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12 / **The midterm results are in, and it's a gridlock -- what does it mean for the financial markets?** - The U.S. midterm elections played out much as expected. We have gridlock, but that may not necessarily be seen as a negative outcome by the markets. The US economy, though currently decelerating, should do all right next year with government control divided between Democrats and Republicans. Divided governments have generally been decent for markets. The Democrats will almost certainly challenge and try to distract the president over his past and current business dealings, tax returns or possible Russian implication. There will be greater difficulty for many aspects of President Trump's agenda, but we do not see the midterms as hobbling Trump as a lame duck by any means. The US Senate remains solidly Republican- more so than before the midterms. A GOP-dominated Senate makes it easier for Trump to confirm appointees and efforts toward deregulation should continue. However, we expect trade policy risk to persist: trade is one of the levers for which the president does not need Congress, so we could see a doubling-down on trade policies. We also see significant upside for infrastructure during Trump's second half tenure. The combination of factors summed up above suggests that after the current soft patch, the US economy should continue to grow from mid/late Q1 2019, but may well decelerate in 2020 as the benefits of the distributed lagged capital inflows and fiscal stimulus moderate in the face of rising Fed policy rates. Finally as some risks remain for financial assets they should be coming from the EM world and Chinese growth deceleration not so from the US side.

15 / **Timing and Tactical Insight - Equities rally post election, and the Dollar remains strong post the FED – How long before the defensive shift resumes ? -** Following their strong rally pre and post mid-term elections, equity market started to retrace again on the Fed's hawkish note last Thursday. We believe that these developments will continue to influence equity markets over the coming weeks. First, the election results seem rather positive for equity. Investors expect them to result in a more constructive dialog between Mr Trump and the Democrats, and possibly reign in some of Mr Trump's more aggressive policies. This consensus approach is reassuring for equity markets going forward, for US equity markets at least. On the other hand, the FED's persistent hawkishness should continue to pressure risk assets around the world, and support further USD strength into Q1 next year. These market conditions could resemble the ones that prevailed from May into August this year, when Europe and Emerging markets were correcting, while the US continued its upside path. Yet, this time around, Contagion may be quicker to come by as since early October, US equity markets have probably lost much of their upside momentum. Our timing suggests that by late November / early December, Global equity markets could enter a new leg down, probably towards early next year (early/mid Q1). During this period, the Dollar and defensive trades will probably continue to outperform.

23 / **Trump, the Federal Reserve and interest rates after the midterm elections: no pause for the Fed; the housing market will become progressively grimmer** - President Trump's comments critical of the Federal Reserve are unlikely to change the Fed's reaction function. The Fed will likely raise rates in December and two more times in 2019. This would put the policy rate on the tighter side of neutral, and tighter policy next year is one reason why we expect a much slower growth at a later stage ie going into 2020. The midterm election gridlocked results should largely keep the Fed on its gradual rate hike/balance sheet reduction path rather than going further or faster in raising rates. Unlike the 2016 U.S. election, the fixed income sector was not dealt surprises this time around. The bond focus shifts right back to the domestic fundamental setting-namely, growth prospects, inflation expectations, and any attendant monetary policy "surprises" from the Fed, if any. For the long term yields, one could argue that a good portion of the rise in yields has already occurred because the market's pricing mechanism has already discounted recent improved economic growth, a moderate increase in inflation and increased Treasury supply owing to Trump's deficit spending. With further policy tightening, the yield curve should continue to flatten, especially so because the 10yr yield may plateau on and actually decline early next year. The recent steepening of the yield curve was caused by an uptick in the term premium due to concerns about the rapid wage growth in the past two months. But is appears to us that the Fed only sees the sunny side, but in reality it is raining on the other side of the street. There is one data series that is looking ominously grim-- the housing market. Housing IS the business cycle – economist Edward E. Leamer famously declared in 2007. The Fed is ignoring these metrics but we believe that the housing market will continue to spiral lower over the next 8 months at least. By the end of 2019, there will be a reckoning, as a slowdown being flagged by the housing market now gets even worse. We could then have a sharp growth recession in H1 2020.

26 / **Timing and Tactical Insight - A hawkish FED, yet limited alternatives other than Treasuries when risk assets correct -** While inflation expectations have probably started to reverse down, real rates have recently continued to rise. The balance will determine the future path of nominal treasury yields in the US. Our analysis of US 10Y yields is confirming that a top may be near (i.e. that the balance is shifting). From late November, it suggests a 60 to 100 basis points retracement on US 10Y yields, probably over the next 6 to 12 months. The yield curve is also helpful to time this reversal point. Indeed, while expectations for further FED rate hikes are still strong, the spread between long term yields and the Federal Funds Rate has provided reliable signals for risk-ON / risk-OFF phases since the beginning of the year. Following a slight bounce, our analysis suggests that by late November, the US Yield curve could start to flatten again, probably towards next February. Developments in Bund yields, Corporate and Sovereign Credit spreads as well as for the banking sector vs the market seem to confirm this timing sequence.

