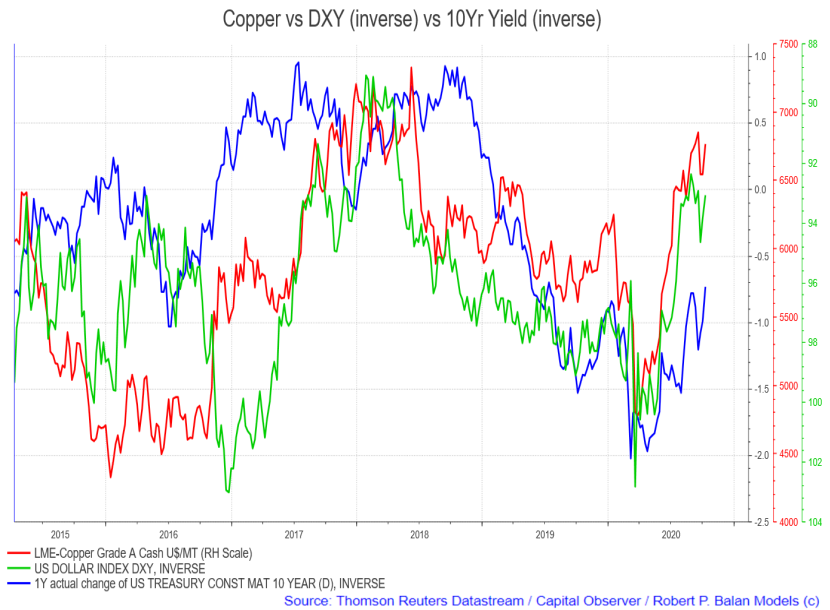
Copper is the leader of the base metals sector. Q3 2020 took the price of nearby COMEX futures 11.76% higher, and LME copper rose by 9.41%. Over the first nine months of 2020, the base metal moved 8.42% on COMEX and 6.96% to the upside on the LME.

In early Q1, copper was trading significantly higher than Q4 2019, when the global pandemic began to take hold of markets and worsened throughout the quarter. The price fell to a low of circa \$4'800/MT on the in mid-March when a V-shaped recovery began and carried the price higher throughout Q2. In Q3, the buying continued as China's economy recovered, and copper rose to a peak of \$6'850/MT.

US interest long-term interest rates declined to the levels seen in the aftermath of the 2008 global financial crisis during Q1 and Q2 – that is very good for copper prices (see 1st chart on this page). Fiscal and monetary policy stimulus rose to unprecedented levels since March. The Fed's willingness to tolerate inflation above the 2% target rate, or any further weakness in the US dollar, and the tidal wave of liquidity were very positive factors for the price of copper and other commodities. We believe this will continue.

The dollar index traded in a wide range as the crisis unfolded, but the greenback index moved higher over the first three months of 2020. The dollar index reversed and retreated in Q2. In Q3, the dollar index continued to decline, and that enabled copper to break out decisively (see 1st chart on this page).

One favourable sign of likely rise in prices comes from data which shows that Money Managers (Hedge Funds) have significantly reduced their holding of short copper, and the Open Interest data shown below illustrates that. With lower resistance from HF short sales, copper should continue to rise from this factor alone. (see 2nd chart on this page)



Another significant indicator of the short-term price direction of the base metal tends to be the level of LME stocks. An over 60,000-ton rise in LME inventories over the final days of the third quarter weighed on copper and caused the price to suffer a significant correction on the first trading day of October 2020. *(See 3rd chart on previous page)*

Since mid-March, the copper market experienced a V-shaped recovery that took it to a higher high for 2020. The path of least resistance for the price of the red metal at the end of Q3 remained higher. However, the price action on October 1 was sobering for the copper market as the price fell dramatically.

That provides a warning that the economic fallout from the unprecedented halt in global business activity could continue to weigh on the prices of industrial commodities and base metals over the coming months and years. Nonetheless, if the 2008 GFC provides an example for the copper market, we could see far higher prices for the red metal in the coming months and quarters.

China's economic recovery (discussed in another article) is also a bright spot for copper and other commodities. Copper and other base metals should continue to trade higher over the next few quarters.

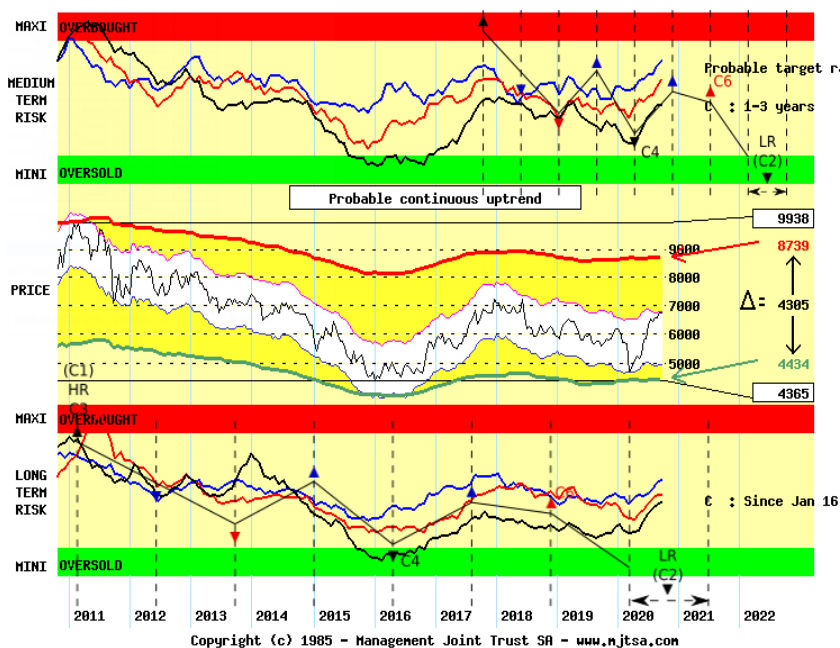
44/ MJT - TIMING AND TACTICAL INSIGHT

Dr Copper is seeing a promising recovery since March. Will it maintain its momentum into next Spring?

Copper demand is often seen as a sign of economic recovery. For China of course, given its historic strong infrastructure spending, but also for the rest of the world. The rally on Copper since March has been strong and has gone some way in recuperating its losses since early 2018. In this article, we will consider its prospects going forward as well as the ones for Copper related trades. We will assess if, as with the MSCI China Index, it could soon break above the 2018-2020 retracement range and enter a new secular bull market.

Copper Spot (LME, USD/ton)

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

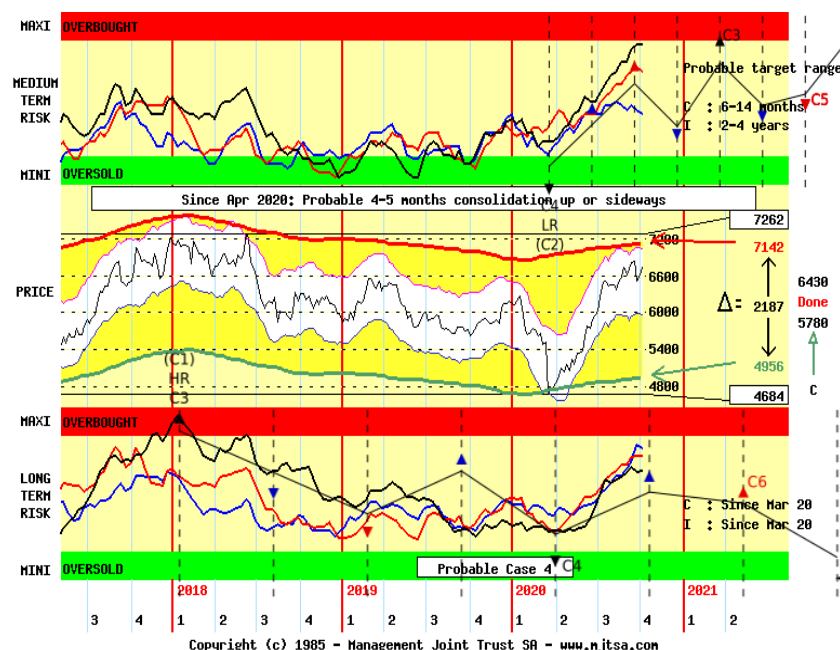


On this bi-monthly graph, the bounce of Copper since March is promising, yet one could argue that it is just a bounce, and that it may roll-over again over the next few months, potentially making new lows over the next couple of years. Indeed, for now, the rally since March is still below of C Corrective targets to the upside (right-hand scale), and hence theoretically still countertrend. Furthermore, as shown on our medium term oscillators (upper rectangle), the potential timing for the start of a new leg down is imminent. Yet, on our long term oscillators (lower rectangle), and considering the long term price action, the situation is more promising. Indeed, **Copper seems to have reached a Low Risk zone on our long term oscillators. Such situations usually indicate 1 or 2 years of correction to the upside at least. In addition, both these long term oscillators and price**

