THE CAPITAL OBSERVER

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

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THE CAPITAL OBSERVER

A Monthly Macro and Asset Review
Featuring MJT's Timing Methodology

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CONTENTS

04 / Executive Summary

06 / Mapping the markets

12 / 2020 Global outlook: de-synchronized growth prospects for US and China suggest flat global growth

17 / Timing and Tactical Insight

Yields should bounce again, into late Q1 / early Q2 at least

The priming of the economic pump and the Fed's complicity in keeping monetary policy on the easy side during the last 12 months of the Presidential election cycle has been a factor in the US markets for almost a century

Eoin Treacy

24/ Emerging Markets: this sector maybe ready for prime time now; EM will outperform developed economies in 2020

27 / Timing and Tactical Insight

Emerging markets are breaking out to the up-side vs developed ones

35/Gold strengthens its negative correlation with bond yields, which are due for more declines in the medium-term (after Q1), ushering in exciting times for investors in Gold and Gold Miners again.

38 / Timing and Tactical Insight

Gold and precious metals could be in blow-off mode throughout the year

45/Liquidity impact on assets as geopolitical tensions calm down: equities, yields should go lower near-term ahead of a rally to another peak in March 2020

51 / Timing and Tactical Insight

Equities – still uptrending although risk/reward is getting very stretched

57/ Splicing the Markets - Update on Oil following the Soleimani's death Spike

4/ Executive Summary

12 / **2020 Global outlook: de-synchronized growth prospects for US and China suggest flat global growth** - *We took the IMF's word for an H2 2019 recovery because the global GDP proxy did bottom on June 15, 2020, and has been rising since then, according to our projections for global growth. The IMF has since then issued an update in July 2019, saying: "Global growth is forecast at 3.2 percent in 2019, picking up to 3.5 percent in 2020 (0.1 percentage point lower than in the April WEO projections for both years) "*

But a sense of foreboding doom just doesn't seem to go away. There seems to be that belief that if a recession did not happen in 2019, it has just been postponed. And so here we go again – a new round of pessimism has again struck the US corporate world. Ninety-seven percent of US CFOs (corporate financial officers) surveyed in a new poll believe that the United States will be in recession by the end of 2020. These CFOs are no lightweights -- eighty-eight percent of CFOs represented in the survey work at companies generating greater than $1 billion in annual revenue. This summation was taken from a new survey of around 150 chief financial officers conducted by the consulting firm Deloitte.

While The Capital Observer report does not disagree with the summary, we believe that Q4 2020 may be too soon for that happen. We believe recession-like conditions will appear in early 2021, and its trough may occur during Q2 2021. This continues from the theme that we have discussed and presented in the September 2019 edition of The Capital Observer, that US GDP growth may indeed see a peak in either Q1 or Q2 2020, but a potential recession is not in the cards this year, but that it may happen in H1 2021, and will likely be a short one. From an expected trough during Q2 2021, US growth should recover smartly during H2 2021.

The de-synchronization of the economies of China and the US should make for a slow global growth in 2020, but there should be no sharp extremes in the evolution of global GDP, with a slight downward bias due to the disproportionate weight of the US economy relative to the Rest of the World.

17 / **Timing and Tactical Insight - Yields should bounce again, into late Q1 / early Q2 at least** - From an asset allocation perspective, 2020 still seems to be a strong year for Equities. Indeed, our Equity to Bond ratios in the US and Europe, both point to potential outperformance for Equities vs Bonds into late H2. Shorter term, these ratios are quite stretched, yet should continue higher into mid Q1 when they may initiate a 2 to 3 months intermediate correction to the downside. Focusing on yields, both the US Treasury and German Bund 10Y yields did retest their 2016 lows last year (slightly higher lows for the US, slightly lower ones for Europe). This base could certainly justify a secular reversal, or at least a bounce into year-end. Yet, for now, our medium term Weekly graphs cannot confirm such a reversal yet. Rather, they are suggesting that the current bounce could die out at some point towards late Q1 / Q2 (in the 2.2 – 2.7% range for US10Y, in the -0.2 to +0.1% range for 10Y Bund yields). Only a move above these levels would then confirm a more secular reversal. Shorter term, US10Y and 10Y German yields could still see some retracement during mid/late January. They should then rise again into February, perhaps even early March. Yield curves on both sides of the Atlantic should also follow similar dynamics as shorter term yields lag long term ones in their rebound.

24 / **Emerging Markets may be ready for prime time now; EM will outperform developed economies in 2020** - The last time we revisited the Emerging Markets was in February 2019 issue of The Capital Observer. At that time, we had the title: "Emerging Markets not yet ready for prime time, but start nibbling at it as another bet for commodities outperformance." That said a lot. After a year, what has changed? For one, the MSCI EM$ was broadly higher, but the price of industrial metals and of copper was largely unchanged – the prices of these commodities traded sideways for most of 2019. Therefore, nibbling at EM risk assets early last year did not bring much benefit from commodity purchases because the US Dollar, from the time we wrote the piece in February last year, almost monotonically rose higher until September. However, what quantifies as "amazing" was that EM assets and currencies held their ground, kept their valuation basically intact, and then some. EM currencies performed very well indeed, as the MSCI EM$ continued an uptrend that has been in place since August last year. There were many reasons for this, including the efforts of many EM economies to re-denominate their US Dollar debts. Also, with the Fed walking back its desire for tighter monetary conditions, the investment case for emerging markets has vastly improved. Furthermore, global investors were betting big that the U.S. dollar will likely ease on less aggressive Fed monetary tightening. This would relieve some of the pressure on emerging economies that must pay higher prices on imports from the U.S. when the dollar is strong. That the US Dollar did strengthen, but EM assets still fared well, nonetheless, was very noteworthy. EM has stopped becoming an alternative for US growth – a destination to go to when US growth falters. In this case, when US growth revives, there are massive outflows from the EM universe – a recurring boom-and-bust. The EM CESI data in the chart above has been turning up even ahead of the US CESI. In fact, many analysts say that EM economies will outperform the developed ones this year. That is certainly true of China, a subject which we discussed in another article in this issue of The Capital Observer. With the outlook for commodities starting to become brighter, and with the Chinese economy set to rejoin a global EM reflation as from Q2 2020, investors should start looking for Tier 1 assets that will benefit from an EM re-vigoration. Emerging markets assets should not only be considered as an asset class that is expected to provide superior returns over an extended period of time, but also as a portfolio diversification tool, and a bet on future commodity outperformance.

27 / **Timing and Tactical Insight - Emerging markets are breaking out to the upside vs developed ones** - Following their strong outperformance in December, we expect Emerging Markets to outperform until mid Q1 in first instance. Then following some retracement towards late Q1 / early Q2, we would probably expect a further move up into the Summer. EM currencies seem to confirm this reversal vs the US Dollar, the Euro or the Yen. This is very promising as Emerging Markets' outperformance is usually a question of flows. Within the index, China, its largest constituent (35% of the Index), is spearheading this breakout. We expect it to rise with the Emerging Markets Index into mid Q1 and then again into the Summer. Among, the other large constituents, we like Taiwan and South Korea, which are rather cyclical, yet also Russia or Brazil, which seem more defensive/growth than other EMs. This combination (China, Taiwan, South Korea, Brazil and Russia) should provide a resilient uptrending profile into the Summer.

5/ Executive Summary

35 / **Gold strengthens its negative correlation with bond yields, which are due for more declines in the medium-term (after Q1), ushering in exciting times for investors in Gold and Gold Miners again** - The current behaviour of gold vis-à-vis bond yields revive a refrain we often use at The Capital Observer – that Gold prices are nothing more than the inverse function of bond yields and, of the broader scope of macro data influencing bond yields, GDP growth and economic activity (US and Global). Gold prices rose, and still remains well-bid as from November 2019, after the economic outlook in the US started to deteriorate again, and stagnation became apparent as the US Citi Economic Surprise Index remains mired a close to zero level. It appears to us that Q1 2020 US GDP growth will be significantly higher than the Q4 2019 growth. However, as indicated by leading indications from the US CESI and the Capital Flow model, Q2 2020 growth will come crashing down; by how much, we still have to determine. And if we juxtapose the inverse of Gold price on US CESI and US GDP, we see that Gold should do well again after Q1 going into a prospective US economic and activity slowdown in Q2 2020.

The US CESI also provided indirect confirmation to broad indications from our Capital Flows model that after Q1 2020, growth in the US will head lower. In that environment, Gold should perform well. We still have to work out the temporal correlations, but it seems to us that given the prospects of growth slowdown after Q1 2020 (and corresponding decline in bond yields), Gold should perform well until year end 2020. In fact, if our Capital Flows model is correct, Gold will be doing well until Q2 2021, when the model expects US GDP growth to fall into recession-like conditions. These are exciting times for Gold and Gold Miner investors.

38 / **Timing and Tactical Insight - Gold and precious metals could be in blow-off mode throughout the year** - Gold does look strong towards year-end. In US Dollar terms, it just broke above the resistance of our C Corrective targets to the upside on our bi-monthly graph, and could be heading towards new historic highs, possibly 20 to 30% above current levels over the next 12 months. In EUR terms, Gold is more advanced. It has already taken out its 2012 highs, yet, may still advance 15 to 20% during 2020. Indirectly, the difference in potential may confirm some US Dollar weakness during 2020. Over the next few weeks, we expect Gold to make an intermediate top during January and then consolidate down slightly into mid Q1. From mid/late Q1, it should then accelerate up again. The ratio of Gold and Goldmines vs the S&P500 as well as Goldmines themselves, are showing similar dynamics. Other precious metals such as Silver and Platinum could also rise strongly during 2020. Their ratios vs Gold are heavily Oversold on a long term basis and they could even start to outperform. This potentially implies a rather cyclical environment and a weaker US Dollar, as well as probably a relatively dovish FED, which won't be so surprising in an election year. Finally, Palladium, which has been a strong outperformer vs Gold in recent years, probably continues its outperformance into February / March. It may then suffer an intermediate correction vs Gold into the Spring as risk-assets correct down for 2 to 3 months.

45 /**Liquidity impact on assets as geopolitical tensions calm down: equities, yields should go lower near-term ahead of a rally to another peak in March 2020** - When news flow fades, the liquidity condition dominates. And the near-term liquidity situation has gone into an occasional mini-seasonality drought (as represented by the behaviour of the Treasury Cash Balances, (TCB)), and SOMA Transactions. That should be the case for another week, or two, at least. Bond yields are especially vulnerable to liquidity conditions, so in the case of the 10yr yield, the lagged effect of relative liquidity drought should depress the long bond yield lower or at least sideways until the end of January 2020, prior to a potential yield rally into March, if this year 10yr yield follows the series' five-year average. Ditto for the S&P 500 Index. The impact of public debt and of government expenditures on growth and risk assets is rarely acknowledged, but it is there, left, right and centre. It is no surprise that capital flows have a high positive covariance with government expenditures because most international investors look at the prospects of growth stemming from fiscal activity, along with monetary policies of the domestic central bank. Capital flows (domestic and foreign) and fiscal expenditures have pervasive and long-lasting impact on growth (and thereby on risk assets). Capital flows and fiscal expenditures, if used properly, can provide eye-opening long-term views of future growth prospects, and the corresponding bond yields that come along with the growth development. That is why, we will be keeping watch on these developments, as they provide the best early warning tools for outlook on the cost of money in the future

51 / **Timing and Tactical Insight - Equities – still uptrending although risk/reward is getting very stretched** – Although risk/reward is getting very stretched (this is no market for risk averse investors), we would still expect the current equity uptrend to grind higher into early/mid February. The S&P500 could reach towards the high 3'300s, the Eurostoxx50 towards 4'000. For now, the S&P500 is still leading world markets higher. We believe this is mostly due to its strong exposure to US Technology (i.e. other large US equity indexes such as the Dow Jones Industrial Average have been underperforming World markets for more than a year). This Tech leadership could continue into mid Q1 in first instance. Among other sectors, we expect Cyclical ones to suffer some underperformance into late January, before they initiate a last bounce into mid/late February. Following that, Defensive profiles should then take on leadership into late Q1 / early Q2 as equity markets may enter an intermediate correction.

57 / **Splicing the markets - Update on Oil following the Soleimani's death Spike** - The current de-escalation sell-off on Oil is quite drastic. Yet, for now, we would maintain our positive medium term outlook on it. Indeed, both Oil and related Inflation Expectations could stabilize towards late January and then reverse up during February, perhaps March (possible targets into the mid/high 60s USD/barrel on WTI). We also believe that the base built last Summer, around the low/mid 50s USD/barrel on WTI, and towards the high 50s on Brent, should provide strong support, thereby somewhat limiting the medium term risk. Finally, considering the Energy sector on a relative basis, it could continue to slide lower vs the market into late January as Oil corrects, and potentially yields also retrace. We would then expect a further bounce of the ratio during February.

6/ Mapping the markets

Last month, when we published on the 17th of December 2019, we expected the current risk assets rally to continue until late January, perhaps mid Q1, and that the main indexes could reach the higher 3’200s on the S&P500 and 3’900s on the EuroStoxx 50 over the next couple of months. These targets have now been achieved in the US, while the EuroStoxx 50 is still working through strong resistance at 3’800. On the sector front, we had a preference for a mix of cyclical and high beta profiles such as the Nasdaq 100. The latter were very strong. The former however underperformed. Geographically, we had a slight preference for Europe and Emerging Markets vs the US. Yet, the Nasdaq 100’s stellar performance, and US Big Tech’s large weighting in the S&P500, killed any chance of European outperformance vs the US (Europe actually was flat vs the equal weighted S&P500 index). Emerging Markets on the other hand outperformed the S&P500 and any other major Equity market segment, except again for the Nasdaq 100. Considering yields, we expected that until mid Q1, the US10Y should break above 2.1%, while the yield curve should steepen accordingly. We are still waiting for this projection to materialize. As for the US Dollar, we believed that it would probably remain under pressure until year-end, and then attempt to bounce into early/mid January, which has proven correct for now. Finally, we expected Oil to continue to rise into early January at least, where it could make an intermediate top, i.e. we did not expect such a spike, while we thought Gold could bounce towards year-end and then retrace into January. Again, we did not expect such a strong move with new highs.

Going forward, Equity markets are starting to feel stretched in terms of risk/reward. Yet, we would still expect them to grind higher into mid February. The S&P500 could reach the high 3’300s, while the EuroStoxx50 pushes above 3’900 towards 4’000. Emerging Markets continue to outperform into February, along with the Nasdaq100. Cyclicals continue to underperform until late January, as yields retrace slightly, but could then bounce into February as these yields resume their uptrend, possibly into mid/late February. They may then reach the 2.1% mark on the US 10Y. Inversely, Defensives profiles could rebound slightly on a relative basis into late January, but then underperform again into mid/late February. The US Dollar will probably resume its downtrend vs most currencies from late January into mid/late February. It should however rise vs Yen (112), and bounce slightly vs Swiss Franc. Oil recovers from late January and probably tops its January highs by late February / March. Gold consolidates at high levels, into the low 1’500s / high 1'400s USD/oz into mid/late February.

From mid/late Q1, risk assets could top out and enter a correction phase. It could last into early/mid Q2. The US Dollar could rebound, Commodities and Cyclical assets should correct. Yields and the Yield curve could retrace, and Gold should then re-accelerate up. Following that, we would probably anticipate a further risk assets rally of some sort from early/mid Q2 into the Summer, probably with a weaker US Dollar and strong Commodities, including Gold.

Main Equities & Government Bonds

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Main Equities	US S&P500	US Equity markets should continue to grind higher probably into mid February. The S&P500 could reach the high 3’300s by then.	Towards mid/late Q1, US Equity markets should make an intermediate top and then correct down into early/mid Q2 (5 to 10 % risk), they could then rise again into the Summer.
	Europe EuroStoxx50	European Equity markets should continue to grind higher probably into mid February. The EuroStoxx50 could reach the high 3’900s by then.	Towards mid/late Q1, European Equity markets should make an intermediate top and correct down into early/mid Q2 (5 to 10% risk), they could then rise again into the Summer.
	EMs MSCIEM USD	Emerging markets could also move higher into mid February. Their upside potential until then is between 3 and 7 %.	Towards mid/late Q1, Emerging markets should make an intermediate top and correct down into early/mid Q2 (8 to 15 % risk), they could then rise again into the Summer
Treasuries	US10Y Bond prices	US10Y Treasuries yields could see some retracement into late January (e.g. -10 bps) before they resume higher into late February / March (towards the low 2s %).	US10Y rates could then reverse down from mid/late Q1 into Q2. A further bounce into the Summer is possible, yet seems unlikely for now.
	Germany 10Y Bund prices	German 10Y Bund yields could see a shallow retracement into late January. They then rise again into late February/March, probably into positive territory.	10Y Bund rates could then reverse down from mid/late Q1 into Q2. A further bounce into the Summer is possible, yet seems unlikely for now.

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

Main Equities

World markets
p 12-18, 43, 51-55

While risk/reward is getting stretched, we would still expect further upside for global equity markets into mid February. The S&P500 could reach the higher 3’300s, while the EuroStoxx 50 could push up to 3’900 and perhaps 4’000. They should then correct down by 5 to 10% into early/mid Q2.

Main Regional picks	The S&P500 should continue to benefit until mid Q1 from the strong performance of US Big tech stocks, i.e. the Nasdaq 100. Yet, the rest of the US market probably underperforms Europe and Japan.
Emerging markets p 24- 34	Emerging markets and China should continue to outperform the S&P500 until mid Q1, along with their currencies vs the US Dollar. They could then underperfom into early/mid Q2 as global equities correct.
Volatility	VIX is reaching the 12 handle once again, which is always worrying, yet probably remains in a downtrend until early/mid February.

Government Bonds

US & European Benchmarks
p 19-23

Treasury and Bund yields could see a moderate retracement towards the end of January. However, we don't' expect a strong dip. From late January, they should resume their uptrend towards mid/late February. US10Y Treasury should test and perhaps break above 2.1%, 10Y Bund yields could move towards positive territory.

Equity to Bond Ratios, Fixed Income Dynamics & Commodities

Main Asset Allocation Drivers		Next 2 months	3 to 6 months ahead
Equity / Bonds	US	The US Equity to Bonds ratio (S&P500 vs 10Y Treasuries) probably grinds higher with equities and rising yields into mid February, possibly by 3 to 5 %.	Towards mid/late Q1, the ratio should make an intermediate top and then correct down into early/mid Q2 by 7 to 12 %. It could then rise again towards the Summer.
	Europe	The European Equity to Bonds ratio (SX5E vs Bund) probably grinds higher with Equities and rising yields into mid February, possibly by 4 to 6 %.	Towards mid/late Q1, the ratio should make an intermediate top and then correct down into early/mid Q2 by 7 to 12 %. It could then rise again towards the Summer.
Duration		US Yield Curve Spreads could retrace down with US 10Y yields into late January. They then rise again to new YTD highs until mid/late February.	Towards mid/late Q1, yield curve spreads should make an intermediate top and then correct down into early/mid Q2. They could then rise again into the Summer.
Credit		Credit spreads should continue to push lower into mid February, possibly following a short retracement period into late January.	Credit spreads could bounce from mid/late Q1 as risk assets retrace. From early/mid Q2, they should then resume higher into the Summer.
TIPs/Treasuries		Following some consolidation until late January, inflation expectations could resume higher into mid/late February.	The TIPs vs Treasury ratio could then consolidate down along with risk assets into early/mid Q2. It then probably resumes higher into the Summer.
Oil		The current Oil sell-off should find support towards late January (max downside : mid/low 50s on WTI, high 50s on Brent), it then rises again into late February / March above its January spike.	Following some retracement from mid/late Q1 into early/mid Q2, Oil could then re-accelerate higher into the Summer and test in 2018 highs.
Industrial metals		Industrial metals and Copper could consolidate into late January, but should then rise into late February / March (target : 6'500 USD/t for Copper).	Industrial metals and Copper may then retrace with risk assets from mid/late Q1 into early/mid Q2, potentially back to current levels before resuming higher into the Summer to new YTD highs.
Gold		Gold may consolidate at high levels until mid/late February. Its downside potential may be quite shallow (low 1'500s, high 1'400 USD/oz).	From mid/late Q1, Gold then re-accelerates higher towards the Summer and could reach the high 1'600s USD/oz or even above.

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

Equity to Bond Ratios

US & Eurozone Market
p 17-18

With rising equities and rising yields, Equity to Bond ratios should also rise into February and then correct down into early/mid Q2 as equities correct and bond yields may resume their downtrend.

Fixed Income Dynamics

Duration (10Y - 3Y/3M)
p 22, 23

US Yield curve spreads could see some retracement with yields until late January, but should then rise consequently into mid/late February, as longer term yields rise and short term yields probably remain stable (i.e. the FED has announced that Federal Fund rates will probably be capped at current levels throughout 2020). They should then correct down until early/mid Q2 along with risk assets.

Credit Credit spreads are still narrowing and could continue to do so until mid/late February when they could reach an intermediate top. They then retrace down with risk assets until early/mid Q2.

Rate Differentials The US rate differentials vs the rest of the world could continue to slip as US yields now seem less dynamic in their rebound that European or even Japanese ones.

Tips The TIPs / Treasury inflation breakeven ratio could continue to retrace along with Oil into late January, and then resume its uptrend into mid/late February. It then retraces down into early/mid Q2 along with risk assets.

Commodities

Oil
p 44, 57-58
Oil should stabilize following its recent spike and subsequent sell-off, probably towards late January and in the mid 50s USD/barrel for WTI, low 60s for Brent. It then resumes higher and could reach back into the mid/high 60s USD/oz on WTI by March. It then probably retraces down again into early/mid Q2 as risk assets correct, before moving up again into the Summer.

Industrial metals
p 41- 42
Copper and Industrial metals could continue higher into mid/late February. Copper could reach 6'500 USD/ton. Industrial metals then retrace back to current levels towards early/mid Q2.

Gold & PMs
p 35- 39
Gold could consolidate at high levels until mid/late February and find support in the low 1'500s USD/oz / high 1'400s USD/oz. It then re-accelerates up to new highs into Q2. Silver and Platinum could follow similar dynamics. Palladium is more pro-cyclical and could rise into February and consolidate down slightly into late Q1. Generally we believe this could bbref e a strong year for precious metals, which could all be rising into H2 2020. Silver and Platinum may even play catch up vs Gold and Palladium.

Agriculture Agricultural Commodities built a volatile yet strong base in 2019. We believe they could rise strongly throughout most of 2020, especially if, as we expect, the US Dollar weakens.

Foreign Exchange

		Next 2 months	**3 to 6 months ahead**
USD vs	EUR	EUR/USD may still retrace into late January (1.105 ?) and then resumes higher in mid/late February and may break above 1.12, possibly towards 1.14.	From mid/late Q1 into early/mid Q2, the US Dollar makes a come back in the 1.12 – 1.10 range, it then weakens again into the Summer.
	GBP	GBP/USD may still retrace down into late January (1.28?) and then resumes higher towards 1.35.	GBP/USD could then retrace down to the low 1.30s between mid/late Q1 and early/mid Q2. It then strengthens again into the Summer.
	JPY	USD/JPY continues higher towards mid February and 112.	USD/JPY probably corrects down from mid/late Q1 into early/mid Q2 back to the 110 – 108 range. It may then attempt a further bounce into the Sum-mer.
	CHF	USD/CHF could rebound slightly into early/mid February towards the 0.98 – 0.99 range.	From mid/late Q1 into mid Q2, USD/CHF then drops to new lows in the 0.96 – 0.94 range.
EUR vs	GBP	EUR/GBP restests down to the low 0.80s into mid Feb-ruary.	EUR/GBP then rebounds back to the mid/high 0.80s from mid/late Q1 into early/mid Q2. It could then drop again into the Summer.
	JPY	EUR/JPY probably rises towards the 125 – 126 range by mid/late February.	EUR/JPY then corrects down again towards the low 120s as risk assets come under pressure from mid/ late Q1 into early/mid Q2. It could then rise again into the Summer.
	CHF	From late January into mid February, EUR/CHF could bounce back towards 1.09.	EUR/CHF then drops below 1.07, potentially to 1.05 from mid/late Q1 into early/mid Q2 as risk assets correct and Gold takes off.
GBP vs	JPY	GBP/JPY probably rises into mid February and probably reaches 150.	From mid/late Q1 into early/mid Q2, GBP/JPY probably retraces back down to the low 140s as risk assets correct. It then probably rises again into the Summer.
	CHF	GBP/CHF probably makes a comeback above 1.30 towards mid/late february.	From mid/late Q1 into early/mid Q2, GBP/CHF retraces down to the low 1.20s as risk assets correct.

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

US Dollar	The Dollar Index is currently bouncing, yet should resume lower from late January into mid/late February. It could then bounce again during the risk asset correction we expect from mid/late Q1 into early/mid Q2. Following that, the Dollar Index probably weakens again into H2 2020 as global growth accelerates vs the US.
Euro p 29	Since early January, EUR/USD has been retracing slightly. From late January, we expect it to resume higher again and probably break above its 1.12 resistance. It could then push higher towards 1.14 by mid/late February. It then probably retraces down again towards the 1.12-1.10 range as risk assets correct between mid/late Q1 and early/mid Q2. Following that, we expect EUR/USD to rise again into H2 2020 along with global equities.
Yen p 30	USD/JPY could follow risk assets higher into mid February. It is currently testing its 110 resistance and could push towards 112 by then. EUR/JPY could also move higher into mid February possibly towards the mid 120s. From mid/late Q1, the Yen probably strengthens again into early/mid Q2 as risk assets correct. USD/JPY may correct back down to the 110 – 108 range, while EUR/JPY falls back to the low 120s.
Swiss Franc	The Swiss Franc has been remarkably strong since early December, this despite the risk asset rally. Indeed, it has moved higher vs all the other majors. Similarly to Gold, we believe it is seen as a store of value, and is hence reacting to the strong liquidity creation by other major Central Banks. USD/CHF may stabilize and rebound slightly into the 0.98-0.99 range from late January to mid February, yet it may then resume down towards 0.96 – 0.94 by early Q2. EUR/CHF could also bounce slightly towards 1.09, but then probably drops down to the 1.07 – 1.05 range also towards early Q2. Similarly, GBP/CHF could rise back up to the low 1.30s, before selling off towards the low 1.20s.
Sterling	Sterling is now in an uptrend vs the other majors, except perhaps Swiss Franc. We expect it to rise vs them into mid/late February (Sterling is the more pro-cyclical one of the majors). It then retraces down into early/mid Q2 following risk assets in their correction.
Oil & Commodities currencies	Commodity currencies (our equal weighted portfolio containing AUD, BRL, CAD, NOK, NZD, RUB, CLP and ZAR) are currently retracing some of their strong December rally vs both the US Dollar and the Euro. By late January, they should then resume their uptrend and make new YTD highs towards late February, perhaps March.
Asian currencies	Our Asian Growth equal weighted portfolio (CNY, INR, KRW, THB and TWD) saw only a slight retracement early January vs the USD and the EUR. It has since made new YTD highs and should continue to rise into mid February.

Equities Markets Segmentation

Core Sector Weightings			**Next 2 months**					**3 to 6 months ahead**				
US Sectors - S&P500 (general comment)			**Technology should continue to lead into mid February, Defensives hold up in January, Cyclicals then rise in February.**					**From mid/late Q1, Defensive profiles may outperform as risk assets could correct down into early/mid Q2.**				
Sectors	Proxy ETF symbols	Benchmark-weights	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Technology	XLK	21%										
Healthcare	XLV	15%										
Financials	XLF	14%										
Discretionary	XLY	10%										
Communication	XLC	10%										
Industrials	XLI	10%										
Staples	XLP	7%										
Energy	XLE	6%										

			Next 2 months					3 to 6 months ahead				
European Sectors - Europe Stoxx 600 (general comment)			**Little conviction on Europe as its Technology sector is quite small, Defensives hold up in January, Cyclicals then rise in February.**					**From mid/late Q1, Defensive profiles may outperform as risk assets could correct down into early/mid Q2.**				
Sectors	Index symbols	Benchmark-weights	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Banks	SX7P	13%										
Industrials	SXNP	12%										
HealthCare	SXDP	11%										
Pers. & HH Goods	SXQP	9%										
Food & Beverage	SX3P	7%										
Insurance	SXIP	6%										
Energy	SXEP	6%										

Main Sectors Allocation
p 56

Please read the detailed allocation comments in our time frame boxes above.

In the US, Technology continues to be a strong outperformer. We expect this trend to resume until equity markets make an intermediate top towards mid February. Until then, we will hence continue to underweight defensive profiles, as well as rate sensitive ones (as we expect yields to push higher again into mid Q1). Europe as a whole is more cyclical (i.e. the Technology sector market weighting is small). We are hence rather neutral on European sectors, but will underweight the defensive Food & Beverage one. Healthcare is also defensive, but still looks rather resilient following its Q4 rally, and we will keep it at neutral.

From mid/late Q1, we expect an equity market correction to materialize, which may last into early/mid Q2. During this period, we will underweight cyclical sectors in the US and Europe and overweight defensive ones. We will probably bring US Technology back to neutral.

Countries allocation

Core Countries Weightings			Next 2 months					3 to 6 months ahead				
All World Country Index Currency hedged (general comment)			**Into mid February, China, EMs and US Tech retain their leadership, Japan profits from Yen weakness, Europe is neutral, the UK and Defensive profiles underperform.**					**From mid/late Q1 we would favor Defensive regions again, problably into early/mid Q2. The UK should profit from a declining Pound. Cyclical regions should retrace some of their outperformance.**				
Countries	Index symbols	Benchmark-weights	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
US	S&P 500	52%										
Canada	TSX	3%										
Europe	SXXP	21%										
-UK	FTSE	6%										
-France	CAC40	3%										
-Germany	DAX	3%										
-Switzerland	SMI	3%										
Japan	N225	8%										
China	MSCICN	3%										

Main Country Allocation

p 12-18, 43, 51-55

Please read the detailed allocation comments in our time frame boxes on the previous page.

Similarly to the sector mix above, we would favor more Cyclical geographies into mid Q1, China, Emerging markets and Japan would be our favorites. We will keep the US at neutral as the Nasdaq100 should continue to show strong performance and neutralize Europe as a whole, Germany and France. We would underweight defensive profiles such as Switzerland and Canada as well as the UK as a strong Pound could create further headwind for its market in local currency.

From mid/late Q1, we would expect some retracement on risk assets and would hence overweight more defensive regions such as Switzerland and Canada, as well as the UK as the Pound may then retrace. We would underweight more cyclical regions as well as emerging markets and keep the remaining geographies at neutral.

Note: the country and regional allocations in the table above are considered hedged for currency risk, ie. the relative performances are anticipated in local currency (except for the S&P500 vs the All Country World Index as both are denominated in US Dollars).

Core factors and Themes

Core Factor/Themes Weightings	Next 2 months					3 to 6 months ahead				
General Comment	**US Technology leads into mid February, Defensives lag. Cyclical plays make a come-back from late January.**					**During mid/late Q1, we expect a risk asset correction and would hence favor more Defensive profiles, probably into early/ mid Q2.**				
Themes	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight	Strong Under-weight	Under-weight	Neutral	Over-weight	Strong Over-weight
Nasdaq 100 (vs S&P500)										
DJ Industrial (vs S&P500)										
Russell 2000 (vs S&P500)										
Wilshire REITs (vs S&P500)										
US Value (vs US Growth)										
Southern EuroZone (vs Stoxx EZ 600)										
EuroZone Small Cap (vs Stoxx EZ 600)										
Japanese Small Cap (vs N225)										
GDX - Goldmines										
XME - Diversified Mining										

Core factors and Themes

Our Factor and Themes allocation would favor the Nasdaq 100 over the S&P500 into mid Q1, and underweight defensive profiles. We will keep cyclical and value themes at neutral.

