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

DC&C
Diapason Currencies & Commodities

MJT

DIAPASON CURRENCIES AND COMMODITIES MACRO ANALYSIS

A Monthly Macro and Asset Review

Featuring MJT's Timing Methodology

CONTENTS

"The market move (towards flattening) accelerated last week with the story between Trump and Taylor, who had seemed out of the running."

Tom Simons, money market strategist at Jefferies & Co., New York

"What has been priced in is continuity and perhaps a hawkish surprise (hence, the flattening)."

Alan Ruskin, global co-head of currency strategy, Deutsche Bank, New York

4/ Executive Summary

08 / **China's Communist Party Congress provided a strong boost for medium-term outlook in commodities -** China represents (and comprises) the demand side of the fundamental equation for commodities as an asset class. China can make or break commodity prices. Recent history can provide proof: double-digit Chinese GDP growth in 2011-2012 boosted many industrial raw materials prices to all-time highs during the period. A deceleration in the Chinese economy in late 2015 and early 2016 caused the prices of these commodities to decline to multi-year lows. The Communist Party of China last week convened for the first time since 2012 to give President Xi another term as leader, appoint new leadership and set the future course of the nation. In the lead up to the Party Congress, many raw materials prices moved sharply to the upside when it became apparent that Mr. Xi would consolidate power further, meaning that China would remain on course for stable and steady growth over the next five years at least. The positive jolt to the market came at a time when commodities have already risen off the lows since June in the wake of the reflation wave led by the recovery in oil prices that could carry into Q1-Q2 2018 as many indicators show.

11 / **Timing and Tactical Insight - China, the motor for reflation II is still humming -** China, Industrial Metals and related sectors (Diversified Mining) are still on track to outperform until early 2018. These trades may consolidate some during November and more patience is probably required to really capture this outperformance. Indeed, the acceleration may be quite short lived, possibly from early December into late January 2018.

17 / **Looking at the historical dynamic of the yield curve, it may be too early for a significant structural steepening -** There has been a lot of reason offered why the yield curves should steepen, but those rationalizations fail to take into consideration what appears to be an immutable relationship – rising policy rates tends to be accompanied by flattening of the yield curves, and vice versa. Once this is understood, the co-called conundrum of flattening of the curves become no mystery at all. So far, yield curve steepening predictions have brought nothing but a world of pain. Over the past few decades, we can see a recurring pattern-- the yield curve flattens as the Fed tightens, until the yield spread reaches 0%, then a recession ensues. However, by the time a recession is officially recognized and dated, the yield curve has already been screaming wider (and steepening strongly) accompanied by frantic efforts by the Fed to cut policy rates as fast as they could. This steepening mechanism is not what we face in the immediate future, which is characterized by global central banks tightening policy rates (or wanting to) – all yield flatteners. To arrive at the conditions conducive to steepening, the central banks first have to tighten monetary policy to a point where growth is choked and recession ensues.

20 / **Timing and Tactical Insight - The Yield Curve is still flattening, yet a short term bounce may materialise from late November into early 2018 -** Despite the rise in yields over the last 2 months, the US Yield Curve is still flattening. It may continue to do so over the coming weeks. Value to Growth indicators, Breadth, or Small cap to Big cap ratios also indicate so. More generally, the US Yield Curve may continue to flatten well into 2018. Shorter term however, it may find a intermediate low mid/late November and initiate a 2 to 3 months bounce.

28 / **Will the US Dollar strengthen when the Fed reduces its balance sheet? It may not be the case -** The prospect of personnel changes at the Fed, and recognition that practically no one of the primary candidates for the Fed chairmanship would be as dovish as Yellen has been, helped the greenback to firm up support.
But will reduction of the Fed's balance sheet really strengthens the currency? In our narrative we document our thinking that instead of weakening the US Dollar, the QE programs served to strengthen the US Dollar instead, and that reducing the Fed balance sheet may therefore prove to be a weakening factor for the currency. If we juxtapose the long bond yield with the US quarterly GDP with a lag, then the relationship between the Fed's assets and growth, the long bond yield, and the US Dollar becomes clear – they are all positively correlated, given the proper lag. If we think about the impact of the Fed's balance sheet deeply, it can't be positive for the stock market and negative for the rest of the assets and growth. The fact is that the accumulation of central bank assets has been good for equities and the economy.

31 / **Timing and Tactical Insight - The Dollar should retrace down into November -** Since early September, the USD Dollar has achieved a nice rebound vs the Euro and the Yen especially. Our analysis suggests that it has now reached an intermediate top and that it should consolidate for 2 to 3 weeks until mid/late November, yet probably not make new lows. Following that, we expect further upside for the Dollar as we move into December (vs the Yen especially). The move may indeed extend towards February, before the Dollar retraces again to the downside towards early Spring.

The Capital Observer editors team, London / Geneva, November 1st 2017
to view previous issues, please visit our website at: http://www.thecapitalobserver.com

5/ Executive Summary

38 / **Seasonality in Oil may trigger a short term dip in November but the uptrend reasserts thereafter -** Global oil consumption ebbs and flows from one season to the next – the seasonality of the oil market is well established and widely understood. From many indications, the oil market has just finished a seasonal peak in many of its fundamental vectors (which have helped push prices higher in past weeks). But the market is due for another, countervailing phase, which may bring price lower over the next few weeks – at least if we go by historical patterns. A positive trend for oil prices has been set by several factors since late June. Prices have edged upward in recent weeks thanks to the decline in US inventories and strong signs of OPEC members' compliance with the agreed-upon output cuts, which were renewed last May and could be renewed again this coming November 30th, when OPEC holds its annual meeting in Vienna. In the face of seasonal factors, buy the dips and not the break out remains our preferred strategy.

41 / **Timing and Tactical Insight - Short term, Oil may Stop and Go, yet is still very positive until late December / January -** Oil and the Energy sector have accelerated up since late August and are confirming the resume uptrend situation, we had expected since early Summer. Following a slight pull-back over the next couple of weeks, they should continue to accelerate towards year-end. Generally, on a relative basis, the Energy sector is still finding it difficult to outperform the market. This is especially true in the US, where new relative lows are possible over the next few weeks. Following that, we would expect it to finally gather some momentum, that could lead it to outperform towards year-end and early 2018.

46 / **Splicing the markets - Strong markets with a rotational bias should continue towards H1 2018, yet short term risk/reward still looks extended -** Equity markets are still extending up and growth rotations are kicking in, bringing further support. Yet, our oscillators are still in exaggeration, risk/reward is still extended and the timing window for some retracement (although it may be benign) is still open over the next couple of weeks. This is a short term market positioning call. If you think about it, what would you do today if you were receiving net new money. In our view, you would probably wait a bit for a better opportunity to enter. Longer term, as we have done over the last few months and quarters, we reiterate our positive bias on equity markets towards Spring next year.

The Capital Observer editors team, London / Geneva, November 1st 2017
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6/ Mapping the markets (part I)

General comment

Late September, we wrote that the rally on risk and reflation assets would probably pause sometime the first week or early in the second week of October. We expected that an intermediate correction would materialize and that it may last into late October and possibly even mid November. We also believed that following that, we would expect risk and reflation assets to start accelerating up again until early next year.

Since then, risk assets and equity markets have continued to break-out higher. As we write, most equity indexes are still making year-to-date or, for some, even all time highs. That said, the time window for the consolidation we then expected is not quite closed yet, and the exaggerations we had measured a few weeks back are even more extended today. It is true that over the course of last week, rotations into Growth have started to kick in, and it is also true, that such rotations have done a great job this year at holding equity markets up. That said, we still expect Defensive assets to make a brief comeback, probably over the next 2 to 3 weeks.

Hence, our short term positioning is still defensive on equities, where we expect a slight consolidation into mid November (which may retrace the late October extension). We also expect that the yield curve, following its sideways move since September, should start to flatten again, probably towards mid / late November. Related trades, such as Yields, the Dollar, Financials, Small Caps or Value could experience a more substantial downside retest. Among, reflation trades, Oil may see a short dip, yet is still well positioned towards year-end. China and Industrial metals may consolidate at high levels before they start accelerating up again in December towards early next year.

Equity markets

Volatility

VIX made an intermediate low on our models mid October. It could lead to some upside pressure into mid/late November.

World markets
p 46, 47

Major equity indexes are currently making intermediate tops of various degrees. These would theoretically lead into 3 to 6 weeks of consolidation. The bounce, we expect on Defensive assets is somewhat shorter (2 to 3 weeks). Corroborating both, we would hence expect equity market to retrace between now and mid November.

Regional picks

Major equity indexes are currently making intermediate tops of various degrees. These would theoretically lead into 3 to 6 weeks of consolidation. The bounce, we expect on Defensive assets is somewhat shorter (2 to 3 weeks). Corroborating both, we would hence expect equity market to retrace between now and mid November.

Emerging markets
p 11 - 13

China and especially Commodity related countries are our favorite Emerging markets towards year-end and early 2018. Yet, until mid / late November, they should continue to underperform as reflation trades retrace somewhat. On the other hand, commodity importers (such as India, South Korea, Mexico), should continue to outperform over the next few weeks..

Relative Sectors
p 15, 16, 22, 24, 42- 45

We still expect Defensive sectors to make a brief come-back as markets eventually retrace during early November. On the other hand, reflationary sectors, such as Industrials, Materials, Energy or Financials should suffer temporary underperformance. Come mid/late November, the rotation should shift back as reflation trades start to re-accelerate towards year-end.

Profiles/Themes
p 22, 23, 25, 26, 27

Until mid/late November, Value, Size, High beta should continue to retrace back, while Growth, Min Vol and Defensives outperform. From late November, the rotation shifts back to reflationary and pro-cyclical themes, probably until year-end or early 2018.

Interest rates

US rates
p 20

Given the retracement we still expect on risk and reflationary assets, US Treasury yields should see some retracement into mid / late November. Following that, yields should make a further attempt to the upside towards year-end and early 2018.

The US yield curve spread
p 21

It continues to flatten, probably until late/mid November before it attempts a short steepening spree until early 2018.

Other countries

Yields and Yield curves in other developed countries are following similar dynamics as in the US, yet with a slightly more positive tilt. In Europe and Japan, 10Y yields and the Yield Curve have held up much better than in the US. That said, they should also see a period of retracement during November.

7/ Mapping the markets (part II)

Credit

High Yield has followed equity up during September and lost momentum during October. It should retrace with other reflationary assets into mid/late November.

Rate Differentials

The US vs Eurozone and Japan short term and long term rates differentials have started to move up again since early September. These spreads have now reached an intermediate top and should retrace along with the USD and Yields during November.

Tips

The ratio of TIPs vs Treasuries has seen a nice bounce in September. It may retrace briefly into mid November as inflation anticipation ease. Following that, it should re-accelerate up towards year-end. On an absolute basis, TIPs are following Gold and other Bonds. They have just made an intermediate low and could bounce towards mid November. Following that, they should resume their downtrend towards early 2018.

Commodities

Oil
p 41

Oil corrected down early October and then extended up. We expect it to briefly retrace during the first half of November and then start moving up again towards late December / January. Price targets could reach into the high 60s on Brent, the mid 60s on WTI.

Industrial metals
p 14, 22

Industrial metals should consolidate at high levels, along with China until late November / early December, before they accelerate up again towards early next year.

Gold & PMs
p 22, 34

Gold and precious metals are reaching intermediate lows, following their retracement from the tops made early September. They should now make one last attempt to the upside over the next 2 to 3 weeks. We believe this should constitute a take profit opportunity on precious metals.

Agriculture

We still believe that Agricultural commodities are still the weaker commodity segment, probably into year-end at least.

Foreign Exchange

Dollar Index
p 31, 32, 33

Since early September, the USD has been bouncing. It is now reaching an intermediate top and should begin to retrace down into mid November. We would probably not expect new lows. Following that, the Dollar makes another attempt to the upside into December and possibly even February.

Euro
p 31, 32, 33, 37

The robust uptrend since last December on EUR/USD has been broken. Following its retracement since early September, it is currently approaching an intermediate low and could bounce for 2 to 3 weeks. Thereafter, it should resume down to December and then possibly February. EUR/JPY on the other hand seems to topping out and could retrace into November, while EUR/CHF may extend up a couple more weeks, yet seems exhausted.

Yen
p 36, 37

Following its September gains, the USD/JPY pushed a bit higher in October. We believe it has reached intermediate tops, and that it should now retrace for 2 to 3 weeks into November.

Sterling
p 35

The Pound still looks rather strong vs all other majors towards early next year. In the meantime, it has probably finished a consolidation to the downside vs the Dollar and is getting ready to move up again towards late November in first instance.

Oil & Commodities currencies

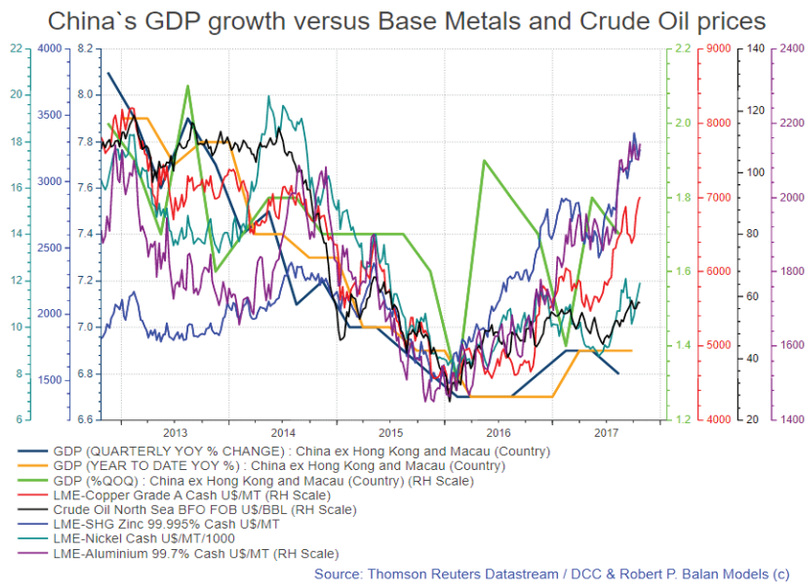
These corrected as planned during October, mostly on the back on a stronger Dollar. They should benefit from the retracement in the Dollar during early November. Following that, their performance should balance between a stronger Dollar and strong Commodities as the reflation trades re-accelerates towards year end.

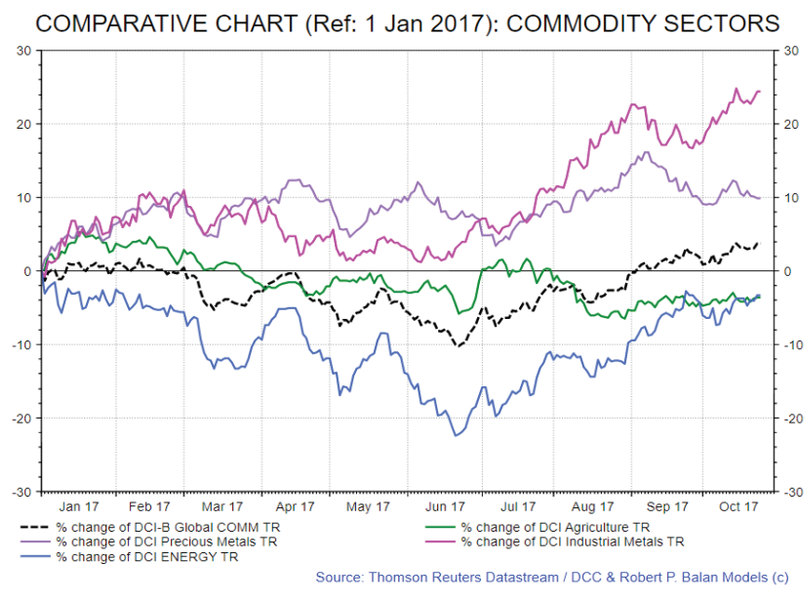
Asian currencies

INR, KRW or TWD have been strong vs the Dollar during October. These “Asian growth” currencies should remain strong vs the Dollar, probably towards late November, early December, before they weaken again towards early next year.

8 / China´s Communist Party Congress provided a strong boost for medium-term outlook in commodities

China represents (and comprises) the demand side of the fundamental equation for commodities as an asset class. With a circa 1.4 billion population (more than 18.5% of the world›s inhabitants), and a steady (although lately flat) economic growth, **China can make or break commodity prices. Recent history can provide proof: double-digit Chinese GDP growth in 2011-2012 boosted many industrial raw materials prices to all-time highs during the period. A deceleration in the Chinese economy in late 2015 and early 2016 caused the prices of these commodities to decline to multi-year lows**. As the country´s economic growth fell below the 7% level for the first time in many years, copper price fell to a low of $4342/MT in January 2016. Crude oil, abetted by copious Saudi Arabia output, also fell to $26.05/bbl in February 2016. At the same time, the Chinese domestic equity market moved to the downside as economic growth in the nation declined to the lowest level since 2010.





That was a severe takedown from an economy that hit a growth of almost 14.50% in 2008, just before the Great Financial Crisis. Apparently, China finally caught up with the maxim that it is a lot easier to achieve double-digit growth levels when the GDP is at a low level than when China´s economy has climbed to the world´s second largest. It became challenging for China to maintain a double-digit growth rate in a larger economy, and that became apparent in 2016 when GDP rose to almost $16.5 trillion, and GDP annual growth remained moored near 6.7%. The Chinese leadership recognized that fact, and in 2016, President Xi Jinping introduced a policy recognizing the «new normal» pertaining to the slowing growth rates. That set the stage for lower but stable rates of economic growth and expansion for the coming years.

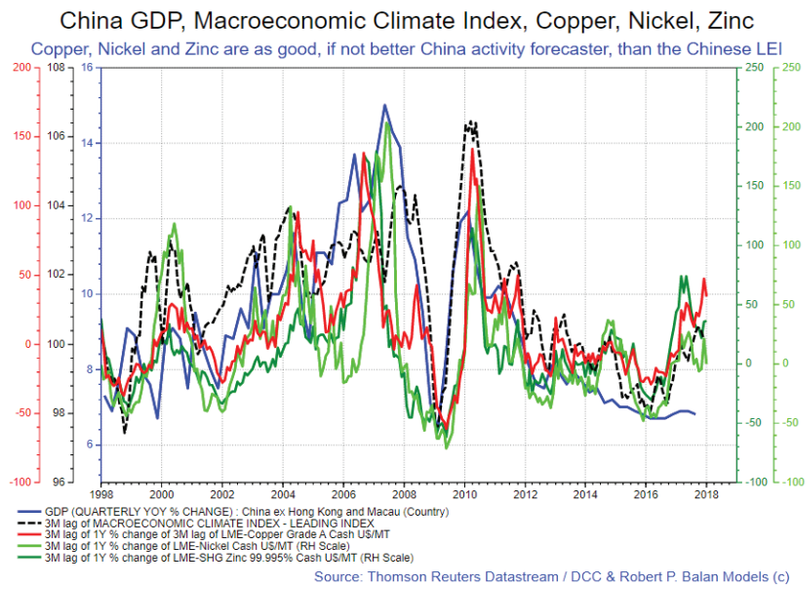
The Communist Party of China last week convened for the first time since 2012 to give President Xi another term as leader, appoint new leadership and set the future course of the nation. In the lead up to the Party Congress, many raw materials prices moved sharply to the upside when it became apparent that Mr. Xi would consolidate power further, meaning that China would remain on course for stable and steady growth over the next five years at least. Commodities markets take cues from events in China because of their huge consumption – and the resource markets saw the outcome of the CCP assembly as good news. And indeed, it was.

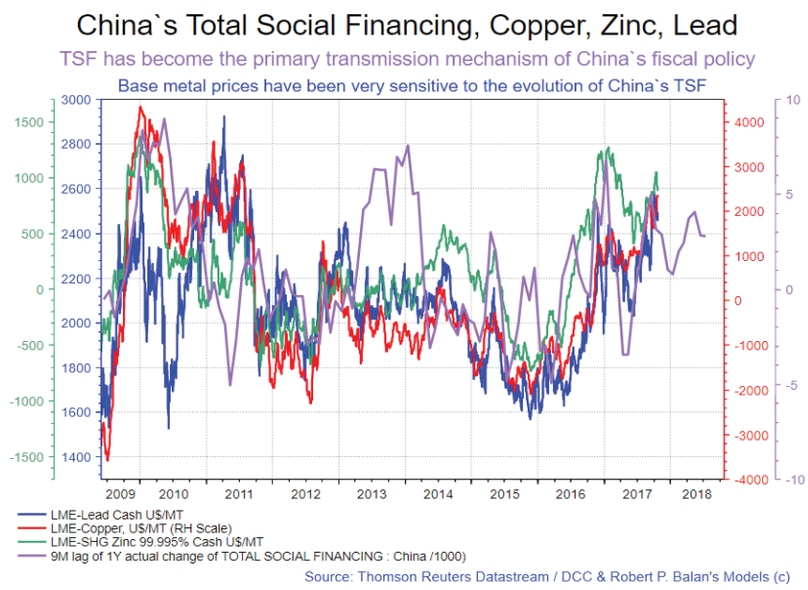
The positive jolt to the market came at a time when commodities have already risen off the lows in June in the wake of the reflation wave led by the recovery in oil prices. The oil recovery was accompanied by impressive gains in industrial resource materials -- base metals were up 24.42% as a sector through the first nine months of 2017, and some continue to go to higher levels as we come close to the end of October. The base metal sector, as testament to the Chinese Effect, has been the best performer in the general commodities asset class, followed by the precious metal sector. Base metals (DCIIMTR) outperformed the general commodity

index (DCI Global Commodity Index) 24.43% versus 1.5% year-to-date.

President Xi introduced several themes for approval of the Party (rubber-stamped approval, as it was), which he discussed for three hours. **He stressed (1) the welfare of the party before individualism, (2) promised to continue to root out corruption, (3) focused on reducing pollution, (4) raise living standards and expand the middle class, and (5) he called for a strengthening of the military to create world-class armed forces by the year 2050. The general theme of the CPP Congress was a continuation of President Xi´s «new normal» or slower but stable economic growth**. Xi has also been walking the talk, even before the Congress started. China cut back on production of many commodities, the process of which has responsible for poisoning the environment. The sharp rally in aluminium prices since early 2017 was due to Chinese cuts in output, especially from sub-standard smelters. China has also decided to go big on supporting electric automobiles. The government expedited the process of registering and documenting vehicles that run on electric power, while the processing of gasoline-powered vehicles took much longer.

There are downsides, when seen via the prism of values by observers in the West. President Xi´s warning that party comes first suggests that while some things in China may continue to change, the CPP will remain the primary force in the dictatorship. **It has become even clearer that Mr. Xi and other leaders in the CPP will never tolerate any political dissent. China´s hopes for the rise of a strong middle class is a reflection of the economics of the «new normal.»** The aspirations for a world-class military by 2050, is at the same time an admission that the current military force of China is not up to certain standards, and a declaration of intent which will invite the attention and focus of current military powers that are mostly located in the Western Hemisphere.





Nonetheless, the commodities market celebrates this year's Chinese Party Congress due to optimism that economic growth in the world´s second most prosperous and one of the fastest growing nations in the world, will remain steady. This is a complete reversal of the prevailing sentiment during the 2011-2015 period when the financial markets expected China´s economy to implode due to issues stemming from huge corporate debt overhang, and domestic capital flight triggered by fears of impending, large devaluation of the domestic currency, the Yuan. One pivotal industrial commodity which has become a bellwether for growth – Copper -- exploded to the highest price since 2014 in the days before the CPP Congress started, after copies of the manifestos started to appear in public, before the Congress that sets the political and economic course for China for the next five years. Copper is a commodity which often reflect for the outlook on the health of the global economy, earning the title as Doctor Copper, one with a Ph.D in economics. **More importantly, over past several years, the red metal has served as proxy for Chinese economic growth (outlook), see chart above. With the sharp rally before and during the CPP Congress, Doctor Copper gave the recent CPP manifestos explicit approval – the good doctor liked what it heard from the CPP Congress on the long-term outlook for Chinese growth.**

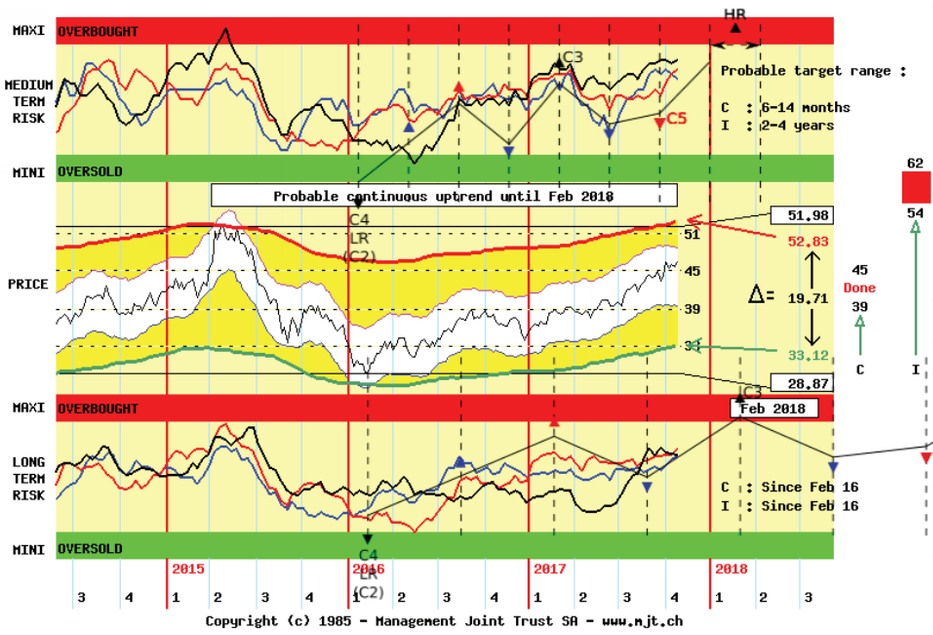
The euphony of Mr. Xi´s plans for China`s future has been pleasing for commodities, but in the final analysis, the nitty-gritty lies in the status of China-based leading short-term indicator for base metals. And that leading indicator is flashing somewhat red in the short-term. In line with our outlook for a short-term risk off environment in the financial markets, the TSF indicator (which leads base metals by 9 months), is indicating the possibility of a correction into December. **However, there seems to be a sound basis for another reflation wave into late Q2 2018. That synchronizes with the outlook we have been laying out at the Capital Observer – a seasonal, Christmas rally from early December, which may extend to late Q1-Q2 2018 for cyclical assets.**

11 / MJT - TIMING AND TACTICAL INSIGHT

China – the motor for reflation II is still humming

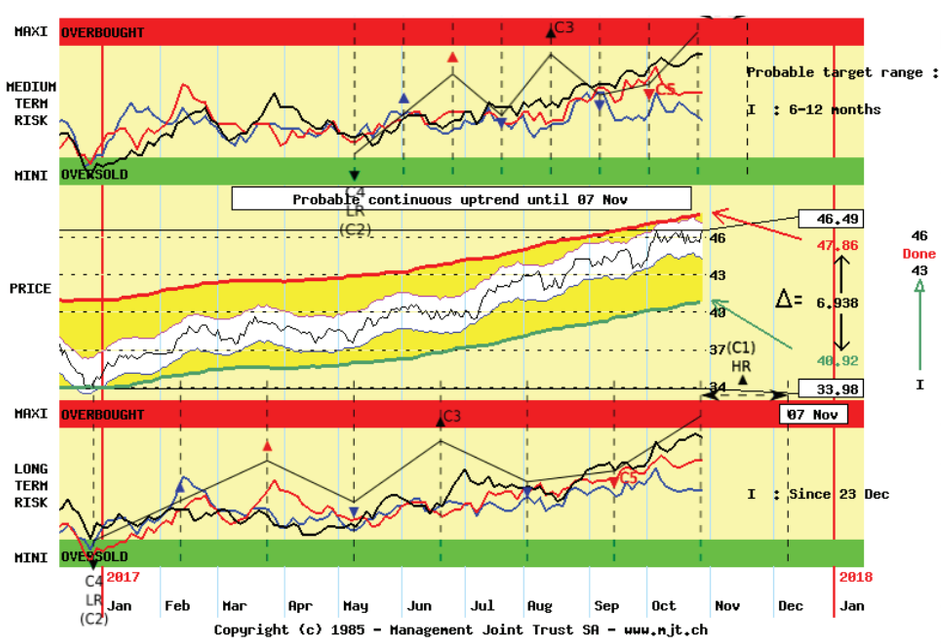
In our article late May, titled "Chinese Equities could outperform during H2 2017" we expected that Chinese Equities were bottoming out on both an absolute and relative basis and that they would be strong performers and out performers during H2 2017. At the time, we found further confirmation of this positive view on China in the Industrial Metals space, which we were seeing re-accelerating up from the early Summer towards early Q1 2018. These projections have proven correct and although we had expected these to happen on the backdrop of a weakening Yuan, the fact that the Yuan has actually strengthened only reaffirms the sustainability of the Chinese re-acceleration (strong equity market with a strong currency). We now review the Chinese theme in light of reflation II or the current cyclical push, which thanks to China is underway again since May.