are showing that a promising base may have formed between early 2016 and March this year, with higher lows on both of their oscillators and price. For now, we are hence inclined to give this recovery rally on Copper the benefit of the doubt.

Copper Spot (LME, USD/ton)

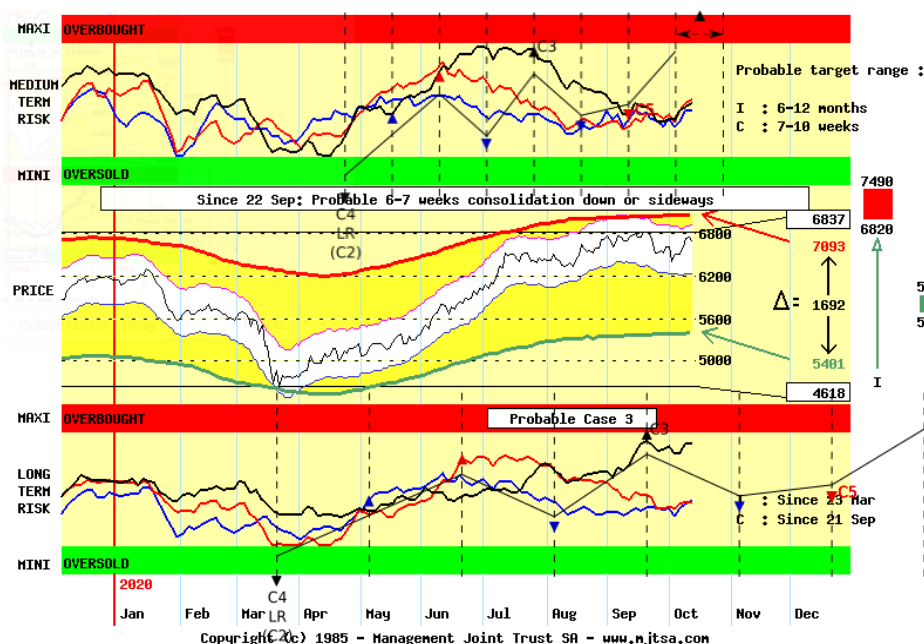
Weekly graph or the perspective over the next 2 to 4 quarters



Medium term, on this Weekly graph, the bounce of Copper prices since March appears very linear. It did break above our C Corrective targets to the upside, which we calculate around 6'430 (right-hand scale), and hence the move is now an impulsive one to the upside. On both oscillator series (lower and upper rectangles), **it may have recently reached an intermediate top and could see some retracement into late Q4, before rising again into next year** on our medium term ones (upper rectangle). On our long term oscillators (lower rectangle), the scenario we show is less positive and suggests a roll-over situation to the downside between now and the Spring and then a new sell-off into mid/late next year. As we are now in an impulsive move to the upside, we would consider this second option less likely and would favor higher highs into Spring. **According to**

our Impulsive targets to the upside (right-hand scale), the potential over the next few quarters is towards the 7'530 – 8'400 range.

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

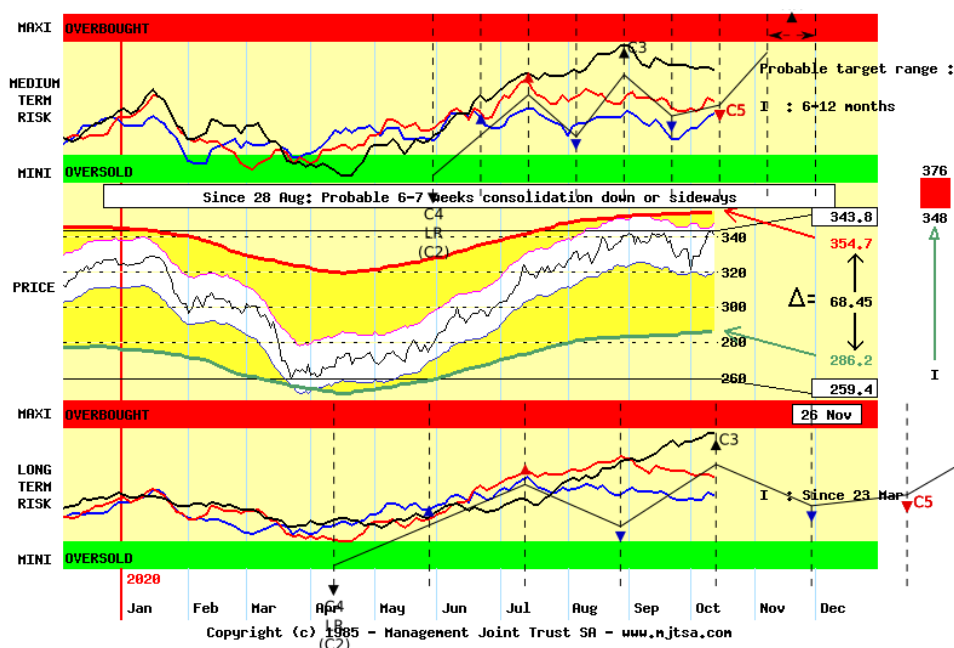


On the Daily graph, Copper probably topped out mid September on our long term oscillators (lower rectangles) and could now consolidate down into early/mid November, perhaps into December. In the meantime, our medium term oscillators (upper rectangle) suggest some upside retesting into mid/late October, and then a consolidation. **Our view is that Copper could hold up over the next week of so, then probably correct down again into early/mid November, gradually stabilize**

thereafter and start accelerating up again from December and towards next year. Downside risk over the next month or so could be calculated towards the low 6'000s (0.5 times our historical volatility measure "Delta", here at 1'692 – middle rectangle, right-hand side, subtracted from the graph's highest point at 6'837), **although visually levels around 6'200 also seem to offer support already. Upside potential into next year is probably above 7'000, perhaps up to 7'490, according to our 1 Impulsive targets to the upside** (right-hand scale).