From mid/late Q1, given the equity market correction and retracement on rates we expect, we would overweight defensive profiles and Goldmines especially and underweight cyclical and value profiles.

12 / 2020 Global outlook: de-synchronized growth prospects for US and China suggest flat global growth

The last time we wrote about US and global growth was in the September 2019 issue of the Capital Observer: "***It looks like the "recession" is over before it even started: monetary, fiscal stimuli to push economic recovery into Q2 2020, at least***." We said at that time:

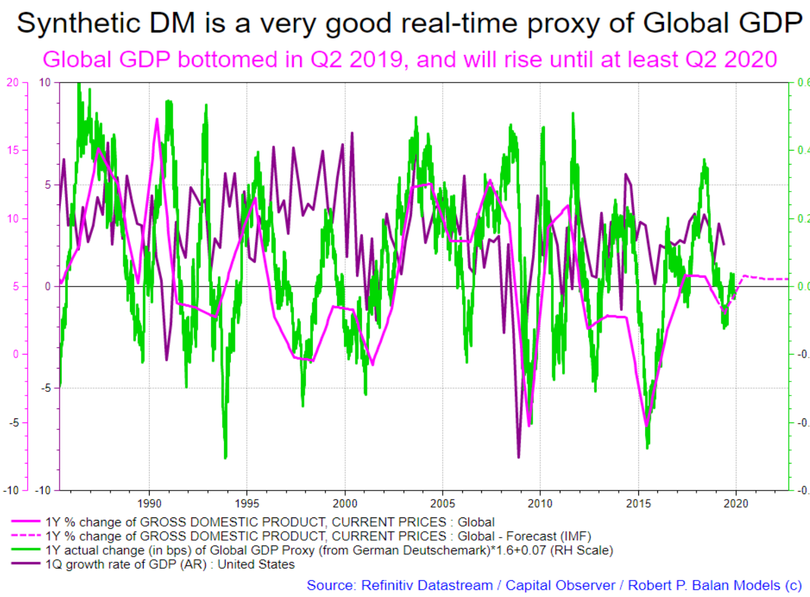
We took the IMF's word for an H2 2019 recovery because the global GDP proxy did bottom on June 15, 2020, and has been rising since then, according to our projections for global growth. The IMF has since then issued an update in July 2019, saying:

Global growth is forecast at 3.2 percent in 2019, picking up to 3.5 percent in 2020 (0.1 percentage point lower than in the April WEO projections for both years)

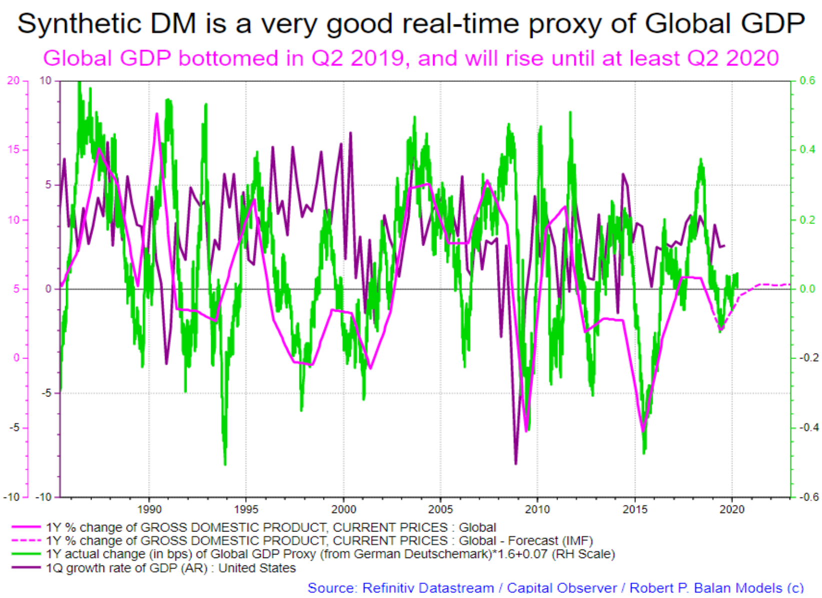
The international agency reduced their 2020 growth forecast by 0.1%, "as the United States further increased tariffs on certain Chinese imports and China retaliated by raising tariffs on a subset of US imports." With US President Donald Trump and President Xi Jinping of China set to meet in September, this month, the primary risks to the IMF global growth projections are set to be addressed affirmatively. Our global GDP proxy should provide a good read on what the global outlook will be as we go along, and Capital Observer will provide periodic updates. (see 1st and 2nd graph on this page).

We have previously created a real-time proxy of global GDP growth by taking elements from the German Deutschemark and from the Hong Kong Dollar. This synthetic currency has backtested very well, and has been out-of-sample for more than five years. It mimics global GDP very well, and as proxy, it has the advantage of providing real-time "updates" to global GDP. We show the results at the graph below (*green line, two first charts on this page*). And indeed, the global growth projections from the IMF of flat growth over 2020 has been confirmed by the trajectory of the proxy (so far).

Original graph in the September 2019 issue of the Capital Observer



This is how that chart looks today:



The 2019 "recession" ended before it even started

Indications from the global proxy was the reason why we took the IMF's word for an H2 recovery, and the Capital Observer report advanced the theme that there will be no recession during 2019. That was contrary to a belief that was rife at that time, when every media outlet and many strategists were blasting the meme that a US recession was all but inevitable in 2019. **But we stuck with the IMF (and the Federal Reserve) more positive outlooks and our proprietary economic and markets models, and indeed, the 2019 "recession" ended before it even started.**

The latest World Economic Outlook (WEO) from the IMF will be published on January 20 this year from Davos, Switzerland, but the organization said in October 15, 2019 that "A notable shift toward increased monetary policy accommodation—through both action and communication—has cushioned the impact of these tensions on financial market sentiment and activity, while a generally resilient service sector has supported employment growth. That said, the outlook remains precarious."

As the IMF pointed out, global monetary policy has been key in "preventing" the much-touted

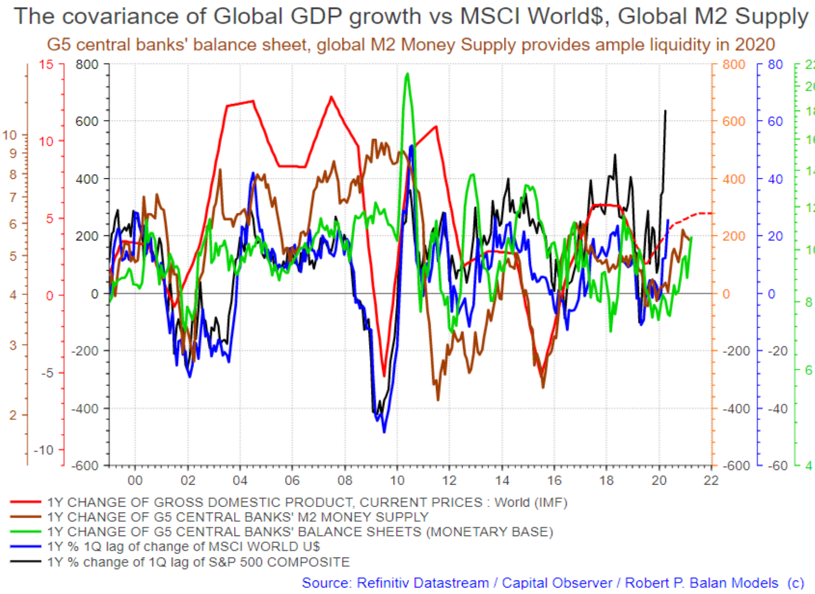
"recession" in 2019. The theme of moderate global growth, and subsequent rise in risk assets, has been also supported by rising central bank provided liquidity. The G5 aggregate central bank M2 Money supply and balance sheet has been very supportive of global growth, and the rise in global financial risk assets (*see 1st graph on this page*). The G5 central banks are the US Federal Reserve Bank (FRB), the European Central Bank (ECB), Bank of Japan (BoJ), The Peoples' Bank Of China (PBoC) and the Swiss National Bank (SNB).

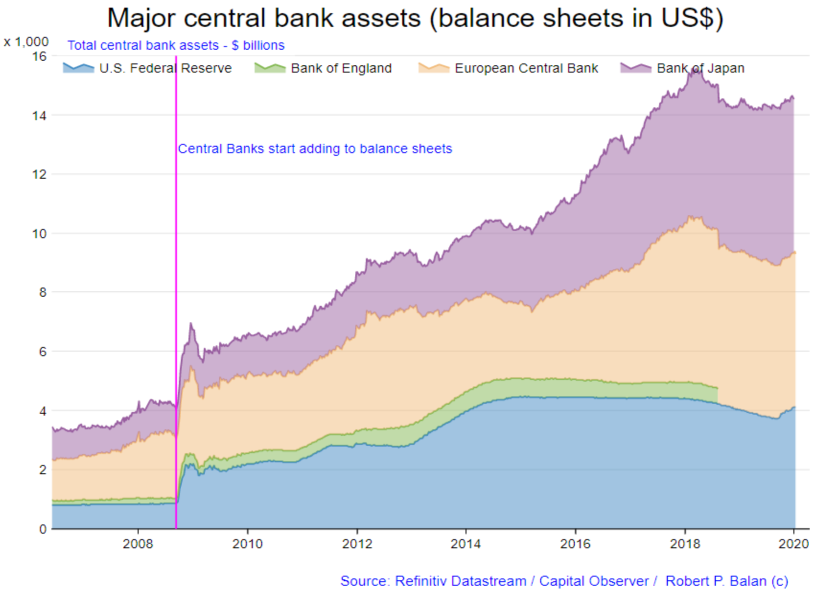
Global central banks on a race to top out the tank

The central banks have gone beyond increasing global money supply (M2 and Monetary Base) which they have done admirably in H2 last year -– the major central banks have also been easing monetary policy, and have been on the race to provide liquidity to their domestic financial systems. After a period when the global central banks embarked on a race to "normalize" monetary policy by shrinking their balance sheets, there is again a race to the top to provide as much ample liquidity and stimulus as possible (*see 2nd graph on this page*). They are, so to speak, in a race to top out the gasoline tank to fuel their respective economies.

But a sense of foreboding does not go away

But a sense of foreboding doom just doesn't seem to go away. There seems to be that belief that if a recession did not happen in 2019, it has just been postponed. And so here we go again – a new round of pessimism has again struck the US corporate world. Ninety-seven percent of US CFOs (corporate financial officers) surveyed in a new poll believe that the United States will be in recession by the end of 2020. These CFOs are no lightweights -- eighty-eight percent of CFOs represented in the survey work at companies generating greater than $1 billion in annual revenue. This summation was taken from a new survey of around 150 chief financial officers conducted by the consulting firm Deloitte.





While The Capital Oberver does not disagree with the summary, we believe that Q4 2020 may be too soon for that happen. **We believe recession-like conditions will appear in early 2021, and its trough may occur during Q2 2021**. This continues from the theme that we have discussed in the September 2019 edition of The Capital Observer, that US GDP growth may indeed see a peak in either Q1 or Q2 2020, but a potential recession is not in the cards this year, but that it may happen in H1 2021, and will likely be a short one. From an expected trough during Q2 2021, US growth should recover smartly during H2 2021. We illustrate this with the tool that we have been showing in The Capital Observer for the past four years – the impact of capital flows (foreign and domestic) on US growth and risk assets (*see 1st graph on the next page*).

We have shown these charts before (*1st graph and 2nd graph on the next page*) **in various issues of the The Capital Observer, but in this issue, we show the linkage between the ultimate liquidity source for US growth and financial risk instruments – capital flows (domestic and foreign) and added the underlying effect of fiscal expenditures/policy on growth.**

As mentioned in another article in this issue, the impact of public debt and of government expenditures on growth and risk assets is rarely acknowledged, but it is there, left, right and center. **It is no surprise that capital flows have a high positive covariance with government expenditures because most international investors look at the prospects of growth stemming from fiscal activity,**

along with monetary policies of the domestic central bank. Those capital inflows have long-lasting, salubrious effect on the economy and US risk assets. However, capital flows and fiscal expenditures have broad strokes that define quarter to quarter changes, but we needed a real-time indicator to warn us when a turn in coming, ahead of the quarterly changes in US GDP growth changes, as well as inflection points of risk assets (as in the SPX, *see 2nd graph on this page*).

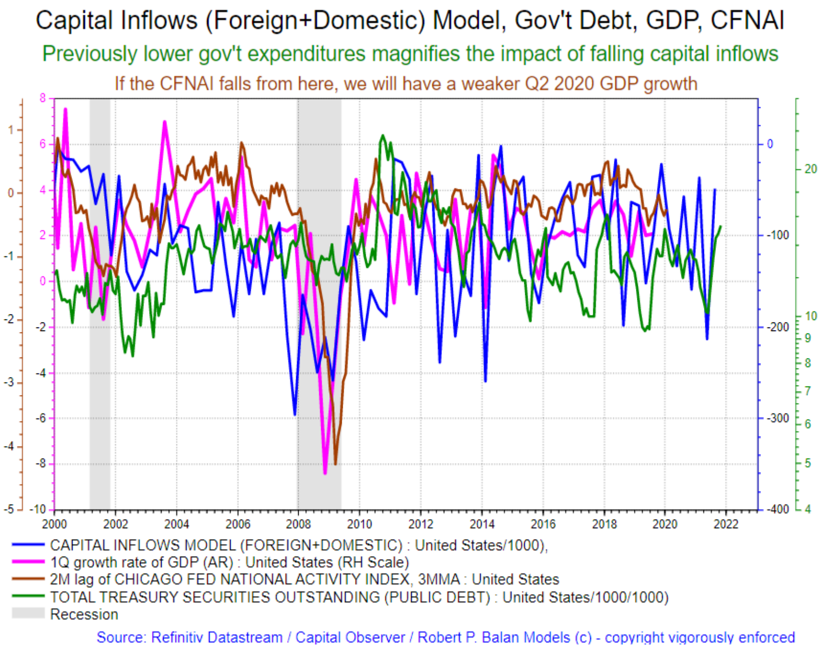
What we added to the underlying tool is the US CFNAI – an indicator that is composed of 88 indexes of US activity and growth. It is designed to oscillate, with zero as mean (denoting neutral growth). Its inflection points have been useful in pinpointing likely periods when US GDP and the SPX (as proxy of risk assets) will likely turn. Since CFNAI is available monthly (in its raw form and as a 3-month moving average), it is one of the best indicators we can use to pinpoint turning points in growth, as well as major inflection points of the S&P 500 Index (*see 2nd graph on this page*).

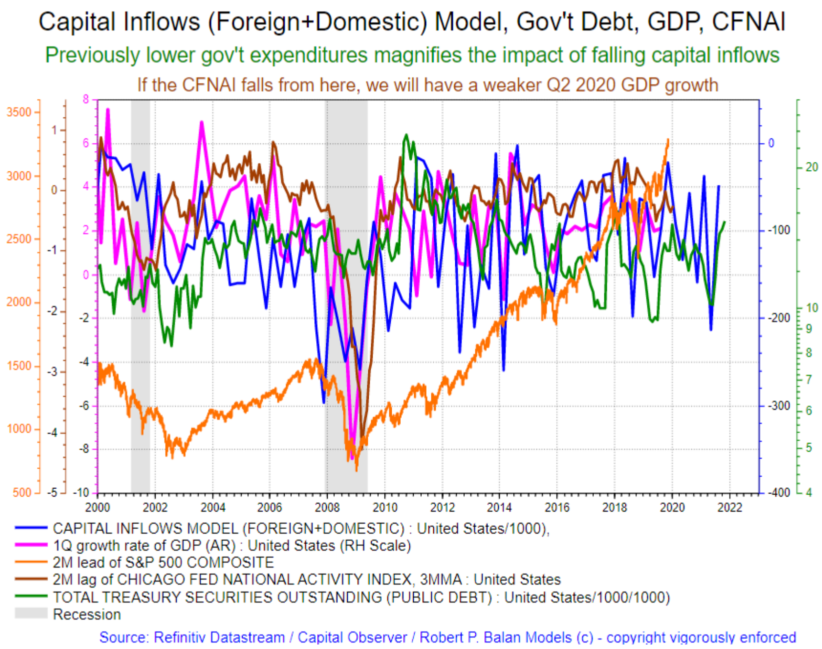
These are the developments The Capital Observer is watching

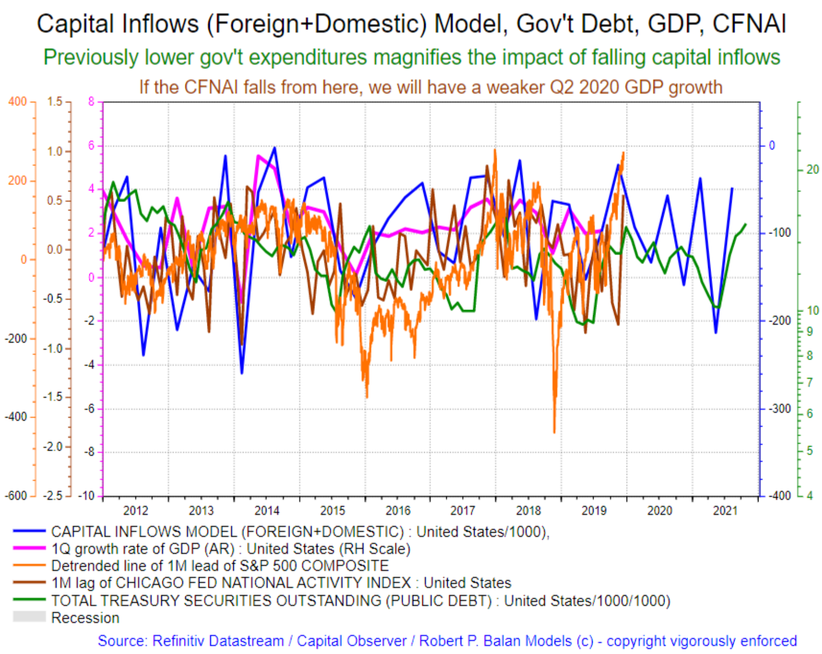
This tool is telling us today that the SPX is at risk of a huge price reversal, and if the raw CFNAI data for December 2019 turns lower (brown line, chart below), as per the broad indications from the lagged capital flows and fiscal expenditures, Q4 2019 or Q1 2020 may be the top for growth at this stage. We do not see indications of a recession during 2020, but we see a potential for a brief recession slowdown in 2021 (*see 3rd graph on this page*).

And indeed, there are troublesome data that refuse to go away.

In the US, the ISM Purchasing Managers Index has not shown any signs of bottoming out, although the Chicago PMI barometer and Manufacturing (NAICS) has already shown sign of rebounding (*see 1st graph on next page*).







China may be having a "false dawn" and remains in a world of hurt as previous stinginess with fiscal policy continues to hobble Total Social Financing (TSF, green line, *2nd graph on this page*), which means aggregate money supplies (M1 And M2) will remain moribund until Q2 this year (*see 2nd graph on this page*). TSF is led by fiscal expenditures, and the long lags suggest it will only bottom in Q2. Hence no meaningful uptick in money supply until then.

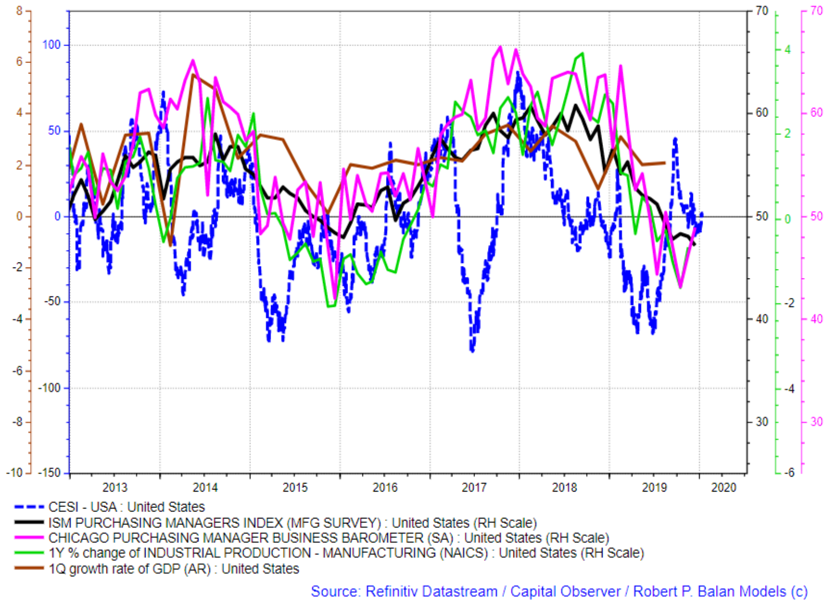
With the TSF still due to decline once more until Q2 2020, China shadow banking's Quasi Money supply will further decline and that does not bode well for the Shanghai Index. The Chinese stock market is highly dependent on the Quasi money supply series, which in turn takes its cue from the TSF. The Capital Observer expects the Shanghai index to retrace the recent upmove (*see 3nd graph on this page*).

Conclusions:

These are the crucial details that The Capital Observer will be watching going forward. The two biggest economies in the world are not synchronized at this point, and it looks like China could be on an upswing during H2 2020, while the US economy looks likely to be on a declining phase. These economies have usually been synchronized in the past, with US leading and China following suit in a quarter or two. But the trade disruptions between the two countries may have been the culprit for the divergence (*see 1st graph on the next page*).

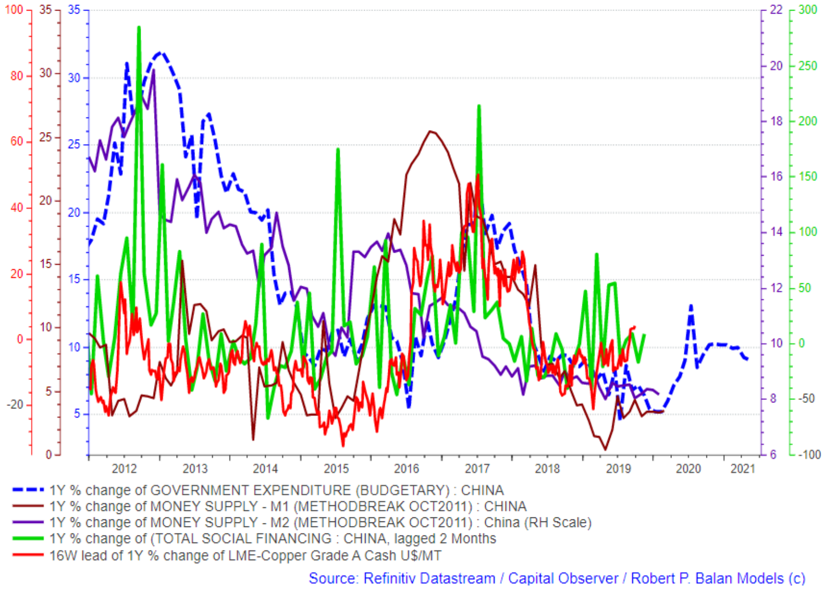
The US trade balance with China has been picking up in recent months but is nowhere near the levels of March 2019, after which the trade war became full blown. The good thing coming out of this is that the USD/CNY exchange rate is falling – the CNY has been firming steadily – and that should contributes to the stability of the financial markets and the global economy over the next 12 months.

US Citi Eco Surprise Index vs US/Chicago PMI vs Ind Production

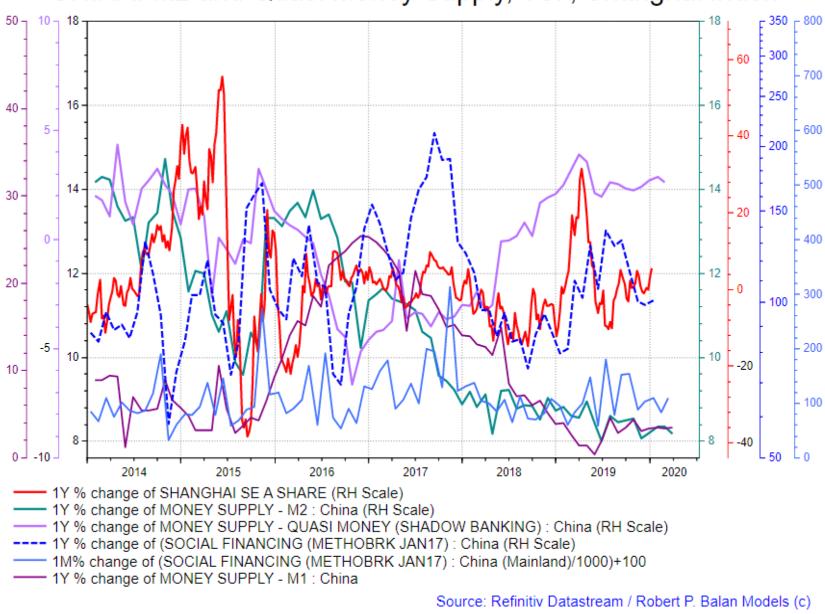


China Gov't Expenditures, Total Social Financing, M1 and M2 Money Supply

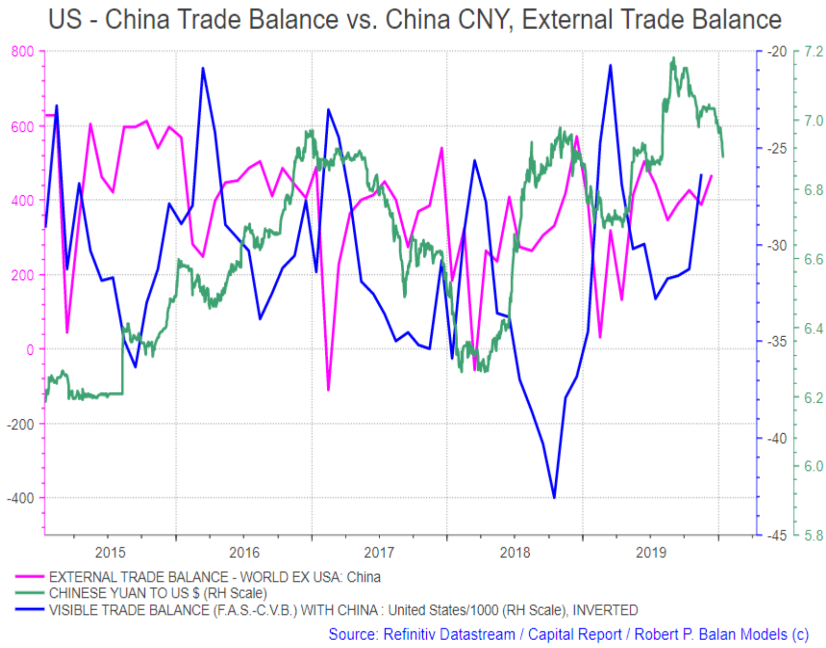
Crucial metric for monetary and systemic liquidity in China is Total Social Financing, which has risen

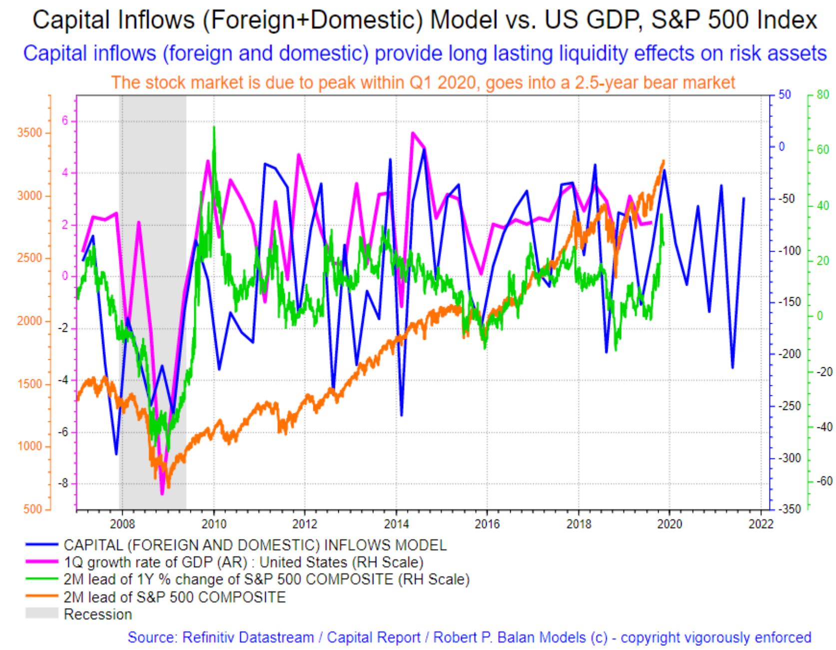


CHINA: M2 and Quasi Money Supply, TSF, Shanghai Index



The de-synchronization of the economies of China and the US should make for a slow global growth in 2020, but there should be no sharp extremes in the evolution of global GDP, with a slight downward bias due to the disproportionate weight of the US economy relative to the Rest of the World. *(see 2nd graph on this page)*

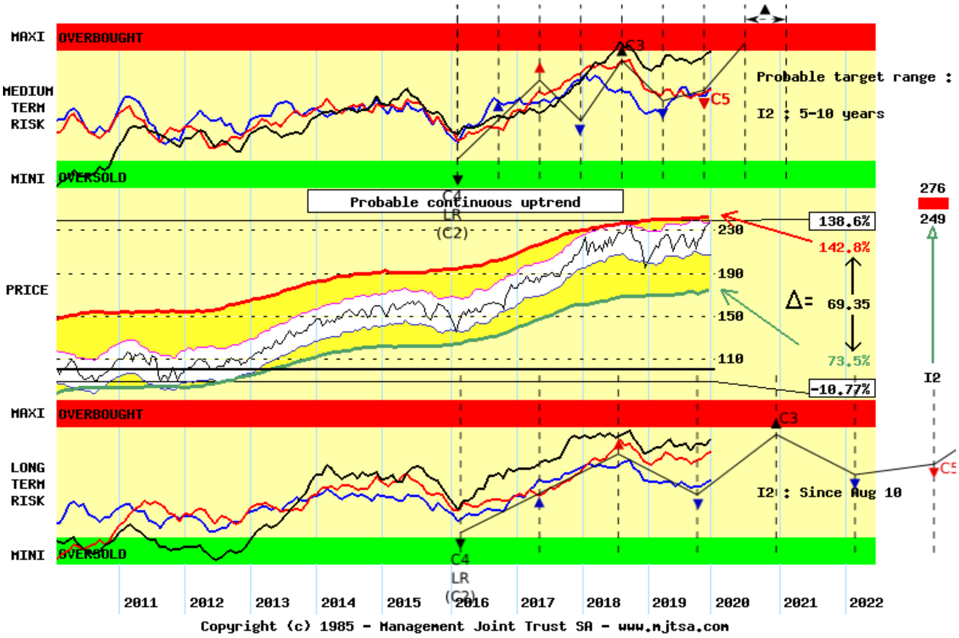




Yields should bounce again, into late Q1 / early Q2 at least

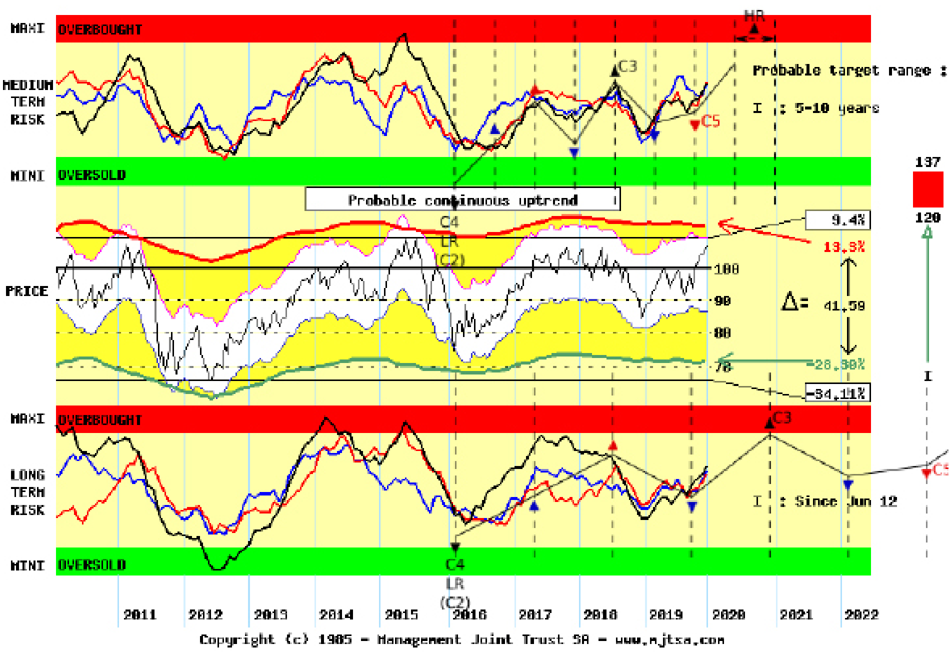
Last August, following 10 months of an aggressive downtrend and a last climax sell-off lower, bond yields bottomed out and started to bounce. Initially, this rebound was very strong, but since November it has lost pace. For now, we are still assessing the scope of this recovery, which we believe could at least see another leg up into the Spring. We detail why in this article. In addition, in the first couple of pages of this article, will first focus on a more general asset allocation question, i.e. the prospects for Equity to Bond ratios for 2020.