FXI - iShares FTSE China 25 Index Fund
Weekly graph or the perspective over the next 2 to 4 quarters



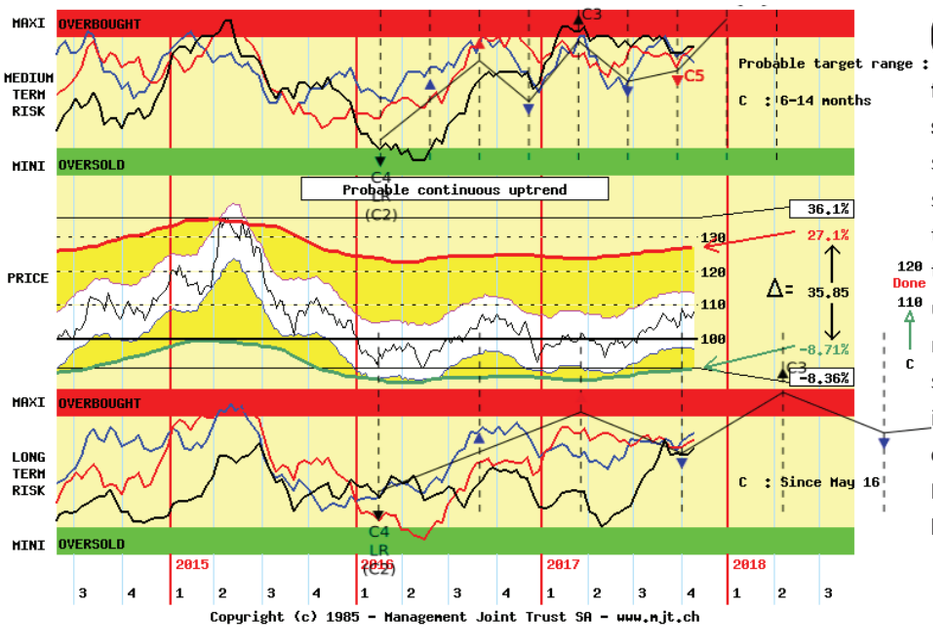
The Chinese market has been ploughing ahead since early 2016. **The outperformance of its large cap FXI ETF (in USD) is now plus 61% from the lows made early in 2016.** On both our oscillator series (lower and upper rectangles), **this uptrend is currently accelerating up again, probably towards late Q1 2018**. Our "C" Corrective targets up have now been taken out; our next level of targets "I" Impulsive targets up points to a **further potential towards the USD 54 -62 range or 15 to 35% above current levels** (right-hand scale).

FXI - iShares FTSE China 25 Index Fund
Daily graph or the perspective over the next 2 to 3 months



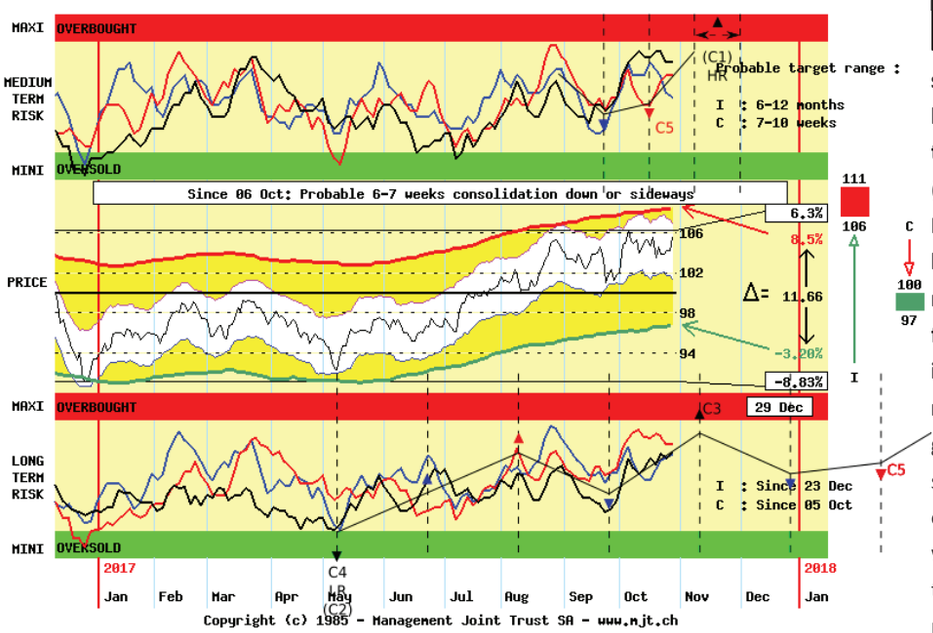
On our Daily graph, however, the current move up since last December does seem somewhat extended. Indeed, on both our oscillator series (lower and upper rectangles), the sequences we show are approaching High Risk situations during November. **Also, in terms of price targets, the move seems somewhat exhausted** with our 'I' Impulsive targets up having been achieved (right-hand scale). **These could trigger some consolidation towards December, before FXI accelerates up again into late Q1 2018 in line with the Weekly graph.**

FXI - iShares FTSE China 25 Index Fund vs ACWI - iShares MSCI ACWI Index Fund
Weekly graph or the perspective over the next 2 to 4 quarters



On a relative basis, China should also be outperforming world markets possibly until Spring next year as shown on both our oscillator series (lower and upper rectangles). From a relative price target perspective, the move up since early 2016 is still corrective ("C" targets to the upside"; right-hand scale), yet it would still justify **circa 10% outperformance potential for FXI vs the ACWI World markets ETF.**

FXI - iShares FTSE China 25 Index Fund vs ACWI - iShares MSCI ACWI Index Fund
Daily graph or the perspective over the next 2 to 3 months

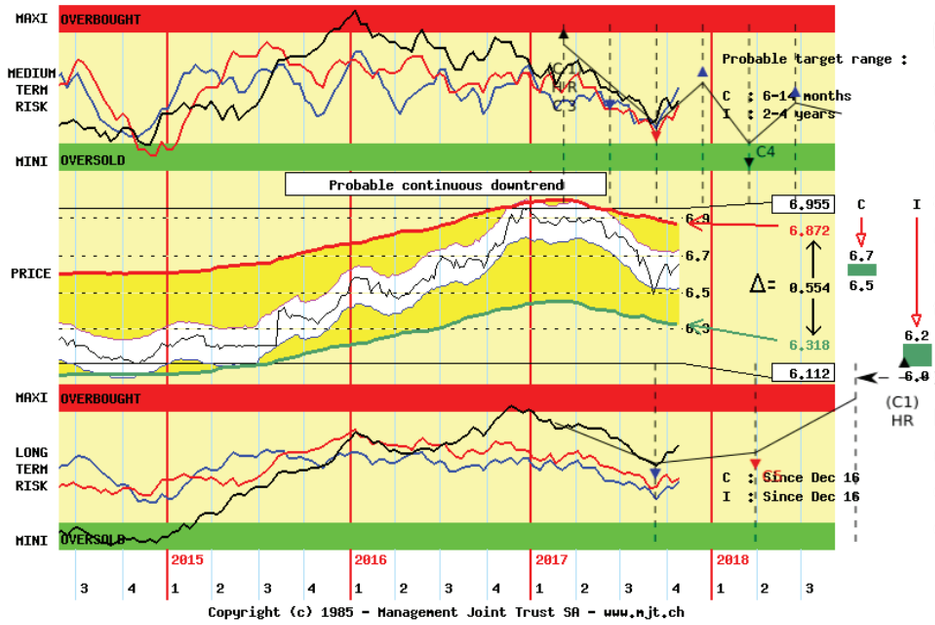


Looking at the same ratio on a daily basis, the oscillator sequences we show would lead us up to an intermediate top early / mid November (lower and upper rectangles). **Following that, FXI may consolidate vs the the ACWI world market ETF into December in first instance, before resuming its outperformance trend into next Spring.** From a price targets perspective (right-hand scale), risk /reward is neutral over the next couple of months with our "C" corrective targets to the upside, pretty much matching our "I" Impulsive targets to the upside.

Initial remarks

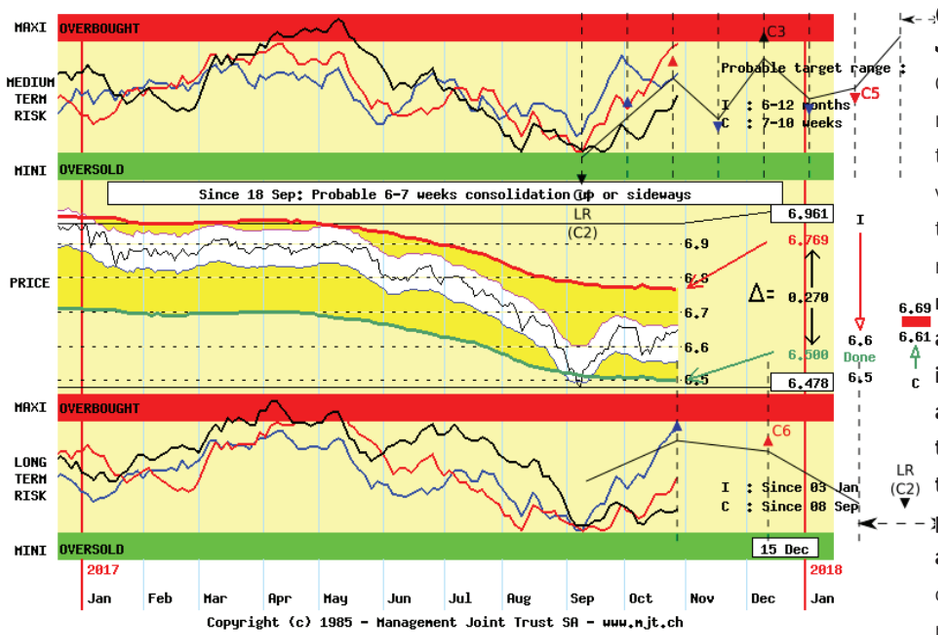
Chinese equity markets should continue to be strong performers towards late Q1, early Q2 next year both on an absolute and relative basis. Shorter term, they may enter a slight consolidation from early / mid November into December, before they start accelerating up again into 2018. From May, Chinese equities' outperformance has also been helped by a revaluation of the Chinese Yuan. The strong move lasted until early September, when reflationary assets and the US Dollar initiated their rebound.

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



On both our oscillators series (lower and upper rectangles), **the bounce of USD vs the Yuan may be only temporary. Indeed, we would expect a further retest down for the Dollar towards late Q1 2018, before it eventually turns up towards next Summer and late 2018**. Our "C" corrective targets down (right-hand scale) have pretty much held for now (6.5). Any move below that during Q1 2018 may open the door to the 6.2 – 6.0 range.

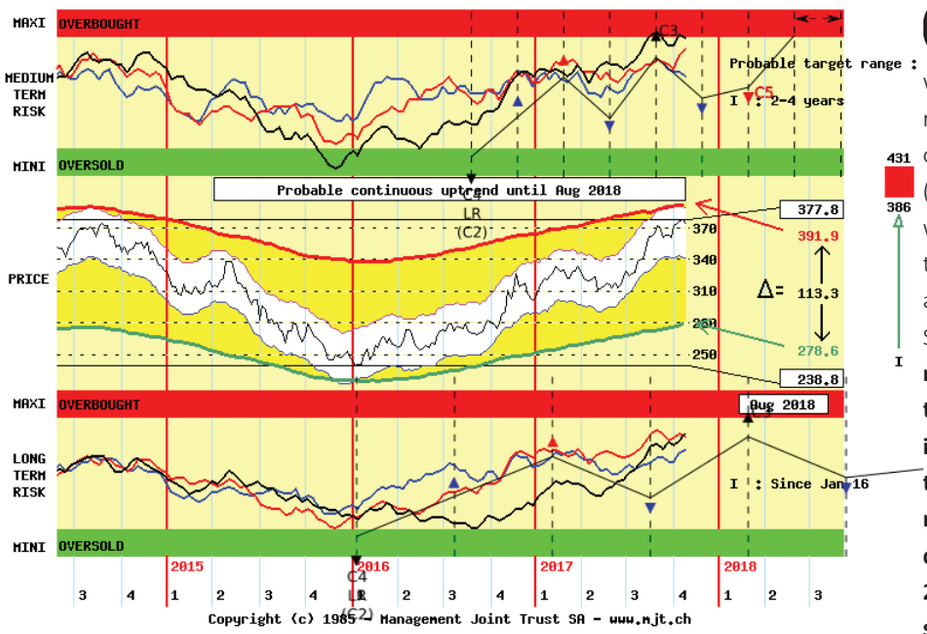
USD/CNY
Daily graph or the perspective over the next 2 to 3 months



Since risk assets re-accelerated early September and China and Industrial Metals made an intermediate top, the US Dollar has bounced vs the Yuan. On our medium term oscillator series (upper rectangle), **USD/CNY has now reached an intermediate top and may start to consolidate into mid November before a new bounce materialises towards December. Following that, we would probably expect the Yuan to strengthen again into Q1 2018** as shown on our long term oscillator series (lower rectangle). The "C" corrective targets up have been achieved. The "I" impulsive targets down may be re-tested somewhere between 6.6 and 6.5 (right-hand scale).

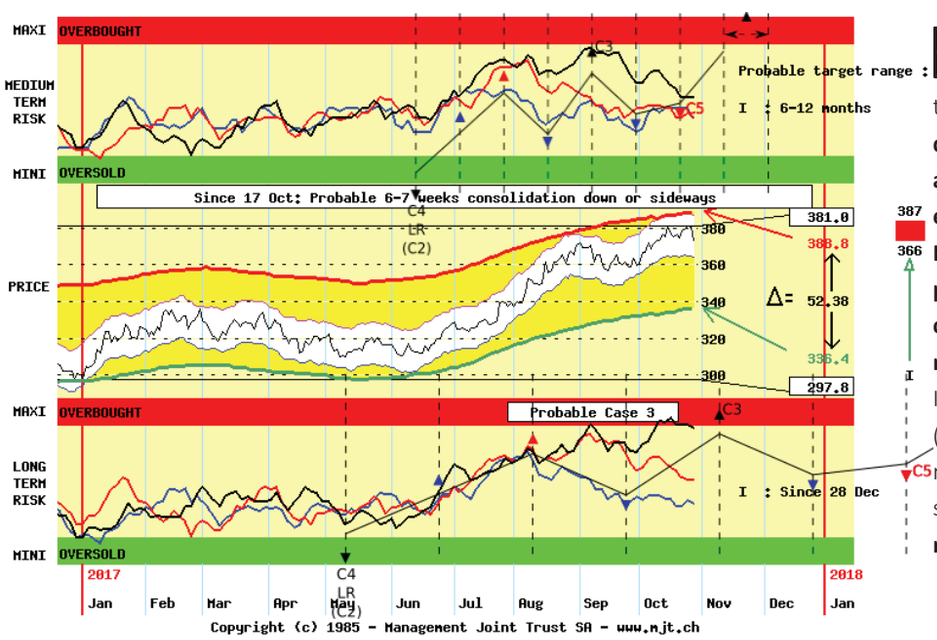
We now focus on Industrial Metals, which are very much linked to the health of the Chinese economy.

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



On our long term oscillator series (lower rectangle), we would expect them to continue up toward late Q1 2018. On our medium term oscillators (upper rectangle), however, we would expect some consolidation into December and then a further move up towards the Summer of 2018. **We would reconcile this by saying that the current acceleration may indeed take a breather over the next month or so, yet thereafter the trend is still heading higher, probably into Q2 2017. Price targets to the upside are slowly reaching their potential though (3 to 15% more upside into next year)** as shown by our I Impulsive targets up (right-hand scale).

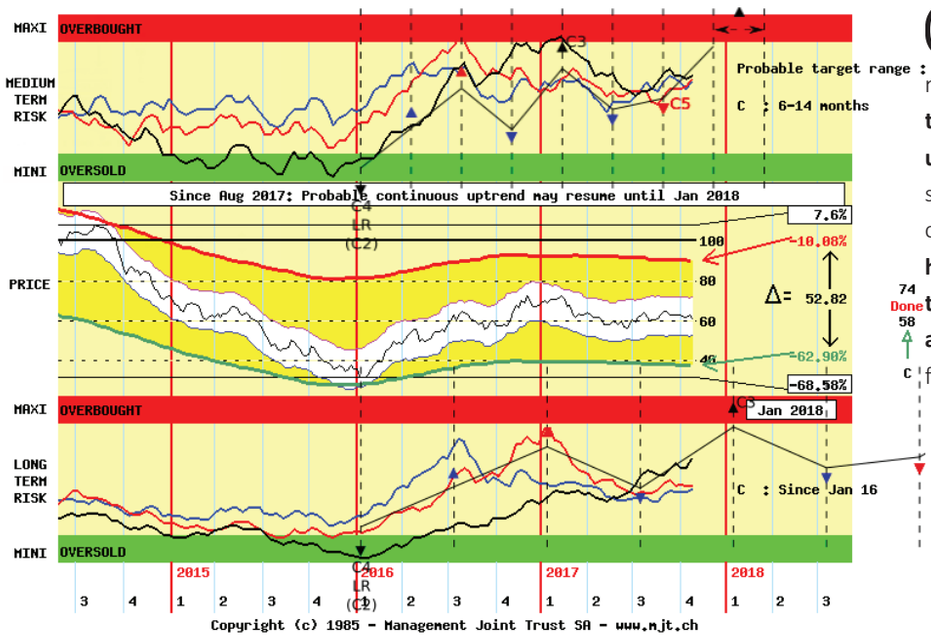
Goldman Sachs Industrial Metals Index
Daily graph or the perspective over the next 2 to 3 months



Both our oscillator series (lower and upper rectangle) on the Daily graph of **Industrial metals would suggest an intermediate top between early and late November. Following that, they should probably consolidate into December before a new move up materializes into Q1 2018**. "I" Impulsive targets to the upside (right-hand scale) have pretty much been achieved for now, so that **the potential up is limited at this stage.**

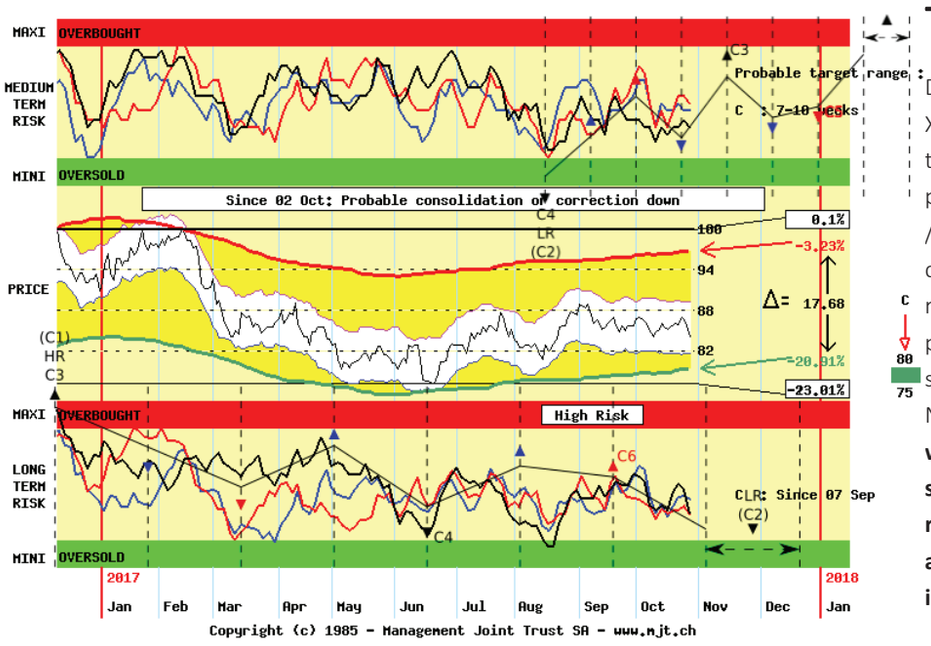
So with China and Industrials metals taking a breather, should we be worried about related sector trades (Materials and Diversified Mining in particular). We will consider these on a relative basis vs their reference Indexes in the US and Europe in an attempt to capture any cyclical acceleration.

XME - SPDR S&P Metals & Mining ETF / S&P 500
Weekly graph or the perspective over the next 2 to 4 quarters



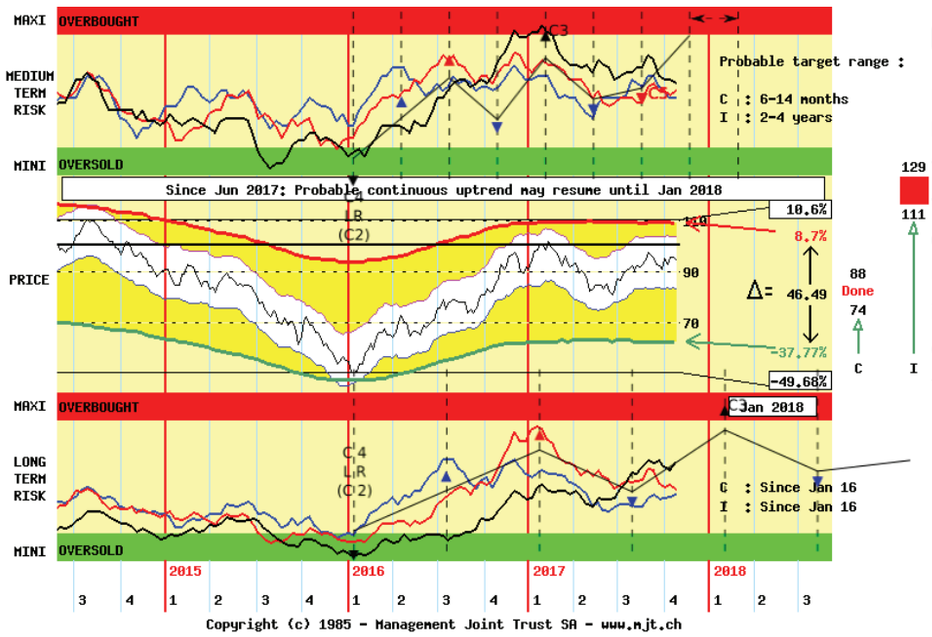
On both our oscillator series (lower and upper rectangles), **XME is still due to outperform the S&P500 until early 2018**. The ratio has stalled lately, yet we are still confident that **it may reach the higher end of its "C" corrective targets up (15% higher on a relative basis)** over the next few months (right hand scale).

XME - SPDR S&P Metals & Mining ETF / S&P 500
Daily graph or the perspective over the next 2 to 3 months



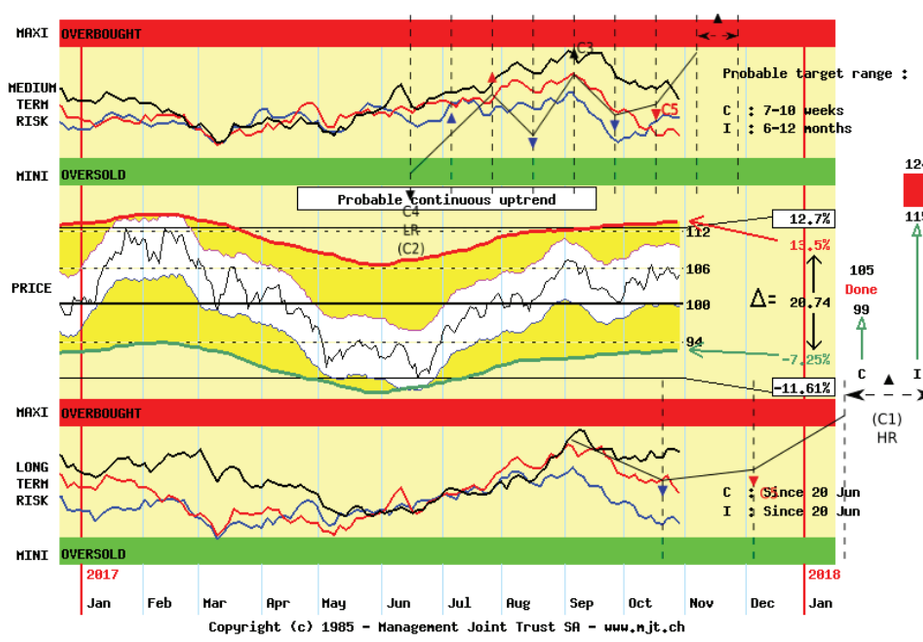
That said, considering our long term oscillators on this Daily graph (lower rectangle), XME may take bit more time to start accelerating up again, probably until late November / early December . Our medium term oscillators (upper rectangle) seem to be more positive, yet would still see some retracement towards late November. Combining both, **we would probably expect a slight underperformance during November, before XME accelerates up vs the S&P500 in December.**

BASIC RESOURCES - Dow Jones STOXX / Dow Jones STOXX Europe 600
Weekly graph or the perspective over the next 2 to 4 quarters



On both our oscillators series (lower and upper rectangles), **European Basic Resources are still on track to continue to outperform their benchmark index until early 2018**. The "I" Impulsive up outperformance potential is important (above 20%), if it can be achieved in such a short time period (3 to 4 months).

BASIC RESOURCES - Dow Jones STOXX / Dow Jones STOXX Europe 600
Daily graph or the perspective over the next 2 to 3 months



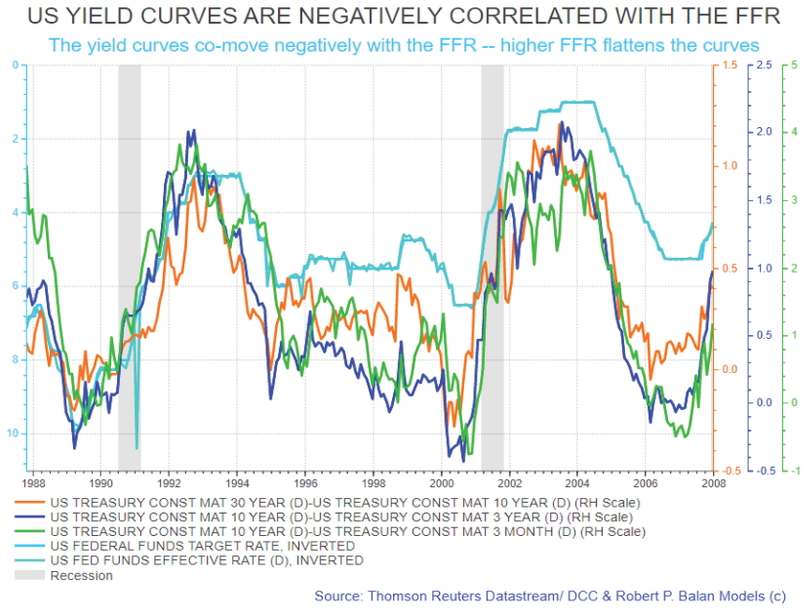
European Basic Materials made an intermediate top vs their benchmark index in early September. **On our medium term oscillators (upper rectangle), they are trying to accelerate up again on a relative basis, probably until mid November. As shown on our long term oscillators (lower rectangle) a further period of retracement may still materialise early December before they move up gain towards early 2018. The relative price potential up is still very interesting, potentially up to 15% (right-hand scale).**

Concluding remarks

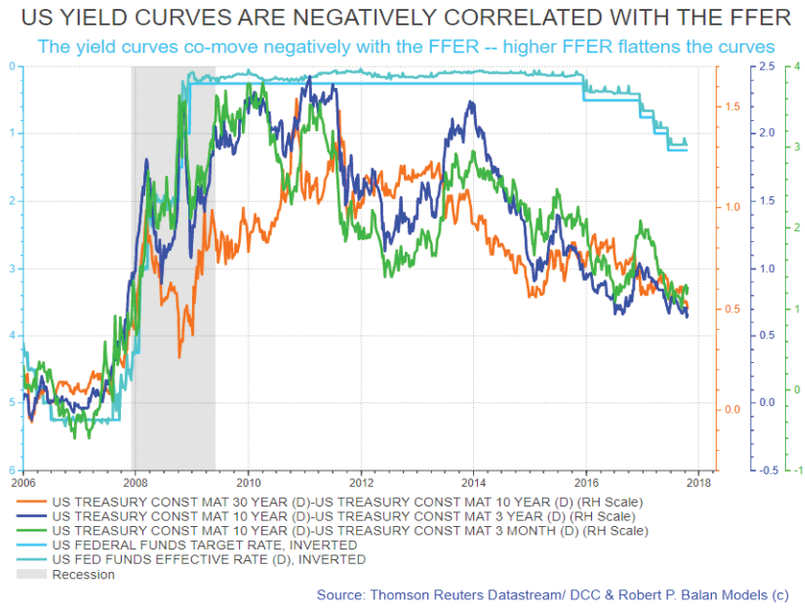
China, Industrial Metals and related sectors (Diversified Mining) are still on track to outperform until early 2018. These trades may consolidate some during November and more patience is probably required to really capture this outperformance. Indeed, the acceleration may be quite short lived, possibly from early December into late January 2018.

