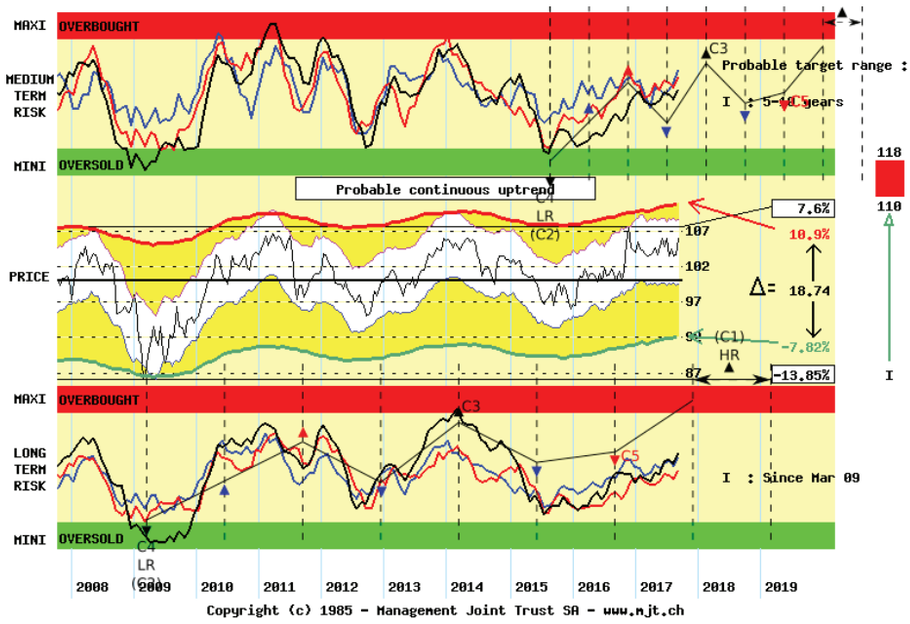
45 / Splicing the markets – Secular rotations between Cyclicals, Growth and Defensives in the US equity markets

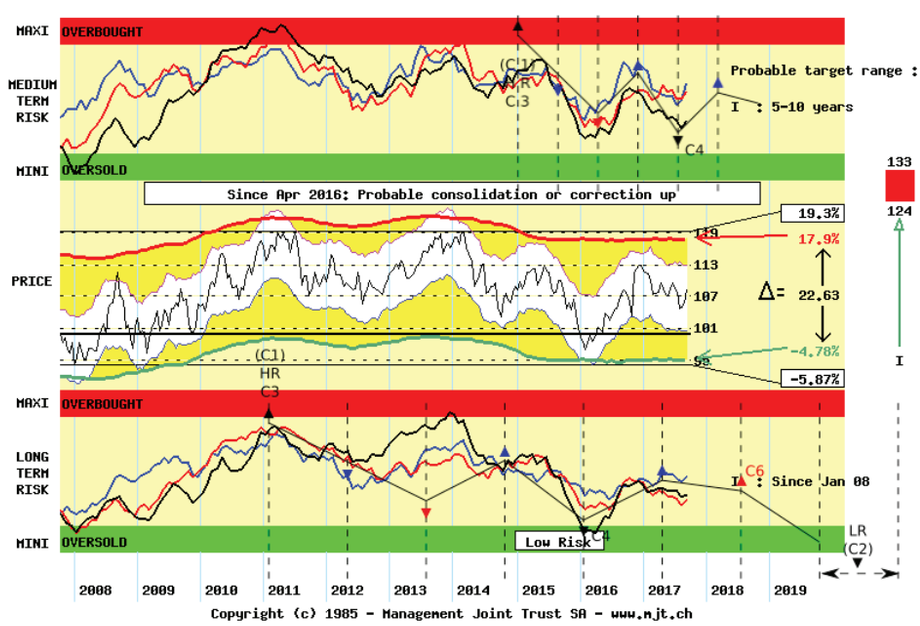
We currently expect the reflationary push that started early last year to move up again quite strongly into H1 2018. This move, in our view, comes in the context of very mature equity markets and hence this cyclical acceleration should be short lived (yet should benefit cyclical assets). Growth profiles, on the other hand has been roaring for years. We expect their secular uptrend to come to an end in 2018 as equity markets top-out towards mid year. Defensive trades should then make a come back, possibly into mid 2019 at least.

