

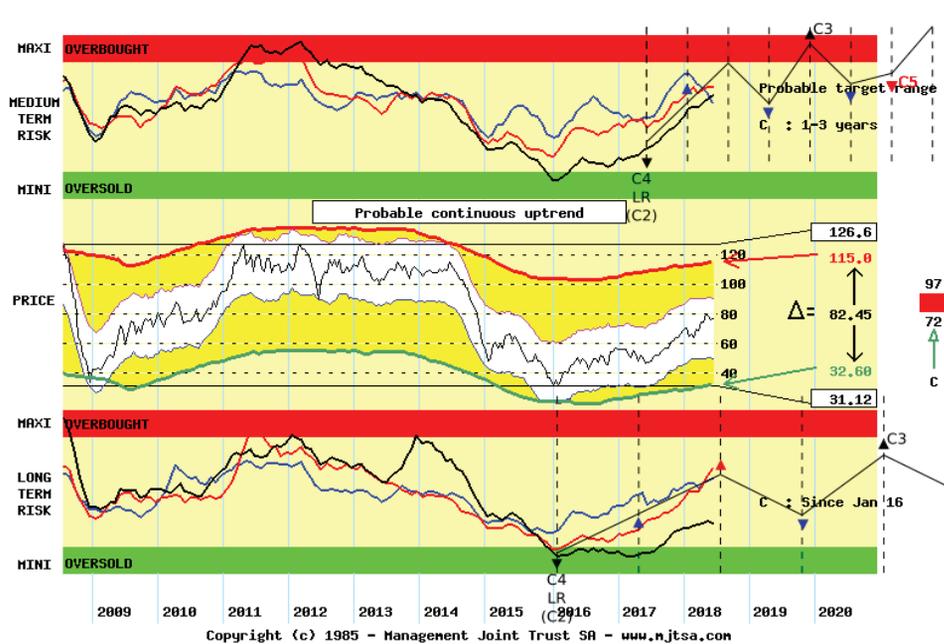
## 35 / MJT - TIMING AND TACTICAL INSIGHT

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

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

### Brent Oil (Spot)

Bi-monthly graph or the perspective over the next 1 to 2 years

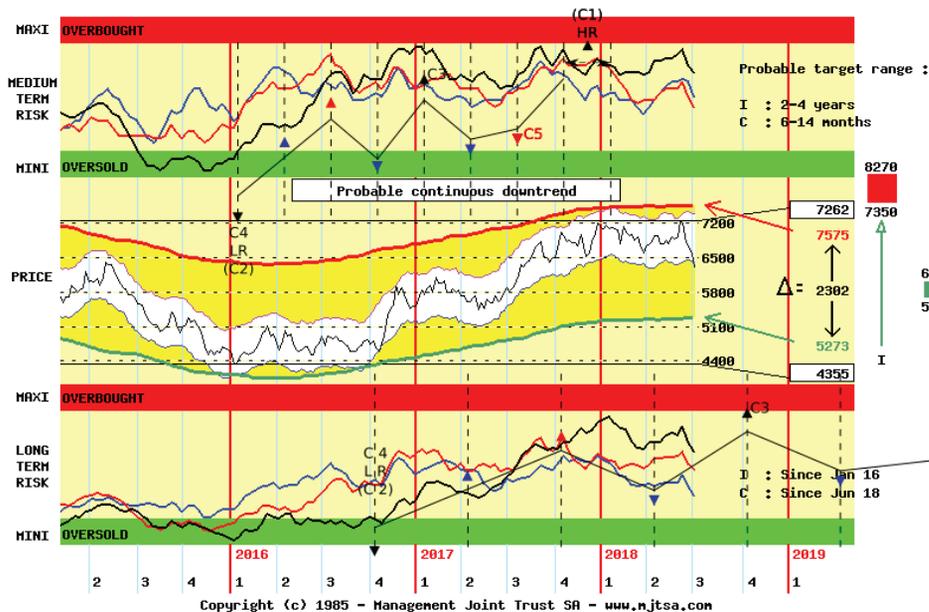


**W**e believe that Oil prices are revealing the state of the reflation trade, and that following a 2.5 years of recovery (from USD 27/barrel to above USD 80/barrel), **Brent Oil is approaching an important intermediate top.** Both our oscillators series (lower and upper rectangle) confirm this inflection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

bably back to the 45 -55 range).