17 / Looking at the historical dynamic of the yield curve, it may be too early for a significant structural steepening.

Some investors have been betting on the yield curve steepening soon, and it has proved to be one of the most vexing conundrum for some money managers. There has been a lot of reason offered why the yield curves should steepen, but those rationalizations fail to take into consideration what appears to be an immutable relationship – **rising policy rates tends to be accompanied by flattening of the yield curves, and vice versa. Once this is understood, the co-called conundrum of flattening of the curves become no mystery at all**. The first graph on this page shows yield curves and the Fed Funds Rate before 2008, and the second graph, shows the yield curves, the FFR and Fed Funds Effective Rate since then. Both illustrate the negative correlation between the FFR and the yield curves.



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



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

Narratives about yield curves can become dense very quickly, but stay with us, as what eventually happens to the yield curves (and what made these curves do **what they do) could become a central issue to the next financial crisis. The core of the issue is that many investors believe that the US yields can only go one way – steepen – but that is problematic if one believes that the global central banks are going to tighten from here on. It is over-dramatic to label yield steepening trades as misplaced positions, but not by much, in our opinion**. There is news about a large macro hedge fund in London launching a new fund set up to bet on a steepening yield curve. Prior to this news, we have not heard of any hedge funds setting up single purpose vehicles to bet on a steepening of the yield curve.

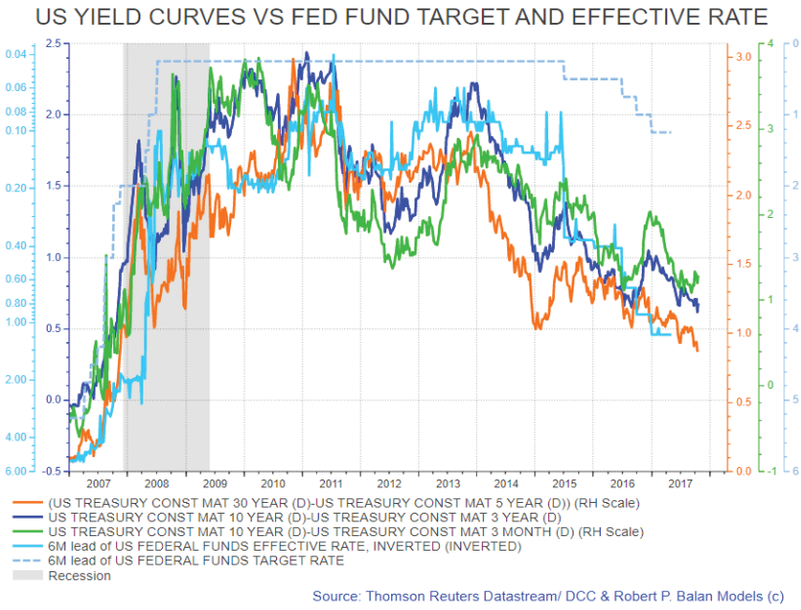
There has been no shortage of financial commentators warning us of imminent repeat of the 2008 Great Financial Crisis episode, or hedge fund monthly letters to investors cautioning of end-of-the-world deflationary collapse (and solicitation for corresponding funds to profit from this "inevitable event".) Many hedge funds were advocating hiding in long-dated sovereign paper, yet there were fewer warnings about inflation, which is the tack that the large London hedge fund is taking. News reports describing the new fund say the strategy is to bet on both a steepening of the US yield curve and an increase in curve volatility. Global central bank interest rate policy and their government bond buying programs have combined to both flatten the curve and reduce volatility. But the new fund is betting that all that will go in reverse as central banks shrink their balance sheets (and/or raise policy rates) and as uncertainty over the leadership of the Fed intensifies. However, **we are not sure whether those mechanisms will produce the correct market response, which will make the steepening trades profitable. The empirical evidence shows otherwise**.

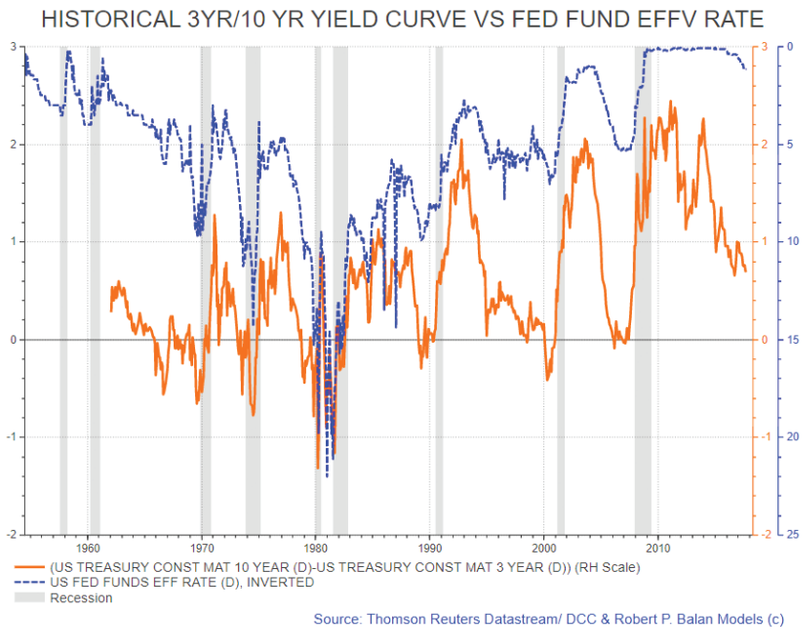
And, so far, yield curve steepening predictions have brought nothing but a world of pain. Quantitative Easing was first implemented in November 2008, triggering a scare that it would cause run-away inflation, pushing up yields higher (and steepening the curves) until 2010. **Since then, the**

long yield curves have been steadily flattening; e.g., the 5yr-yield has risen on relative basis, while the 30-year yield has declined. The facile explanation is of course the impact of inflation term premium on the bond yields, but the reality was that declining policy rate steepened the yield curve, and the opposite action (tightening policy rate) has flattened the 5y/30yr yield curve, as well as the short-term ones. Yes, tighter policy, or raising the Fed Funds Rate, will flatten the yield curves.

But what does this signify? Financial observers bearish on the economy often use the flattening of the yield curve as a sign that the economy is about to go into recession. While there are elements of truth in this observation, it is not that simple to exploit this knowledge. Let us extrapolate the picture as far as the data provides (see 2nd graph on this page) so we can see the nuances of this observation. Recessions period are indicated by grey bands.

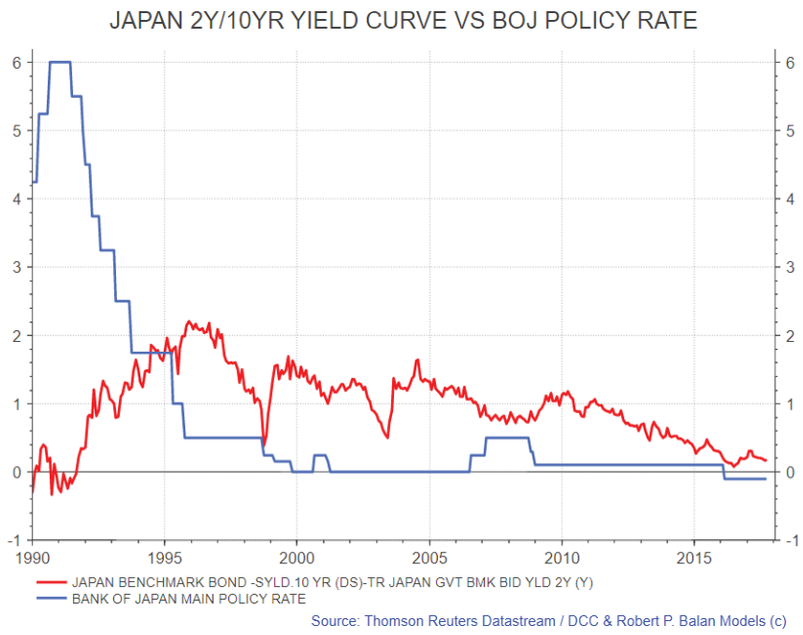
Over the past few decades, we can see a recurring pattern -- the yield curve flattens as the Fed tightens, until the yield spread reaches 0%, then a recession ensues. However, by the time a recession is officially recognized and dated, the yield curve has already been screaming wider (and steepening like mad), accompanied by frantic efforts by the Fed to cut policy rates as fast as they could. This steepening mechanism is not what we face in the immediate future, which is characterized by global central banks tightening policy rates (or wanting to) – all yield flatteners. So this raises all sorts of questions for yield curve steepener bulls – the conditions need to steepen the yield curves are simply not there. **To arrive at the conditions conducive to steepening, the central banks first have to tighten monetary policy to a point where growth is choked and recession ensues**. But we are hardly at the first step of that process in the US, and nowhere near the initial stage in the case of the eurozone and Japan. The problem faced by steepener bulls at this point is correct timing -- and our opinion is that we are way, way off that stage yet. With global central banks wanting to tighten policy (with various degrees of conviction), the immediate outlook is for more flattening of the US yield curves (and other global yield curves as well).





We expect counter-arguments, saying that it may be different this time. The humungous pile of QE throughout the globe may have distorted bond yields and yield curves, and have make previously reliable signals, well, unreliable. **However, it is rarely that different. Fourteen of the 17 recessions since WW2 have all been accompanied by inversion of the yield curve or the spread having gone to zero or even negative. We concede that the flattening of the curve this time around came from very wide levels, so there may be no actual spread narrowing to zero or sub-zero levels**. But it may not matter, especially for early proponents of steepener trades – these trades are too early, given the predilection of the central banks at this stage, and given that the specific mechanisms which will produce steepening of the yield curves are not there.

The Japanese Quantitative Easing program situation is a good study in this regard. The Bank of Japan was a decade ahead of any other central bank in implementing QE to cope up with deflation. The BoJ has embarked in so much stimulus and for so long that it has reached a point where the JGB yield curve has stopped providing clear signals. Nonetheless, the JGB market has not imploded, contrary to what some hedge funds have speculated about (and lost) -- for the longest time, it was (and remains) one of the best performing bond markets in the world. So maybe the US yield curve will experience the same sort of decade-long spiral lower as the spread continues to narrow. **A flattening of the yield curve down to 0% could even be possible too. And that may be the trigger for a recession**. But with rates practically zero-bound, the Fed has little leeway cutting rates, so the only option left to the Fed is further Quantitative Easing. That is one way of saying that we are back to Square One, and in terms of yield curve profiles, the flattening continues or resumes. There is very little consolation for curve steepener bulls from this, and other then steepening of short term nature that could happen we envisage in the near-term (like early 2015 or late 2016). Our Conclusion – it is too early to be heavily positioned for on a structural sustained steepening of the US yield curve.

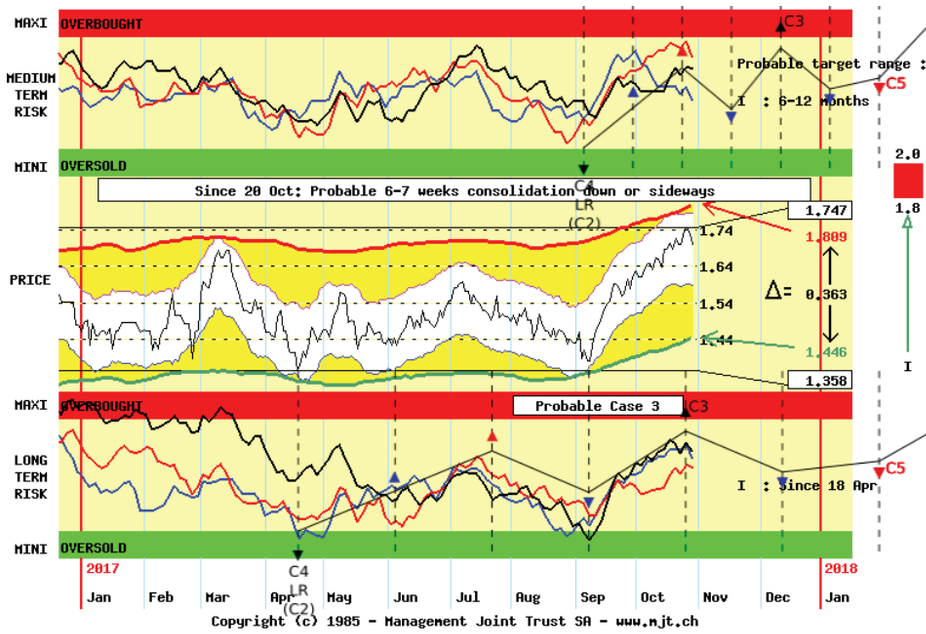


20 / MJT - TIMING AND TACTICAL INSIGHT

The Yield Curve is still flattening, yet a short term bounce may materialise from late November into early 2018

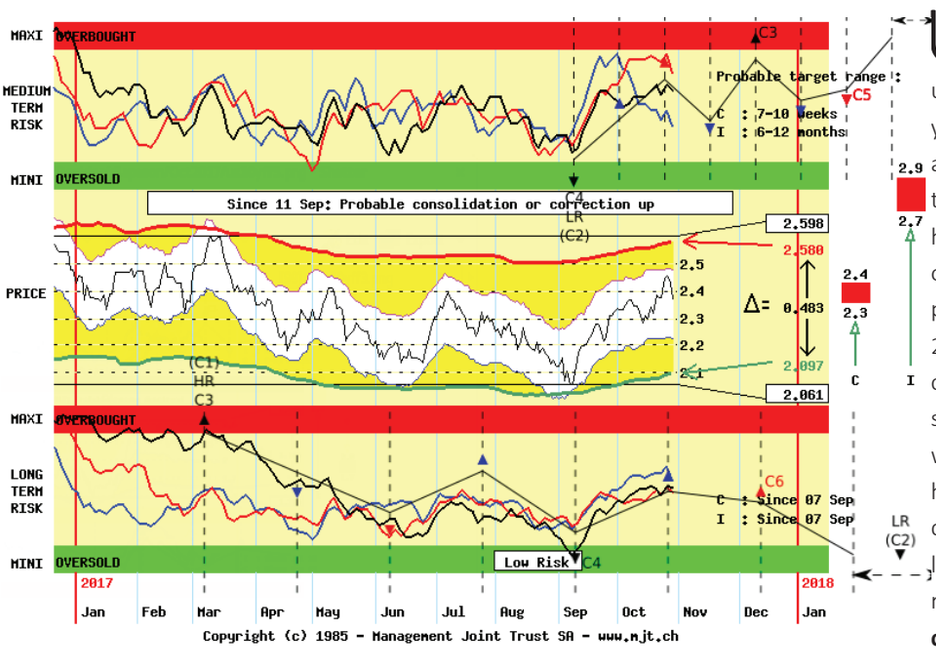
With US 3 Year Treasury yields at year-to-date highs and the US 10Y close to 2.5%, it seems that the reflation theme is back in full force. Indeed, the acceleration up in yields over the last 2 months is impressive and it was accompanied by similar moves in the Dollar, Equity Markets and Oil. We believe this is a good time to pause and reconsider. In this article, we will focus on yields, the yield curve and the internal structure of the market.

US 3 years Benchmark Bond Yield
Daily Graph or the perspective over the next 2 to 3 months



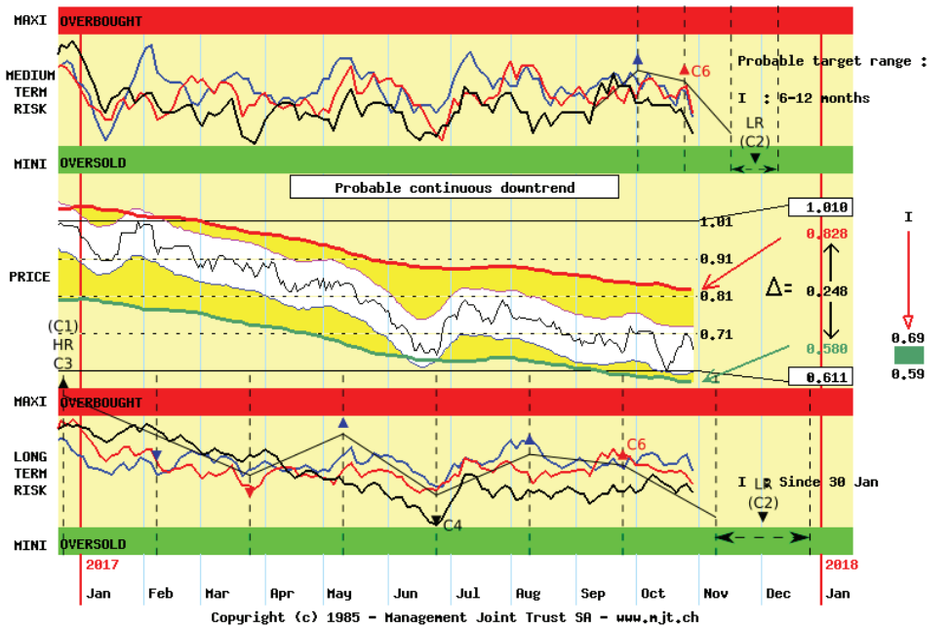
US 3Y Treasury yields just made new year-to-date highs. Apart from this Spring, these levels have not been seen since the early stages of the recovery in mid 2009. The rally has been impressive and on both our oscillators series (lower and upper rectangles), **US 3Y Treasury Yields have probably just made intermediate tops**. The oscillator sequences we project suggest between 3 to 6 weeks of consolidation to the downside or towards a period which ranges between mid November and early December. Following that, our "I" Impulsive targets up (right-hand scale) would suggest further upside just below 2.0%. Yet, in the meantime**, we could await a worthwhile correction that may amount to between 0.5 to 0.8 times our historical volatility measure delta (0.363; middle rectangle; right-hand side) or between 18 and 29 bps.**

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



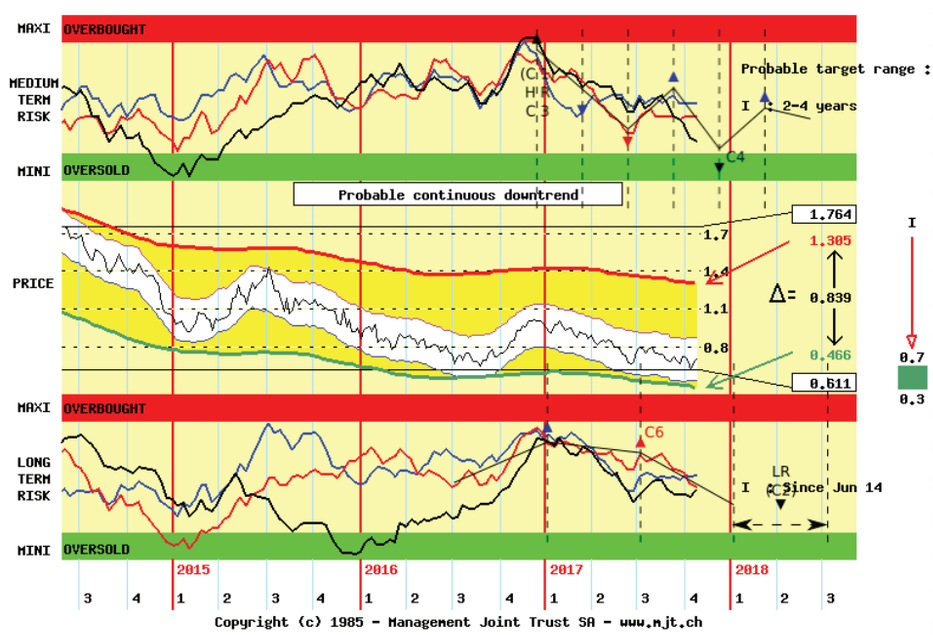
US 10Y Treasury Yields also saw a strong move to the upside. It fell short of new year-to-date highs, yet inched above our "C" Corrective targets to the upside (right-hand scale), which potentially opens the door to our "I" Impulsive targets up towards the 2.7 – 2.9 range. Before we can consider these, we first expect some retracement. Indeed, as with the US3Y yields, US10Y has now reached intermediate tops on both our oscillator series (lower and upper rectangles). **The correction could last into mid/late November** (our medium term oscillators; upper rectangle) and in worst cases extend towards year-end on our long term oscillators (lower rectangle). **Given our current measure of historical volatility delta (0.483; middle rectangle; right-hand side), US10Y may now retrace between 29 and 38 bps, or 0.5 to 0.8 times delta, i.e. in a worst-case scenario US10Y may even retest its September lows.**

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



The bounce in US Treasury Yields since September has had little impact on the yield curve. As we mentioned in our last newsletter, it is still in a downtrend for now, and on both our oscillator series (lower and upper rectangles), **the downward pressure may resume until mid November / early December.** Our "I" Impulsive targets down (right-hand scale) have almost been reached, **yet in a worse-case scenario, the curve could flatten a further 10 bps. Our view is that such an extension to the downside may create the Oversold conditions that may trigger a 2 to 3 months bounce into early 2018.**

US 10 years Benchmark Bond Yield - US 3 years Benchmark Bond Yield Weekly Graph or the perspective over the next 2 to 4 quarters



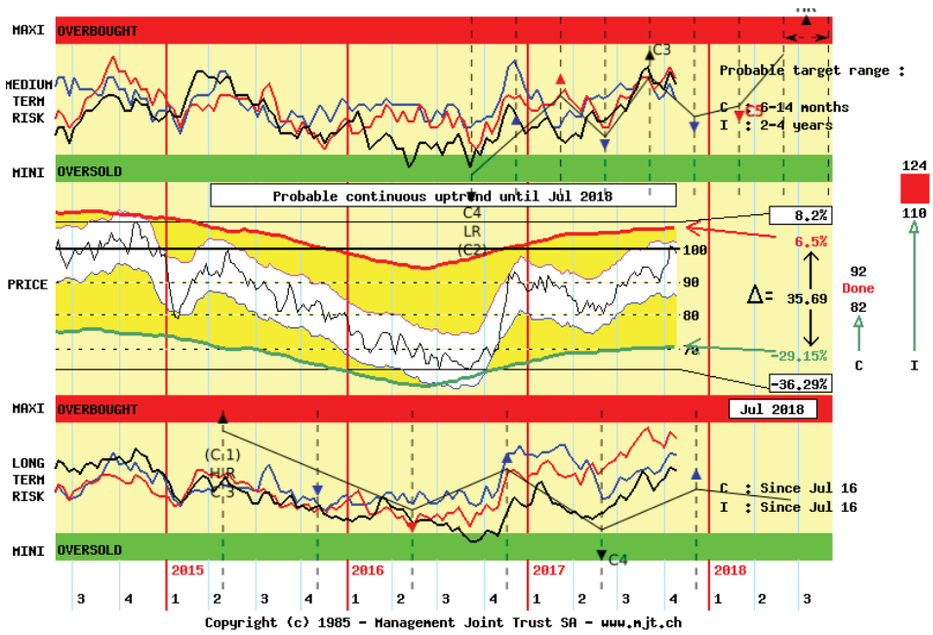
Considering the same spread on a Weekly graph, we can note that the downward pressure is still there on both our oscillator series. Our long term oscillators (lower rectangle) would suggest further downside into early 2018, while **our medium term oscillators (upper rectangle) are pointing to an intermediate low (and the possibility to initiate a bounce) sometime in the second half of Q4 this year.** This second scenario is closer to our analysis on the Daily graph above. From a price targets perspective, the spread has now reached the range of its "I" Impulsive targets down (right-hand scale), yet nothing on the graph for now prevents the Yield Curve to flatten again later in 2018, possibly towards 0.3%.

Initial remarks

The projections above may sound quite pessimistic for yields and the yield curve over the next few weeks. Yet, from our analysis, the Yield Curve is still flattening and given the current environment, we find it difficult to justify it could continue to do so without some downward pressure on both the US3Y and US10Y. That said, the scope may be limited to our less aggressive targets, or towards the levels last seen in the second half of September.

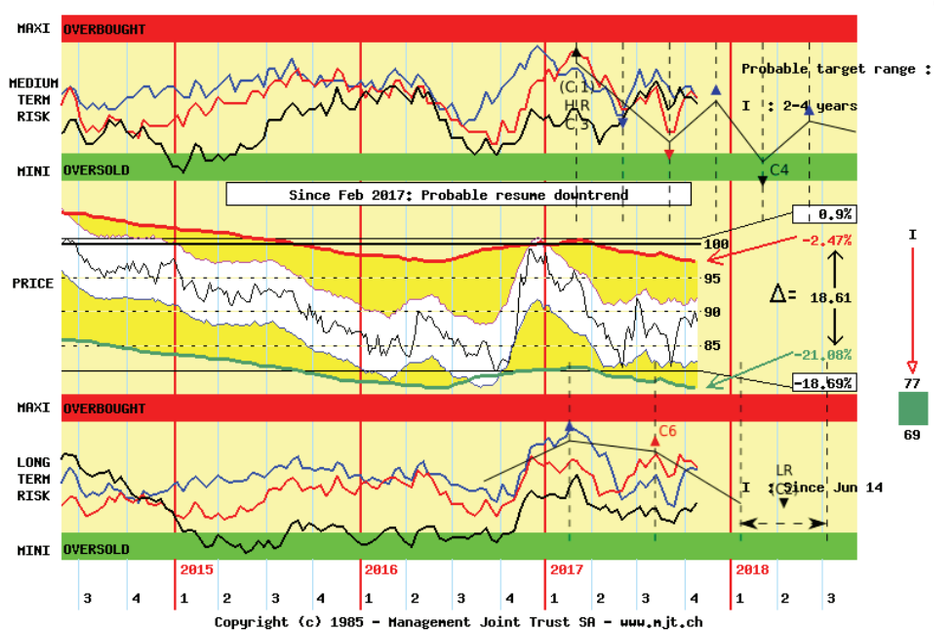
Over the following pages, we will review related trades and ratios in order to confirm this view.

Copper Spot (USD, LME) / Gold Spot (USD)
Weekly Graph or the perspective over the next 2 to 4 quarters



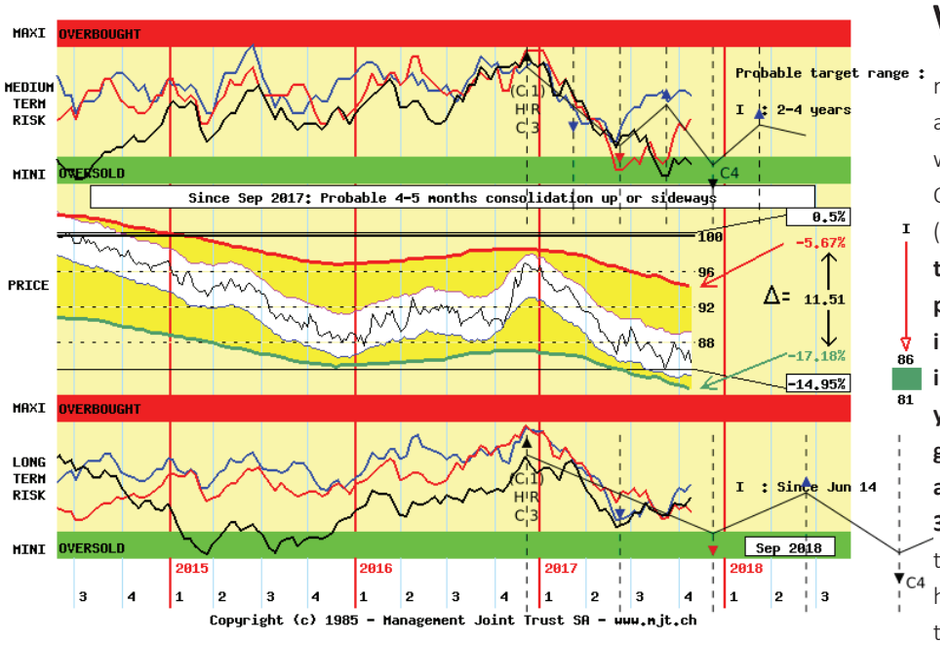
Lately, this ratio has been heavily advertised by Jeff Gundlach, a famous guru bond manager, as a reason for why the Yield Curve should steepen again soon and quite aggressively. Indeed, over the last 10 years, this ratio and the Yield Curve have advanced quite synchronously. Yet, over the last 6 months, while the ratio has re-accelerated up, the yield curve has flattened further. Mr Gundlach's opinion is that the Yield Curve should now be starting to catch up. From what we can analyse on both our oscillators series (lower and upper rectangles), the ratio is probably still heading up towards next year. That said, on our medium term oscillators (upper rectangles), **it seems to have reached an intermediate top. The ratio should now retrace into mid / late Q4**. In our view, over the next month or so, it's the Copper/Gold ratio that should be moving lower in the direction of the yield spread, not the opposite.

