6/ Mapping the markets (part I)

General comment

Last month (late August) we wrote that the correction to the downside initiated early August had probably finished a first leg down. We expected that risk assets should bounce or extend into late September or early October, before a new risk off phase could materialize into mid October / early November. We believe that this scenario, expressed back then, is still correct.

As we write US markets are still making all-time highs, while Europe and Japan are continuing to rally towards, or into, their year-to-date highs. Interest rates have also made strong rebounds, while oil saw an almost 20 % rally from its through late August into its peak earlier this week. All these developments are very promising and many voices have joined us over the last few weeks in calling the re-acceleration of reflation trades. That said, we believe that as we move into mid/late October, some of them may be deceived.

Indeed, risk/reward on equity markets seems stretched again, and Oil has probably just started a period of intermediate correction (thereby joining China and Industrial metals, which peaked a few weeks back). We hence expect that over the next week a so, risk and reflation assets could top-out again and enter an intermediate correction that may last into late October and possibly even mid November. During this period, assets that are currently defensive, such as Gold, Treasuries, the Yen or the Euro should make a last push to the upside. Most of them could even reach new year-to-date highs. Then, coming late October / early November, they should start to correct down or resume their existing downtrends towards H1 2018. On the other hand from November on, we would expect reflation trades to start accelerating up again towards early next year.

Equity markets

Volatility

As planned last month, VIX retraced down towards its base into mid/end September. We believe it is bottoming out again and it should see a new bounce materialize over the next couple of weeks.

World markets
p 11, 12, 13, 15, 16

The extension/rebound we expected on equity markets last months has materialized. We believe that world equity markets should top out again over the next week or so and start retracing into late October, early November. The downside potential during this period on major equity indexes is possibly between 3 and 6%.

Regional picks
p14 - 16

We expect the Euro and the Yen to extend to the upside once more during October. While all major equities should see a correction, European and the Japanese markets should hence underperform once more during this period. Coming November, the Dollar should initiate a more sustainable rebound as reflation trades re-accelerate. Equities in Europe and Japan will then break their glass ceiling to substantially outperform the US into early 2018.

Emerging markets
p 17, 38

China and especially Commodity related countries are our favorite Emerging markets towards year-end and early 2018. Yet, during October, as Commodities correct to the downside, they should also experience some temporary underperformance. On the other hand, commodity importers (such as India, South Korea, Mexico), should see a relative bounce.

Relative Sectors
p 25, 32- 33, 40- 46

Defensive sectors should make a come-back as markets retrace during October. Reflationary sectors such as Industrials, Materials, Energy or Financials should suffer temporary underperformance. Come late October, early November, the rotation should shift back as reflation trades start to reaccelerate towards year end.

Profiles/Themes
p 21, 34, 45, 46

Following their strong bounce during September Value, Size, High beta should retrace back into late October, early November, while Growth, Min Vol and Defensives should make a comeback. From November, the rotation shifts back to reflationary and pro-cyclical themes, probably until yearend or early 2018.

Interest rates

US rates and Yield curve
p 22, 23, 24

Given the retracement we expect on risk assets during October, US Treasury yields should see further retracement into end October. Following that, yields should position themselves to the upside until year-end and early 2018.
The US yield curve spread (10Y - 3M): it will continue to flatten during the October, early November risk-off period. Following that, we would expect the yield curve to start steepening towards year-end.

Other countries
p32

Yields and Yield curves in other developed countries are following similar dynamics as in the US, yet with a more positive tilt. For example, in Europe and Japan, 10Y yields are approaching their year-to-date highs, while the shorter term tenures are still well below them. Hence, their yield curves are already getting steeper again. That said, we would also expect some retracement on these during October.

7/ Mapping the markets (part II)

Credit
p20

High Yield should follow equity up during September and could consolidate down again with them into October.

Rate Differentials

The US yield should curve continues to flatten, at least for the next couple of months, while in Europe and Japan, the Yield curves are already steepening again. Hence, the US vs Eurozone and Japan short term rates differentials (2 years tenures) are starting to move up again, while the long term rates differentials (10 year tenures) are still retracing.

Tips
p 20

The ratio of TIPs vs Treasuries has seen a nice bounce in September. It may retrace down again in October as inflation anticipation ease, before it re-accelerates up towards year-end. On an absolute basis, TIPs are following Gold and Treasuries, and could hence extend up, possibly into mid Q4.

Commodities

Oil
p 39

Oil made a further leg up towards late September as we had planned. It should now retrace again into October (support is probably towards the August highs), before it re-accelerates up again from November to early 2018.

Industrial metals

Their intermediate top came in with China early September. They should now continue to retrace, possibly into late October, before they re-accelerate up towards year-end.

Gold & PMs
p 28, 30, 32

During October / early November and the last retracement down we expect on reflation assets, Gold could make a last acceleration to the upside. It could reach into the high 1'300s. We expect this timing and these levels to offer a last exit opportunity, before Gold starts to correct down into 2018. Silver has bounced versus Gold, yet may still see a last downside re-test against the golden metal into October.

Agriculture

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

Foreign Exchange

Dollar Index
p 29

Last month we expected a slight bounce into September for the Dollar. Yet, we still believe that it will now resume its downtrend, possibly into late October / early November. Following that, the Dollar could start to bottom as reflation trades finally reverse and start to accelerate up towards year-end (the Dollar is the more reflationary of the top 5 currencies).

Euro
p 13- 14, 31

The uptrend on EUR/USD may be getting somewhat exhausted, yet we would still expect one last push up vs the Dollar into late October, early November. Vs other majors, the Euro should see some retracement vs the Yen in October, a failed attempt to revisit recent highs vs the Pound and a last extension up vs Swiss Franc.

Yen
p 16, 31

Last month we expected the Yen to remain weak into the second half of September, possibly early October. We then also mentioned, that during October, it should move up again with other defensive assets. We still believe this is the case. Following that, from late October / early November, it should start to weaken substantially towards year-end as reflation trades re-accelerate.

Sterling

As planned last month, the Pound rallied vs all other majors in September. We believe it should retrace some of these moves into October, yet without reversing them. Indeed, the re-rating of the Pound seems underway and it looks rather strong vs all other majors towards next year.

Oil & Commodities currencies
p 44

These have been strong since June vs the majors and could correct some to the downside as oil retraces during October. Following that, from November to early next year, we are very positive on Oil and Commodity related currencies.

Asian currencies

INR, KRW or TWD have started to reverse down vs the Dollar, yet could see a last upside re-test during October. These "Asian growth" currencies should then weaken again from November to early 2018 as the reflation trade re-accelerates.