THE CAPITAL OBSERVER

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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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One risk is that with so much money on the sidelines, managers will end up overpaying for assets, reducing returns. A change in conditions, either higher intrest rates or a macro shock that slows the global economy, might hit returns.

“Valuations in private equity are extremely high and expected returns super-low,” said Ludovic Phalippou, finance professor at Oxford's Saïd business school and author of *Private Equity Laid Bare.* A drop in returns would mean “ embarrassment for pension funds, which will not only have earned little, but will have made Wall Street a lot richer”

Javier Espinoza

4/ Executive Summary

12 / **The peak of risk asset prices for 2018 could take place in late July - August period -** The purpose of this recent series of articles about systemic liquidity is to prepare the readers of Capital Observer to the eventuality of a peak in many of the risk asset markets this summer. This view is still not a part of the mainstream sentiment profile.
The last bull market phase should last until a late July-August top, with intermediate pauses .The ensuing sell-off should last until late September, after which we could see some temporary recovery in asset prices. But by and large, the trough in this forthcoming sell-off may only be seen by early spring 2019. Consequently an exit strategy from risk asset and defensive strategy should now be prepared to be implemented over the next 2 months. Therefore, if this forecast actually takes place, the impact on asset prices will be significantly worse than otherwise. We urge readers to take measures to minimize the impact of a sharp break in risk asset prices very soon.

16 / **Timing and Tactical Insight - UP and OUT, one a last rally on equities into the 2nd half of July, use it to take profit and reduce your risk** - This is not a market for Buy and Hold equity investors anymore. Indeed, over the medium term (next quarters), we believe that the risk/reward has very much deteriorated: the risk of a substantial correction seems strong, while the remaining upside potential we calculate is pretty much exhausted. On the timing front, our view is that the S&P500, for example, could soon enter into a period of correction to the downside, which may last between 12 and 18 months and possibly bring the index lower by 20 to 35%. Shorter term, the support points we were expecting end June seem to have held, and we would now expect a last push higher on most developed markets, possibly making new highs on some during the 2nd half of July (such as the Nasdaq 100 or the CAC40). That said, from late July, we would strongly suggest to opportunistically start reducing risk quite substantially on equity positions given the more negative developments we expect from August into year-end and 2019.

23 / **The US Congressional Budget Office Forecasts Growth Recession In Late 2018, Then GDP Falls Further In 2019, Bottoms In 2020 -** One of the recent projections of the Congressional Budget Office that caught our attention is that they have shown a forecast of a top in growth in 2018, and a subsequent growth recession from late 2018 to 2020. The reason for the recession (from this construct) is that, at the end of 2018, private tax relief clauses expire. All of a sudden, tax rates rise and extract billions of dollars out of the economy where they will appear on no measure of the money stock, not M1, M2, M3. What is especially relevant and telling, in our opinion, is the sharp decline in fiscal discretionary spending from late 2018 to 2020. It resonates with us because the changes in this data lead the changes in GDP and changes in risk asset prices. The sharp fall in fiscal discretionary spending after 2018 could lead to growth recession in 2019-2020. Furthermore, a monetary policy tightening in the entirety of 2018, and fiscal consolidation in by late 2018, extending into 2019-2020, are scary prospects, as they would be happening at the same time. A more difficult environment for risk assets is on the horizon.

25 / **Timing and Tactical Insight - As the economy starts to decelerate, Treasuries, Defensive sectors and Gold should outperform equities, probably into 2019/2020 -** We believe the asset environment will soon turn defensive, probably not quite yet, but from the end of this month. The yield curve should start to flatten quite aggressively, long term yields should soon top out in the US, while in Europe they will continue lower, Equity to Bond ratios are also topping out, Credit spreads should continue to accelerate up, while Defensive equity sector should start to outperform the market. Finally, Gold may take a bit more time to reverse up as the US Dollar remains strong, yet from late Summer, we expect it to turn up, and gradually gather momentum towards year-end and then possibly throughout 2019.

32 / **CNY devaluation: China got what it wants, and dealt The Donald a stunning riposte; Mr. Xi will not use the devaluatin route any further as weapon in the trade spat** - Many China observers say CNY devaluation was a weapon-- to us, it is an admission that the economy is in dire straits, which Mr. Xi, et al, expect it to get worse. China needed to do it to kickstart a flagging economy. It was an opportunity too juicy to ignore or waste. “
China got what it wants-- a devaluation of its currency, and a chance to shove a shiv up Mr. Trump’s figurative behind. There is a reason why China cannot lower the value of CNY too much too soon. Weaker CNY will negatively impact FDI inflows-- and for China incoming FDI is even more important than higher trade balances. Moreover, Chinese corporates have a huge overhang of USD-denominated external debts, so a sharp CNY devaluation is driving those companies witless-- hence the collapsing Shanghai Index has been an expression of these corporate fears. Therefore, a stable CNY is desired to make sure the fallout from slowing FDIs will not go out of control. The Chinese are also now leery of a repeat of the early 2016 partial CNY devaluation which triggered a large amount of capital flight from China. We believe that the Chinese will not use this “weapon” again in the trade spat with The Donald.

The Capital Observer editors team, London / Geneva, July 10th 2018
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5/ Executive Summary

35/ **Timing and Tactical Insight - Chinese equities and the Yuan may find support towards mid Summer, yet their reflationary momentum is broken, further downside is expected towards year-end and early 2019** - Chinese Equity markets along with the Yuan have taken a strong hit since mid June. We believe they will take some time to stabilize, probably until mid/ late August. Shorter term, we expect a short bounce over the next couple of weeks, and then a new downside retest. In the initial Yuan sell-off, probably 70 to 80% of the downside potential has been achieved. Hence, the remaining risk from today's levels into mid August is probably limited. Following that, from mid/end August, we expect Chinese equities and the Yuan to bounce again into the Fall, but believe that they will resume lower once more from early/mid Q4 towards year-end and 2019.

41 / **The US Dollar pulls back at a resurgence of financial risk appetite in July, but the ongoing uptrend continues thereafter** - The US Dollar ascent has been accompanied by rising long-term rates, as well as short-term rates, due to the published intention of the Federal Reserve to raise policy rates three times this year. This triple whammy situation presents risks, not only to Emerging Markets, but to the US and global economies as well – a fear which we expressed at various issues of Capital Observer as early as February this year. The US dollar is now winning the FX "beauty contest. Almost all the macro factors remain in favour of the US currency, especially those that matter in FX currency valuation. We also pinpointed that the US dollar's continuing strength is, and will be, coming from the steady improvement of the US Capital Account Balance. Continuing strength of the US Dollar during most of 2018 will have repercussions to a lot of assets and asset classes. Further US dollar strength may contribute further to stresses in the Chinese economy, the rest of the Emerging Markets have also been devastated by the recent US Dollar strength and are reeling again from new blows from the US currency's recent appreciation. Finally, distress in financial assets also tends to drive the valuation of the US currency even higher, as many investors seek the safety of US Treasuries, with concomitant capital inflows, which strengthens the US Dollar.

44 / **Timing and Tactical Insight - The first leg up in the US Dollar is probably not finished yet** - Over the next couple of weeks, we expect the US Dollar to resume higher vs the Euro possibly until mid/late August (EUR/USD towards the 1.14-1.10 range). This move will probably be concomitant with a sharp correction in risk assets during August. Following that, the Euro and Asian Growth currencies could rebound vs the US Dollar. This environment is not dissimilar to the one that prevailed in H1 2017 (a Growth extension). Yet, we do not expect it to be as strong and last as long as it did back then. Indeed, from early/ mid Q4, the US Dollar should resume its uptrend, possibly well into 2019 as the risk asset environment further deteriorates and the US Dollar regains its Flight to Safety status. We would back this view by the fact that Commodity Currencies seem to be the weakest link as we move into H2 2018 and 2019. This would conclude the 2016-2017 reflationary period, leading to an economic deceleration that may last well into 2019, perhaps even 2020. In this context, USD/JPY may attempt a last push higher into late July /early August, but will suffer thereafter, probably until late next year as a more risk-off environment gradually takes hold.

50 / **Splicing the markets - What do to with your favorite Growth stocks ? -** The important equity market top we are expecting is approaching, potentially towards late July / early August. We believe that during this period, Big US technological stocks may also top out on a relative basis vs the market. Indeed, the general market correction to the downside we expect over the next 3 to 5 quarters could be relatively serious, and these Big Tech stock could be hard it given their traditionally "high beta" features. On the other hand, BioTech stocks may offer an interesting alternative. They are more defensive that Big Tech ones, as part of the Healthcare sector. They usually perform well very late in the cycle. Following some correction into late August, we expect them to extend up, possibly towards October/November with interesting upside potential.

The Capital Observer editors team, London / Geneva, July 10th 2018
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6/ Mapping the markets

Last month, we suggested that equity markets should continue to stabilize during June, and that from end June, they could start to accelerate up again for a last leg higher into late July / early August. This last move up is developing as we write, and we still expect it to push higher into the 2nd half of July. Some developed markets will make new highs, others may retest. We would suggest to use this Summer rally to take profit and reduce risk. Indeed, this is not a market for Buy and Hold equity investors anymore, and we believe that equity markets could soon enter a period of correction to the downside that could last between 12 and 18 months, and bring down the S&P500 Index by 20 to 35 % for example. More generally, we believe that the cross asset environment will soon turn much more defensive (from end July). The yield curve should start to flatten quite aggressively, long term yields should top out in the US while they continue lower in Europe, Equity to Bond ratios are also topping out, and Credit spreads should continue to accelerate up. On the sector front, we would start to overweight Defensive profiles from months' end, would reduce exposure to Big technological stocks, which are inherently "high beta" and could underperform in a widespread market correction. As an alternative, Biotech probably looks interesting from end August into the Fall.

Looking towards Emerging markets and China, we believe that the conjunction of a higher US Dollar with industrial commodities (energy and base metals), which are topping out, will gradually reverse most of the 2017 – 2016 gains within a 12 to 18 months' period. Indeed, the "reflation trade" in place since early 2016 seems to be coming to an end, and the deceleration phase that follows, will be accompanied by lower commodities, lower emerging markets and a higher US Dollar. The process is already underway. The Dollar bottomed out against the majors in February and despite the recent Italian political crises and the devaluation of the Chinese Yuan, its first leg up may not be over yet. During, July we expect the Euro to hold on slightly longer, while commodities attempt a last move up and emerging markets perform a dead cat bounce. Coming late July / early August, we expect these trades to reverse down again, probably towards mid / late August as risk assets more generally start to sell-off. September and October may then see a weak growth extension, some defensive sectors may make new highs, but probably not the main indices, the US Dollar may retrace some, China and Emerging markets may bounce, and Gold will start to move up. Coming November, we expect risk assets to resume lower again as the environment will become even more defensive. This will bring renewed support to the US Dollar, to the Yen, to Gold, to Treasuries and Bunds as well as to Defensive sectors vs the market, as Investors flee to Safety, probably into Spring 2019 and beyond.

To conclude, after having followed risk assets up for the last 18 months, we will finally be pulling the "take -profit trigger" on most of them by the end of this month. We cannot exclude, further Growth extensions into the Fall, but believe that at current levels, the risk/reward relationship is certainly worth adopting a more defensive stance, first into late Summer, and then into Spring 2019.

Main Equities & Government Bonds

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Main Equities	US S&P500	We believe the current July rally is a take profit opportunity, probably towards end July, before equity markets start moving lower into August	From August, we expect the S&P500 to top out for this cycle. The Bear market that follows could last 12 to 18 months. We would start reducing risk by end July.
	Europe EuroStoxx50	On most European markets, the current July rally will probably not make new highs, yet it is also a take profit opportunity, probably towards end July, before equity markets start moving lower into August	As in the US, from August, we expect European Equities to top out for this cycle and start reversing down into late Summer, and then towards 2019.
	EMs MSCIEM USD	EMs may attempt a dead cat bounce during July, but a strong USD into late July/August will keep them under pressure until late Summer.	During the Fall, EMs may find some relief as the USD retraces a bit, yet global deceleration should keep them under pressure.
Treasuries	US10Y Bond prices	US Treasuries should bottom out towards late July, US10Y yields may still make marginal new highs above 3.1 % by then.	From August, US Treasuries will start bottoming out. Start accumulating. 10Y Yields may retrace 70 to 100 bps into 2019.
	Germany 10Y Bund prices	Bund Futures may still retrace some of their recent gains during July, yet we do not expect a widespread sell-off. Accumulate on Dips.	From August, Bund Futures should resume their uptrend, probably towards year-end and then into 2019.

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

Main Equities

World markets
p 16 - 18, 20, 22

Equities markets are reaching the last stages of their Bull market since early 2016. We expect them to top towards late July / early August and some markets will achieve new highs. Following that, from August, we expect them to start reversing down and gradually enter a Bear market which could last between 12 and 18 months.

Main Regional picks
p 16 - 18, 20, 22

The Euro is currently bouncing while markets are heading up. This should keep European markets under relative pressure although these do have some catching up to do. We are hence neutral for now on our Europe/US positioning. Japan may fair slightly better as the Yen seems quite weak into end July, yet don't overstay as the Yen should start to strengthen again as soon as risk assets start to correct.

Emerging markets
p 36-37, 40, 49

We remain prudent on Emerging markets for now. They may bounce slightly during July, but should resume lower and under-perform again during August as the US Dollar strengthens

Volatility

Volatility continues to move lower, probably towards early August according to our Daily graphs.

Government Bonds

US & European Benchmarks
p 26- 27

US 10Y yields could see one last move up into late July, perhaps early August (probably marginal new highs above 3.1%) before they top out for this cycle. European long term yields bounce slightly during July, but will then resume lower during August.

Equity to Bond Ratios, Fixed Income Dynamics & Commodities

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Equity / Bonds	US	The ratio should top-out towards end July/ early August.	From August, Equities and Treasury Yields top out for this cycle, the ratio starts to reverse down, possibly towards year-end.
	Europe	The ratio should top-out towards end July/ early August.	From August, European markets reverse down again, while the Bund gathers more steam again. The ratio starts to consolidate down towards year-end at least.
Duration		European long term yields may make a dead cat bounce during July, while US yields attempt to reach new highs towards late July.	Long term Yields and Yield Curves on both sides of the Atlantic start to correct down from August, probably until Spring 2019 at least.
Credit		US High Yield may still retest up during July vs Investment Grade. Concomitantly Sovereign spreads may also retrace a bit.	From August, Credit starts to deteriorate as the business cycle starts to turn, and conditions gradually worsen towards year-end.
TIPs/Treasuries		TIPs vs Treasuries still seem to rise until late July / early August as residual inflation expectations continue to rise into the Summer.	The TIPs/Treasury ratio gradually loses momentum towards the Fall, as inflationary pressures subside.
Oil		Oil attempts a last move up towards the mid/ high 80s$/barrel on Brent. It tops out for this cycle towards end July/early August.	From August, Oil gradually rolls over as the business cycle starts to top out and risk assets start to correct.
Industrial metals		Industrial metals and Copper may bounce slightly during July, but their current downtrend seems to continue towards late August at least.	Copper and Industrial metals may attempt a last retest to the upside during the Fall, but will find it difficult to make new highs.
Gold		Gold may attempt a slight bounce during July, but then continues lower from end July into late August.	From late Summer, Gold initially benefits from a retracement in USD, then gradually gains momentum as Financial Conditions start to deteriorate.

Legend:	Strong Underweight	Underweight	Neutral	Overweight	Strong Overweight

Equity to Bond Ratios

US & Eurozone Markets
p 28

Equities and Yields resume their uptrend in the US until late July / early August when we expect them to top out. In Europe, the ratio may bounce slightly during July, but resumes lower during August.

Fixed Income Dynamics

Duration (10y - 3Y/3M)
p 25, 27

Yield Curve spreads in the US should start to accelerate lower from late July probably towards year-end as the FED continues its hiking spree and long term yields start to retrace down. Many US yield curves spreads may invert by year-end / early next year. In Europe, long term yields are now in a downtrend. It may take a slight pause during the Fall, but then continues lower well into 2019. 10Y Bund Yields will see negative yields again, at least.

Credit
p 29

US Investment Grade Bonds are already in a downtrend vs US Treasuries. High Yield Bonds may retest up one last time vs Investment Grade in July, but then starts to sell-off, probably towards 2019. Sovereign credits spreads are now also on the rise both in Southern Europe and in Emerging markets. They may continue to retrace a bit during July, but should resume up during August.

Rate Differentials

The progression of the Rate differentials remains in favor of the US (vs Europe, Japan or the UK) probably into late Summer / early Fall at least.

Tips

Inflation expectations (TIPs/Treasuries ratio) remain in an uptrend for now. That said, we expect TIPs yields and Treasuries yields to confirm their reversal down from late July /early August (marginal new highs are still possible). Hence real yields may start to fall more rapidly than nominal yields. This would explain why TIPs continue to outperform Treasuries until later this year.

Commodities

Oil
p 35

Oil attempts a last push into the mid/high 80s USD/barrel (Brent) between now and early August, and then probably tops out for this cycle.

Industrial metals
p35

Industrial metals may attempt to bounce slightly during July, but should resume lower during August, They may extend attempt a retest to the upside during the Fall, but the trend is mature and achieving new highs will be difficult.

Gold & PMs
p31

Following a slight bounce during July, Gold should resume lower towards mid/late August as the US Dollar continues to strengthen. Gold should then benefit from a retracement in the US Dollar from early September, and then start to accelerate up vs all currencies and most assets towards late Fall, as financial conditions start to deteriorate.

Agriculture

Agricultural Commodities are typical late cycle commodities. They are more defensive than Energy or Industrial Metals and should perform better than them in the upcoming environment. For now, following their June sell-off (Chinese devaluation), we would expect them to remain under pressure until mid/late August. During the Fall, they should resume higher, until early/mid Q4 at least.

Foreign Exchange

		Next 2 months	3 to 6 months ahead
USD vs	EUR	EUR/USD could continue to hold up until mid/late July (1.18 - 1.20 range), it then gradually resumes down again until mid/late August (1.14 - 1.10 range)	From late August, EUR/USD may start to stabilize and could bounce into the Fall
	GBP	GBP/USD could continue to hold up until mid/late July (up to 1.35 ?), it then resumes lower until mid/late August.	From late August, GBP/USD may start to stabilize and could bounce into the Fall
	JPY	USD/JPY is attempting to break out above 111. It may reach above 115 by late July / early August.	From August, USD/JPY gradually loses momentum and starts reversing back down. The move down gradually accelerates into the Fall.
	CHF	USD/CHF is attempting to resume its uptrend, and by August pushes back above parity and possibly slightly higher.	From late August , the Dollar loses mometum and could start to retrace down into the Fall.
EUR vs	GBP	EUR/GBP could still retest down during July, but gradually gains upside momentum during August.	From late Summer, EUR/GBP should resume its uptrend towards 2019 on risk-OFF considerations. Indeed, longer term, the EUR still seems more defensive than the GBP.
	JPY	EUR/JPY could continue its rebound into late July and could test its 132 resistance. It should then reverse lower into August.	From August, EUR/JPY starts reverses down, probably well into 2019
	CHF	EUR/CHF could continue its weak rebound into late July towards the 1.17 - 1.18 range, it then reserves this move during August.	EUR/CHF may still attempt to retest up during September/October (1.20), yet reverses down towards year-end on risk-off considerations
GBP vs	JPY	GBP/JPY could continue to rebound into late July towards 150, it then tops outs and starts to reverse down during August	From August, GBP/JPY reverses down and gradually gains downside momentum towards year-end as risk-off considerations increase
	CHF	GBP/CHF could continue to rebound into late July towards 1.33 – 1.34, it then tops outs and starts to reverse down during August	From August, GBP/CHF reverses down and gradually gains downside momentum towards year-end as risk-off considerations increase

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

US Dollar
p 44- 46

We believe the US Dollar has turned up for this cycle and that it will gradually strengthen in successive stages towards mid/late 2019. Shorter term, we expect its current retracement to continue perhaps into mid July or so, before the US Dollar resumes up towards mid/late August. Following that, the US Dollar could retrace down into the the Fall as the deceleration also begins to hit the US, before it accelerates up again towards year-end and into 2019 on Flight to Safety concerns.

Euro
p 45

The upside momentum on EUR/USD that prevailed throughout 2017 has stalled. Indeed, we believe that the recoupling story (European Growth catching up with the rest of the world) is fading. Indeed, since mid Q1 2018, the Economic surprise index has steadily deteriorated, while the recent Italian Political crisis highlights the persistent structural imbalances in the EuroZone. We expect that the current rebound on the EUR/USD to die out towards mid, perhaps late July (1.18 – 1.20 range), and that during August, EUR/USD could sell-off towards the 1.14 – 1.10 range. Following that, it rebounds back up towards the high teens during the Fall, as the US starts to face its own economic deceleration. In 2019, EUR/USD weakens further as economic, financial and political problems accumulate. Vs CHF, the upside momentum seems to have been broken, EUR/CHF should remain under pressure until mid/late August, yet could attempt to retest up during the Fall, but should then start reversing lower again towards year-end on risk-OFF considerations. EUR/GBP may still retest down during July, but gradually starts to gain upside momentum from August towards year-end and 2019 as Sterling is probably more sensitive than the Euro to any upcoming cyclical downturn.

Yen
p 46

The rebound on USD/JPY has been strong and we expect it to continue towards late July / early August. It will first need to confirm that it can break above 111, possibly opening the door towards 115 over the next 2 to 3 weeks. Following that as risk assets top-out in August and financial conditions start to deteriorate towards year-end, we expect the Yen to regain its risk-OFF profile and that USD/JPY starts to reverse down towards 2019. Vs the Euro and Sterling, the Yen could remain quite weak until late July, before it regains strength towards year-end and into 2019 on Flight to safety concerns.

Sterling

Cable (GBP/USD) is following similar dynamic than EUR/USD. Its current rebound should die out towards mid, perhaps late July (1.33 – 1.35 range), before the pair resumes lower in to mid/late August (price targets below 1.30). As with the Euro, from late Summer / early Fall, GBP may start to bounce vs USD probably into early/ mid Q4, before it resumes lower into 2019.

Oil & Commodities currencies
p 48

Commodity currencies (our equal weighted portfolio containing AUD, BRL, CAD, NOK, NZD, RUB, CLP and ZAR) topped out in early February against the Dollar and has been consolidating down since. We expect this downtrend to continue into August in first instance. Following a slight bounce during late Summer, early Fall, Commodity currencies should weaken substantially vs the US Dollar from late 2018 and well into 2019. Against the Euro, Commodities currencies should also weaken towards year-end and 2019.

Asian currencies
p 47

Our Asian Growth equal weighted portfolio (CNY, INR, KRW, THB and TWD) should continue to resume lower vs the USD towards August. Following that, it may rebound during the Fall before it corrects down again towards year-end and 2019. Vs the Euro, our Asian Growth currencies could see further bounces between now and early Q4, yet could then resume lower towards early next year.

Equities Markets Segmentation

Core Sector Weightings			Next 2 months					3 to 6 months ahead				
US Sectors - S&P500			**We will remain Underweight Defensive and Overweight Technology and Energy until late July and then turn Defensive**					**From August, we expect Equity, Commodities and Yields to start topping out for the cycle. Our sector allocation will hence turn defensive to reflect this view.**				
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	26%										
Financials	XLF	15%										
HealthCare	XLV	14%										
Discretionary	XLY	12%										
Industrials	XLI	10%										
Staples	XLP	8%										
Energy	XLE	6%										

			Next 2 months					3 to 6 months ahead				
European Sectors - Europe Stoxx 600			**We will remain Underweight Defensive and Overweight Technology and Energy until late July and then turn Defensive**					**From August, we expect Equity, Commodities and Yields to start topping out for the cycle. Our sector allocation will hence turn defensive to reflect this view.**				
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 19, 21, 30, 50-51

Our scenario on equities is still positive until late July / early August. This move up is potentially the last one to the upside before equity markets top out for the cycle and start to reverse down towards year-end and 2019. Hence, our sector allocation is quite neutral as the visibility is quite short coming into an important turning point. We will hence remain underweight Defensive sectors for now and overweight Technology and Energy, which should perform well in the current late cycle environment.

Then, from the end of this month (late July/early August), we expect Equity, Commodities and Yields to top out for the cycle. Our sector allocation will turn defensive and will probably remain so throughout most of H2 2018.

Countries allocation

Core Countries Weightings			Next 2 months					3 to 6 months ahead				
All World Country Index Currency hedged			**Until late July, we will Overweight the US and Japan.**					**From early August, we will Underweight Europe and Commodity producers. Overweight the US and Switzerland**				
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
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 16- 18, 20, 22, 36-37, 40, 49

We expect Equity markets to top out towards late July, perhaps early August, and then correct down during August. Until then, we would favor the US, which still shows strong momentum and Japan, which may accelerate one last time as USD/JPY also attempts a last leg up above 111.

From August, we believe that equity markets in general may make an important top and that these could start to correct down towards 2019. We also expect that by September, EUR/USD could start to stabilize as the deceleration story begins to also impact the US. Our allocation will hence turn quite defensive, favoring the US and Switzerland and avoiding Europe as a whole, given the negative relative impact that a rebound in EUR and GBP could have on European markets from late August into the Fall.

Core factors and Themes

Core Factor/Themes Weightings	Next 2 months					3 to 6 months ahead				
General Comment	**Until late July, we remain positive on Growth themes and underweight Value and Defensives**					**From August onwards, we would favour Defensive profiles as we expect equity markets to top out, and move away from cyclical themes**				
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)										
Goldmines										
Diversified Mining										

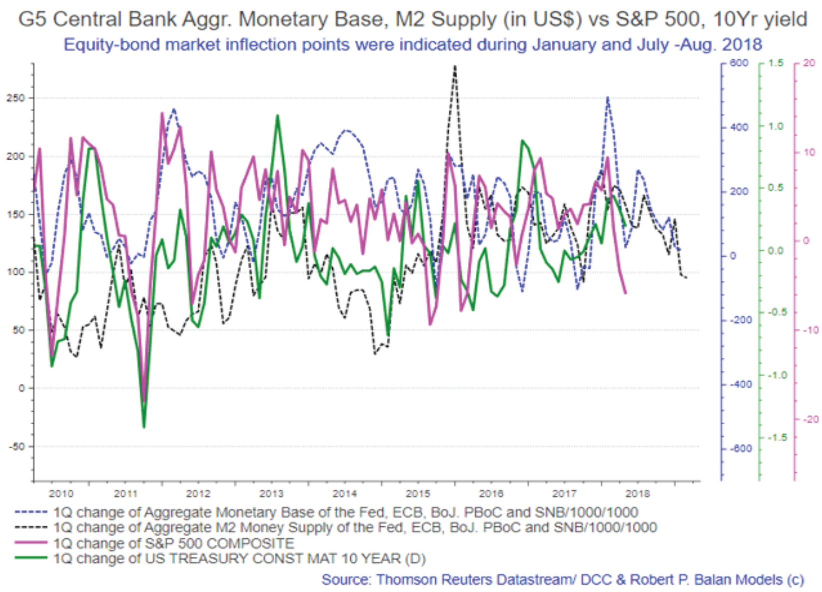
Core factors and Themes
p 17- 18

Our scenario on equities is still positive until late July, yet we believe that this leg up is probably the last one, before an important top is made on risk assets towards late July / early August. We will hence remain underweight all defensive themes until then (in the table above: REITS and Goldmines) and continue to favor pro-cyclical ones (e.g. Diversified Mining). We have also neutralized the Nasdaq vs the S&P500, which could still outperform slightly longer, yet for which the risk/reward vs the S&P500 is starting to look quite extended.

From August into year-end, our Themes & Factors allocation is turning much more defensive as we expect most Equity markets to be topping out for this cycle.

12 / The peak of asset prices for 2018 happens in late July-early August: how did financial markets get to this point

Original chart in the May Capital Observer issue



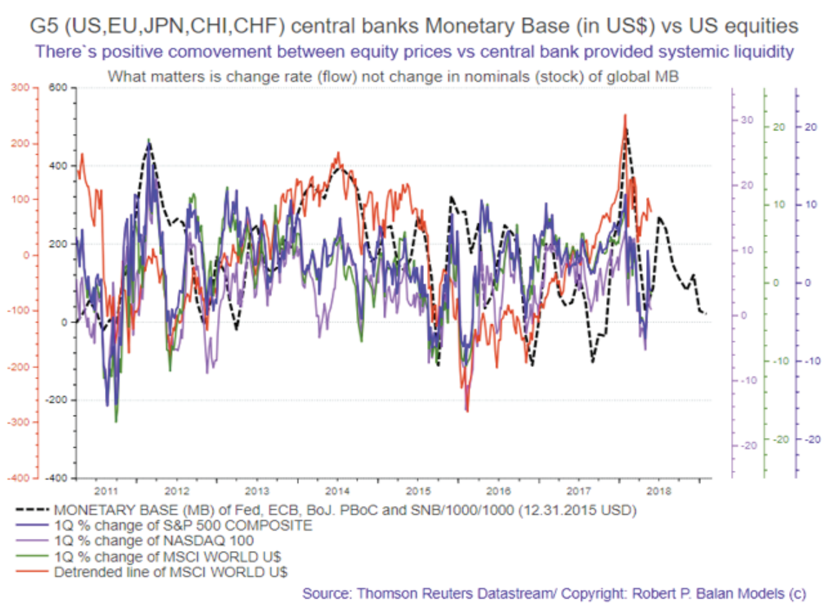
The US-China trade spat had the financial markets going into fly-to-safe-haven mode, pummelling equity indices and lowering global bond yields and pushing the US Dollar (DXY). For readers of Capital Observer, this was not an unexpected event. **The market recent sell-off since June 12 is the last test of the May 3 lows before a significant rally to late July- August period.** We have been speaking about the confluence of systemic liquidity factors, even as early as Q1 2018, during which we identified early May as likely trough of risk assets prior to a rally into a July-August peak. **Last month, we went one step even further and described the mechanics of a market break and subsequent rally in risk assets** *(see "Systemic Monetary Liquidity: A Top-Down Look To Understand Where We Came From, Where We're Going")***.** This is how we discussed the concept in last month's (June 2018) Capital Observer issue:

"After the US Federal Reserve launched its Quantitative Easing programs, major global central banks followed suit. The volume of the global bank reserves generated by those large-scale asset procurements were so large that for all intents and purposes those reserves have become the Monetary Base of the central banks of the US, the EU, Japan, China and the Switzerland (CB5). The aggregate global central bank balance sheet has been credited with pushing up the valuation of equity and other asset markets around the world.