XLF - Financial Sector SPDR Fund / QQQ – PowerShares Nasdaq 100 ETF
Weekly Graph or the perspective over the next 2 to 4 quarters



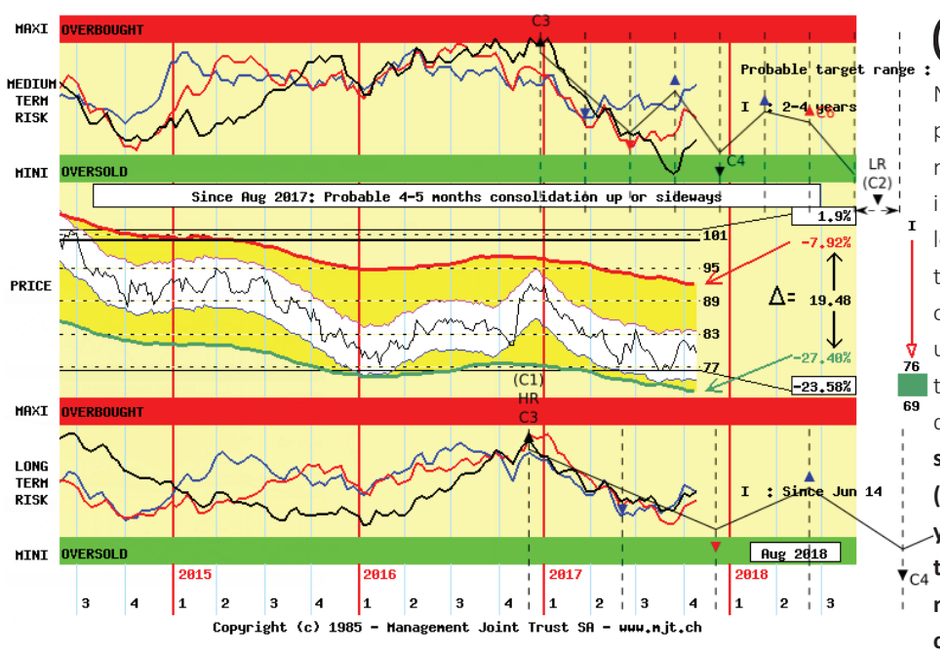
Building on the analysis above, we wanted to propose our own proxy for the yield curve. Last year, the rapid re-rating of inflation expectation (reflation I) triggered a rapid and substantial revaluation of the Financial sector. Indeed, **Financials are the ultimate short duration trade** (they pay short term interest rates and lend out long ones), **while the Nasdaq with its Big Tech heavyweights is typical of long duration equity profiles. Looking at the history of the ratio, it mirrors the yield spread quite well (with a slightly more negative twist). Currently, it is indeed quite negative and also volatile**: both our oscillator series (lower and upper rectangles) would suggest more downside pressure into Q1 2018 at least. It is also interesting to note that the latest rally has not been able to break above the one made in June, never-mind the one made in Q4 last year. This seems to proxy the loss of momentum in the reflation trade.

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



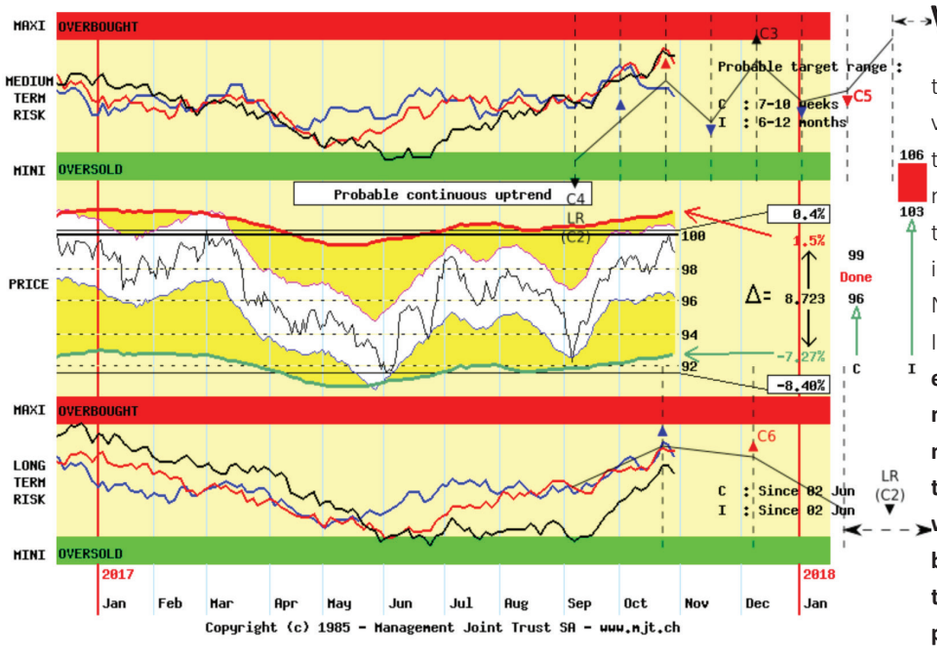
We now turn to the wider Value to Growth relationship, which is usually also very much correlated with the yield curve spread. On both our oscillator series (lower and upper rectangles), **the downtrends are still in place. Yet, they could reach an intermediate low sometime in the second half of Q4 this year. Such lows on a Weekly graph are usually followed by a bounce that could last 2 to 3 months**. Our "I" Impulsive targets to the downside (right-hand scale) had previously been touched in early September, so that **the downtrend is relatively exhausted for now**.

IWM - iShares Russell 2000 ETF / QQQ – PowerShares Nasdaq 100 ETF
Weekly Graph or the perspective over the next 2 to 4 quarters



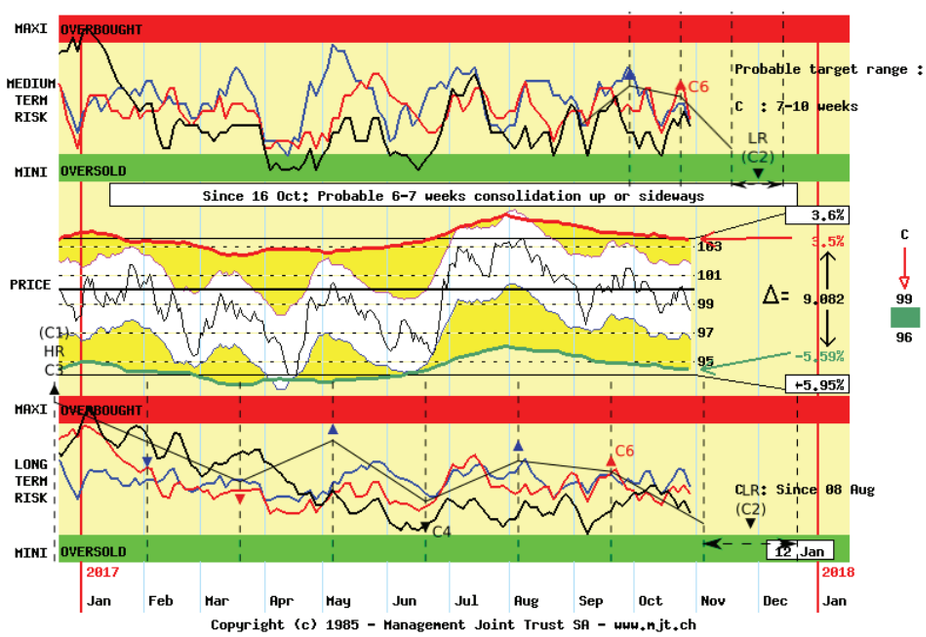
Comparing the Russel 2000 Small Cap Index to the Nasdaq also delivers a similar picture. Indeed, small caps are relatively immune to rises in interest rates as they are usually less levered that large caps, they are also more cyclical, and on a relative basis, they are usually less impacted by rises in the US Dollar as they are more domestic. **Both our oscillators series are still in a downtrend (lower and upper rectangles), yet both would also suggest that an intermediate low may materialise in the second half of Q4 2017. It could trigger a 2 to 3 months bounce.**

XLF - Financial Sector SPDR Fund / SPY - SPDR S&P 500
Daily Graph or the perspective over the next 2 to 3 months



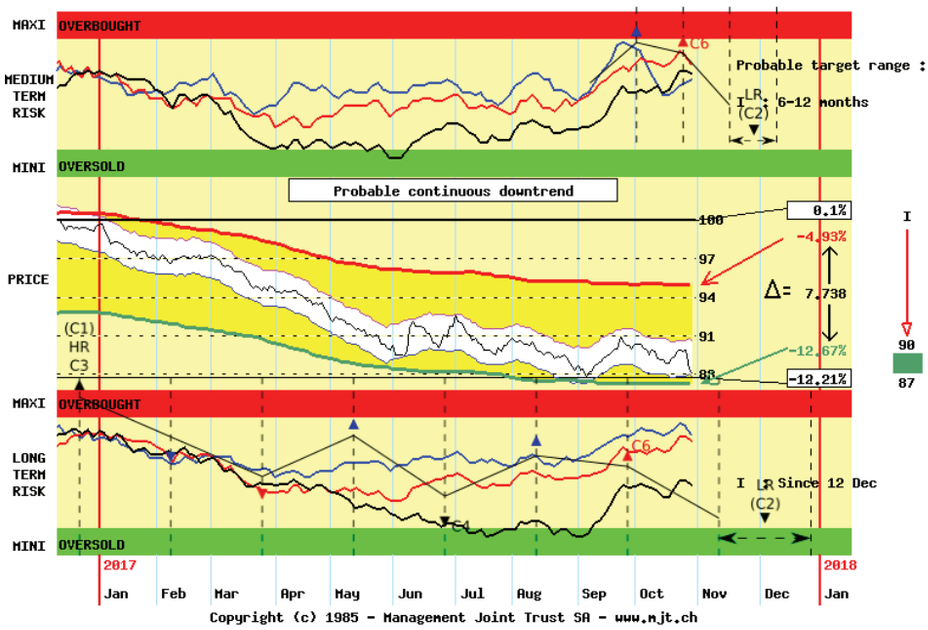
We now move to a shorter time frame and look at the Daily graph of US Financials vs the S&P500. On our medium term oscillator series (upper rectangle), we map a continuation of the uptrend initiated in early September, from late November to early next year. In the meantime, **we would expect some retracement into mid November**. That said, **if by mid December, the ratio fails to break-out to new highs, it will probably imply that the bounce would have lived and that a new period of underperformance towards early next year lies ahead.** This more negative scenario is shown on our long term oscillators (lower rectangle). **Given this uncertainty, and the retracement in outperformance we expect over the next few weeks, it may be an opportunistic time to underweight US Financials.**

BANK - Dow Jones STOXX / Dow Jones STOXX Europe 600
Daily Graph or the perspective over the next 2 to 3 months



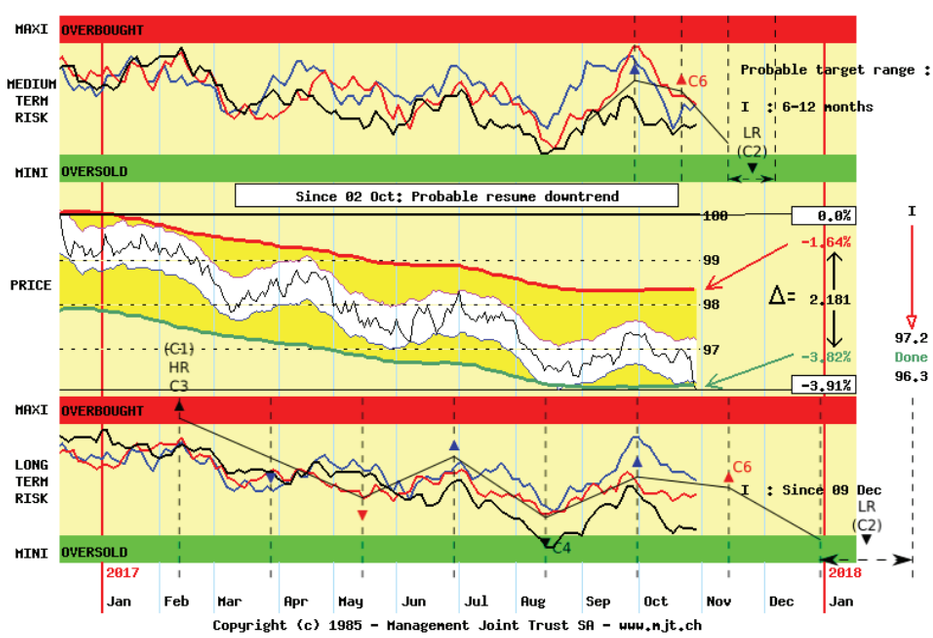
European Banks also seem quite weak vs the Europe STOXX 600. They topped out in August and have since been making lower highs. On both our oscillator series (lower and upper rectangles), they are now resuming their downtrends. **Further underperformance is expected into mid / late November.**

IVE - iShares S&P 500 Value ETF / IVW - iShares S&P 500 Growth ETF
Daily Graph or the perspective over the next 2 to 3 months



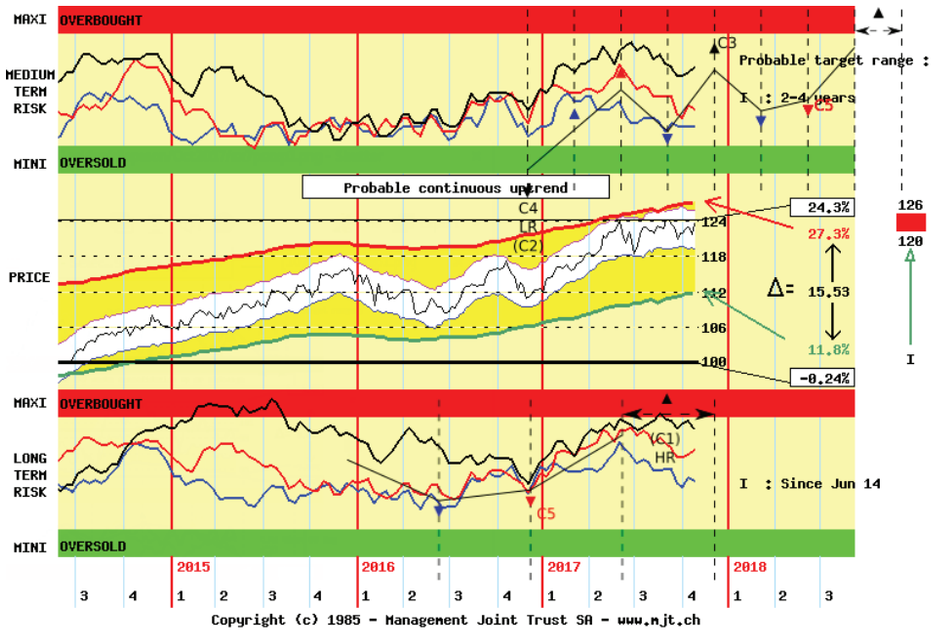
The Value to Growth relationship within the S&P500 is also retesting to the downside and it is currently approaching its September lows. On both our oscillator series (upper and lower rectangles), it is still in downtrend situations, which should lead to **further underperformance of Value vs Growth probably into mid/late November.**

RSP - Guggenheim S&P 500 Equal Weight ETF / SPY - SPDR S&P 500
Daily Graph or the perspective over the next 2 to 3 months



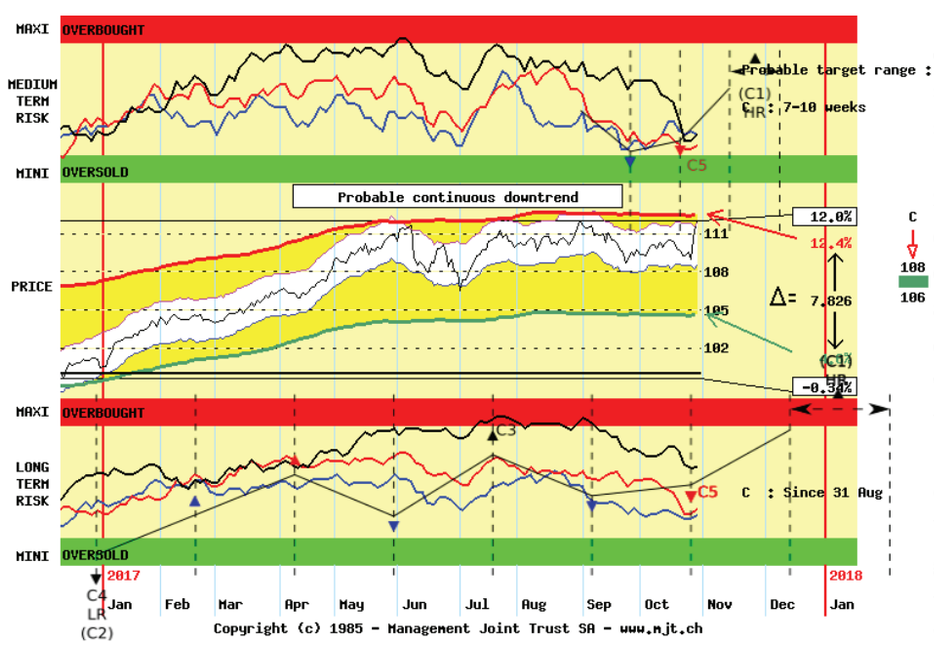
Finally, we look at breadth within the S&P500 Index by comparing the S&P500 equal weighted RSP ETF vs the S&P500 SPDR ETF (which is cap. weighted and tracks the S&P500 Index). The situation is quite extreme as **the ratio is already making YTD lows again, following steady underperformance throughout the year.** On our long term oscillators (lower rectangle), the downtrend may even extend into early next year. That said, our medium term oscillators (upper rectangle) point to **a potential low in mid/late November.**

QQQ – PowerShares Nasdaq 100 ETF / SPY - SPDR S&P 500
Weekly Graph or the perspective over the next 2 to 4 quarters



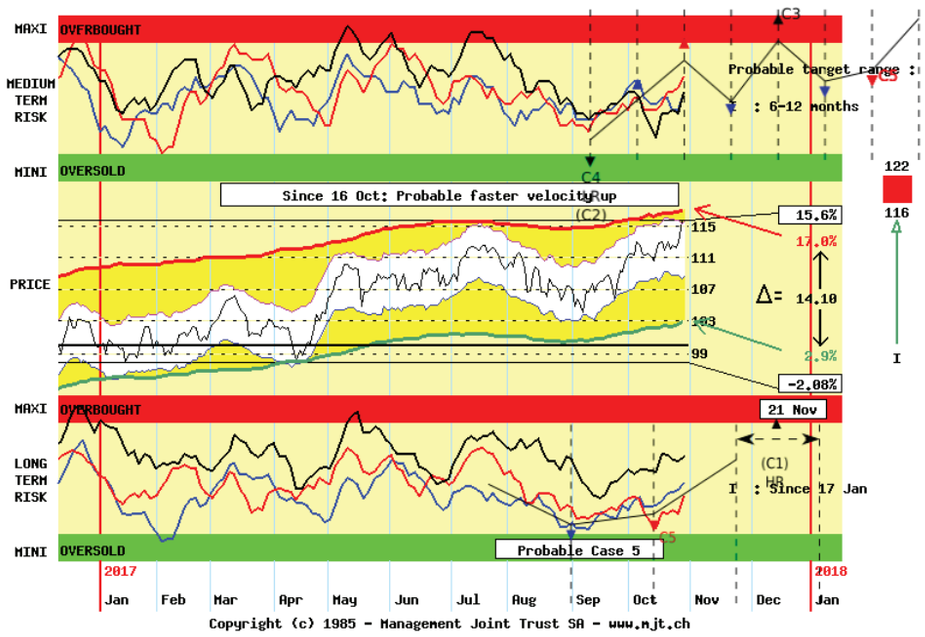
The Nasdaq 100 has been the ultimate Growth trade this year. Indeed, its outperformance vs the S&P500 reflects the reversal of the reflation trade (along with the flattening yield curve). On our long term oscillators (lower rectangle), the Nasdaq 100 has probably reached a High Risk position vs the S&P500. On our medium term oscillators (upper rectangle) **it is nearing an intermediate top, expected mid/late Q4. This implies that the Nasdaq 100 may underperform the S&P500 as we move into year-end and possibly early 2018.** Following that, the Nasdaq 100 will probably resume its outperformance until the Summer of 2018. **"I" Impulsive targets up (right-hand scale) for this ratio have been reached so that the move is getting somewhat exhausted.**

QQQ – PowerShares Nasdaq 100 ETF / SPY - SPDR S&P 500
Daily Graph or the perspective over the next 2 to 3 months



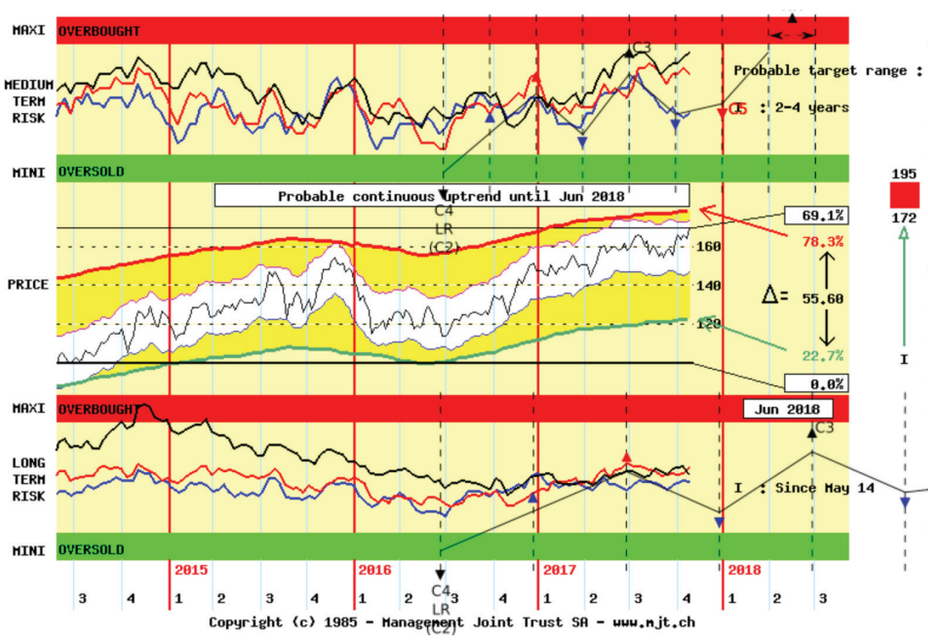
Shorter term however, on the Daily graph, we can see that the Nasdaq 100 just started a new period of acceleration to the upside vs the S&P500. **The move is already quite extended, yet on both our oscillator series (lower and upper rectangle), it may continue until mid/late November** (medium term oscillators; upper rectangle), possibly December on our long term oscillator series (lower rectangle). The mid/end November target is probably a better match for the analysis above on our Weekly graph.

QQQ – PowerShares Nasdaq 100 ETF / Gold Spot (USD)
Daily Graph or the perspective over the next 2 to 3 months



In order to get a better indication of forthcoming risk-off situations (rather than mere Cyclical to Growth rotations), **we compare the Nasdaq 100 to Gold (a defensive asset). In 2017, this ratio has synchronized quite well with risk-on / risk off periods**. On our long term oscillators (lower rectangle), the Nasdaq is **still heading up vs Gold, possibly into December** and its "I" Impulsive target potential to the upside is not extended yet (right-hand scale). That said, our medium oscillators (upper rectangle) **may have reached a short term intermediate top. It could imply 2 to 3 weeks of consolidation to the downside (a short risk-off period).**

QQQ – PowerShares Nasdaq 100 ETF / Gold Spot (USD)
Weekly Graph or the perspective over the next 2 to 4 quarters



We now look at the Nasdaq 100 vs Gold ratio on a longer term basis. On both our oscillators series (lower and upper rectangles), **the Nasdaq 100 is till trending up vs Gold, possibly into mid 2018.** The potential to the upside for this ratio is still comfortable as indicated by our "I" Impulsive targets up (right-hand scale). This remains positive for equity markets and risk assets more generally.

Concluding remarks

Despite the rise in yields over the last 2 months, the US Yield Curve is still flattening. It may continue to do so over the coming weeks. Value to Growth indicators, Breadth, or the Small cap to Big cap ratio also indicate so. More generally, the US Yield Curve may continue to flatten well into 2018. Shorter term however, it may find an intermediate low mid/late November and initiate a 2 to 3 months bounce.