Goldman Sachs Industrial Metals Index

Daily graph or the perspective over the 2 to 3 months

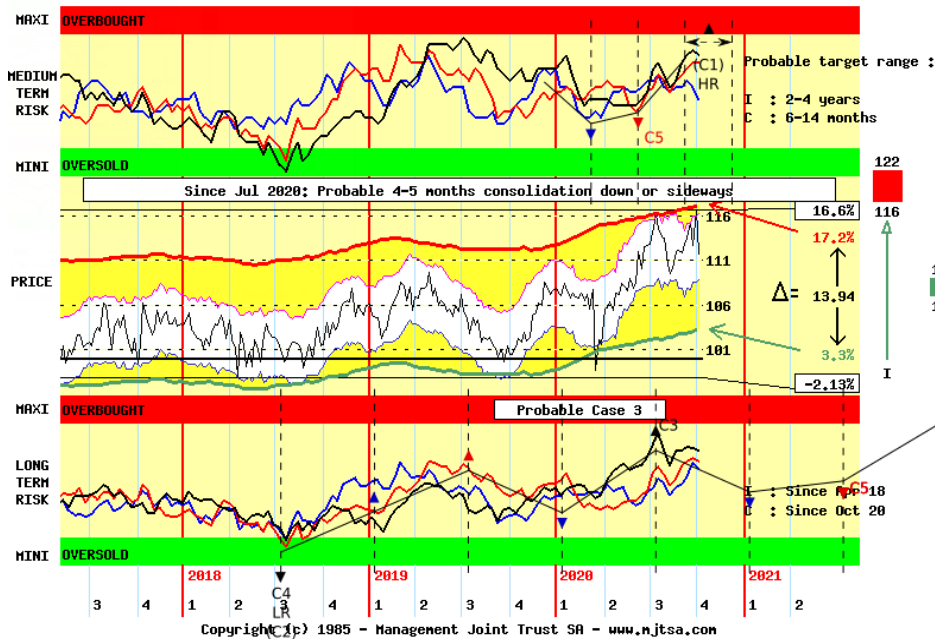


The broader Goldman Sachs Industrial Metals index has also been consolidating since mid September. The projections based off our oscillators (lower and upper rectangle) are however more differentiated than for Copper with further upside expected on our medium term ones (upper rectangle) into early/mid November, and a consolidation down into late November / December on our long term ones (lower rectangle). We hence believe that **the Industrial Metals space as a whole, probably**

remains quite resilient over the next couple of months, holding rather well during October and then retracing into mid/late November (perhaps towards the 320 – 310 range). Thereafter, from December, the index probably resumes its uptrend towards next year and potentially up to the 348 – 376 range (right-hand scale), or up to 10% above current levels.

Copper Spot (LME, USD/ton) vs the Goldman Sachs Industrial Metals Index

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

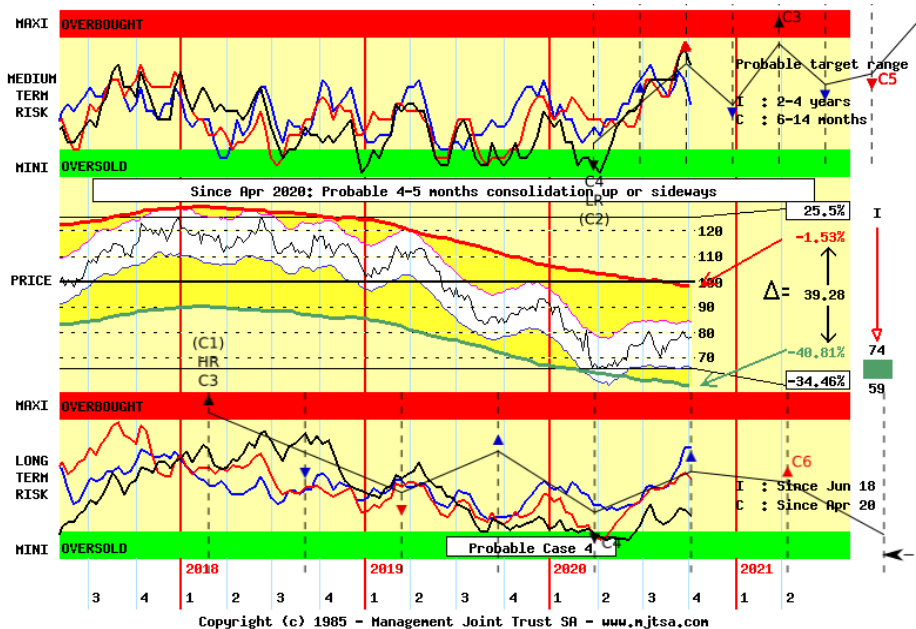


Comparing Copper to the Goldman Sachs Industrial index, we can note that Copper appears more risk-ON / more Cyclical than other Industrial Metals. The ratio did indeed drop during the 2019 intermediate correction, rose into early 2020 and then dropped again during the Covid-19 sell-off in March. It then rebounded strongly into July. The other factor which is influencing the ratio is China. One can notice it during the mid Q1 to April 2018 rally, or more recently, from July, as Copper and the MSCI China have both

underperformed. Generally, however, we believe that the risk-ON / risk-OFF relation is more robust considering the strong sell-off in the ratio in March this year, when the MSCI China widely outperformed other markets. Furthermore, the inflection points on the ratio are quite similar to the ones on Copper itself, suggesting that Copper is probably a high beta component of the industrial metals space. **Going forward, we expect the ratio to consolidate in its recent range into late Q4 / early Q1 and then rise into next Spring. This is rather risk-ON from early next year and probably corresponds to further upside in Copper and Industrial Metals prices into next Spring.**

Copper (LME, USD/ton) vs Gold (USD/oz)

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

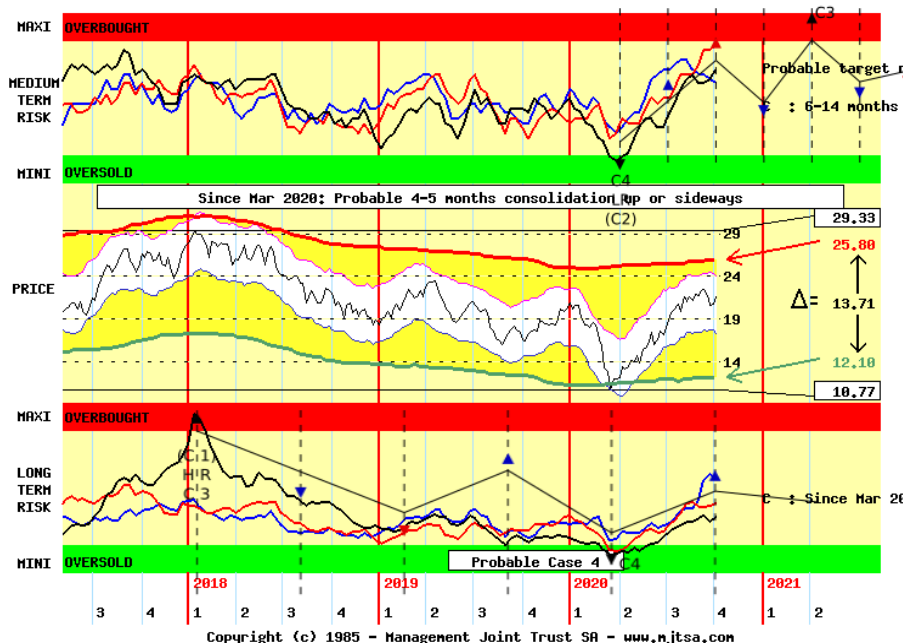


The Copper to Gold ratio is another one to watch. It is highly considered as a proxy for the strength or weakness of cyclical factors. Into next Spring, our scenario is bullish on both metals. Further developments in the ratio will hence probably depend on the depth of the correction on both during Q4 and their respective pace of re-acceleration to the upside during Q1 next year. On both oscillator series (lower and upper rectangles), the ratio probably reached an important low in April. It has since been re-

bouncing, yet for now is still well below our C Corrective targets to the upside (right-hand scale), i.e. **a long term reversal to the upside cannot be confirmed yet**. On our medium term oscillators (upper rectangle), an uptrend sequence seems to be underway. It should retrace during Q4, yet, would imply further upside momentum with new highs on Copper into next Spring. Our long term oscillators (lower rectangle), however, point to a roll-over scenario from next Spring and into late 2021. **Our consensus scenario is that Copper will probably be more dynamic than Gold during Q1, but may fail to make up for its underperformance in Q4. Indeed, will it be able to create enough upside momentum during Q1 to lead the way towards further highs late next year?** Many cyclical factors will be stuck in the same expectative.