XLI - Industrial Select Sector SPDR Fund vs S&P 500
Bi-monthly chart or the perspective over the next 1 to 2 years



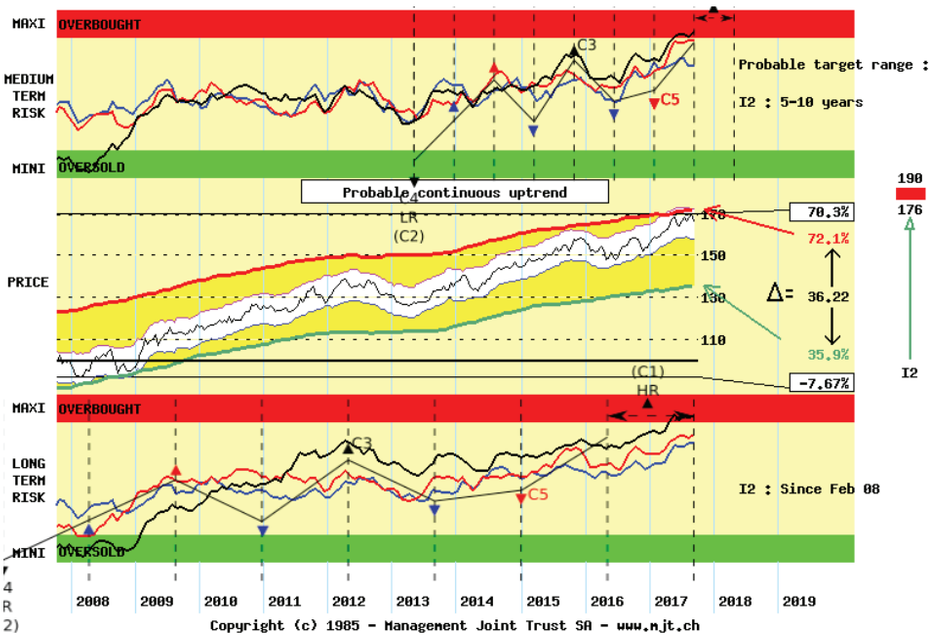
We have chosen the XLI Industrials ETF as a proxy for cyclical stocks and compared it to the S&P500. As you can note on this relative graph, this ratio has followed very well the different pro- and anti-cyclical periods we have experienced over the last 10 years. On our long term oscillators series (lower rectangle), **we would expect it to top out sometime next year**. Our medium oscillator series (lower rectangle) suggest that the cyclical peak will probably materialize in the first months of 2018. **Following that, we would await that XLI underperforms the S&P500 index into 2019 at least. We believe that this timing sets the time window for the reflationary acceleration we expect, sometime between now and the first months of 2018.**

IWM - iShares Russell 2000 ETF vs S&P 500
Bi-monthly chart or the perspective over the next 1 to 2 years