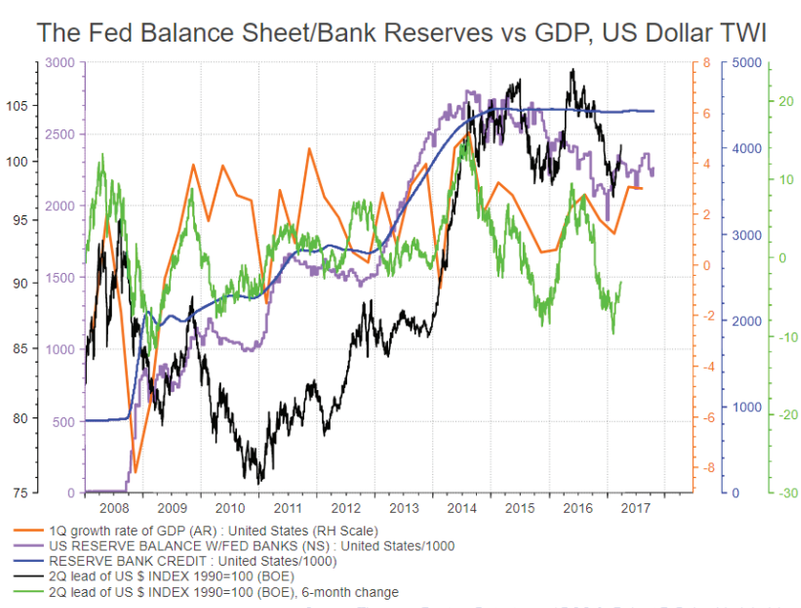
28 / Will the US Dollar strengthen when the Fed reduces its balance sheet? It may not be the case

The dollar fell from late April earlier in the year on the assumption that the Trump government will enact policies that will weaken the currency, and when it became clear that the populist-nationalist wave was not going to sweep across Europe in the magnitude that investors assumed initially. **The prospect of personnel changes at the Fed, and recognition that practically no one of the primary candidates for the Fed chairmanship would be as dovish as Yellen has been, helped the greenback to firm up support**. Likewise, optimism about tax reform, helped backed up of US rates in absolute terms as well as relative to other high-income countries. Higher US bond yields and widening premiums have indeed helped drive the dollar higher in the past 8 weeks. The recovery accelerated after momentum and trend followers which have built substantial short dollar position in recent months in the futures market, covered their positions following the surge in US rates and the US currency. However, primarily, the US currency started to recover due to efforts by the Fed›s leadership to convince investors that a December rate hike was still seen as appropriate. **But also helping put a bid to the greenback is investors` perception that systematic "normalization" of the balance sheets (reducing it to levels not far from its levels before the Great Financial Crisis (GFC) struck in 2008) will strengthen the US Dollar.**

But will reduction of the Fed's balance sheet really weakens the currency? Indeed, what would be the effect of fully reversing the quantitative easing that has taken place since 2007, a period in which the Fed's balance sheet has risen by $3.5 trillion, from $0.9 trillion to $4.4 trillion? We have written about some of the effects of the normalization process in the previous issue of this publication, but we have refrained from discussing its impact on the US currency, as it needs a more detailed treatment. There have been studies on the economic effects of this unconventional monetary easing, including an analysis by Fed economists that has been quoted recently by Fed Chair Janet Yellen. **Eric Engen, Thomas Laubach and David Reifschneider (all staffers at the Federal Reserve), presented conclusions that the effect of the entire QE programs was to reduce 10-year term premium, and therefore the bond yield, by 120 basis points by 2013. This is estimated to have reduced US unemployment by about 1.25 percentage points and increased inflation by about 0.5 percentage points. The researchers also indicated that the QE increased US equity prices by 11-15 per cent, and reduced the dollar effective exchange rate by 4.5-5 per cent**. These are obviously very large effects (if true) and if we are to assume that normalization of the balance sheet will produce the opposite results, then there would be plenty of reason to be worried. However, **we take some exceptions to those claims, as there is ample empirical evidence that some of the conclusions may not be correct.**

We are particularly intrigued about the claim that QE reduced the value of the US Dollar by 4.5-5.0 per cent. **In the narrative below, we document our thinking that instead of weakening the US Dollar, the QE programs served to strengthen the US Dollar instead, and that reducing the Fed balance sheet may therefore weaken the currency.** In the graph below, we show that the QE programs influenced the US currency via the GDP linkage. QE boosted economic growth and that the US quarterly GDP was positively influenced by the flow of the Fed`s balance sheet and the Fed`s bank reserves. **There is a lag between the flows and its impact on GDP growth (by about 1 quarter). GDP growth, in turn, positively correlated with the US Dollar, and positive GDP growth was matched by a US Dollar rise in value 1 quarter thereafter.**

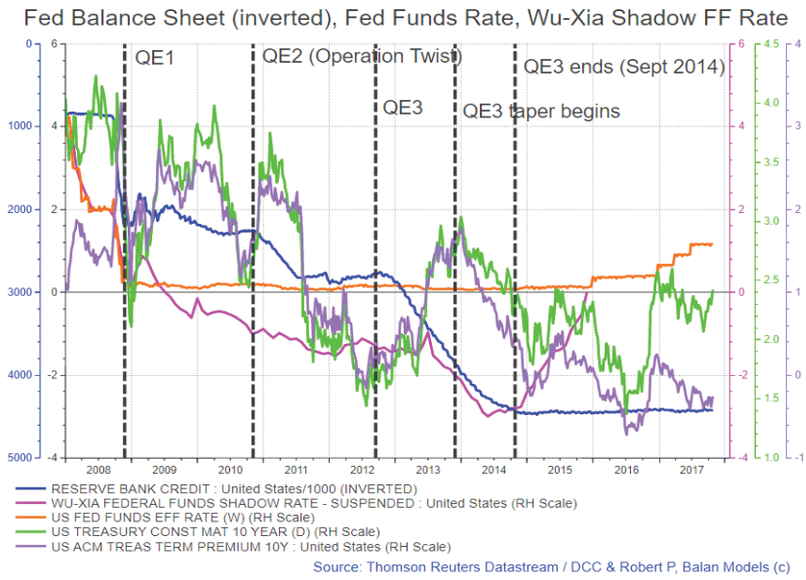
We can also show that the US Dollar also strengthened via the interest rate channel but before we can do that, we have to show the correlation that has happened between the QE programs and interest rates. The claim was that the effect of the QE programs was to reduce 10-year term premium, and therefore the bond yield, by 120

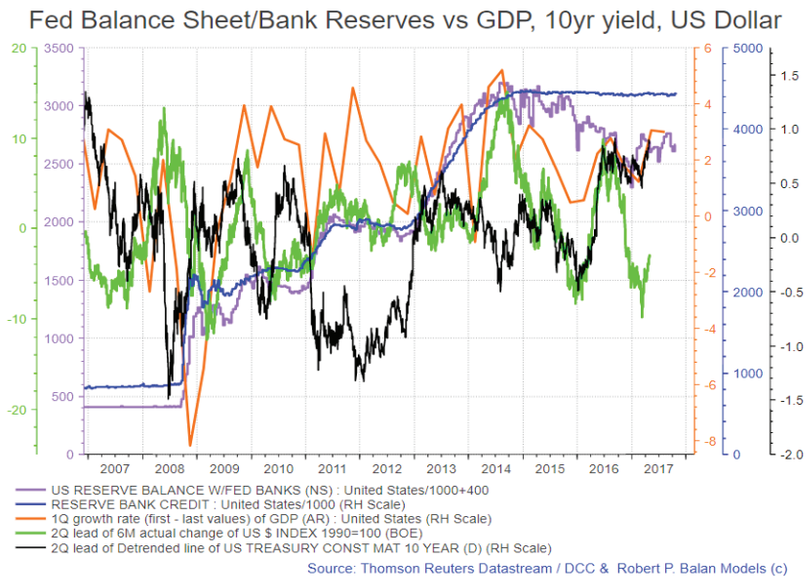


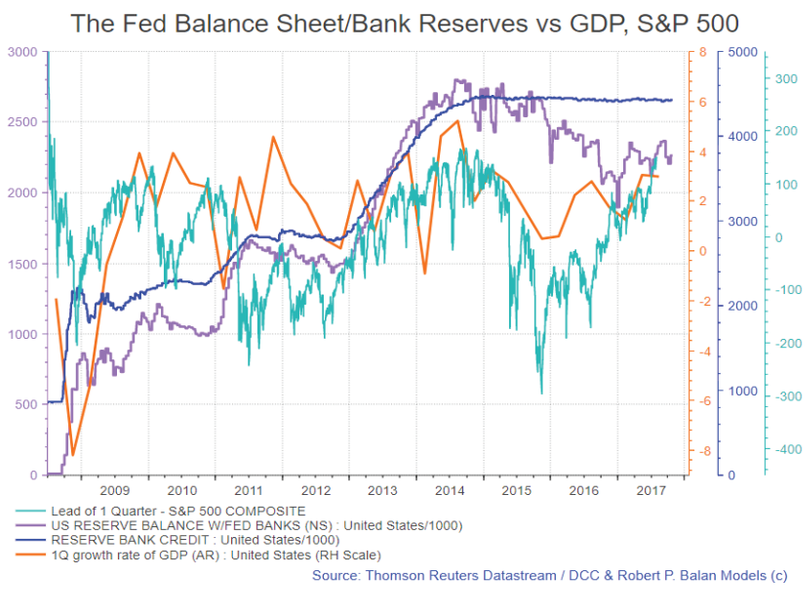
basis points by 2013. QE3, the last in the series, actually ended in September 2014. We can show that the programs indeed managed to lower long term rates by 2016, but the changes in the rates have been influenced primarily by the flows in the balance sheet rather than the changes in the nominal amounts of the ledger. There were counter intuitive moves observed – as the nominal amounts of the program rose sharply, long bond yields went sharply higher, instead of lower as the Fed expected. The culprit of course was the bond yield term premium which rose correspondingly, as the balance sheet increased on investor fears that inflation will be ignited (see 1st graph on this page).

Therefore, the relationship between the incremental changes in the balances sheet and the changes in the long bond yield can be said to be positive due to the influence of the term premium. We show the empirical evidence for that conclusion in the chart below. **If we juxtapose the long bond yield with the US quarterly GDP with a 6-month lag, then the relationship between the Fed's assets and growth, the long bond yield, and the US Dollar becomes clear – they are all positively correlated, given the proper lag which allows the impact of QE to flow into rising GDP, and which in turn, flows into the rising long rates and a stronger US Dollar** (see 2nd graph on this page).

Intuitively, we see the positive correlation of the balance sheets to GDP, rates, and the USA Dollar, in the very well-documented positive contribution of the increase in Fed`s assets to the phenomenal rise of the stock market since the onset of the GFC recovery in 2009. **The changes in the stock market bull market has corresponded well to the quarterly changes in GDP growth since the initial point of the GFC recovery. The changes in the stock market actually lags behind the changes in the balance sheet by one quarter** (see 3rd graph above).







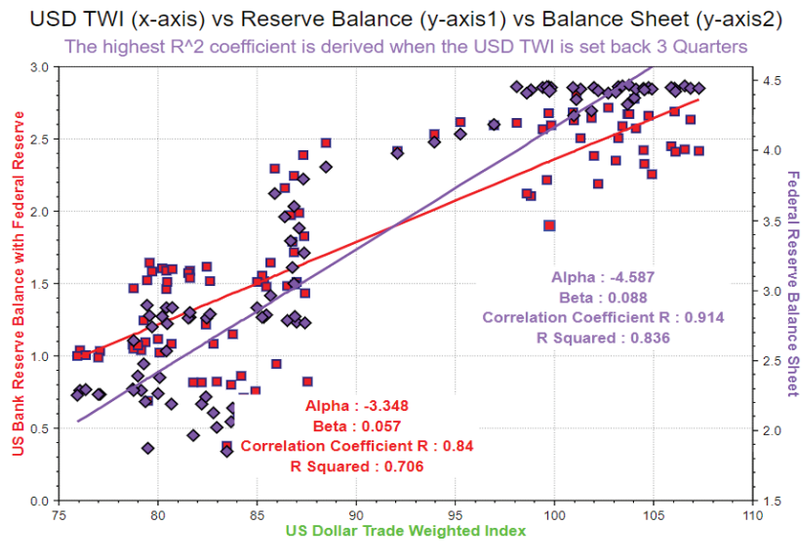
This positive correlation is very well-documented, **so there is no need for us to rehash the evidence. So, we ask rhetorically – if the increase in the Fed's balance sheets has done wondrous positive things for the stock market, is it too far-fetch to say that the rising stock market was accompanied by positive changes in the US GDP? And if that is the case, is it too far-fetched as well to say that both the stock bull market and corresponding**

rise in GDP were accompanied by rising rates and therefore a firmer US Dollar? We have seen all these come to pass. The only thing that hinders many of us to see the phenomenon is the time lags that occur before the impact of the positive changes in the Fed balance sheet flow into the economy, the stock market, the long bond yields and the domestic currency. These lags can be documented properly, and we did that with the following graphs on this page:

Conclusion:

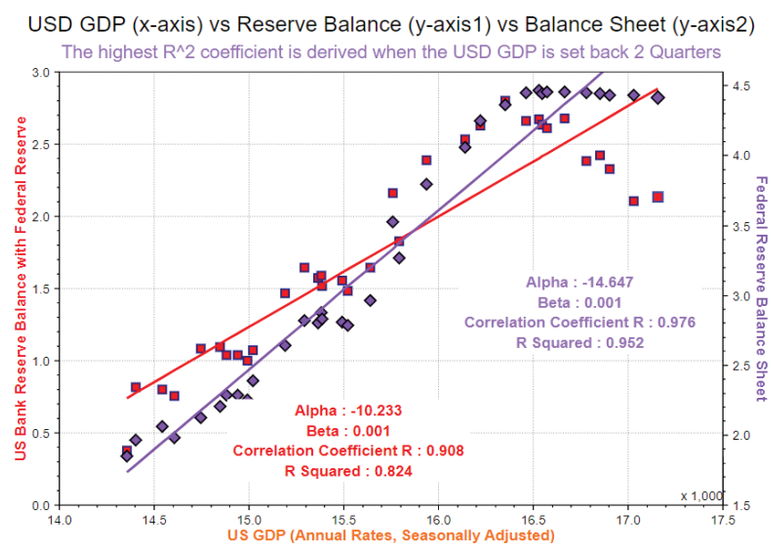
If we think about the impact of the Fed's balance sheet deeply, it can't be positive for the stock market and negative for the rest of the assets and growth. The fact is that the accumulation of central bank assets has been good for equities and the economy. And long rates and the US Dollar will be impacted positively by the rise of the economy. If the economy grows, rates will rise and the US Dollar will rise in tandem – these are relationships that endure. Those relationships do not go one way – if the Fed's balance sheets will be reduced, it will have a negative impact on the stock market and the economy. Falling equity markets and declining growth will cause bond yields to fall, and the US Dollar may also fall in tandem. We say "may" because we have seen cases of weaker growth post GFC where the US Dollar rose instead, when the demand for US government paper (the historical safe haven) – the demand channel – overrode the effects of lower US rates against the rates of other major countries (the rate differential channel). At this stage we do not discount that happening the next time growth falters in the US. This is a purely growth phenomenon and has nothing to do with the Fed's balance sheet.

For the US Dollar, the highest coefficient of determination (R<2) between it and the Fed balance sheets comes after 3 quarters from the change in the balance sheet.



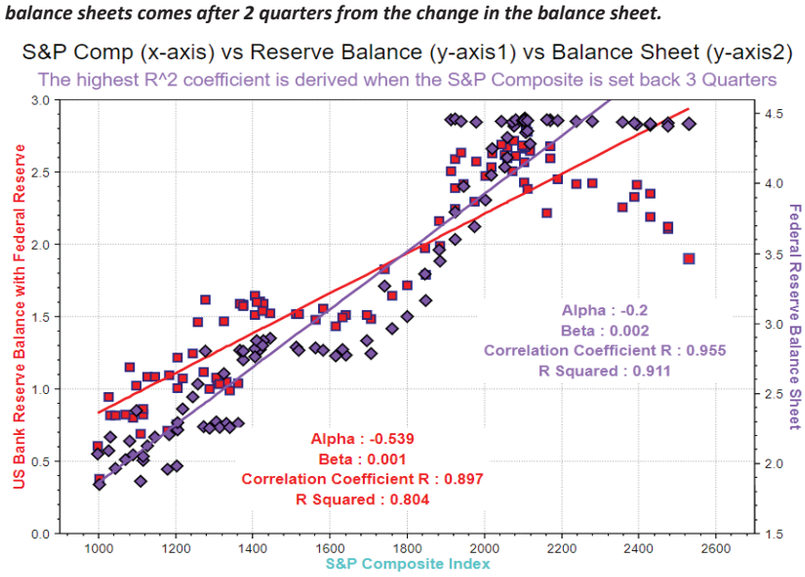
Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

For the US GDP, the highest coefficient of determination (R<2) between it and the Fed balance sheets comes after 2 quarters from the change in the balance sheet.



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

For the S&P Composite, the highest coefficient of determination (R<2) between it and the Fed balance sheets comes after 2 quarters from the change in the balance sheet.



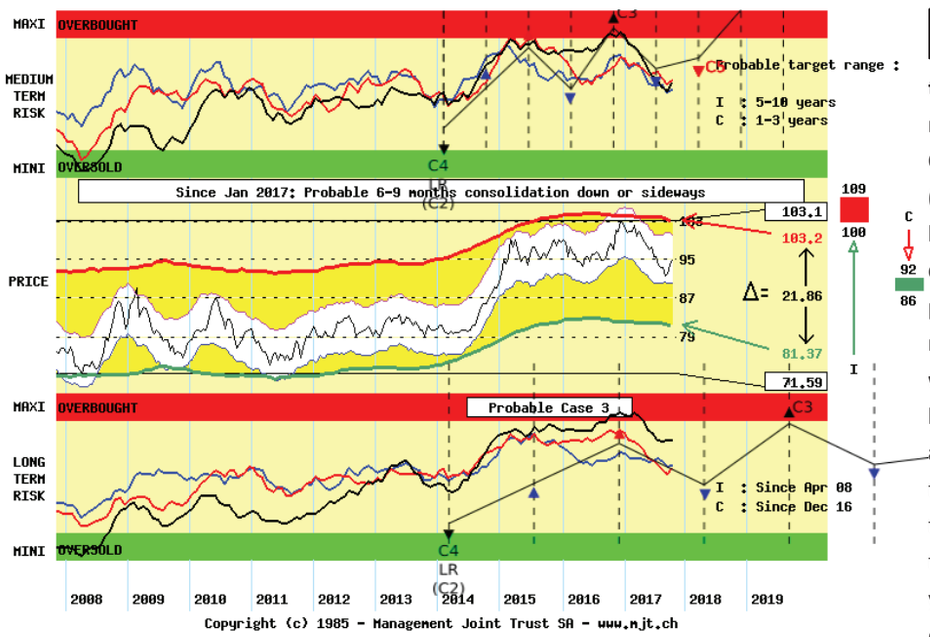
Source: Thomson Reuters Datastream / DCC & Robert P. Balan Models (c)

31 / MJT - TIMING AND TACTICAL INSIGHT

The Dollar should retrace down into November

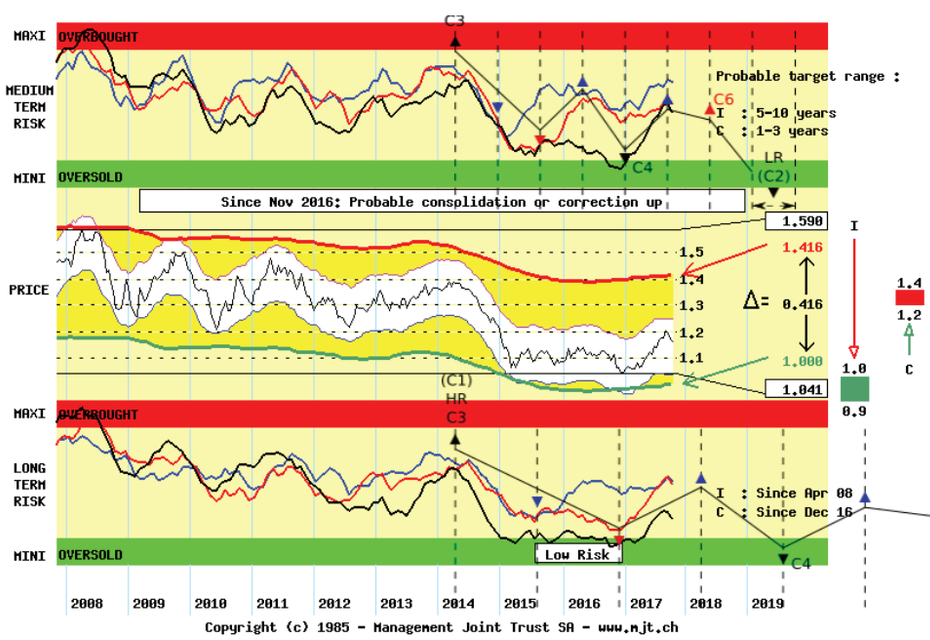
From its lows early September, the Dollar has followed risk assets and interest rates up in their recent rebounds. This positive momentum was further supported last week by the re-election of Shinzo Abe in Japan, famous for his Abenomics or aggressive monetary and fiscal stimulus, and the extension of the ECB bond buying program, possibly beyond September 2018. That said, the reaction up since early September still pails in comparison to the downtrend year-to-date and we would probably expect further retests to the downside between now and late Spring next year.

Dollar Index
Bi-monthly Graph or the perspective over the next 1 to 2 years



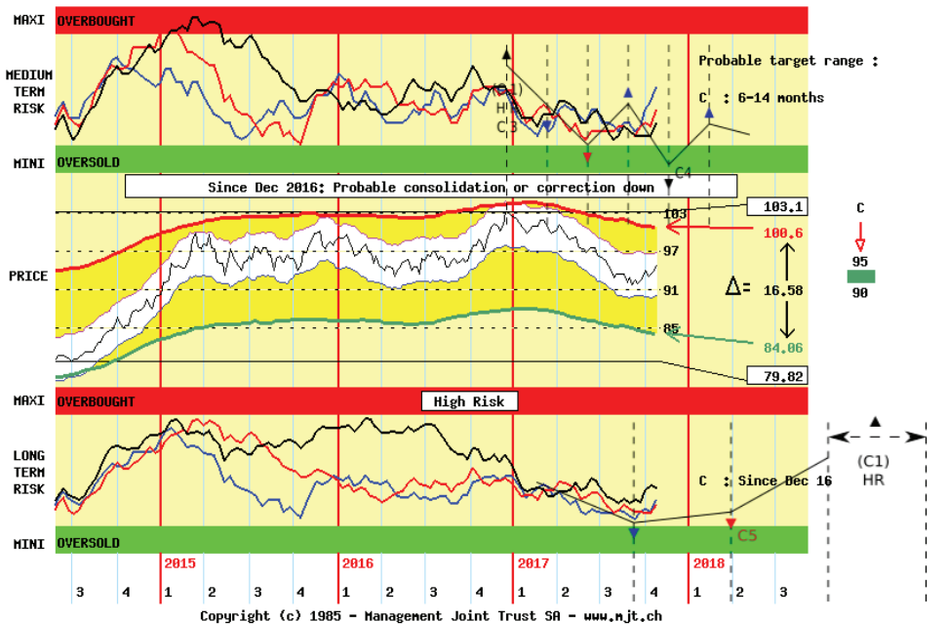
Following its persistent uptrend since 2008 and then 2011, the US Dollar finally topped out late last year. On our long term oscillators (lower rectangle), we would label this top as an intermediate one. Indeed, at some point during the course of next year (late H1 probably), we would expect the US Dollar to resume its uptrend for another couple of years. In the meantime, this implies that the current consolidation to the downside may not over yet. Indeed, such periods of consolidation of our bi-monthly graphs usually last 5 to 6 quarters or possibly into the Spring next year. This is what is shown on our medium term oscillators (upper rectangle). The US Dollar may have recently made a first inflexion point higher, yet we would expect a further downside retest sometime during H1 next year (lower or higher than recent lows).

EUR/USD
Bi-monthly Graph or the perspective over the next 1 to 2 years



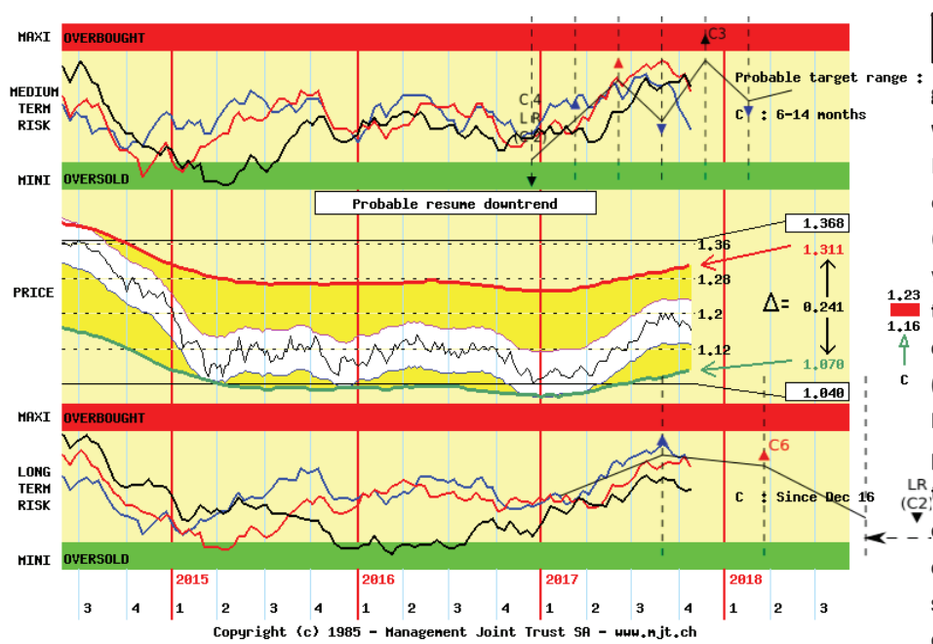
EUR/USD shows a similar picture in reverse. It made an important low late last year and has since been bouncing up. We would also label this bounce as a corrective move and would expect EUR/USD to resume its downtrend sometime from H1 next year into late 2019. This is what we show on both our oscillator series (lower and upper rectangles). We have probably just made an intermediate top, yet a second one (higher or lower than recent tops) is still expected in the Spring next year.

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



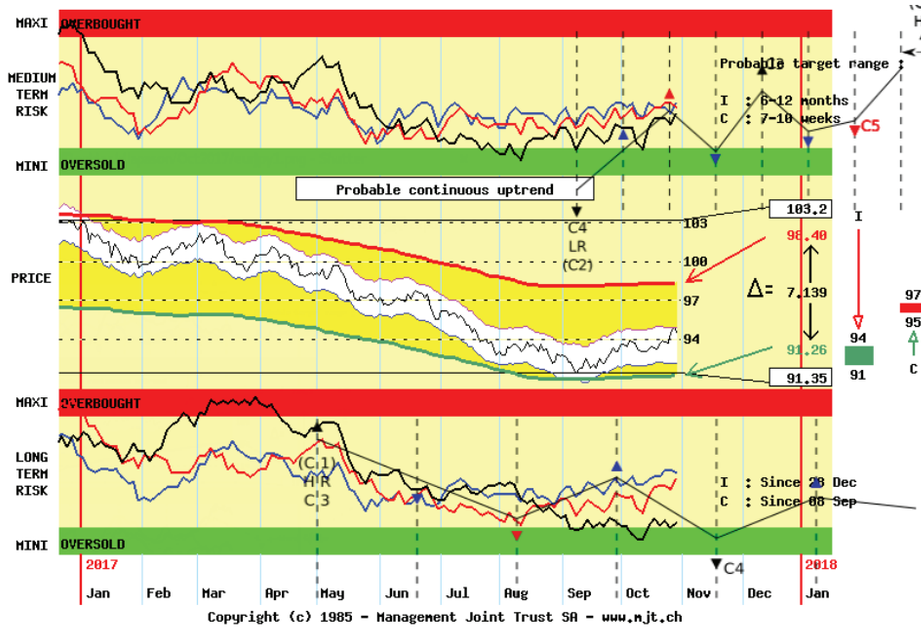
On the Weekly graph, an intermediate low was made early September. It has come early in respect to our medium term oscillators (upper rectangle). As shown, we cannot exclude that **a further downside retest is possible over the next month or so (not necessarily new lows). Following that we would expect the current bounce to continue, possibly into early Q1 2108. Our long term oscillators (lower rectangle) also bring some support over the next few months, yet another retest to the downside is projected towards the end of Q1 2018**. Following that, the Dollar should start to resume its long term uptrend. Our "C" Corrective targets to the downside (between 95 and 90; right-hand scale) have pretty much been reached, yet have also held. We expect them to continue to hold until Spring next year.

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



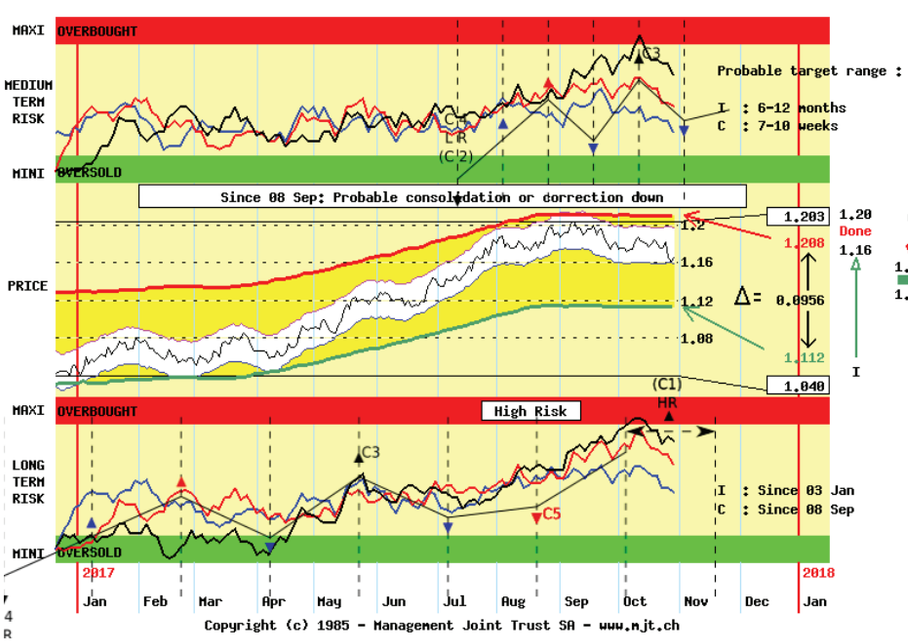
EUR/USD is very similar in reverse. On the Weekly graph, an intermediate top was made early September. It has come early in respect to our medium term oscillators (upper rectangle). As shown, we cannot exclude that **a further upside retest is possible over the next month or so (not necessarily new highs). Following that we would expect the current consolidation to continue, possibly into early Q1 2108. Our long term oscillators (lower rectangle) should also weigh on prices over the next few months, yet another retest to the upside is projected towards the end of Q1 2018**. Following that, EUR/USD should start to resume its long term downtrend. Our "C" Corrective targets to the upside (between 1.23 and 1.16; right-hand scale) have pretty much been reached, yet have provided worthwhile resistance. We expect them to continue to cap EUR/USD's potential until Spring next year.