S&P500 Mini Futures vs the US 30Y Treasury Bond Futures
Bi-monthly graph or the perspective over the next 1 to 2 years



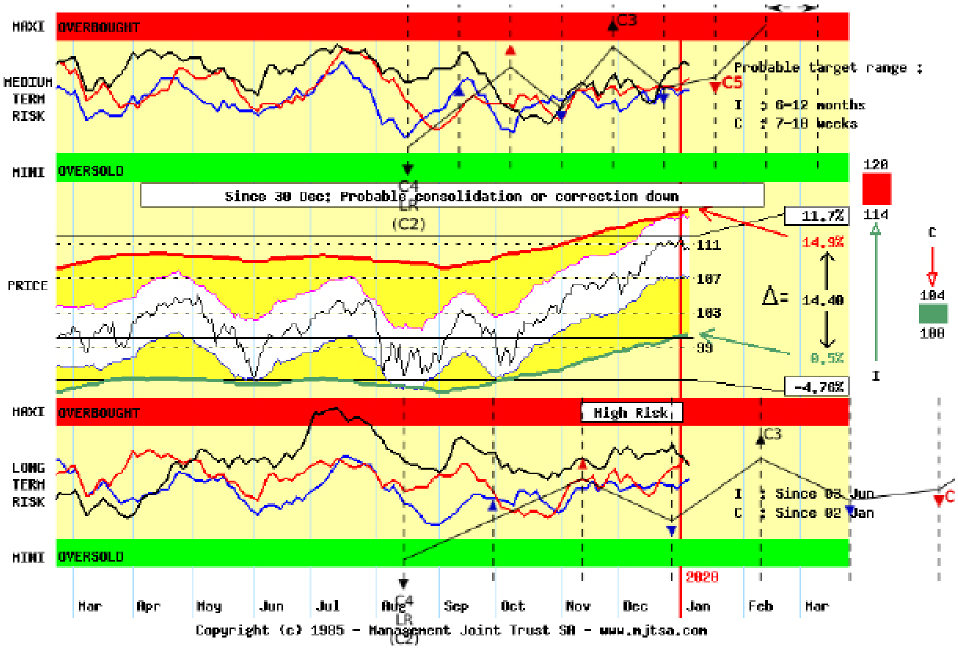
Over the last decade, the US Equity to Bond ratio has been rising steadily. In October 2018, it made an important top. Our long term oscillators (lower rectangle) were potentially in a High Risk position, while our medium term ones (upper rectangle) had reached an intermediate top. Since then, the Q4 equity sell-off saw the ratio correct sharply. During H1 2019, Equities rallied more than Bonds and the ratio built a base. It then accelerated higher from August as yields started to rebound and the Equity rally continued. It has now reached back to its 2018 tops. Is this a double top structure? Is a new sell-off imminent? We do not think so, considering both our oscillator series (lower and upper rectangles), which seem to point to further upside for the US Equity to Bond ratio, potentially into H2 2020 and perhaps until year-end. On the targets front, **this long term uptrend is very extended and we are now eyeing our extended I2 Impulsive 2 targets to the upside (right-end scale). Yet, these would still suggest between 2 and 10% of further upside potential for the S&P500 vs 30Y Treasuries.**

EuroStoxx 50 Futures vs the 10Y Bund Futures
Bi-monthly graph or the perspective over the next 1 to 2 years



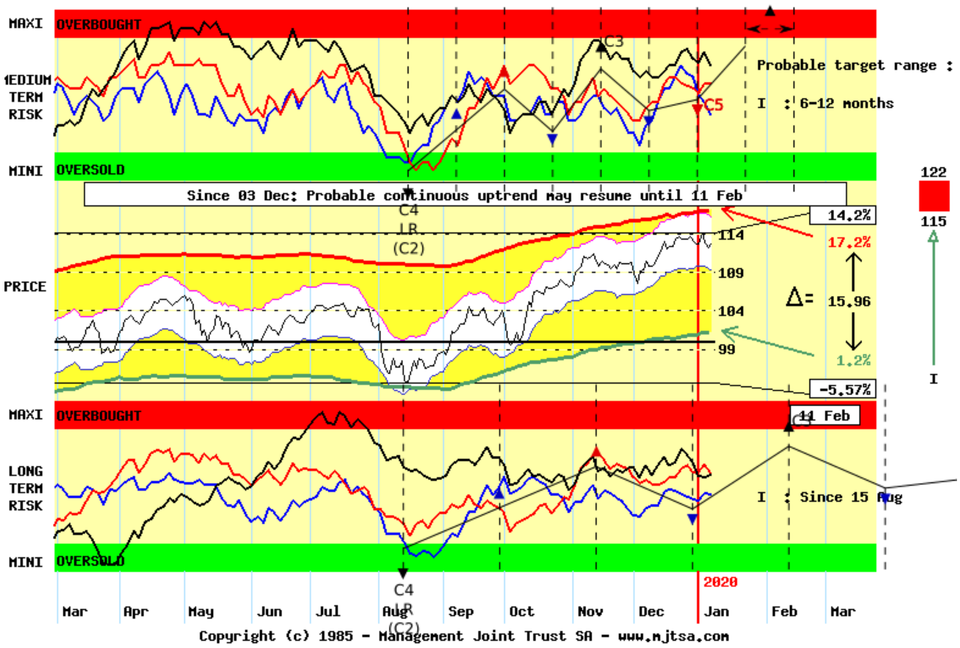
In Europe, the Equity to Bond ratio has remained range-bound throughout the decade. Here also, a strong sell-off in H2 2018 was followed by a stabilization and base building process during the first 8 months of 2019. Bunds did rally, yet the rebound of European Equities was stronger. Since August, the ratio has been accelerating higher again. It is now approaching the top of its range again. As in the US, both our oscillator series (lower and upper rectangles) are suggesting that **the current re-acceleration is not over yet. We expect it to continue, probably into H2 2020, and perhaps until year-end. Potential upside for the EuroStoxx 50 vs the 10Y Bund is stronger here than in the US. Indeed, our I impulsive targets to the upside (right-hand scale) are suggesting that European Equities could outperform the Bund by 10% at least during 2020, perhaps even by more than 20%.**

S&P500 Mini Futures vs the US 30Y Treasury Bond Futures
Daily graph or the perspective over the next 2 to 3 months



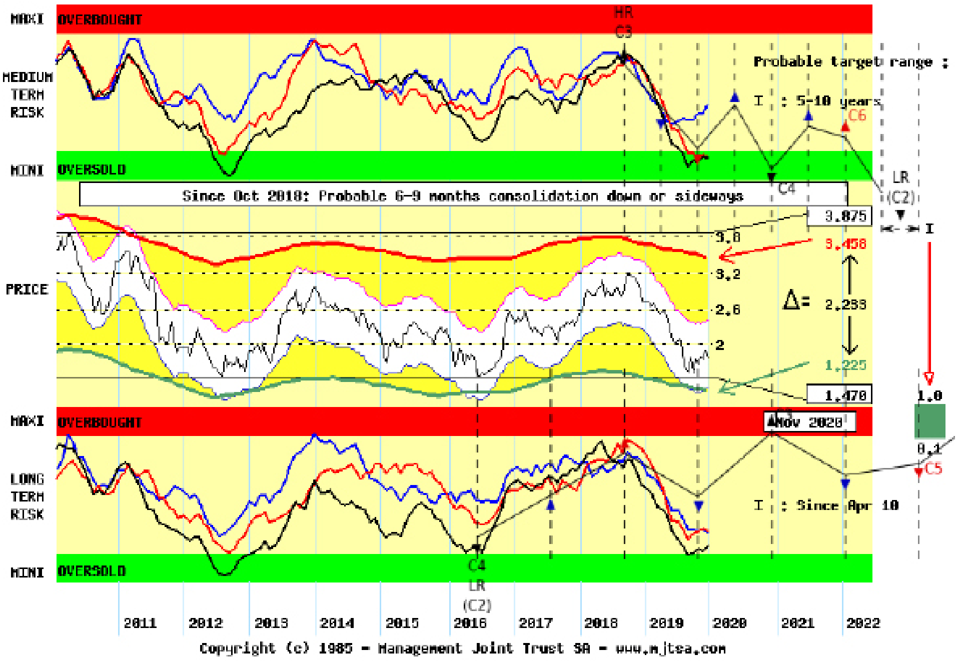
Shorter term, on this Daily graph, the ratio may have reached a "High Risk" position as suggested by our automatic messaging. Yet, both oscillator series (lower and upper rectangles) seem to point to **some kind of extension to the upside into February, perhaps early March**. On our medium term oscillators (upper rectangles), a couple of weeks of consolidation are still possible during mid January. On the price targets front, our I Impulsive targets to the upside (right-hand scale) would point to **further upside of 3 to perhaps 10% for the S&P500 vs Treasuries over the next few months.**

EuroStoxx 50 Futures vs the 10Y Bund Futures
Daily graph or the perspective over the next 2 to 3 months



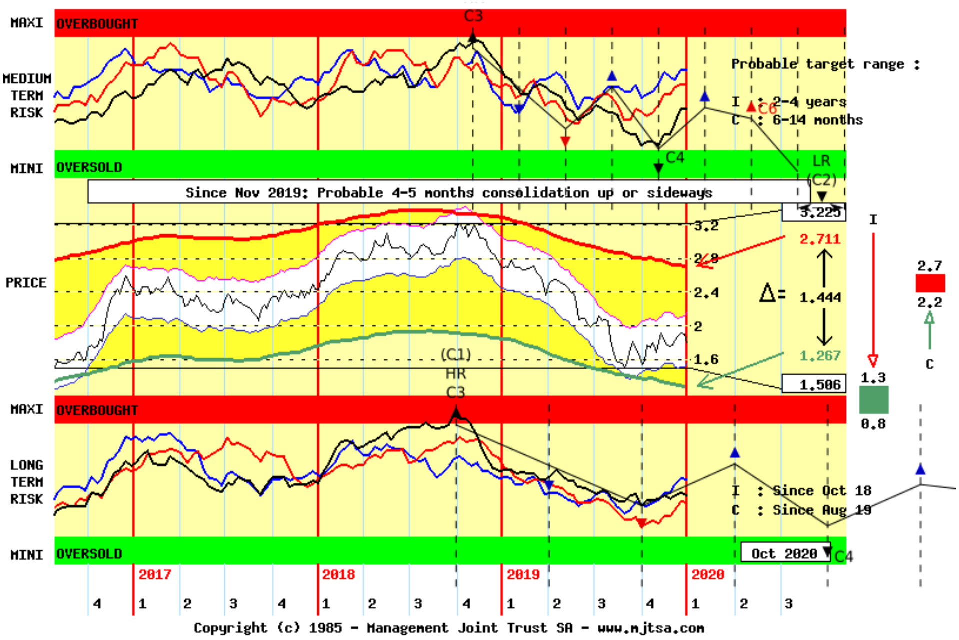
In Europe, the EuroStoxx 50 to Bund ratio has also seen a powerful rally since August. Yet, here also, both our oscillator series (lower and upper rectangles) suggest that **the ratio could extend one leg higher, possibly into February. Our I Impulsive targets to the upside (right-hand scale) indicate between 2 and 8% of further upside potential until then.**

US10Y Treasury Yield
Bi-monthly graph or the perspective over the next 1 to 2 years



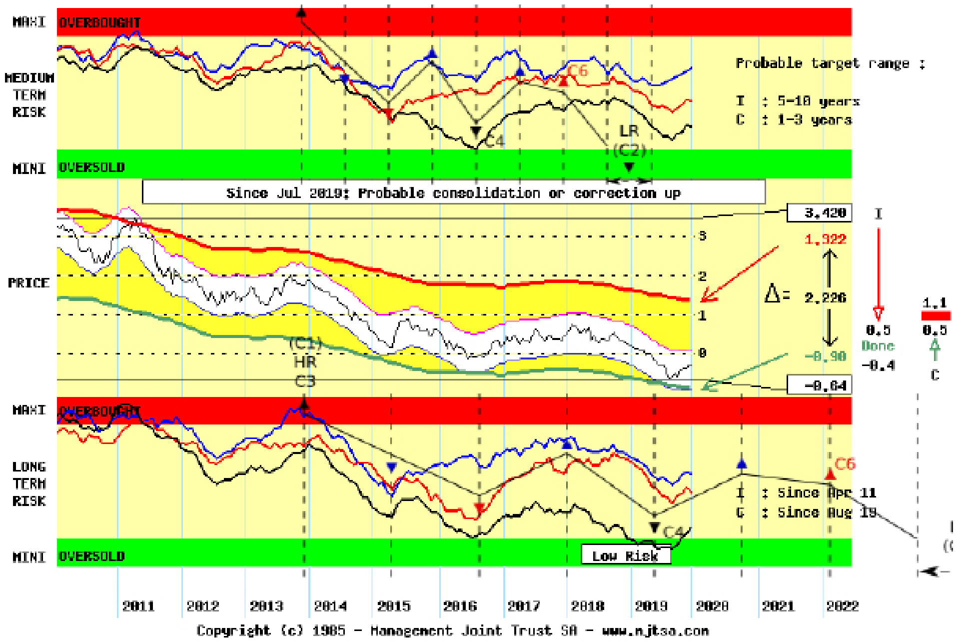
We now turn to the long term graph of the US10Y Treasury yield. In August, it was Oversold on both oscillator series (lower and upper rectangles) and the sell-off came very close to breaking below its 2016 and 2012 lows. This triple bottom structure is appealing as it creates a very strong base for a potential secular reversal. Yet, for now, the rebound since August is still in its very early stages. **While the sequence we show on our long term oscillators (lower rectangle) would hint to a possible secular reversal with a first leg up into late this year, our medium term ones (upper rectangle) are pointing to a bounce that continues into Spring before a further downside retest into H2 2020. Given this uncertainty, we will hence settle for the less aggressive scenario and consider that the current rebound may continue into the Spring in first instance.**

US10Y Treasury Yield
Weekly graph or the perspective over the next 2 to 4 years



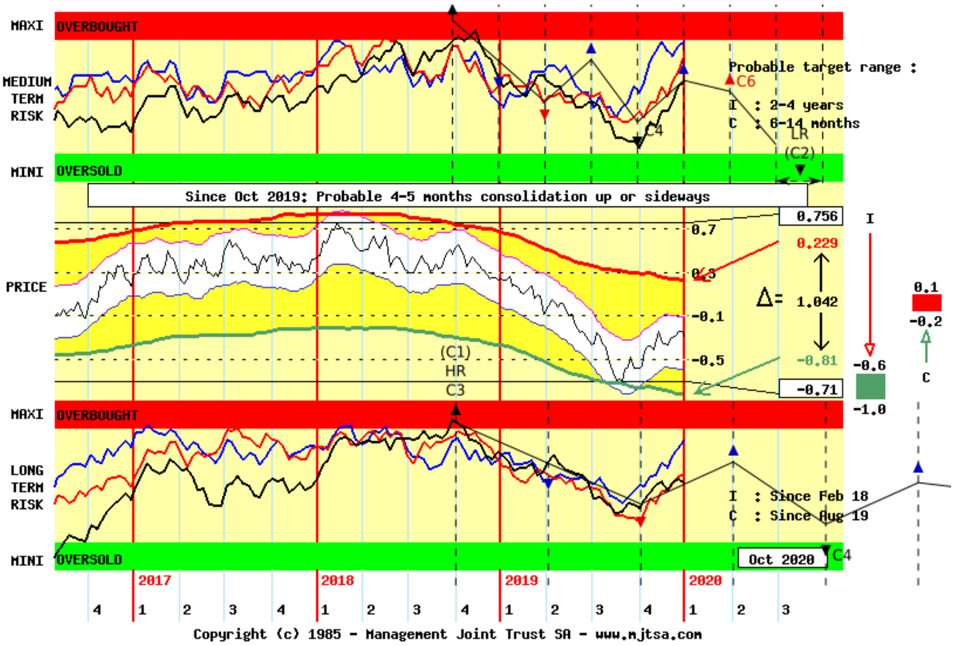
For now, on the Weekly graph, both oscillator series (lower and upper rectangles) are also suggesting that **the current rebound may continue into late Q1 / early Q2, but that, following that, the US 10Y Treasury yield could see a further leg down into the Fall. Our C Corrective targets to the upside indicate that rebound potential could be towards the 2.2% to 2.7% range over the next few months**. Only once/if, the US10Y Treasury yield breaks above this range, or if, for example, it continues to climb beyond early Q2 into the Summer, will we be able to start considering the prospects of a more secular reversal up of the US 10Y Treasury yield.

10Y German Bund Yield
Bi-monthly graph or the perspective over the next 1 to 2 years



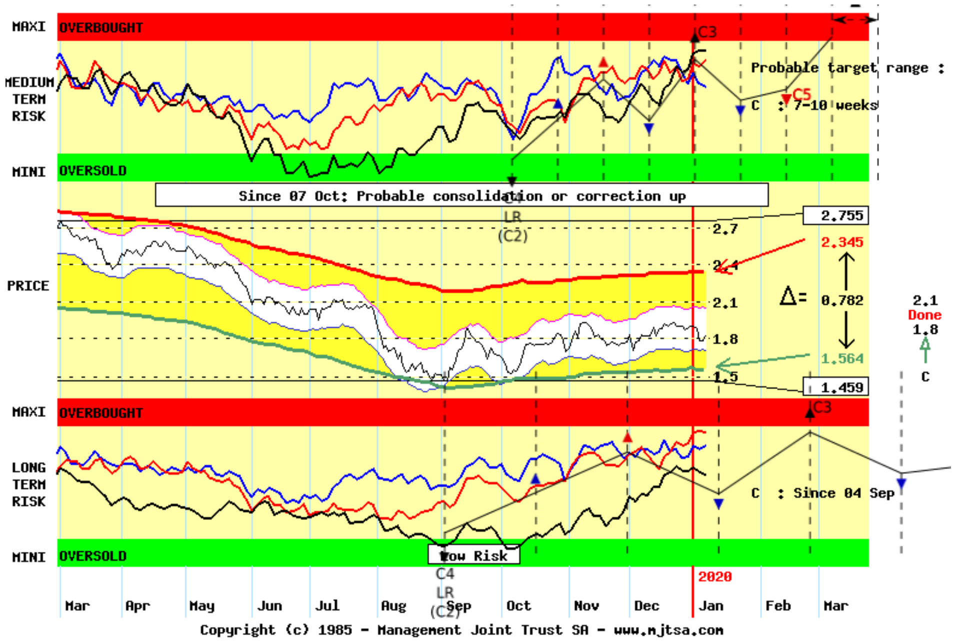
Long term, the 10Y Bund yield was also Oversold last August. Indeed, both our oscillator series (lower and upper rectangles) had reached "Low Risk" positions. Such situation would usually trigger a 1 to 2 years rebound, if not a secular reversal. Similarly, to the US 10Y Treasury yield's bi-monthly graph on the page above, a first leg up would probably lead the 10Y Bund yield higher into late this year.

10Y German Bund Yield
Weekly graph or the perspective over the next 2 to 4 quarters



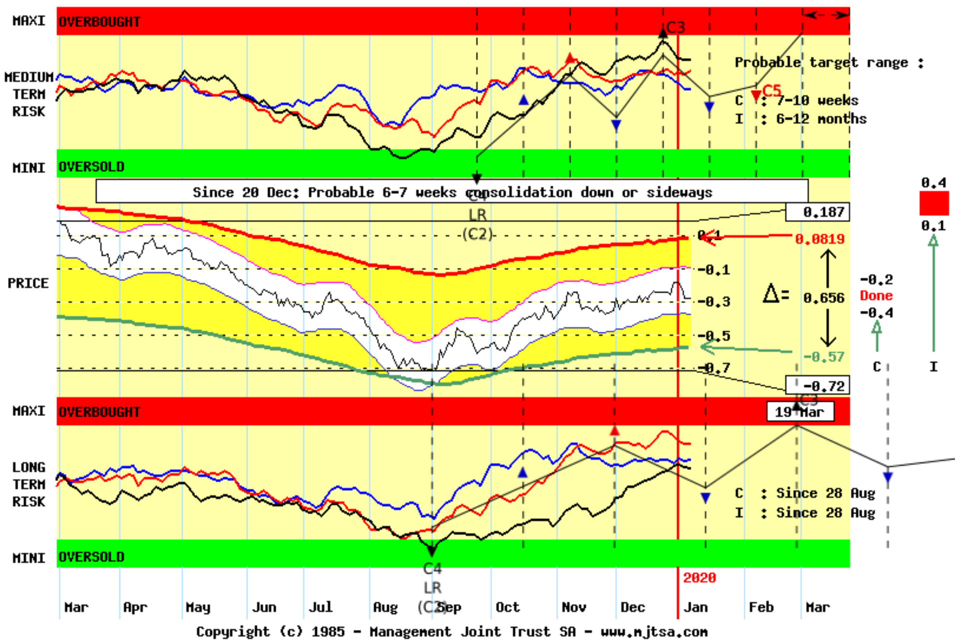
On this Weekly graph, however, the sequences on both oscillator series (lower and upper rectangles) are struggling to confirm a secular reversal to the upside. Indeed, the low in August does appear as an intermediate bottom. **The bounce currently underway (and which, on a volatility adjusted basis, has been more dynamic that in the US) may last into late Q1 / early Q2. Following that, the sequences we show would imply a new leg down into the Fall. The target range for the current rebound is in the -0.2% to +0.1% range** (right-hand scale). Only once / if the 10Y Bund yield manages to break above this range, or if, for example, the rebound extends beyond early Q2 into the Summer, will we be able to start considering a more secular reversal to the upside.

US10Y Treasury Yield
Daily graph or the perspective over the next 2 to 3 months



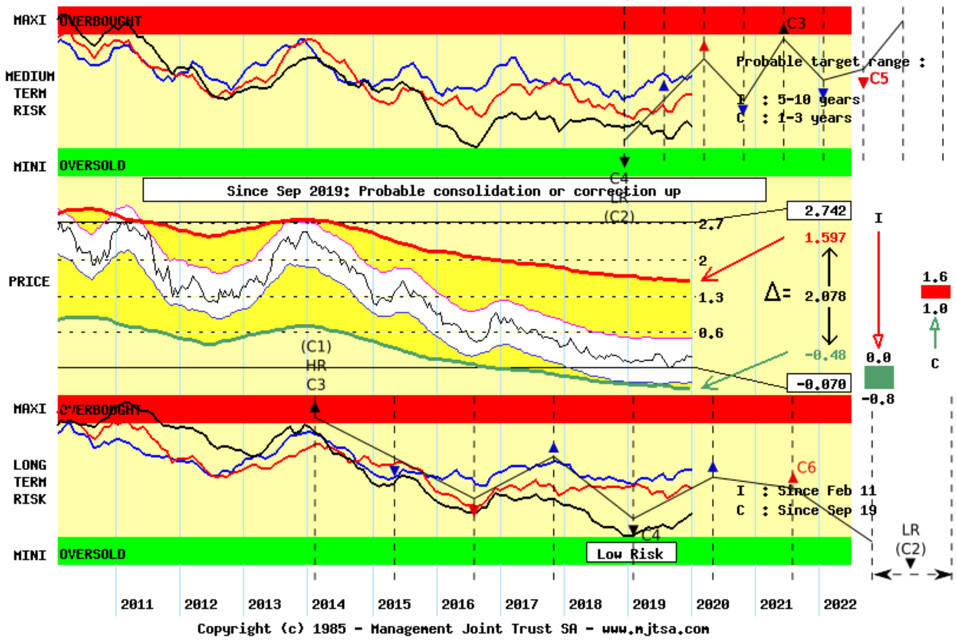
Shorter term, on this Daily graph, the rebound on the US10Y Treasury yield has stalled since early November. The price action since August is either a weak upside consolidation before a new sell-off, or a base building process, which may precede a new move higher. Given our Weekly scenario above, which suggests that the rebound could last into late Q1 / early Q2, we would probably favor the latter. Nevertheless, both our oscillator series (lower and upper rectangles) do point to **some short term weakness ahead, probably towards late January, before the next move up eventually starts and extends into late February / March. On the target front, crucial resistance is around the higher end of our C Corrective targets to the upside at 2.1%** (right-hand scale). Only once/if the US 10Y Treasury yield breaks above this level, will we be able to consider a more substantial rebound in terms of targets.

10Y German Bund Yield
Daily graph or the perspective over the next 2 to 3 months



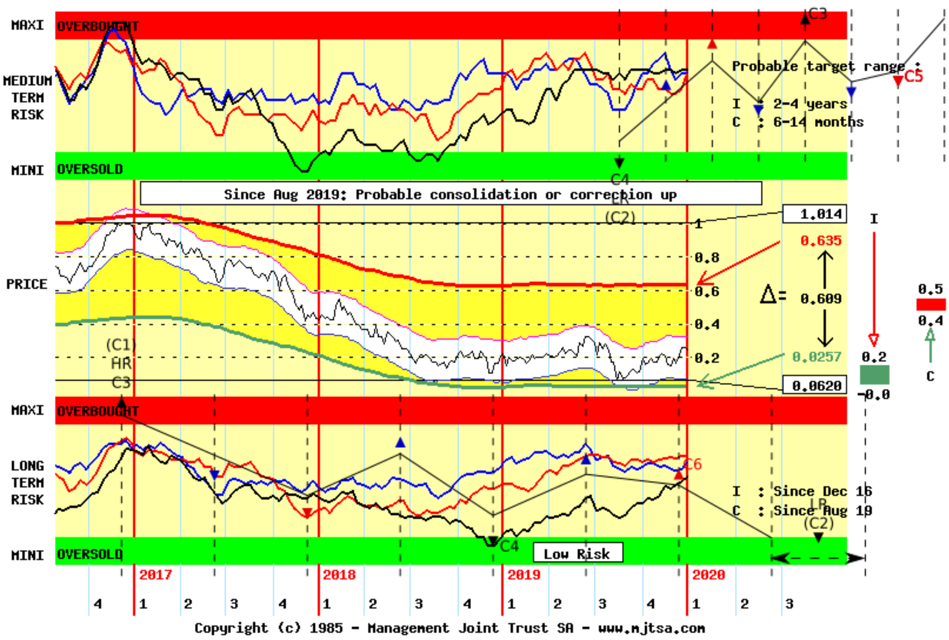
Interestingly, in late December, the Bund peaked slightly above the resistance of the upper end of our C Corrective targets to the upside (right-hand scale). **The rebound has hence been more dynamic than in the US on a volatility adjusted basis**. If/once confirmed, this breakout would open the door to much higher targets towards our I Impulsive target range to the upside between 0.1% and 0.4%. From a timing perspective, **we expect some consolidation into mid/late January on both oscillator series (lower and upper rectangles) before a new leg up eventually starts, probably extending into late February / March.**

10Y – 2Y USD IRS Swap rates Spread
Bi-monthly graph or the perspective over the next 1 to 2 years



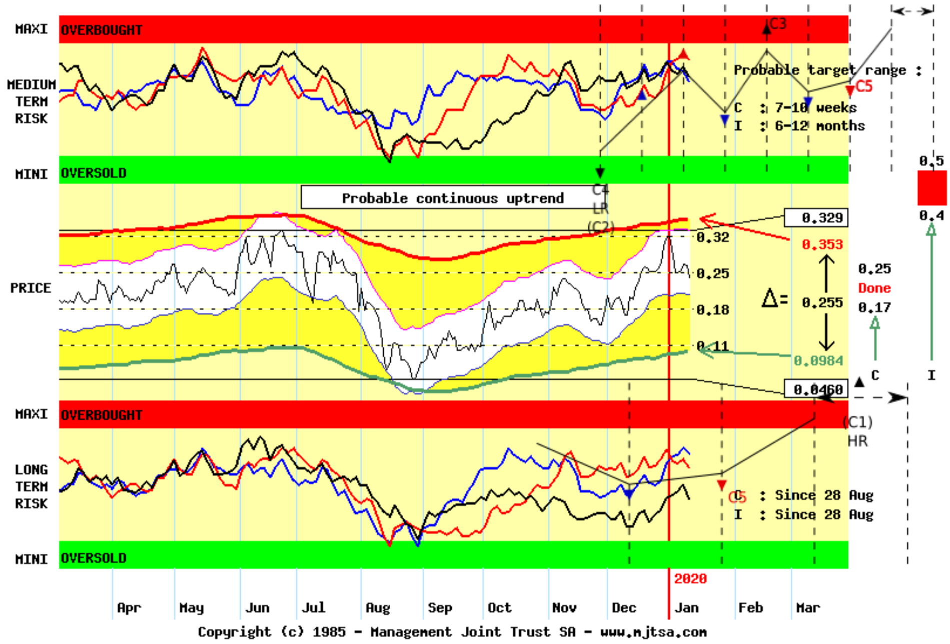
We now turn to the US yield curve, which was Oversold early last year on our long term oscillators (lower rectangle). Our medium term ones (upper rectangle) were then also in a Low Risk position, which allows us to tentatively show the beginning of a possible uptrending sequence on them. **For now, the rebound has been quite weak, yet this first leg up may extend into late Q1 / early Q2** on both oscillator series. To justify a more secular reversal, the US yield curve would probably need to hold up this Spring before starting to rise again into Summer, and then possibly continue higher towards year-end and into 2021. For now, this is still rather far fetched.