Copper Mines

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

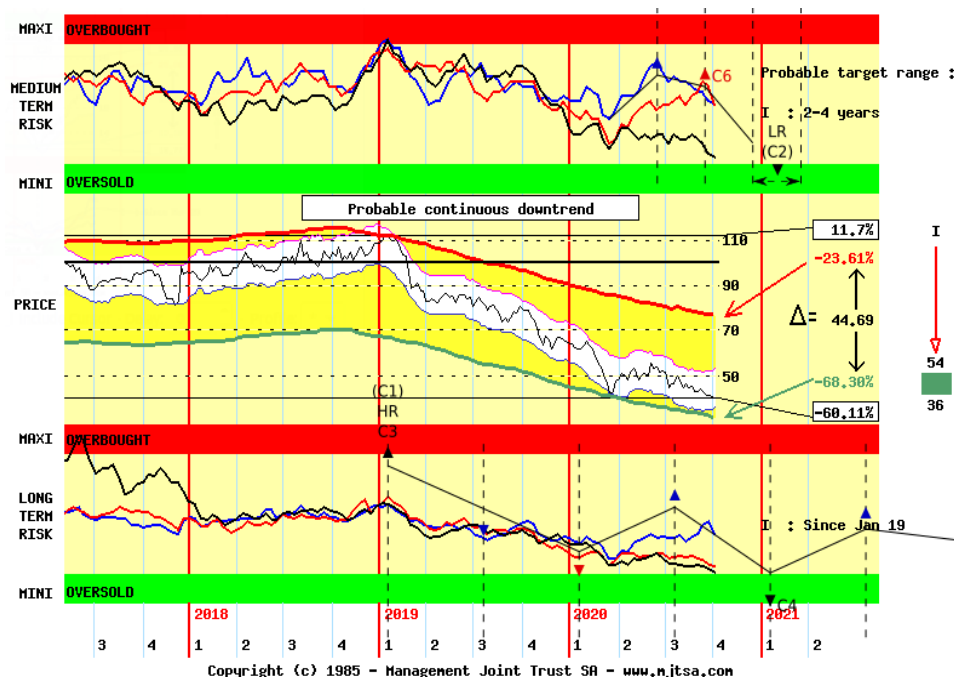


We now turn to Copper mines (which are proxied by the COPX ETF). Their rebound since March has also been impressive and recently broke above the resistance of our C Corrective targets to the upside (right-hand scale). This should theoretically open the way to **further upside over the next few quarters, probably to above their early 2018 highs**. In the meantime, both oscillator series (lower and upper rectangles) have **probably reached an intermediate top and could correct down during Q4, before potentially resuming their uptrend from late this year / early next year on our medium term oscillators (upper rectangle), probably into Spring next year.**

before potentially resuming their uptrend from late this year / early next year on our medium term oscillators (upper rectangle), probably into Spring next year.

Chile vs China CSI 300 Index

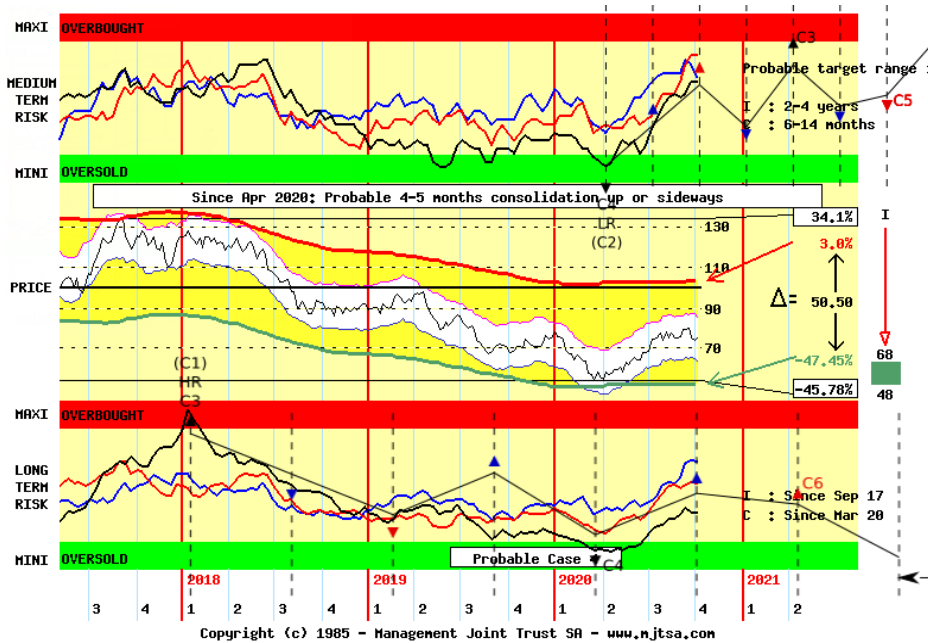
Weekly graph or the perspective over the next 2 to 4 quarters



Considering Copper's largest producing country (i.e. Chile, proxied by the ECH ETF) vs its strongest source of demand (i.e. China, proxied by the ASHR ETF) would confirm the softness of Copper prices into late this year / early next year. Indeed, both oscillator series (lower and upper rectangles) are in resume downtrend situations until then. Early next year, the ratio could then start to stabilize (at some point from late year to mid Q1 next year on our medium term oscillators – upper rectangle) and bounce into next Spring, perhaps next

Summer. We would probably come to the same conclusion on most Commodity exporting countries vs China during this period.

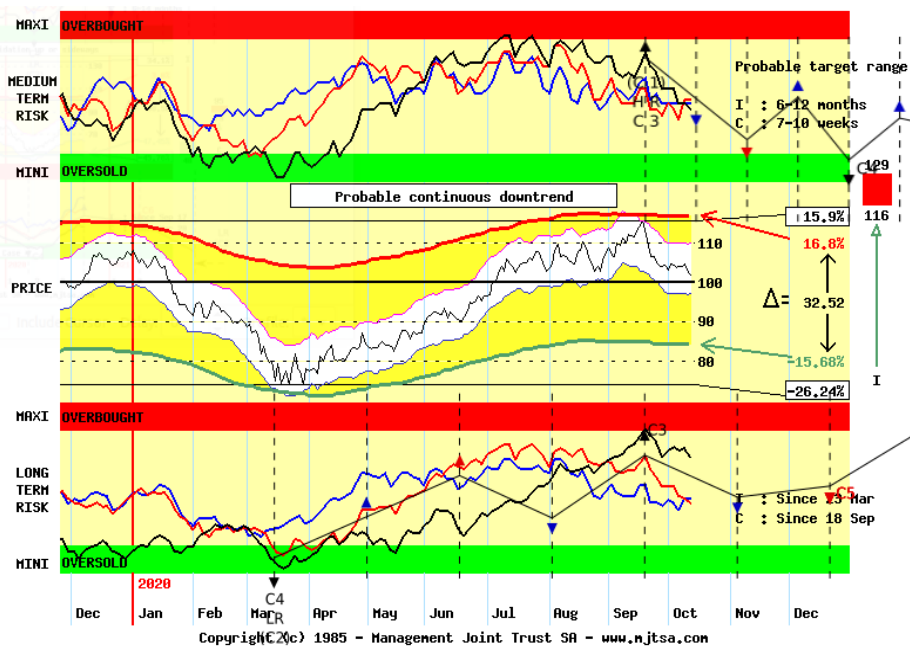
Weekly graph or the perspective over the next 2 to 4 quarters



The ratio of Copper mines (COPX ETF) vs the S&P500 is also approaching an intermediate top on both oscillator series (lower and upper rectangles). Yet, although the rebound since March is still below our C Corrective target to the upside (right-hand scale), it has been rather dynamic. Hence, we cannot exclude the roll-over scenario featured on our long term oscillators (lower rectangle), but would favor a more positive outcome, **with some retracement during Q4 and then further highs towards next Spring**, as

shown on our medium term oscillators (upper rectangle). **By then, the ratio may break above the resistance of our C Corrective targets to the upside around 95 (right-hand scale), thereby confirming that a longer term uptrend may have started.**