Dollar Index
Daily Graph or the perspective over the next 2 to 3 months



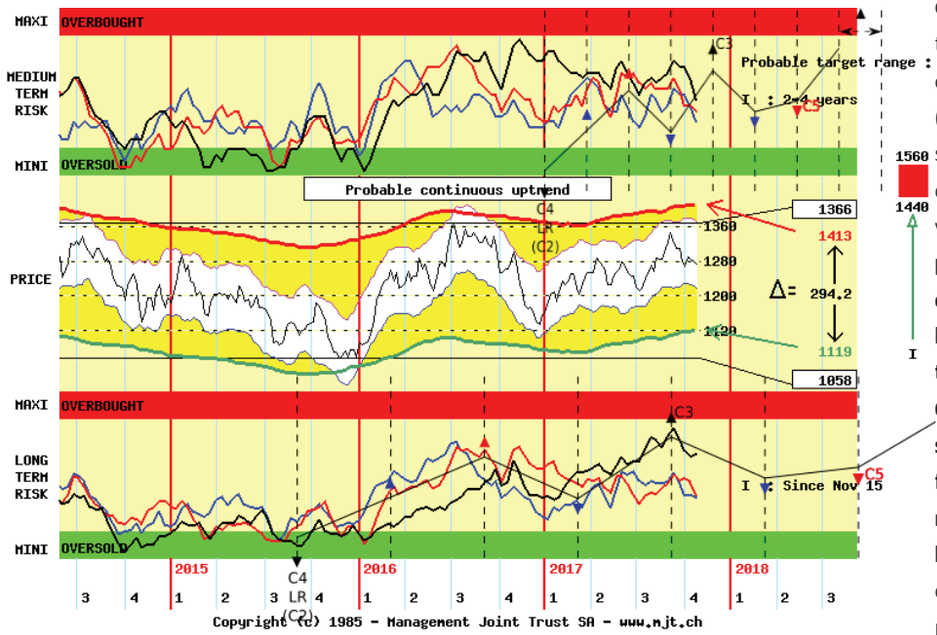
Since it started to bounce early September, the US Dollar has regained a fraction of the ground it lost since last December. That said, the downtrend, which was in place on our long term oscillators (lower rectangle) now seems to have been broken. In line with this sequence, **we would still expect a re-test into mid November, yet probably no new lows**. On our medium oscillators, we would now feature a nascent uptrend (upper rectangle). It has probably just reached an intermediate top and is due to retrace over the next 2 to 3 weeks. **Following that, the uptrend should continue into December and then potentially into February. A further move up into February would imply that the moves gathers further momentum, and that it reaches above its "C" Corrective targets up above 97** (right-hand scale). Until then 97 also acts as the crucial resistance.

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



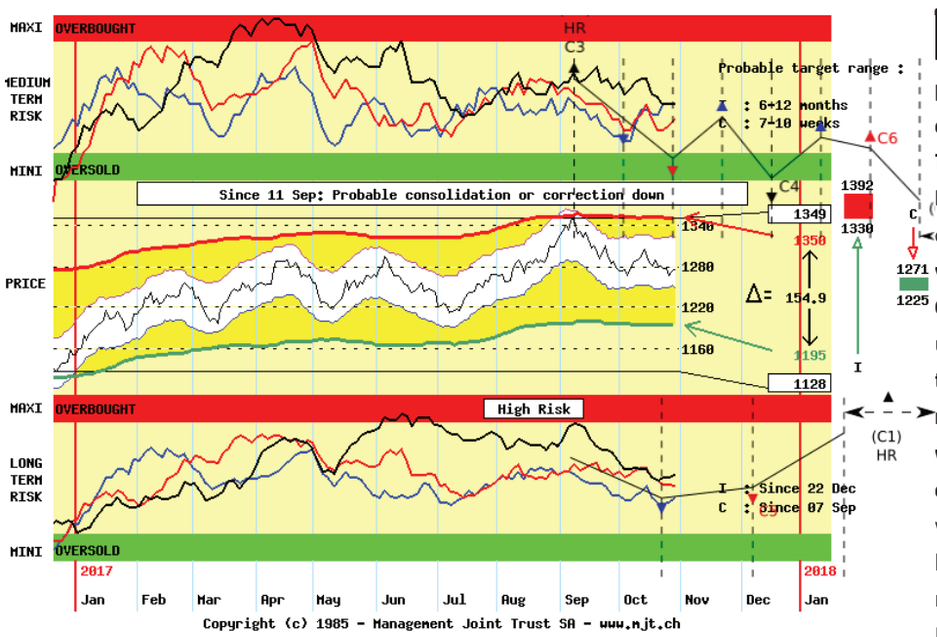
On EUR/USD, our oscillators have been much harder to read. On both our oscillator series (lower and upper rectangle), we had initially projected a "High Risk" situation on the lower highs, which were made in October. **Currently, on EUR/USD, the whole world is seeing a complex Head& Shoulder pattern**. It has recently broken its neckline and is currently attempting the pull-back towards it. If confirmed, it could lead us back down towards the 1.13 area. **We can't avoid a feeling that "What's obvious, is obviously wrong" or "slightly wrong". Our medium term oscillators (upper rectangle) do warrant a slight bounce into mid November, yet our feeling, is that it may be slightly more powerful than the 1.17 implied by the pullback to the neckline**. We corroborate this view with our projections further below on Gold and GBP/USD. **Following that, EUR/USD should move lower into December and possibly early next year to test the lower end of our "C" corrective targets down towards 1.13** (right-hand scale).

Gold Spot (USD/oz)
Weekly Graph or the perspective over the next 2 to 4 quarters



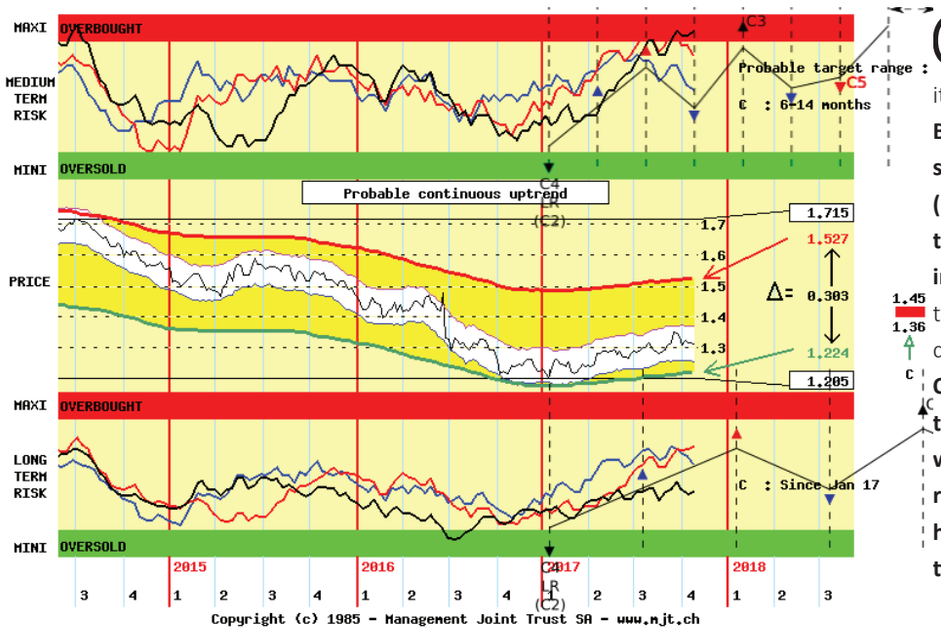
Gold made an important intermediate top in September on our long term oscillators (lower rectangle) an has since started to retrace. On our medium term oscillators, however, **a last upside re-test is still possible over the next month or so (upper rectangle). Following that we expect Gold to consolidate down into mid Q1 2018, before it gradually stabilizes and re-accelerates from the Spring / Summer next year and then towards late 2018.** Given the intermediate tops, which were just made, the "I" Impulsive targets to the upside we currently calculate (right-hand scale) are probably valid for the end of next year, not over the next few months. They would reach into the 1'500s levels.

Gold Spot (USD/oz)
Daily Graph or the perspective over the next 2 to 3 months



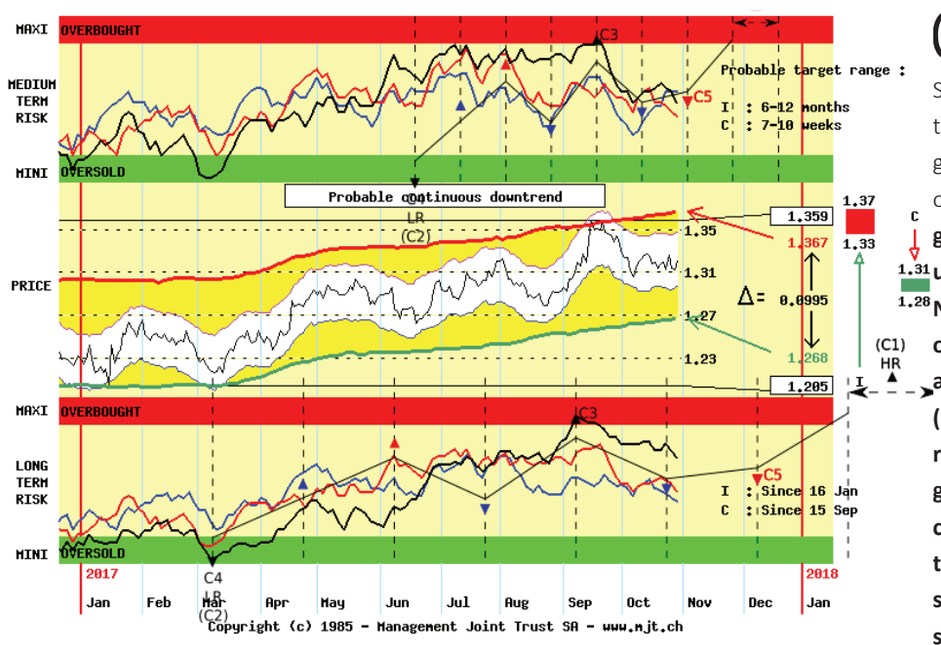
From the "High Risk" top made early September, we project downside sequences on both our oscillator series. They should lead us lower into December at least (long term oscillators; lower rectangle)**, yet most probably into late Q1** (our medium oscillators; upper rectangle)**. In meantime, Gold has probably just reached an intermediate low, which should see it rebound over the next 2-3 weeks**. We would expect a move into the lower 1'300s, yet probably not new highs given the "High Risk" top made in September. Following that and in first instance, Gold should start to move lower again towards December to test the lower end of our "C" corrective targets down towards 1'225 USD/oz (right-hand scale).

GBP/USD
Weekly Graph or the perspective over the next 2 to 4 quarters



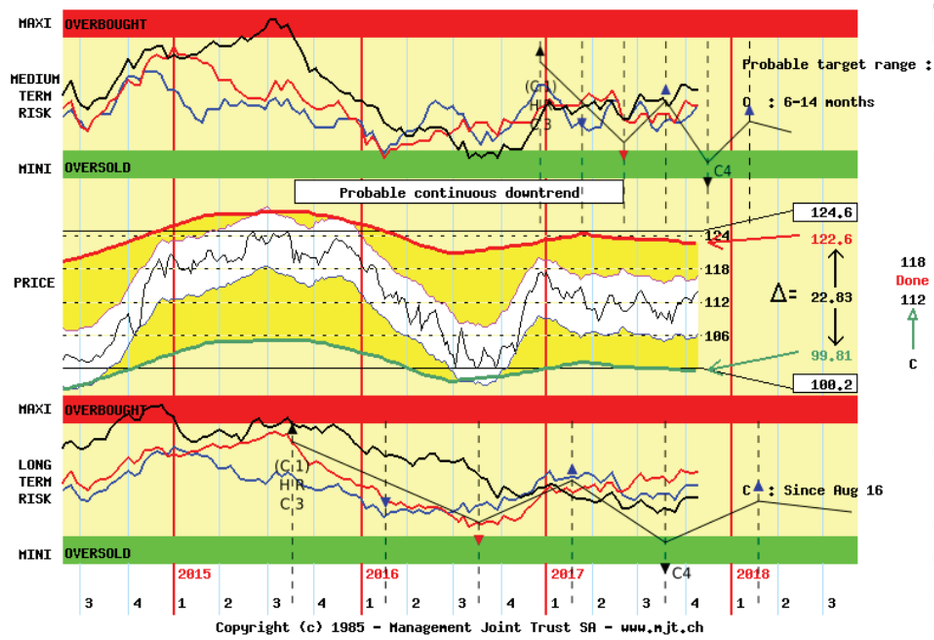
Cable is showing similar dynamics that EUR/USD, yet it appears to be more robust. **Both our oscillator series are still following a correction up (lower and upper rectangles), that could extend possibly into early 2018**. Following that, it is due to correct to the downside during H1 2018. **Our "C" corrective targets to the upside (right-hand scale) would suggest that it could retest up towards previous highs (1.36), and even potentially make it above 1.40.**

GBP/USD
Daily Graph or the perspective over the next 2 to 3 months



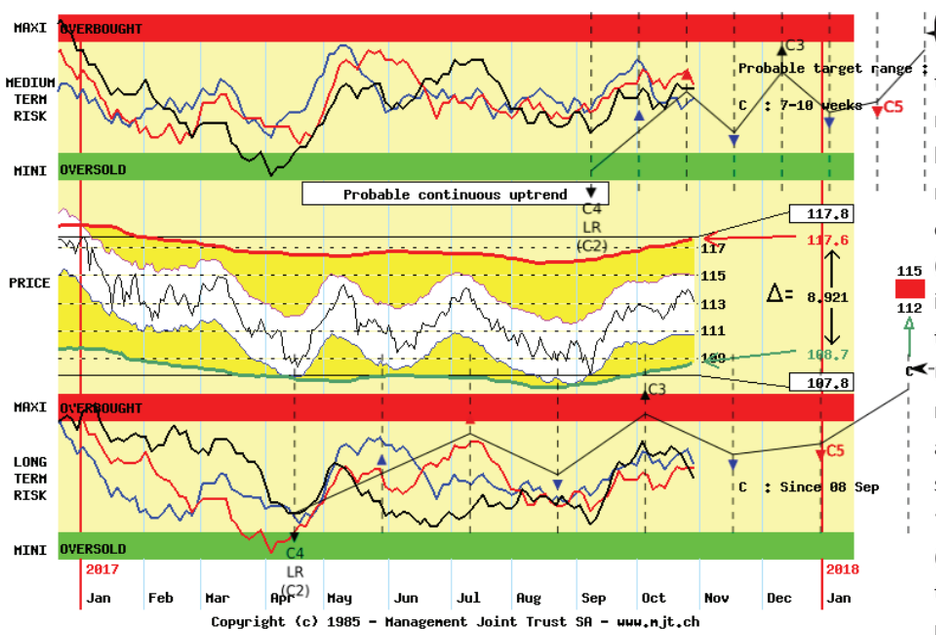
On its Daily graph, Cable also topped out during September, yet slightly later than EUR/USD (a sign of strength vs EUR/USD). On both our oscillators series, it may be **getting ready to resume its uptrend, possibly into late November (medium term oscillators; upper rectangle) and even early next year (long term oscillators; lower rectangle). "I" Impulsive targets up (right-hand scale) could lead us up to new highs towards 1.37. To the downside, we still expect strong support within our "C" Corrective targets down between 1.31 and 1.28.**

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



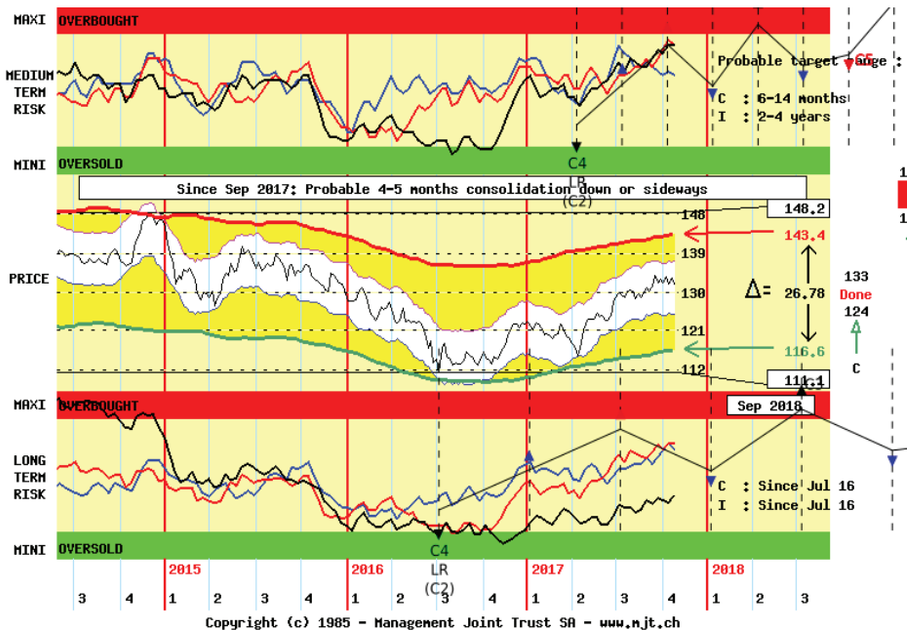
USD/JPY is currently building off the base it made in Q3 2017 (high lows on our long term oscillators; lower rectangle). It should continue to be supported until at least early next year. Our medium term oscillators (upper rectangle) would suggest **one last retest over the next month or so. Yet, thereafter, we would also expect the bounce to continue into Q1 2018**. From a price target perspective, **we are still eying the higher end of our "C" Corrective targets up around 118** (right-hand scale). We would continue to point that if these are taken out, the next level of targets are around 130.

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



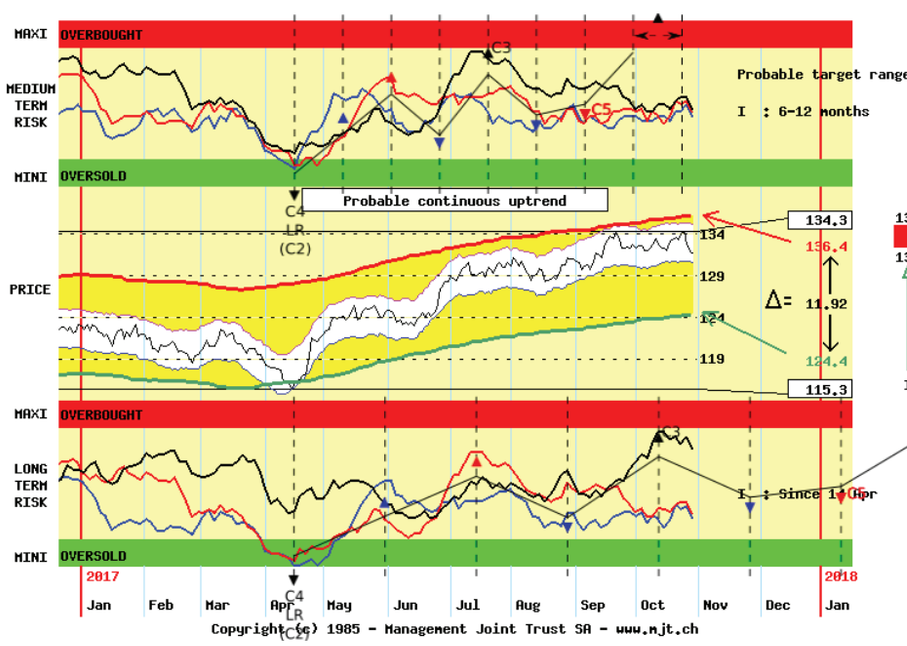
On both our oscillator series, USD/JPY reached intermediate tops. These were made early October on our long term oscillators (lower rectangle) and late October on our medium term oscillators (upper rectangle). Both would imply an intermediate correction into mid November, before USD/JPY recuperates and starts moving up towards December and Q1 2018. Currently, we are still below the upper end of "C" Corrective targets at 1.15 (right-hand scale), and hence the uptrend is still weak. This may imply that **the retracement into mid November may be quite strong. Yet, we do not expect new lows** given the base that was made in Q3 2017 on our Weekly graph above. **From late November / December, we would expect USD/JPY to start moving higher towards next year and reach above 115, opening the door to 118 and potentially even higher targets.**

EUR/JPY
Weekly Graph or the perspective over the next 2 to 4 quarters



Given the above, our view over the next 6 months is that EUR/USD is relatively range-bound, while from late November, the Yen starts to weaken again. This should translate into the perspectives we see for EUR/JPY. Both our oscillators series (lower and upper rectangles) would suggest that **EUR/JPY is currently due for some consolidation during Q4** and that from early next year, it should start to accelerate up again. **It is currently stalling on the resistance given by the higher end of its "C" Corrective up targets around 133. Once it can make it clearly above these, sometime early next year, our "I" Impulsive targets up would point to greater potential, possible into the high 140s, low 150s.**

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



On a Daily basis, EUR/JPY recently reached an intermediate top on both our oscillator series. Its correction could last between 3 to 6 weeks, possibly into mid/late November. Following that, we would expect, EUR/JPY's uptrend to gradually resume into next year. Our "I" Impulsive targets up (right-hand scale) had pretty much been met between late September and late October. The "C" Corrective targets down, we can now calculate amount to 0.5 to 0.8 times our historical volatility measure "Delta" (11.92; middle rectangle; right-hand side). **This would calculate to a retracement potential between 6 and 10 figures (128-124 range). This is interesting as EUR/JPY is often considered as one of the best risk-on/risk-off proxies in the market. This would corroborate our slightly defensive bias over the next few weeks throughout this document.**

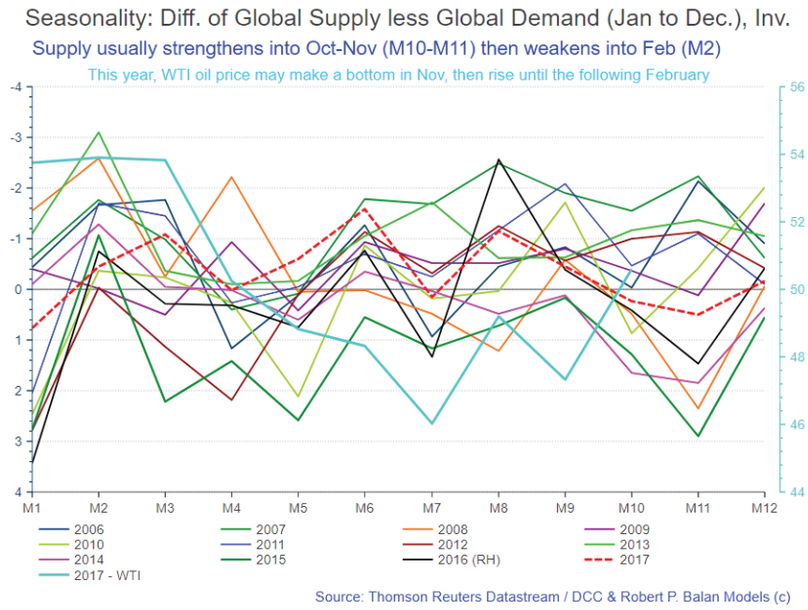
Concluding remarks

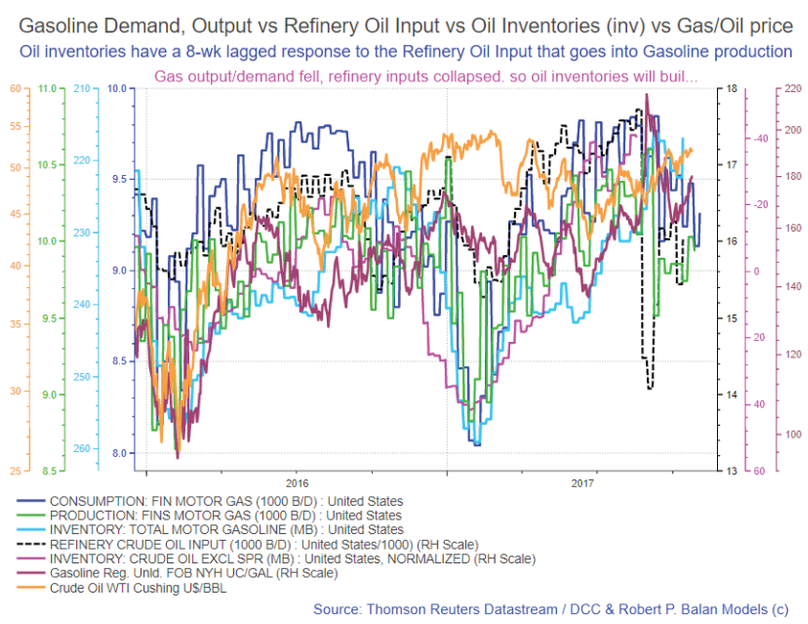
Since early September, the USD Dollar has achieved a nice rebound vs the Euro and the Yen especially. Our analysis suggests that it has now reached an intermediate top and that it should consolidate for 2 to 3 weeks until mid/late November, yet probably not make new lows. Following that, we expect further upside for the Dollar as we move into December (vs the Yen especially). The move may indeed extend towards February, before the Dollar retraces again to the downside towards early Spring.

38 / Seasonality in Oil may trigger a short term dip until late but the uptrend reasserts thereafter

Global oil consumption ebbs and flows from one season to the next – the seasonality of the oil market is well established and widely understood. From many indications, the oil market has just finished a seasonal peak in many of its fundamental vectors (which have helped push prices higher in past weeks). But the market is due for another, countervailing phase, which may bring price lower over the next few weeks – at least if we go by historical patterns. During other times, this would not invite much discussion, but the fact that the OPEC-NOPEC have been trying to put a firm bid on oil prices, puts the historical pattern at some risk. OPEC-NOPEC has been jawboning oil prices higher in past weeks, with hints of further oil production cuts to come. OPEC-NOPEC have been struggling to clear the global oil glut that has kept prices below $60 a barrel – less than half the oil price level three years ago. **Indeed, for analysts looking for clues which will lead to a good forecast of oil prices in the near-term, the seasonality in the variance of global supply and demand will continue to provide guidance due to its consistent pattern (see 1st graph on this page).** There is a distinct seasonality in the variance between global supply and demand – the supply variance strengthens (more supply) into Oct-Nov (M10 - M11), then weakens (less supply) into Feb (M2). This impacts oil prices accordingly, after a short lag.

With OPEC and Russia apparently keeping their obligation to keep output under control per recent agreements, it will be US oil production and oil consumption which hold the key to further changes in the global oil price. US production and oil consumption have become the swing data – the annual rhythms of refiners, US motorists and the weather will play crucial parts in determining whether the cartel's effort to boost prices is successful or not. US oil supply and consumption will be crucial oil price determinants over the next few months, so this makes it important to understand how product consumption (mainly gasoline) play out from here. Demand for oil did increase during the summer as U.S. households hit the road for their vacations. Consumption started to tail off last month (in September) as the driving season ended and refineries halt for maintenance. But product demand should rise again at the start of winter as people burn oil for heating. For now, the product cycle has turned. In the following graphs, we document what we believe will be a consolidation/correction in the current uptrend in oil prices due to the onset of a weaker phase in product demand in the US. This, however, may be a brief respite to what we see as a trend for stronger oil prices until Q1 2018.