### Copper Spot (LME)

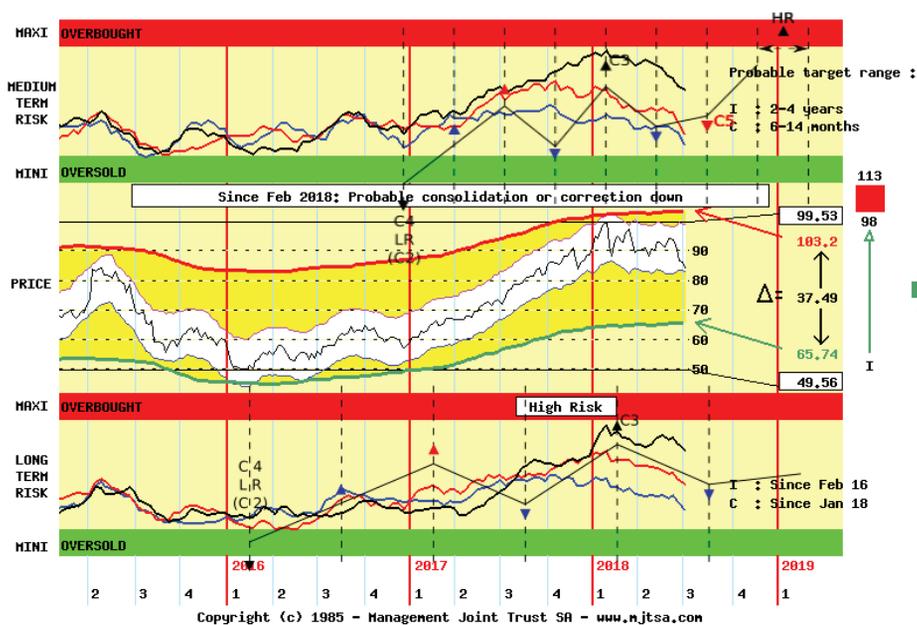
Weekly graph or the perspective over the next 2 to 4 quarters