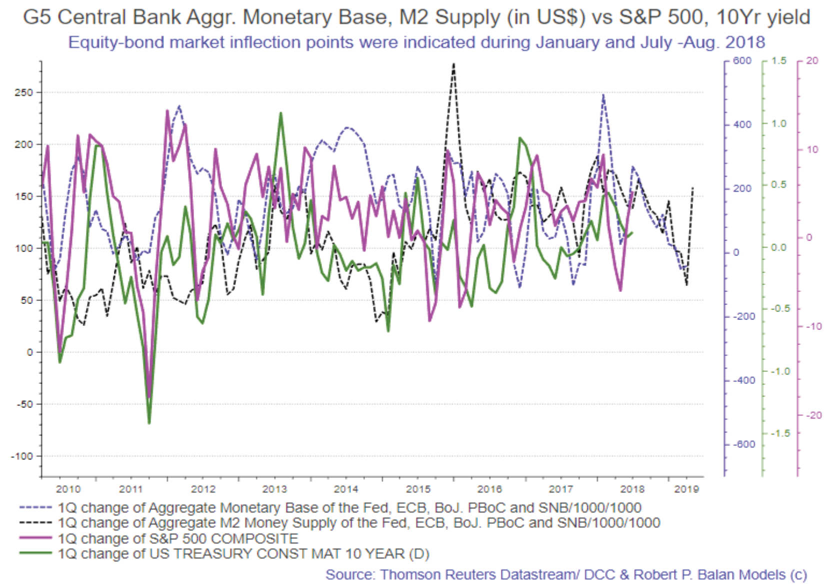
The impact of those aggregate global reserves on financial assets was, and is, enormous. During the time global central banks were adding to their balance sheets, financial assets have become beholden to the flow of that global aggregate systemic liquidity. The prices of financial assets have risen as the flow of the aggregate Monetary Base rose, and opposite is also true. This is especially true of the US stock market and US bond markets (see 1st graph on this page)."

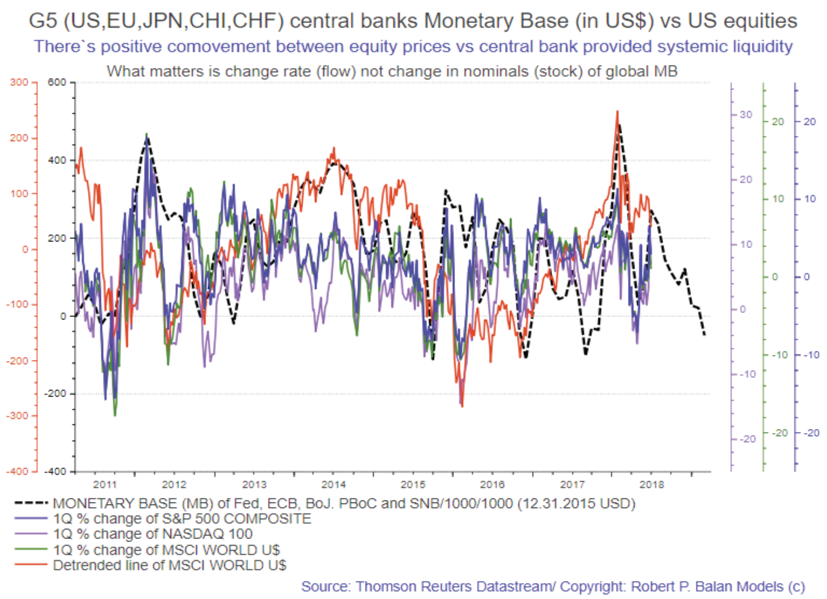
"In the graph provided above, for 2018, the flows peaked in January, which coincided with the peak in the S&P 500 Composite, and in the 10-year US Treasury Bond Yield. There is another peak in the liquidity flow being shown in July – August, this year. We therefore expect financial assets, especially equities, to make significant peaks at that time (see also graph below)."

Original chart in the May Capital Observer issue



And this is how those two previous charts look now:





It is highly apparent that risk assets are in their last push higher before the withdrawal of liquidity world-wide undercuts the equity bull market thesis, at least in the near-term. If the distributed lag effect does its job, equity markets should be in a world of hurt until early Q2 2019 *(see the two graphs above).*

Liquidity flows from the US Treasury and Federal Reserve

At The Capital Observer, we have augmented the global central bank balance sheet flows with information coming from systemic liquidity data from the US Treasury and Federal Reserve. Effectively, what this did was to make the global central bank liquidity flows the broad carrier wave, and the liquidity flows from the Fed and Treasury providing the impetus for high-frequency turns in the price of risk assets. This has enabled us to use these tools in real time trading.

Very often, it is the change rate in the nominal values (flows) from the Fed and Treasury, not the absolute changes in nominal value (the stock), which makes the most impact on asset prices. Note, however, that the response of asset prices to the impact of those flows is variable; some assets respond more quickly to the flows; for other assets, the impact of those flows come later. The systemic liquidity from the Fed and Treasury are issued in various guises, and those sources are not necessarily synchronized in their activity.

The periodic, and episodic, infusion and claw-back of systemic liquidity conducted by the Federal Reserve and the US Treasury can be highly variable. To cite one such example: the US Treasury Cash Balances expand and contract in significant degrees at least 6 times a year (perhaps even eight times, if minor episodes are included), see graph below. There was only one instance in the past 12 years when the cadence of the inflow and outflow of the Treasury's cash balances deviated from historic norms. That was in late Q3 2008, when the Great Financial Crisis was full-blown. The Treasury Cash Balance at that time mushroomed circa 350 times in about two months. That period, indeed, was crunch time, so the Treasury let loose a massive wave of systemic liquidity *(see 1st graph on this page, orange line)*. This is just one example of liquidity infusion and claw-back from the Treasury. There are others.

The Federal Reserve has plethora of ways available to them to control systemic liquidity. The central bank may deploy its balance sheet, the bank reserves, the required reserves (although this is more used to sop up liquidity in the narrower sense), reverse repos (take out liquidity from the system, as well).

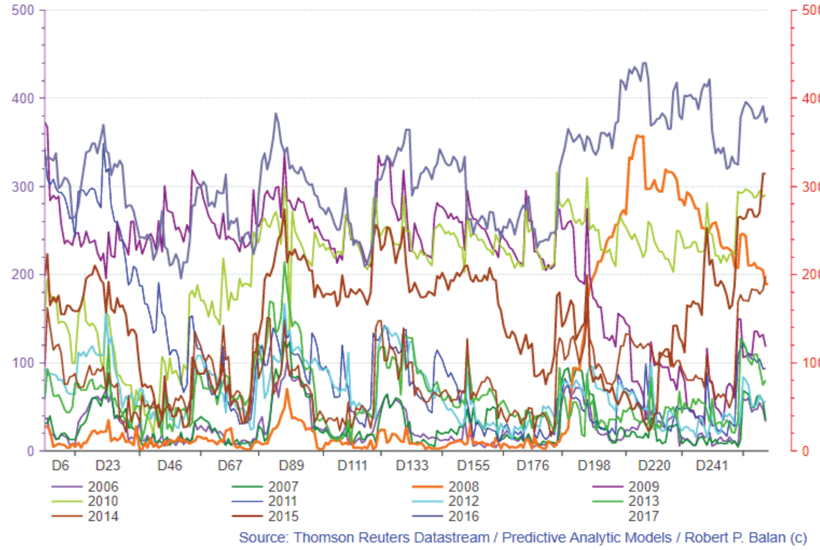
All these tool, and the various Open Market Operations which the New York Fed conducts on a regular basis (e.g., Temporary OMO Repos), or buying or selling securities, provide the means for the central banks to control the Monetary Base. Of course, the Fed has total control over the size of the Monetary Base (MB). It has become synonymous with the Fed's balance sheet after the central bank's Large-Scale Asset Purchases (LSAP), more popularly known as Quantitative Easing (QE), conducted during the early part of the Great Financial Crisis (GFC). *(see 2nd graph on this page)*

Putting it all together

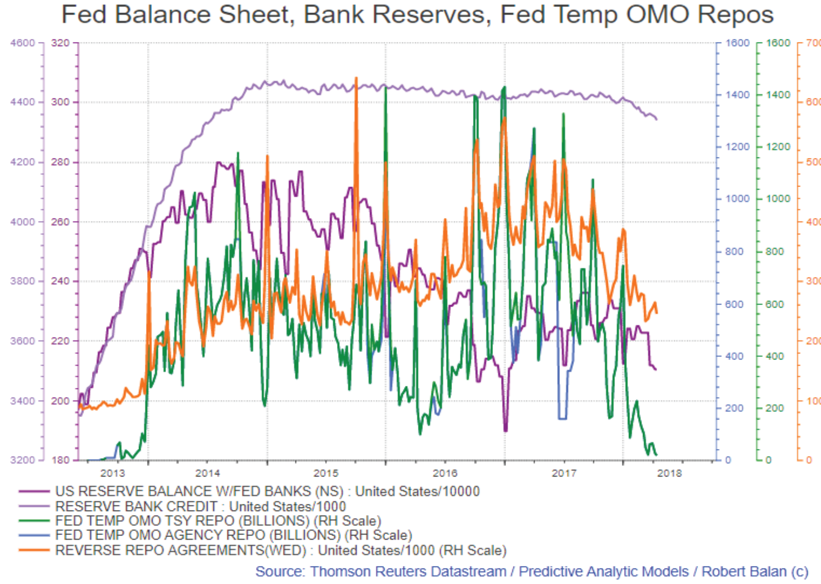
The liquidity from the Fed's Open Market Operations and the US Treasury interacts with the systemic liquidity stemming from fiscal and monetary policy on cumulative basis. If the disparate waves of liquidity from various sources coincide, the aggregate, subsequent positive impact on risk assets' prices will be huge. The inverse is, of course, also true - the negative impact on safe haven assets will be huge as well. If the aggregated withdrawal of liquidity from various sources coincide, risk asset prices will subsequently tend to crumble (and safe haven asset prices will subsequently outperform). *See the example in the last graph on this page.*

Liquidity sources have combined to push up bond yields higher in the near term. That is not a good sign for safe haven assets, which adds to our conviction that risk assets remain in ascendancy as liquidity inflows stoke upwards pressure for equities.

US TREASURY CASH BALANCE (Jan to Dec, year by year)

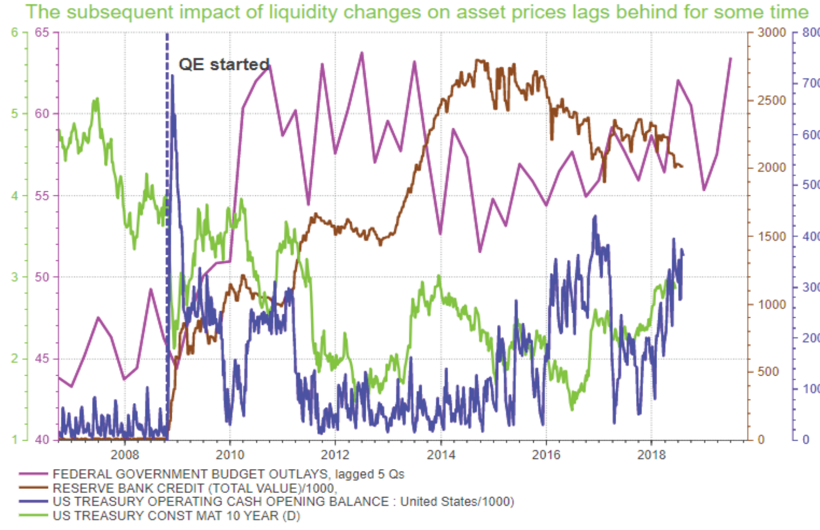


Fed Balance Sheet, Bank Reserves, Fed Temp OMO Repos



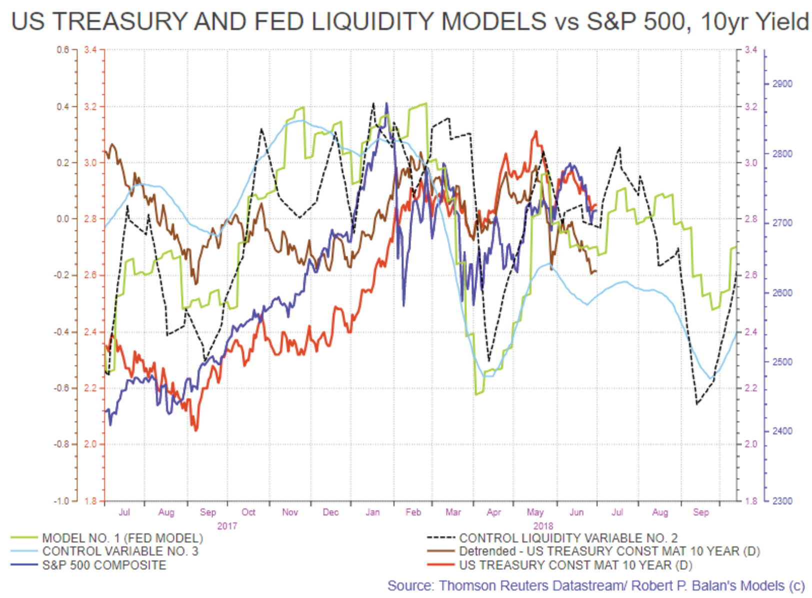
The impact of disparate sources of liquidity on assets is cumulative

The subsequent impact of liquidity changes on asset prices lags behind for some time



The final push higher, then a sharp fall

A significant short term bottom in the price of risk assets may have been seen already last week, and **the last bull market phase should last until a late July-August top, with intermediate pauses** *(see graph on this page)*. **The ensuing sell-off should last until late September, after which we could see some temporary recovery in asset prices. But by and large, the trough in this forthcoming sell-off may be seen only by early spring 2019.**

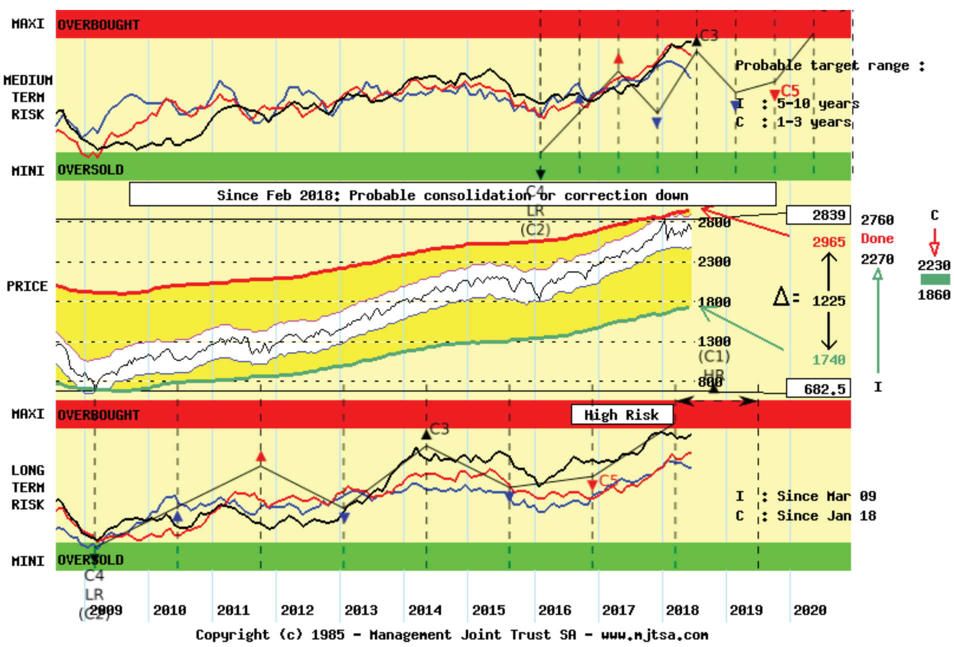


The purpose of this series of articles about systemic liquidity is to prepare the readers of Capital Observer to the eventuality of a peak in the markets very soon, which is still not a part of the mainstream sentiment profile. An exit strategy and defensive strategy should now be prepared to be implemented over the next 2 months. Therefore, if this forecast actually takes place, the impact on asset prices will be significantly worse than otherwise. We urge readers to take measures to minimize the impact of a sharp break in risk asset prices very soon.

UP and OUT, one a last rally on equities into the 2nd half of July, use it to take profit and reduce your risk

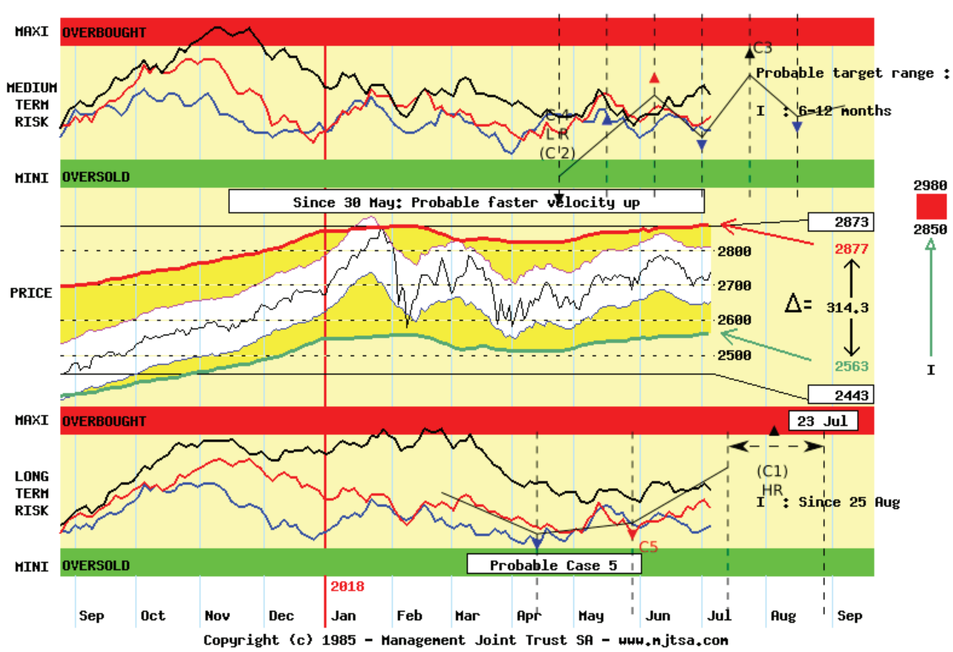
Since early 2016, we've been monitoring the reflation trade up. As we have written many times in The Capital Observer over the last 18 months, we have been expecting that equity markets should top out for this cycle at some point between the Spring and the Summer of 2018. If some markets may have already done so in January, we are still eying further upside retests on others, and these may make marginal new highs over the next few weeks. In our view, this last rally may offer an ultimate take profit opportunity in an environment where the medium term risk/reward has very much deteriorated.

S&P500 Index
Bi-monthly graph or the perspective over the next 1 to 2 years



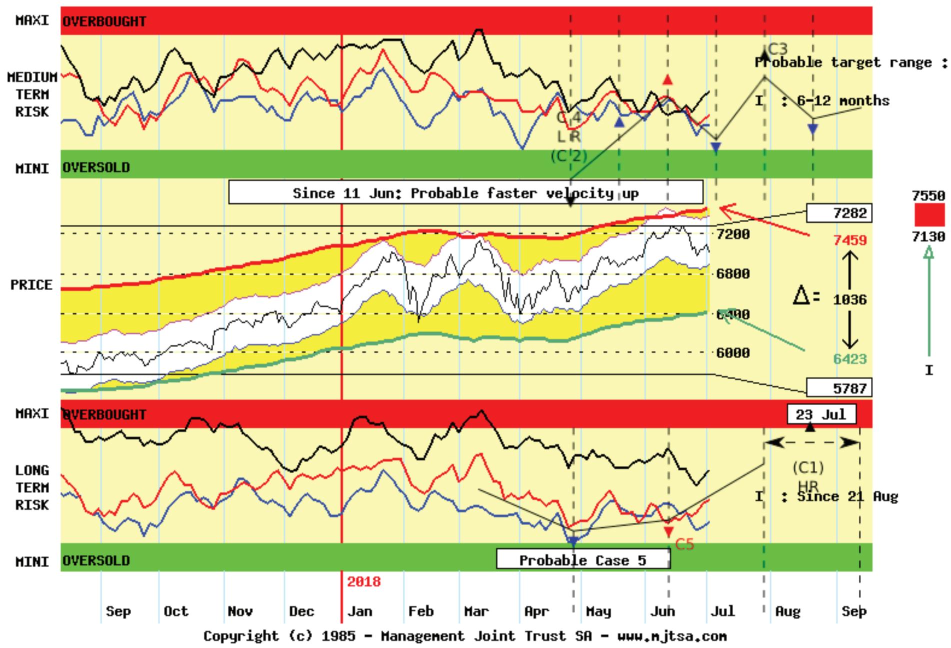
On our long term oscillator series (lower rectangle), this long term graph of the S&P500 has come to the end of our uptrend model. **This situation, which is labelled "High Risk" usually trigger one or two years of downside correction**. On our medium term oscillators (upper rectangle), the S&P500 is also approaching an important top this Summer, although perhaps only an intermediate one. Nevertheless, on this long term time frame, it would still imply **at least 3 quarters of downside consolidation**. Beyond market timing, the risk/reward is also very much stretched. Our I impulsive price targets to the upside (right-hand scale) has been achieved, while the **C Corrective downside risk we calculate is between 20 and 35%. Hence over the next 12 to 18 months, we are turning extremely prudent on the S&P500 and more generally on equity markets.**

S&P 500 Index
Daily graph or the perspective over the next 2 to 3 months



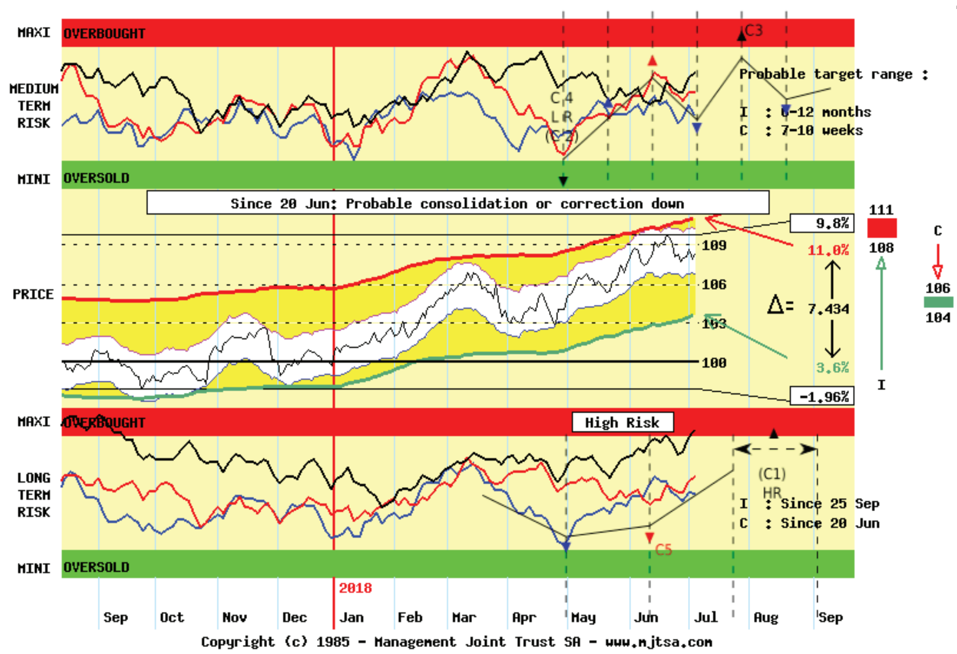
On this daily graph of the S&P500, the situation is labelled as a "Case 5" on our long term oscillators (lower rectangle). This means that **we may expect one last acceleration to the upside before the market eventually tops out**. Our automatic messaging expects this top to happen during the 2nd half of July (a tentative 23rd July date has been calculated). The I impulsive target range to the upside for this move (right-hand scale) is between 2'850 and 2'980, **hence possibly retesting the January highs**. In the meantime, the S&P500 will first need to hold above the support point from which this Case 5 originates (30th May at around 2'680). Below that, the lower end of our C Corrective targets to the downside (2'622), would provide an ultimate stop loss level. In general, **this is a late cycle situation where investors should be prepared to take profit opportunistically and play their stop-losses strategy close to their chest.**

Nasdaq 100 Index
Daily graph or the perspective over the next 2 o 3 months



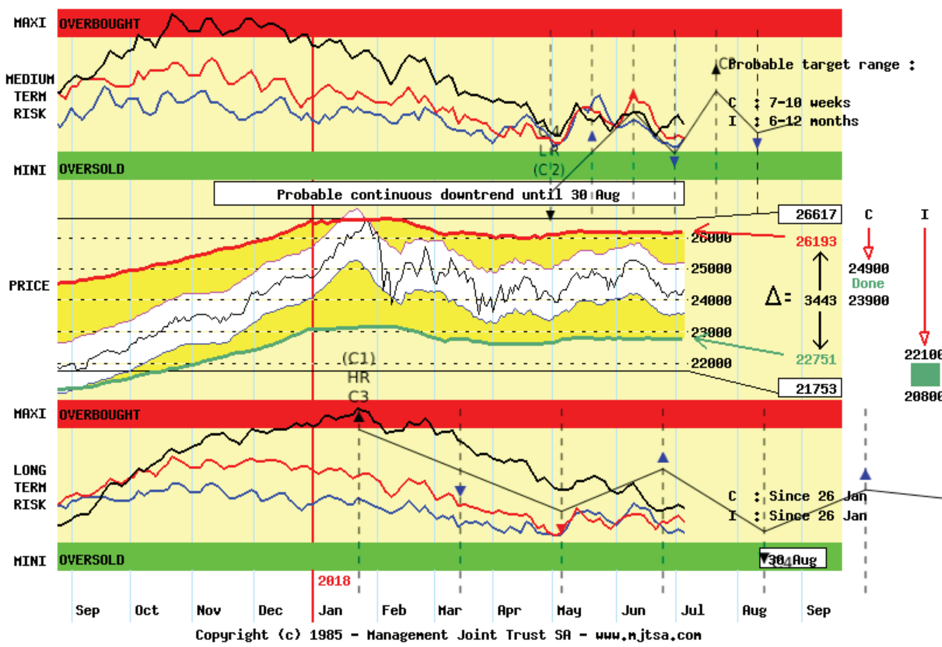
Since April, we had planned for the Nasdaq 100 to make new highs and it recently did. Now, both our oscillator series (lower and upper rectangles) are suggesting **that it may still push higher on last time into the second half of July** (a tentative 23rd July has been calculated). **Our I Impulsive targets to the upside (right-hand scale) would confirm this view and their upper end even reaches as high as 7'550 (6% above current levels)**. The Nasdaq 100 has indeed been leading US markets higher over the last few quarters. More recently, as Europe and Emerging markets have suffered, it has positioned as the ultimate Growth trade refuge in global equity markets.

Nasdaq 100 Index vs S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



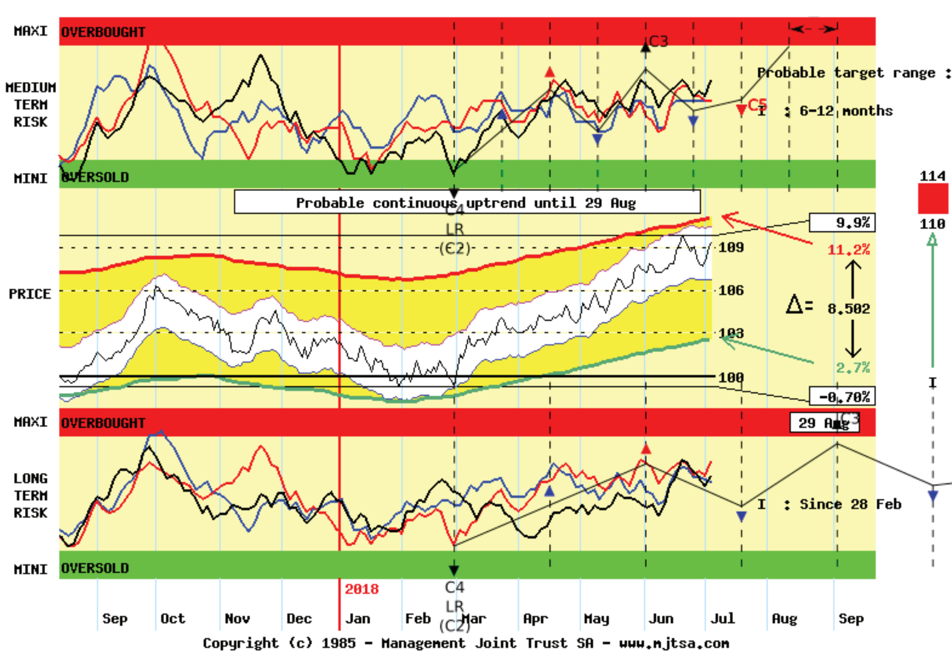
Indeed, against the S&P500, the Nasdaq 100 is still uptrending. The move may be close to exhaustion ("High Risk" label on our automatic messaging), yet both our oscillator series (lower and upper rectangles) would suggest that the ratio could still extend slightly higher into late July. Our I Impulsive targets to the upside (right-hand scale) would suggest 2 to 3 % of additional outperformance until then (i.e. possibly, the S&P500 retests its January highs, while the Nasdaq 100 makes new highs once again).

Dow Jones Industrial Average
Daily graph or the perspective over the next 2 to 3 months



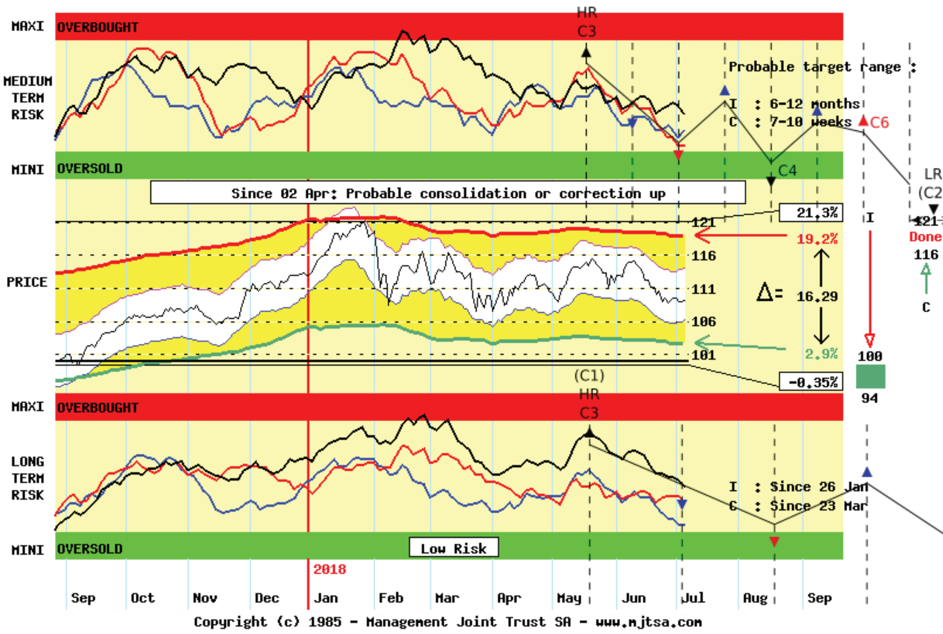
The picture is weaker on the Dow Jones Industrial Index. Indeed, while our medium term oscillators (upper rectangle) are also suggesting a bounce into late July, our long term oscillators (lower rectangle) are already in a downtrend, possibly into early/mid August in first instance. On the price targets front (right-hand scale), as long as the lower end of our C Corrective targets hold up (above 23'900), the bounce into the 2nd half of July is still supported. That said, below this level, our I impulsive targets to the downside are quite scary. They indicate downside price targets between 22'100 and 20'800 or circa 9 to 15% below current levels. This risk, in our view, highlights the dangerous situation markets are in at the moment: **a rebound is still possible, yet we would highly suggest to exit before month's-end as the next move lower could be quite strong.**

Russell 2000 Index vs the S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



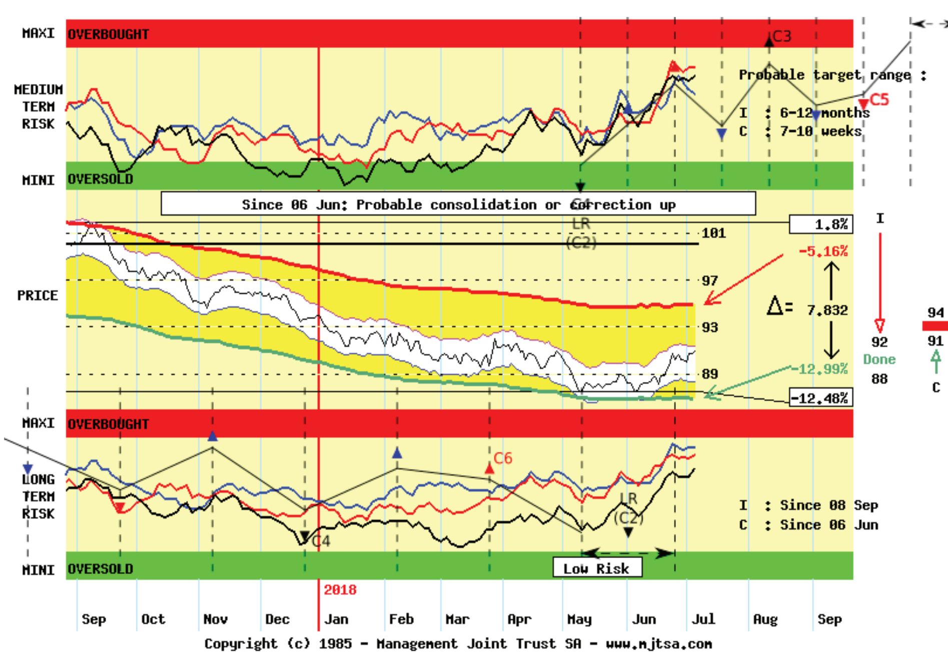
Small Caps have been strong outperformers since last February. Some analysts are suggesting that this is a good sign for markets as generally Small Caps are considered more cyclical and that their outperformance usually results in an increase in market breadth. Although historically, this may often be true, we believe that it is not the case at present. Indeed, **we trace the recent outperformance of Small caps to other reasons, and most importantly to the strength of the US Dollar. Indeed, Small Caps are more domestic than large Caps and hence bear less translation risk on their foreign earnings. They hence tend to outperform when the US Dollar is strong. This relationship seems particularly strong at the moment and according to both our oscillator series (lower and upper rectangles), we would expect it to continue possibly from mid July into late August in first instance**. Indirectly, this would imply that the US Dollar starts strengthening again during the second half of July, which in recent months has been rather a risk-off factor rather than a risk-on one.