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



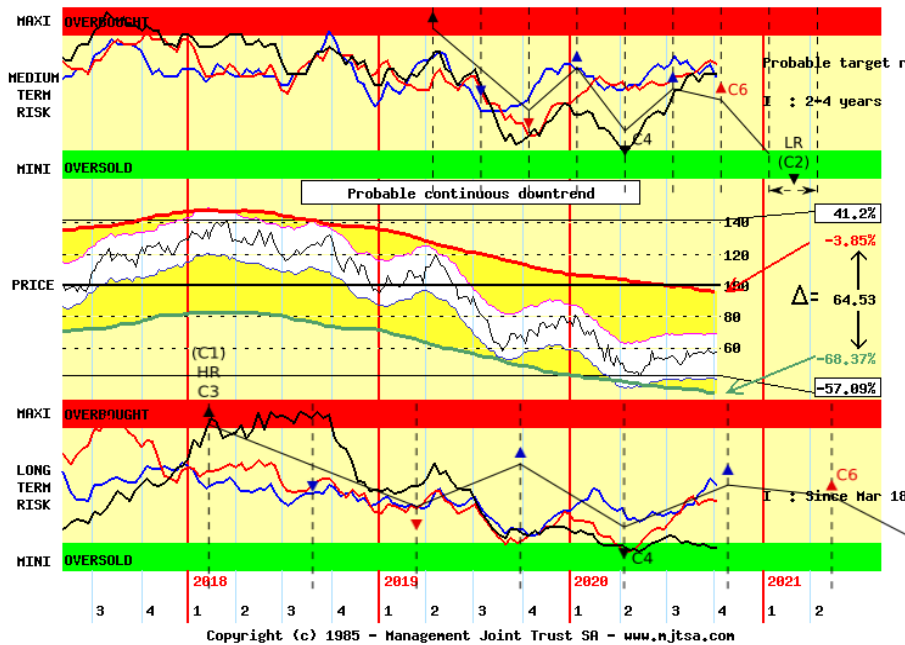
Shorter term, on the Daily graph, the ratio entered an intermediate consolidation period mid September. It may last into early/mid November on our long term oscillators (lower rectangle), gradually stabilize into December, before the ratio accelerates up again into early next year. On our medium term ones (upper rectangle), the sequence we show implies a longer consolidation period into December until the trend then resumes higher again into next year.

Broadly, we would probably remain prudent on the ratio

into December with a downside risk of 5 to 10% as shown by our C Corrective targets to the downside (right-hand scale). Thereafter from early/mid December, we would look to reenter Copper mines in the anticipation of a period of outperformance into next Spring.

Copper Mines vs Goldmines

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

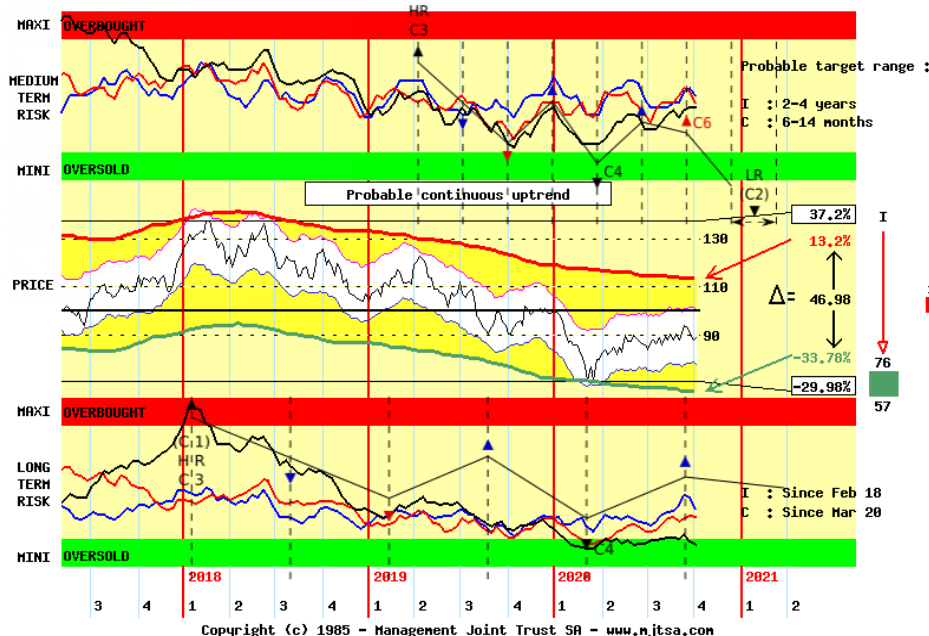


This graph comparing Copper Mines (COPX ETF) to Goldmines (GDX ETF) is a slight caveat to our cyclical bullishness above, which we expect to start from early Q1. Indeed, while on our long term oscillators (lower rectangle) we continue to present the negative roll-over scenario, with lower highs next Spring and further downside into mid/late next year. It is more difficult on this relative ratio than on other ratios above, on our medium term oscillators (upper rectangle), to counter-balance it with an upside breakout scenario from late this year (into late Q1). Indeed, these medium term oscillators seem to be following a new downside sequence, which started in April 2019,

saw an intermediate bottom this April and could remain positioned to the downside into early next year, even next Spring. This more negative scenario does not exclude a bounce from early/mid Q1 into late Q1 / early Q2 next year, but for now, it is hard to confirm that it will benefit from strong upside momentum towards new highs.

European Natural Resources vs European Utilities

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



Considering, a similar ratio in Europe, the one comparing European Natural resources to the defensive Utilities sector, would raise similar concerns. Indeed, while both oscillator series (lower and upper rectangles) are positioned for some retracement during Q4, our medium term ones (upper rectangle) suggest that the downside pressure probably extends into early/mid Q1. Hence, it may take some time for cyclical themes to outperform again in Q1 next year.

Concluding remarks:

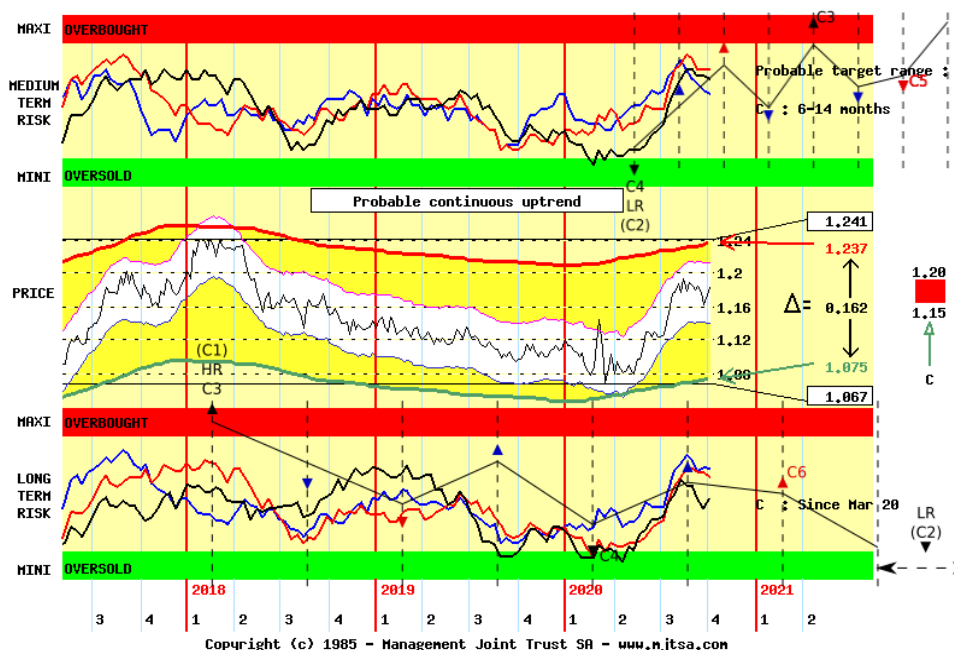
Copper has performed a strong rebound since April and has made it above our Corrective resistance levels to the upside, i.e. into Impulsive territory on our Weekly graph. It has now probably reached an intermediate top and could correct vs other less cyclical industrial metals and Gold into late this year. Copper mines have also been quite dynamic, should also correct during Q4, yet could resume their uptrend from late this year into next Spring and new highs. Some doubts persist as to the strength of this cyclical recovery from late Q4 / early Q1 into Spring next year. Indeed, on a relative basis, the Copper to Gold ratio, or the ratio of Copper mines vs Goldmines may take some time before resuming their uptrend during Q1. This may imply that our expectations of further upside momentum into next Spring on these ratios may be deceived, and that they could continue to underperform for much of 2021. On an absolute basis, however, we expect Copper and Copper mines to tag along other risk assets at least, and following some retracement into Q4, make new highs towards next Spring.