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

## MSCI China

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

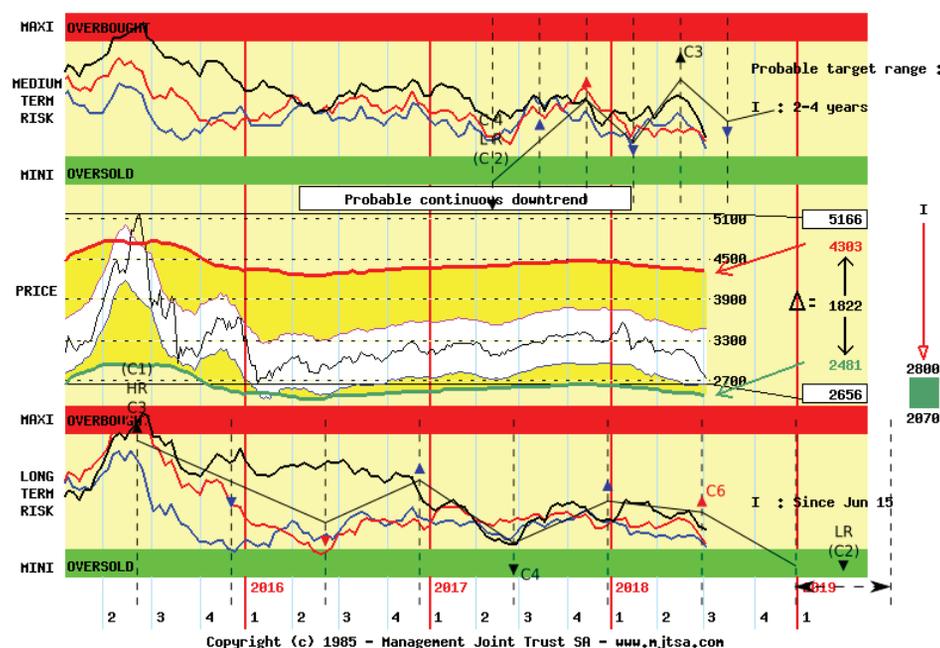


On the equity side, China's upside momentum also seems to have stalled. We first look at the MSCI China index, which is quite "Growth" oriented as it includes many larger international companies and especially large holdings in Tencent, Alibaba and Baidu (the so-called "BATs"). Both oscillator series (lower and upper rectangles) would suggest that **following further weakness into mid Summer, the MSCI China Index could rally once more into the Fall.** Risk/reward (right-hand scale) is also quite

neutral at this stage and **we wonder if the MSCI China will still manage to make new highs (upper rectangle) or if it will merely stabilize (lower rectangle), before it resumes lower towards end 2018 and into 2019.**

## Shanghai Composite

### Weekly graph or the perspective over the 2 to 4 quarters

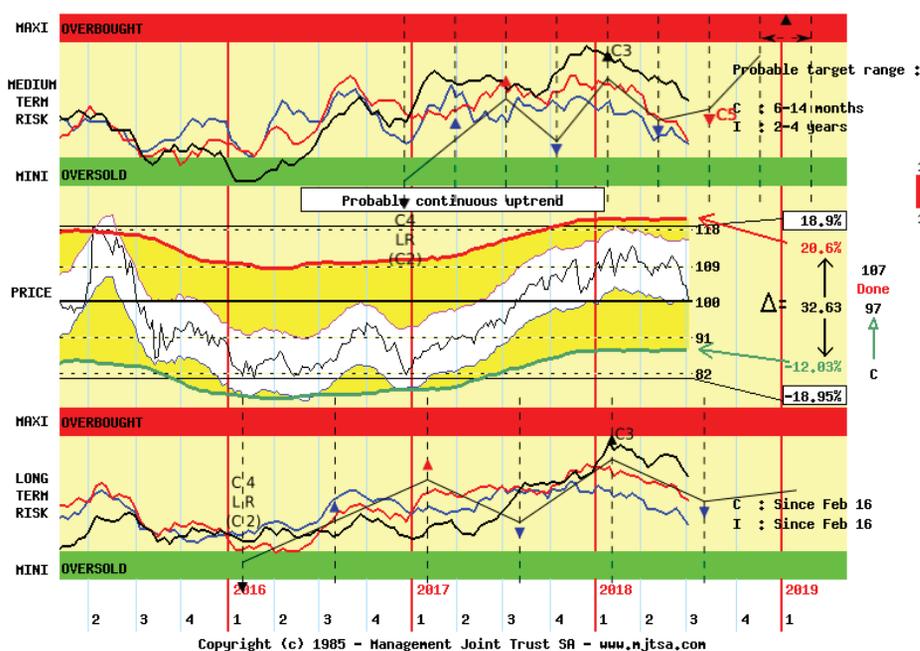


China's domestic market has suffered more than the MSCI China year-to-date. Indeed, the brewing trade war, the declining effects of stimulus, and the pressure of US Dollar denominated debt have led the Shanghai Composite to retrace aggressively since the beginning of the year. According to both our oscillator series (lower and upper rectangles), **the current downtrend is far from over and could extend well into H1 2019 with I Impulsive targets to the downside (right-hand scale) that could reach as**

**much as 25% lower.** That said, shorter term, our medium term oscillators (upper rectangle) do show a short stabilization period from mid Summer into the Fall.