US Reflationary Sectors (capitalization weighted portfolio)
Daily graph or the perspective over the next 2 to 3 months



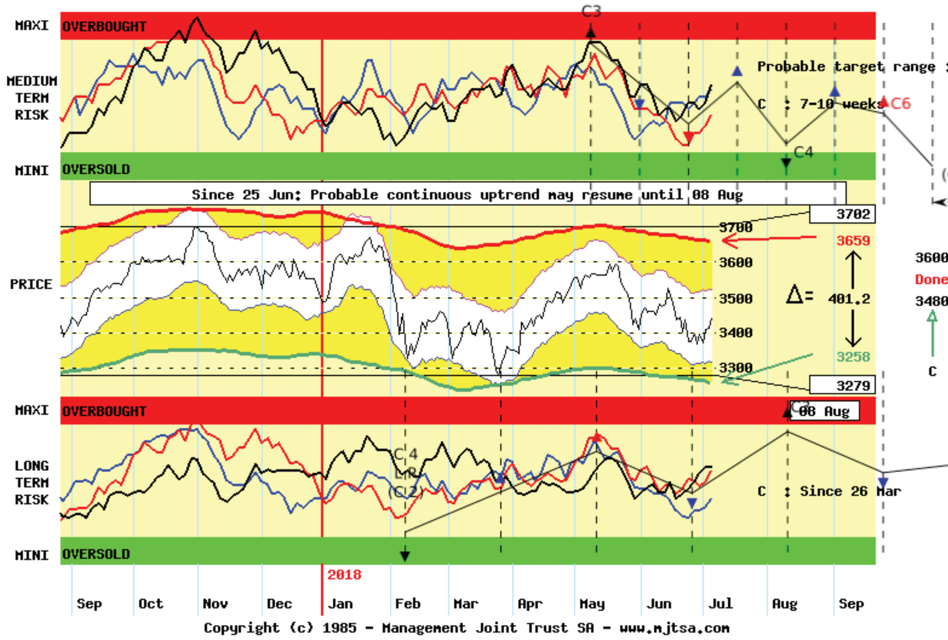
This graph represents a **capitalization weighted portfolio of the sectors which have been the more reflationary since 2016 (Industrials, Materials, Energy, Financials).** Incidentally, this graph is very similar to the one for the Dow Jones Industrial Average on the previous page, and on both oscillator series (lower and upper rectangles) we would suggest that it is already in a downtrend. Hence, **following a slight bounce into the 2nd half of July, we expect it to resume lower from late July into mid/late August** in first instance. According to our I Impulsive targets to the downside (right-hand), the **risk on these sectors is also quite compelling, somewhere between 9 and 14% over the next couple of months.**

US Defensive sectors (capitalization weighted portfolio) vs the S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



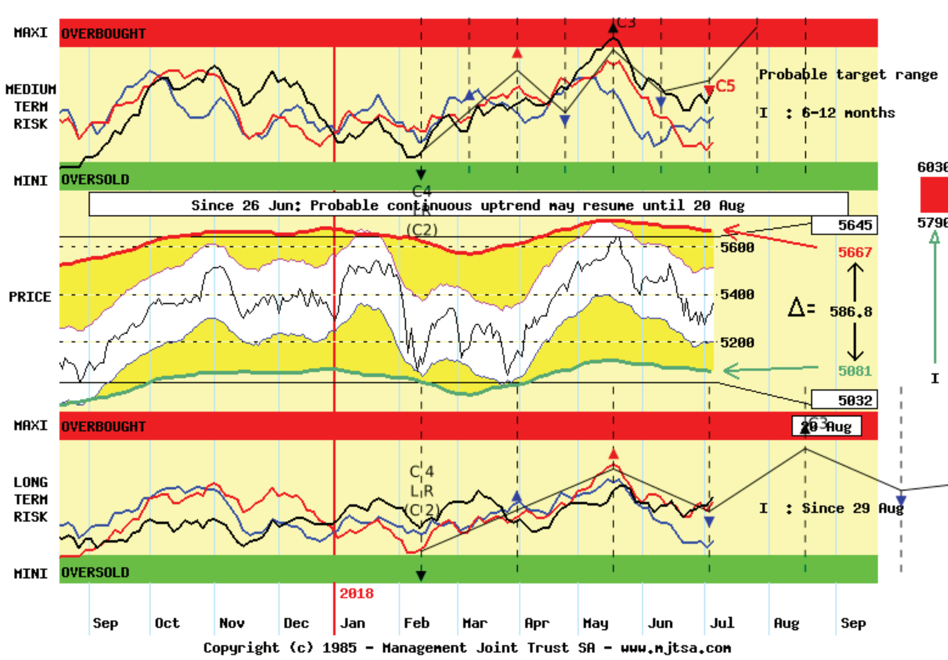
This relative graph of US Defensive sectors vs the market (Staples, Healthcare, Utilities and Real Estate) reached a Low Risk position on our long term oscillators (lower rectangle) during May and early June. Their underperformance potential was also exhausted with our I Impulsive targets to the downside (right-hand scale) labelled as "Done". Our medium term oscillators (upper rectangle) suggest that these **Defensives sectors are already in an early uptrend vs the S&P500 Index. They may pause and retrace until mid/late July, before they start to outperform again into mid August in first instance**. Hence, this relative graph suggest that the switch to more defensive profiles (as well as bond proxy profiles) is already happening, i.e. start buying the dip on a relative basis following the short retracement period ahead (i.e. in 2 to 3 weeks time).

EuroStoxx 50 Index
Daily graph or the perspective over the next 2 to 3 months



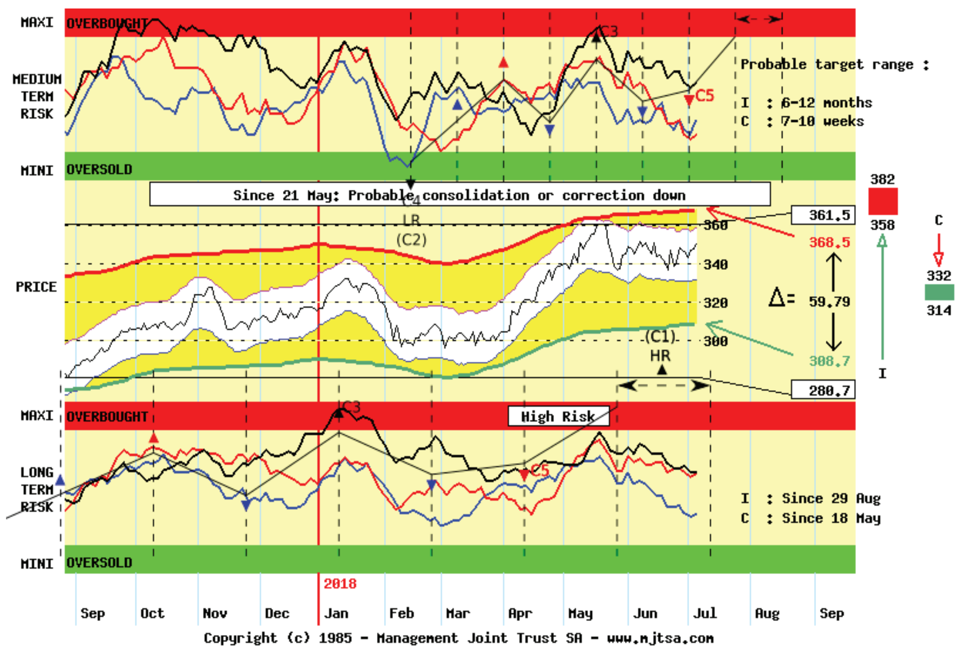
In Europe, the EuroStoxx 50 is also attempting to resume up. It held the support point we were expecting late June** on both oscillators series (lower and upper rectangles) and is now trying to move higher. **For now, we are still below the higher end of our C Corrective up targets (below 3'600; right-hand scale) and hence the move is still labelled as a correction. If it remains so, we probably expect the rebound to die out during the second half of July** (upper rectangle), before the EuroStoxx 50 resumes lower towards August and even September. Our long term oscillators (lower rectangle) show a slightly more bullish view, where the EuroStoxx 50 could continue higher until early August, yet we would really need to see a break above the 3'600 resistance before we can envisage such a strong upside retest.

CAC40 Index
Daily graph or the perspective over the next 2 to 3 months



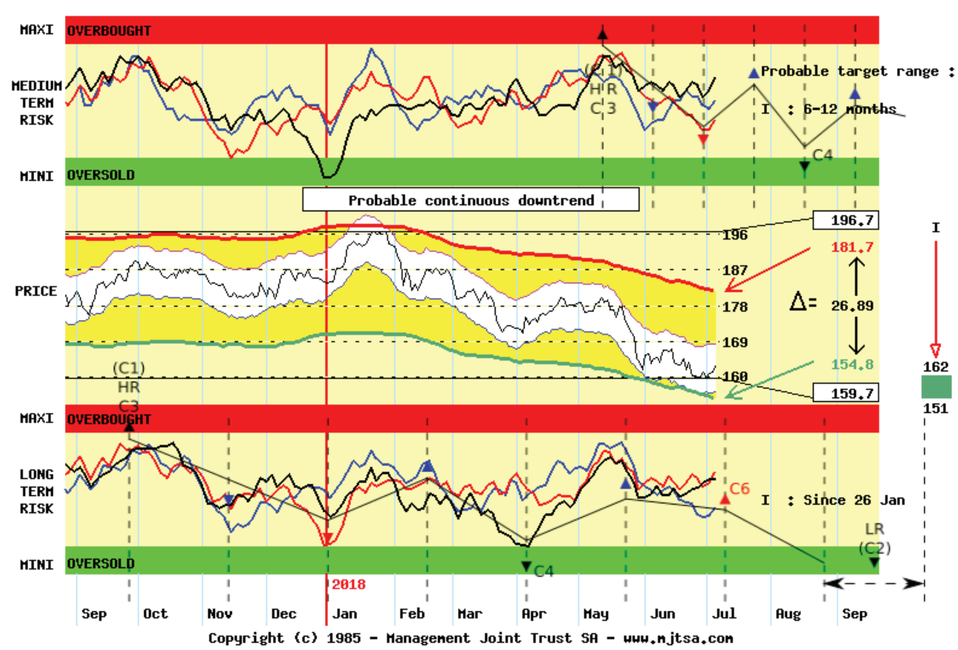
The CAC40 has been the strongest large EuroZone market since late March. It effectively made new highs in May and could be set to do so again over the coming weeks. Indeed, on both our oscillator series (lower and upper rectangles), **the CAC40 is still trending up possibly into late July/early August. I Impulsive targets to the upside would suggest new highs between 5'790 and 6'030** (right-hand scale). Intuitively, we believe that if such strength materializes, it will probably need to be accompanied by further EUR weakness probably from the second half of July.

European Energy Sector
Daily graph or the perspective over the next 2 to 3 months



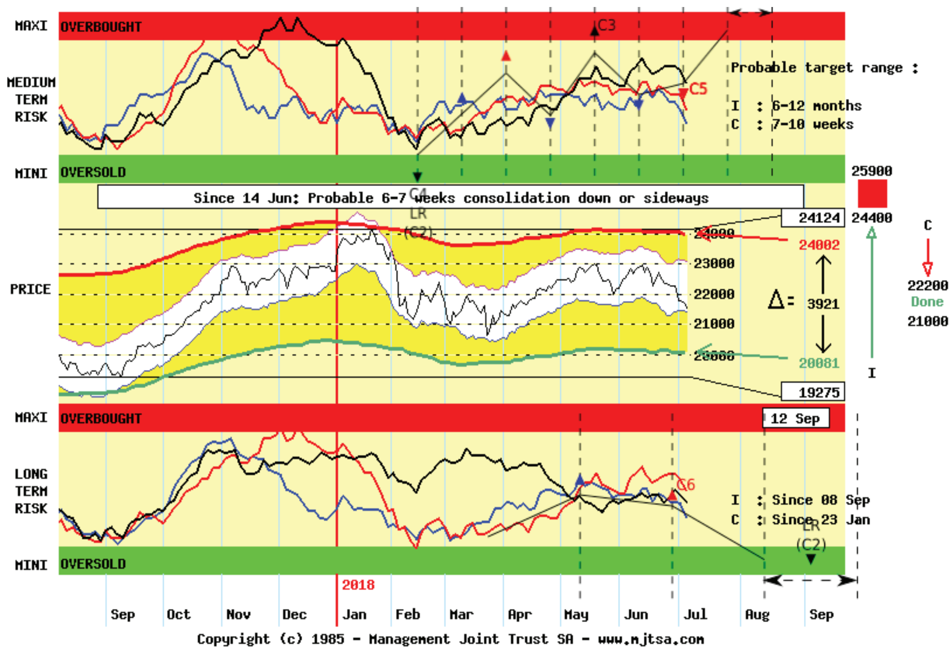
The European Energy sector has had a good run over the last 24 months on an absolute and relative basis. This contrasts with the US Energy sector which has widely underperformed the S&P500. That said, our long term oscillators (lower rectangle) have now entered a "High Risk" position, which indicates that from a timing perspective the uptrend is getting close to exhaustion. That said, **both our medium oscillators (upper rectangle) and our I Impulsive targets to the upside (right-hand scale) would suggest that a last push higher is possible, probably until late July / early August and into the 358 – 382 range (2 to 9% above current levels).**

European Banks Sector
Daily graph or the perspective over the next 2 to 3 months



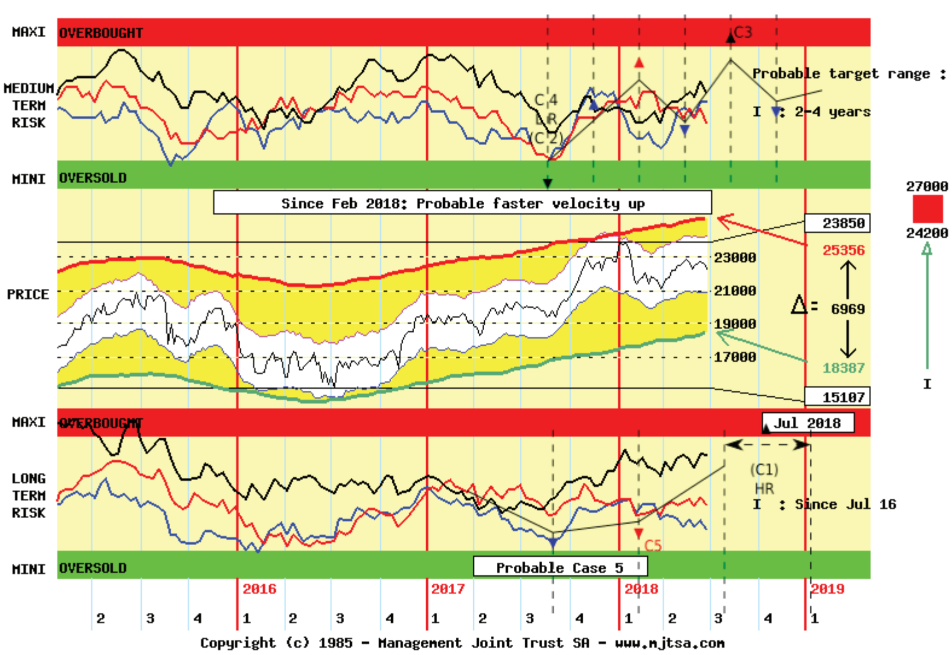
European Banks have been burdened by the deterioration in European economic conditions since mid Q1. The recent anxiety around the Italian political crisis has added additional downside pressure. Although **we expect the downtrend to continue until mid/late August, possibly even September** on both oscillator series (lower and upper rectangles), **we will probably see a rebound over the next few weeks, possibly into mid/late July** on our medium term oscillators (right-hand scale). Following that, there is still some downside risk left on European banks, potentially towards the lower end of our I Impulsive targets to the downside (151; right-hand scale).

Nikkei 225 Index
Daily graph or the perspectives over the next 2 to 3 months



The Nikkei is probably one of the more complex indexes at the moment. Its price action has been deceiving over the last couple of months, while USD/JPY is attempting to break out above 111 (usually a Nikkei positive factor). This is probably the result of some South East Asia spill-over effect as well as the consequences of the looming trade war, especially on the auto manufacturing side. On our long term oscillators (lower rectangle), **we show a bleak projection that could lead us lower on the Nikkei towards late August / September. Yet for now, the support of our C Corrective targets down has held (lower end at 21'000; right-hand scale), and we believe it is still premature to call for an imminent sell-off. Instead, we would favour the projection we show on our medium term oscillators (upper rectangle), where the Nikkei attempts one last move higher into late July / early August and then starts to sell-off.** Obviously, we would need to hold above 21'000 to keep this positive view until month's-end.

Nikkei 225 Index
Weekly graph or the perspective over the next 2 to 4 quarters



Our longer term Weekly graph, would confirm this positive inclination. Indeed, for now the uptrend is still in place and **our I Impulsive targets to the upside (right-hand scale) are pointing towards new highs above 24'000 and possibly even higher. This is quite aggressive, yet seems to be confirmed by both our oscillators series (lower and upper rectangles) and our automatic messaging, which are pointing towards potential tops towards late July / early August**. We hence, remain positive for now on the Nikkei and expect it to resume up soon. **That said, as with other markets, we would suggest to start reducing exposure from late July.**

Concluding remarks

This is not a market for Buy and Hold equity investors anymore. Indeed, over the medium term (next quarters), we believe that the risk/reward has very much deteriorated: the risk of a substantial correction seems strong, while the remaining upside potential we calculate is pretty much exhausted. On the timing front, our view is that the S&P500, for example, could soon enter into a period of correction to the downside, which may last between 12 and 18 months and possibly bring the index lower by 20 to 35%. Shorter term, the support points we were expecting end June seem to have held, and we would now expect a last push higher on most developed markets, possibly making new highs on some during the 2nd half of July (such as the Nasdaq 100 or the CAC40). That said, from late July, we would strongly suggest to opportunistically start reducing risk quite substantially on equity positions given the more negative developments we expect from August into year-end and 2019.

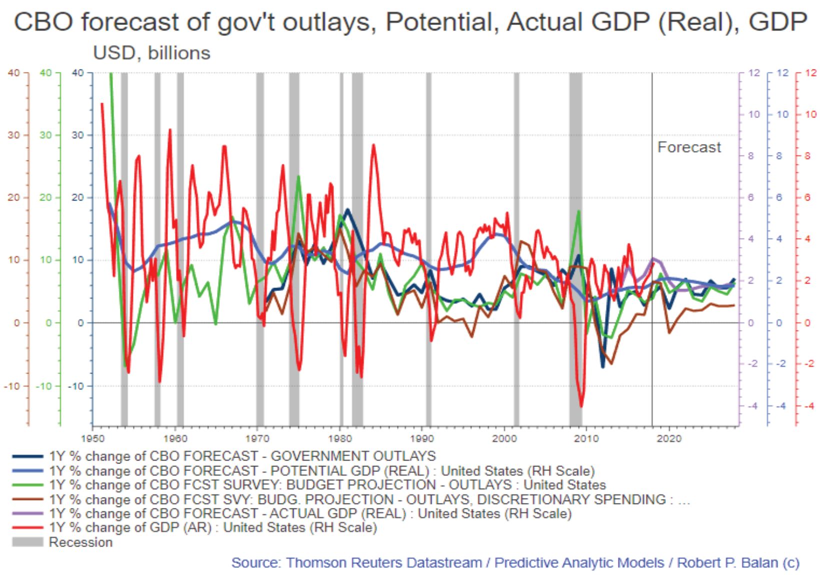
23 / The US Congressional Budget Office Forecasts Growth Recession In Late 2018, Then GDP Falls Further In 2019, Bottoms In 2020

We have been working on this thread for some time, as part of a long-term "scan" of systemic liquidity -- of the very long-term variety. **What is telling about the most recent projections of the Congressional Budget Office is that they have shown a forecast of a top in growth in 2018, and a subsequent growth recession from late 2018 to 2020.**

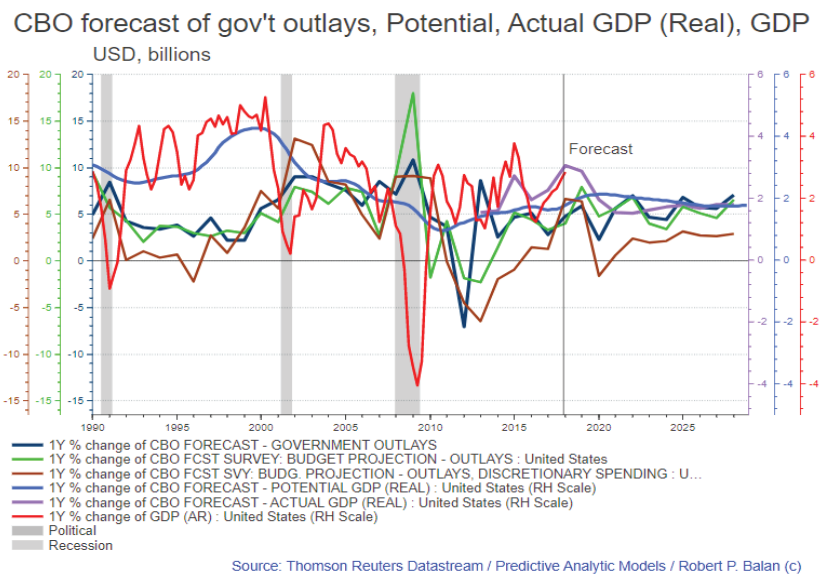
We have been using the graph below as part of our long-term "scan" of systemic liquidity - the very long-term variety. It has also provided as a general view of what could be the next growth crunch -- and indeed, a likely top in GDP growth this year may possibly morph into a recession until 2020. We are still working out the details (looking at other long-term variables) if GDP growth (AR) falls below zero in 2020, or not. But we believe we could see it coming close to zero, at the very least. *(see 1st graph on this page)*

The 2nd graph on this page is one of the best charts for predicting the recession that starts after late 2018. Here, one can see that the CBO expects real GDP to lift into late-2018 and then fall into 2019 and bottom in 2021. That is the first and next recession. **The reason for the recession (from this construct) is that, at the end of 2018, private tax relief clauses expire. All of a sudden, tax rates rise and extract billions of dollars out of the economy where they will appear on no measure of the money stock, not M1, M2, M3**. We challenge anyone to show where these tax dollars are stored for later usage – they are not. **When one extracts dollars from an economy, it has to shrink by that amount, and that is shown in the CBO chart.**

The CBO chart on this page *(3rd chart)* predicts that GDP growth peaks in 2018 and falls thereafter for a decade. It seems from the CBO that all the things we do not want increase after 2018. Inflation goes up; unemployment goes up. In 2019-2020, payroll employment falls off a cliff, which heralds in the recession identified in the first chart in the series.



Here is a zoomed view:



CBO's Projections of Key Economic Indicators for Calendar Years 2018 to 2028

	Actual, 2017	2018	2019	2020	Annual Average 2021–2022	Annual Average 2023–2028
	Percentage Change From Fourth Quarter to Fourth Quarter					
Gross Domestic Product						
Real[a]	2.6	3.3	2.4	1.8	1.5	1.7
Nominal	4.5	5.2	4.5	3.9	3.7	3.9
Inflation						
PCE price index	1.7	1.8	2.0	2.1	2.1	2.0
Core PCE price index[b]	1.5	1.9	2.1	2.2	2.1	2.0
	Annual Average					
Unemployment Rate (Percent)	4.4	3.8	3.3	3.6	4.4	4.8
Payroll Employment (Monthly change, in thousands)[c]	181	211	182	62	25	57
Interest Rates (Percent)						
Three-month Treasury bills	0.9	1.9	2.9	3.6	3.7	2.8
Ten-year Treasury notes	2.3	3.0	3.7	4.1	4.1	3.7

Sources: Congressional Budget Office; Bureau of Economic Analysis; Bureau of Labor Statistics; Federal Reserve.

PCE = personal consumption expenditures.

a. Real values are nominal values that have been adjusted to remove the effects of inflation.

b. Excludes prices for food and energy.

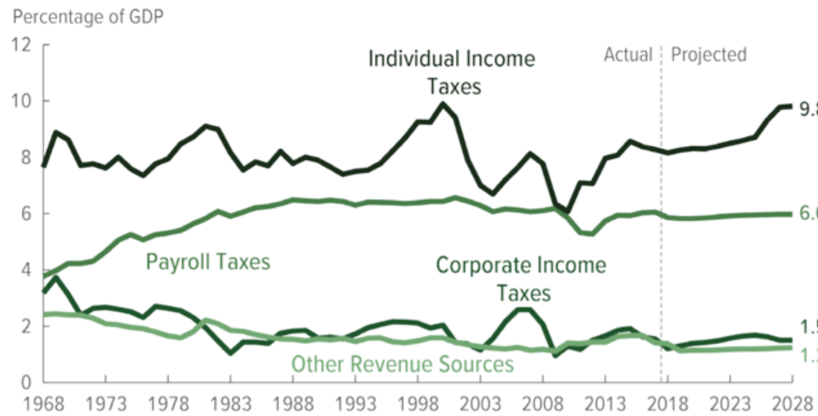
c. Calculated as the change in payroll employment from the fourth quarter of one calendar year to the fourth quarter of the next, divided by 12 (the average monthly amount).

In the CBO graph on this page *(1st graph)*, we can see, on a tax-for-tax basis, how much money the Fed gov will extract from the economy and destroy out to 2028. **All taxes are harmful and damage the economy – when taxes are going to rise quickly as the CBO forecasts foretell, the economy is in trouble.**

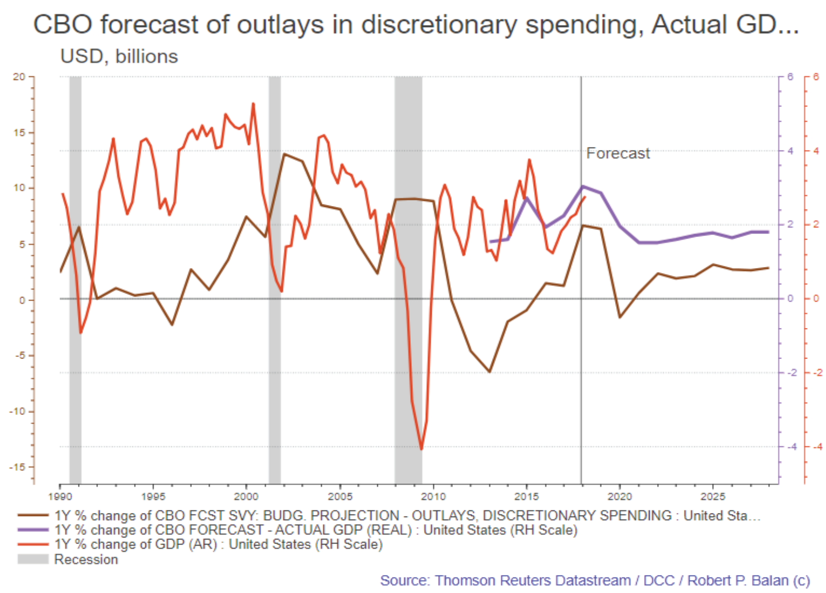
We take another look at a streamlined view of the first two graphs shown in the article. What is especially relevant and telling, in our opinion, is the sharp decline in fiscal discretionary spending from late 2018 to 2020 *(brown line in the 2nd graph on this page)*. **It resonates with us because the changes in this data lead the changes in GDP and changes in risk asset prices. The sharp fall in fiscal discretionary spending after 2018 could lead to growth recession in 2019-2020, and that would bring down the price of risk assets** *(see 3rd graph on this page)*.

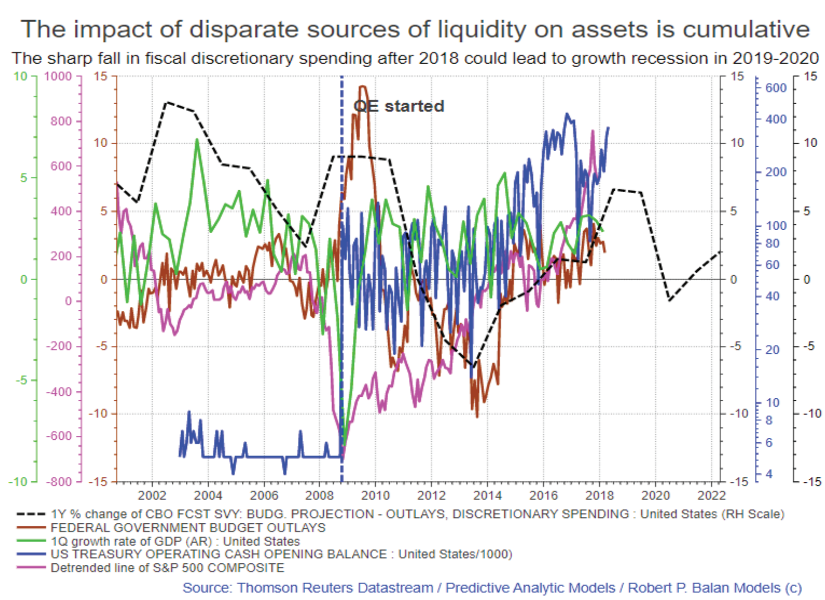
Nonetheless, the short term for risk assets may still be all right but we may be looking at this period with fond memories during the 2019 - 2020 blah period. Take advantage of the run up into the end of July when the tax exemptions are at their maximum. But do not overstay -- take profits late in the month. Have exit strategies ready by late July. The economy is also at risk for the rest of year if the Fed follows through on their rate hike regime of two, possibly three more this year, which could morph into a deflationary bust. We discussed this in detail in last month's Capital Observer issue.