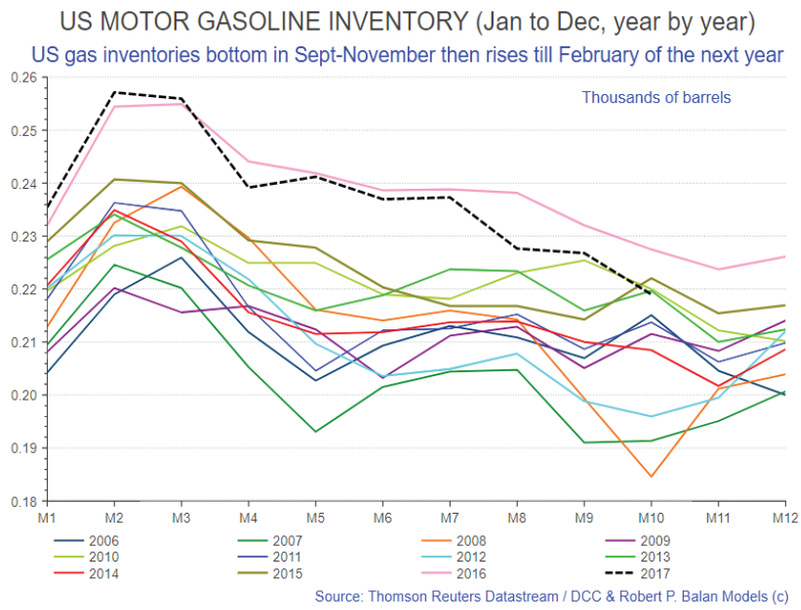


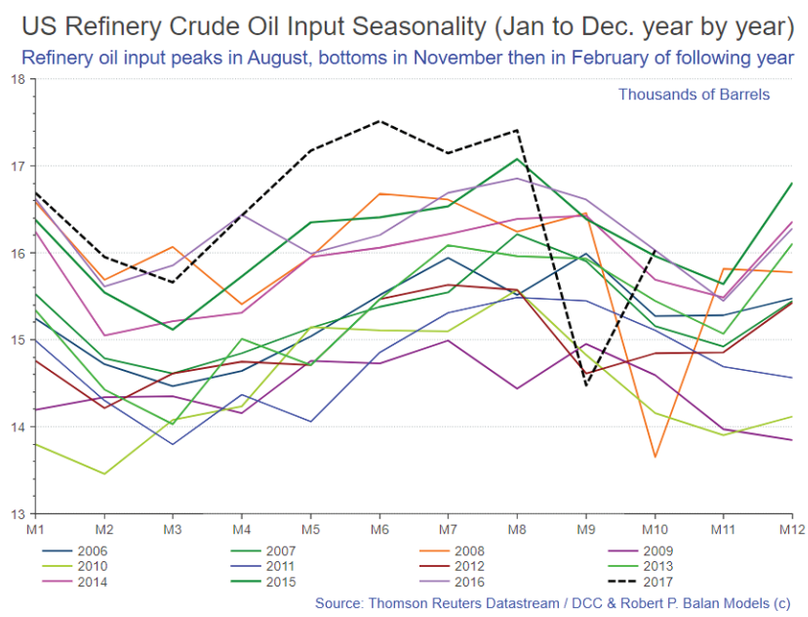


US product demand cycle seems to have already tipped over -- crack spreads leading the way and have been coming off their spike high in September (see 2nd graph on previous page). The bearish seasonality for products and crude is knocking on the door. The product universe is important because consumers do not buy crude oil -- they buy products. So, watch the decline of gasoline consumption and production closely. Refinery inputs will follow their trajectory, and oil inventories follows the trajectory of the oil inputs after a short lag. Gasoline and oil price usually follow the trajectory of gas consumption, after a very short lag. And although oil inventory is a lagging vector, it impacts market sentiment. We expect oil inventories to stop drawing in 2 to 3 weeks (even sooner), and will start building, and could weigh on market sentiment.

The 1st chart on this page and the previous charts show the seasonality of gasoline inventory. We expect reports from the EIA to reflect the seasonality of falling gasoline consumption, production and inventory over the next 4 to 5 weeks. EIA reported a decline in gasoline stockpiles for the most recent period, of 5.5 million barrels, which was only to be expected as refinery maintenance season begins and production declines. This decline is more likely a result of lower refinery activity than an increase in production, but traders are apparently oblivious to the causes behind inventory movements as long as these movements are in the right direction. This underlines the bullish sentiment prevailing in the market. If the seasonal pattern holds true this year, gasoline inventory should bottom in November, this year (see 1st chart on this page).

Last week, the EIA said refineries in the US processed an average 16 million barrels of crude, versus 15.4 million bpd in the week before, producing 9.9 million barrels of gasoline daily, down from 10 million bpd in the week before. The facilities ran at 87.8 percent of capacity, versus 84.5 percent in the prior week, and could fall further in the coming weeks as maintenance season sets in. US is the world's largest gasoline consumer, and earlier processed a near record of 17.6 million barrels a day. But the usual seasonal pattern is reasserting, and demand dropped to about 16.5 million by late September. **Those numbers show that the seasonality inherent in oil refinery input is on course this year (see 2nd graph above). If the seasonality patterns run true to form, refinery inputs will fall further in November before rising in December, and then falling again in February.**

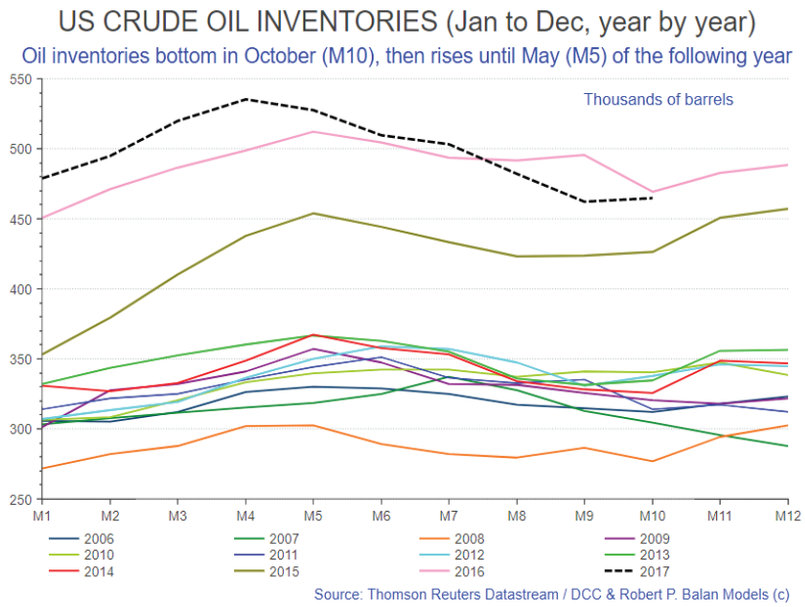


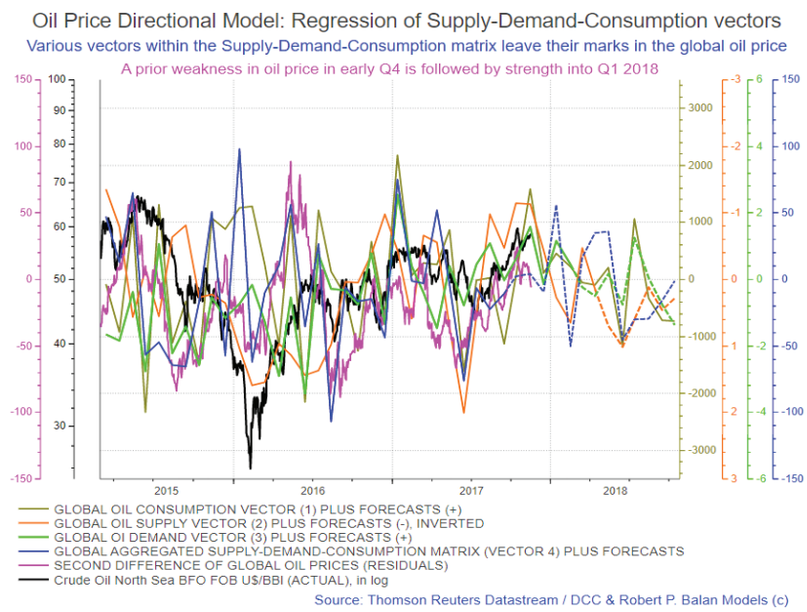


Meanwhile, US oil inventories draws continue to be a positive vector for oil prices. The EIA said crude stocks last week fell by 5.7 million barrels, dropping from 462.2 million barrels down to 456.6 million barrels. While this decline is smaller than the 7.1 million barrel drop estimated by the API (American Petroleum Institute), it was quite a bit bigger than the 3.2 million barrel decline forecasted by analysts. Nonetheless, inventory draws are coming to a seasonal end, and we expect builds to grow as we go through the winter months. The seasonal pattern in US inventories call for a peak in build sometime in April, next year (see 1st graph on this

page). US inventory draws in the past few months have been a huge factor in building positive sentiment for oil prices, but that supportive element will likely come to an end in a few weeks. US oil inventories follow global and US oil consumption trends, after a lag. Hence, better over-all demand going into year-end and early next year should reinstate the interrupted builds during the past three months, when oil demand slackened.

The EIA says that economic conditions appear to be strengthening globally, which could contribute to oil demand growth in 2018. However, it looks like the work is cut out for OPEC-NOPEC partnership which is trying to push prices higher -- data from the International Energy Agency (IEA) show that inventories in industrialized nations could remain oversupplied even after the end of 2018. The US Energy Information Agency (EIA) also forecasts that US production will continue growing next year to more than 10mb/d. The latest data shows that U.S. crude production rose 1.1 million barrels per day (bpd) last week to 9.5 million bpd, recovering from a decline due to Hurricane Nate. Compare this to the 8.9 million bpd output in January.





Conclusion

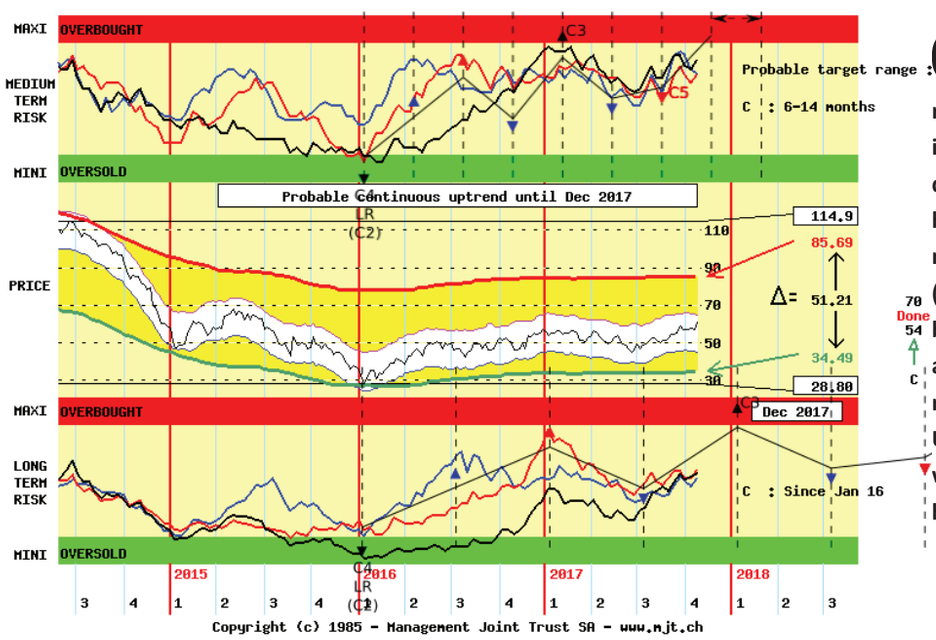
A positive trend for oil prices has been set by several factors. Prices have edged upward in recent weeks thanks to the decline in US inventories and strong signs of OPEC members' compliance with the agreed-upon output cuts, which were renewed last May and could be renewed again this coming November 30th, when OPEC holds its annual meeting in Vienna. Nonetheless, seasonal factors should provide a brief dip in oil prices sometime soon. But we expect the uptrend to reassert thereafter, and oil prices to carry on higher into Q1 2018. This outlook is illustrated by our directional price model shown in the 2nd graph above.

41 / MJT - TIMING AND TACTICAL INSIGHT

Short term, Oil may Stop and Go, yet is still very positive until late December / January

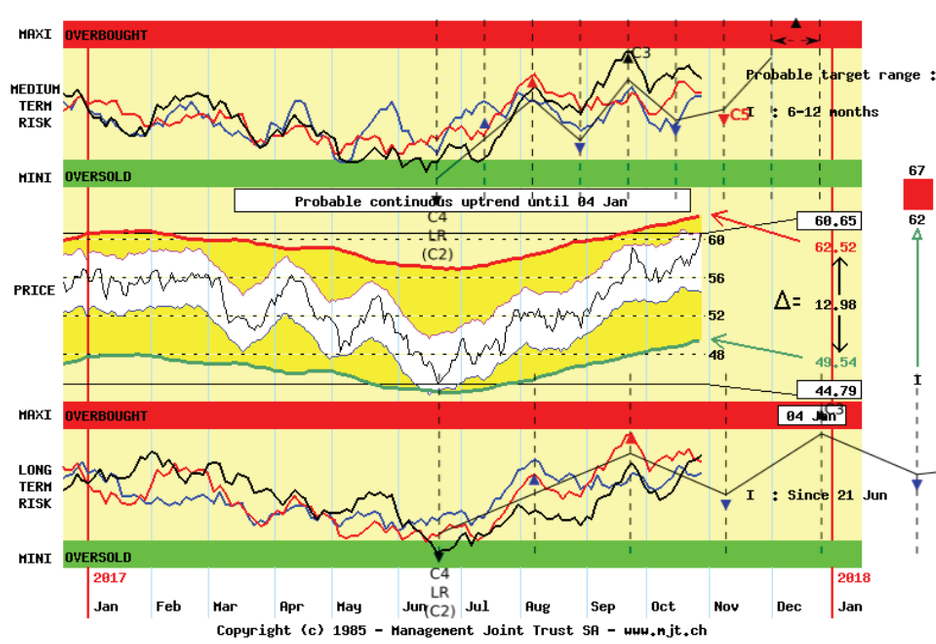
Oil has re-accelerated up since June and then again in September. It made an intermediate top late September, but the consolidation was short lived and Brent recently broke above USD 60/ barrel. Along with other reflationary assets, we believe it could take a slight pause during early November, before it accelerates up again, possibly towards late December or early January.

Brent Oil – Spot
Weekly graph or the perspective over the next 2 to 4 quarters



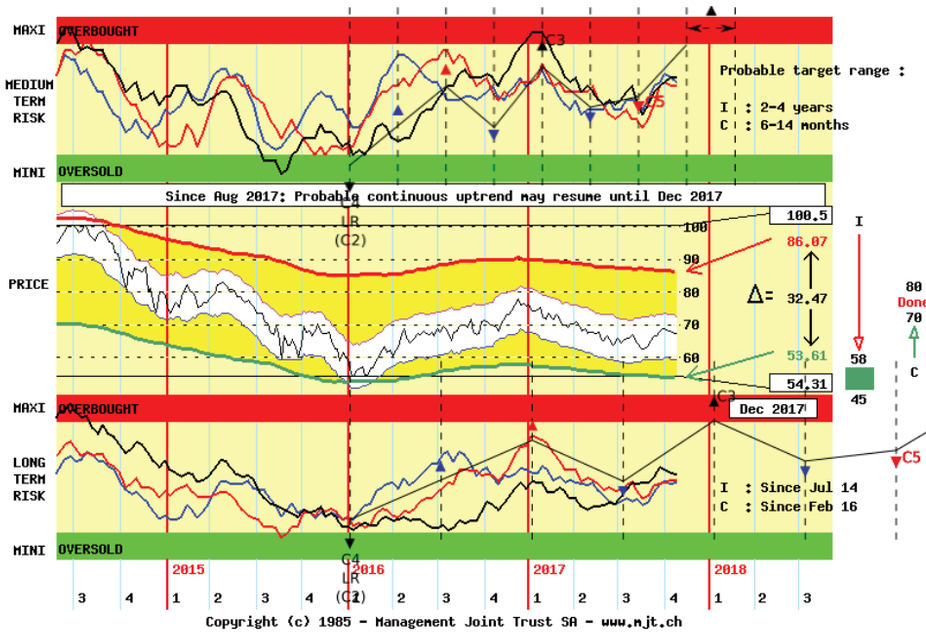
On both our oscillator series (lower and upper rectangles), Oil has resumed its uptrend, probably towards year-end or January. The higher end of our "C" corrective targets to the upside (right-hand scale) are probably the levels we would be aiming for over the next few months (high 60s, low 70s USD/barrel on Brent, which would correspond to mid, high 60s on WTI).

Brent Oil – Spot
Daily graph or the perspective over the next 2 to 3 months



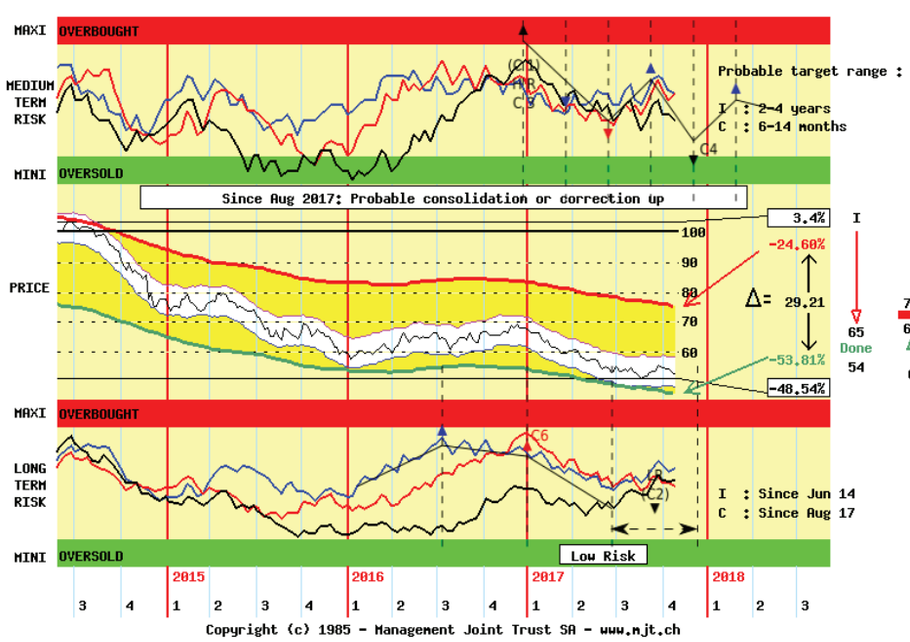
An intermediate top was made on both our oscillator series (lower and upper rectangles) late in September. The correction rapidly found support on our medium term oscillators (upper rectangle) and then accelerated up to new highs. On both oscillators, we would still expect **a short pull-back early November, before Oil accelerates up again towards late December or early January. "I" Impulsive price targets for this move point to a range between 62 and 67 USD/barrel** (the higher mark is closer to our Weekly targets mentioned above).

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



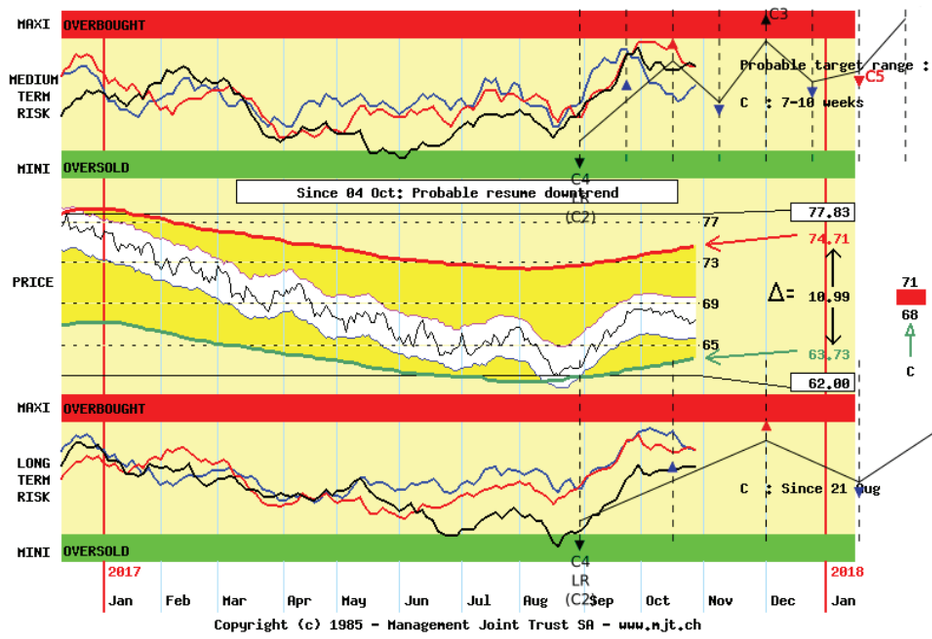
The US Energy sector is pointing to similar dynamics as Oil, yet it is finding it harder to re-accelerate. As mentioned further above in this issue of The Capital Observer, Energy is a value sector and as such it is still finding hard it to follow Oil's rapid rise (i.e. the yield curve is still flattening/retesting lows). Nevertheless, on both our oscillator series, **it should continue to push higher, possibly until year-end or early 2018**. "C" Corrective potential to the upside (right-hand scale) point to a range between 70 and 80, or **possibly as high as 15% higher**.

XLE - Energy Select Sector SPDR Fund / SPY - SPDR S&P 500
Weekly graph or the perspective over the next 2 to 4 quarters



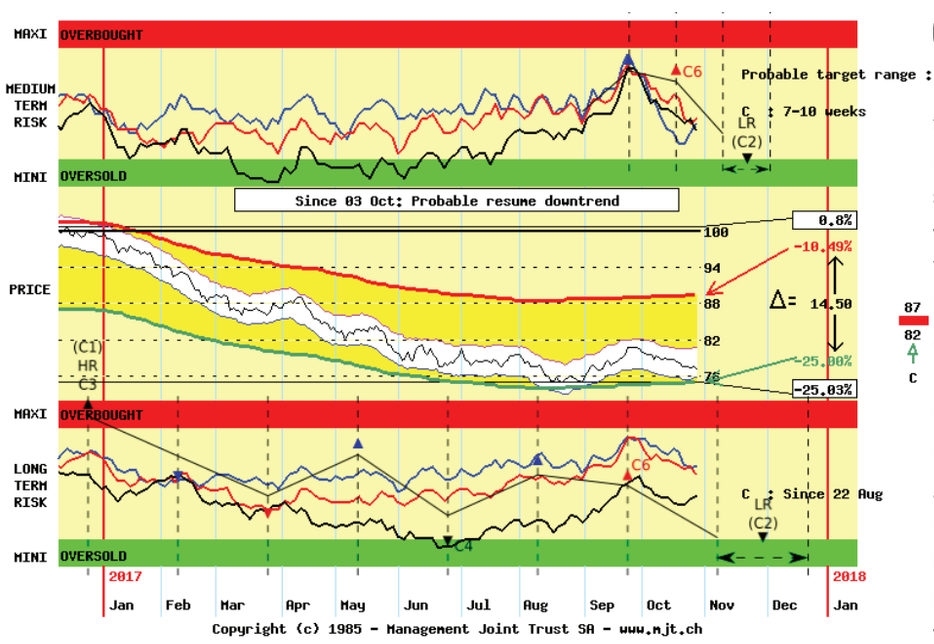
The lag of US Energy vs Oil itself is clearer to see when the sector is compared to the S&P500. Indeed, US Energy recently made new historical lows on a relative basis in August. On our long term oscillator series (lower rectangle), Energy is now in a "Low Risk" position vs the market. However, our medium term oscillators would suggest **one last underperformance re-test into late November and then a bounce into Q1 2018. "I" Impulsive targets (right-hand scale) to the downside have been achieved, so that the downtrend is close to exhaustion**. When/if the bounce materialises from late November to early 2018, the potential may be quite strong as shown by our "C" Corrective targets up. Yet, the ratio would need to make a worthwhile low before we can confirm these.

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



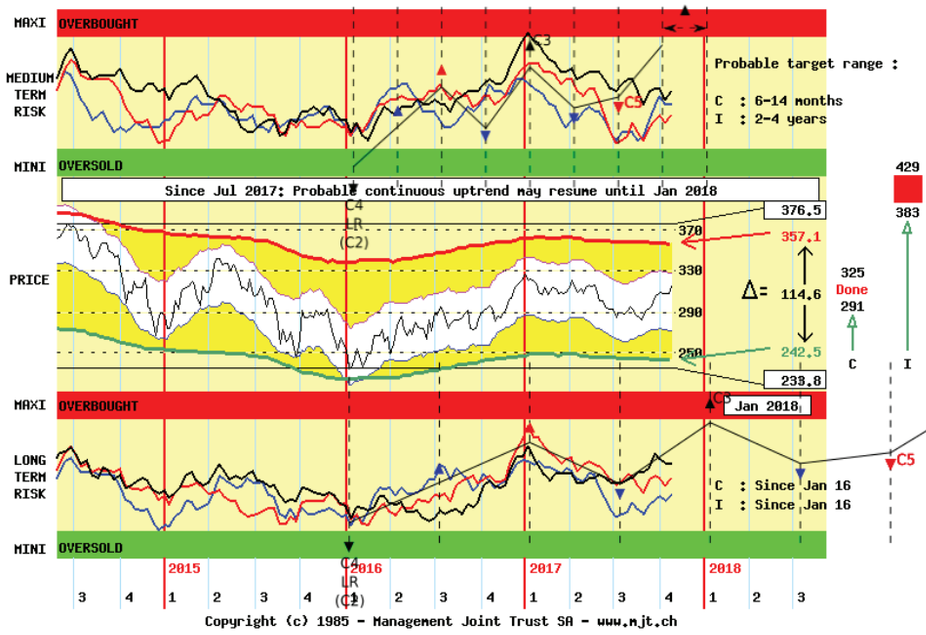
US energy has seen a strong bounce since mid August and may have reached intermediate tops between early and mid October. On both our oscillator series (lower and upper rectangle), **we would expect it to move up towards December and then possibly into Q1 2018. In the meantime, our medium term oscillators (upper rectangle) would suggest that the current slight consolidation continues into early November**. Prices will need to break-above the support of our "C" Corrective targets up, or above 71, to really start to accelerate (right-hand scale).

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



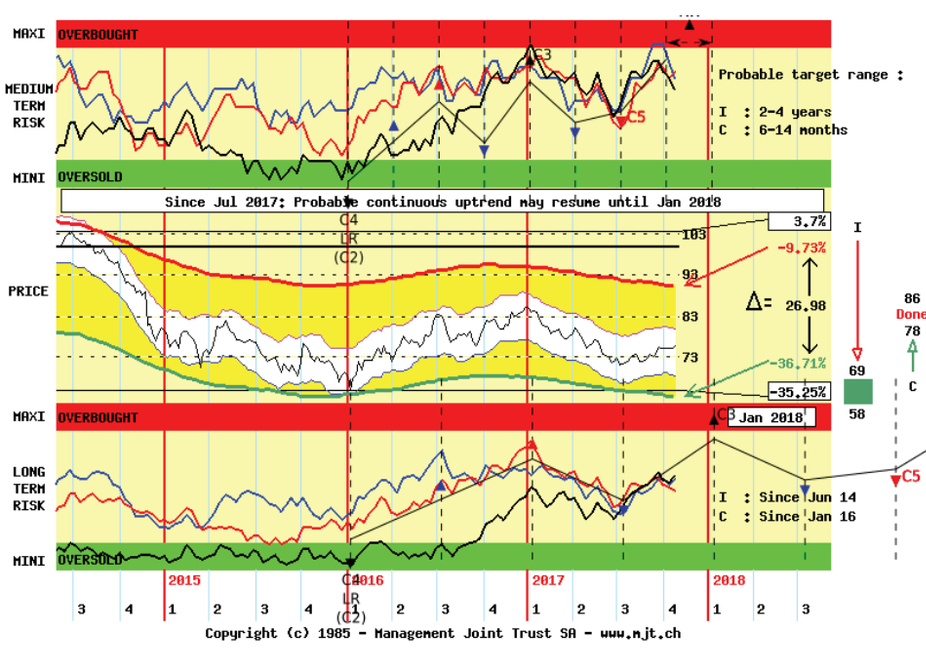
On a relative basis, vs the S&P500, US Energy did bounce during September, yet that bounce is rapidly being retraced. **Both our oscillators series probably suggest a retest of lows during November.** The trend may be nearing exhaustion, with our wider yellow envelope starting to turn up and our thinner white envelope bouncing against it once more (middle rectangle; in the graph), yet there is no confirmation yet of a reversal. **Once/ If it materialises, the "C" Corrective relative potential to the upside (right-hand scale) would suggest between 10% and 15% outperformance for US Energy vs the market towards early next year.**

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



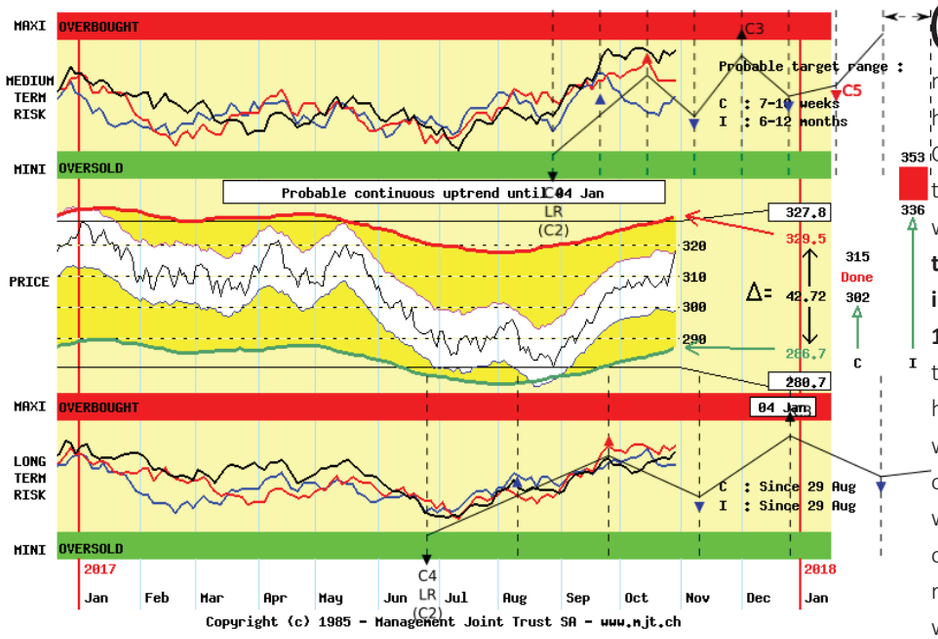
The uptrend for the European Energy sector seems more solid that in the US. Indeed, prices have accelerated up strongly since August and are now approaching the tops, which were achieved earlier this year. On both our oscillator series (lower and upper rectangles), **we expect the current uptrend to continue towards year-end and possibly early 2018. In order to really accelerate, the sector would first need to clear its "C" Corrective targets up above 325, 2% higher than today** (right-hand scale). Above that, our "I" Impulsive targets up would suggest between 20 and 30% of additional performance.