## MSCI China / MSCI World

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

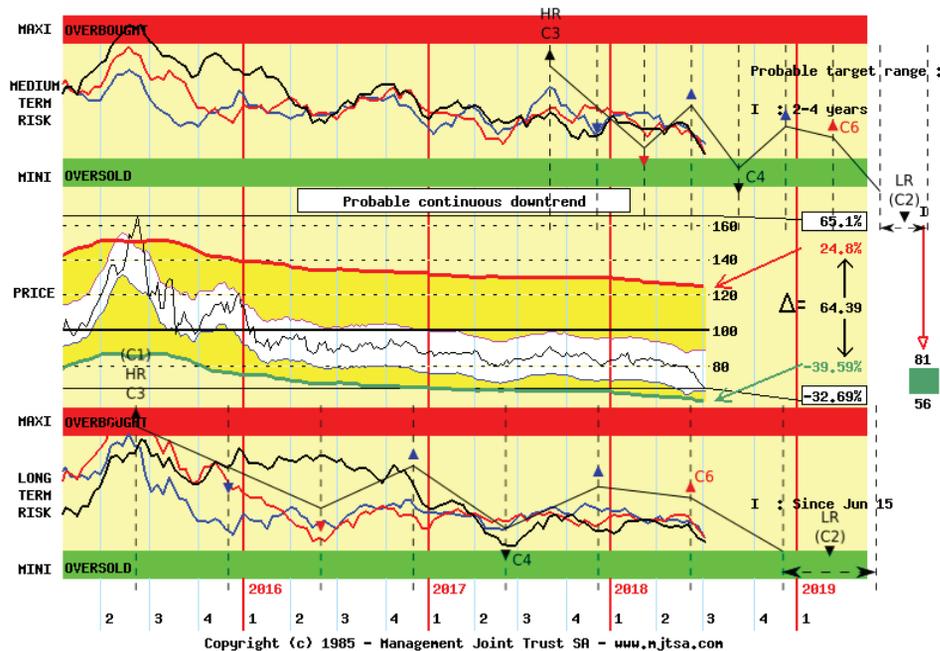


On a relative basis, vs the MSCI World, the MSCI China Index has also been correcting quite aggressively since late Q1. Here also, both oscillator series (lower and upper rectangles) suggest that **the ratio could stabilize by mid Summer and bounce into the Fall.** For now, however, we are back within our C Corrective targets to the upside (right-hand scale) and their upper end will serve as strong resistance over the next few months. Hence, **we would probably favor a scenario where the MSCI China bounces from mid Summer vs**

**the MSCI World, yet without making new highs (lower rectangle), rather than a strong outperformance towards new highs (upper rectangle).**

## Shanghai Composite / MSCI World (in USD)

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

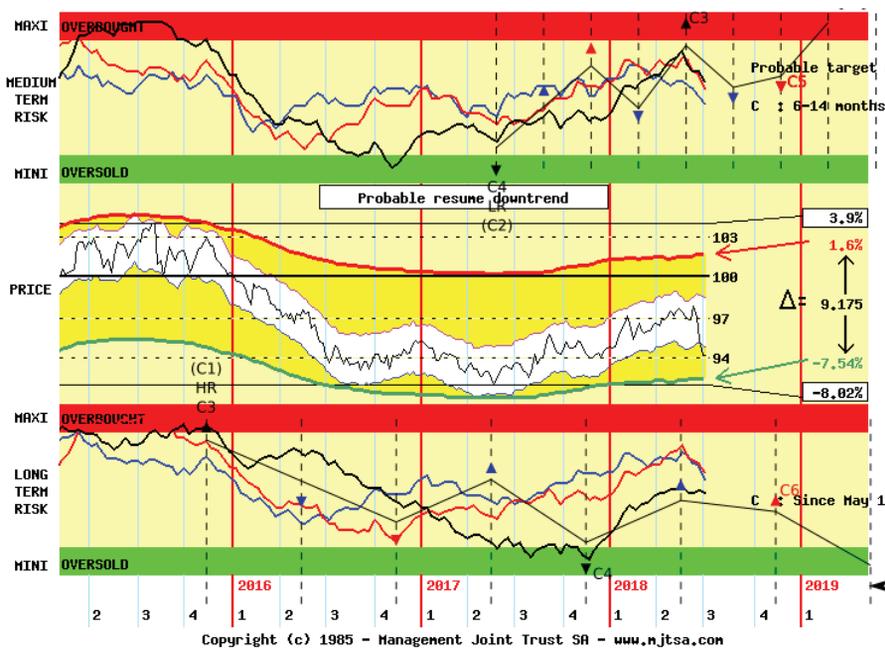


Interestingly, the ratio of the Shanghai Composite vs the MSCI World also shows the possibility of a bounce from mid/late Summer into the Fall, before the ratio resumes lower from Q4 into mid next year. For now, the upper end of our I Impulsive targets to the downside (right-hand scale) has been reached,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