A monetary policy tightening in the entirety of 2018, and fiscal consolidation in by late 2018, extending into 2019-2020, are scary prospects, as they would be happening at the same time. But there is still time to benefit from the recent up welling of growth world-wide as it would spill over into risk assets over the next few weeks. Why are we telling this to you now? It is because it is early July, and we have an opportunity to take advantage of this phase.



Individual income tax **revenues** rise sharply following the expiration of temporary provisions of the 2017 tax act at the end of 2025.



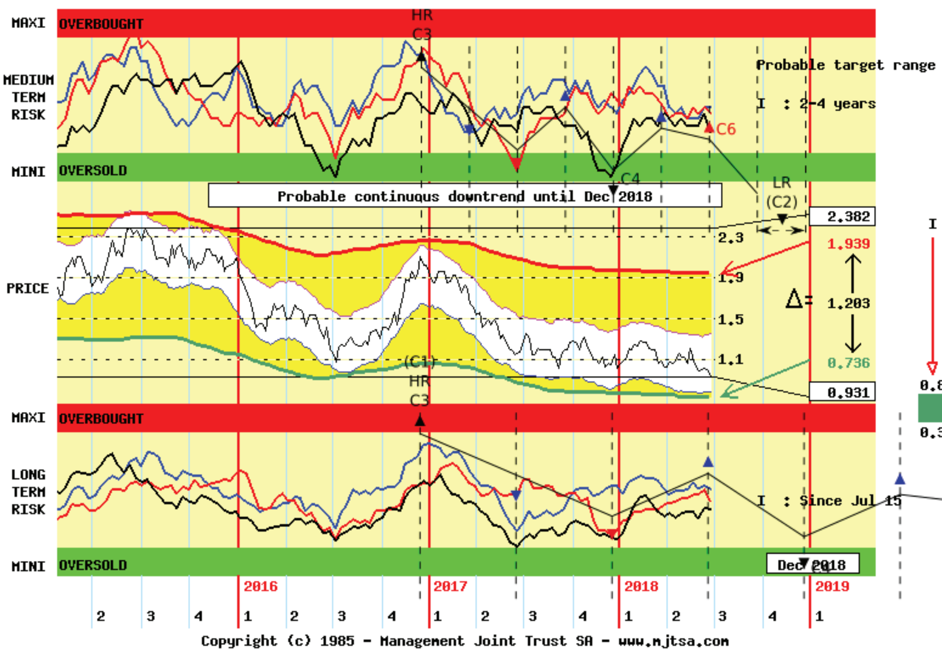


25 / MJT - TIMING AND TACTICAL INSIGHT

As the economy starts to decelerate, Treasuries, Defensive sectors and Gold should outperform equities, probably into 2019/2020

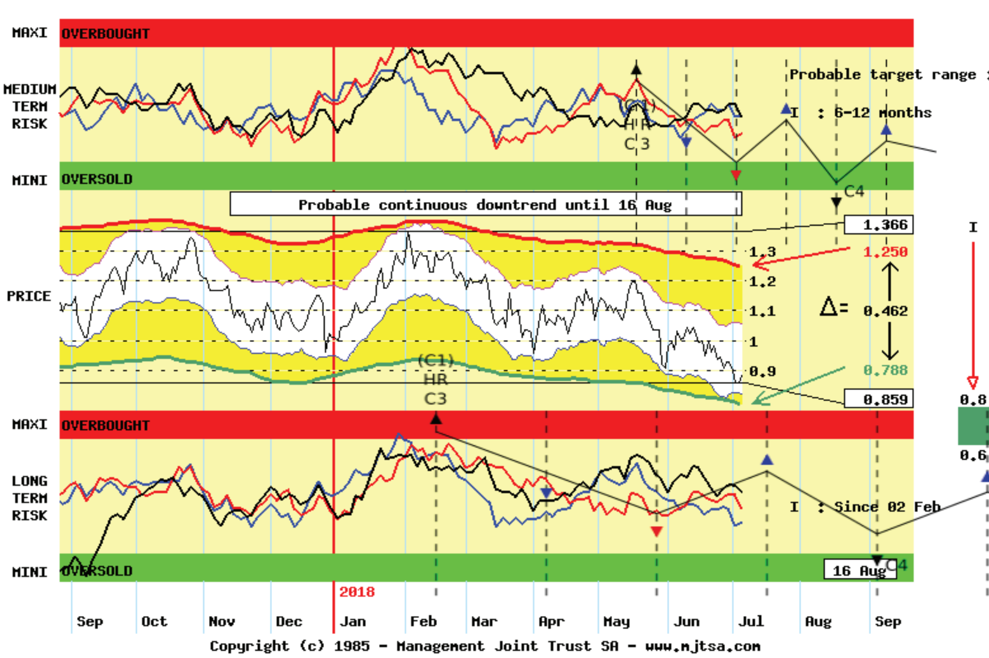
Last month's in The Capital Observer, we detailed the lag between the US GDP growth and the yield curve. Historically, this lag has been about 6 quarters, which means that the US Yield curve usually tops circa 6 quarters before GDP growth starts to decelerate. Following its bounce during H2 2016, from late 2016/early 2017, the US Yield curve started to flatten again. Now, 6 quarters latter, we are expecting this flattening to gradually spill over into GDP growth, which should start to decelerate soon. We believe high quality bonds, bond proxies and Gold will offer worthwhile alternatives to declining equity markets.

US 10Y - 3M Benchmark bond yield spread
Weekly graph or the perspective over the next 2 to 4 quarters



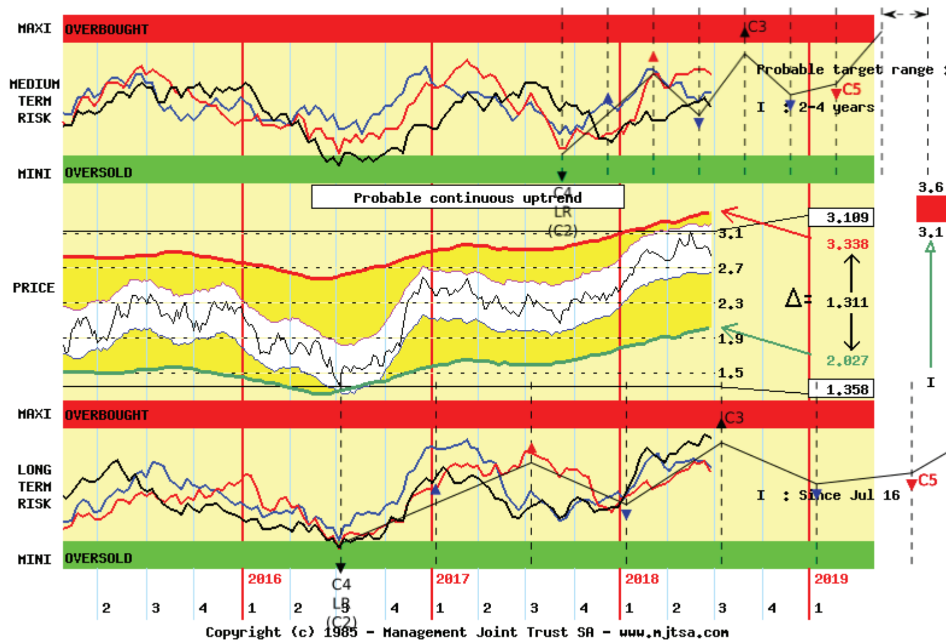
On both our oscillators series (lower and upper rectangles), the US 10Y-3M spread which had been pretty much flat over the last 3 quarters is getting ready to resume its downtrend. This means that while the whole curve has managed to shift up since last Summer (i.e. long term yields were keeping pace with rising short term yields), going forward, we would probably expect long term yields to start to top out and reverse, while short term yield under the FED's impulse continue higher a while longer. **From a target perspective, our I Impulsive targets to the downside (right-hand scale), would suggest that the US10Y – 3M yield curve spread may flatten down to 30 basis points by late 2018 / early 2019. Such flattening probably implies that many other spreads along the US yield curve will probably start to move into negative territory, i.e. that they will start to invert (e.g. US10Y-US3Y or US30Y – US5Y).** Inversion usually implies that a deceleration/recession is upon us.

US 10Y - 3M Benchmark bond yield spread
Daily graph or the perspective over the next 2 to 3 months



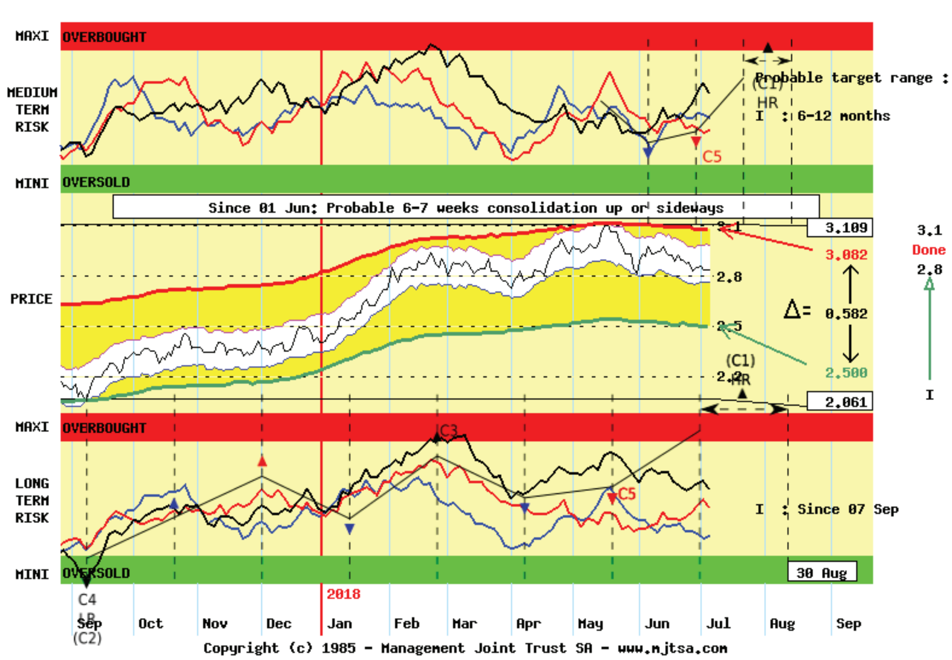
Shorter term, it is interesting to analyse the yield curve spread to identify periods which are rather risk-ON or risk-OFF. Indeed, since the beginning of the year, a steepening yield curve has accompanied risk-ON phases (the January risk assets acceleration up, or the rebound from late March to May), while a flattening yield curve was clearly risk-OFF (the February sell-off, the consolidation down since mid May). Both our oscillator series (lower and upper rectangles) would suggest that **the US 10Y-3M spread could still attempt to bounce until mid/late July, before its resumes lower towards late August/early September. Hence, our cross asset view is quite defensive from the end of this months, probably into late Summer**. Our price targets (right-hand scale) indicate that the downside risk is still quite compelling over the next few months (rapidly flattening yield curve).

US 10Y benchmark bond yield
Weekly graph or the perspective over the next 2 to 4 quarters



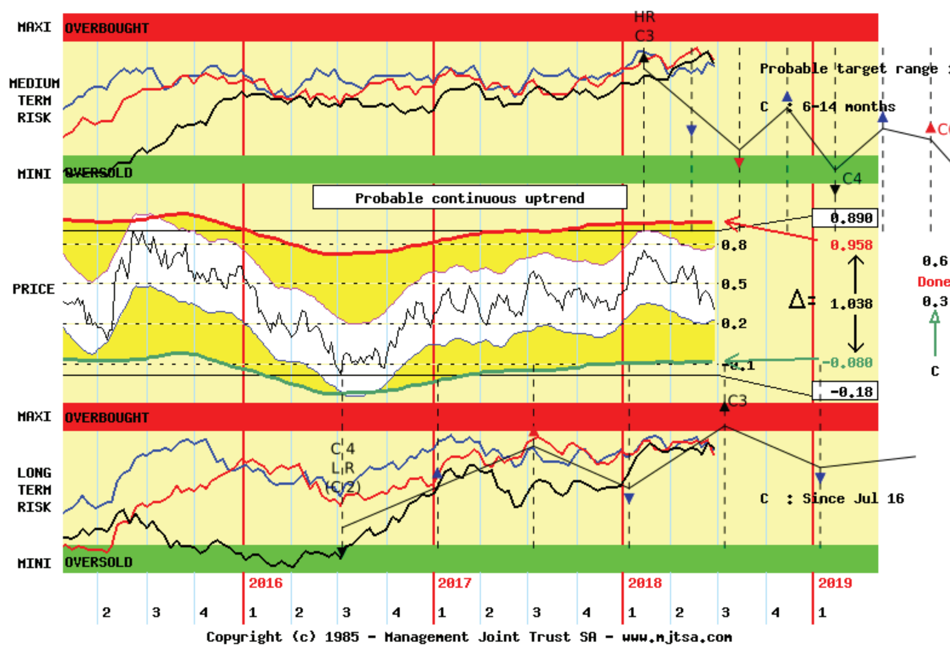
Our standalone graph of the US 10Y benchmark bond yield, confirms that an important intermediate top is near and that the retracement period could last into 2019 (upper rectangle) and perhaps even into late 2019 (lower rectangle). Both the sequences we show on our oscillator series do indeed point towards a top between now and mid Summer. **Hence, over the next month or so, we may expect one last push higher**. Our I Impulsive targets to the upside indicate a possible range between 3.1 and 3.6%, yet given the limited time left, **we believe that we may see marginal new highs above 3.1% and perhaps towards 3.2-3.3%, but not much more. Following that, the Corrective targets to the downside we can calculate would imply a retracement of 70 to 110 basis points for US 10Y yields into 2019.**

US 10Y benchmark bond yield
Daily graph or the perspective over the next 2 to 3 months



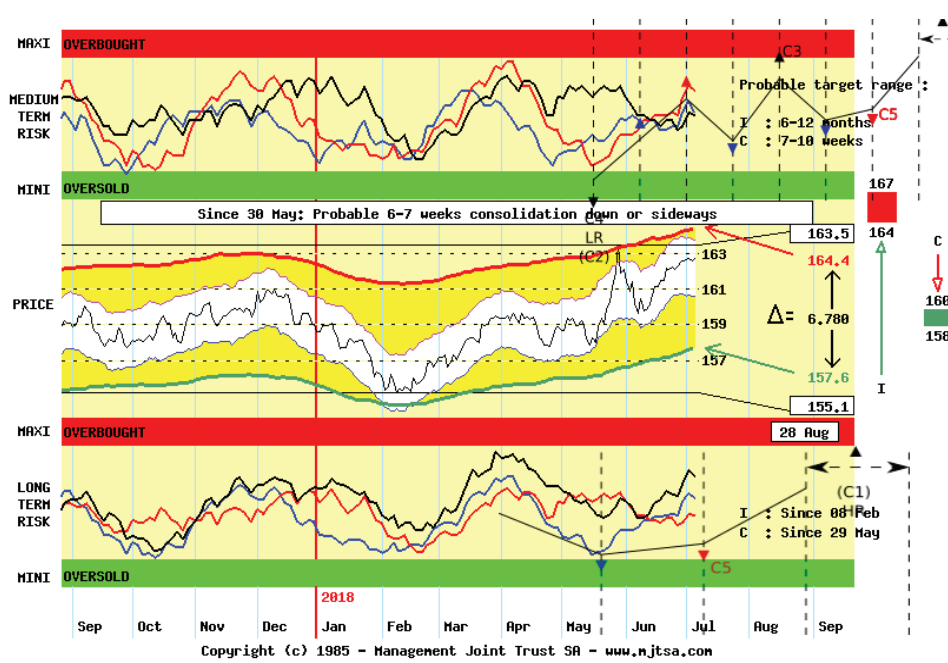
The Daily graph of the US 10Y benchmark bond yield does seem even more exhausted. Our I Impulsive targets to the upside (right-hand scale) are labelled as "Done", which means that **it will be difficult over the next few months to push much higher than the 2.8 – 3.1% range.** On the Timing front, our long term oscillators have entered a "High Risk" zone and should gradually start to reverse down during the Summer, while our medium term oscillator (upper rectangle) would suggest **one last push up until late July / early August.**

German 10Y benchmark bond yield
Weekly graph or the perspective over the next 2 to 4 quarters



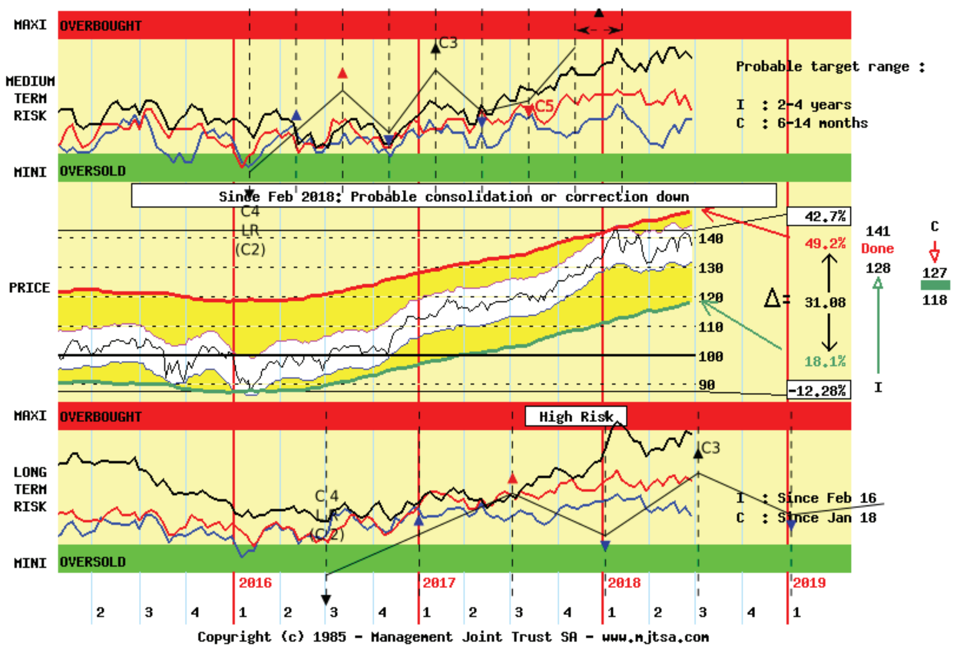
In Europe, the Bund 10Y benchmark bond yields already started to turn lower from mid Q1 2018. This is when the European Economic Surprise Index actually started to deceive. The recent Italian political crises was a further blow, as it was revealing that Europe's and the EuroZone's structural problems remain unresolved. The sequence we show on our long term oscillators (lower rectangle) turned down prematurely earlier this year and it should continue to weigh on prices until year-end. On our medium term oscillators (upper rectangle), **we now show a downtrend sequence. It may reach an intermediate low towards mid Summer, could bounce into the Fall, but will probably resume lower thereafter until early next year**. On the price target front, the whole move up since mid 2016 never really made it above our C Corrective targets to the upside (above 0.6%). **Yields should now revert to the downside, and the I Impulsive targets down we can calculate until next year will probably bring the German benchmark bond yield back below zero again.**

Bund Future (September)
Daily graph or the perspective over the next 2 to 3 months



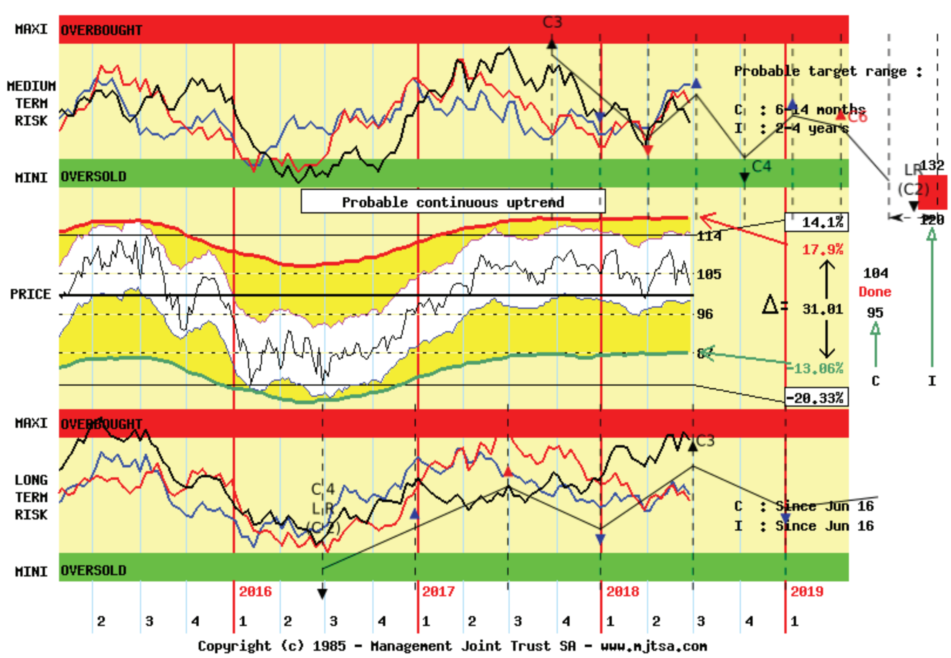
On both oscillators series (lower and upper rectangle), **the Bund Futures are now in uptrend sequences. Their rise may take a slight pause during July as shown on our medium term oscillators (upper rectangles), but they will then resume higher during August and into early September.** Our I Impulsive targets to the upside do point to 3-4% of additional upside potential for the Bund over the next 2 to 3 months, a projection which confirms our defensive bias towards risk assets over the same period.

S&P 500 Futures (Sep) vs 10 Year Treasury Notes Futures (Sep)
Weekly graph or the perspective over the next 2 to 4 quarters



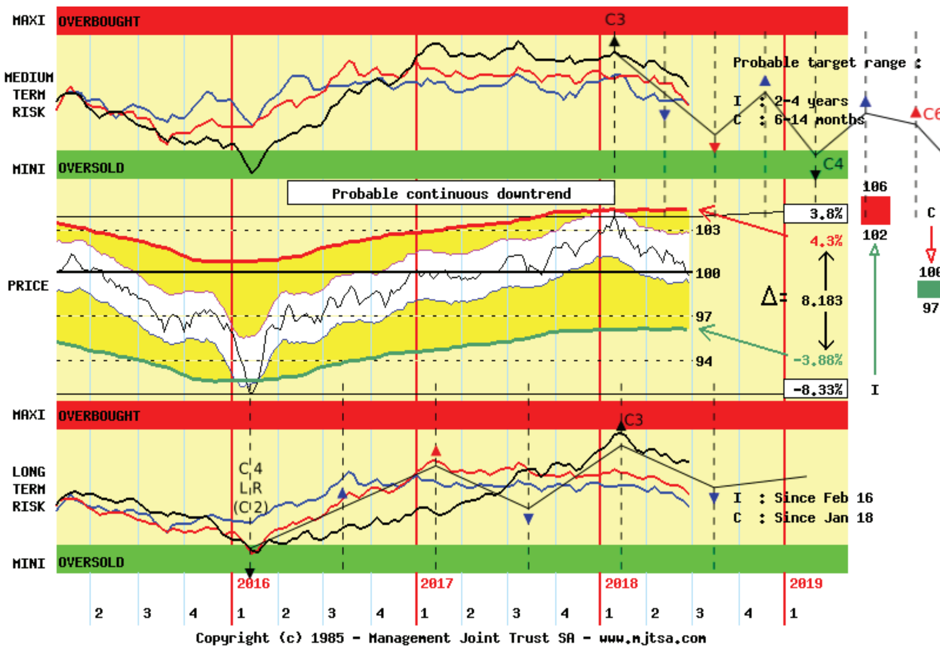
In accordance with the top on long term yields and equities we currently expect, the US Equity to Bond ratio is currently in a "High Risk" position. The sequence we show on our long term oscillators (lower rectangle) suggests that **the ratio should soon start to move lower, probably over the next few weeks and until early 2019 at least**. Our I impulsive targets to the upside are exhausted and labelled "Done" (right-hand scale), while our C Corrective potential to the downside is compelling. We believe **that investors should probably shift an important portion of their portfolios out of equities and into high quality bonds before the end of July.**

EuroStoxx 50 Futures (Sep) vs Bund Futures (Sep)
Weekly graph or the perspective over the next 2 to 4 quarters



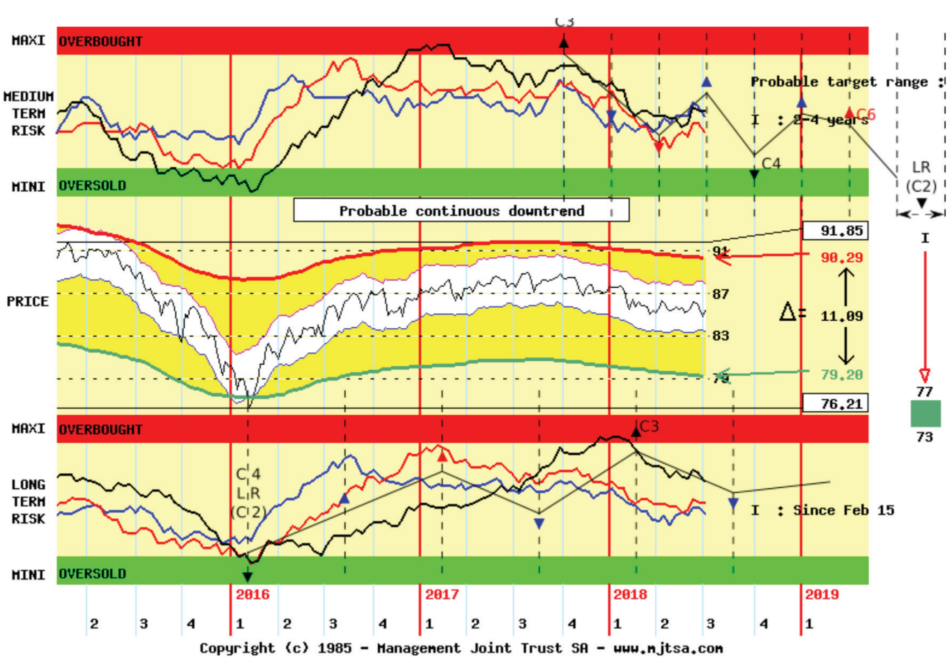
In Europe the situation is similar, but the Equity to Bond ratio may have already topped out for this cycle. Following almost 12 months of distribution (i.e. range-bound price action at high levels), we expect the ratio to start breaking lower during the Summer, first into late Q3 (medium term oscillators; upper rectangle) and then towards 2019 (long term oscillators; lower rectangle). On the target front, our I Impulsive targets to the upside are probably much too aggressive. Indeed, while the ratio did make it slightly above our C Corrective targets to the upside, it never really broke above them. **We believe that the time window to accelerate up is now closing, and that the next strong move will be to the downside, i.e. the mid 2016 – early 2018 uptrend was just a temporary rebound, and the long term downtrend should come back in force.**

LQD - iShares iBoxx $ Investment Grade Corporate Bond ETF / IEF - iShares 7-10 Year Treasury Bond ETF
Weekly graph or the perspective over the next 2 to 4 quarters



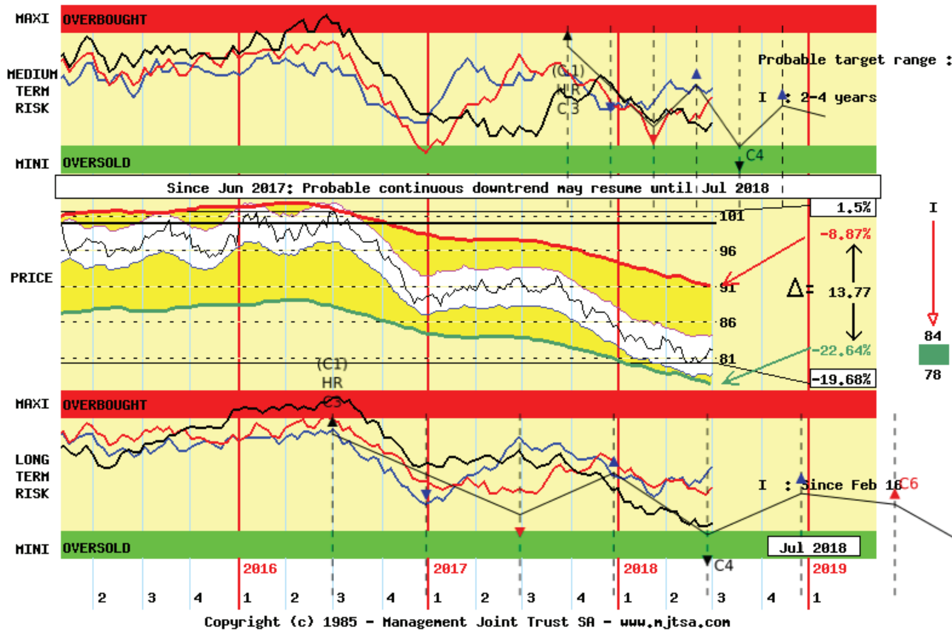
Since mid Q1 2018, credit spreads in the US have started to move higher again (the ratio of investment grade corporate bonds vs treasuries is hence moving lower). According to both our oscillator series (lower and upper rectangles), **this first leg down on the ratio could reach an intermediate low by mid Summer (mid/late August probably). Following a slight rebound during the Fall (upper rectangle), Investment Grade Corporate Bonds will probably continue to underperform until late Q1 2019 at least. Following 2 years of reflation (Q1 2016 – Q1 2018), the Credit Cycle has probably topped out, i.e. corporate spreads will continue to widen over the next few quarters.**

HYG - iShares iBoxx $ High Yield Corporate Bond ETF
Weekly graph or the perspective over the next 2 to 4 quarters



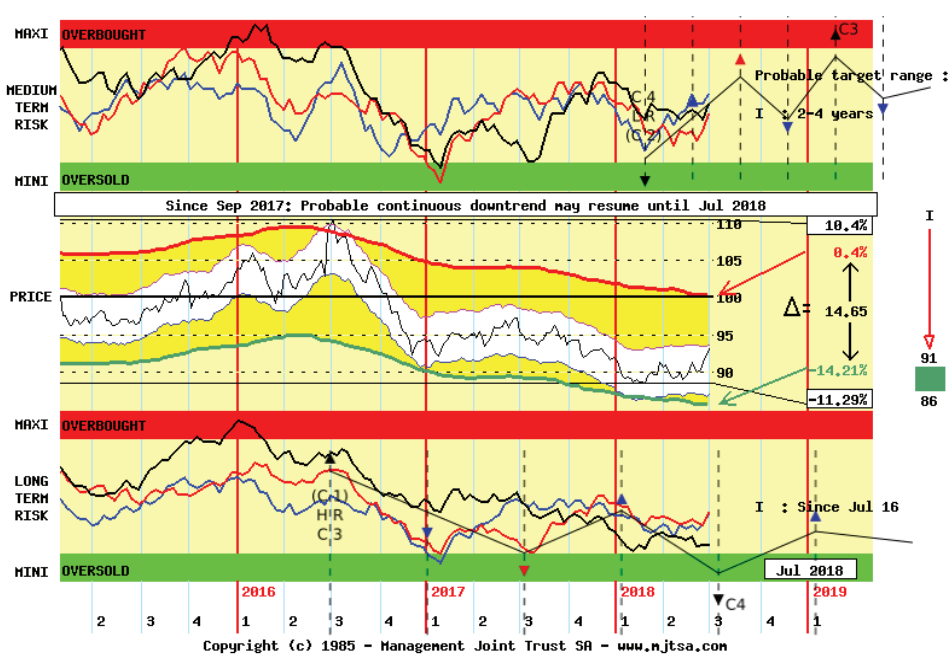
Since mid last year, High Yield Bonds have also started to move lower again, i.e. the benefits from declining credit spreads could not compensate for the rise in interest rates anymore. We believe this downtrend could accelerate over the next few quarters as credit spreads now continue to widen again, while interest rates move lower, yet to a lesser extent. Our long term oscillators (lower rectangle) show the cyclical rebound of High Yield bonds since early 2016. According to our model, it topped out prematurely (a sign of weakness), and should now start to accelerate lower. As shown by our medium term oscillators (upper rectangle), **we expect the current stabilization phase since March to die out over the next few weeks, before High Yield Bonds resume lower first into mid/late Summer and then into next year.**

US Defensive sectors vs the S&P500 Index
Weekly graph or the perspective over the next 2 to 4 quarters



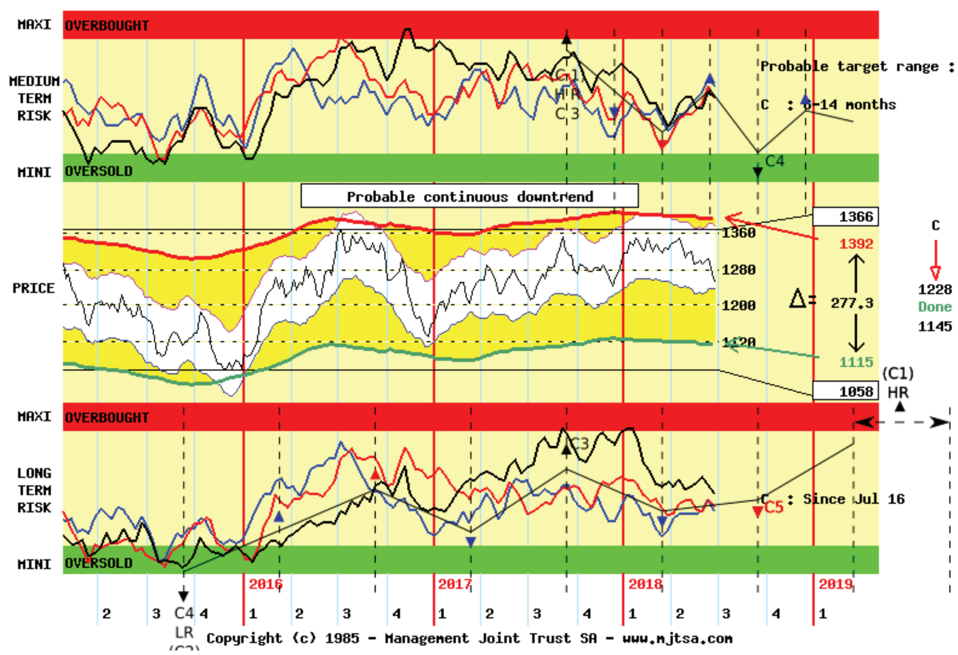
On the equity side, we believe it's almost time to start shifting some exposure towards more defensive sectors. The portfolio above is capitalization weighted and includes the four larger US defensive sectors (Staples, HealthCare, Utilities, Real Estate), which we compare to the S&P500 index. On our long term oscillators (lower rectangle), the trend down since H1 2016 has probably ended These defensive sectors should now outperform the S&P500, probably towards year-end in first instance. On our medium term oscillators (upper rectangle), we would expect a slight retest down over the next month or so, and then also a bounce. In general, the downside risk seems limited for defensive sectors vs the S&P500 as shown by our I Impulsive targets to the downside which have now been achieved (right-hand scale). We are hence in Buy The Dips mode on defensives sectors vs the S&P500, probably from the 2nd half of July (see Daily graph on page 19 for a more precise timing).