US10Y – US3Y Treasury Yields Spread
Weekly graph or the perspective over the next 2 to 4 quarters



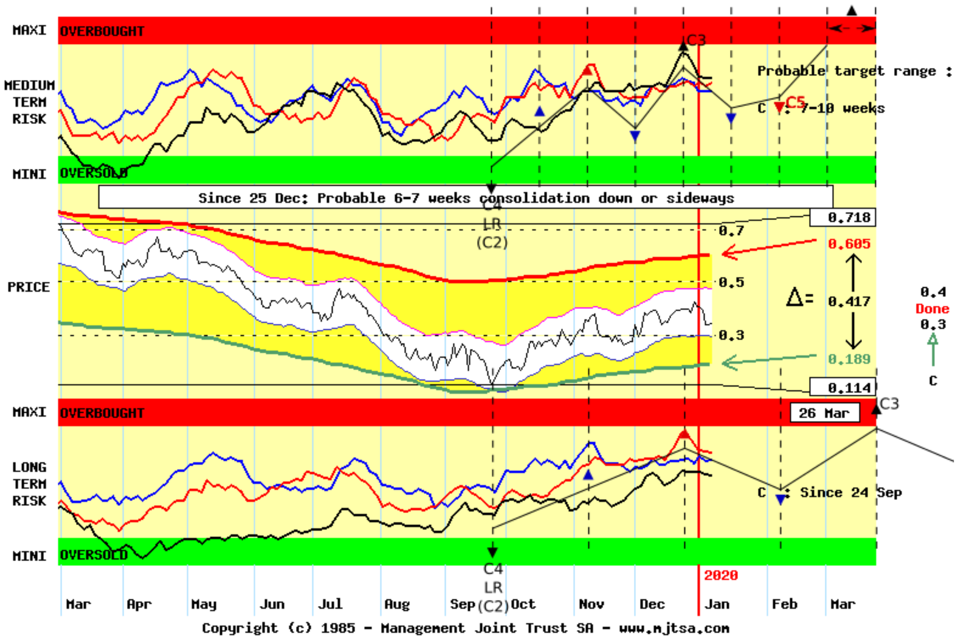
Yet, our Weekly graph may have recently broken out of its downtrend. Indeed, while our long term oscillators (lower rectangles) were pointing to further weakness from November into Spring 2020, the rally into year-end was rather surprising. **In fact, our medium term oscillators (upper rectangle) may be indicating the early stages of an uptrend. Indeed, the sequence we show on them would imply further upside progression into mid Q1, some retracement into the Spring and then a second leg up into the Summer.** The fact that the sell-off in August did fulfill our Impulsive targets to the downside (right-hand scale) would indicate that the downtrend was then very much exhausted and supports the view that a reversal up could be starting.

US10Y – US3Y Treasury Yields Spread
Daily graph or the perspective over the next 2 to 3 months



On the Daily graph, the rally into year-end appears quite strong. On both oscillator series (lower and upper rectangles), **we now expect some retracement during mid/late January, before a new leg up, materializes, probably into mid/late February, perhaps into late Q1**. This positive view is supported by the fact that the spread has also broken above our C Corrective targets to the upside and is now eyeing our I Impulsive ones in the 0.4% - 0.5% range (right-hand scale).

10Y – 2Y German Bund Yields Spread
Daily graph or the perspective over the next 2 to 3 months



The German 10Y – 2Y Bund spread is showing a similar configuration. On both oscillator series (lower and upper rectangles), **we expect it to consolidate during mid/late January, perhaps into early February. Yet, the spread should then rise again into March**. On the target front, the spread came close to breaking above our C Corrective targets to the upside in late December and we believe that a further leg up will probably confirm an upside breakout, opening the door to our much higher I Impulsive targets to the upside, which we calculate in the 0.6% to 0.8% range.

Concluding remarks:

From an asset allocation perspective, 2020 still seems to be a strong year for Equities. Indeed, our Equity to Bond ratios in the US and Europe, both point to potential outperformance for Equities vs Bonds into late H2. Shorter term, these ratios are quite stretched, yet should continue higher into mid Q1 when they may initiate a 2 to 3 months intermediate correction to the downside. Focusing on yields, both the US Treasury and German Bund 10Y yields did retest their 2016 lows last year (slightly higher lows for the US, slightly lower ones for Europe). This base could certainly justify a secular reversal, or at least a bounce into year-end. Yet, for now, our medium term Weekly graphs cannot confirm such a reversal yet. Rather, they are suggesting that the current bounce could die out at some point towards late Q1 / Q2 (in the 2.2 – 2.7% range for US10Y, in the -0.2 to +0.1% range for 10Y Bund yields). Only a move above these levels would then confirm a more secular reversal. Shorter term, US10Y and 10Y German yields could still see some retracement during mid/late January. They should then rise again into February, perhaps even early March. Yield curves on both sides of the Atlantic should also follow similar dynamics as shorter term yields lag long term ones in their rebound.

24 / Emerging Markets: this sector maybe ready for prime time now; EM will outperform developed economies in 2020

The last time we revisited the Emerging Markets was in February 2019 issue of the Capital Observer. At that time, we had the title: "Emerging Markets not yet ready for prime time, but start nibbling at it as another bet for commodities outperformance." That said a lot. We said at that time:

The second half of 2018 was admittedly a tough one for emerging markets. A number of currencies were under considerable pressure, with some of them falling to record or near-record lows against the strong U.S. dollar.

EM risk assets sold off with the general market when the October sell-off started, but have done much better than US equities. The reason was that the US Dollar also fell, allowing the EM assets room to grow during the interim. But as we anticipated, US-dominated assets roared back in early January, and have again eclipsed MSCI EM$ (see 1st and 2nd charts on this page).

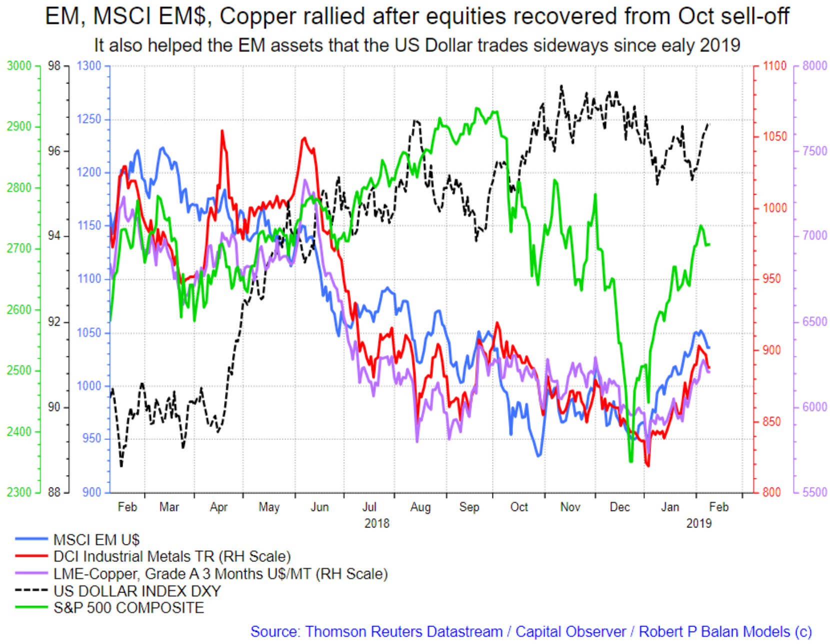
After a year, what has changed?

For one, the MSCI EM$ was broadly higher, but the price of industrial metals and of copper was largely unchanged – the prices of these commodities traded sideways for most of 2019. Therefore, nibbling at EM risk assets early last year did not bring much benefit from commodity purchases because the US Dollar, from the time we wrote the piece in February last year, almost monotonically rose higher until September. However, what quantifies as "amazing" was that EM assets and currencies held their ground, kept their valuation basically intact, and then some.

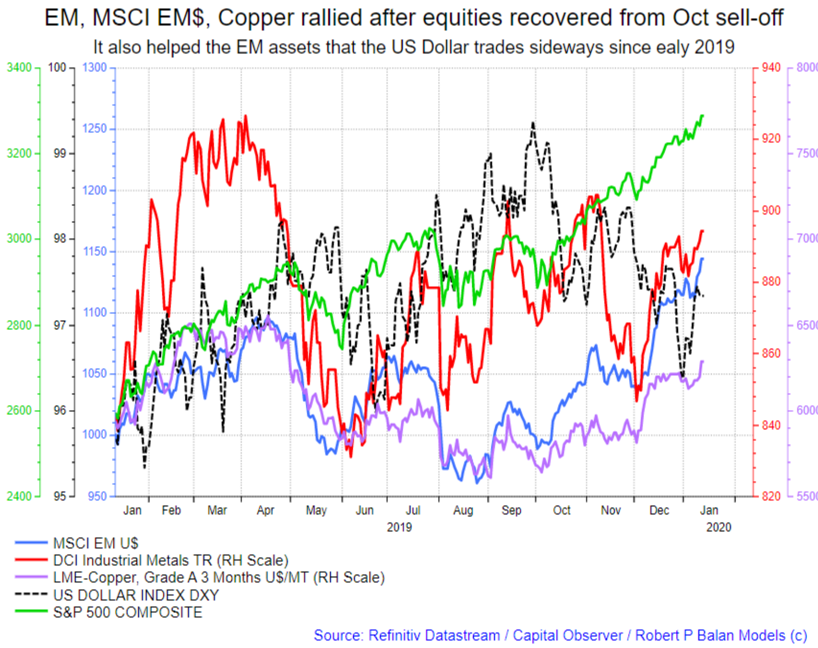
EM currencies performed very well indeed, as the MSCI EM$ continued an uptrend that has been in place since August last year (*see 3rd graph on this page*, EM currencies and the DXY inverted).

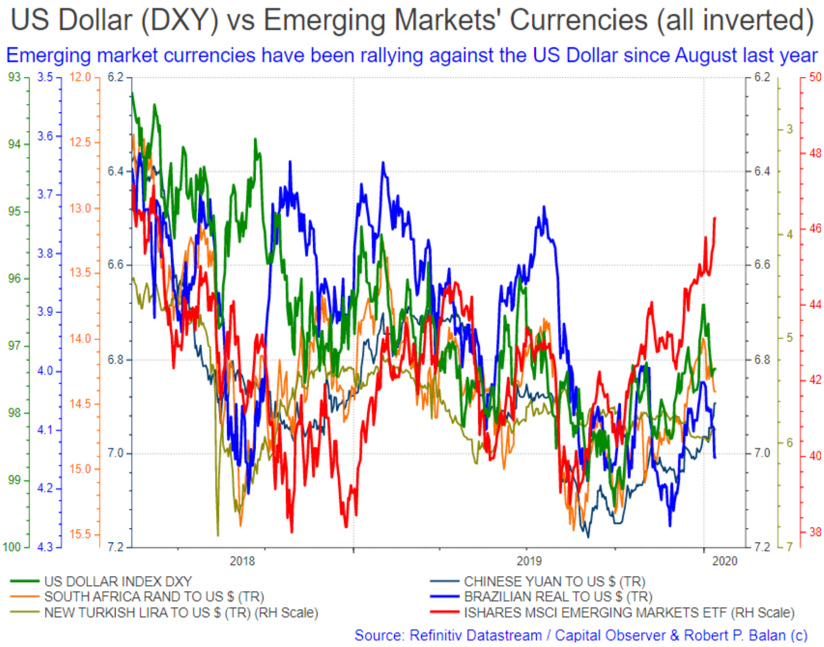
There were many reasons for this, including the efforts of many EM

Original chart from the February 2019 issue of The Capital Observer



This is how the above graph looks today



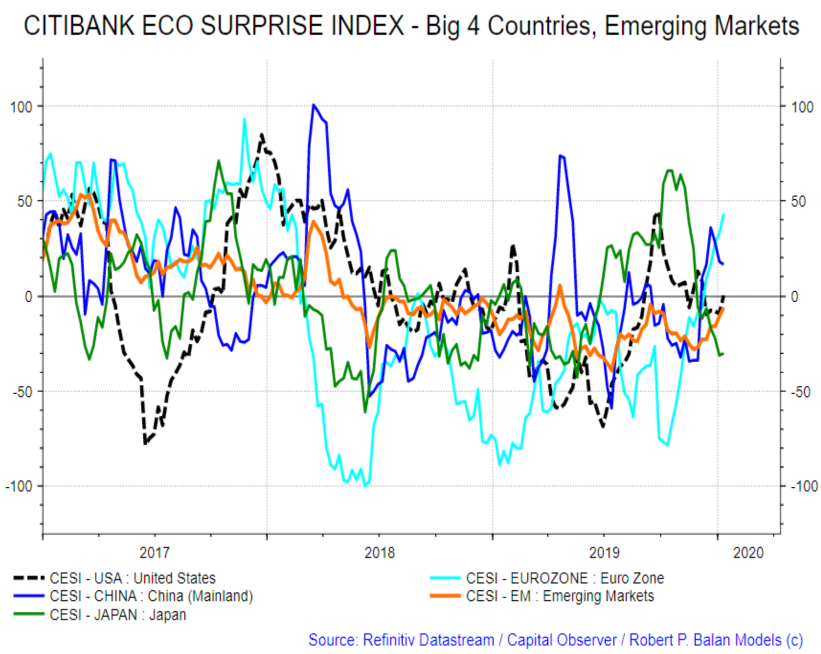


economies to re-denominate their US Dollar debts. Also, with the Fed walking back its desire for tighter monetary conditions, the investment case for emerging markets has vastly improved. Furthermore, global investors were betting big that the U.S. dollar will likely ease on less aggressive Fed monetary tightening. This would relieve some of the pressure on emerging economies that must pay higher prices on imports from the U.S. when the dollar is strong. That the US Dollar did strengthen, but EM assets still fared well, nonetheless, was very noteworthy.

There are many factors why a strong Dollar has become the EM's nemesis. A rising dollar not only limits the ability of emerging countries to assume U.S. dollar denominated debt -- it increases the credit risk of most of these countries. As the dollar continued to rise, emerging markets found it difficult to service their dollar denominated debt, which provided another reason for investors to go short emerging market securities or flee that market for the safety of US-based dollar denominated assets. Also, a stronger US Dollar encourages capital flows from EM capital base itself, and the US gets flows which could be destined for EM economies. **That, primarily, is how a strong US Dollar undercuts EM economies and assets.**

That may change soon. The growth of EM economies has started to be synchronized with that of the US (*see 1st graph on this page*), **and firming US Dollar could actually become positive for this sector in many ways.**

What is positive in all of this is that EM has stopped becoming an alternative for US growth – a destination to go to when US growth falters. In this case, when US growth revives, there are massive outflows from the EM universe – a recurring boom-and-bust. The EM CESI data in the chart above has been turning up even ahead of the US CESI. In fact, many analysts say that EM economies will outperform the developed ones this year. That is certainly true of China, a subject



which we discussed in another article in this issue of The Capital Observer *("The Capital Observer's 2020 global outlook: de-synchronized growth prospects for US and China suggest flat global growth).*

That helps explain our observation that following outflows from emerging-market equity funds during the first three quarters of 2019, significant inflows are occurring in the fourth quarter. International investor sentiment has become more positive, anticipating stronger performance for this asset class in 2020. The adage works well: possible future outperformance for emerging markets would follow an extended period of underperformance.

There are four main factors underlying the strengthened sentiment for emerging-market equities:

(1) the prolonged period of EM underperformance has left equities in EM markets inexpensive compared to equities in developed markets, particularly the US market;

(2) Second, the rally in EM stocks has been stimulated in part by signs that the global economic slowdown that began in the first half of 2018 is now bottoming out;

(3) there is evidence that the global decline in manufacturing has bottomed out. The Markit J.P. Morgan Global Manufacturing PMI for November was at a seven-month high. At 50.3, this indicator has, for the first time since April, moved above the 50.0 line that divides expansion from contraction; and

(4) renewed optimism on the trade front. The US-China trade war and other trade disputes have been a major cause of the global slowdown in economic growth and declines in world trade and manufacturing. The "Phase One" trade agreement between the US and China will be signed this week.

Then, there is also the anticipated acceleration of a number of emerging-market economies in 2020, including Brazil, Mexico, India, Turkey, South Africa, and Russia, follows weak performances earlier in the current year. The Brazilian economy, for example, is already showing strong signs of a healthy recovery following a severe recession. A sweeping program of deregulation and privatizations promises to give important support going forward, encouraging improved investment activity.

Conclusion:

U.S. markets outperformed emerging markets with ease in the last five years, and therefore investors have lost their confidence in investing in emerging markets. In addition to this outperformance of U.S. markets in the last several years, future prospects of emerging markets have not developed in the way that proponents of the group had hoped. This has prevented many investors from investing in emerging markets in the recent past. **However, the past is not prologue in this instance. Emerging Markets are morphing – for the better.**

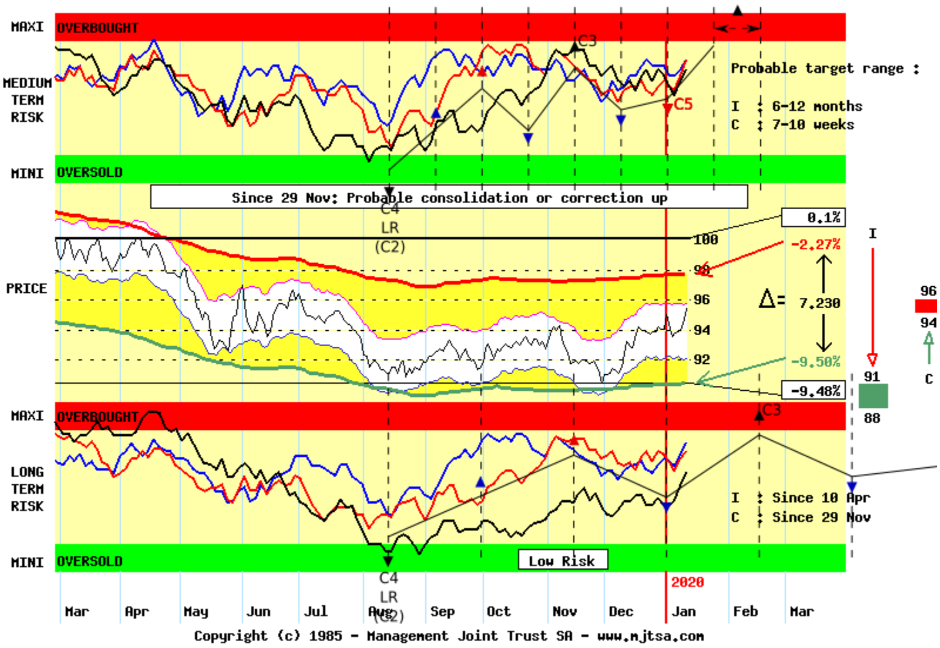
With the outlook for commodities starting to become brighter, and with the Chinese economy set to rejoin a global EM reflation as from Q2 2020, investors should start looking for Tier 1 assets that will benefit from an EM revigoration. Emerging markets assets should not only be considered as an asset class that is expected to provide superior returns over an extended period of time, but also as a portfolio diversification tool, and a bet on future commodity outperformance. We will periodically revisit this topic in the next issues of The Capital Observer.

27 / MJT - TIMING AND TACTICAL INSIGHT

Emerging markets are breaking out to the upside vs developed ones

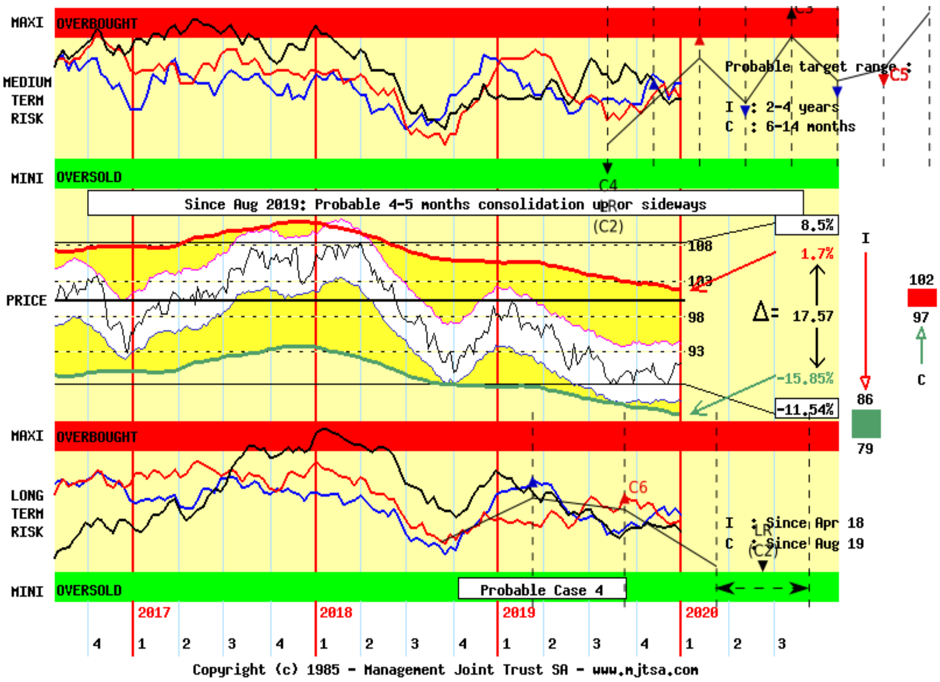
Since August, Emerging Markets seem to have built a base vs developed ones and may have broken out of their 2 years relative downtrend. With a possible trade deal between China and the US in its final stages, and a US Dollar which may have started to weaken, the prospects for Emerging Markets seem quite promising for 2020. In this article we review the main Emerging Markets Indexes, their currencies as well as compare the performance of some of the large Emerging Countries vs the All Country World Index.

MSCI Emerging markets Index vs All Country World Index
Daily graph or the perspective over the next 2 to 3 months



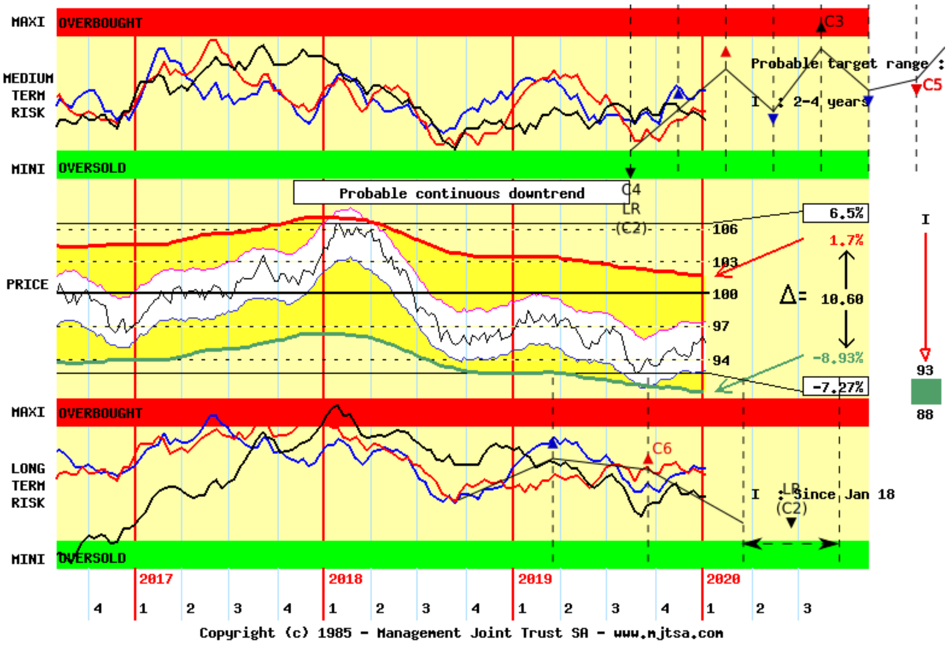
As mentioned in the introduction above, Emerging Markets (EEM ETF) seem to have built a base since August vs the All Country World index. Both oscillator series (lower and upper rectangles) would now **suggest further upside into early/mid February. By then, the ratio may have broken above the resistance of the upper end of our C Corrective targets to the upside (right-hand scale), circa 1% higher than today**. This would clear the way to much higher targets (another 5 to 7% of potential additional outperformance) over the next 6 months.

MSCI Emerging markets Index vs All Country World Index
Weekly graph or the perspective over the next 2 to 4 quarters



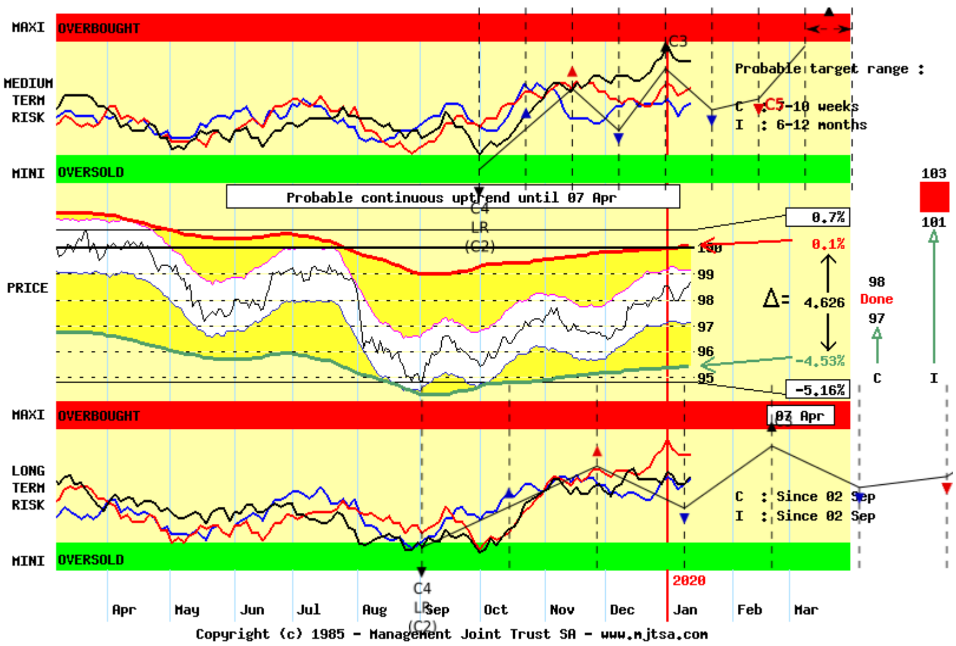
Longer term, on the Weekly graph, the ratio may be bucking its 2 years downtrend. Indeed, our long term oscillators (lower rectangle) would have suggested a strong move lower from late Q3. Instead, the ratio stabilized and even rallied strongly in December. This divergence allows us to consider the possibility of reversal to the upside on our medium term oscillators (upper rectangle), which indicate **further upside towards a mid Q1 intermediate top. Following some retracement into late Q1 / early Q2, the ratio could then see a second leg up into the Summer.** On the target front (right-hand scale), although some downside risks remains, possibly towards the 86 – 79 range over the next 6 to 12 months (i.e. our I Impulsive targets to the upside), **our C Corrective targets to the upside also show interesting potential in the 97 to 102 range (5 to 10% higher than today).** The risk/reward is hence rather neutral in terms of targets and the trend seems to be reversing up.