**towards next year for the Shanghai Composite vs the MSCI World.**

## Trade Weighted Yuan

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

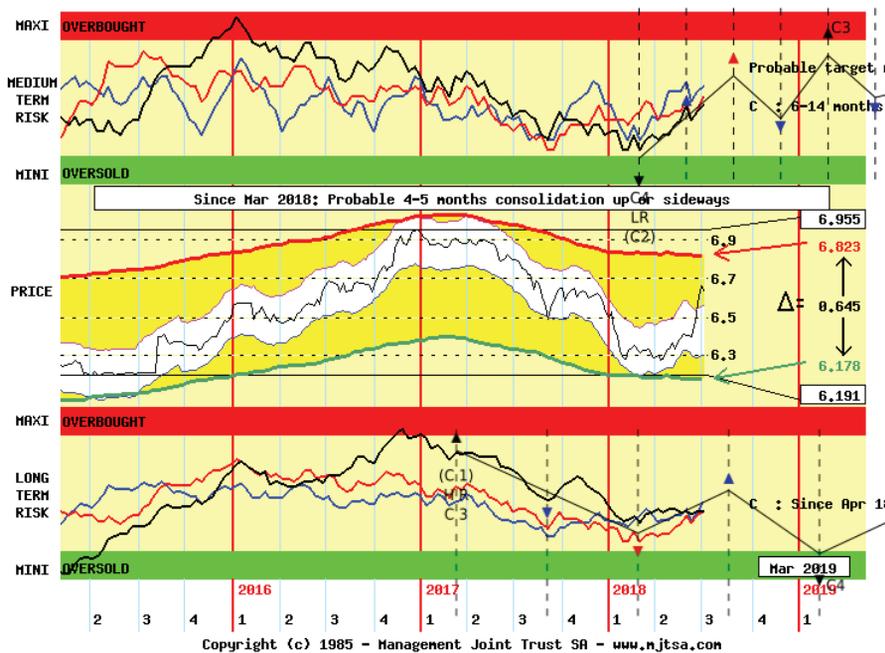


Since mid Q2 2017, the Yuan had been rising vs a portfolio of currencies of China's main trading partners. The recent devaluation retraces some of this move. **Going forward, we expect the Yuan to stabilize during the Summer and attempt a further upside retest during the Fall.** Given that the whole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

could make new year-to-date highs (upper rectangle).