European Defensive sectors vs the Europe Stoxx 600 Index
Weekly graph or the perspective over the next 2 to 4 quarters



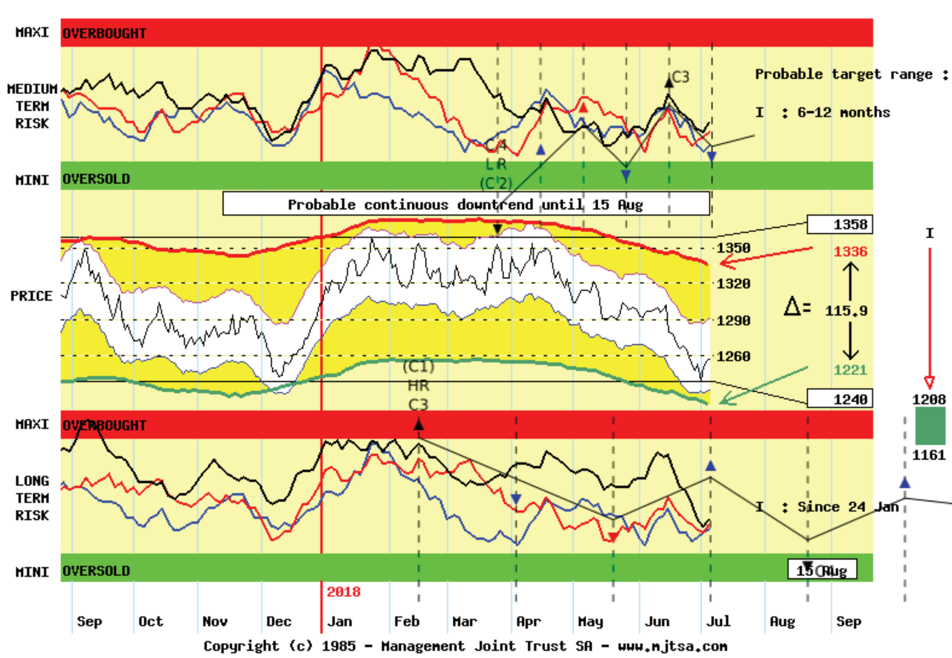
In Europe, Defensive sectors have probably already started to reversed up vs European markets. We hereby compare a capitalization weighted portfolio of the European Food & Beverage, HealthCare and Utilities sectors vs the Europe Stoxx 600 Index. According to the model we show on our long term oscillators (lower rectangle), the ratio started to reverse up prematurely (a sign of strength) from Q1, and should now be supported at least until early 2019. On our medium term oscillators (upper rectangle), **the sequence we show would see an intermediate top towards mid/end Summer, some consolidation into the Fall and then a new move higher into Q1 2019. Risk to the downside is also pretty much exhausted with our I Impulsive targets down having been achieved** (right-hand scale).

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



As risk assets gradually enter a more risk-OFF environment, first from late July into September, and then from late Autumn into Q1 2019, Gold should theoretically start to gather upside momentum. That said, it may take some time before Gold really starts to reverse up as for now it is mostly influenced (negatively) by the strength of the US Dollar. According to both our oscillators series (lower and upper rectangles), **Gold should remain under pressure until late Summer (September)**, before it starts moving up again during the Fall, and then probably during most of 2019. Our C Corrective targets to the downside (right-hand scale) suggest that **Gold should find support somewhere between 1'228 and 1'145. We then expect Gold to move up towards the 1'400-1'500 range into early next year and perhaps beyond if the risk-OFF environment persists throughout 2019. Hence, Buy the Dip from late Summer on Gold.**

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



Our Daily graph confirms this view. **Following a slight bounce over the next couple of weeks on our medium term oscillators (upper rectangle), we expect Gold to resume lower in line with our long term oscillators (lower rectangle) probably until mid/late August and the 1'208 – 1'161 range** (I Impulsive targets down; right-hand scale). Again, we believe this sell-off towards late August will offer a great Buy the Dips opportunity on the Golden metal.

Concluding remarks

We believe the asset environment will soon turn defensive, probably not quite yet, but from the end of this month. The yield curve should start to flatten quite aggressively, long term yields should soon top out in the US, while in Europe they will continue lower, Equity to Bond ratios are also topping out, Credit spreads should continue to accelerate up, while Defensive equity sector should start to outperform the market. Finally, Gold may take a bit more time to reverse up as the US Dollar remains strong, yet from late Summer, we expect it to turn up, and gradually gather momentum towards year-end and then possibly throughout 2019.

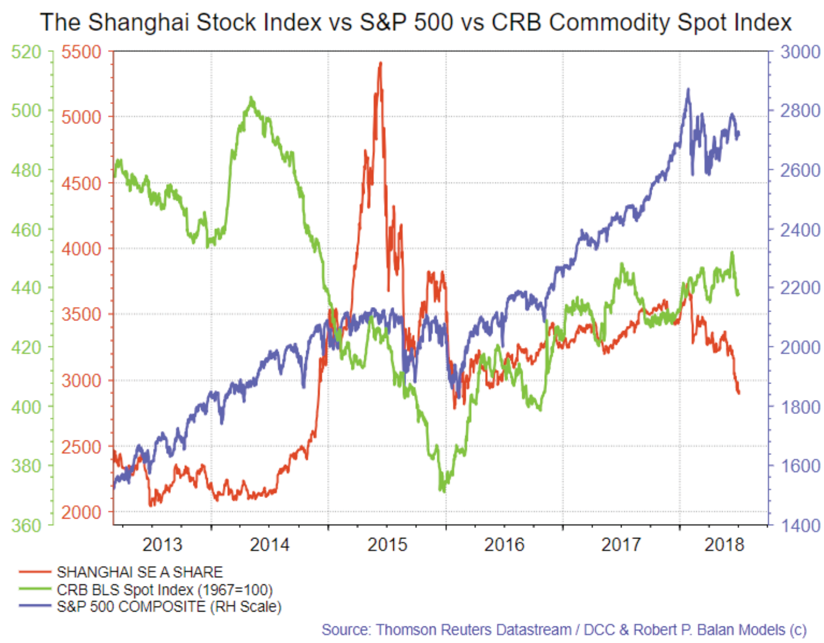
32 / CNY devaluation: China got what it wants, and dealt The Donald a stunning riposte; Mr. Xi will not use the devaluation route any further as weapon in the trade spat

It started out as media speculation: about 5 weeks ago, business and popular media claim that as part of the trade wars, China may have the ultimate weapon at hand, i.e., inject further liquidity and devalue the Yuan (CNY). The point of the media, something which we discussed at length in last month's Capital Observer *("Devaluing The CNY: China's Secret Weapon In The "Trade Wars"? Not Really, But An Opportunity Too Juicy To Ignore, Or Waste"):*

> *The media claims that this squeezes the US Dollar strongly higher, thereby worsening the US competitive situation. On the other hand, it allows China to come through relatively unscathed through the upcoming economic crisis by having a competitive currency. Thereby it can continue to export its products even in the event of a US economic crisis (and subsequently, a global crisis).*

Our counter-argument in the article: "For us, we conclude that devaluing the CNY is not a secret weapon in the "trade wars" -- China has to do it to kickstart a flagging economy. It is also an opportunity that is too juicy to ignore or waste. "

The situation that was subject of the intense discussion – a CNY devaluation – has come to pass, as the China-US trade spat deteriorated into a tit-for-tat exchange of increased trade tariffs for each country's export products. The exchanges of threats and counter-threats has roiled the global financial markets; the Shanghai stock market index (SHSE), which was slowly regaining momentum since early 2016 following a sharp breakdown from a bubble top in 2015, has already fell 12% since mid-May when the trade spat reached a crescendo. The S&P 500 fell as well, but at a less threatening 4%, while the CRB commodity Index fell 3.5% *(see 1st graph on this page)*.



When will the blood-letting end? The obvious answer, of course, is when US and China stop exchanging threats and counter-threats. However, by the time they do, anyone just reading the news will be too late to take advantage of a relief rally which will certainly follow. Equity markets from both sides of the Pacific are less worried about the fallout from the increased tariffs, which most companies can pass off to consumers anyway. **What has caught the markets' attention has been the sharp decline of the CNY in its valuation against the US Dollar. Simply put, will China really use the devaluation of the CNY as a weapon? And if so, to what extent? And what are the consequences?**

Therefore, the primary key to calling the bottom of the risk assets is understanding why China is letting its currency devalue, in the first place. Deliberately devaluing a currency is not a trivial thing to do for a sovereign country. And letting it fall in value abruptly and to a great extent, is fraught with risks that are non-linear. The devaluing country has to be careful as other parts of the economy are also impacted by the sudden swings in the international exchange value of the domestic currency. **In many emerging economies, the currency is a primary expression of domestic "wellness" and is the main link to international trade and capital inflows**. Manipulating the domestic currency value could open cans of worms that would have been otherwise tucked away out of sight.

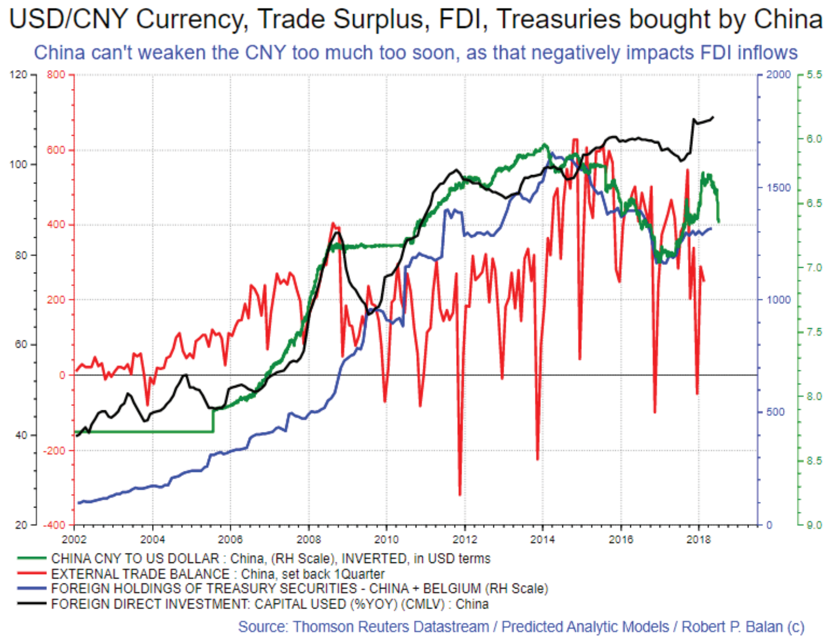
And in the case of China, the risks are even greater. There is fine balance that China has to observe in manipulating their currency (yes, that is what they do). If this is not the case, the CNY would always be undervalued against its peers. Forever.

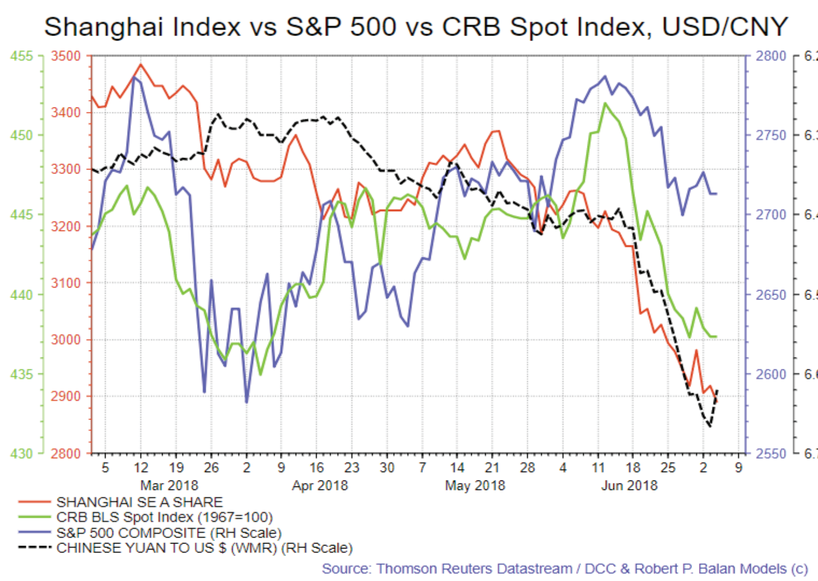
There is a reason why China cannot lower the value of CNY too much too soon. Weaker CNY will negatively impact FDI inflows -- and for China incoming FDI is even more important than higher trade balances (which is like a red rag for Trump, and the EU). Therefore, China cannot devalue CNY steeply in one go. Moreover, Chinese

corporates have a huge overhang of USD-denominated external debts, so a sharp CNY devaluation is driving those companies witless -- hence the collapsing Shanghai Index has been an expression of these corporate fears. *(see 1st chart on this page)*

However, the predictability of Mr. Trump's mindset has given China an opportunity. **Many China observers say CNY devaluation was a weapon -- to us, it is an admission that the economy is in dire straits, which Mr. Xi, et al, expect to get worse. We explained that in last month's Capital Observer. The Chinese were practically counting of this trade spat to get what they want, i.e., a CNY devaluation, and still put the onus of the blame on The Donald.**

In this aspect, the Chinese have largely exceeded. There is no peep from the Trump administration, the EU or from other trading partners about the sharp decline in the value of CNY. Many consider the sharp devaluation as a rightful riposte to Mr. Trump, not understanding that the Chinese have basically manipulated the trade spat narrative to justify doing just that. Of course, they were aided by what we described as The Donald's Pavlovian reaction function to resistance to his demands. It was clear that the Chinese used natural market mechanisms to depress the CNY at the start; when the CNY was not falling as fast as they wanted (because meanwhile, Chinese corporates were blood-letting at the Shanghai Exchange), they engineered sharp declines to get to where they want the CNY to be, ASAP. That started on June 22, which sent the CNY plunging vs the USD until Tuesday, July 3, when the domestic currency plumbed a low at 6.66. That day, the SAFE (agency in charge of FX business in China) started to intervene in small quantities. But on Wednesday, July 4, when many FX traders are off the trading desks due the US Independence Day holiday, the agency came out in force. The CNY staged a remarkable comeback rising



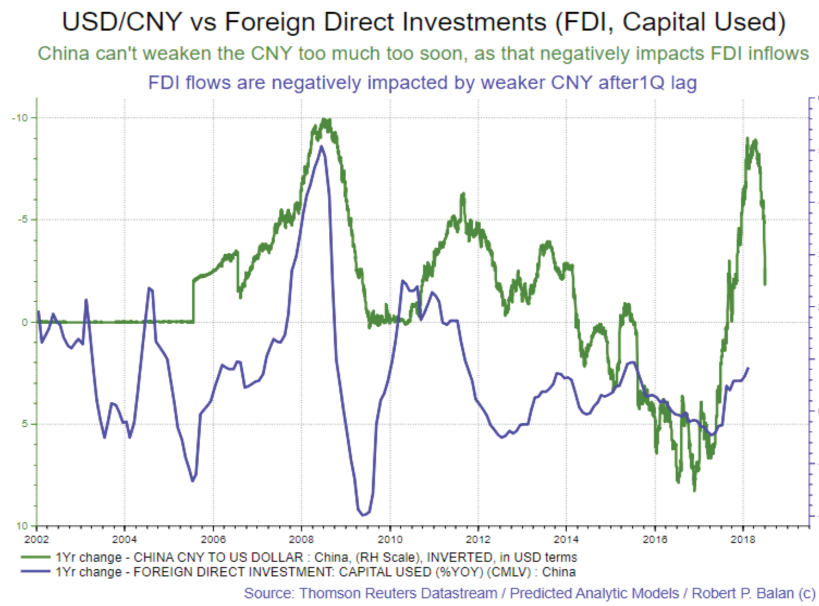


1,200 pips in 24 hours after the PBOC issued a "red line" on further devaluation *(see 2nd graph on this page)*.

So, it's over then? Further weakness in the CNY of course can not be discounted, but considering that the PBoC drew a red line means to say that further declines, if any, will be met with appropriate countervailing force, or else the PBoC will "lose face". In this respect, we should consider that the Shanghai Composite, which after staging a sharp rebound on Tuesday the 3rd during the violent yuan reversal, resumed its selloff deeper into bear market territory Wednesday the 4th. The stock market ignored a better than expected print in the China Caixin services PMI (53.9 vs 52.7 est) -- it closed lower by 1% with Chinese stocks dropping to their lowest since March 2016. The ill-timed PBOC's latest reverse repo net drain of 80bn Yuan did not help as well. **However on the short term, for us, it's all over – China got what it wants -- a devaluation of its currency, and a chance to shove a shiv up Mr. Trump's figurative behind**. When China's FX regulator say's China is confident of maintaining the CNY basically stable, and keep it at reasonable level, then that is what will happen. They will have to keep the CNY "stable" because Foreign Direct Investments (FDI), which have been slowing, will actually fall three to 4 months from now – that is pretty much baked in the cake. **Therefore, a stable CNY is desired to make sure the fallout from slowing FDIs will not go out of control** *(see graph on this page)*.

Summary:

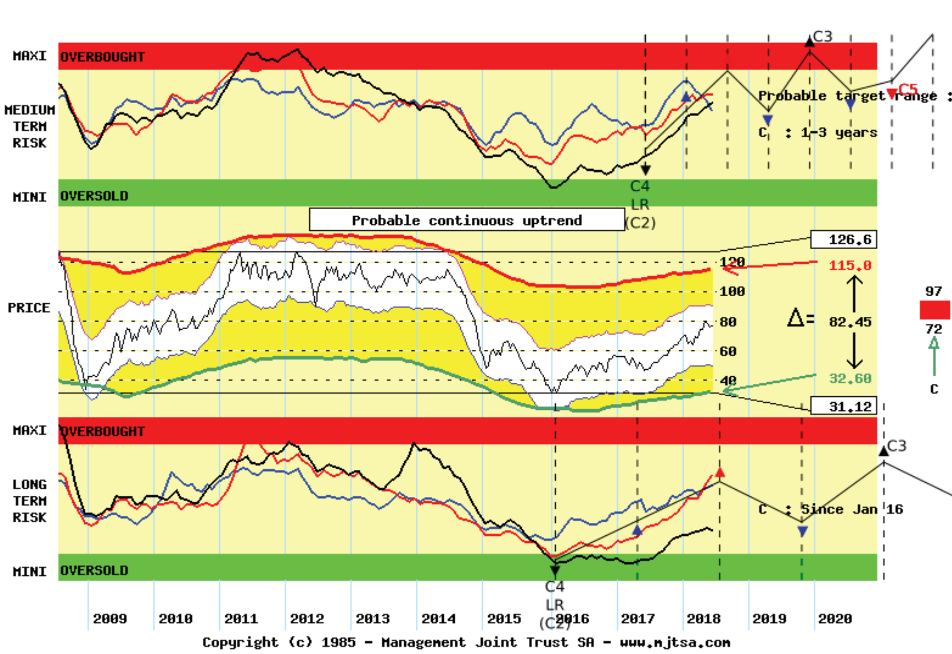
We believe that the worse is over on the short term, and there will be no more sharp devaluation of the CNY – further declines will now be working against China in the longer run. The trade spat has not blown over, it is true, but if exchange of words do not translate into declines in the value of the domestic currency, then fallout in global risk assets will be limited. The Chinese are also now leery of a repeat of the early 2016 partial CNY devaluation which triggered a large amount of capital flight from China. The devaluation was widely misinterpreted as the start of a downward trend, hence it only accelerated the capital outflows. As a result, the Chinese central bank, the PBoC had to spend $1T of its forex reserves in order to stem the rot and to impose strict capital and currency controls to throw sand in the wheels of the capital flight. The Chinese will also be likely leery of the Fed's desire to tighten policy further and shed a significant portion of its balance sheet – a double whammy which will serve to strengthen the US Dollar. Even if the PBoC will keep the CNY level "stable," a much stronger US Dollar will make the CNY weak in relative terms, and therefore the domestic currency will have to be shored up, so as not to trigger any weak CNY syndrome again. We believe that the Chinese will not use this "weapon" again in the trade spat with The Donald.



Chinese equities and the Yuan may find support towards mid Summer, yet their reflationary momentum is broken, further downside is expected towards year-end and early 2019

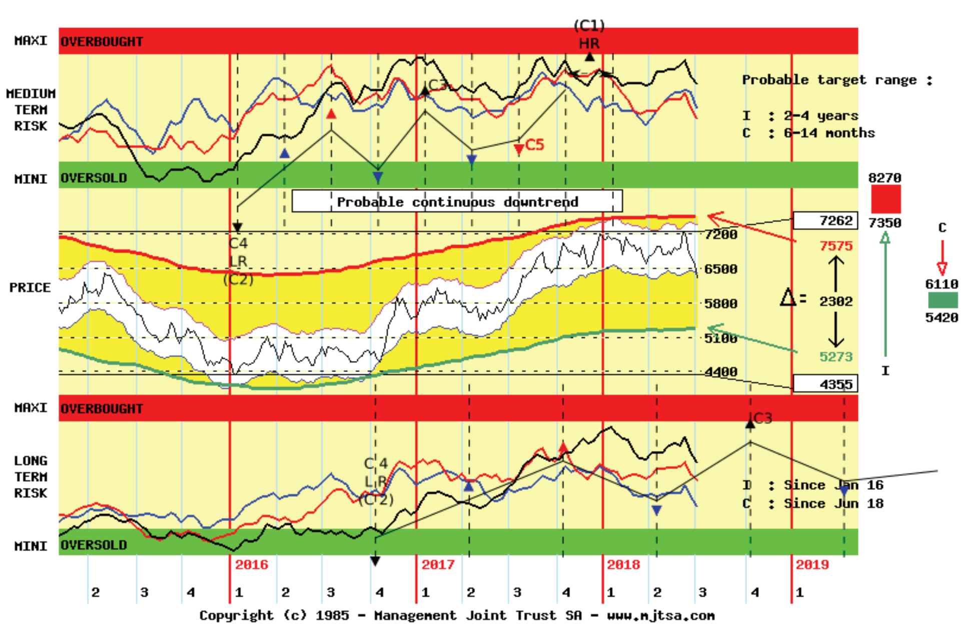
Strong stimulus from China quick-started the reflation trade some 2.5 years ago. Today, following a strong run on risk assets, yields and commodity related trades especially, we believe that reflation is losing momentum and that much of its gains may be retraced over the coming quarters. China is not immune, and as we mentioned in our May The Capital Observer issue, the recent Chinese devaluation was too good an opportunity to pass in this decelerating environment. Conveniently, the Trade war with the US has provided an ideal cover up. That said, the Yuan and Chinese equities will first need to stabilize and then we wonder how much relief this devaluation will actually provide. Its effect may be relatively short-lived.

Brent Oil (Spot)
Bi-monthly graph or the perspective over the next 1 to 2 years



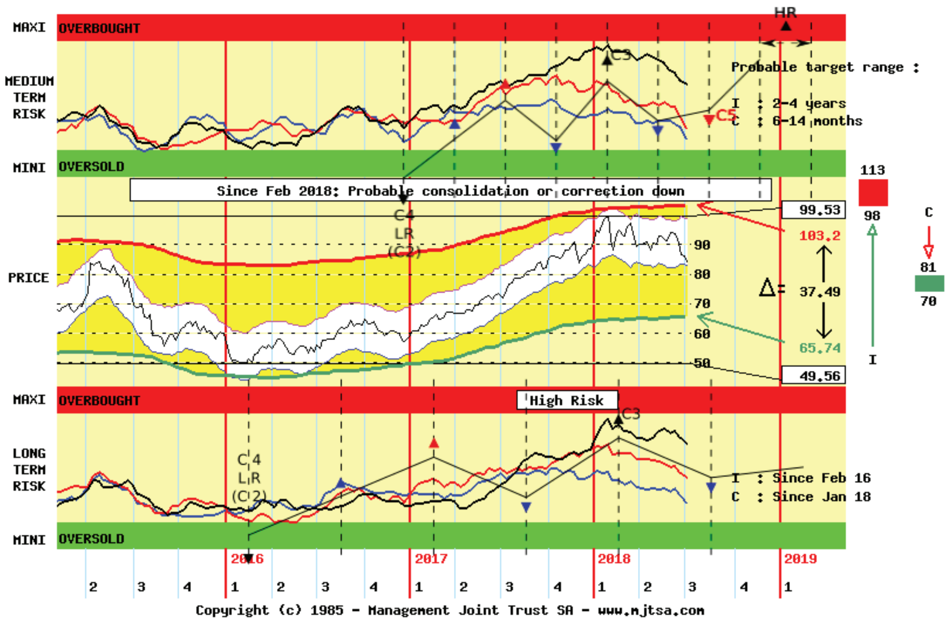
We believe that Oil prices are revealing of the state of the reflation trade, and that following a 2.5 years of recovery (from USD 27/barrel to above USD 80/barrel), **Brent Oil is approaching an important intermediate top. Both our oscillators series (lower and upper rectangle) confirm this inflection point which we expect during this Summer. The retracement period that follows could last between 3 and 5 quarters**. On the price target front, as we mentioned in our last The Capital Observer (June 2018), we may still see a last push up towards new highs over the coming weeks, yet after that, the retracement potential is quite compelling **(probably back to the 45 -55 range).**

Copper Spot (LME)
Weekly graph or the perspective over the next 2 to 4 quarters



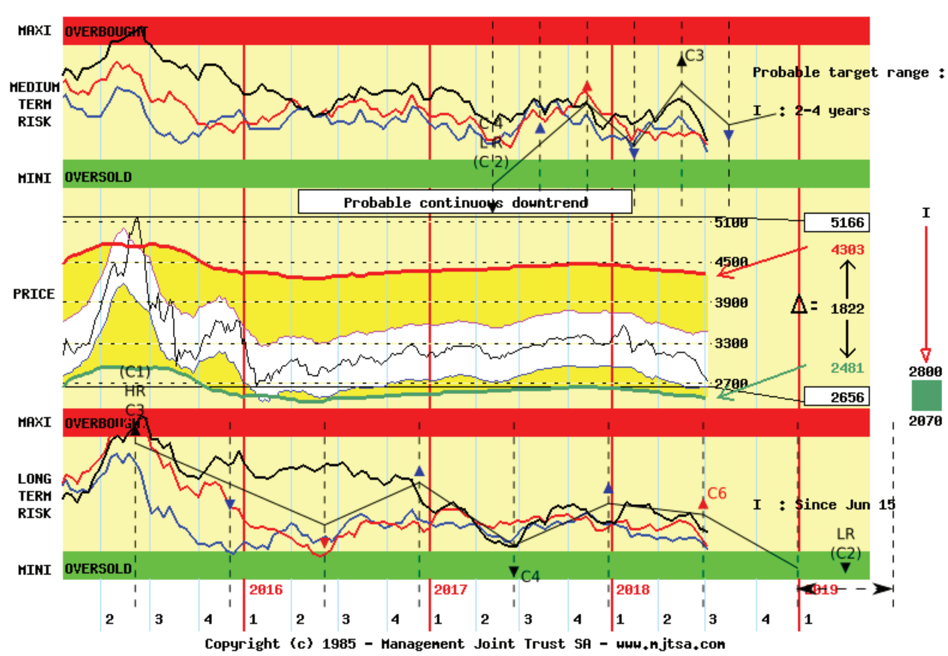
Copper is also approaching the end of its positive run. Our medium term oscillators (upper rectangle) have been in a High Risk position since the beginning of the year, and prices may have topped out in June. That said, **our long term oscillators (upper rectangle) would suggest one last attempt up towards late Q3, before Copper resumes lower into year-end and 2019. Given the advance state of this trend, the Risk/Reward seems unappealing**. Indeed, our I Impulsive potential to the upside is not much bigger that our C Corrective potential down (right-hand scale); i.e. neutral risk/reward in a trend which is already quite mature.