Emerging Markets currencies vs USD
Weekly graph or the perspective over the next 2 to 4 quarters



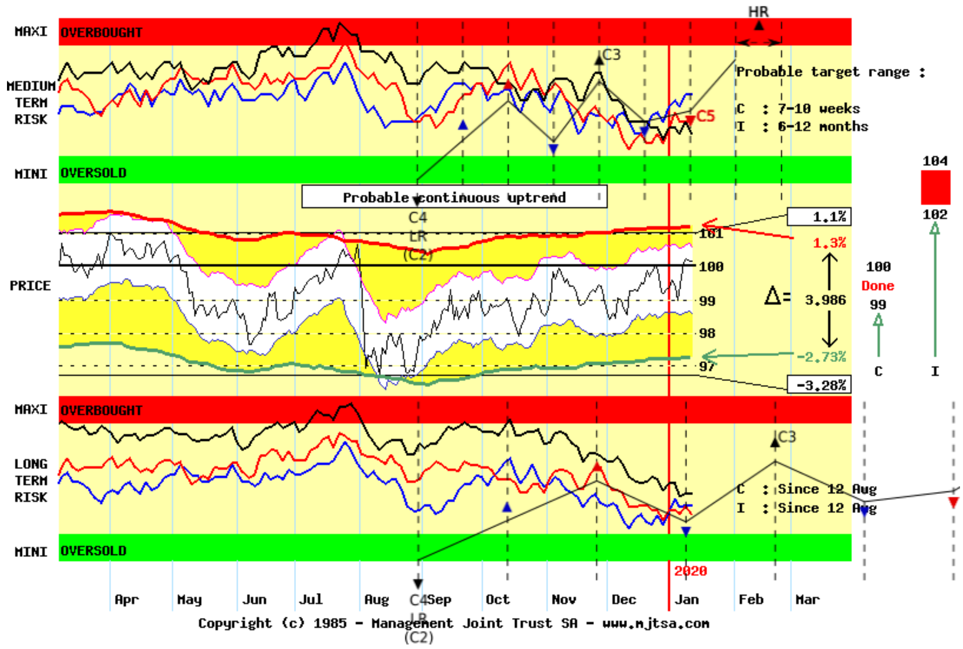
The performance of Emerging Markets is often a question of flows. Hence the performance of the various Emerging Markets in US Dollars (and even in local currency) is often very closely related to the performance of their currencies. This Weekly graph shows the cap. weighted performance vs the US Dollar of the currencies of the Top 8 countries represented in the MSCI Emerging Markets Index (i.e. CNY, TWD, KRW, INR, THD, BRL, RUR, ZAR). The basket had been in a strong downtrend against the US Dollar since Q1 2018, and our long term oscillators (lower rectangle) would have suggested further underperformance from late last Q3 into Spring this year. Instead, these Emerging Market currencies have risen sharply against the US Dollar in Q4. This allows us to consider a new uptrend sequence on our medium term oscillators (upper rectangle). It points to **an intermediate top mid Q1 and then following a late Q1 / early Q2 retracement period to a further leg up into the Summer.**

Emerging Markets currencies vs USD
Daily graph or the perspective over the next 2 to 3 months



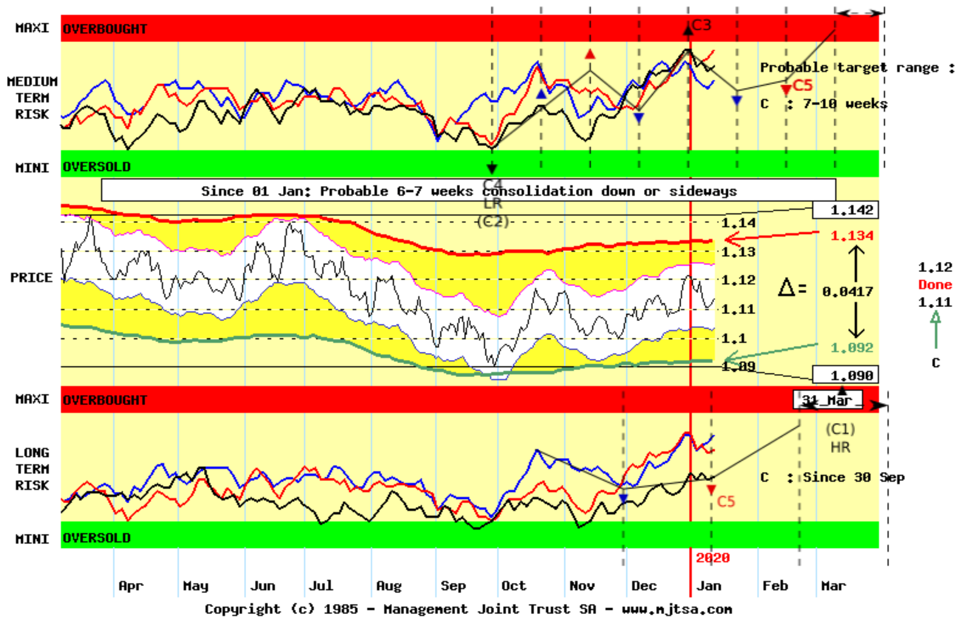
We now consider the same graph on a Daily basis. Its uptrend since late August is indeed very promising as the basket is currently testing above the resistance of the upper end of our C Corrective targets to the upside, here at 98 (right-hand scale). A strong break above these levels would indeed clear the way for **further upside potential into our I Impulsive targets up, another 3 to 4% above current levels, probably over the next 6 months**. Timing wise, we show two uptrend sequence on our oscillators series (lower and upper rectangles) stemming from both the late August and late September lows. They suggest **further upside into mid/late February at least (lower rectangle) and possibly into March (upper rectangle)**. Short term this sequence on our medium term oscillators (upper rectangle) may point to **a short period of retracement over the next week or so, yet by late January, the uptrend should resume.**

Emerging Markets currencies vs EUR
Daily graph or the perspective over the next 2 to 3 months



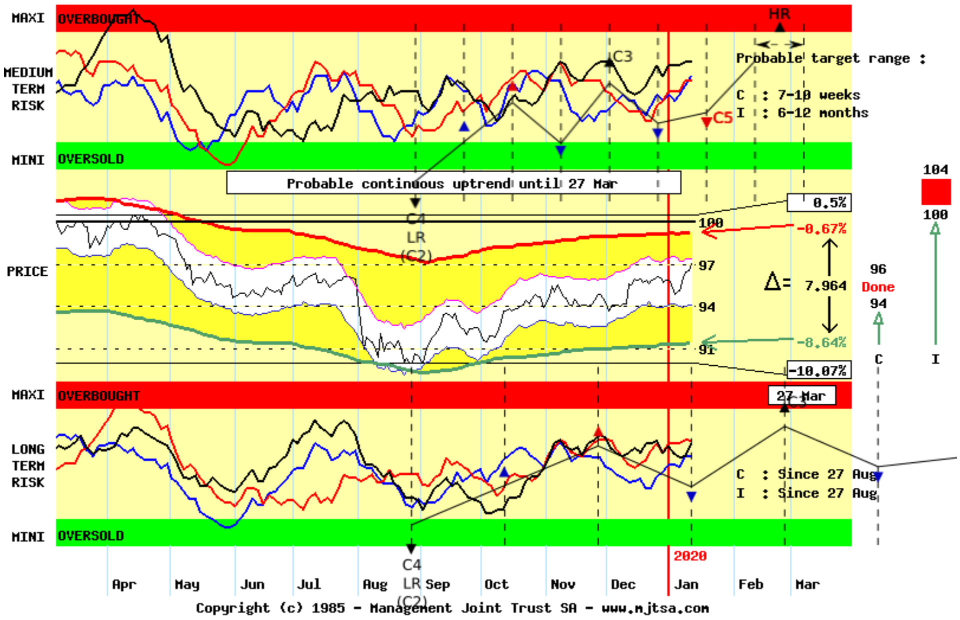
Looking at the same Emerging Markets currency portfolio in Euros confirms this strong uptrend. The basket in Euros has just broken above our C Corrective targets to the upside (right-hand scale) and **could now reach our I Impulsive targets to the upside (2 to 4% higher over the next 6 months)**. Both oscillator series (lower and upper rectangles) are also very promising as they **point to a resume uptrend situation and towards a top in mid February.**

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



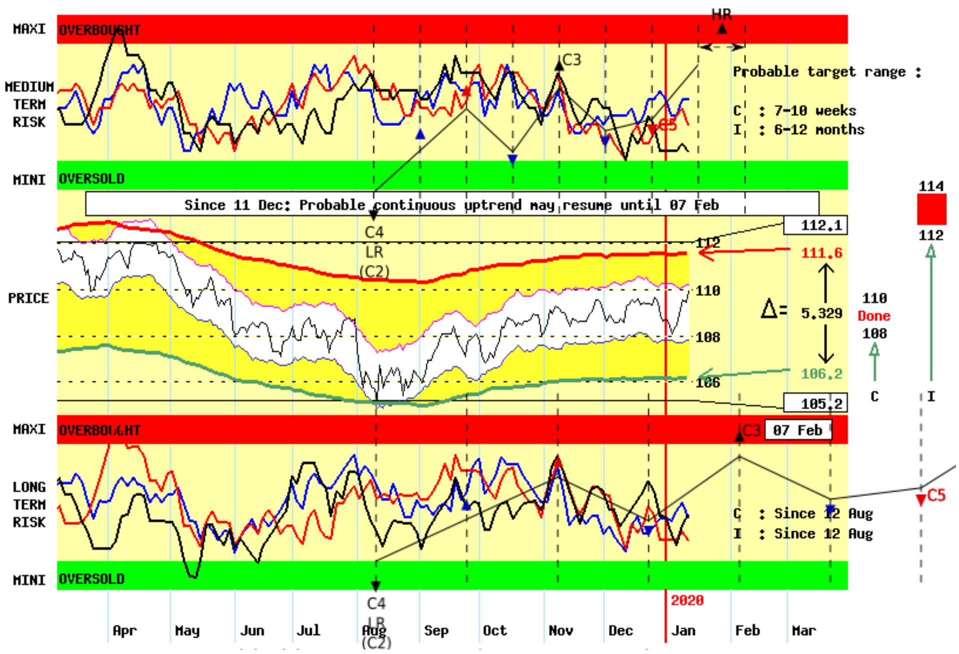
In this graph, we relate these performances above to EUR/USD. Indeed, often the performance of Emerging Markets currencies vs the USD is rather correlated to EUR/USD. Last month, we suggested that the US Dollar had probably entered a distribution period, that it could fall into year-end (rise in EUR/USD), and then bounce into mid/late January (fall in EUR/USD), before finally resuming lower (new rise in EUR/USD) towards February / March. These dynamics are under way. Our long term oscillators (lower rectangles) have built a base and are supportive for EUR/USD into late February / March. Our medium term ones (upper rectangle) would suggest **more consolidation for EUR/USD during mid/late January before the pair resumes its uptrend into February and March**. A break above the resistance of our C Corrective targets to the upside at 1.12 (right-hand scale) would confirm an upside breakout, and the possibility of move towards 1.14.

Emerging Markets currencies vs JPY
Daily graph or the perspective over the next 2 to 3 months



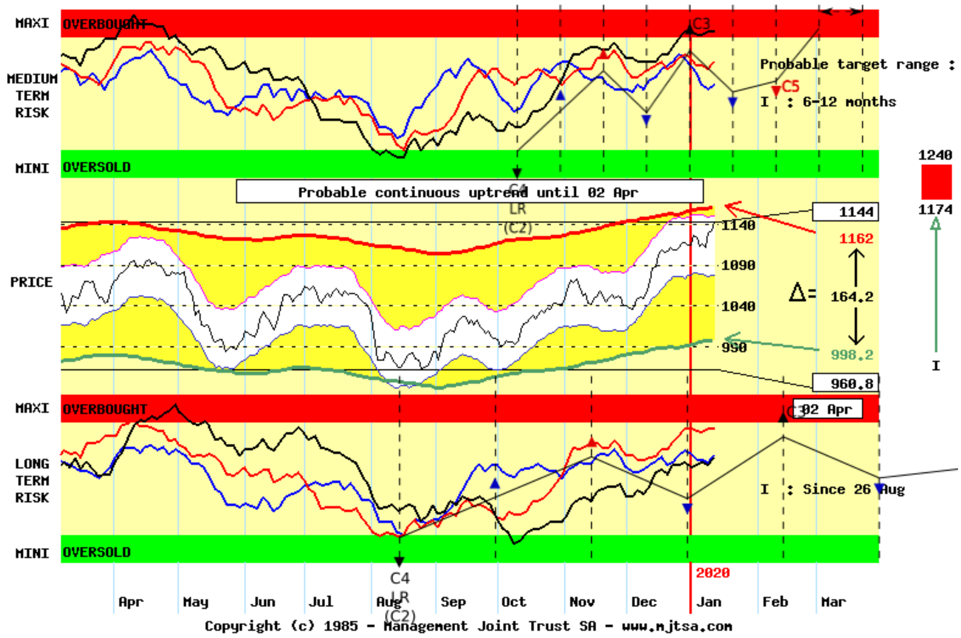
Similarly, we now consider our Emerging Markets currency portfolio vs the Yen. More generally, as the Yen is traditionally risk-off, this comparison should also help us monitor the risk assets rally going forward. On both oscillator series (lower and upper rectangles), **we expect the basket to continue to rise vs the Yen probably towards late February / March**. On the targets front, the trend has just broken above our C Corrective targets to the upside, opening the door towards our I **Impulsive targets to the upside 3 to 7% above current levels** (right-hand scale). Indeed, this graph bodes well for Emerging Market currencies, Risk assets more generally, as well as for Yen Carry Trades.

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



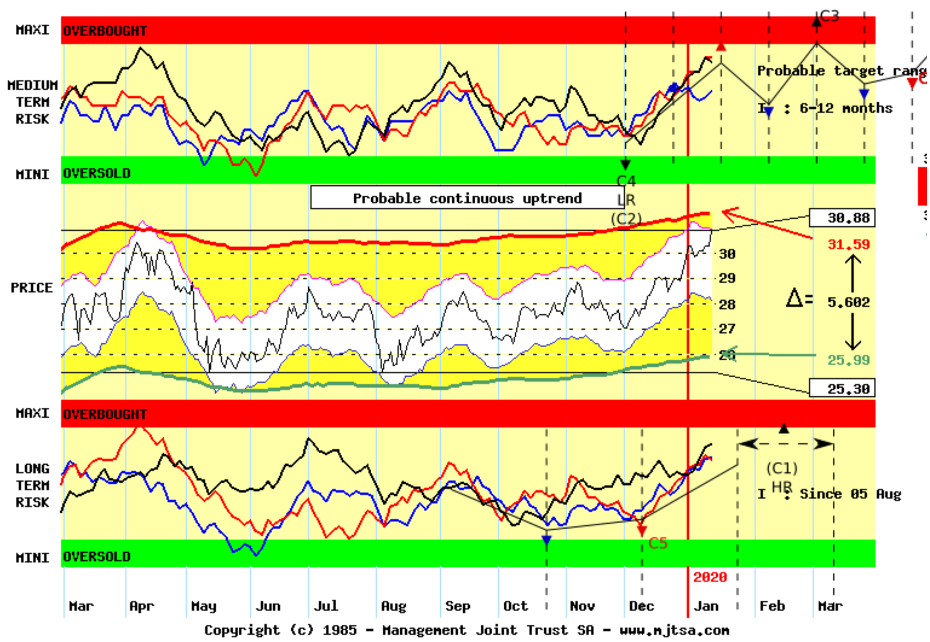
We now consider to USD/JPY which seems to confirm the Yen's weakness into mid Q1. Indeed, the sequences we show on both oscillator series (lower and upper rectangles) **would suggest further upside for USD/JPY into early/mid February. Furthermore, USD/JPY recently broke above our C Corrective targets to the upside at 110 (right-hand scale), thereby clearing the way for much higher targets into the 112 – 114 range** over the next few months. This again is generally risk-ON into February.

MSCI Emerging Markets Index
Daily graph or the perspective over the next 2 to 3 months



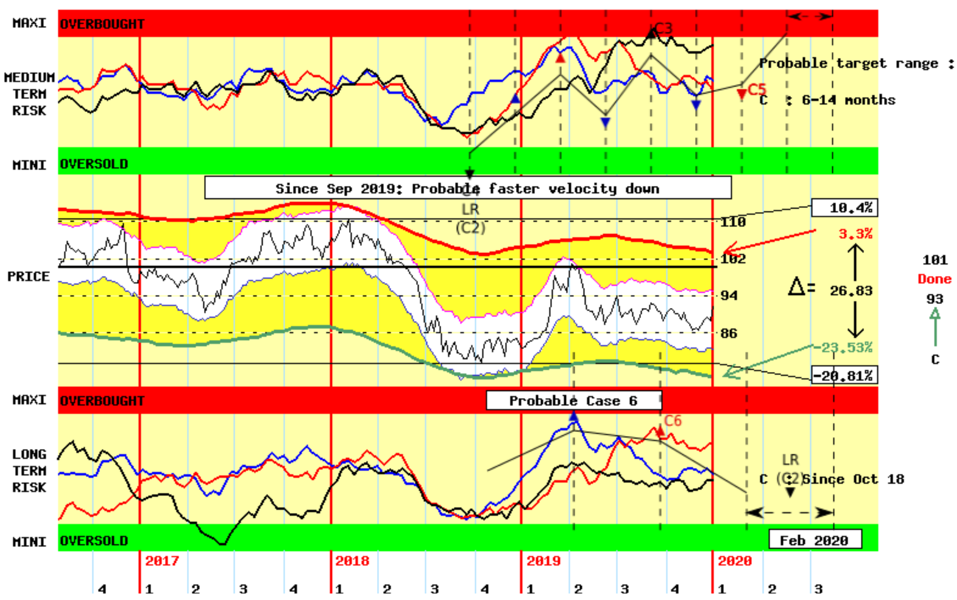
We switch back to Emerging Markets equity, on an absolute basis. According to both our oscillator series (lower and upper rectangles), **the current uptrend should continue into mid/late February, perhaps March. Our I Impulsive targets to the upside (right-hand scale) suggest potential in the 1'174 – 1'240 range or circa 3 to 9 % higher than today over the next few months.** This is rather compelling. We would hence consider buying dips during mid/late January if there are some.

China's CSI 300 China A-Shares in US Dollars
Daily graph or the perspective over the next 2 to 3 months



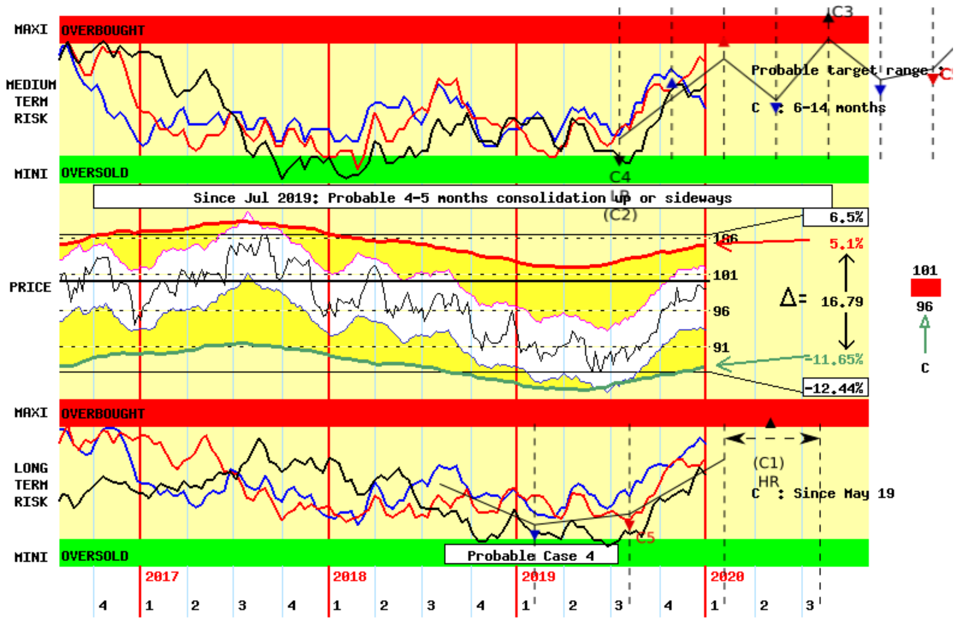
Similarly, China's CSI 300 Index (in US Dollars), i.e. the ASHR ETF, is also in a strong uptrend. Our long term oscillators (lower rectangle) project that it probably continues into mid Q1. Our medium term ones (upper rectangle) may point to **some consolidation over the next couple of weeks (following ASHR's strong performance since early December), yet given the strength of the trend we believe it could be quite short and shallow. Following that the uptrend resumes, probably into late February / early March**. Our I Impulsive targets to the upside (right-hand scale) point to further upside **potential until then in the 33 – 35 range, or a further 7 to 12% above current levels.**

China's CSI 300 China A-Shares vs All Country World Index (both in US Dollars) Weekly graph or the perspective over the next 2 to 4 quarters



Given our positive relative strength analysis for Emerging Markets and their currencies into February/March and then perhaps once again into the Summer, as well as the strong uptrends we see on the MSCI Emerging Markets and the China CSI 300 Index in US Dollars into mid/late February / March, we now consider a selection of the largest Emerging Markets Country Indexes vs the All Country World Index. We will start with China, the MSCI Emerging Markets Index's largest weighting at circa 35%. Similarly to the MSCI EM relative graph above, we believe that Chinese equities are currently bucking their downtrend vs the All Country World Index. Indeed, while our long term oscillators (lower rectangle) would have implied further weakness into late Q1 / Q2, the ratio has rallied strongly since early December. On our medium term oscillators (upper rectangle), **we expect the ratio to hold up during Q1 and then probably reaccelerate higher into the Summer**. Our C Corrective targets to the upside (right-hand scale) suggest that it could test back up to its April high by then **(7 to 8% above current levels**, i.e. towards the resistance of the upper end of our C Corrective targets to the upside around 101).

MSCI Taiwan Index vs the All Country World Index (both in US Dollars) Weekly graph or the perspective over the next 2 to 4 quarters



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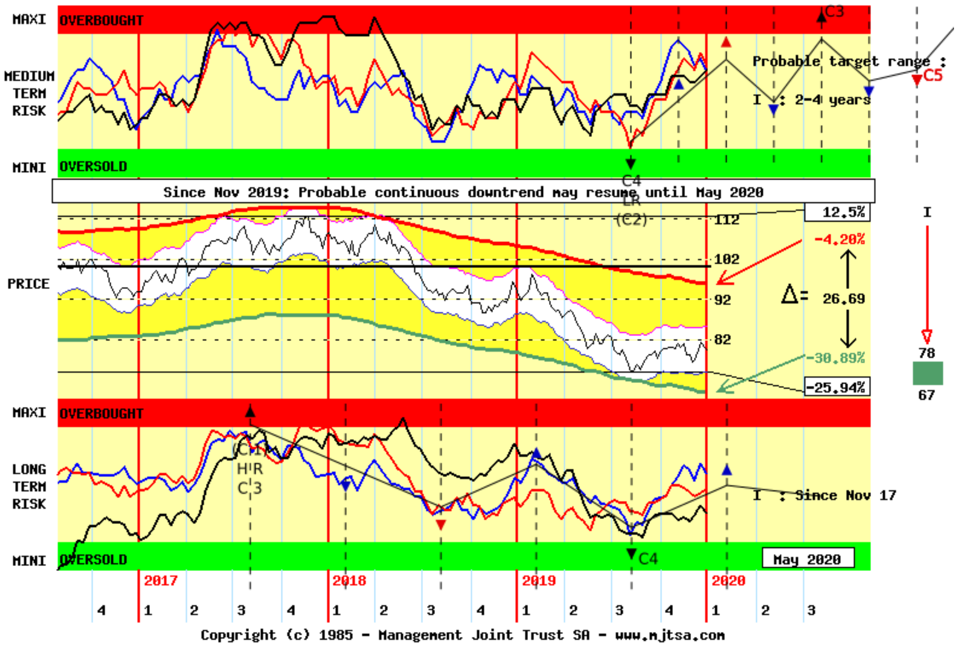
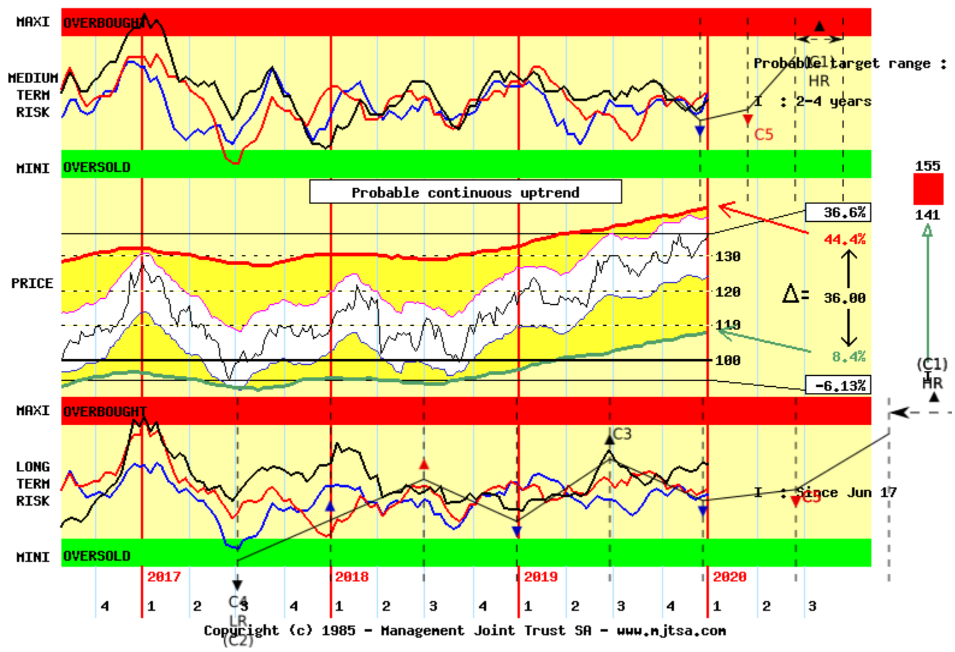
We now consider the MSCI Taiwan Index (EWT ETF in US Dollars) vs the All Country World Index. Taiwan's stock market started to reverse up on a relative basis mid Q2 last year. On both oscillator series (lower and upper rectangles), **we believe its outperformance could now continue into the Summer, with an intermediate top towards mid Q1** on our medium term oscillators (upper rectangle). On the target front, the ratio could break above its C Corrective targets to the upside (right-hand scale) over the next couple of months, which would open the door to much higher targets towards the Summer (i.e. 8 to 15% higher).

MSCI S Korean Index vs the All Country World Index (both in US Dollars)
Weekly graph or the perspective over the next 2 to 4 quarters



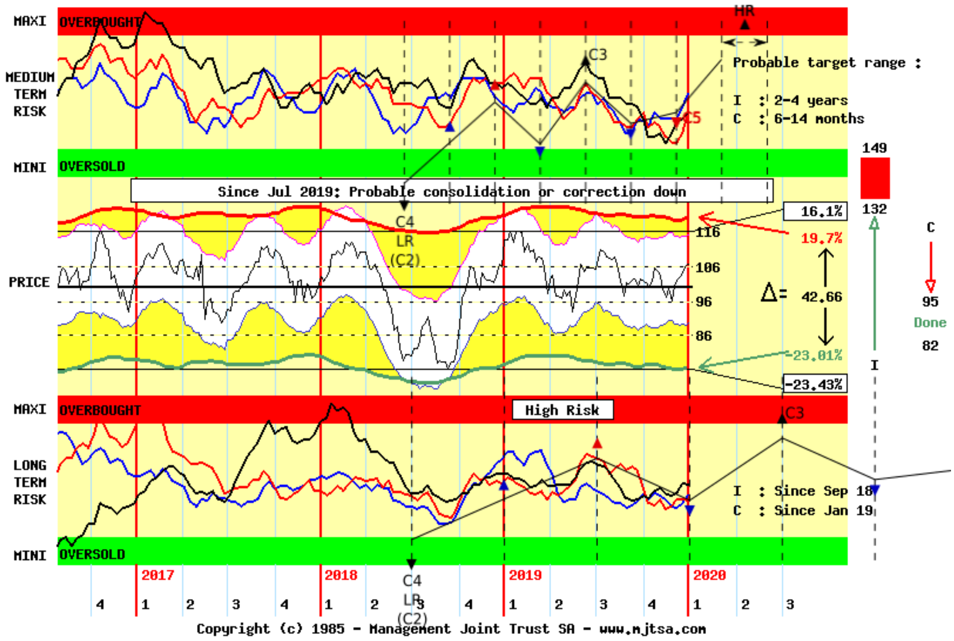
The MSCI South Korea Index (EWY ETF in US Dollars) is a very cyclical market and its bounce vs the All Country World Index only started with the reversal up in cyclicity and rates mid Q3 last year. Both oscillator series (lower and upper rectangles) are now suggesting **that it could outperform into mid Q1 in first instance**. Following that, the ratio may retrace down into late Q1 / early Q2, and then potentially rise again into the Summer. From a targets perspective (right-hand scale), the downside potential of our I Impulsive targets was pretty much achieved last August. The rebound potential we can now calculate is towards the 87 – 95 range on this relative graph (0.5 to 0.8 times our historical volatility measure “Delta”, here at 26.69 – middle rectangle, right-hand side – added to the graph’s low at -25.94, i.e. at 74.06). This is **circa 5 to 12% above current levels**. South Korea is more cyclical than Taiwan, which is featured above. It may hence bounce more dynamically into mid Q1, yet would then correct down more sharply towards late Q1 / early Q2, and may then also find it more difficult to rebound once again strongly into the Summer.

MSCI Russia Index vs the All Country World Index (both in US Dollars)
Weekly graph or the perspective over the next 2 to 4 quarters



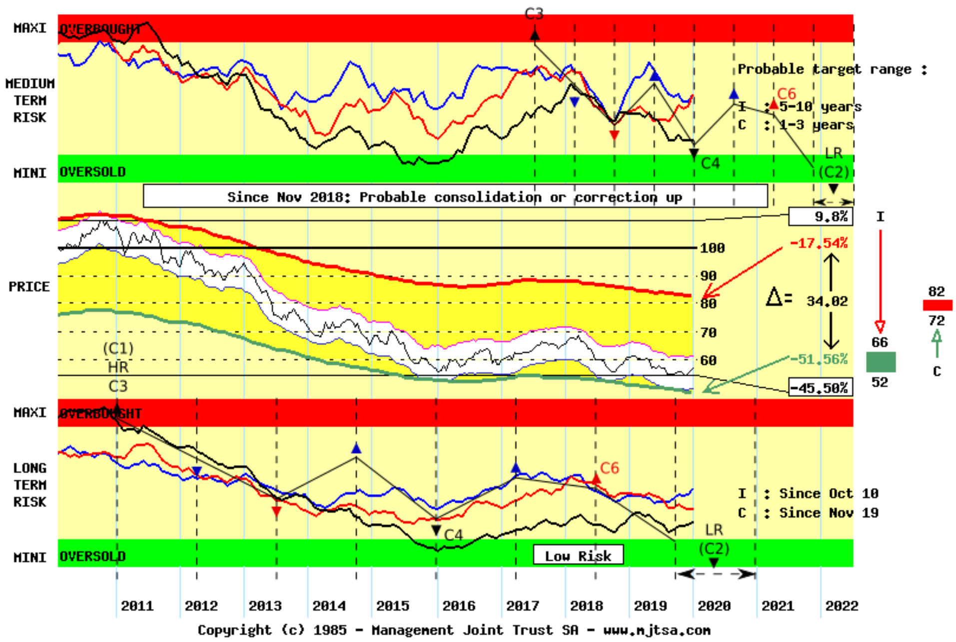
The MSCI Russia Index (ERUS ETF in US Dollars) has been a stellar performer vs the All Country Wolrd Index since the Summer of 2018. Its profile is rather Defensive/Growth among Emerging Markets and vs the All Country World Index. It is hence a bit of an All Weather alternative at present when investing in Emerging Markets. Both our oscillator series (lower and upper rectangles) suggest that this secular **outperformance is probably not over yet, and could extend into the Summer, perhaps even into 2021. Our I Impulsive targets to the upside (right-hand scale) suggest between 4% and 18% of further outperformance over the next few quarters.**

MSCI Brazil Capped Index vs the All Country World Index (both in US Dollars)
Weekly graph or the perspective over the next 2 to 4 quarters



The ratio of the MSCI Brazil Capped Index (EWZ ETF) vs the All Country World Index resembles the Russian one above, yet with more volatility. It also appears rather counter-cyclical yet possibly with less of a Growth components than Russia (less of a linear uptrend). That said, it may have some catching up to do over the next few quarters. Both our oscillator series (lower and upper rectangles) suggest that **the ratio could continue to rise into Q2 and perhaps early Summer, with upside potential which is still quite compelling on a relative basis, i.e. 25% to 40%** according to our I Impulsive targets to the upside (right-hand scale).

MSCI Emerging Markets vs the MSCI World Index
Bi-monthly graph or the perspective over the next 1 to 2 years



We conclude this section by looking at the long term bi-monthly graph of the MSCI EM Index vs the MSCI World. Although some doubts could always persist given the strong downtrend since 2010, our long term oscillators (lower rectangle) seem to have reached a "Low Risk" position while our I Impulsive targets to the downside (right-hand scale) have been achieved. The long term downtrend is hence quite exhausted. Furthermore, our medium term oscillators (upper rectangle) seem to point to, at least, an intermediate bottom with **a possible bounce into H2 2020**. Our C Corrective targets to the upside (right-hand scale) **indicate a rebound potential between 15 and 25% on a relative basis**. Hence, we believe that the outperformance of Emerging Markets during last December may be the beginning of a stronger rebound on a relative basis.

Concluding remarks:

Following their strong outperformance in December, we expect Emerging Markets to outperform until mid Q1 in first instance. Then following some retracement towards late Q1 / early Q2, we would probably expect a further move up into the Summer. EM currencies seem to confirm this reversal vs the US Dollar, the Euro or the Yen. This is very promising as Emerging Markets' outperformance is usually a question of flows. Within the index, China, its largest constituent (35% of the Index), is spearheading this breakout. We expect it to rise with the Emerging Markets Index into mid Q1 and then again into the Summer. Among, the other large constituents, we like Taiwan and South Korea, which are rather cyclical, yet also Russia or Brazil, which seem more defensive/growth than other EMs. This combination (China, Taiwan, South Korea, Brazil and Russia) should provide a resilient uptrending profile into the Summer.

35 / Gold strengthens its negative correlation with bond yields, which are due for more declines in the medium-term, ushering in exciting times for investors in Gold and Gold Miners

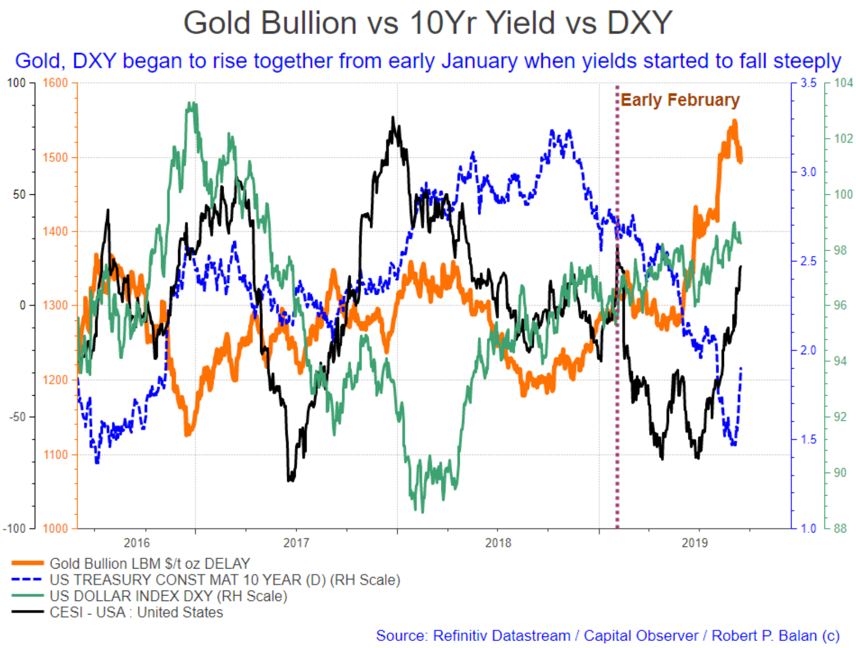
In our most recent Gold article at the Capital Observer, in the September 2019 issue, we noted the following:

Gold continued to rise despite cooling of rhetoric between US and Iran, which suggested to us that other factors, undoubtedly of macro origin, were moving gold prices higher at that time. Actually, gold started to catch a serious bid in early February this year, when bond yields started to fall sharply as economic news flow started to become unfavourable (see 1st and 2nd charts on this page). The evidence lies in the way Gold and the US Dollar (DXY) went up together when economic activity started to surprise to the downside (proxy: Citi Economic Surprise Index). Normally, the DXY is antithesis to Gold, and the covariance is normally negative. But Gold, and the DXY, have become safe havens along with bonds, as yields plummeted sharply (see 1st and 2nd charts on this page). It is apparent that Gold is not being subject to the usual macro data which determined its trajectory in the past.