## USD/CNY

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

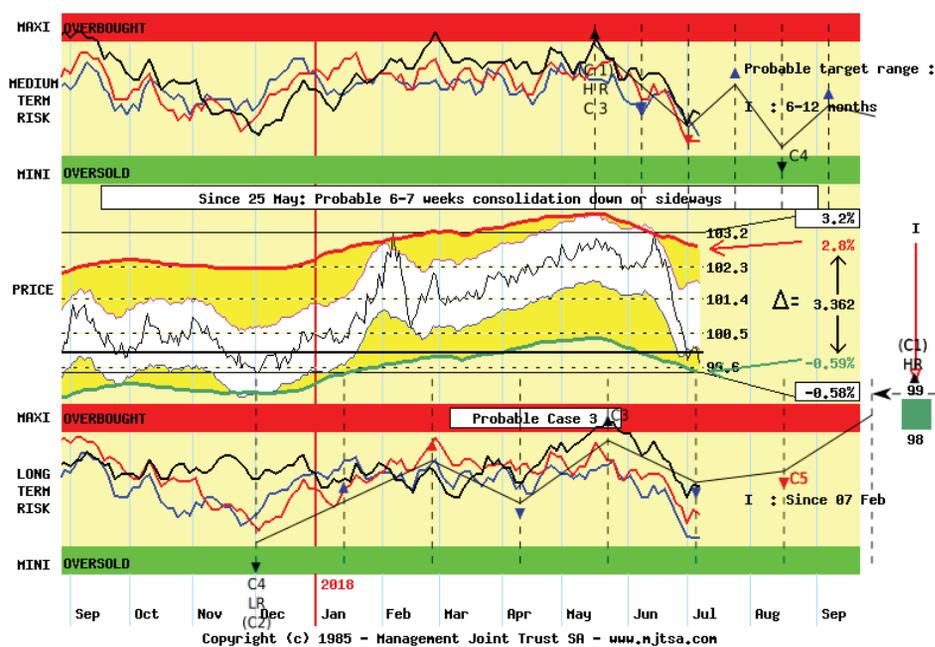


The strong sell-off of USD/CNY from Q2 2017 into Q1 2018, was rapidly retraced during the recent devaluation. **From mid Summer, however, we expect the Yuan to start strengthening again vs the US Dollar (lower USD/CNY).** Our long term oscillators (lower rectangle) suggest that USD/CNY could make new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

Ideally, to confirm this view, we would like to see USD/CNY break above 6.8, or above our C Corrective targets to the upside (right-hand scale).

## Trade Weighted Yuan

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

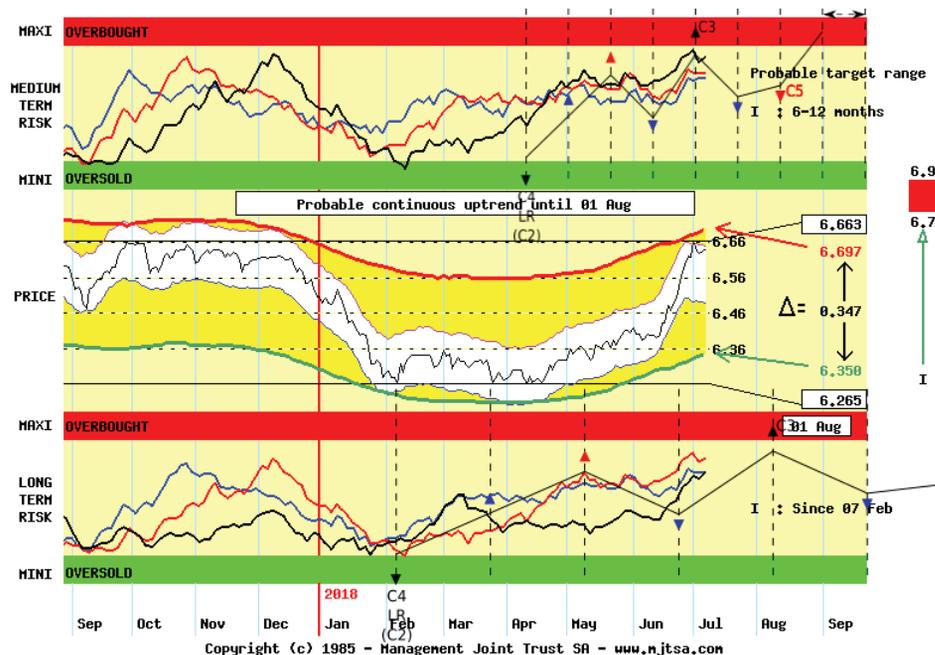


Shorter term, the Trade Weighted Yuan saw a strong sell-off between mid June and today. For now, on both our oscillator series (lower and upper rectangles), it is too early to call the end of this downtrend. Indeed, following a short bounce, which could last until late July, the Trade Weighted Yuan should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

% of the move down has been done (the remaining risk is rather limited).