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



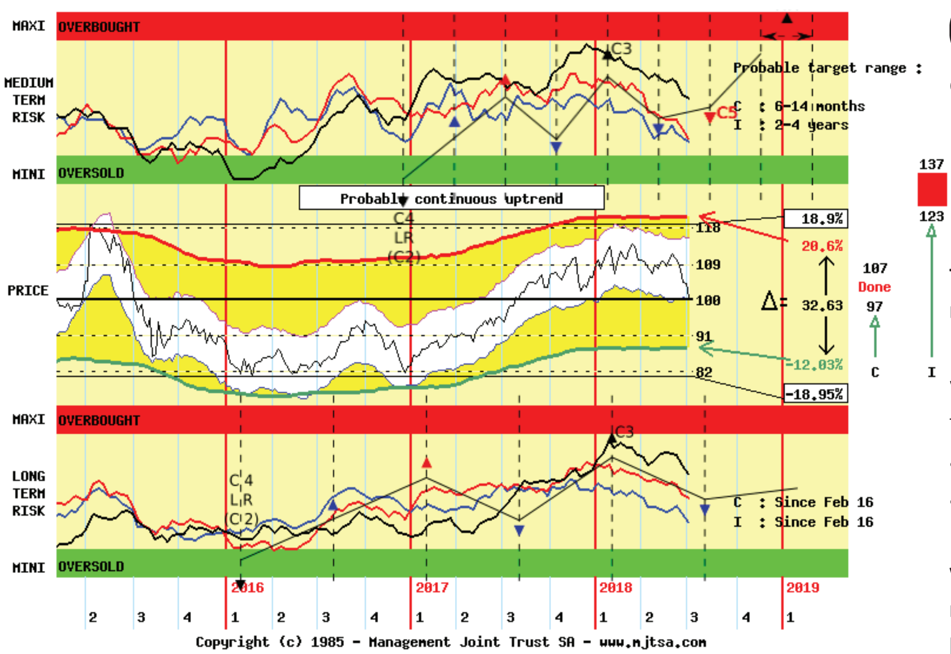
On the equity side, China's upside momentum also seems to have stalled. We first look at the MSCI China index, which is quite "Growth" oriented as it includes many larger international companies and especially large holdings in Tecent, Alibaba and Baidu (the so-called "BATs"). Both oscillator series (lower and upper rectangles) would suggest that **following further weakness into mid Summer, the MSCI China Index could rally once more into the Fall.** Risk/reward (right-hand scale) is also quite neutral at this stage and **we wonder if the MSCI China will still manage to make new highs (upper rectangle) or if it will merely stabilize (lower rectangle), before it resumes lower towards end 2018 and into 2019.**

Shanghai Composite
Weekly graph or the perpsective over the 2 to 4 quarters



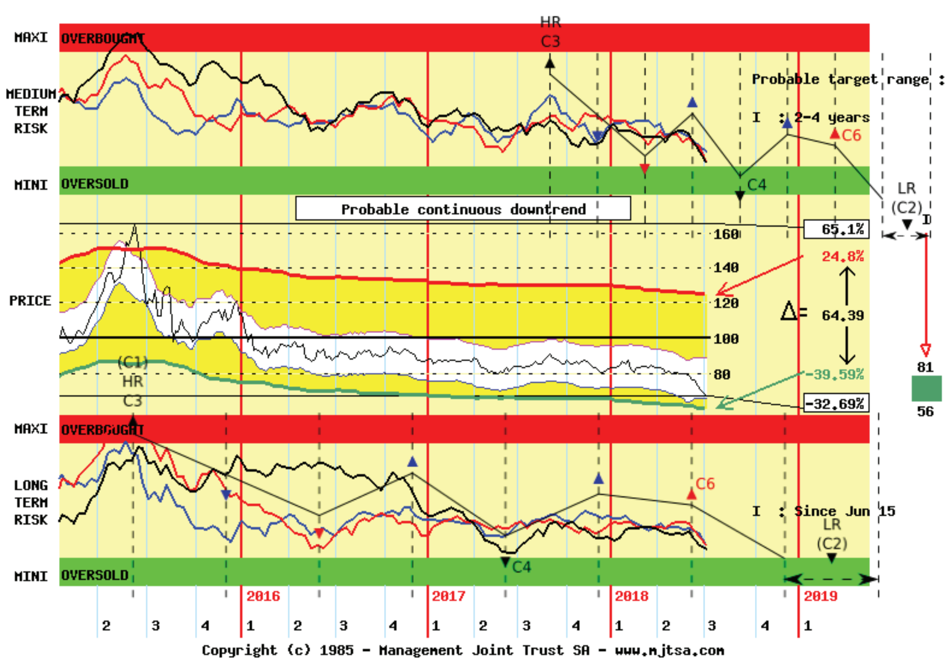
China's domestic market has suffered more that the MSCI China year-to-date. Indeed, the brewing trade war, the declining effects of stimulus, and the pressure of US Dollar denominated debt have lead the Shanghai Composite to retrace aggressively since the beginning of the year. According to both our oscillator series (lower and upper rectangles), **the current downtrend is far from over and could extend well into H1 2019 with I Impulsive targets to the downside (right-hand scale) that could reach as much as 25% lower**. That said, shorter term, our medium term oscillators (upper rectangle) do show a short stabilization period from mid Summer into the Fall.

MSCI China / MSCI World
Weekly graph or the perspective over the next 2 to 4 quarters



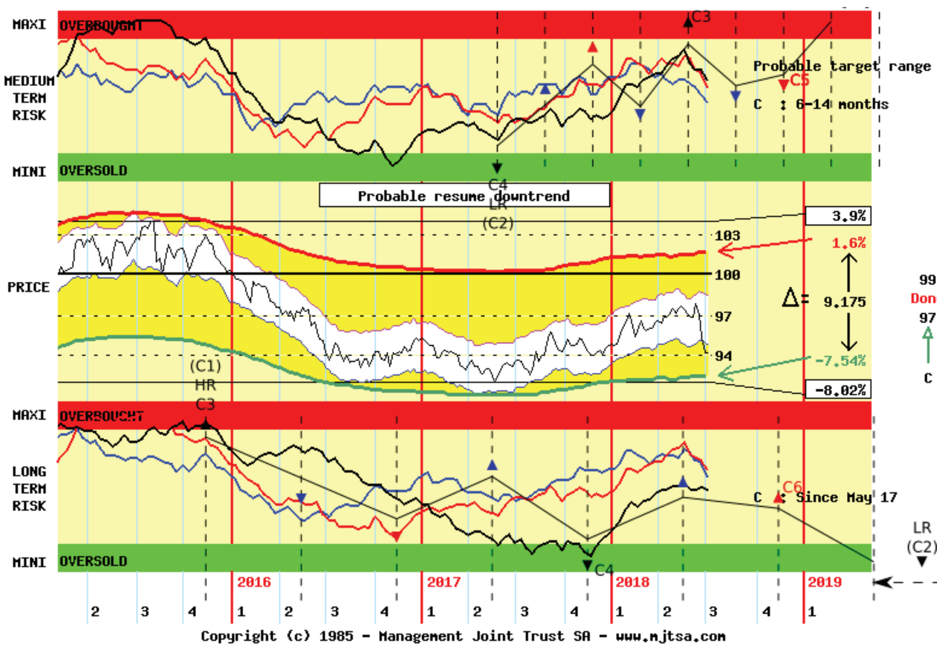
On a relative basis, vs the MSCI World, the MSCI China Index has also been correcting quite aggressively since late Q1. Here also, both oscillator series (lower and upper rectangles) suggest that **the ratio could stabilize by mid Summer and bounce into the Fall.** For now, however, we are back within our C Corrective targets to the upside (right-hand scale) and their upper end will serve as strong resistance over the next few months. Hence, **we would probably favor a scenario where the MSCI China bounces from mid Summer vs the MSCI World, yet without making new highs (lower rectangle)**, rather than a strong outperformance towards new highs (upper rectangle).

Shanghai Composite / MSCI World (in USD)
Weekly graph or the perspective over the next 2 to 4 quarters



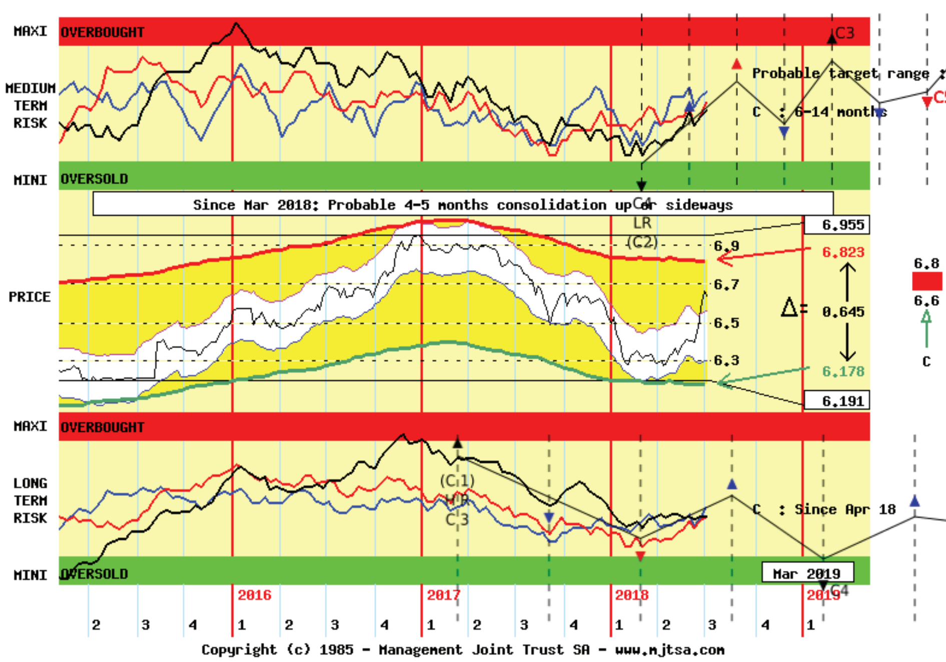
Interestingly, the ratio of the Shanghai Composite vs the MSCI World also shows the possibility of a bounce from mid/late Summer into the Fall, before the ratio resumes lower from Q4 into mid next year. For now, the upper end of our I Impulsive targets to the downside (right-hand scale) has been reached, although their lower end would suggest further under-performance potential, possibly as much as minus 20% into next year. Hence, **any bounce will have to be monitored with care as the prevailing trend is still heading lower towards next year for the Shanghai Composite vs the MSCI World.**

Trade Weighted Yuan
Weekly graph or the perspective over the next 2 to 4 quarters



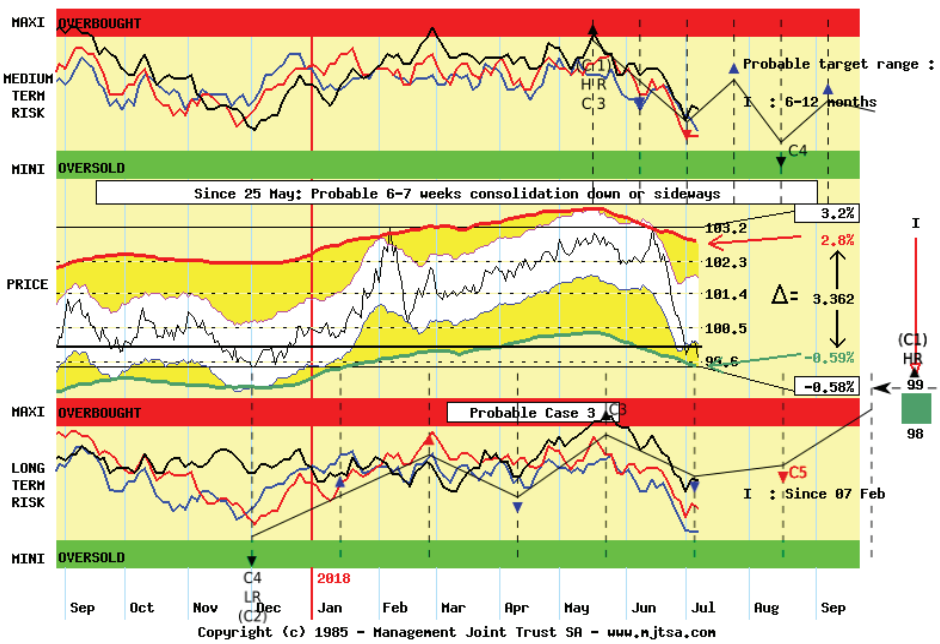
Since mid Q2 2017, the Yuan had been rising vs a portfolio of currencies of China's main trading partners. The recent devaluation retraces some of this move. **Going forward, we expect the Yuan to stabilize during the Summer and attempt a further upside retest during the Fall**. Given that the whole move up since last year is still corrective i.e. relatively weak as it is confined within the range of our C Corrective targets to the upside (right-hand scale), **we would favor a scenario where the bounce tops out mid Q4 and the Yuan then starts moving lower again towards next year** (lower rectangle), rather than a strong move up that could make new year-to-date highs (upper rectangle).

USD/CNY
Weekly graph or the perspective over the next 2 to 4 quarters



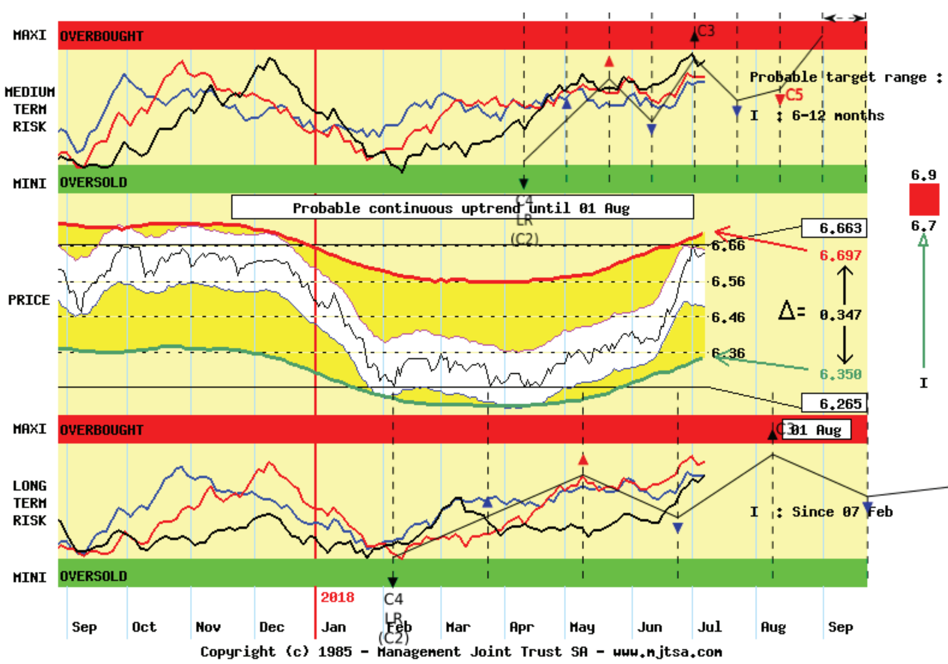
The strong sell-off of USD/CNY from Q2 2017 into Q1 2018, was rapidly retraced during the recent devaluation. **From mid Summer, however, we expect the Yuan to start strengthening again vs the US Dollar (lower USD/CNY).** Our long term oscillators (lower rectangle) suggest that USD/CNY could make new lows by early next year. Yet, this doesn't really match our current cross asset scenario, which anticipates a global deceleration and US Dollar strength. **We would hence favor the sequence where USD/CNY retraces down from mid Summer to mid Fall, but then moves up again into next year** (upper rectangle). Ideally, to confirm this view, we would like to see USD/CNY break above 6.8, or above our C Corrective targets to the upside (right-hand scale).

Trade Weighted Yuan
Daily graph or the perspective over the next 2 to 3 months



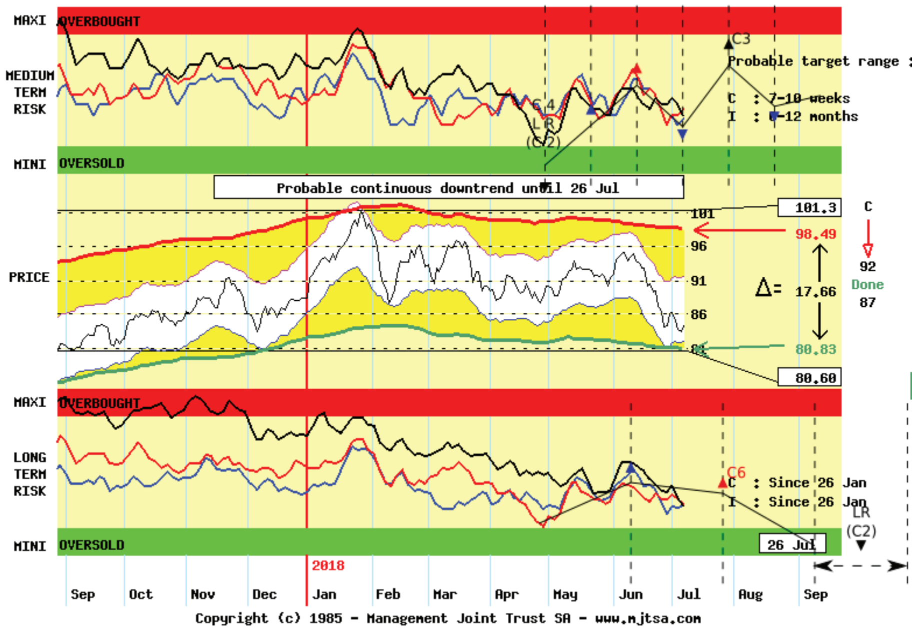
Shorter term, the Trade weighted Yuan saw a strong sell-off between mid June and today. For now, on both our oscillator series (lower and upper rectangles), **it is too early to call the end of this downtrend. Indeed, following a short bounce, which could last until late July, the Trade Weighted Yuan should resume lower (or at least retest down) until mid August.** Following that, it may start to bounce into the Fall as mentioned above on the Weekly graph. According to our I Impulsive targets to the downside (right-hand scale) **70 to 80 % of the move down has been done (the remaining risk is rather limited).**

USD/CNY
Daily graph or the perspective over the next 2 to 3 months



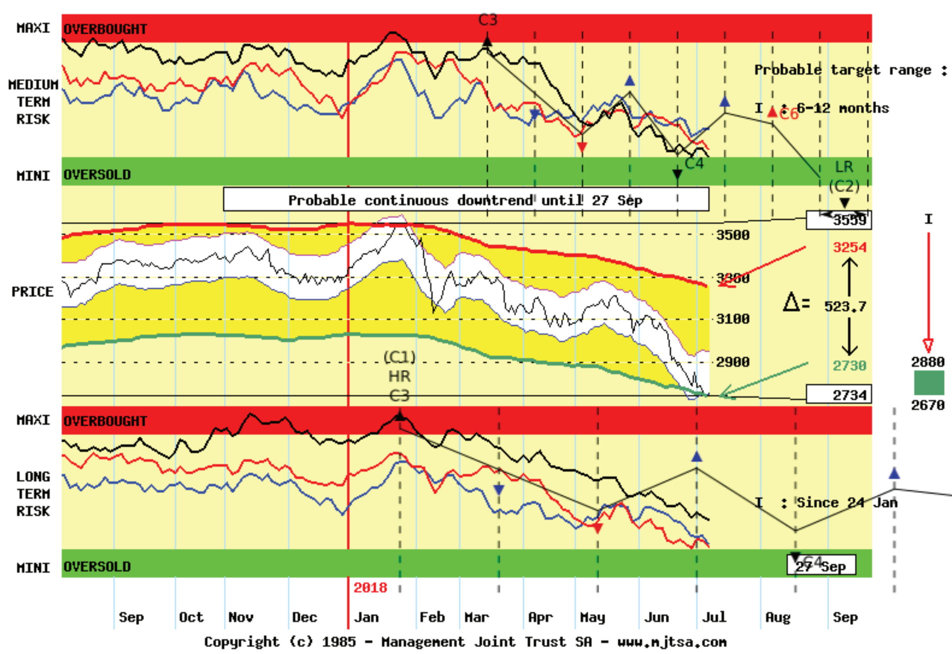
Inversely, USD/CNY is still heading up from now. Also here, our I Impulsive targets to the upside (right-hand scale) indicate that **circa 70 to 80% of the move has been done. From a timing perspective, we expect a slight consolidation during July** (upper rectangle) **and then a new move up towards early, perhaps even late August** (lower and upper rectangles).

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



On this MSCI China index, it is still too early for now to confirm a worthwhile low. Yet, we do expect a bounce, probably over the next couple of weeks. Following that, the sequences we show on both oscillator series (lower and upper rectangles) indicate that **the MSCI China could move lower again into mid/late August**. The Risk is quite compelling as we have just broken the support of our C Corrective targets to the downside (right-hand), which opens the door to much lower levels in the 78 – 71 range. **We would hence probably wait until mid/late August (and a more sustainable low) before we venture back into the Chinese market.**

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



The Shanghai Composite also seems ready to bounce on our medium term oscillators (upper rectangle). Our long term oscillators are also quite Oversold (lower rectangle). However, their sequence down doesn't seem quite over yet, and **further lows are probably expected into mid/late August. That said, the Shanghai Composite might not make it much lower as our I Impulsive targets to the downside (right-hand scale) have been pretty much achieved.**

Concluding remarks

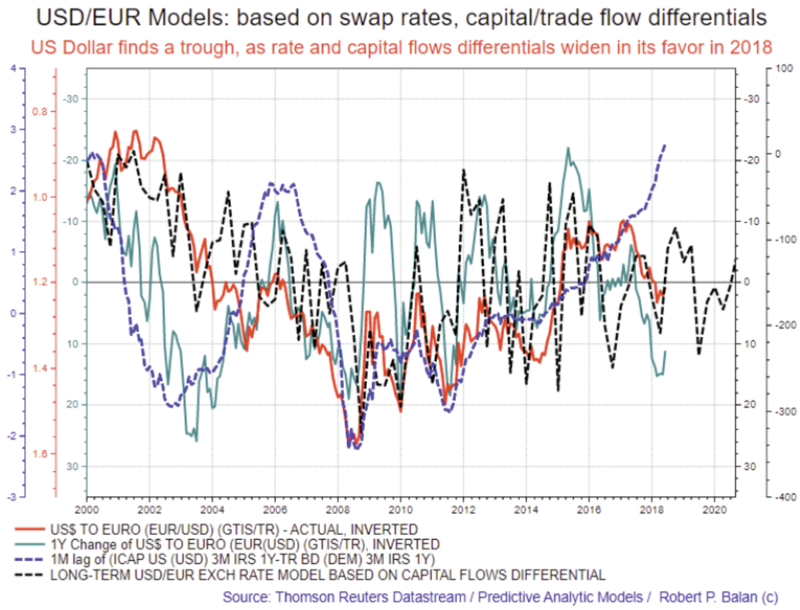
Chinese Equity markets along with the Yuan have taken a strong hit since mid June. We believe they will take some time to stabilize, probably until mid/late August. Shorter term, we expect a short bounce over the next couple of weeks, and then a new downside retest. In the initial Yuan sell-off, probably 70 to 80% of the downside potential has been achieved. Hence, the remaining risk from today's levels into mid August is probably limited. Following that, from mid/end August, we expect Chinese equities and the Yuan to bounce again into the Fall, but believe that they will resume lower once more from early/mid Q4 towards year-end and 2019.

41 / The US Dollar pulls back at a resurgence of financial risk appetite in July, but the ongoing uptrend continues thereafter

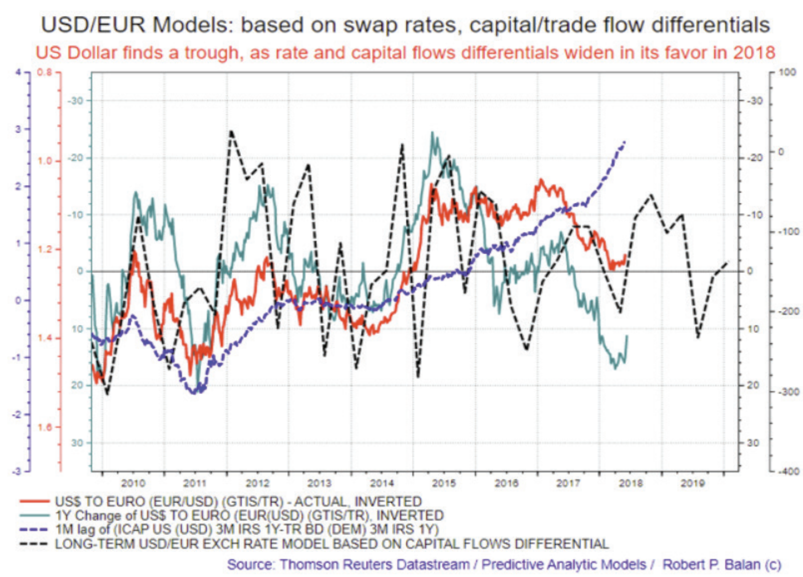
The US Dollar has been front and center of financial news after rising sharply in the past few weeks. This has been accompanied by fears that Emerging Markets will be in again for a lot of pain. Reason: **the US Dollar ascent was also accompanied by rising long-term rates, as well as short-term rates, due to the published intention of the Federal Reserve to raise policy rates three times this year. This triple whammy presents risks, not only to Emerging Markets, but to the US and global economies as well – a fear which we expressed at various issues of Capital Observer as early as February this year.**

In February, the almost-universal theme in FX has been that the US Dollar will continue to decline further. Our call that the US Dollar will turn around within Q1 2018 and strengthen for most of the year was very much a contrarian call. By March, the USD has plumbed bottom, and was getting set to breakout to the upside, and we did document the reasons why the greenback should continue to rise further. In last month's Capital Observer (June 2018 issue), we said:

"The US dollar is now winning the FX "beauty contest. Almost all the macro factors remain in favor of the US currency, especially those that matter in FX currency valuation. Against the EUR, the dollar's most stalwart rival, GDP growth spreads now lean favourably towards the U.S. With regards to the spread of the 2yr bond and 2yr bund (instruments closest to the official policy rates), it's almost no contest – the spread is massively in the U.S. dollar's favour *(see the two graphs on this page)*. The very recent EUR bounce against the US Dollar has been triggered by a relief that no Italexit is likely to happen soon. But the EUR rebound is unlikely to last very long."



Zoomed view



". . . the US dollar's continuing strength is, and will be, coming from the steady improvement of the US Capital Account Balance *(see 1st graph on next page)*. The capital account balance reflects net change in ownership of national assets and is one of the components of a country's Balance of Payments ledger, the other being the Current Account Balance. A surplus (or improvement) in the capital account balance means money is flowing into the country, the inbound flows represent non-resident borrowings or purchases of assets. A deficit (or deterioration) in the capital account means resident capital is flowing out of the country, in the pursuit of ownership of foreign assets."

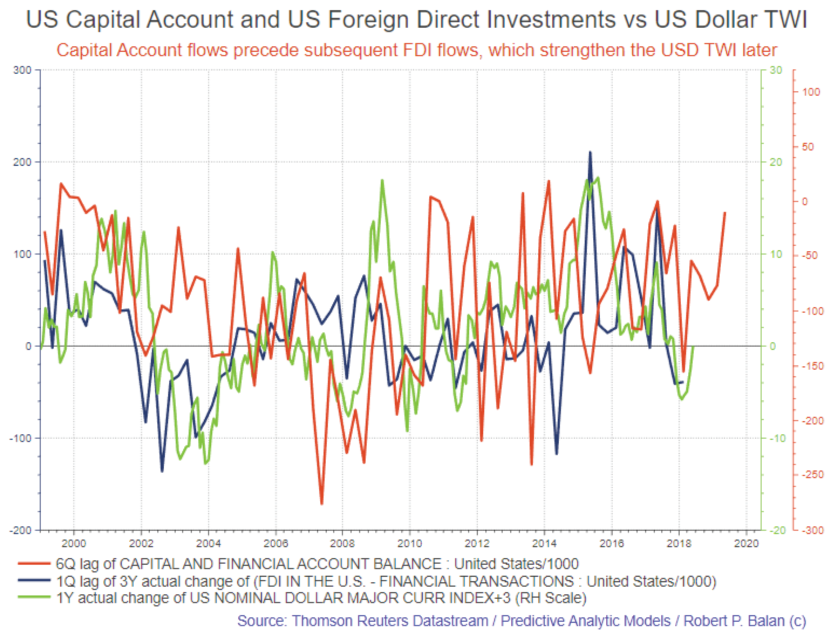
Changes in the US capital account normally show up in the valuation changes of the US currency 5 to 6 quarters later. Capital accounts improve when non-resident (external) capital inflows increase or resident (domestic) capital outflows slow. The sharp improvement in the domestic capital account since Q3 of 2016 will therefore likely to result in further rise of the US dollar during this year, a small decline from Q3 to Q4, and then we see a rising US currency during the first half of 2019 before falling again *(see 1st & 2nd graph on this page).*

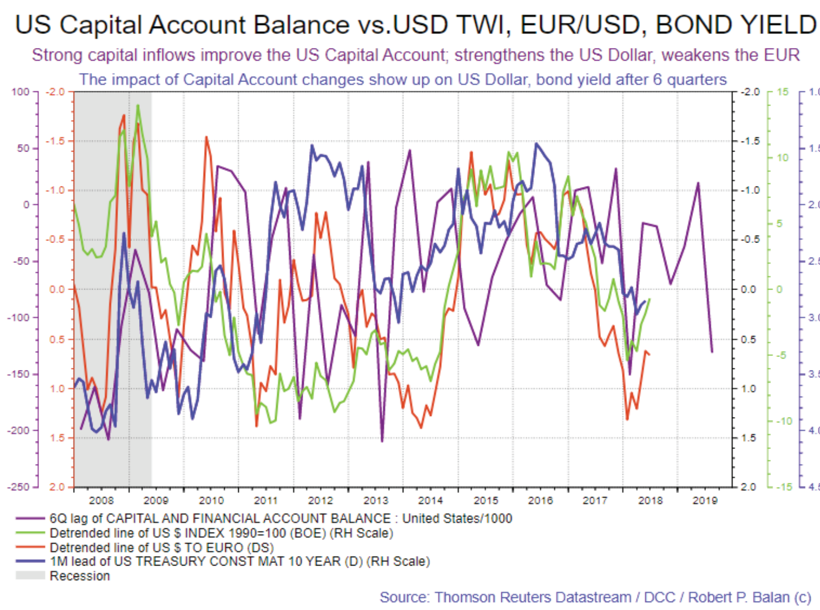
Since the publication of the June issue, the US Dollar did strengthen further, the Euro weakened and yields rose further *(see 2nd graph on this page)*. Other factors may have helped bring these developments about but the underpinnings provided by rising US Capital Accounts have facilitated these events into taking place.