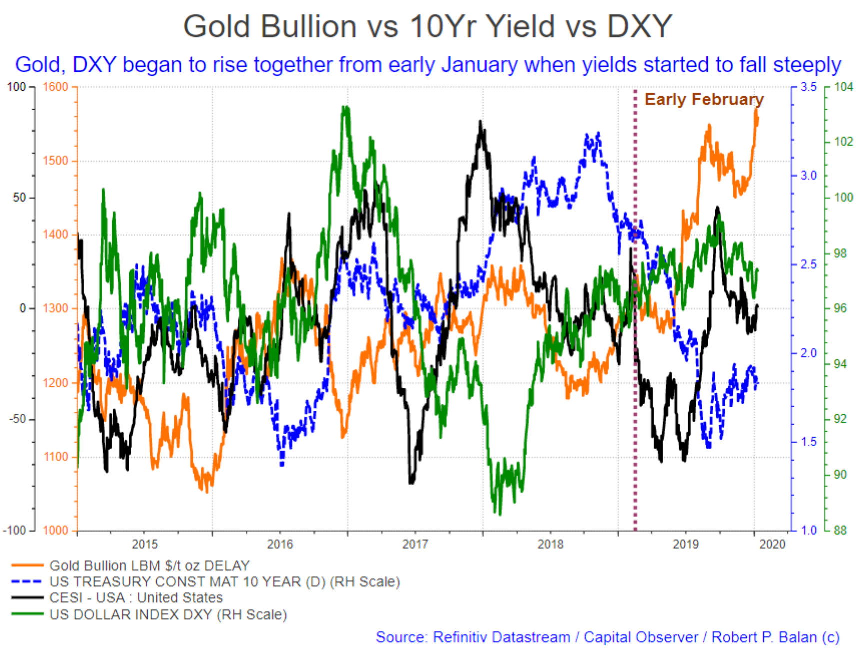
Since we wrote the gold article in the September 2019 issue of The Capital Observer, the Citi Economic Surprise Index took a tumble, with varying responses from financial risk assets: (1) bond yields *rose* as the safe haven trades were unwound; and (2) gold prices *rose* alongside a fall in DXY, as these erstwhile safe haven destinations resumed their negative covariance. Gold was further bid after bond yields showed signs of declining again, while DXY continued to decline on signs of falling yield and rising prices of gold.

The current behaviour of gold vis-à-vis bond yields revives a refrain we often use at The Capital Observer – that Gold prices are nothing more than the inverse function of bond yields and, of the broader scope of macro data influencing bond yields, GDP growth and economic activity (US and Global).

Original graph in the September 2019 Capital Observer



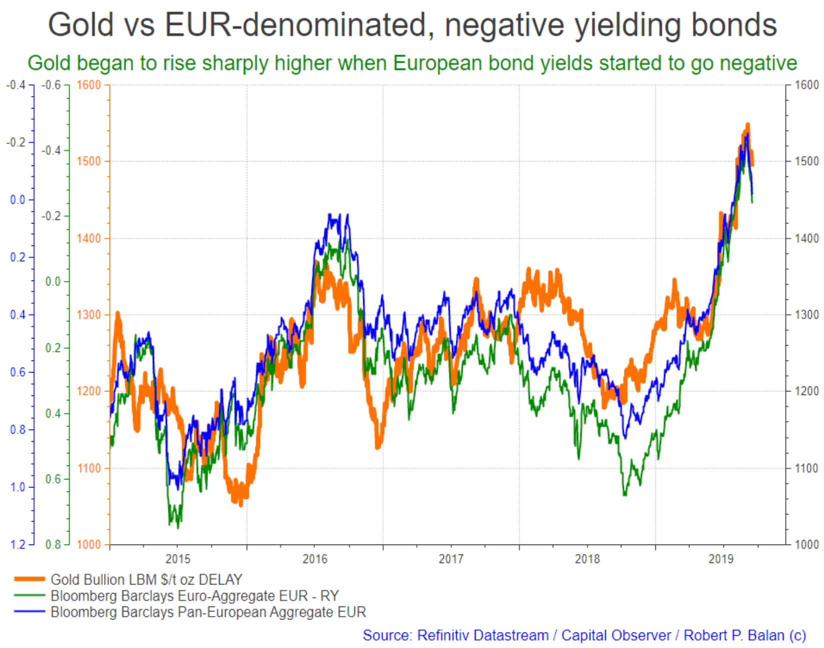
And here is that same graph today:



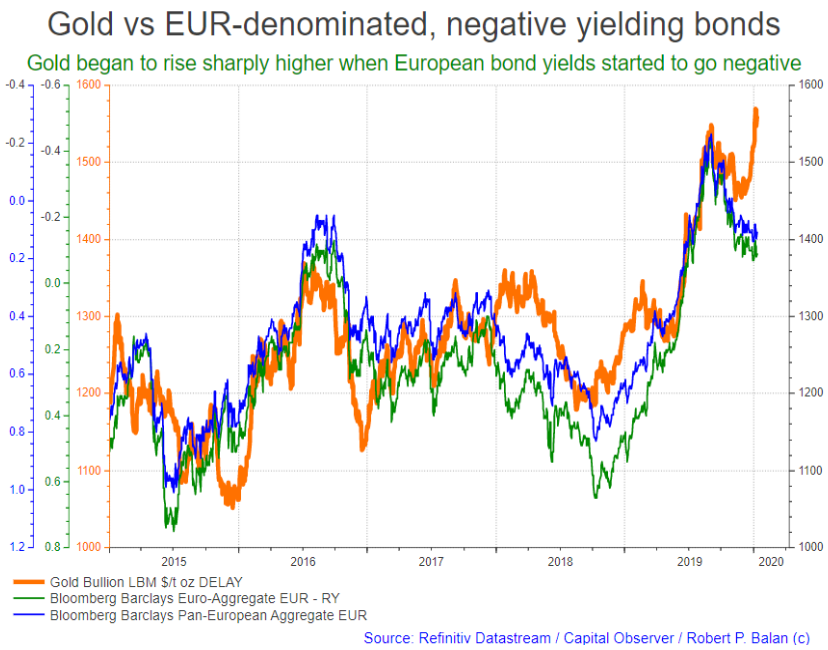
In September 2019, developments in Europe bond markets were also impacting gold prices positively. In a stunning display of what we considered to be collective insanity, the amount of outstanding government debt with negative yields to maturity hits a new record high of $13 trillion in what appeared to be in great hurry. The trend towards negative interest rates was gaining momentum at that time *(see 1st and 2nd graphs on this page)*, so investors looked for alternative investments, and focused on gold. The stunning tight covariance of gold to EUR-denominated debt (shown in these two graphs) suggests that a great number of European investors opted for the sense of "relative" stability provided by gold.

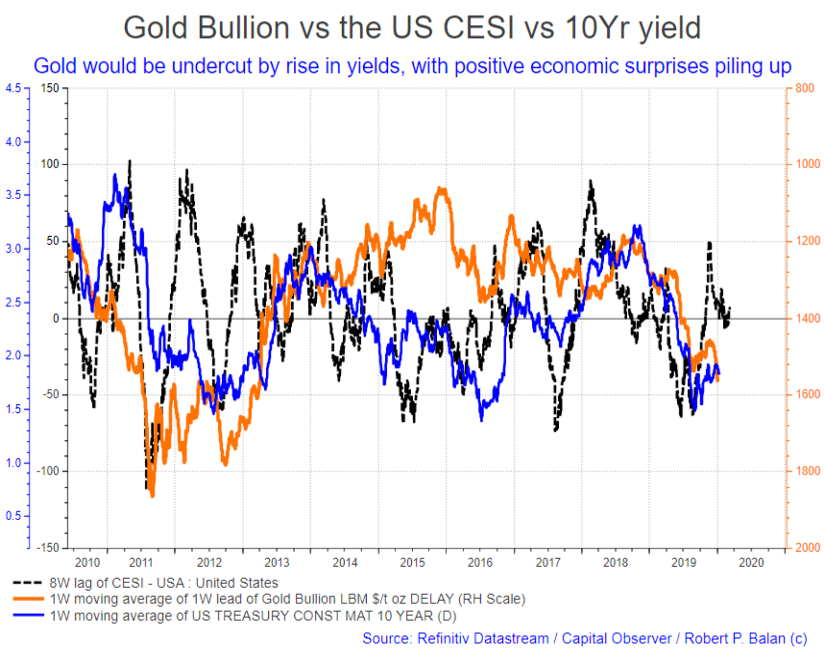
European bond yields have started to rise (but not by much) after the European Central Bank decided to emulate the example of the US Federal Reserve in providing further stimulus to the European economy. Nonetheless, gold prices still rose, and still remains well-bid as from November 2019, after the economic outlook in the US started to deteriorate again, and stagnation became apparent as the *US Citi Economic Surprise Index* remains mired a close to zero level (*see 3rd graph on this page).*

Original graph in the September 2019 Capital Observer



Here is how that chart looks today:

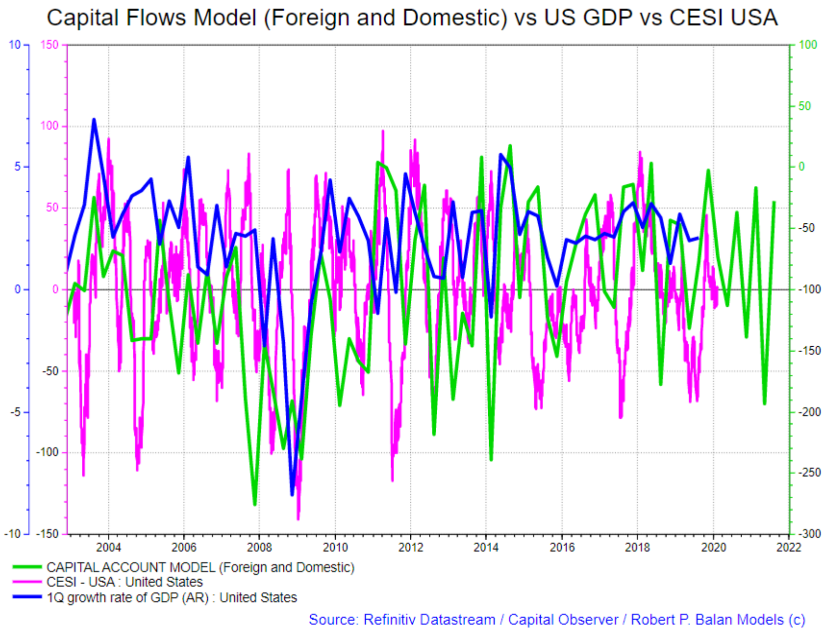


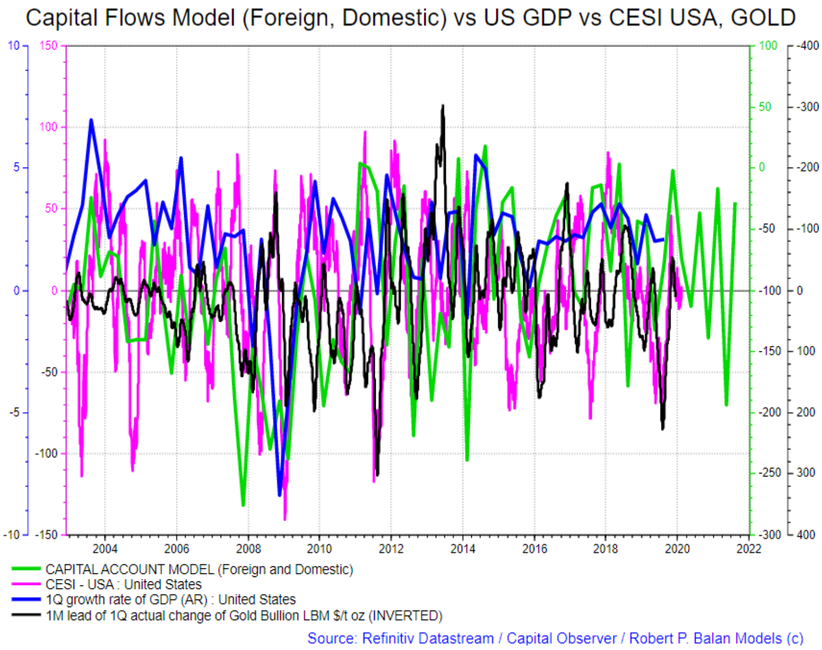


The good thing about the CESI tool, is that it usually leads the inflection points of bond yields by eight weeks.

Therefore, given the negative covariance between yields and gold which is usually strong under conditions of declining growth and activity outlook, gold should rise further over the few weeks or so, before pausing for some technical consolidation. **Obviously, the key thing to ask is how persistent is the activity decline potential being signalled by the US CESI?** We use the Capital Flows model which we have successfully used in past issues of The Capital Observer to forecast the direction and approximate magnitude in the change of GDP from quarter to quarter (*see 1st graph on this page*):

It appears to us that Q1 2020 US GDP growth will be significantly higher than the Q4 2019 growth. However, as indicated by leading indications from the US CESI and the Capital Flows model, Q2 2020 growth will come crashing down; by how much, we still have to determine. And if we juxtapose the inverse of Gold price on US CESI and US GDP, we see that Gold should outperform going into a prospective US economic and activity slowdown in Q2 2020 (*see 2nd graph on this page*).





Let's recapitulate the Gold outlook: We expect gold prices to remain upbeat over the next few weeks, as US outlook via the US CESI will likely deteriorate further. This economic surprise indicator leads a positive covariance with the 10Yr yield by circa 8 weeks. Given the negative covariance of Gold prices to economic activity and bond yields, we expect Gold prices to be rising over the next few weeks at least and consolidate/correct into the end of Q1 waiting for Q2 to take off again.

The US CESI also provided indirect confirmation to broad indications from our Capital Flows model that after Q1 2020, growth in the US will head lower. In that environment, Gold should perform well. We still have to work out the temporal correlations, but it seems to us that given the prospects of growth slowdown after Q1 2020 (and corresponding decline in bond yields), Gold should perform well until year end 2020. In fact, if our Capital Flows model is correct, Gold will be doing well until Q2 2021, when the model expects US GDP growth to fall into recession-like conditions. These are exciting times for Gold and Gold Miner investors.

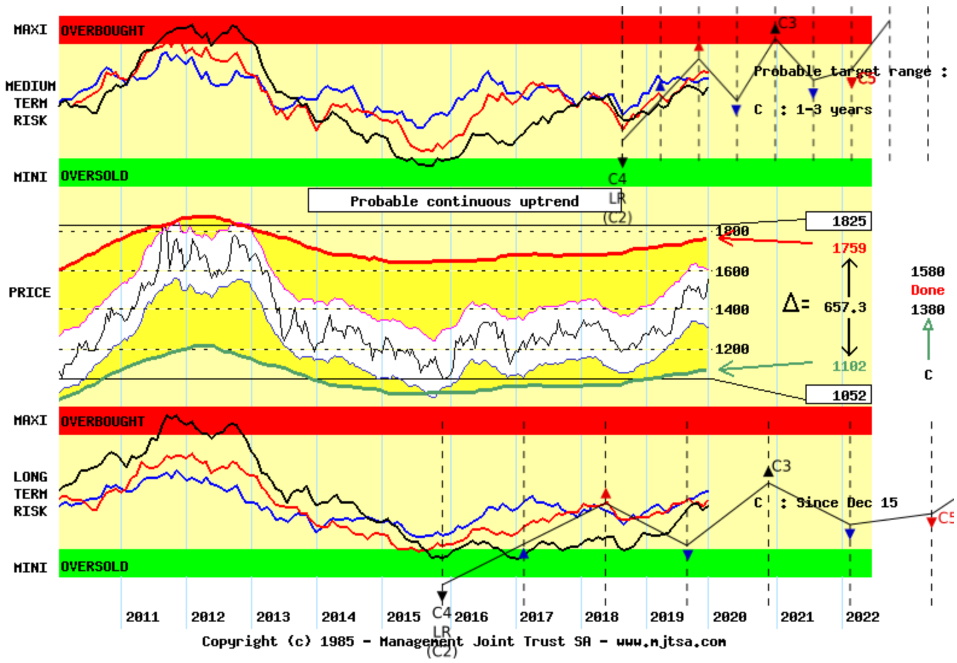
38 / MJT - TIMING AND TACTICAL INSIGHT

Gold and precious metals could be in blow-off mode throughout the year

Following its consolidation down since early September, we did expect Gold to bounce during December. The fact that it blew up to new highs was however rather surprising. Indeed, that the US would take out Major General Soleimani and risk a new conflict in the Gulf was rather hard to anticipate. Yet, in retrospect, we believe this highlights the blow-off stage of the current uptrend in Gold, where any risk-off or geo-political scare can trigger substantial rallies. In this article, we review the long term trends of Gold and precious metals, on a standalone basis and against each other.

Gold Spot (USD/oz)

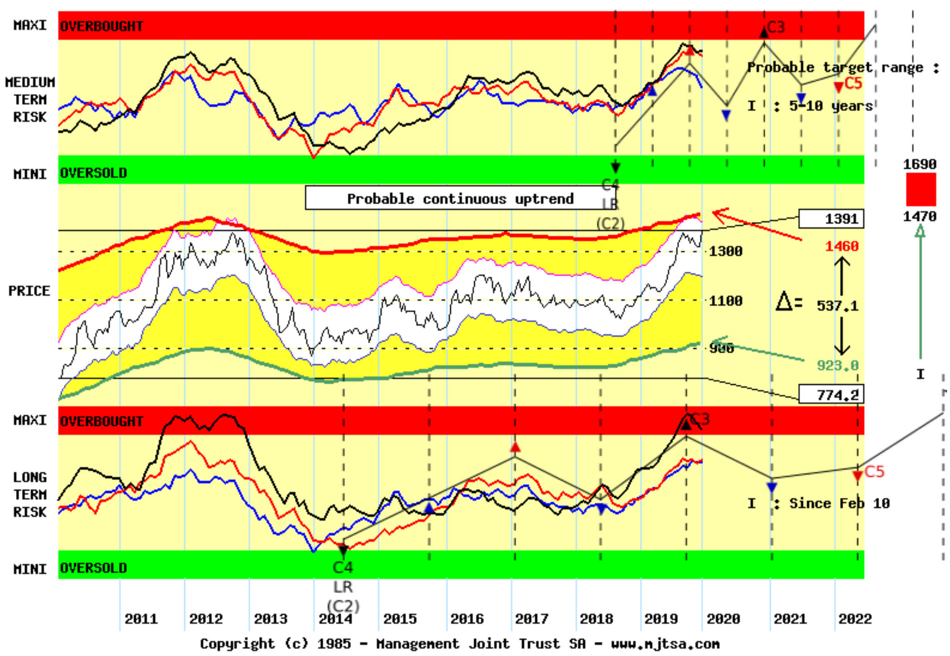
Bi-monthly graph or the perspective over the next 1 to 2 years



In 2019, Gold broke out above its long term accumulation base. Both oscillator series (lower and upper rectangles) are now suggesting that **this dynamic uptrend could last into year-end in first instance. With its recent spike, Gold did briefly break above the upper end of our C Corrective targets to the upside. This theoretically opens the door to much higher targets, our I Impulsive targets to the upside which we can calculate in the 1'900 to 2'200 USD/oz range** (or 1.3 to 1.7 times our historical volatility measure "Delta", here at 657.3 – middle rectangle, right-hand side – added to the graph's low point at 1'052).

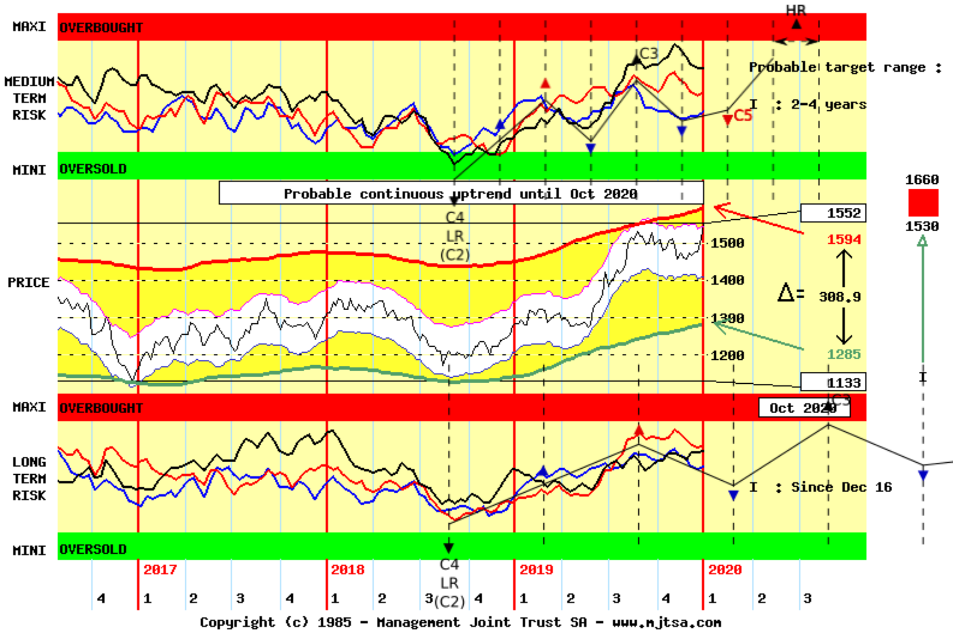
Gold in EUR (EUR/oz)

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



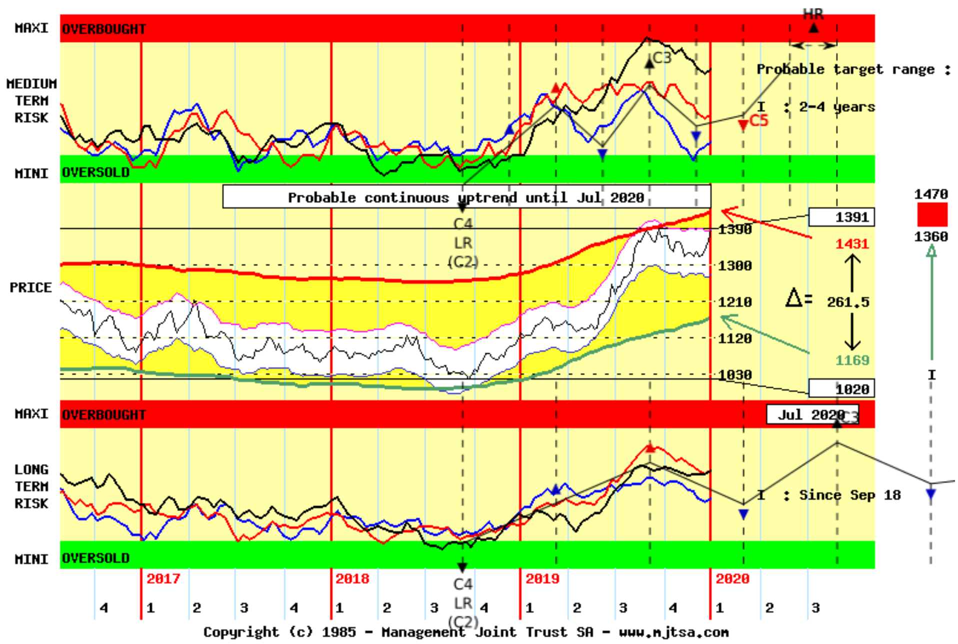
Gold in Euros is also in a dynamic uptrend, yet it seems more mature already that the one on Gold in US Dollars. Indeed, just recently, Gold in Euros did reach an important intermediate top on our long term oscillators (lower rectangle). On our medium ones (upper rectangles) we would however expect a continuation trade probably into year-end. On the price target front, Gold in Euro just broke above its 2012 all time highs. **Our I impulsive targets (right-hand scale) point to further upside in the 1'470 to 1'690 range. This is compelling, yet less impressive than Gold in US Dollars. This can be explained by the fact that the uptrend on Gold in Euros is indeed more mature in terms of our oscillator configurations. It should also indirectly imply that the US Dollar is probably due for some correction vs the Euro during 2020.**

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



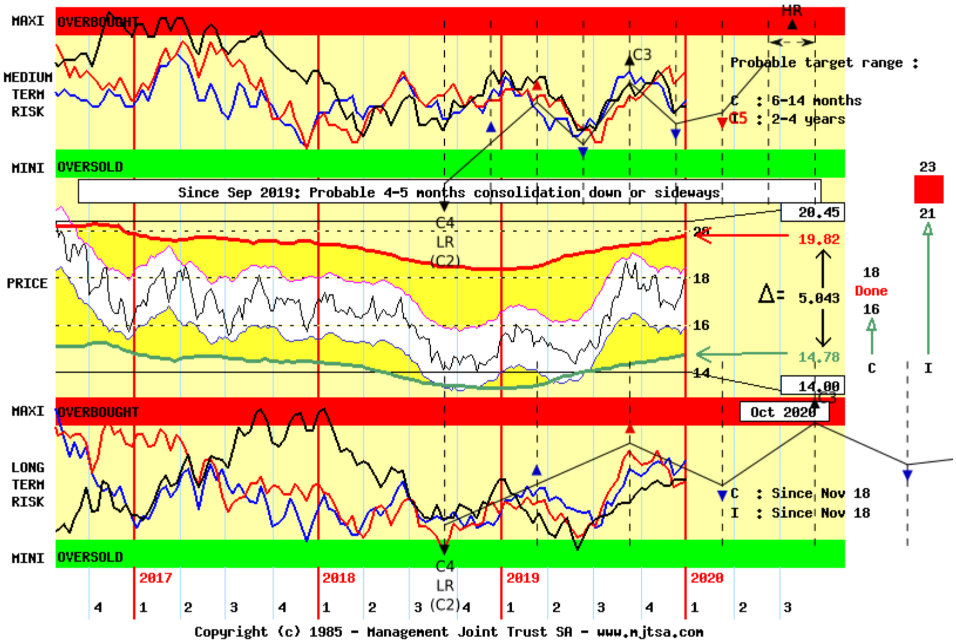
On the Weekly graph, the consolidation since early September found support in the mid 1'400s USD/oz late November with a first retracement bottom on our medium term oscillators (upper rectangle). **We now expect a further support point, and until then probably some retracement, towards mid Q1** on both oscillator series (lower and upper rectangles). Theoretically, in a strong uptrend, **we would not expect this new low to break below the previous one made in November. Hence, the retracement potential into mid Q1 may be quite limited. Following that, from mid/late Q1, Gold should reaccelerate up towards the Fall**, possibly towards the high 1'600s in first instance, and potentially much higher as suggested by our bi-monthly graph on the previous page.

Gold in EUR (EUR/oz)
Weekly graph or the perspective over the next 2 to 4 quarters



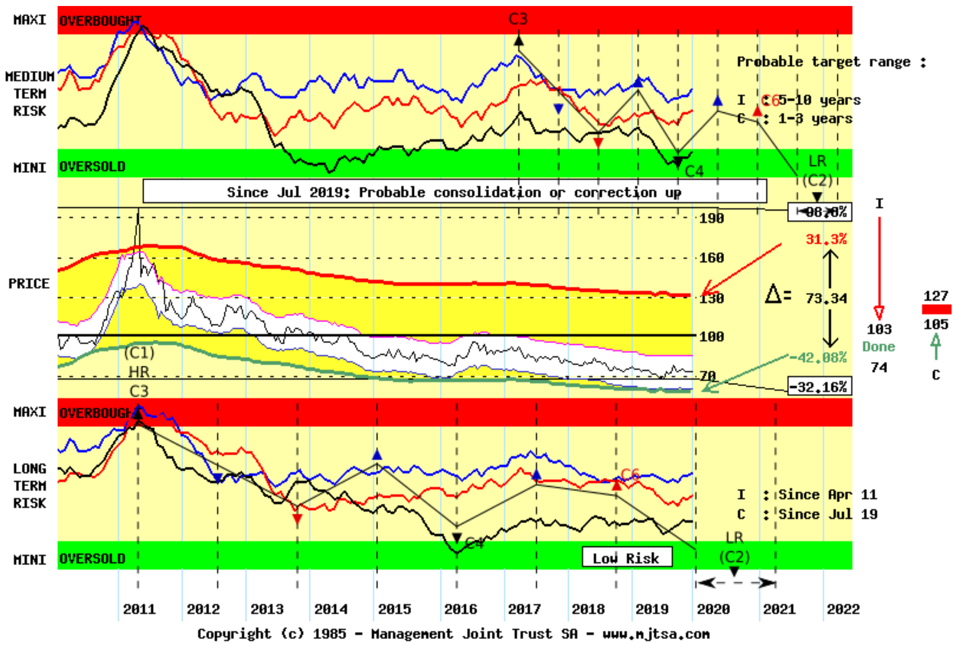
Gold in EUR is showing a similar pattern than Gold in USD, yet our oscillator configurations do look even clearer. Both our oscillator series (lower and upper rectangles) suggest a **slight dip, higher than the one made into November, towards mid Q1, and then from mid/late Q1, a further acceleration to the upside, probably into the Fall**. According to our I Impulsive targets to the upside (right-hand scale), Gold in Euro could reach the high 1'400s EUR/oz by then, or even perhaps another 100 EUR higher according to our bi-monthly graph on the previous page.