## USD/CNY

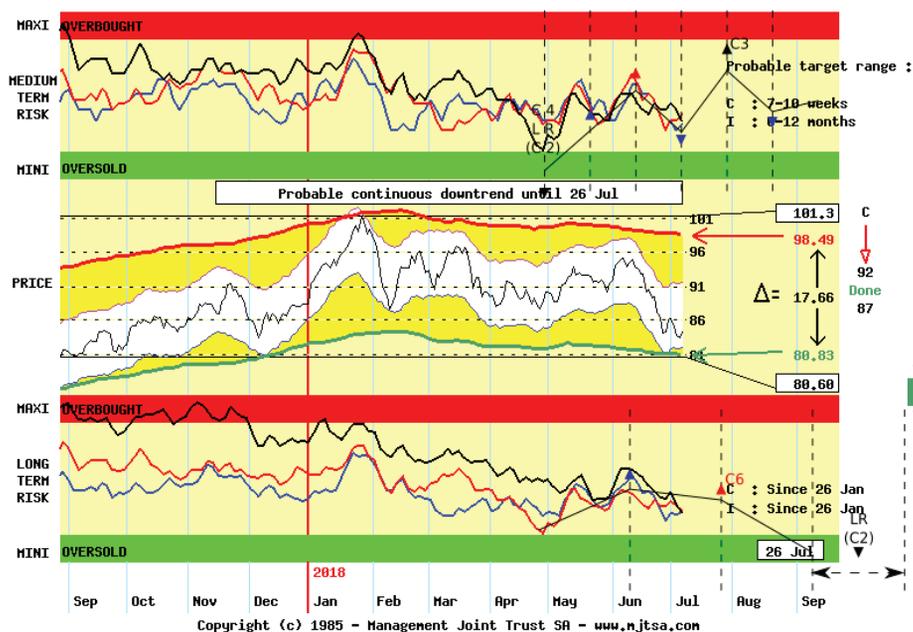
### Daily graph or the perspective over the next 2 to 3 months



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

## MSCI China

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

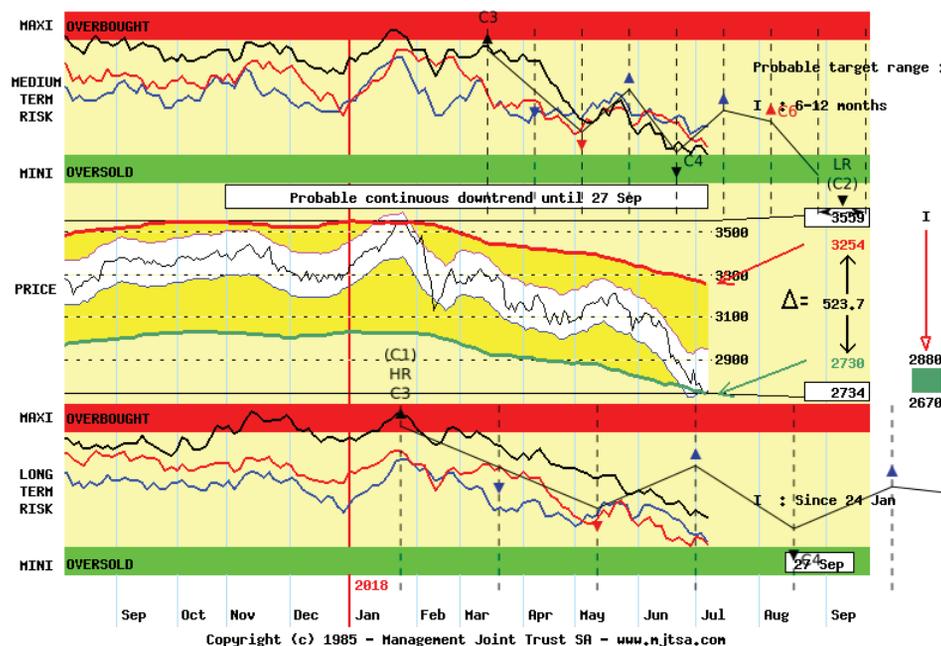


On this MSCI China index, it is still too early for now to confirm a worthwhile low. Yet, we do expect a bounce, probably over the next couple of weeks. Following that, the sequences we show on both oscillator series (lower and upper rectangles) indicate that the MSCI China could move lower again into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

til mid/late August (and a more sustainable low) before we venture back into the Chinese market.

## Shanghai Composite

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



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

#### Concluding remarks

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