50/ Splicing the markets : The US Dollar may bounce during November, yet probably drops again thereafter into the Spring

Since early 2018, the US Dollar had traded the opposite side of cyclical factors. This year, it turned outright defensive, first in March, during the US Dollar's brief funding crisis, and since then, as risk assets have rebounded on the back of the humongous stimulus efforts by the FED and the US Treasury. Going forward, we expect this relationship to continue for now, and the US Dollar should remain under pressure when cyclical factors are bid, inflation expectations rise and long term yields attempt to bounce.

EUR/USD

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

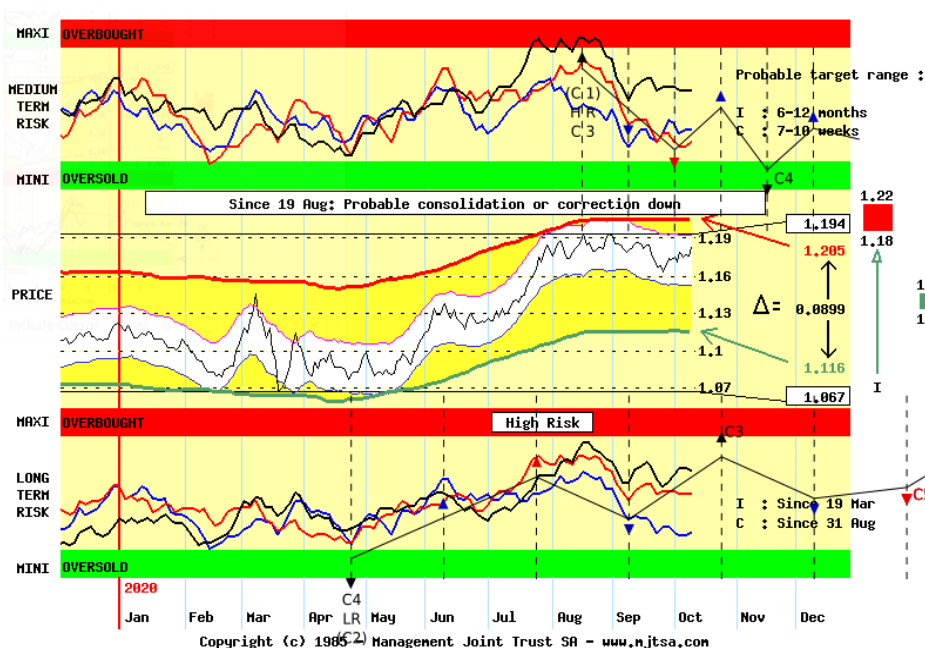


EUR/USD did indeed start to reverse up this year following the FED's 150 basis point cut. It then confirmed this reversal as the ECB first outlined its own stimulus program in May. While on our long term oscillators (lower rectangle), EUR/USD may have reached an important top, could gradually start to roll-over between now and next Spring, and then drop into next Summer, our medium term ones (upper rectangle) suggest a more bullish scenario for EUR/USD over the next few quarters. This second scenario has our preference for now. It should accompany the risk asset rally into next Spring as well as the gradual recovery we expect in cyclical factors. **Short term, the current upside**

retest may push into mid/late October, and then some retracement should materialize into late this year, perhaps even early next year. Thereafter, EUR/USD should rise into late Q1 / Q2, break above our C Corrective targets to the upside around 1.20 (right-hand scale) and probably travel to the mid/high 1.20s by next Spring.

EUR/USD

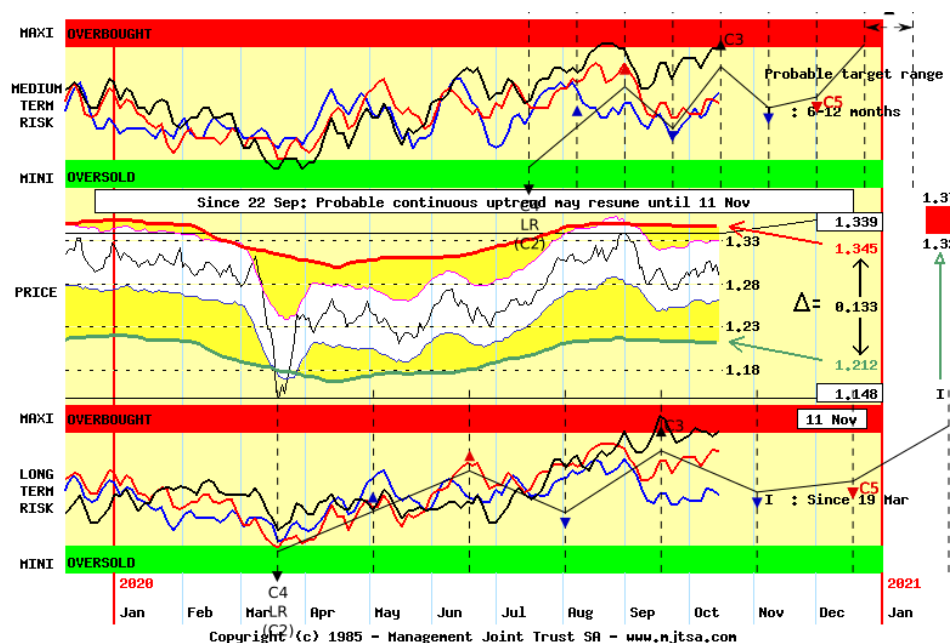
Daily graph or the perspective over the next 2 to 3 months



On its Daily graph, EUR/USD is indeed attempting to retest up and could continue to do so over the next week or so. It is now back in its I Impulsive targets to the upside (right-hand scale) and may push to new highs above 1.20 by then. Thereafter, we expect **a further period of retracement, probably into mid November, perhaps into December, before the trend resumes higher from early next year into the Spring.** During this second retracement period, the downside risk is probably towards the 1.16 – 1.15 range, or marginally below its late September lows.