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



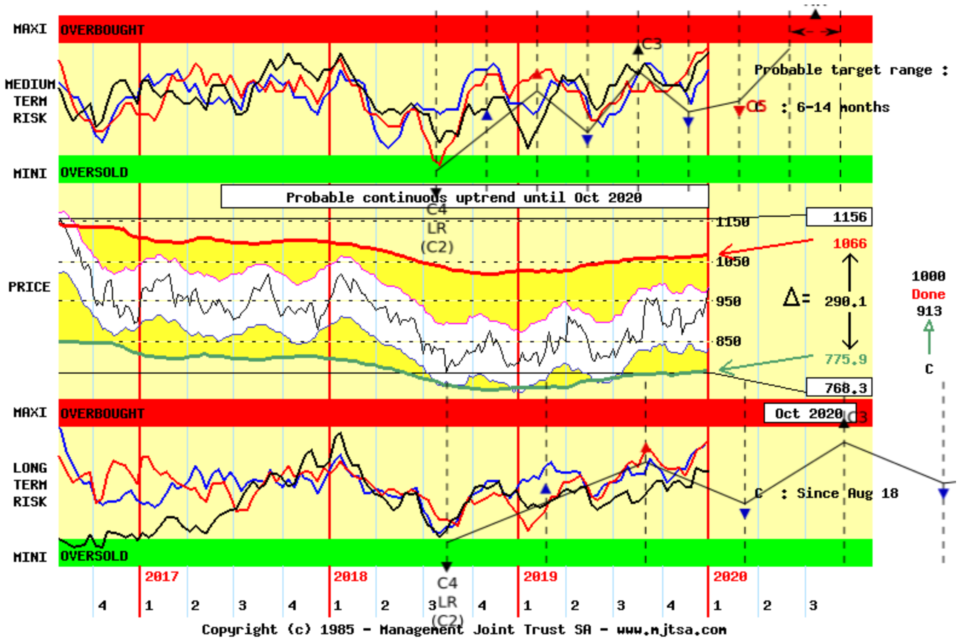
We now turn to Silver, which has also seen a strong rally over the last 18 months but hasn't broken out of its long standing accumulation range yet. Both our oscillator series (lower and upper rectangles) are quite positive going forward, showing configurations similar to Gold. Indeed, **following the current upside retest, we expect a rather shallow consolidation into mid/late Q1** on both oscillator series (lower and upper rectangles). **Following that, Silver then starts to accelerate up again, probably towards the Fall**. On the target front, it has been testing above our C Corrective targets to the upside since last August, i.e.above 18 USD/oz. This theoretically should clear the way for **a move higher towards the 21 – 23 USD/oz range over the next 6 to 12 months. Our bi-monthly graph (not shown here) would indicate even higher targets, potentially above 30 USD/oz.**

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



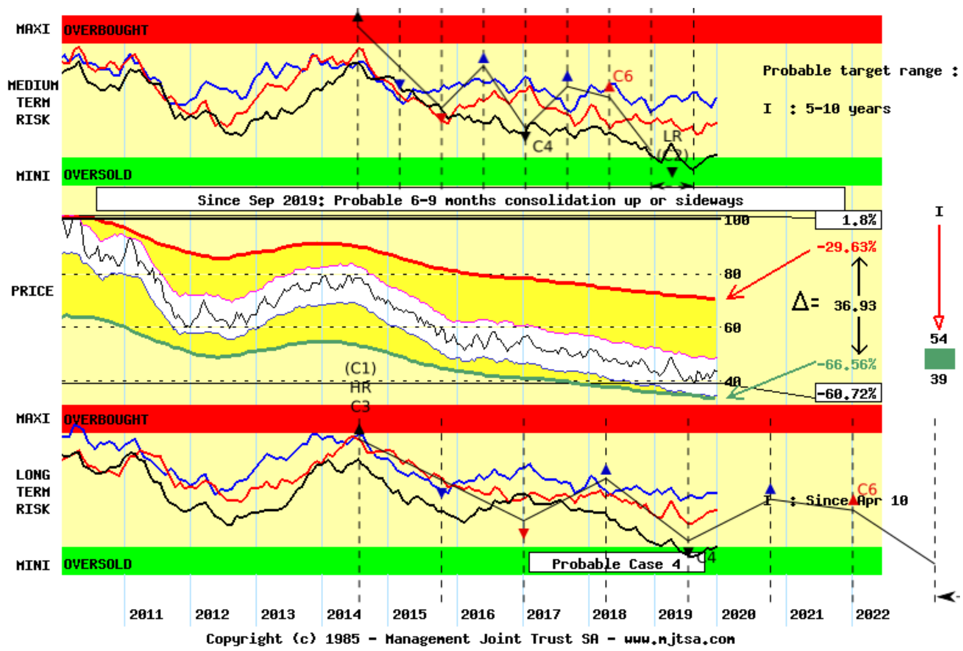
This longer term graph of the ratio of Silver vs Gold is now in a "Low Risk" position on our long term oscillators. Our medium term ones (upper rectangle) indicate **an important intermediate low and a possible rebound into midyear, perhaps year-end. Silver usually outperforms Gold when risk assets are still rising and Central Banks are stimulating. This is pretty much the environment we expect, at least into the Spring, and probably into the Fall**. Thereafter, if indeed the ratio starts falling again into 2021, as indicated by the sequence we show on our medium term oscillators (upper rectangle), this would imply a more risk-off environment, where Gold is likely to outperform Silver again.

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



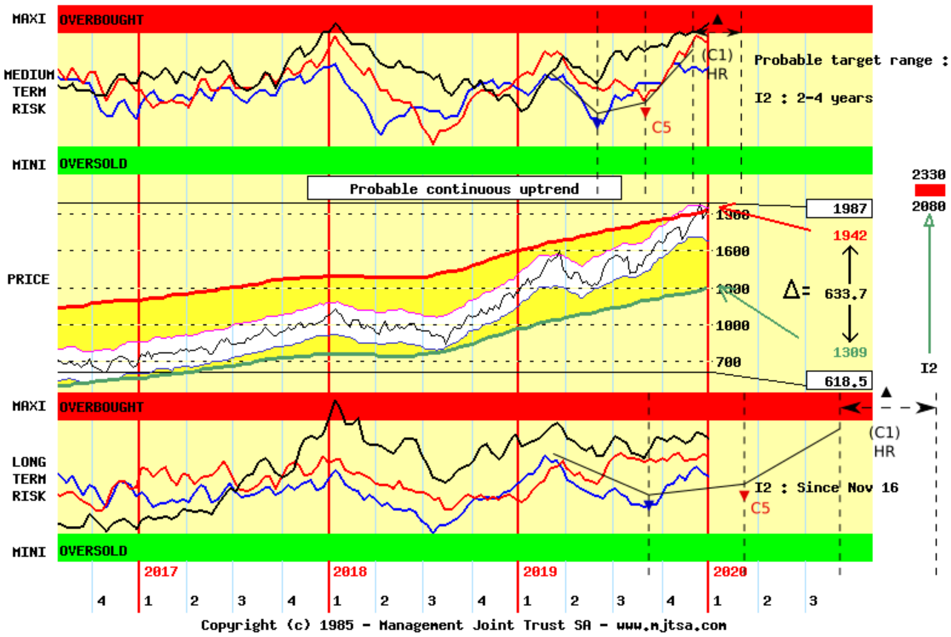
Platinum has also lagged Gold in its rebound. Yet, it is now approaching the resistance of the upper end of our C Corrective targets to the upside at 1'000 USD/oz (right-hand scale). A break above these levels would open the door towards **our I Impulsive targets to the upside, which we calculate in the 1'145 to 1'261 range** (or 1.3 to 1.7 times our historical volatility measure "Delta" – middle rectangle, right-hand side – added to the graph's low point at 768.3). **Our bi-monthly graph (not shown here) would indicate even higher targets towards 1'400 USD/oz**. Both oscillator series (lower and upper rectangles) are also very promising, with a **slight consolidation expected into mid Q1 (Buy the Dip) and then following that, a strong move higher into the Fall.**

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



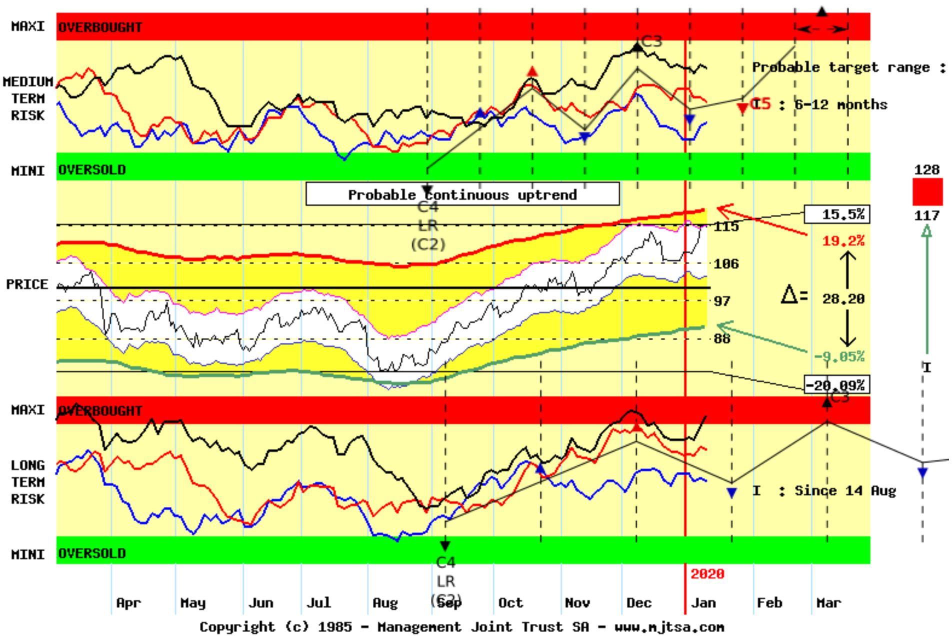
On a relative basis vs Gold, the ratio is similar to the Silver to Gold one shown on the previous page. **Our long term oscillators (lower rectangle) have reached an important intermediate bottom last August and could bounce into late this year**. Our medium ones (upper rectangle) are in a Low Risk position which suggests a similar outcome. **Platinum is more cyclical than Gold. A strong bounce in the ratio during 2020 would probably confirm a risk-ON environment into late 2020.**

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



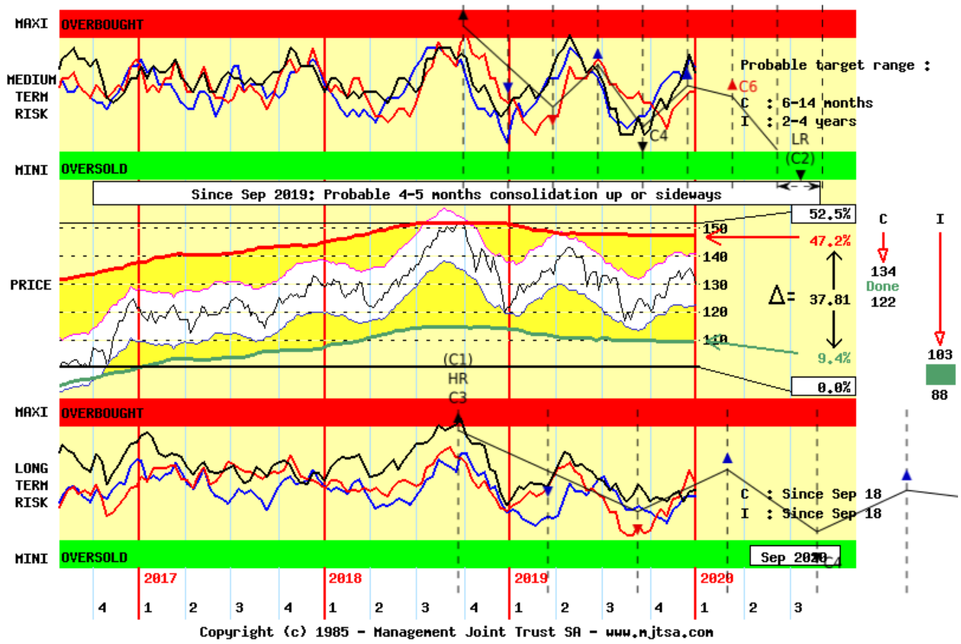
Palladium has seen stellar performance over the 4 years. It is indeed a precious metal with increasing industrial applications and hence probably enjoys a profile similar to aggressive Growth stocks. **Despite its strong rally, it still shows remaining potential on our extended I2 Impulsive 2 targets to the upside, probably towards the 2'080 -2'330 range** (right-hand scale). From a timing perspective, our medium term oscillators (upper rectangle) are in a High Risk position. **Palladium may hence see a slight consolidation over the next month or so. Yet, it should then find support towards mid/late Q1** on our long term oscillators (lower rectangle). **Following that, from mid/late Q1, Palladium should continue to rise into the Fall.**

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



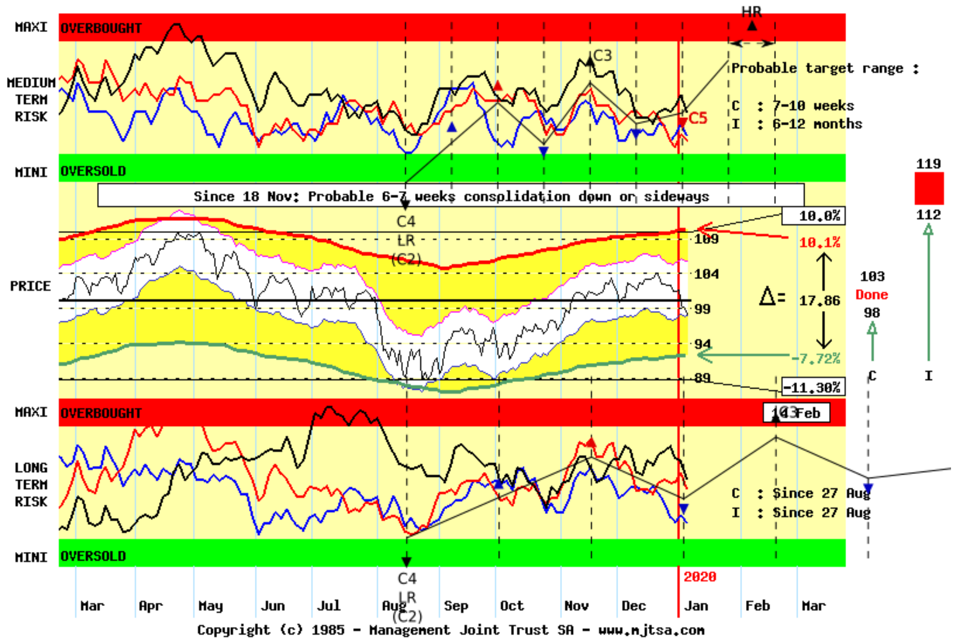
The uptrend on Palladium is already mature, and although the metal is still uptrending, we would probably switch to other precious metals at some point during 2020, as we believe they may have much catching up to do. That said, for now, Palladium is still the outperformer as it is well correlated to the ongoing risk asset / growth profiles blow off. Hence, comparing it with Gold may give us some confirmation as to the state of the risk assets rally. We do so with this Daily graph where, on both oscillator series (lower and upper rectangles), **we would expect further outperformance for Palladium vs Gold into late February / March. Hence, if we were to switch into other precious metals (Gold, Silver or Platinum), we would probably wait until mid Q1 to do so.**

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



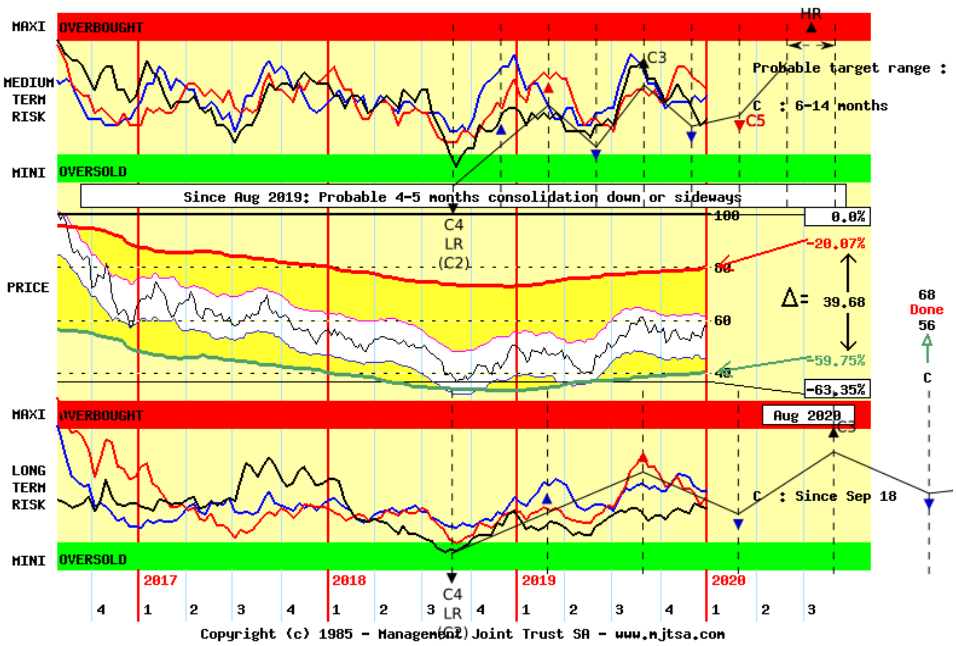
On a similar note, we now turn to the ratio of the S&P500 Index vs Gold. Following almost 10 months of correction to the downside, it bottomed in August last year and has since been rebounding. According to both our oscillator series (lower and upper rectangles), **we expect this rebound to continue into mid/late Q1. Following that, the ratio probably resumes its downtrend towards the Fall. By then, it may break below our C Corrective targets to the downside again, around 122 on this relative graph (right-hand scale) and drop towards our I Impulsive targets to the downside another 20 to 30 % below that.** This suggest either a strong sell-off in equities or a blow-off in Gold. Given our cross asset scenario, a sell-off in equities may materialize towards late Q1/ early Q2, but these should then resume up into the Summer. Hence, **Gold's strength is probably the key driver for its outperformance vs Equities into the Fall.**

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



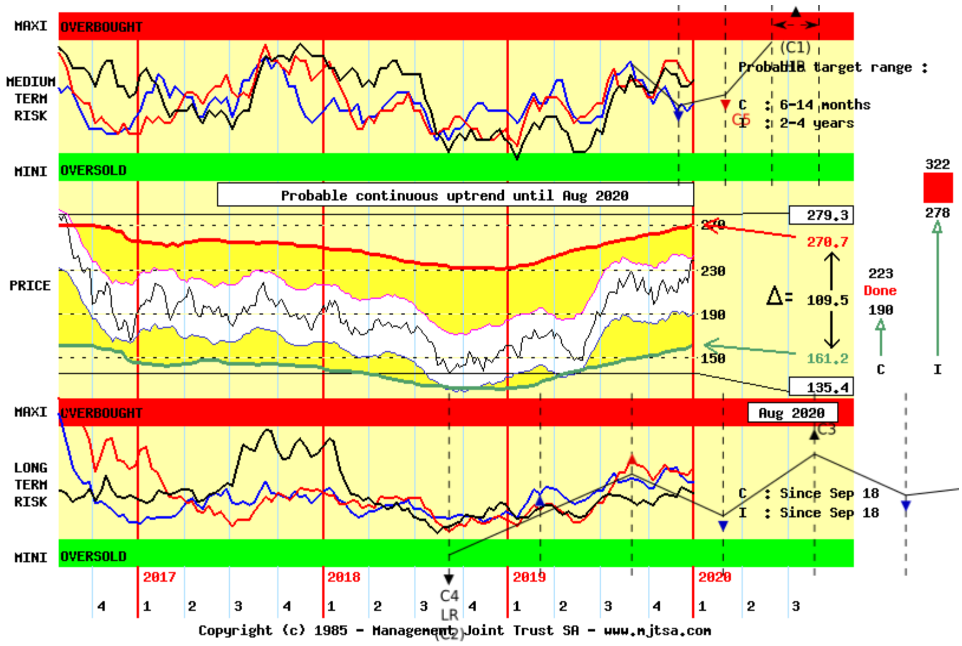
Shorter term, the S&P500 to Gold ratio also enables us to monitor the current risk asset rally. On both oscillator series (lower and upper rectangles), we believe that **the ratio could soon find support and resume its uptrend into February**. The move could even break above our C Corrective targets to the upside again (right-hand scale) opening the door to our I Impulsive ones, 10 to 20% above current levels. This is probably too aggressive though, given the time window left and the fact that we don't expect a strong sell-off (i.e. rather a slight consolidation) on Gold until then.

HUI Gold Bug Index vs the S&P500 Index
Weekly graph or the perspective over the next 2 to 4 quarters



We now look at Goldmines vs the S&P500. There are showing a similar profile than the S&P500 to Gold ratio, in reverse. On both oscillator series (lower and upper rectangles), we expect them to consolidate slightly until mid Q1 and then start to outperform strongly into the Fall.** The ratio would first need to break above the upper end of our C Corrective targets to the upside around 68, i.e. 8% above current levels (right-hand scale). Above that, we would then expect the ratio to move towards our I Impulsive targets to the upside. We would calculate these around the 88 to 104 range (1.3 to 1.7 times our historical volatility measure "Delta", here at 39.68% - middle rectangle, right-hand side – added to the graph's low at -63.35%, i.e. 36.65% on a relative basis). **This would imply between 18% and 44% of outperformance for Goldmines vs the S&P500 into the Fall.**

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



Finally, looking at the Gold mines on a standalone basis confirms our positive scenario on Gold, Mines and other Precious Metals. The Gold Bug Index has just broken above its C Corrective targets to the upside (right-hand scale). **Following some consolidation on both oscillator series (lower and upper rectangles) into mid Q1, we would then expect it to rise into the Fall, probably towards our I Impulsive targets to the upside in the 278 – 322 range, or 17 to 40% above current levels.** Note: given our relative outperformance calculation for HUI vs the S&P500 index above which is pretty much the same, this would imply that the S&P500 probably has limited upside for the rest of the year.

Concluding remarks:

Gold does look strong towards year-end. In US Dollar terms, it just broke above the resistance of our C Corrective targets to the upside on our bi-monthly graph, and could be heading towards new historic highs, possibly 20 to 30% above current levels over the next 12 months. In EUR terms, Gold is more advanced. It has already taken out its 2012 highs, yet, may still advance 15 to 20% during 2020. Indirectly, the difference in potential may confirm some US Dollar weakness during 2020. Over the next few weeks, we expect Gold to make an intermediate top during January and then consolidate down slightly into mid Q1. From mid/late Q1, it should then accelerate up again. The ratio of Gold and Goldmines vs the S&P500 as well as Goldmines themselves, are showing similar dynamics. Other precious metals such as Silver and Platinum could also rise strongly during 2020. Their ratios vs Gold are heavily Oversold on a long term basis and they could even start to outperform. This potentially implies a rather cyclical environment and a weaker US Dollar, as well as probably a relatively dovish FED, which won't be so surprising in an election year. Finally, Palladium, which has been a strong outperformer vs Gold in recent years, probably continues its outperformance into February / March. It may then suffer an intermediate correction vs Gold into the Spring as risk-assets correct down for 2 to 3 months.

45 / Liquidity impact on assets as geopolitical tensions calm down: equities, yields should go lower near-term ahead of a rally to another peak in March 2020

In the immediate aftermath of the US killing of Iran's Revolutionary Guards' leader Qassem Soleimani, **the financial markets were strangely muted in their response**. Two things may explain this muted reaction from risk assets at that time:

(1) The markets believe that the global central banks will come to the rescue, and any risk asset decline will be an opportunity to pick up cheapened assets, and/or

(2) The market believes that, despite hot words, Iran is not really willing to go to war with the US - at least not at this time, and not in the form that many believe it would take: a clash of arms.

Just as Ayatollah Khamenei tweeted to US President Trump right before he then killed Iranian Revolutionary Guards Council head Qasem Soleimani - "You can't do anything" – we speculated that at that point, Iran can't, or more likely, won't do anything to bring on a massive US retaliation on their military and "cultural" assets. Not right away, that is. That outlook proved to be correct, as Iran's riposte on Wednesday last week proved to be very restrained.

Iran's Revolutionary Guards attacked US positions in Anbar and Erbil, Iraq with 16 ballistic missiles. True, in the minutes after al-Asad airbase in Iraq came under attack, US equity futures plunged. Asia CDS blew out. The yen surged and bond futures tripped the circuit breaker. Cash yields plunged as much as 11.5bps. WTI futures surged higher. And, as testament to the making of an apocalypse trade, Gold rose above $1,600 for the first time since 2013. Social media ran rampant with "World War III" memes. The computer algo programs ran wild.

The market reaction was understandable: Soleimani's multi-day funeral procession across Iraq and Iran brought millions of mourners into the streets. The religious leaders of Iran had to do something to satisfy the mourners call for revenge. Soleimani was not just "a general" – he was the brains behind Iran's "proxy wars" carried out by Iran's Revolutionary Guards and various organizations which the US government has labelled as "terrorists." Many news organizations called him the "second most powerful man" in Iran, after the Ayatollah leadership.

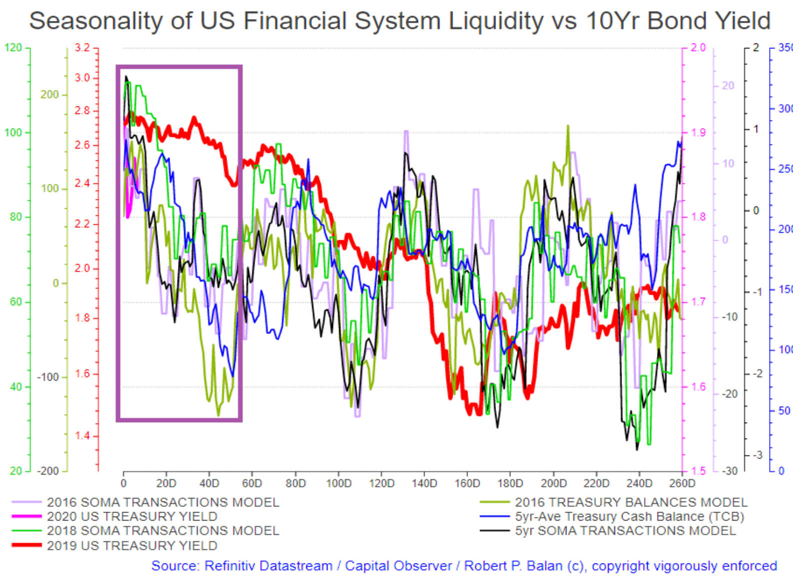
Iran's "shattering" riposte did not live up to hype

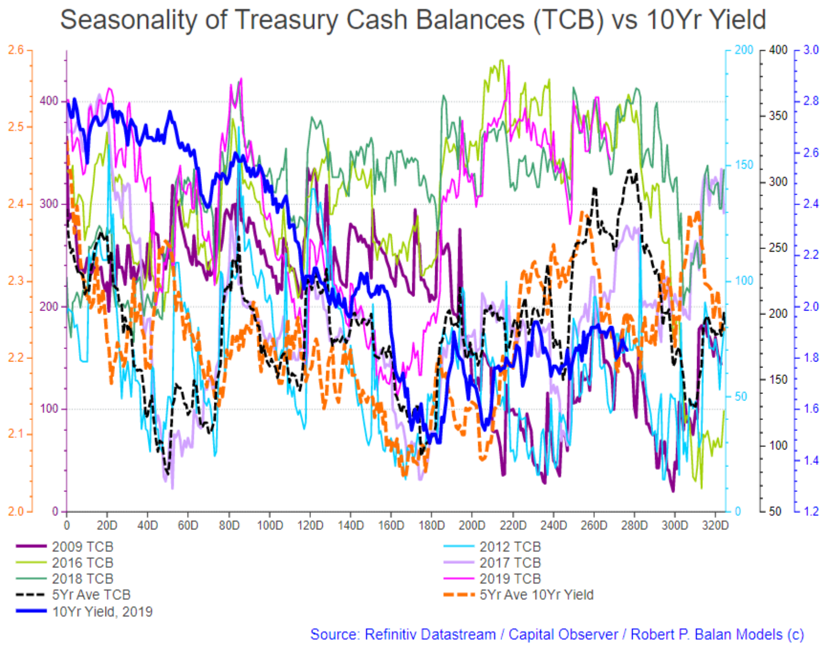
But the supposed "shattering" riposte failed to live up to the hype. First, Iran's Foreign Minister Javad Zarif said Iran wasn't seeking war in a tweet after the barrage of missiles. Then, the White House said that, contrary to initial reports, President Trump would not be addressing the nation until the following morning. Finally, it became clear that the IRGC attack was directed at US military gear and not at military personnel. Moreover, it didn't do much damage. It didn't take a leap of logic to surmise that the absence of casualties has been intentional, and that Trump postponing a speech meant that the US wasn't planning to bomb targets inside Iran that night, either.

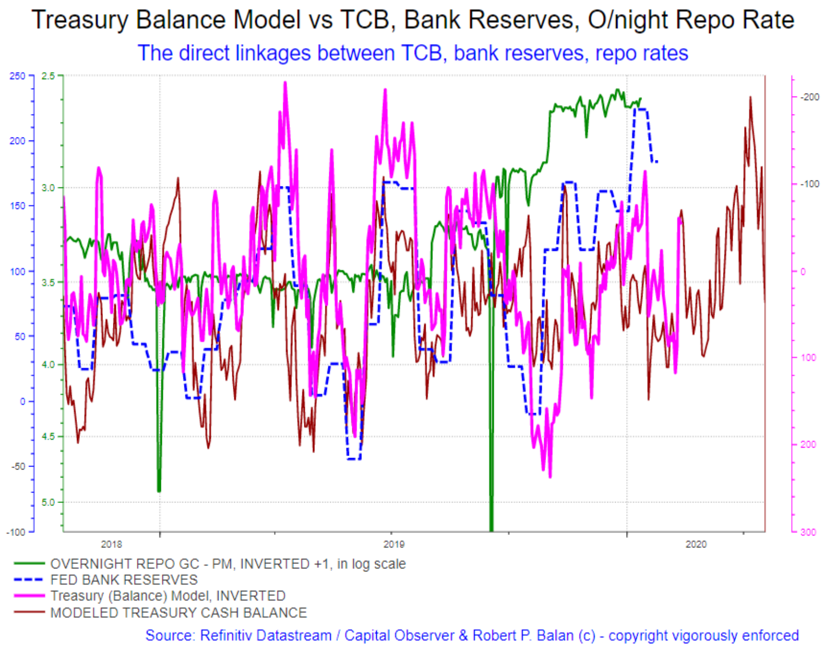
Of course, those headlines also triggered the algos, and by the time everyone was done chasing everybody else's buying and selling, the move was partially unwound. By the start of New York trading, the entire trade was faded in US equity futures. Every single one of the headlines mentioned in the earlier part of this article have been completely retraced, and then some. After President Trump made it clear in his address to the nation that the US would not be taking further military action barring another escalation from Iran, the markets had the green light to chase the market higher. The risk assets did rally hard on Thursday, last week.

When news flow fades, the liquidity condition dominates

However, we've seen some fading out in equities and yields on Friday. And this brings us up to the point we've illustrated before – once the news flow has come and gone, the systemic liquidity condition takes over. And the near-term liquidity situation has gone into an occasional mini-seasonality drought (as represented by the behaviour of the Treasury Cash Balances, (TCB)), and SOMA Transactions. That should be the case for another week, or two, at least (*see purple rectangle in graph below*). **US liquidity shows are seasonal and recur in amazing regularity year after year, after year, after year.**







TCB is a US Treasury account at the Fed, which is the conduit for the Treasury's payment to non-financial entities. Lower levels of TCB denotes smaller potential inflows from the Treasury to the world-at-large economy, while higher levels denote the opposite – larger amounts of potential inflows to the general economy. **SOMA Transactions** are aggregate total of all the OMOs, TOMOs and POMOs conducted by the New York Fed in behalf of the entire Fed Reserve Bank. This is the aggregate series which gives rise to level of bank reserves and of the TCB.

Bond yields are especially vulnerable to liquidity conditions, so in the case of the 10yr yield, the lagged effect of relative liquidity drought (as modelled by Treasury Cash Balances) should depress the long bond yield lower or at least sideways until the end of January 2020 *(see 1st chart on this page)*, **prior to a potential yield rally into March**, if this year 10yr yield follows the series' five-year average (*yellow, dashed line in 1st chart on this page*).