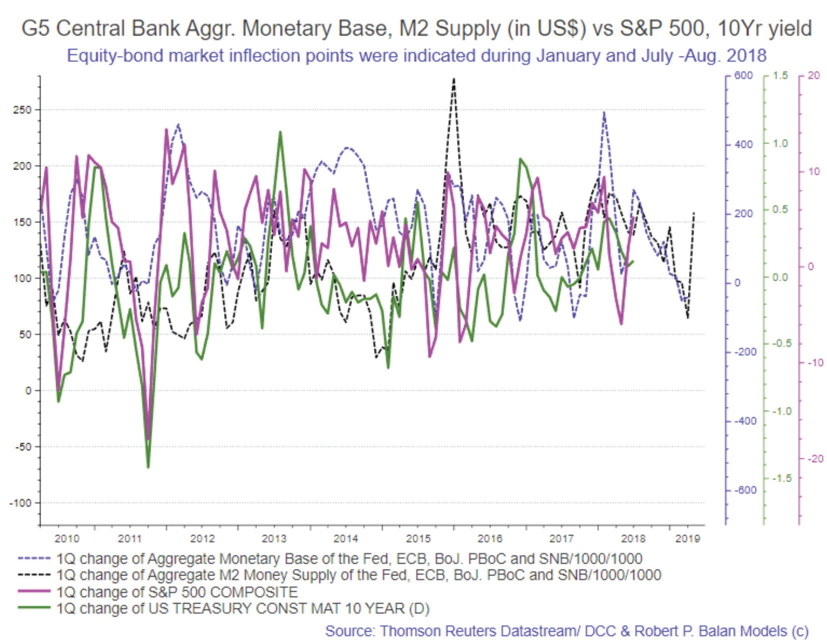
Continuing strength of the US Dollar during most of 2018 will have repercussions to a lot of assets and asset classes. The commodities asset class can come under pressure if this projection actually happens. This thesis has already been validated by the practical collapse of Precious Metals and Miners in the last few weeks, following the sharp surge in DXY and the US Dollar TWI.

Further US dollar strength may contribute further to stresses in the Chinese economy - a stronger US dollar piles further pressure on the Chinese CNY, which also strengthens in the wake of a firmer US Dollar, after a short time lag. A strong CNY is not welcome in China at this time, and the rising trajectory of US policy rates are specially vexing as the PBoC feels constrained to match it commensurately. **The rest of the Emerging Markets have also been devastated by the recent US Dollar strength and are reeling again from new blows from the US currency's recent appreciation.** However, there could be a brief EM reprieve soon if risk assets will rally from here (early July) until late July (as we expect), and as indicated by the lagged flows in global central bank assets *(see 3rd graph on this page).*

Original graph accompanying the June article



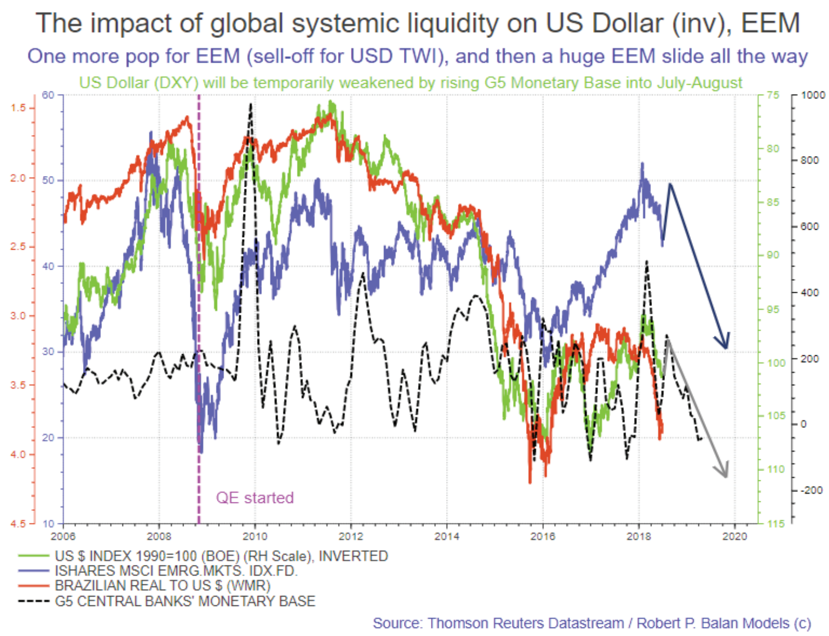


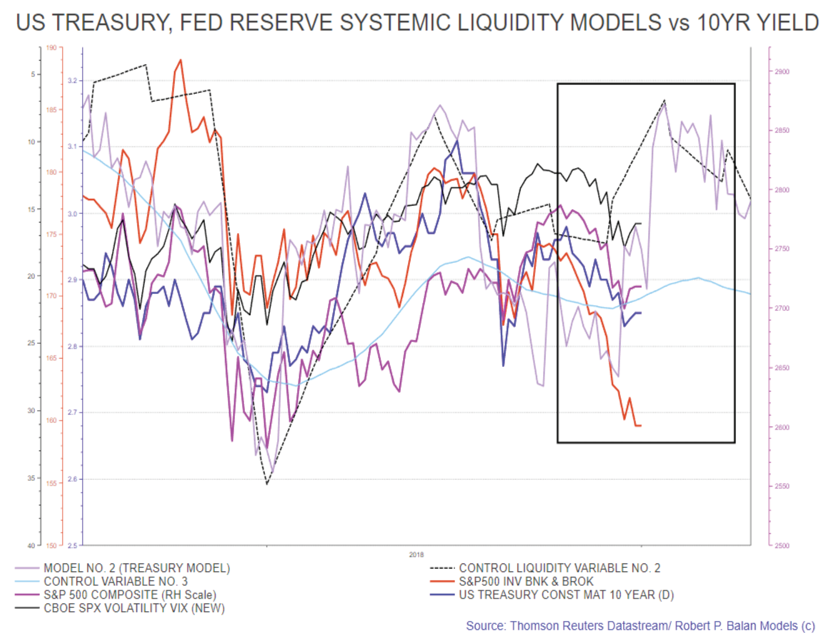


If the systemic liquidity flows are a guide, the US Dollar weakens from here to late July but will thereafter strengthen again, especially against EM currencies *(see 1st graph on this page).* That will likely hammer EM equities and other risk assets as well.

A short term inflection points in equities, bond yields, crude oil, and EEM is due as we write this article, when the distributed lagged effect of systemic liquidity flows converge. The recent lows likely mark a significant temporary trough in risk assets, followed by a rally into a late July/early August *(see 2nd graph on this page).* The US Dollar (DXY) follows the move lower in those risk assets after a week or two of lag .

However, by the time a new US Dollar rally is on its way up, risk assets, especially EEM, should already be falling vigorously. **Distress in financial assets tends to drive the valuation of the US currency even higher, as many investors seek the safety of US Treasuries, with concomitant capital inflows, which strengthens the US Dollar.**

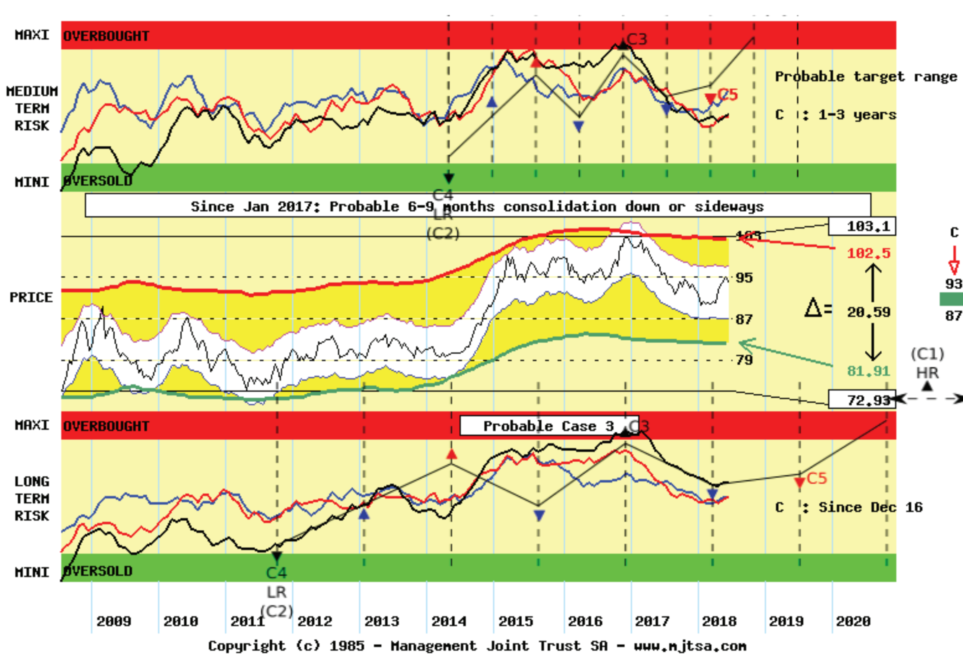




The first leg up in the US Dollar is probably not finished yet

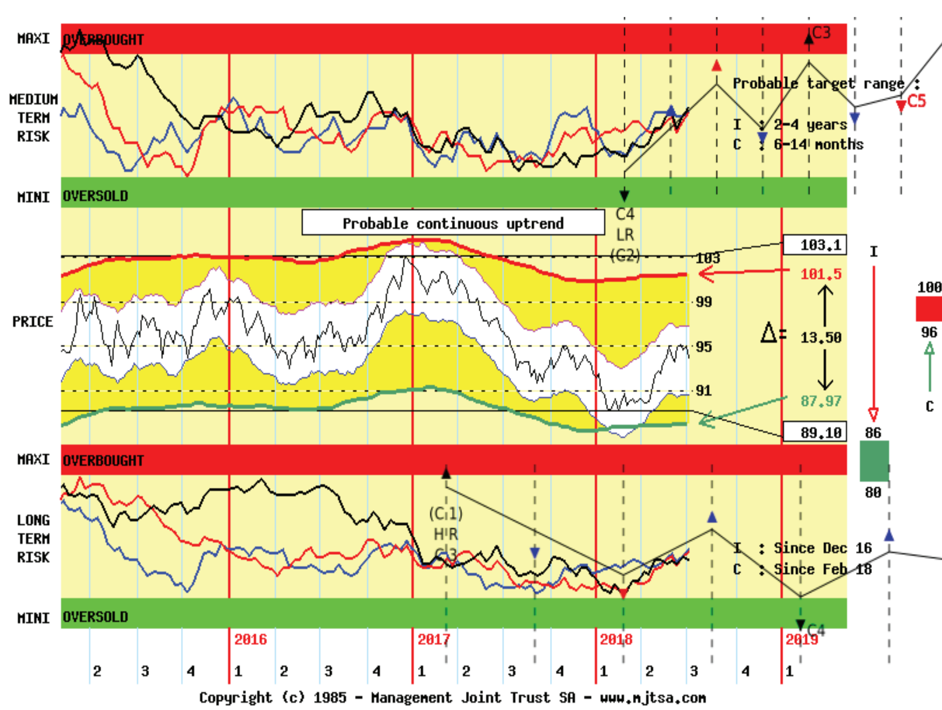
As we had projected earlier this year, the US Dollar is resuming up on the back of a widening interest rates differential between the US and Europe and inflationary surprises in the US, which have started to recede. Political crises across Europe and the ongoing Trade war between the US and China have added additional momentum to the strong US Dollar move, and the sharp acceleration it saw between mid April and end May did feel like it was reaching a climax. In such circumstances, one may wonder if the current counter-trend since late May may start to accelerate in the other direction. We believe not and expect a further move up for the Dollar, probably from mid/late July into mid/late August. This will conclude a first leg up in the US Dollar before it retraces down into the Fall.

Dollar Index
Bi-Monthly graph or the perspective over the next 1 to 2 years



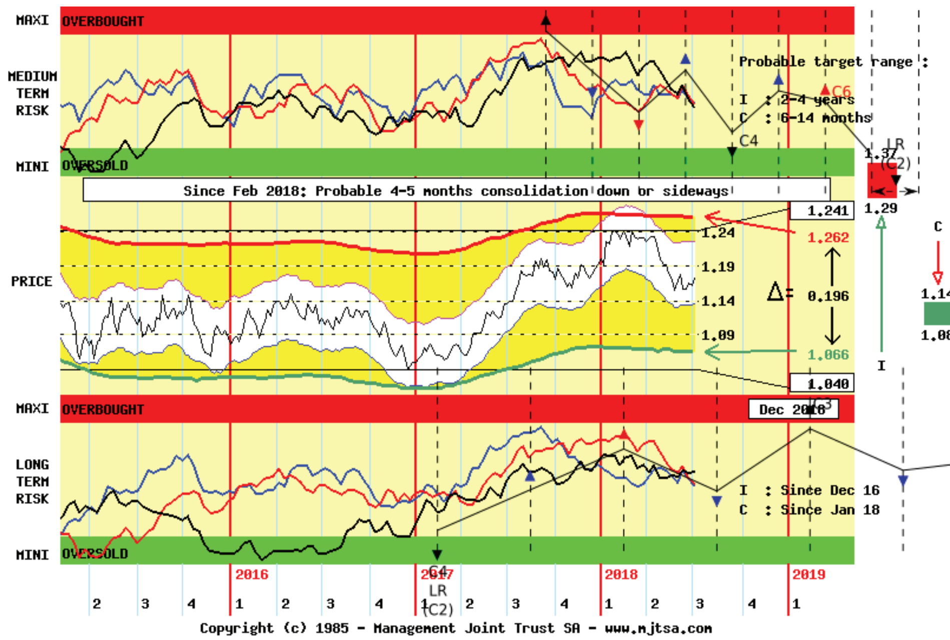
Over the last few quarters, **our view has been (and still is) that the move down in the US Dollar from late 2016 into early 2018 was counter-trend, and that during H1 2018, the Dollar would start to reverse up probably into H1 2019** (medium term oscillators; upper rectangle) and perhaps into late 2019/2020 (long term oscillators; lower rectangle). This scenario is supported by the fact that the whole move down since late 2016 never broke through the support of our C Corrective targets to the downside (here at 86; right-hand scale) and that hence, the uptrend since 2011 still prevails.

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



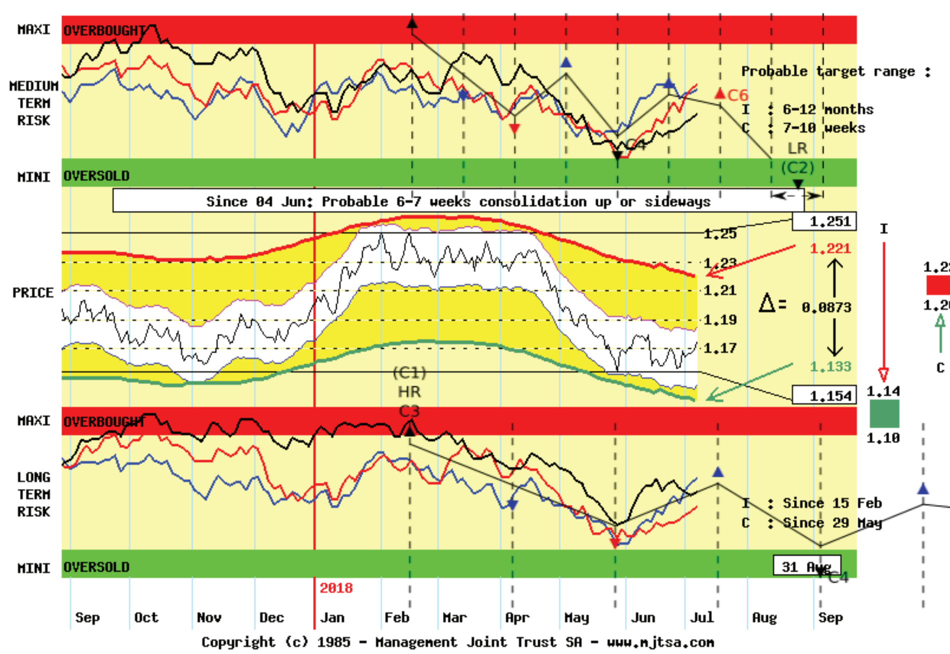
Yet, as Mr J.P.Morgan once cited, "Prices will fluctuate", and **the US Dollar will certainly retrace lower at some point during H2 2018 before it accelerates up again towards year-end and 2019. From what we can read on both our oscillator series (lower and upper rectangles), this counter-trend (Dollar retracement) will probably start from mid Summer.** Thereafter, although we cannot exclude a sell-off towards early 2019 (lower rectangle), we would rather favor a scenario where **the US Dollar resumes higher again from mid Q4 into early 2019 and beyond (upper rectangle). This more Bullish scenario matches our defensive cross asset view as well as the long term projection on our bi-monthly graph above. Upside targets over the next month or so are towards our C Corrective targets to the upside in the 96 – 100 range (right-hand scale).**

EUR/USD
Weekly graph or the perspective over the next 2 to 4 quarters



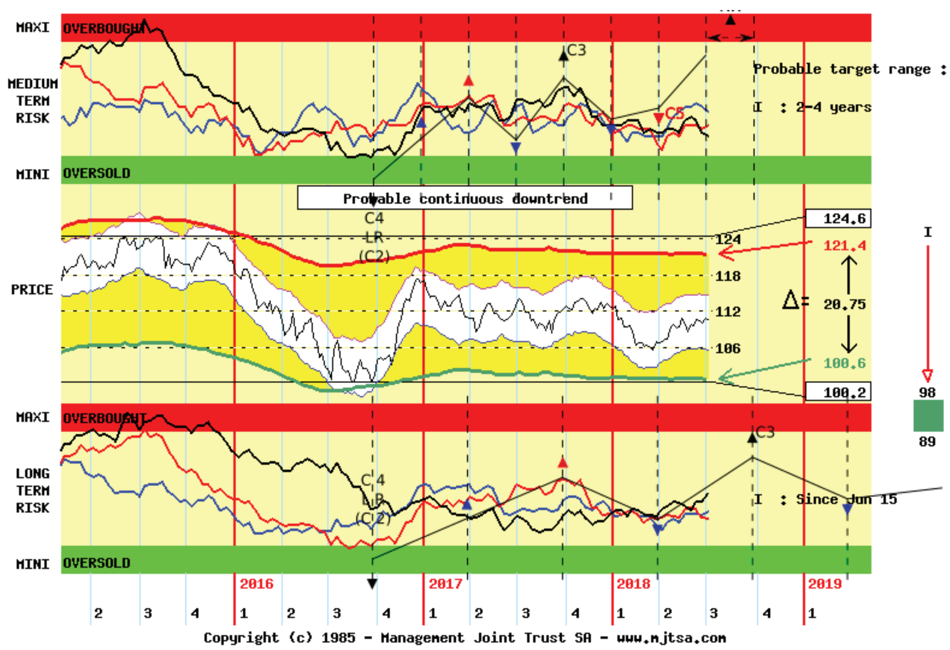
The Weekly graph of the EUR/USD shows similar dynamics and **we would expect a support point for the Euro around mid/late Q3 in the 1.14 – 1.08 range (right-hand scale). It should be followed by a counter-trend move to the upside which could materialize between late Q3 and mid/late Q4**. Here also, we cannot exclude that EUR/USD then accelerates up to new highs (long term oscillators; lower rectangle), but our favored scenario given our cross asset scenario is **that its bounce will die out during mid/late Q4 and that EUR/USD will then resume lower into early 2019 and beyond** (medium term oscillators; upper rectangle).

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



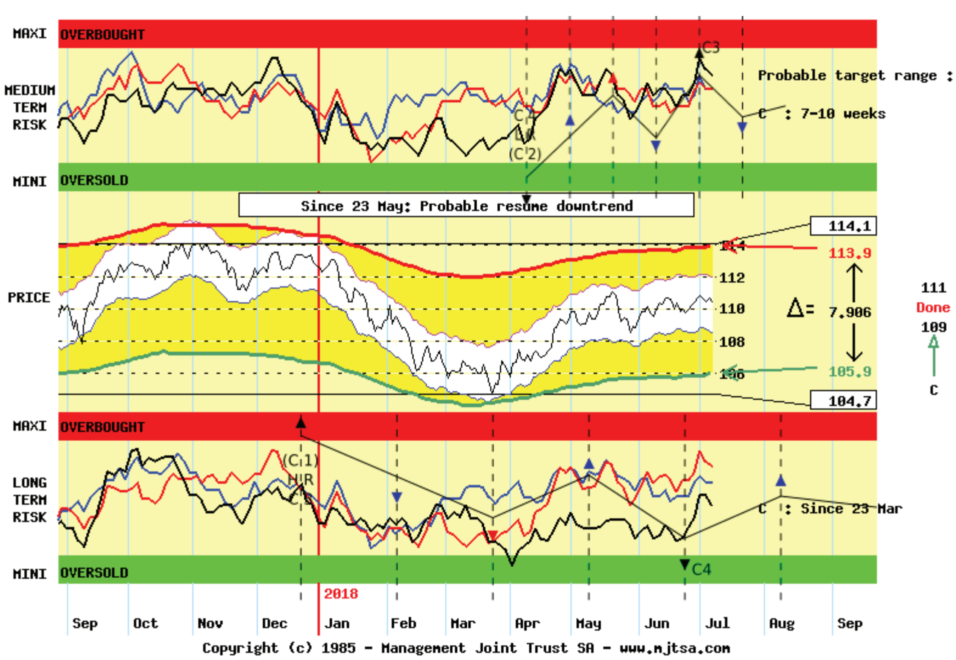
Switching to the Daily graph, EUR/USD has been correcting to the upside since late May. On both our oscillator series (lower and upper rectangles), **we expect the rebound to die out between now and the 3rd week of July. Following that, EUR/USD should then resume lower towards mid/late August.** On the target front (right-hand scale), EUR/USD may reach up to the range of our C Corrective targets to the upside (1.20 -122) although this projection does seem aggressive given the limited time left. Following that, our I Impulsive downside targets are **towards the 1.14 – 1.10 range** into mid/late August.

USD/JPY
Weekly graph or the perspective over the next 2 to 4 quarters



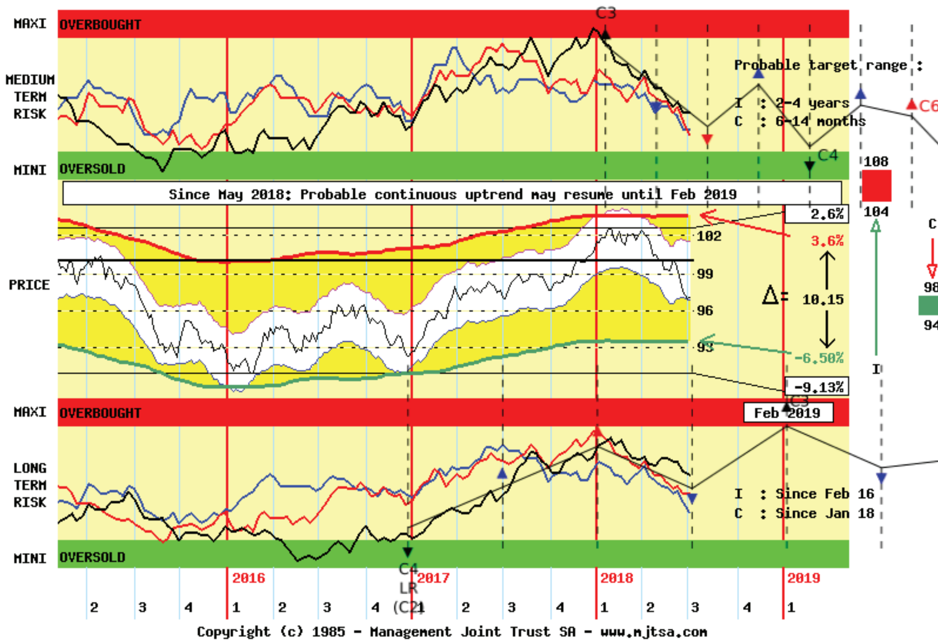
The Yen usually weakens vs the US Dollar during risk-ON phases, this has been the case since late Q1 this year. According to both our oscillator series (lower and upper cases), we expect USD/JPY to top out at some point during this Summer. Given our rather negative scenario on equity markets from late July/early August, we would probably act sooner than later and **would favor exiting USD/JPY over the next few weeks.** Indeed, looking into late 2018 and 2019, we expect much lower levels on USD/JPY possible below 100 in the 98 – 89 range as shown by our I Impulsive targets to the downside (right-hand scale).

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



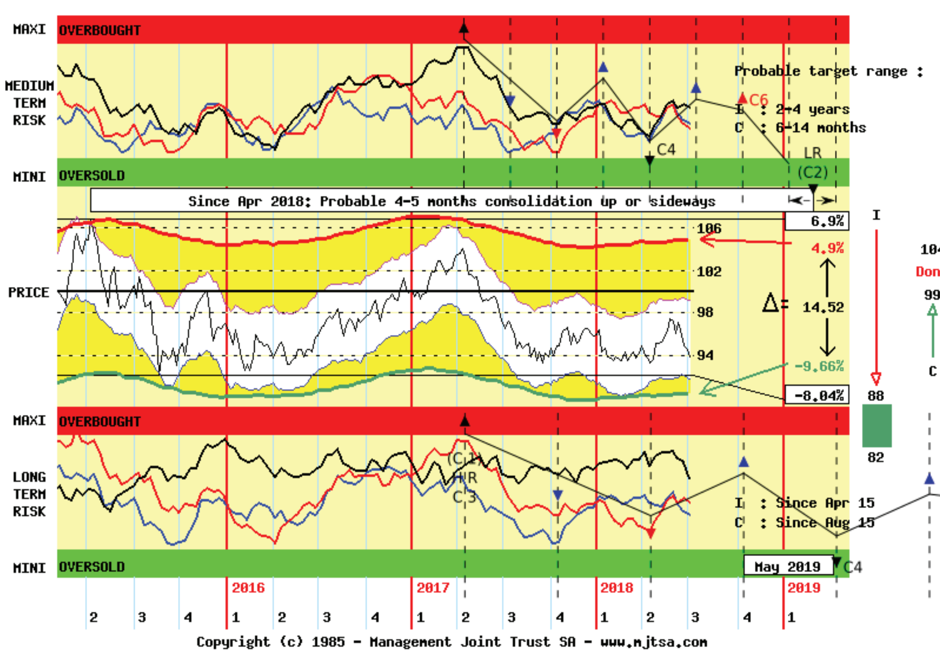
Given the Weekly graph above, the time window left for USD/JPY to break above the resistance of its C Corrective targets to the upside, i.e. above 111 (right-hand scale) is quite limited. If it manages to do so, which could happen between now and the 3rd week of July according to both our oscillator series (lower and upper rectangles), it will probably reach our I Impulsive targets to the upside which we calculate in the 115 – 118 range. **Any failure to do so by late July, will probably mean that this move will never happen and we would then recommend to protect any USD/JPY long positions.**

Asian Growth Currencies (ex China) in USD
Weekly graph or the perspective over the next 2 to 4 quarters



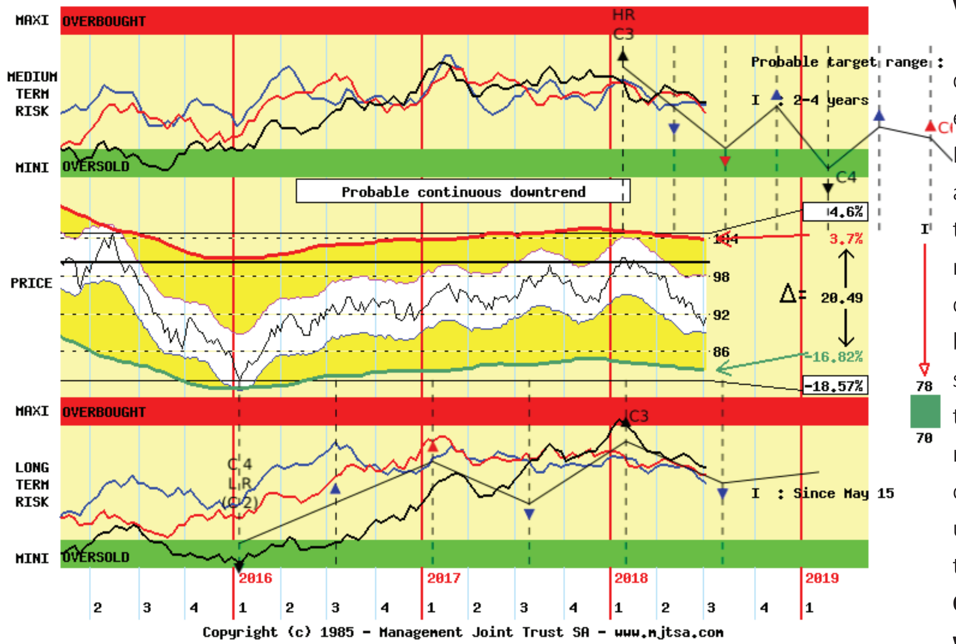
Since February, Asian Growth currencies (our equal weighted portfolio which includes the Korean Won, the Taiwanese Dollar, the Indian Rupee and the Thai Baht) have suffered from US Dollar strength. According to both our oscillator series (lower and upper rectangles), they should reach an intermediate low between now and mid Summer. Similarly to our assessment on EUR/USD, we would favor a scenario where **these Asian Growth currencies bounce against the US Dollar until mid Q4 before they resume lower into early 2019 and beyond** (upper rectangle). Nevertheless, we cannot exclude a scenario where they could make new highs by early 2019 (lower rectangle).

Asian Growth Currencies (ex China) in EUR
Weekly graph or the perspective over the next 2 to 4 quarters



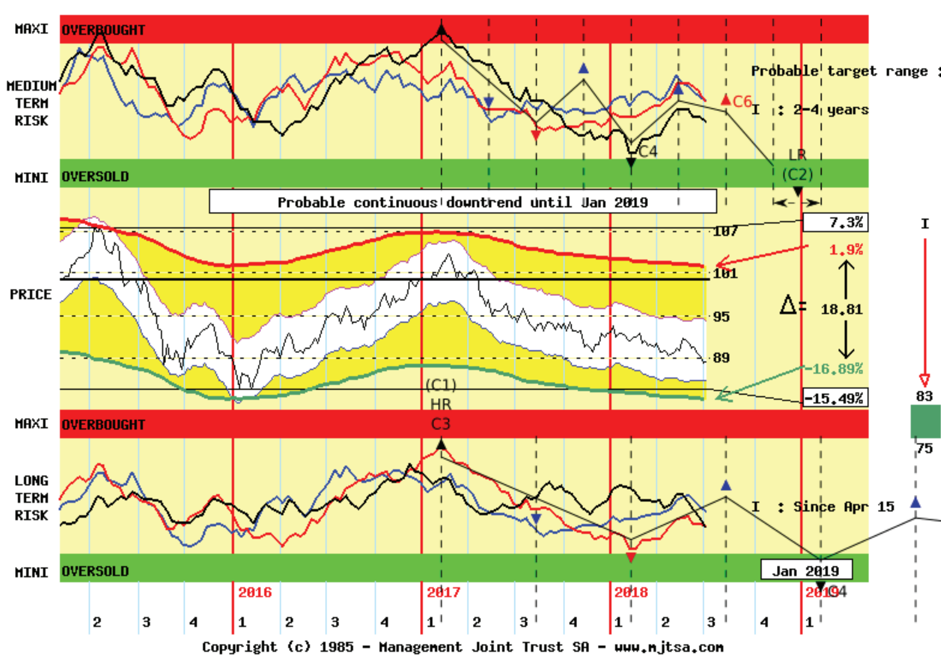
This graph shows the same Asian Growth currencies vs the Euro. It confirms a rather strong Euro from this Fall into Spring next year. Indeed, both oscillators series (lower and upper rectangles) would suggest that **while further rebounds are possible between now and early Q4, Asian Growth Currencies will then resume lower vs the Euro towards late Q1/early Q2 2019**. Our I Impulsive targets to the downside (right-hand scale) point to a range, which is 6 to 13% lower than today. This quite compelling and would confirm a rather defensive environment from Q4 2017 into Spring next year.