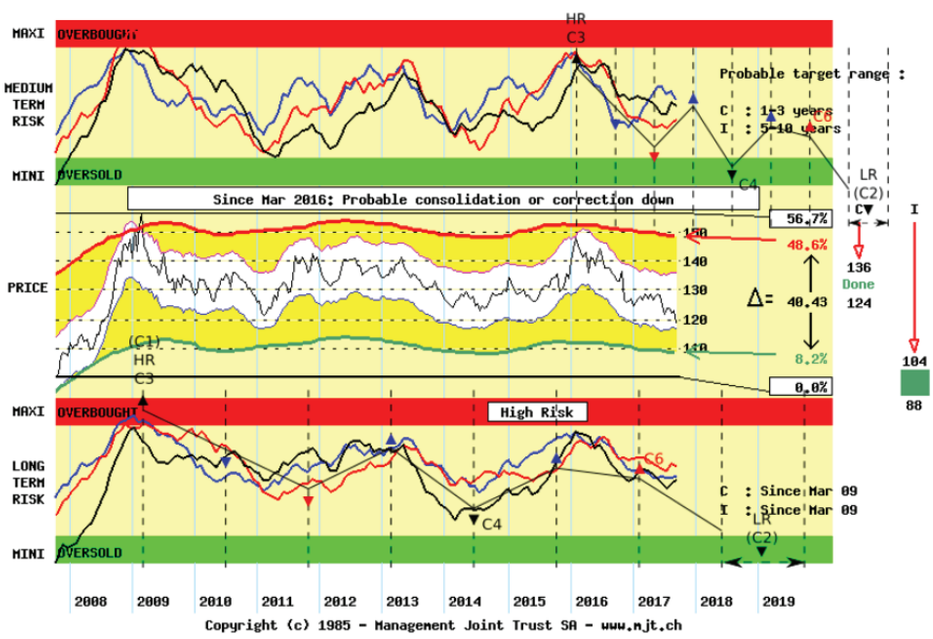
Comparing the Russell 2000 IWM ETF with the S&P500 also captures this cyclicality. This graph shows similar articulations that the one above with a bit more volatility. Our medium term oscillators (upper rectangle) are showing a succession of higher lows, early 2016 and Summer 2017, and from there, a possible reaction up to early 2018. The sequence we show on our long term oscillators (lower rectangle) would justify a further attempt to the upside towards mid 2018. **The reaction up to H1 2018 seems weaker, yet consistent, with the previous graph, confirming our time frame towards early 2018 for the acceleration of cyclical and reflation trades.**

NDX - NASDAQ 100 vs S&P 500
Bi-monthly chart or the perspective over the next 1 to 2 years



We now look at a typical Growth index, the Nasdaq 100 vs the S&P500. Growth usually thrives in most phases of the market except for early cyclical accelerations and periods when interest rates are rising rapidly (Growth is usually long duration). Growth is also quite prone to long gradual uptrends as was experienced during the 1990's in the run-up to the Internet Bubble. The current secular uptrend since 2006 (and even 2002) is not as exaggerated as the one that topped-out in 2000, yet, on both our oscillator series, it has entered "High Risk" zones, which is a typical sign of exhaustion. **We would hence expect Growth vs the market to start topping out during the reflationary acceleration we expect into early 2018. It may make a last come-back as the market starts to top-out towards the Spring and mid 2018. Yet, the extended nature of its trend should make Growth more a "beta" play rather than a defensive play if the market downturn we expect from mid 2018 into 2019 materialises.**

XLP - Consumer Staples Select Sector SPDR Fund vs S&P 500
Bi-monthly chart or the perspective over the next 1 to 2 years



Finally, we look at Staples vs the S&P500, or at a typical Defensive profile vs the market. Defensives have been underperforming the market since the current reflation trades turned-up in early 2016. On both our oscillator series (lower and upper rectangles), **we expect them to continue lower at least until mid 2018, where we expect them to bottom-out. Following that, they should start outperforming towards 2019 as the general market tops and reverses. Until then, the potential underperformance ('I' Impulsive targets, right-hand scale; middle rectangle) is still quite substantial, a further indication that the reflationary acceleration into early 2018 may be strong.**

Concluding remarks

Throughout this late September issue of The Capital Observer, we have repeatedly outlined our view that cyclical and reflation trades should see an acceleration from mid Q4 to early 2018. The move may be strong, especially as the time-frame is quite short. From the Spring, we would expect some rotation back into Growth before the markets starts to top-out mid next year and Defensive profiles start to outperform into 2019. We will be monitoring the situation closely over the upcoming months to confirm this view.