GBP/USD

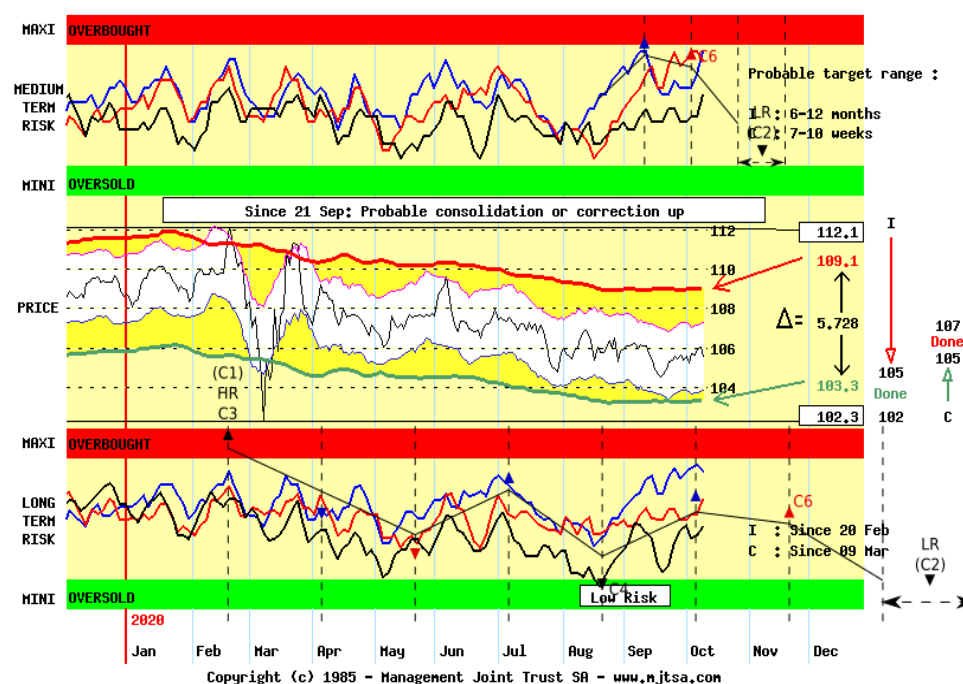
Daily graph or the perspective over the next 2 to 3 months



Cable is probably also approaching the end of its bounce since late September on our medium term oscillators (upper rectangle). It could now start to retrace down again into mid November, perhaps December, and potentially down to our C Corrective targets to the downside, which we calculate in the 1.27 – 1.23 range. Following this dip, it then rises towards new highs and into next Spring.

USD/JPY

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



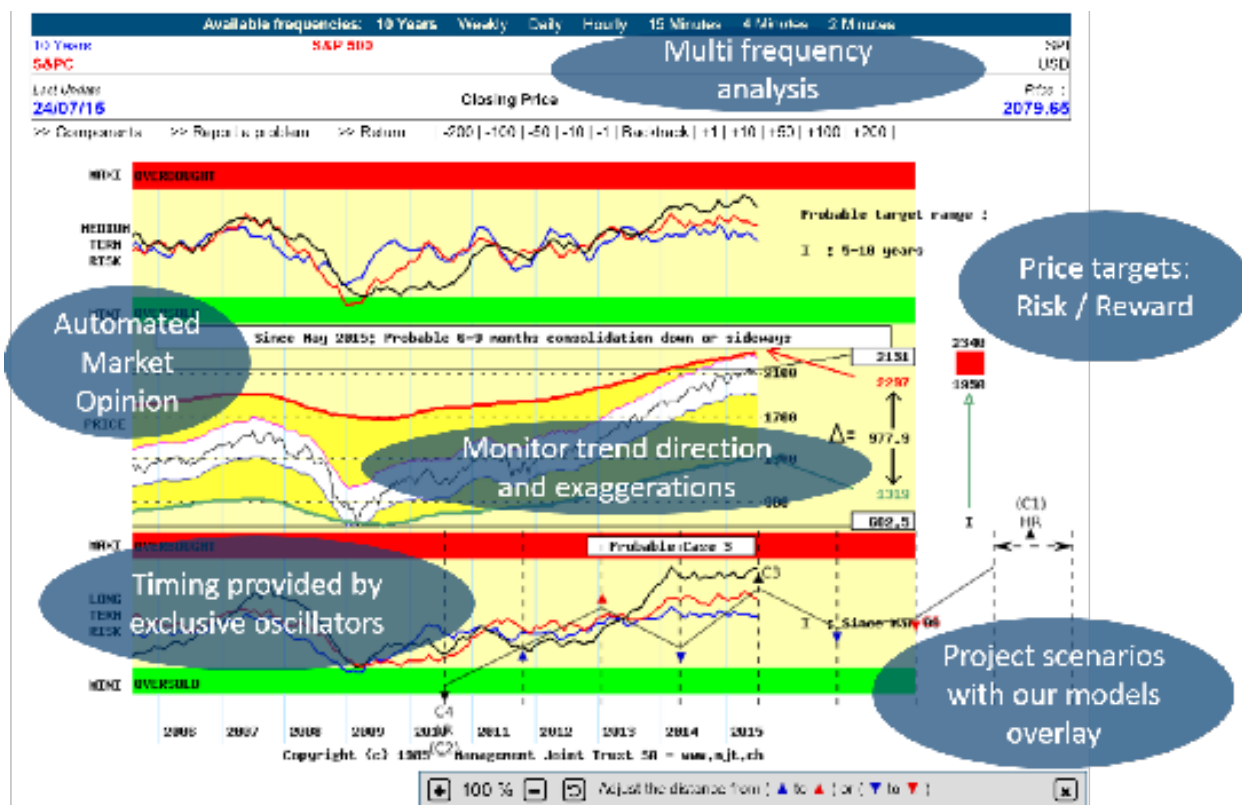
USD/JPY on the other hand is in a steady downtrend, which probably continues into early next year at least. On our medium term oscillators (upper rectangle), it may first drop into late October, perhaps early November. It could then see a weak bounce as shown on our long term oscillators into mid/late November (lower rectangle), but should then resume its downtrend again into next year. Upside resistance is in the current 105 – 107 range, while downside risk over the next few months is between 105 and 102 (right-hand scale). The risk/reward is hence skewed to the downside.

Concluding remarks :

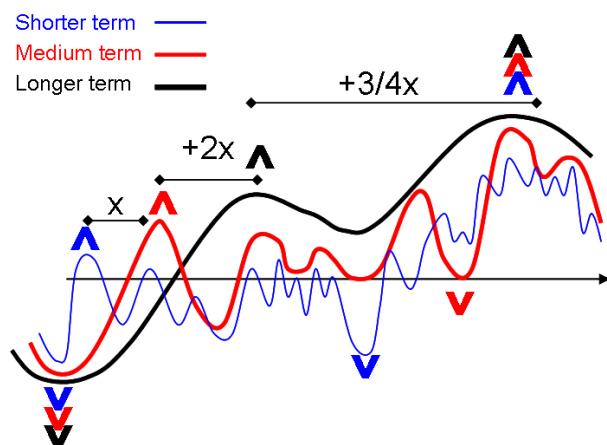
The USD may bounce from late October into the November. EUR/USD could reach back to the 1.16 – 1.15 range, while Cable could fall back to between 1.27 and 1.23. If these dips materialize, we believe these could be interesting Buy the Dips opportunities (probably towards late November / early December) as the following leg-up could travel into the Spring with EUR/USD reaching the mid/high 1.20s, while GBP/USD approaches 1.40. Vs more defensive currencies such as the Yen, the US Dollar may bounce slightly during November, but then also drops back to new lows into early next year in first instance.