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



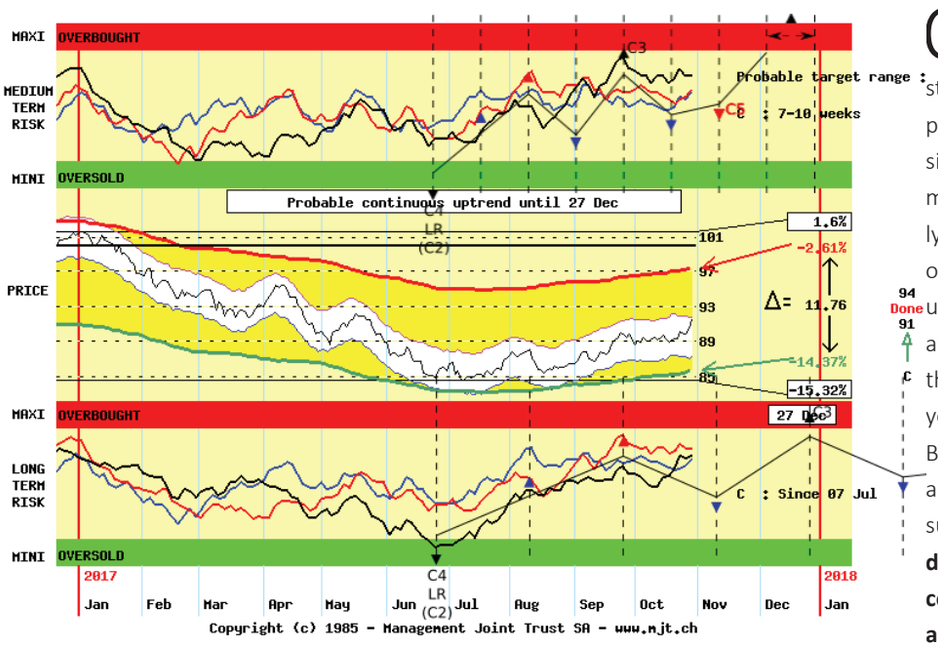
On a relative basis, however, the European Energy sector is also struggling vs the Europe Stoxx 600 Index. Yet, both our oscillator series (lower and upper rectangles) would suggest **that the sector continues to outperform its benchmark into year-end or early 2018. Our "C" Corrective targets up (right-hand scale) would suggest an outperformance that could reach above 10% until then.**

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



On a Daily basis, the European Energy sector is currently in an acceleration up. It has just made it above its "C" Corrective price targets up and the move is now "impulsive" with **"I" Impulsive targets to the upside that could reach into the 336-353 range (5 to 10% higher than today)** over the next few months (right-hand scale). This is less than what we are projecting above on the Weekly graph, yet it would constitute a first level of break-out targets in the current uptrend. The sequences we show on both oscillator series (lower and upper rectangles) would suggest **a pull-back over the next couple of weeks and then a new period of acceleration towards year-end.**

ENERGY - Dow Jones STOXX Europe / Dow Jones STOXX 600 Europe
Daily graph or the perspective over the next 2 to 3 months



On a relative basis, the European Energy sector is stronger that its US counterpart. It has been moving up since July (shortly after the lows made on Oil) and is currently approaching the resistance of its "C" Corrective targets up (right-hand scale). A break above these would lead to further outperformance towards year-end and early next year. Both our oscillator series (lower and upper rectangles), would suggest **a slight period of underperformance over the next couple of weeks and then a new period of outperformance towards year-end.**

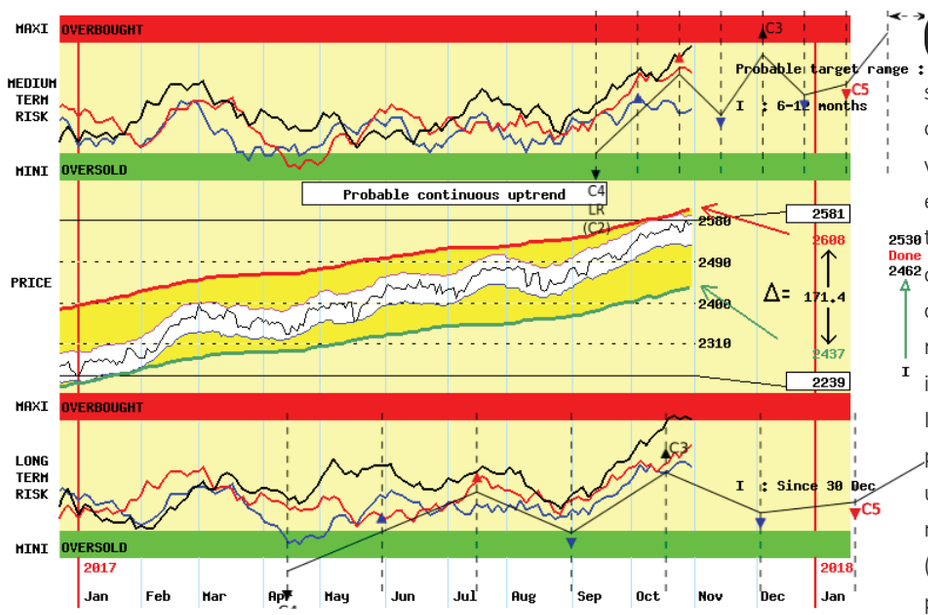
Concluding remarks

Oil and the Energy sector have accelerated up since late August and are confirming the resume uptrend situation, we had expected since early Summer. Following a slight pull-back over the next couple of weeks, they should continue to accelerate towards year-end. Generally, on a relative basis, the Energy sector is still finding it difficult to outperform the market. This is especially true in the US, where new relative lows are possible over the next few weeks. Following that, we would expect it to finally gather some momentum, that could lead it to outperform towards year-end and early 2018.

46 / Splicing the markets – Strong markets with a rotational bias should continue towards H1 2018, yet short term risk/reward still looks extended

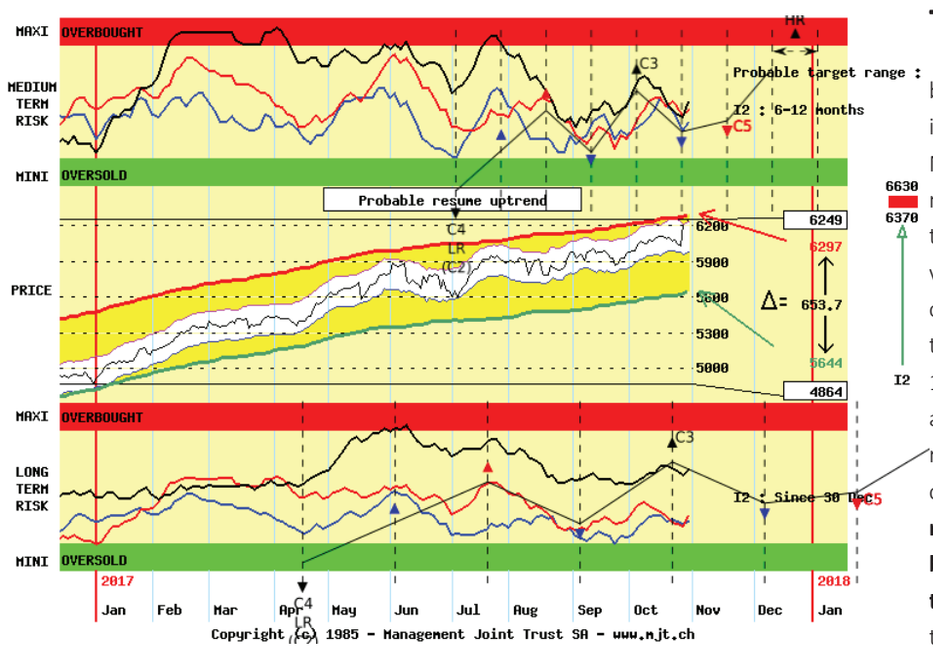
Linear markets are a challenge for medium term markets timers. We had mailed the equity bottom in late August, yet advised to shift back to prudence towards the end of the first week of October. Our shorter term risk reward was then getting extended and our oscillators were already showing important exaggerations. The window for retracement, we had then envisaged was between end October and possibly mid November. Three weeks down the line, equity markets are still extending up and growth rotations are kicking in, bringing further support. Yet, our oscillators are still in exaggeration, risk/reward is still extended and the timing window for some retracement (although it may be benign) is still open over the next couple of weeks. We hereby review the markets main equity indices.

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



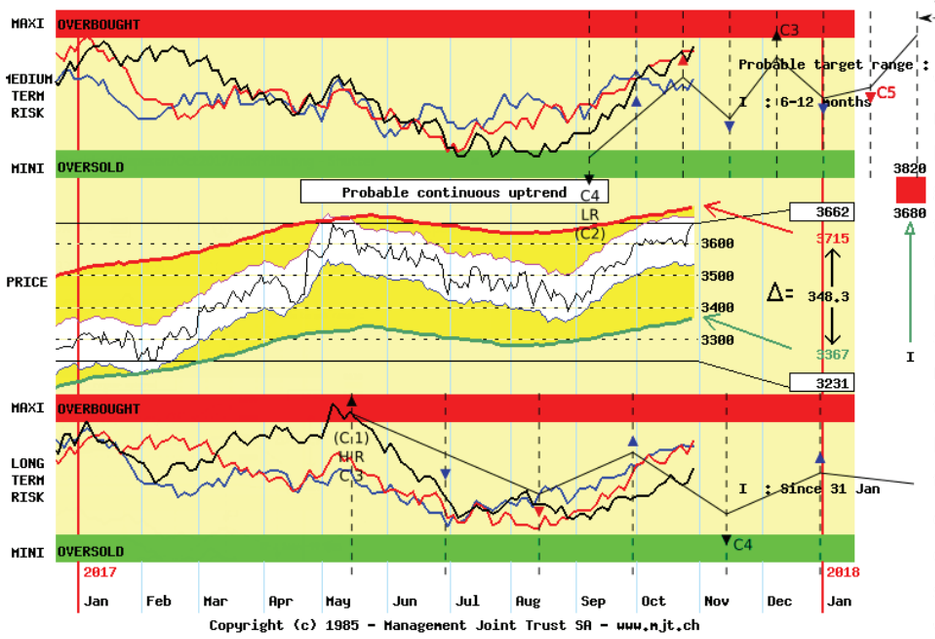
Our 'I' Impulsive targets to the upside (right-hand scale) have been reached and over-run, and our standard deviation envelopes are touching each other again (middle rectangle). Both are indications of **extended risk/reward**. On our long term oscillators (lower rectangle), we had reached an intermediate top mid October. It would theoretically imply a possibly consolidation window until end November. On our medium term term oscillators (upper rectangles), we could possibly map a number of further extensions to the upside, yet the latest to date does lead into **some consolidation over the next 2 to 3 weeks**. We will remain prudent as to the scope of this **retracement** and would conservatively calculate it as 0.5 of historical volatility measure "delta" (here at 171.4, middle rectangle; right hand side) or **possibly 85 points.**

NASDAQ 100 - Daily graph or the perspective over the next 2 to 3 months



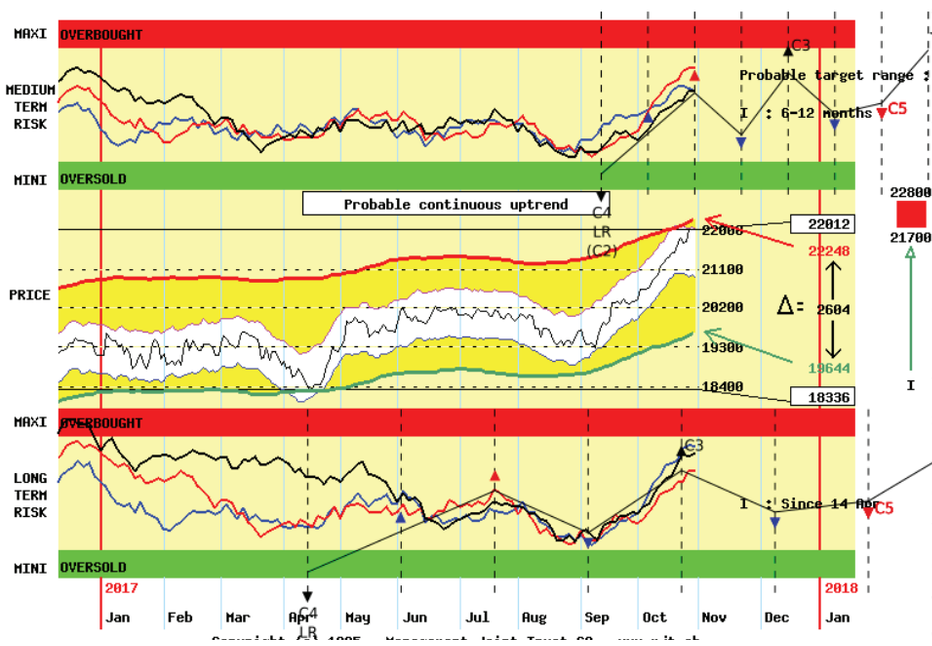
The recent short term extension in equity markets is being led by further rotation into Growth and especially the Nasdaq 100. This is a phenomenon we have seen many times this year and it has prevented any widespread market consolidation. On our medium term oscillators, the Nasdaq 100 seems to be making yet another push higher (upper rectangle). It may last into December, yet could see **a slight retest towards mid November, before it accelerates higher thereafter.** Our "I" Impulsive targets up have been met and we are now eying our extended measure of targets "I2" Impulsive 2. Historically, using our methodology, only about 10% of moves make it that high, so that we are already in extended territory. We also use a conservative measure to assess the scope of a possible **retracement** or 0.5 of historical volatility measure "delta" (here at 653.7, middle rectangle; right hand side) or **possibly 327 points.**

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



The EuroStoxx 50 did stop momentarily early October, yet it is pushing ahead once more on the back of the weak Euro, following the ECB's policy guidance last week. Our view throughout this document, is that the current reflationary push since early September should retrace somewhat during November. This may weigh to a certain extend on the Dollar and reverse this advantage for European markets. On our long term oscillators, the downtrend which was in place since May is now invalidated, yet a pull-back could still materialize to meet the cyclical low that could have been expected mid November (lower rectangle). On our medium term oscillators (upper rectangle), the intermediate top made early October may justify a sequence were **some retracement is expected over the next couple of weeks**. Risk/Reward is still very much neutral at this stage as there is still room to move higher over the next few months on our "I" Impulsive targets up (tight-hand scale). We would probably expect some retracement back to the **breakout last week**.

Nikkei 225 – Daily graph or the perspective over the next 2 to 3 months



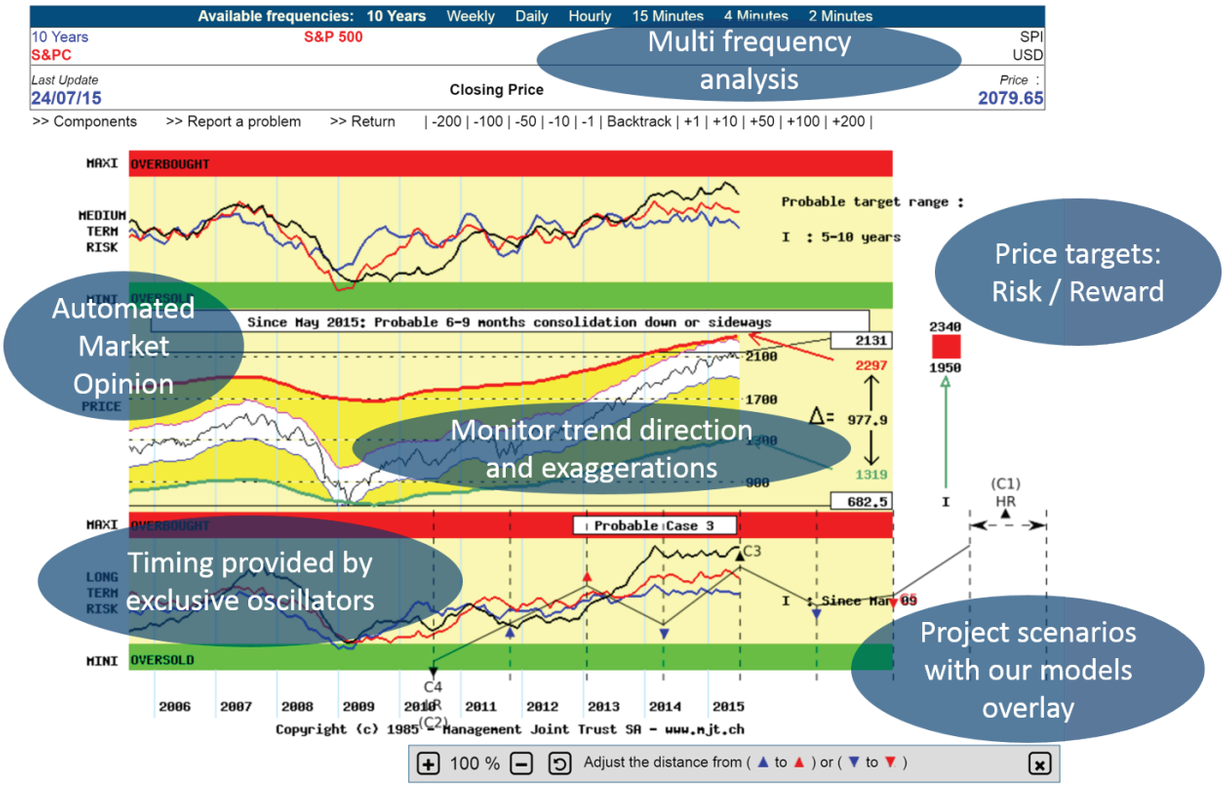
The Nikkei 225 has been gliding higher and has now reached into its "I" Impulsive targets to the upside (right-hand scale). Another 3% potential would theoretically still be possible before these become really extended. Our long term oscillators are approaching an intermediate top (lower rectangle) that theoretically could see them consolidate until early December. Our medium term oscillators are also in exaggeration and showing an intermediate high that could **retrace for 2 to 3 weeks until mid November** (upper rectangle). Also here, we would conservatively calculate the scope of a possible **retracement** using 0.5 of historical volatility measure "delta" (here at 2'604, middle rectangle; right hand side) or **possibly 1'300 points.**

Concluding remarks

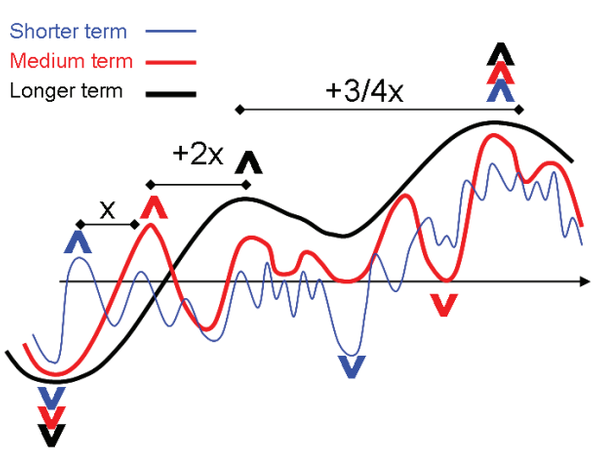
The above consolidation targets may appear quite benign, yet the time window for the consolidation we had then expected early October, and still expected today, is still open for another couple of weeks. This is indeed a short term market positioning call. If you think about it, what would you do today if you were receiving net new money. In our view, you would probably wait a bit for a better opportunity to enter. Longer term, as we have done over the last few months and quarters, we reiterate our positive bias on equity markets towards Spring next year.

48/ METHODOLOGY

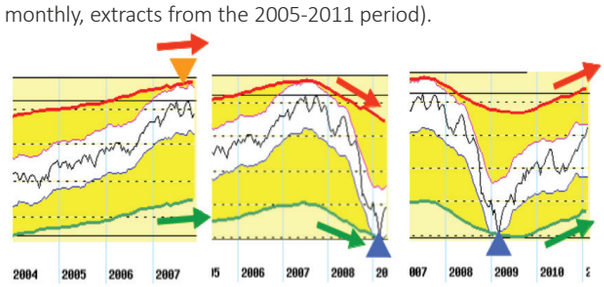
MJT's proprietary methodology uses Timing Oscillators to help investors position themselves either in an uptrend or downtrend. It will hence allow them to anticipate and project the future sequence of events. Coverage extends over 5'000 instruments, long term to intraday, across all asset classes. Relative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



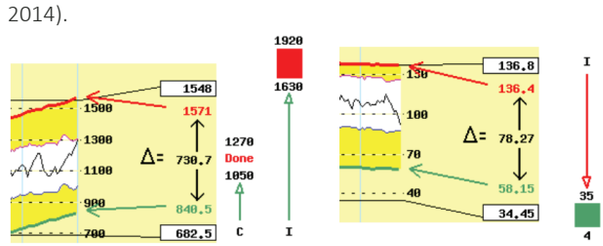
Timing oscillators: Different prices cycles are captured by our 3 Timing oscillators. Monitor how their relative positioning defines specific situations (Cases) to always know where you stand within the Trend (e.g. please see below the ideal Uptrend Case succession sequence)



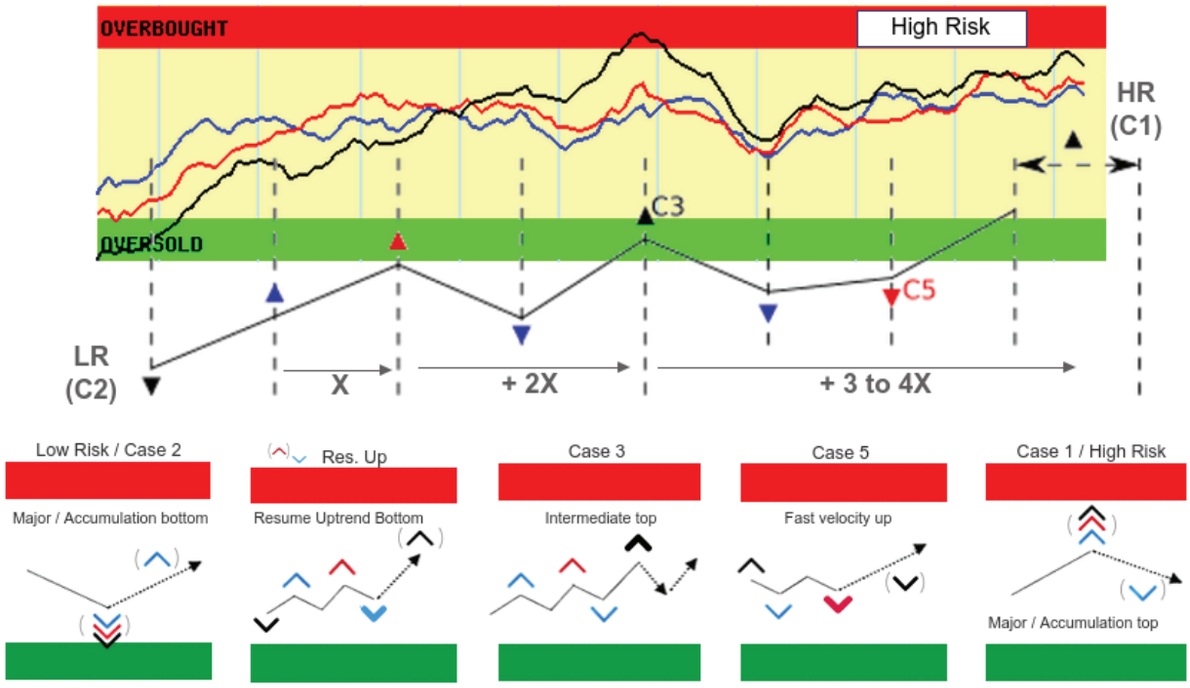
Trend direction: the direction of FinGraphs' large envelope will help you decide either to apply an uptrend or a downtrend model. Contacts between the wider and thinner envelopes will help you anticipate and confirm market turning points (e.g. S&P500 bi-monthly, extracts from the 2005-2011 period).



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).

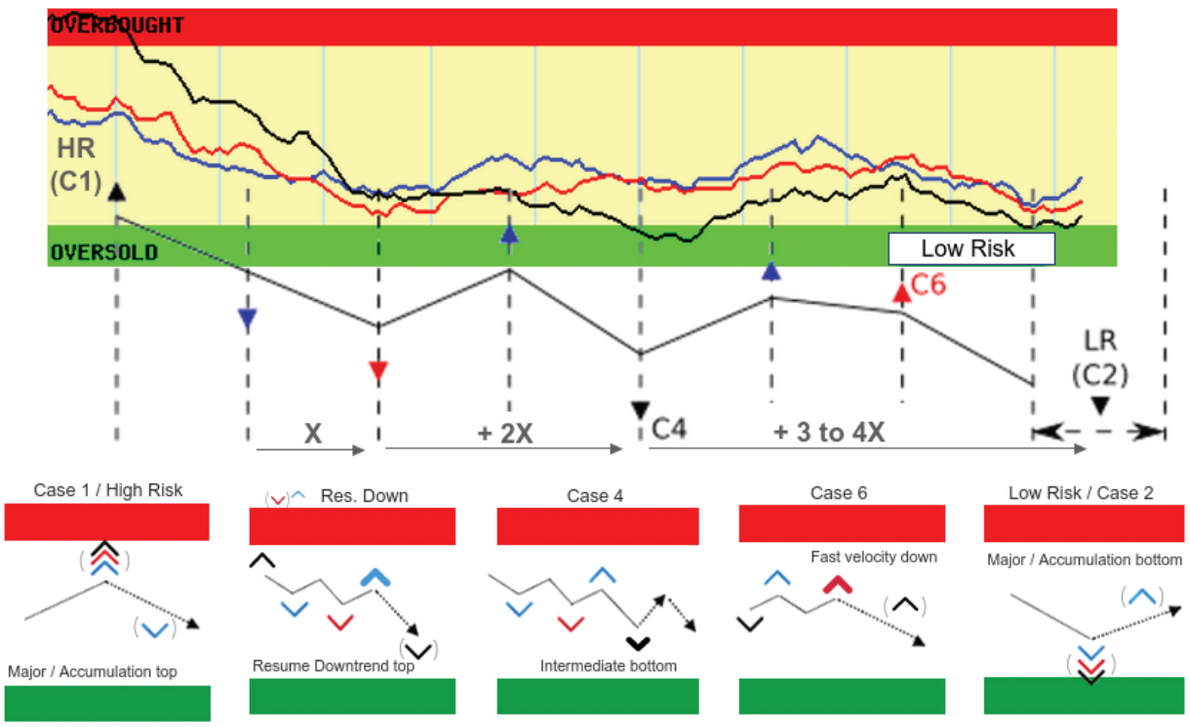


Ideal Uptrend Model



(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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