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33 / **Commodities outperformance over equities: it has started, it is pausing and will likely accelerate again mid Q1 2019** - At no other time in the history of commodities has the asset class been as weak against equities, as it is today. Over the past 50 years, commodities have never been cheaper relative to equities than they are at present. However, that underperformance is changing quickly to a more positive outlook for resource materials; the ratio between the two assets classes has been stable for more than a year now, and is starting to trend in favour of commodities. Indeed, on the long term picture, the commodity-equity relationship could be setting up a trade of a lifetime, as commodities revert to the mean in the relationship, similar to the one seen in the early 2000s. In 2019, it will be a contest between growth in the US and likely the Rest of the World (and the rising core inflation that it will generate), and a slowdown in China, as represented by that country's TSF. China's domestic currency the CNY has been falling a lot in recent time. That should translate into good manufacturing performance at some point in time, even if the Chinese services sector suffers some slowdown. That will also help the outlook for commodities outperformance over equities stay upbeat during next year. However on the short term horizon (into Q1 2019) we still consider that a strong dollar, decelerating US growth, tightening US policy and negative Chinese dynamic could still challenge commodities and risk assets on absolute level into the start of the new year.

37 / **Timing and Tactical Insight - Expect one last retest down on Commodities, probably towards mid/late Q1 2019 -** While Oil recently topped out in early October, other Commodities (Industrial Metals, Gold, Softs and Grains) have been suffering since the Spring, mainly from USD strength and a deceleration in China. We believe these factors should continue to influence the wider Commodity space probably towards mid/late Q1 next year. Oil should correct down until then, Industrial Metals should continue their correction, and Gold and Agricultural Commodities should retest down once more. Although, we do expect Equities to also resume lower during this period, Commodities are more volatile, and should hence continue to underperform Equities over the next few months. From mid/late Q1, however, Commodities may represent a strong investment case both on an absolute basis and vs equities, probably until Summer next year at least.

46 / **China's growth and trade woes will bring down the Emerging Markets with it; USD-dominated assets should continue outperforming the RoW** - There are a few items of interest in recent Chinese data, and one of them is the country's current account deficit. It may surprise investors drowning in US-China trade tension news that China ran a current account deficit in the nine months of 2018, its first since 1993. Just a decade ago, China's surplus was as high as $420 billion, or 9% of GDP. However, the capital account, which recently rose sharply, suggests to us that this deficit will be short lived. Also, don't expect that blip of current account deficit to mollify Mr. Donald Trump. China's trade surplus (external trade balance), a narrower measure that excludes investment income, remains massive. Insofar as the domestic currency (CNY) is concerned, its devaluation by Beijing is a mixed blessing. For us, devaluing the CNY is not a secret weapon for China to get on top of the trade issues-- Beijing has to do it to kickstart a flagging economy. On the negative side, the sharp decline in the exchange rate of the CNY against the US Dollar has negatively impacted the inflow of Foreign Direct Investments (FDIs) – FDI inflows slowed sharply in H2 2018. On the GDP front, GDP still declined to 6.5% in Q3 2018 (latest data on hand). China's GDP growth woes however are not caused by an errant currency policy. We can also say that the trade skirmish with the United States has probably reduced some growth, but the primary source of decline in activity has been the lack of government largesse. It's is not hard to fathom why. Government expenditures in China have virtually collapsed since January 2016. A slowing China cannot be good for many EM markets. Adding to the woes of the EM market sector, which includes China, is the surge in the US Dollar, which promises to become even more forceful.

49 / **Timing and Tactical Insight - Exploring the links between China, Emerging Markets and Commodity Producers -** Over the next few months, into mid/late Q1 at least, we remain prudent on China and other Emerging markets. Indeed, during November, we expect the US Dollar to start to strengthen again vs Emerging Market currencies. This process should first impact Asian Growth Currencies and with a slight lag their equity markets, while the process could then spread to Commodity producing Emerging Markets towards early December. We then expect China and all Emerging markets to remain weak until mid/late Q1. Looking into next year, and beyond Q1, our analysis suggests that Commodity producing Emerging Markets could outperform China and Asia Growth countries for the rest of 2019..

55 / **Splicing the markets - What's happened to defensive currency trades? -** From the end of this month, we expect defensive currency pairs to start to strengthen in line with the further risk asset correction we expect, probably from late November towards February next year. During this period, USD/JPY may reach back below 110, EUR/JPY below 125 and EUR/CHF below 1.10, while EUR/GBP may climb back above 0.90. Shorter term, considering our cross assets scenario, a slight risk-ON bounce may still materialize over the next couple of weeks. It should die out towards the end of this month and defensive Currency pairs should then strengthen for good.