All Commodity currencies (developed and emerging) in USD
Weekly graph or the perspective over the next 2 to 4 quarters



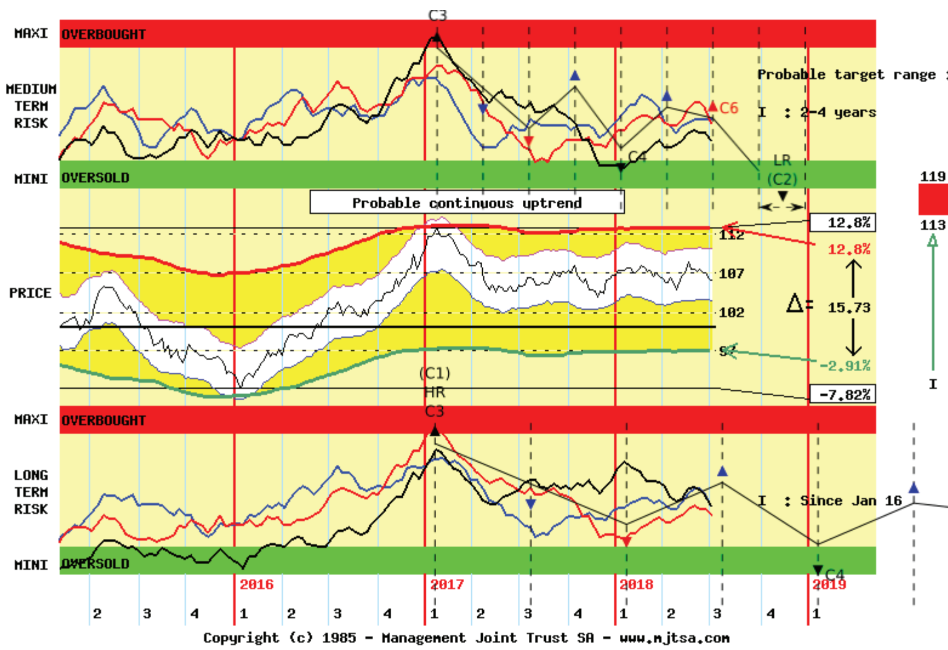
We now look at a currency portfolio of commodity producing countries. It is equal weighted among AUD, NZD, CAD, NOK, BRL, RUB, CLP and ZAR. We first analyze it vs the US Dollar. As with many reflation trades, commodities currencies topped out in February vs the USD. They have since been retracing down and this first leg lower may last into mid Summer according to both our oscillator series (lower and upper rectangles). Following that**, we expect a bounce into Q4 and then a new period of weakness from mid Q4 into early next year. Our I Impulsive targets to the downside (right-hand scale) are suggesting that the downside risk for Commodity currencies vs the US Dollar is compelling, between 15 and 25%. This would definitely conclude the 2016-2017 reflation parenthesis.**

All Commodity currencies (developed and emerging) in EUR
Weekly graph or the perspective over the next 2 to 4 quarters



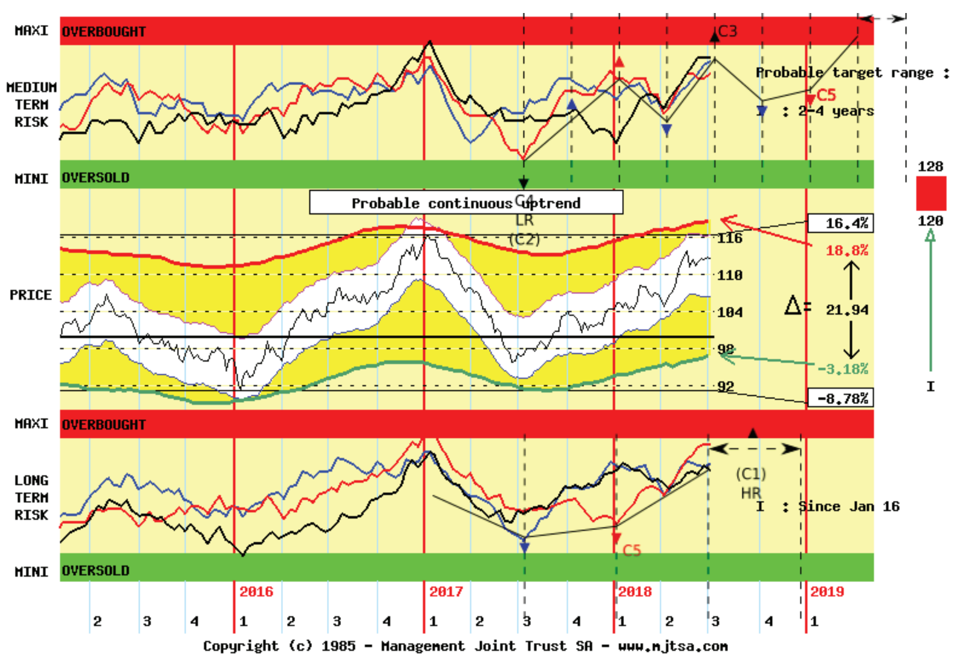
Vs the EUR, Commodity currencies also show **compelling downside risk into early next year, between 7 and 14%** according to our I impulsive targets to the downside (right-hand scale). Both our oscillator series (lower and upper rectangle) would suggest that **following a slight bounce over the next few weeks, Commodity currencies will then start to slide again in Euro terms, probably until early next year at least.**

Currencies from Commodity producers vs Net Importers in Emerging Market Weekly graph or the perspective over the next 2 to 4 quarters



We now look at a classic cross currency comparison. It compares Commodity currencies (AUD, NZD, CAD, NOK, BRL, RUB, CLP and ZAR) vs a portfolio of Emerging market currencies which are net importers of commodities (KRW, THB, TWD, INR, MXN, TRY, HUF, PLN). Historically, both show similar profiles in terms of risk, while Commodity currencies are much more cyclical. On our long term oscillator series (lower rectangles), **Commodity currencies may still see a slight bounce over the next few weeks, but from mid Summer at the latest, they should start to underperform on both oscillators series** (lower and upper rectangles), probably into the Fall and potentially towards early next year.

Equities from Commodity producers vs Net Importers in Emerging Markets Weekly graph or the perspective over the next 2 to 4 quarters



We now compare the equity markets of commodity producing countries vs the ones of emerging countries, which are net importers of commodities. For both, we have used to same selection of countries as above. Although the ratio has been stronger that the currency comparison above, it shows the same dynamics. **Commodity producing countries are approaching a High Risk zone vs Importers on our long term oscillators (lower rectangle). These would usually trigger several quarters of consolidation, possibly into early next year** at least as shown on our medium term oscillators (upper rectangle).

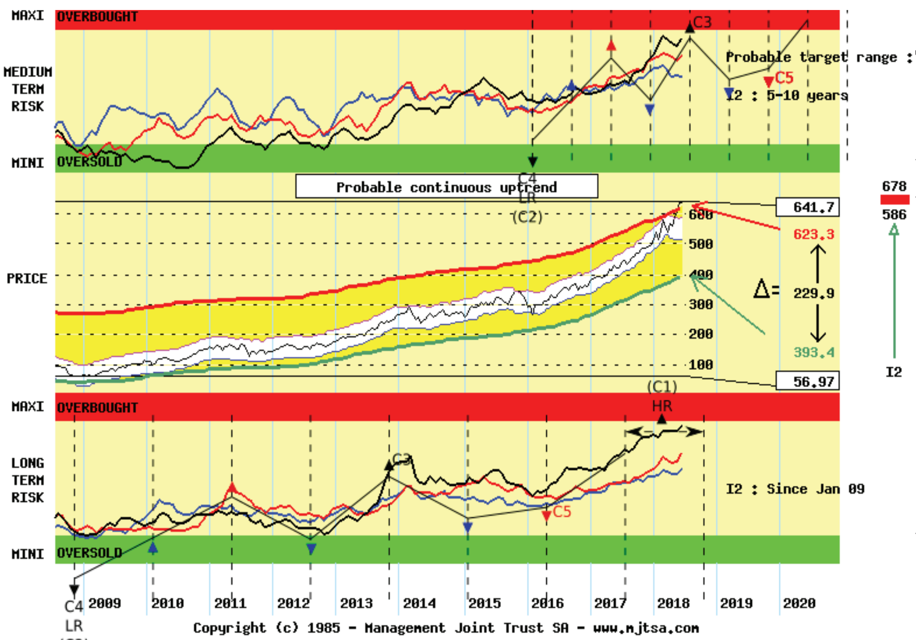
Concluding remarks

Over the next couple of weeks, we expect the US Dollar to resume higher vs the Euro possibly until mid/late August (EUR/USD towards the 1.14 -1.10 range). This move will probably be concomitant with a sharp correction in risk assets during August. Following that, the Euro and Asian Growth currencies could rebound vs the US Dollar. This environment is not dissimilar to the one that prevailed in H1 2017 (a Growth extension). Yet, we do not expect it to be as strong and last as long as it did back then. Indeed, from early/mid Q4, the US Dollar should resume its uptrend, possibly well into 2019 as the risk asset environment further deteriorates and the US Dollar regains its Flight to Safety status. We would back this view by the fact that Commodity Currencies seem to be the weakest link as we move into H2 2018 and 2019. This would conclude the 2016-2017 reflationary period, leading to an economic deceleration that may last well into 2019, perhaps even 2020. In this context, USD/JPY may attempt a last push higher into late July /early August, but will suffer thereafter, probably until late next year as a more risk-off environment gradually takes hold.

50 / Splicing the markets – What do to with your favorite Growth stocks ?

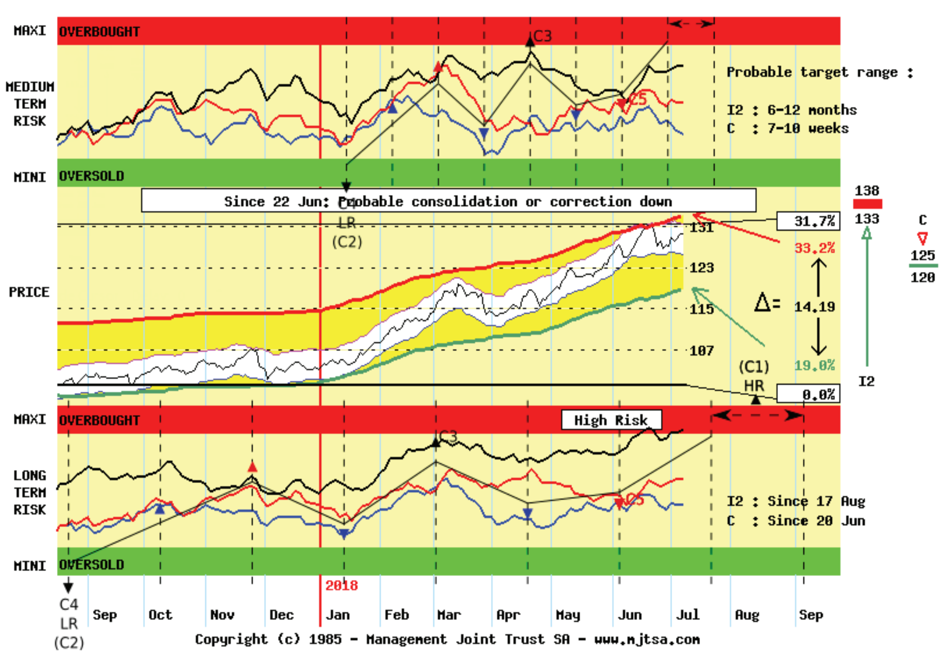
They will always tell you that « This Time is different », and that there are stocks which are immune to the business cycle (if they even admit that the business cycle exists). In this brief review, we will go over 2 Growth themes, US Internet Services, which includes the famous "FANGs" and US Biotech. We are trying to avoid jumping the gun, but believe that by the end of this month, the timing might be right to reduce some of that Big Technology exposure. Biotech on the other hand still seems relatively well positioned from late August into the Fall.

Dow Jones Internet Composite Index
Bi-Monthly graph or the perspective over the next 1 to 2 years



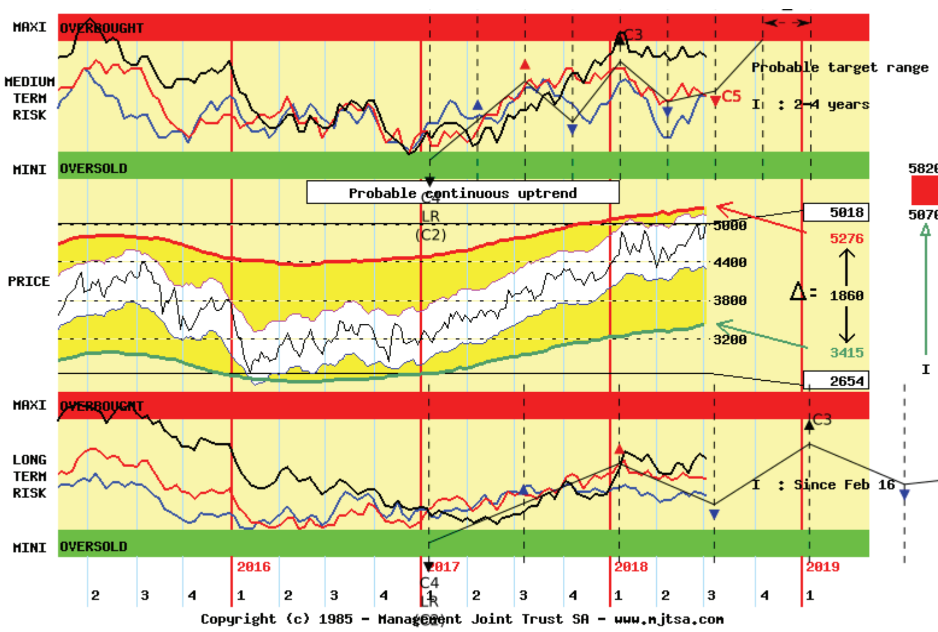
Similarly to the S&P500 on page 16 of this issue, the Dow Jones Internet Composite Index, which includes the FANGs and other large US listed Internet companies, has come the the end of our uptrend model on our long term oscillators (lower rectangle). Our medium term oscillators (upper rectangle) also suggest **that an important inflection point is approaching, which could leads to 3 to 5 quarters of correction to the downside.** Our price targets (right-hand scale) are in I2 Impulsive 2 territory (out most extended upside targets). It is extremely rare that any price move actually makes it above these. Currently, the top of the range is at 678, which from current levels would leave circa 5-6% of additional upside potential. Given the current equity rally, these may be achieved **by month's end. The move will then be exhausted, long term, in terms of risk/reward. Given the current historical volatility we calculate ("Delta", here at 229.9; middle rectangle, right-hand side), the correction than follows could amount to between 115 and 184 points (or 0.5 to 0.8 times "Delta"), 18 to 29% lower than today.**

Dow Jones Internet Composite Index / S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



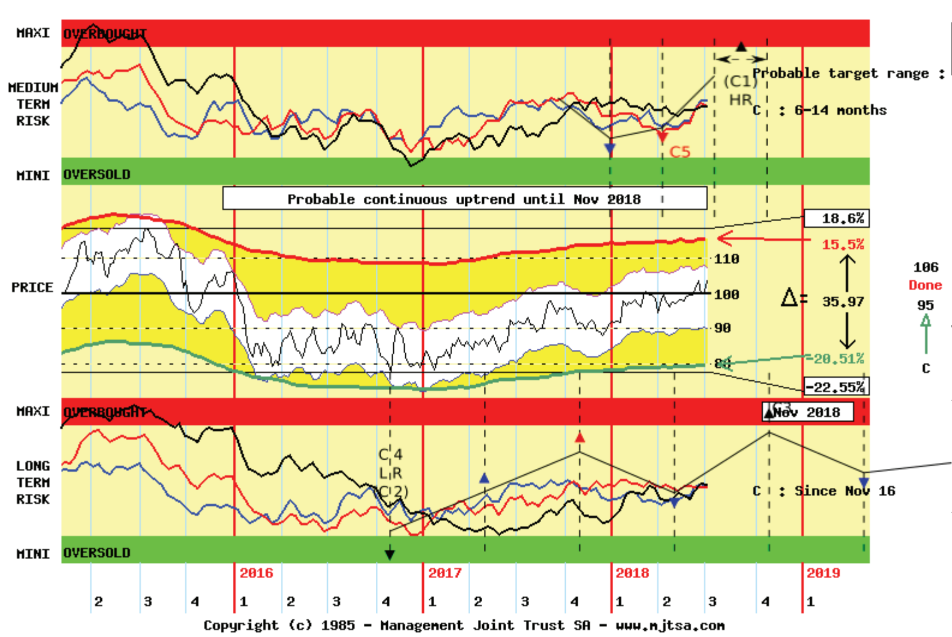
One particularity of these Big Growth tech stocks, is that over the last 9 years, and even more over the last 2 years, they have outperformed the S&P500 in almost all market conditions. On this shorter term relative graph vs the S&P500 Index, the move is also getting very extended, and a **"High Risk" position is expected between now and late July/August** on both oscillator series (lower and upper rectangles) . We believe it could mark an important inflection point, not only for the Dow Jones Internet Composite Index vs the market, but also for equity markets in general. **It could lead to at least several months of correction. Such underperformance by Big tech stocks would probably imply that an important stock market correction has started**. From a risk/reward perspective (right-hand scale), the ratio is also getting closer to our I2 Impulsive 2 targets (our most extended upside targets) some 3 to 6% above current levels, i.e. the upside outperformance potential will probably be exhausted on the next rally.

BTK - Biotechnology Index (NYSE Arca)
Weekly graph or the perspective over the next 2 to 4 quarters



Biotechnology is also considered a Growth theme, yet a more defensive one. From this Weekly graph of the NYSE Biotech index, we can probably expect a few more months of upside momentum. The models we show on both oscillator series would suggest a **top towards Q4, perhaps even early next year. As we have seen in Q1 this year,** Biotech is not immune to market corrections, yet, in this late cycle environment, any subsequent rally does seem to have a stronger effect on it (i.e. Biotech will probably follow the market lower in August, but could re-accelerate strongly come September/October). Our I Impulsive targets to the upside (right-hand scale) are suggesting that **Biotech may still perform by an additional 18% before it tops out towards Q4.**

BTK - Biotechnology Index (NYSE Arca) / S&P500
Weekly graph or the perspective over the next 2 to 4 quarters



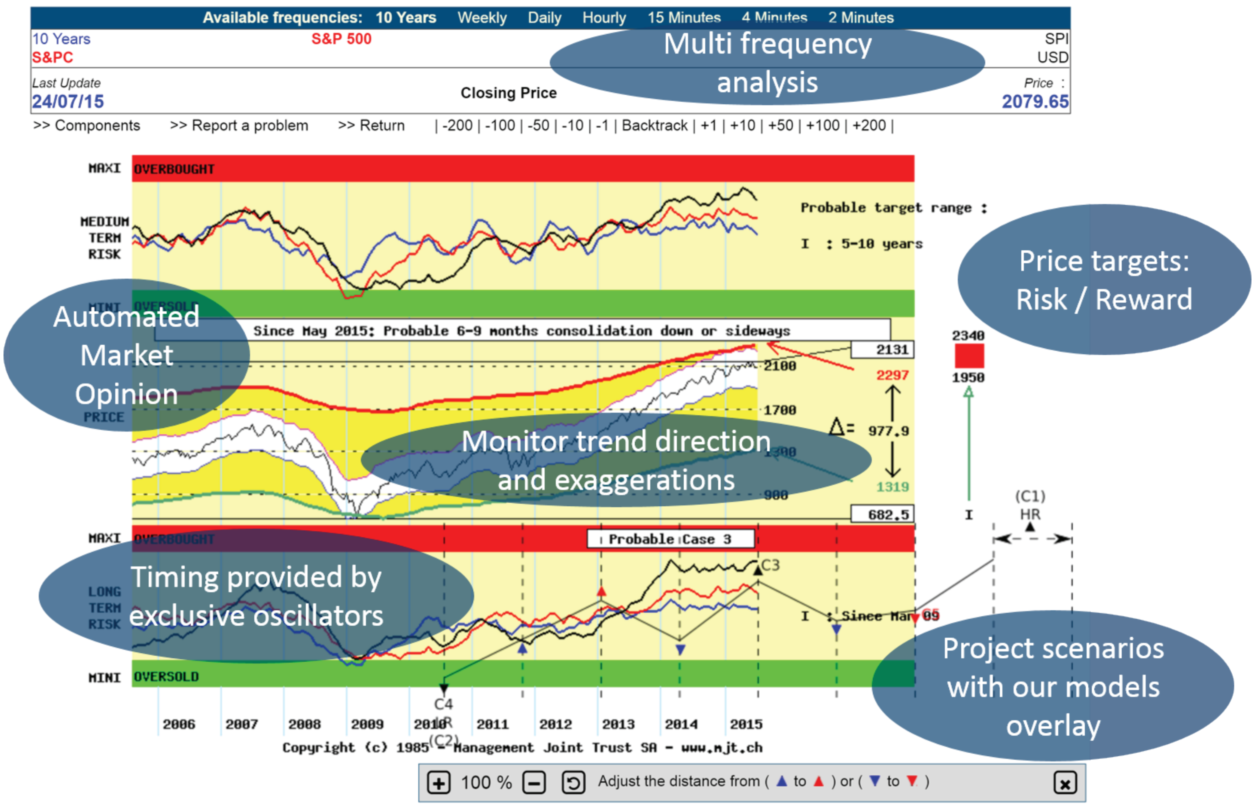
It is also interesting to look at the same graph on a relative basis. The sequences we show here on both oscillator series (lower and upper rectangles) as well as on our automatic messaging, also point to **Q4 as a possible relative performance top.** From a price target perspective (right-hand scale), Biotech vs the S&P500 may soon be breaking out above its corrective targets up. If this were to happen, **its outperformance potential is important, possibly above 25%.**

Concluding remarks

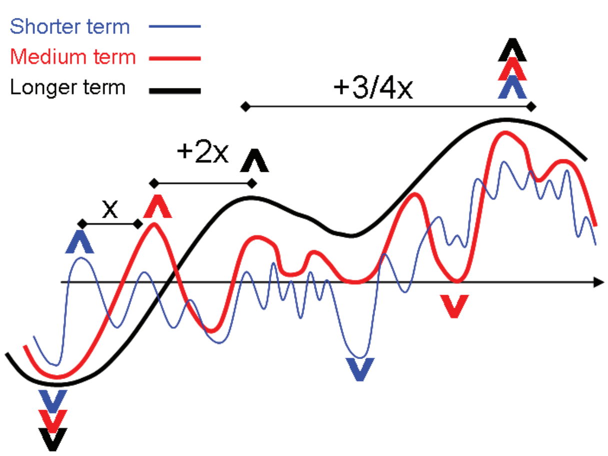
The important equity market top we are expecting is approaching, potentially towards late July / early August. We believe that during this period, Big US technological stocks may also top out on a relative basis vs the market. Indeed, the general market correction to the downside we expect over the next 3 to 5 quarters could be relatively serious, and these Big Tech stock could be hard it given their traditionally "high beta" features. On the other hand, BioTech stocks may offer an interesting alternative. They are more defensive that Big Tech ones, as part of the Healthcare sector. They usually perform well very late in the cycle. Following some correction into late August, we expect them to extend up, possibly towards October/November with interesting upside potential.

52/ METHODOLOGY

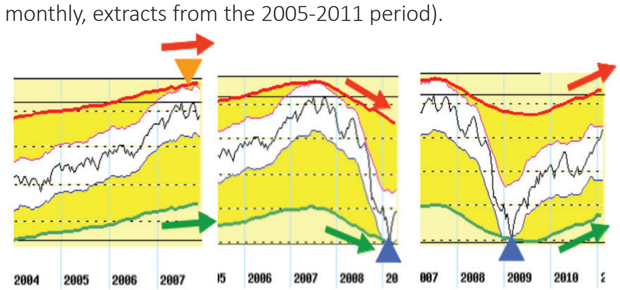
MJT's proprietary methodology uses Timing Oscillators to help investors position themselves either in an uptrend or downtrend. It will hence allow them to anticipate and project the future sequence of events. Coverage extends over 5'000 instruments, long term to intraday, across all asset classes. Relative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



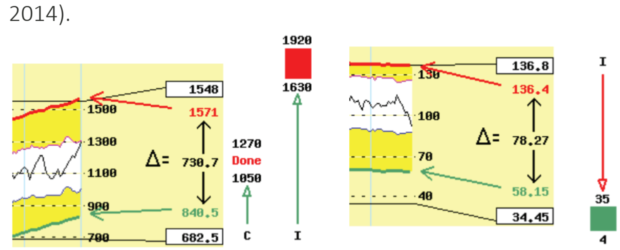
Timing oscillators: Different prices cycles are captured by our 3 Timing oscillators. Monitor how their relative positioning defines specific situations (Cases) to always know where you stand within the Trend (e.g. please see below the ideal Uptrend Case succession sequence)



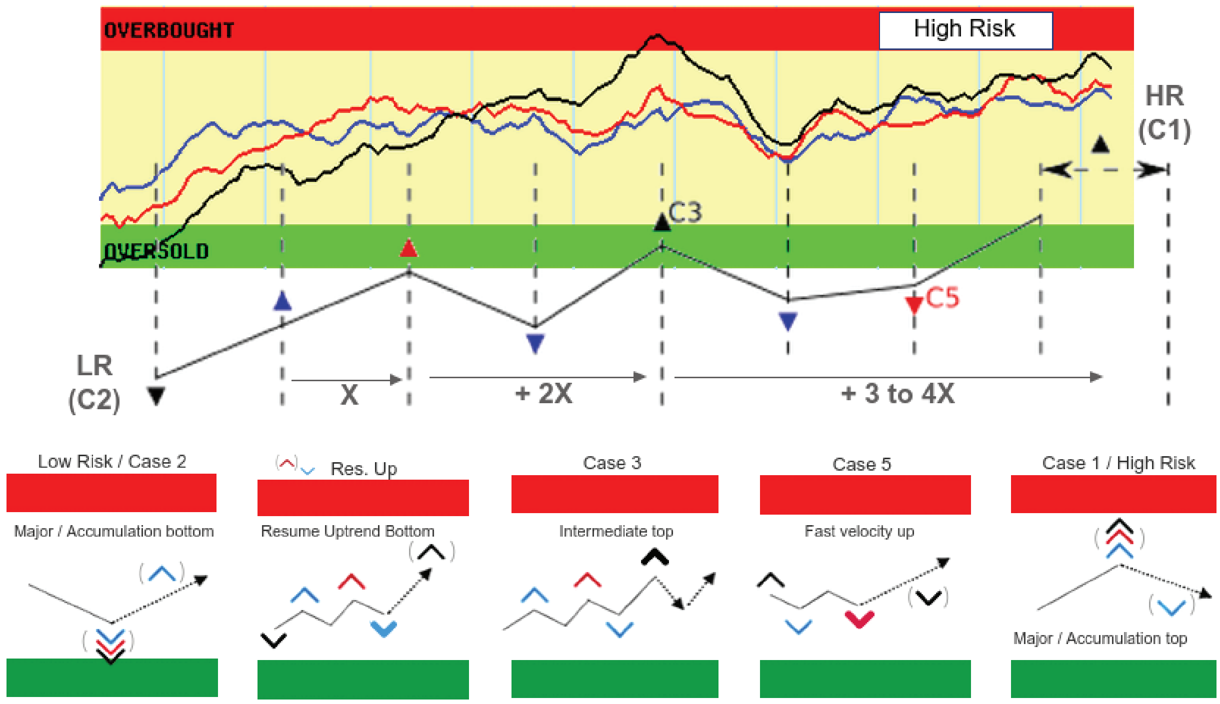
Trend direction: the direction of FinGraphs' large envelope will help you decide either to apply an uptrend or a downtrend model. Contacts between the wider and thinner envelopes will help you anticipate and confirm market turning points (e.g. S&P500 bi-monthly, extracts from the 2005-2011 period).



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).

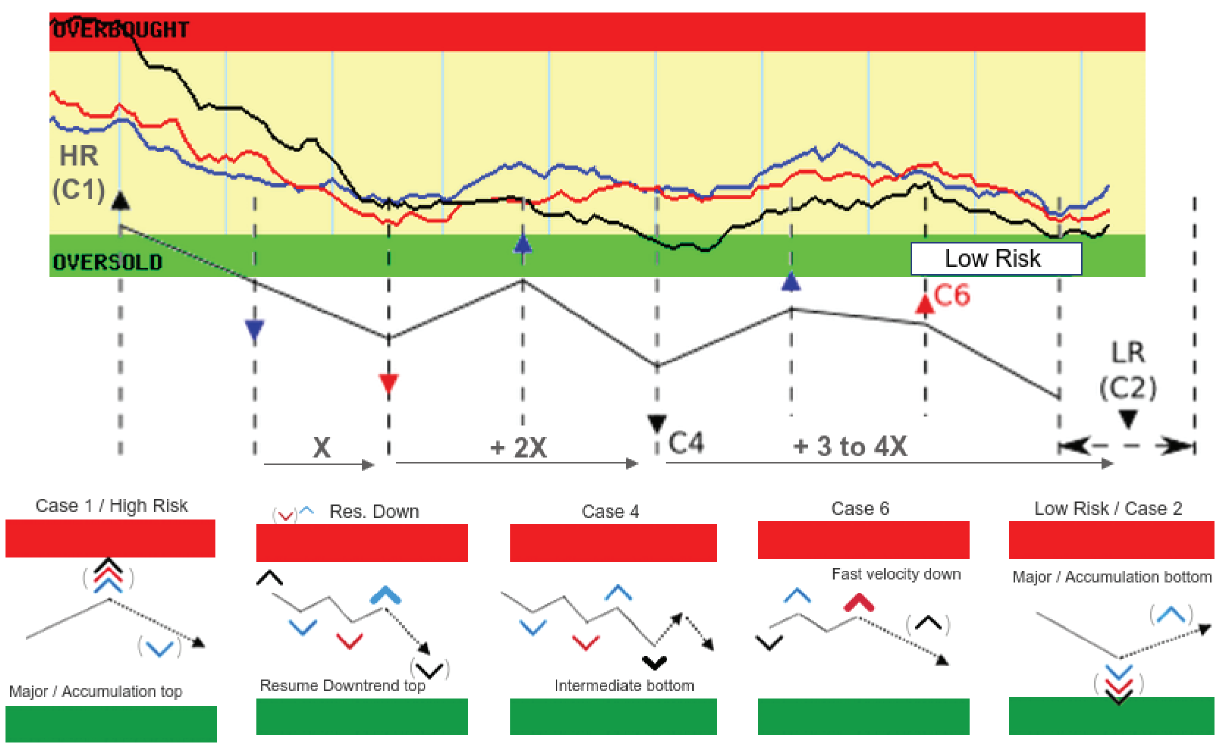


Ideal Uptrend Model



(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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