52/ 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)

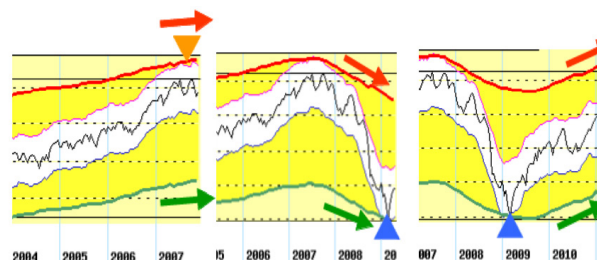


Timing oscillators: Different prices cycles are captured by our 3 Timing oscillators. Monitor how their relative positioning defines specific situations (Cases) to always know where you stand within the Trend (e.g. please see below the ideal Uptrend Case succession sequence)

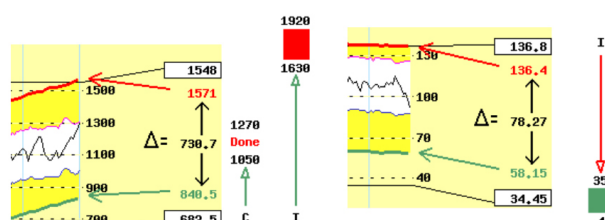


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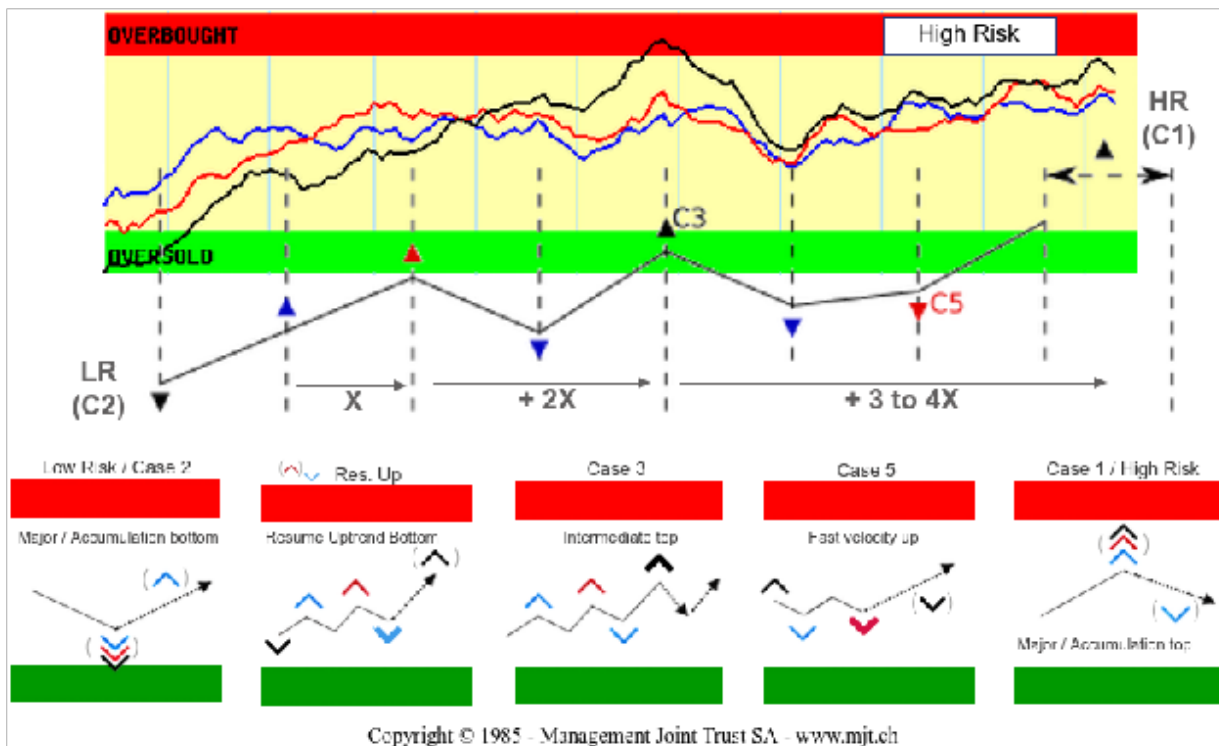
Trend direction: the direction of FinGraphs' large envelope will help you decide either to apply an uptrend or a downtrend model. Contacts between the wider and thinner envelopes will help you anticipate and confirm market turning points (e.g. S&P500 bi-monthly, extracts from the 2005-2011 period).



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

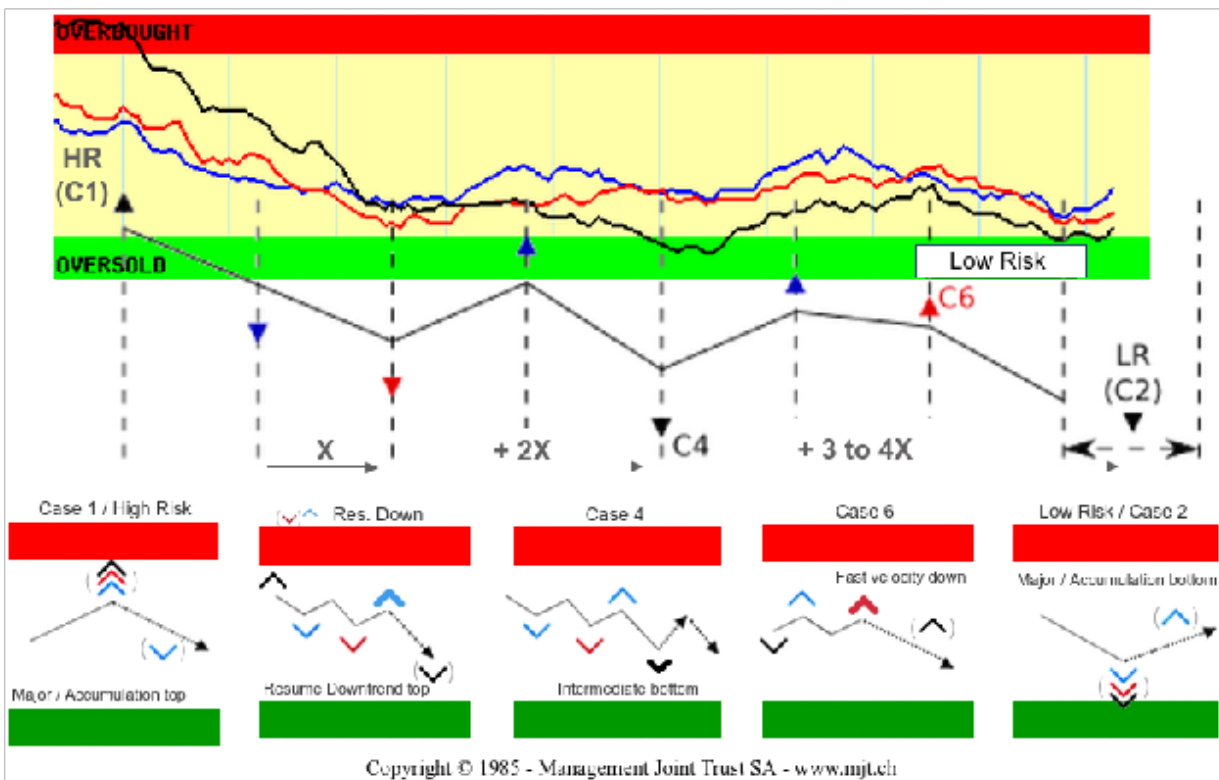


Ideal Uptrend Model



(left to right) from an oscillator black bottom (usually a Low Risk or a Case 2), the oscillators and prices will start moving up. An uptrend is confirmed once a red top can be made above a blue one. The correction down that follows delivers a buying opportunity ("Resume Uptrend") followed by an intermediate top (Case 3). A new period of consolidation down or sideways then starts, ending with a Case 5 acceleration up towards an important top (usually a High Risk or a Case 1). For each time frame, a fixed time unit separates each timing incidence, so that the distance between a blue and red top is usually X , the distance from the red to the black top is then $2X$ and the distance between the first and second black top is 3 to $4X$.

Ideal Downtrend Model



(left to right) from an oscillator black top (usually a High Risk or a Case 1) the oscillators and prices will start moving down. A downtrend is confirmed once a red bottom can be made below a blue one. The correction up that follows delivers a selling opportunity ("Resume Downtrend") followed by an intermediate bottom (Case 4). A new period of consolidation up or sideways then starts, ending with a Case 6 acceleration down towards an important bottom (usually a Low Risk or a Case 2). For each time frame, a fixed time unit separates each timing incidence, so that the distance between a blue and red bottom is usually X , the distance from the red to the black bottom is then $2X$ and the distance between the first and second black bottom is 3 to $4X$.

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