The current, 2019-2010 10yr yield has been following the yearly seasonality of Treasury Cash Balance closely, and has very close resemblance to the evolution of the 2009 TCB (*brown line, 1st chart on this page*), a period when the Fed has just opened Quantitative Easing No. 1 spigots, a pretty much similar situation with the Fed's new "Not QE" stimulus program just initiated a few months ago. If 10yr yields go this route, we could potentially see the likes of 1.5/1.6% levels again on the short term before going higher

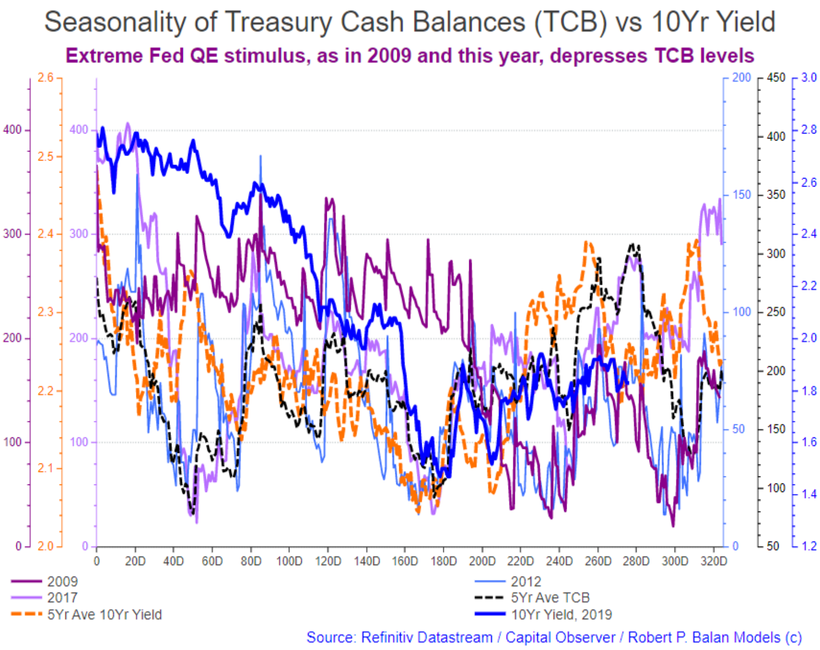
The shadow banking's "plumbing" and liquidity issues

The Fed has been pouring significant liquidity to the financial system in the form of very short-term loans to Primary Dealers and other financial entities via Temporary Open Market Operations (TOMOs) in support of the Repo markets, after repo rates recently soared ten times the normal daily rate in some instances. The central bank also announced further financial stimulus by purchasing government securities via Permanent Open Market Operations (POMOs), which adds to its balance sheets permanently until taken away.

The Fed's POMOs (which Fed Chairman called "Not QE") have also been intended as added palliative to the repo markets in its efforts to shore up bank reserves which have been falling precipitously following the Fed's Quantitative Tightening (QT) initiative in October 2017. QT was abruptly terminated by the Fed on August 2019 following a series repo rate surges as a consequence of highly inadequate levels of bank reserves, which serve as collateral for rehypothecated, repo loans. Just like in the real-world, when demand is greater than the supply, the cost of that widget would rise proportionally. Proof of stress in the repo market has been a series of repo rate blow-ups (*see 2nd graph above*).

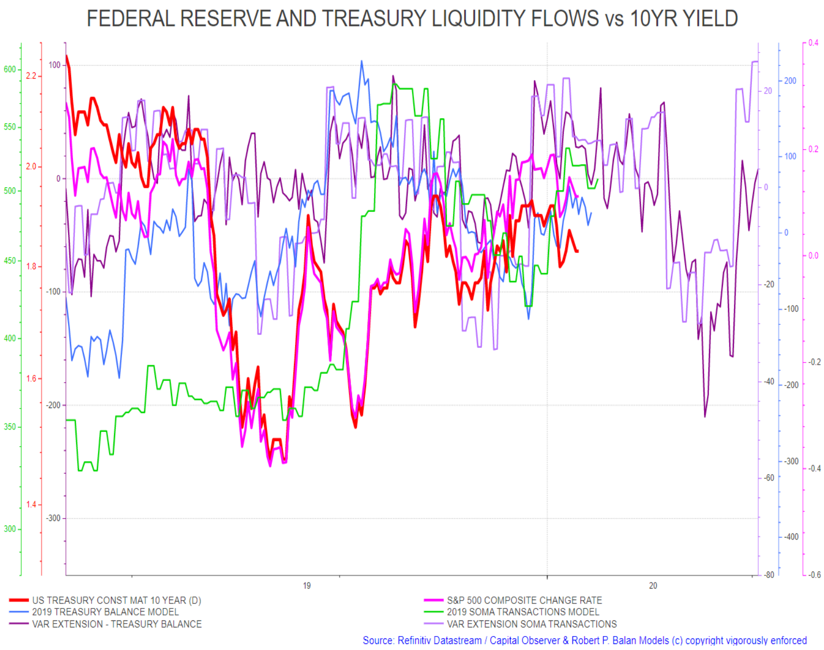
However, any monetary policy move, as in the Fed's current "Not QE" will always have consequences, whether intended or not. Efforts to increase bank reserves will depress Treasury Cash Balances. Always. TCB and bank reserves are both liabilities of the Federal Reserve, and they have opposite signs (like yin and yang); increasing bank reserves will deplete the TCB, and vice versa (*see 2nd graph above*). Therefore, **if the Fed decides to increase banks reserves to alleviate**

the plight of the repo markets, the levels of TCB will plummet. And falling TCB levels will be followed by plunging bond yields. As in 2009 (*see 1st graph on this page*).



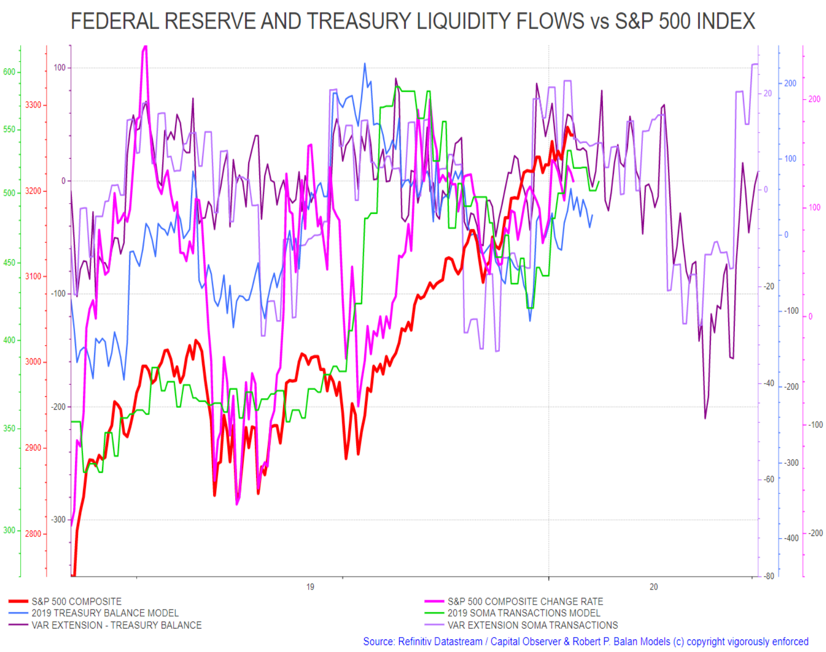
Risk asset outlook, near term, based on liquidity conditions

Note that there is a lagged effect which is consistent, and as we said at The Capital Observer articles a few times in the past, this process through the shadow market's plumbing is almost-industrial like in its consistency, enabling us to model future states of these financial variables with some degree of accuracy. We provide several examples in the following the *2nd and third graphs on this page*.

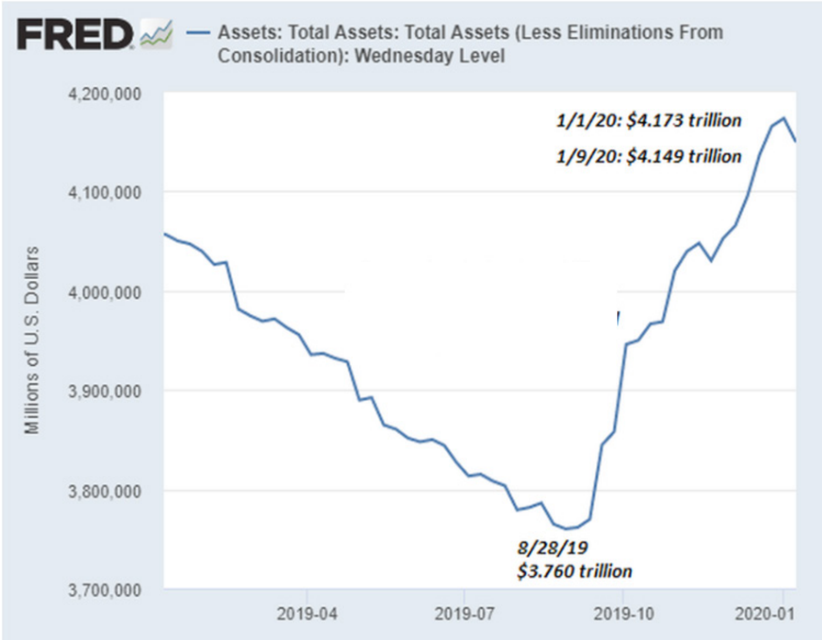


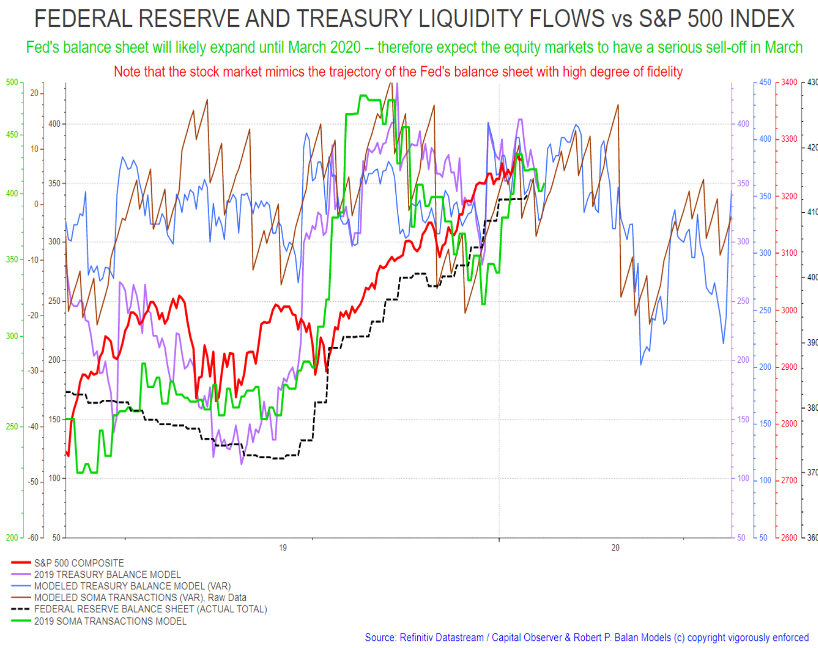
The modelled SOMA transactions and treasury balances provide short-term projections of where bond yields should be and the possible route taken to those levels (*see 2nd graph on this page*). We added Vector AutoRegression (VAR) projections of where the SOMA and TCB models will be further out (optimum 3 months horizon).

What these models tell us is that the 10yr bond yield should still be falling over the next two weeks (from January 10) and then there is a risk of a yield updraft from 4th week of January towards the end of February. Then follows a potential for sharp decline in the 10yr yield in March



We applied the same analytical platform to the S&P 500 Index (SPX). Essentially, we see the same timing (plus or minus 2 days – the variability of SPX inflections points vs yields'). The SPX should still be falling over the next two weeks (from January 10) and then there is a risk of a yield updraft from 4th week of January late February. Then follows a sharp decline in the SPX in March (*see 3rd graph on thos page).*





Near-term outlook for liquidity conditions and risk assets

The liquidity situation will soon worsen. The Fed started "Not QE" to help ease the tight situation in the repo markets by pushing up the levels of bank reserves. However, the Fed said that the $60 billion purchases of government securities (T-Bills, that's why it is "not QE") will cease in March. Taking out $60 billion of monthly stimulus will definitely take out a lot of systemic liquidity.

The liquidity situation is, even now, maybe getting worse -- the Fed had just reduced the assets it holds. After printing $410 billion in a few months, a $24 billion decline in the Fed's ledger is not much, but it does suggest the Fed might finally be thinking about slowing its money-creation expansion, perhaps ahead of schedule. Some background on this issue: between September 1, 2019 and January 1, 2020, the Fed's assets zoomed from $3.760 trillion to $4.173 trillion in a mere 17 weeks (*see 1st graph on this page*).

However, note that the Fed only added a paltry $8 billion in the final week of 2019. Given the hundreds of billions of monetary expansion that was promised earlier, this works out to a monthly run-rate of around $30 billion -- not quite the $60 billion promised as a baseline, or the $100 billion per month panic-printed in Q4 2019.

It may be that the Fed will make up for this shortfall ahead of the March 2020 end of the "Not QE" stimulus (we believe they would). **Therefore, the Fed's balance sheet will likely expand until March 2020. But that is when we at The Capital Observer expect the equity markets to have a serious sell-off, beginning early March, when it becomes apparent that this "Not QE" stimulus will not be extended. Remember, the economy will still do well in Q1 2020 – no urgent reasons to be applying stimulus when the Core CPI is already surging hot. And "Not QE" was, after all, a mere palliative solution for the clogged-up repo market plumbing in Q4 2019. We have modelled how that should happen and its effect on the TCB and SOMA models** (*see 2nd graph above*).

Note that the "SOMA Transactions" series in the graph above represents the Gross Amount of the Fed's balance sheet, not merely the assets (securities) that it holds. In fact, the asset part of the balance sheet is relatively inert; it is the liabilities side (TCB, bank reserves, etc) that generates more visible activity which becomes important to the price discovery of risk assets.

Longer-term outlook for liquidity conditions and risk assets

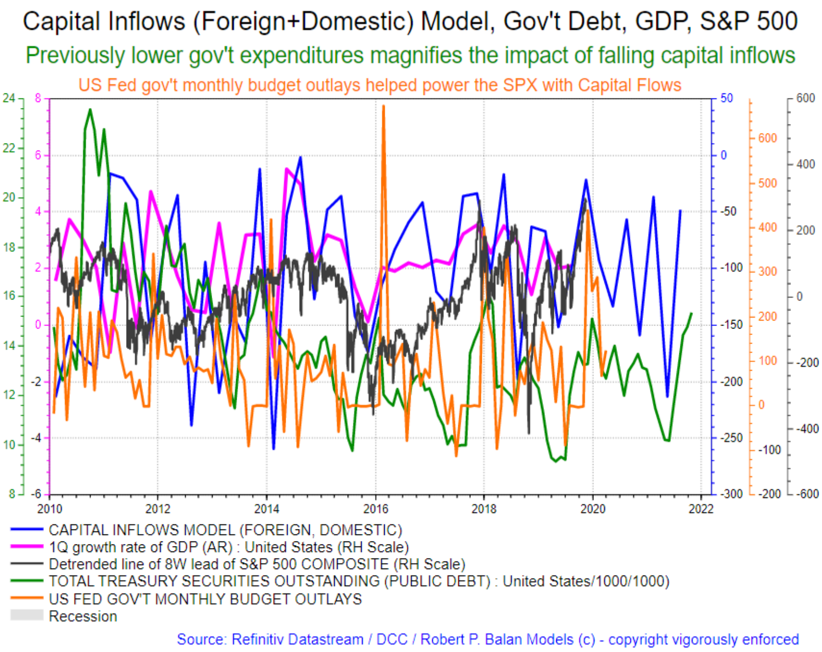
We have shown before this graph (*1st graph on the next page*) in various issues of The Capital Observer, but in this issue, we show the linkage between the ultimate liquidity source for US financial risk instruments – capital flows (domestic and foreign) plus fiscal expenditures, and US risk assets, with the S&P 500 index and Oil as proxies. **As we presented in the earlier part of this article (and in the graph above), SPX is a natural proxy for exploring the linkage between liquidity (from whatever source) and**

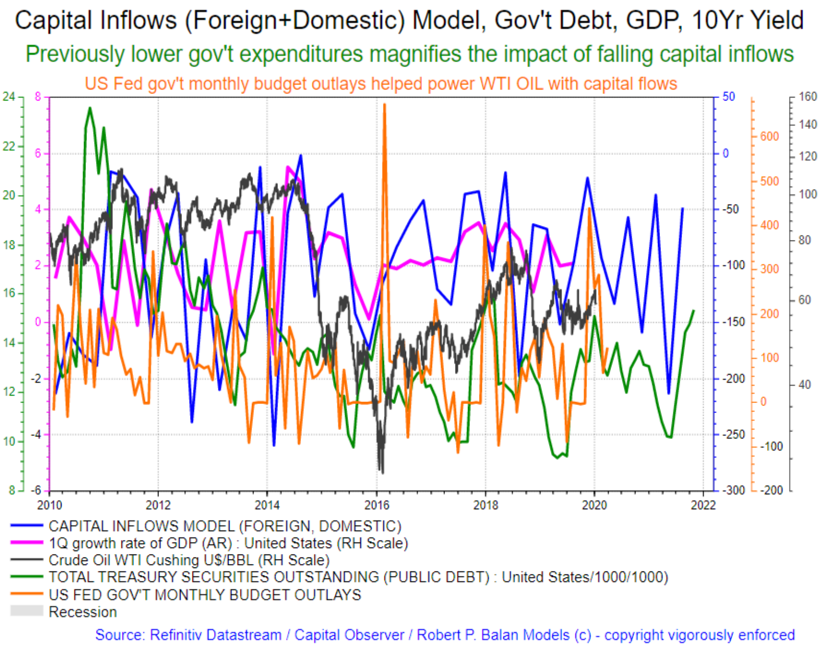
financial instruments. SPX is a natural and coincidental manifestation of US economic growth, and therefore a valid proxy for US GDP (*see 1st graph on this page*).

The impact of public debt and of government expenditures on growth and risk assets is rarely acknowledged, but it is there, left, right and centre. It is no surprise that capital flows have a high positive covariance with government expenditures because most international investors look at the prospects of growth stemming from fiscal activity, along with monetary policies of the domestic central bank. To add further visibility on the impact of fiscal policy,The Capital Observer added the Federal government's monthly budget outlays – the biggest, single input in the Treasury Cash Balances account being maintained at the Fed. The direct link between risk assets and the largesse from the US Treasury is the Treasury Cash Balance. Now you know.

But why do we include oil in this discussion (*see 2nd graph on this page*) ? **Oil price is driven by fundamentals in the short term, but by growth issues in the long-term**. Therefore, institutional investors in oil (producers, large consumers, hedgers, large investors in oil producers and refiners) strive to have an understanding of the prospects of future economic and activity growth. These large oil investors have a huge influence on the price of oil, and their outlook on US and global growth impact oil price trajectory correspondingly. **And if you have been observing closely, changes in oil prices lead changes in equities by circa two months, which is why oil should be part of any attempt to link US growth with capital flows and fiscal expenditures.**

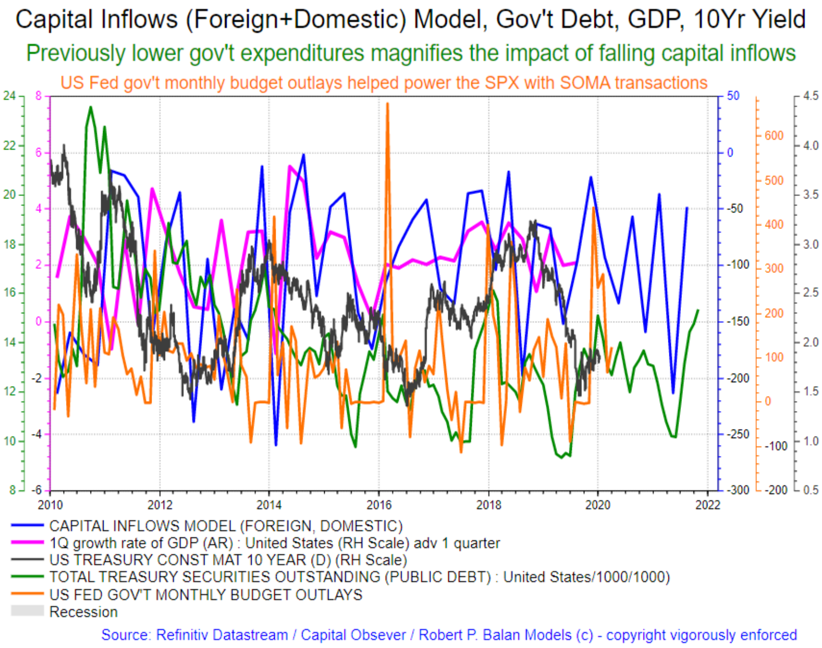
This segue tells you how better these oil investors are in assessing growth and activity prospects vis-a-vis stock market investors. But that is probably not fair – stock markets investors have been primed to move lately by President Donald Trump's tweets about the signing of the US-China trade deal rather than these investors' appreciation or understanding of US growth and economic conditions, which may turn the corner for worse at some near-future, probably in Q2 2020 (*see again 2nd graph above*).





Conclusion:

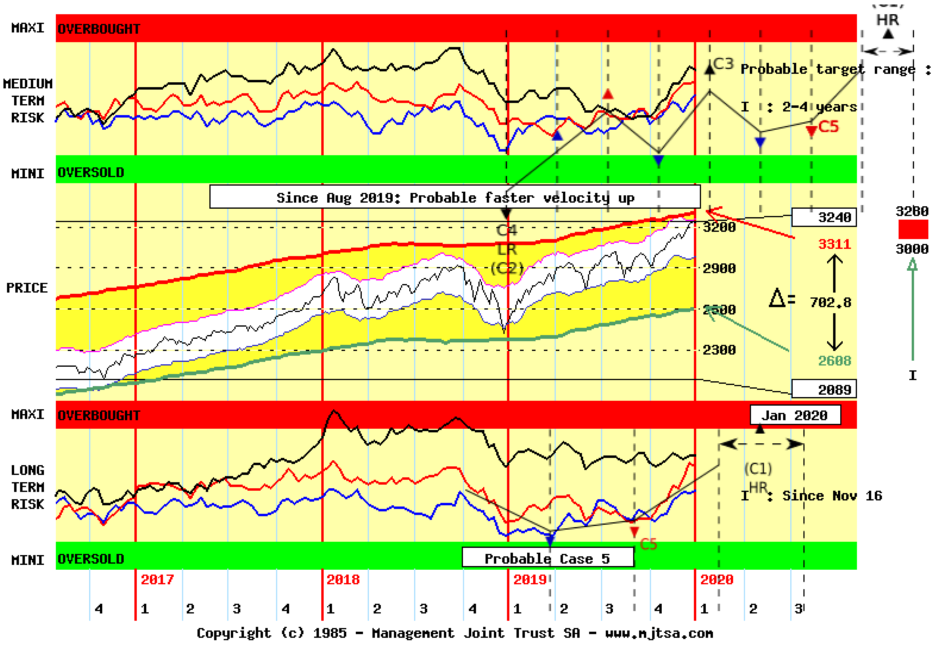
Capital flows (domestic and foreign) and fiscal expenditures have pervasive and long-lasting impact on growth (and thereby on risk assets). But these two sources of liquidity have broad strokes, and should be calibrated by other tools, like the SOMA transactions of the Fed and of the activities happening at the TCB account of the Treasury being maintained at the Fed. **But capital flows and fiscal expenditures, if used properly, can provide eye-opening long-term views of future growth prospects, and the corresponding bond yields that come along with the growth development.** That is why, we will be keeping watch on these developments, as they provide the best early warning tools for outlook on the cost of money in the future (*see graph on this page*).



Equities – still uptrending although risk/reward is getting very stretched

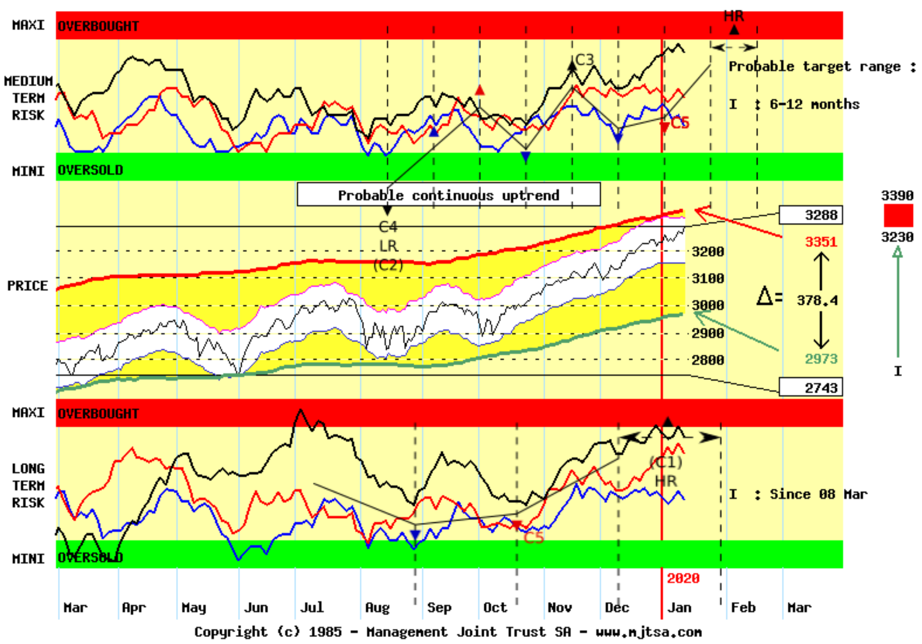
The FED's rate cuts last Summer and Fall have laid the conditions for an Indian Summer in equity markets. The current liquidity injections are now helping to extend the tail of this rally. The S&P500, the Nasdaq 100, the Dow Jones Industrial Average or the MSCI World Index are making a series of all time highs, while European markets have broken above their 2015 and 2017 ones. In this article, we review the state of global equity markets, which seem stretched, yet may linger on up another few weeks.

S&P500 Index
Weekly graph or the perspective over the next 2 to 4 quarters



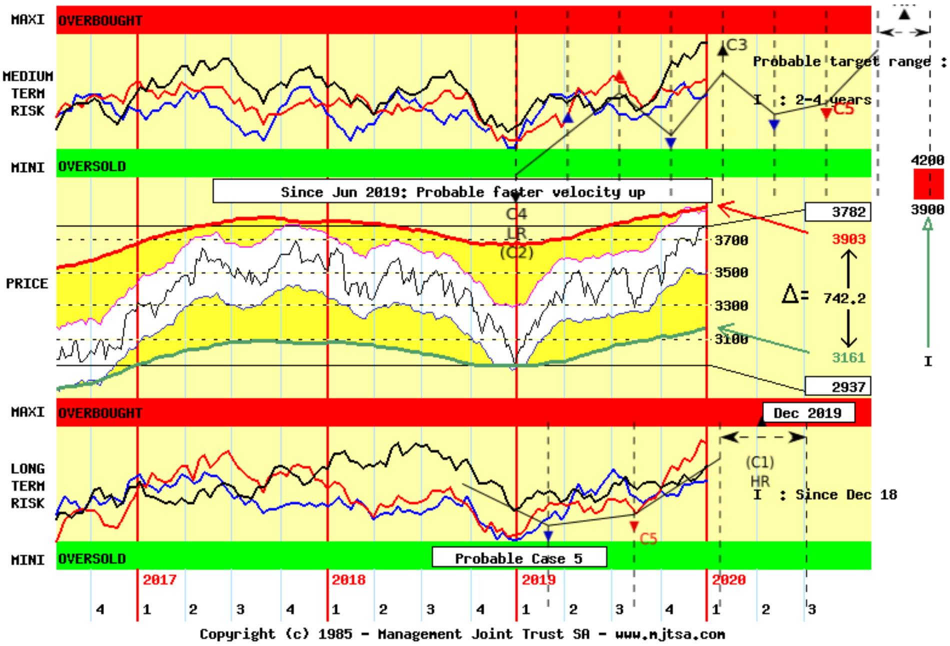
Following circa 12 months of re-acceleration to the upside, the S&P500 could be approaching an important intermediate top on our medium term oscillators (upper rectangle). We expect it to materialize at some point during early/mid Q1. On our long term ones (lower rectangle), our oscillators are indicating continued strength, probably into mid Q1 at least and perhaps into the Summer. On the price targets front, the upper end of our I Impulsive targets to the upside (right-hand scale) has been reached. **Hence, in terms of risk/reward, this market is very much stretched. Yet, our oscillators would suggest that this uptrend could linger on higher into mid Q1 in first instance. We then expect a period of downside correction into late Q1 / early Q2 (shown on our medium term oscillators), and then a possible new leg up into the Summer.**

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



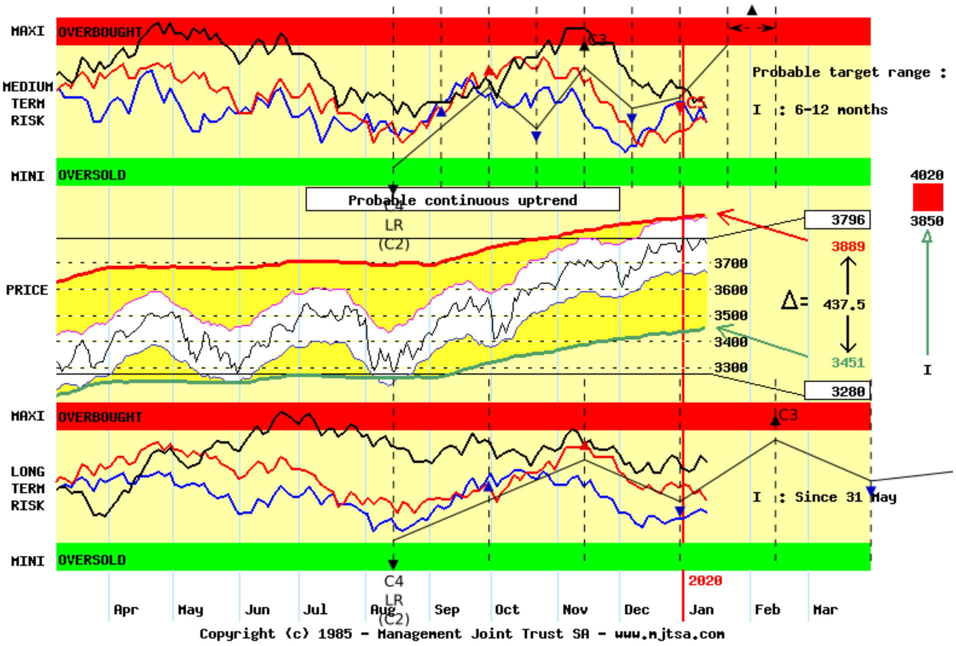
The Daily graph of the S&P500 is also getting Overbought on our long term oscillators (lower rectangle). These have indeed entered a High Risk position. Our medium term ones (upper rectangle) would suggest **another month or so of uptrend, probably into early/mid February. Our I Impulsive targets to the upside indicate that some upside remains, possibly towards the higher 3'300s**. Following that, an intermediate correction may materialize, which could last 1 to 3 months and drop between 185 and 300 points (or circa 0.5 to 0.8 times our historical volatility measure "Delta", here at 378.4 – middle rectangle, right-hand side).

EuroStoxx 50 Index
Weekly graph or the perspective over the next 2 to 4 quarters



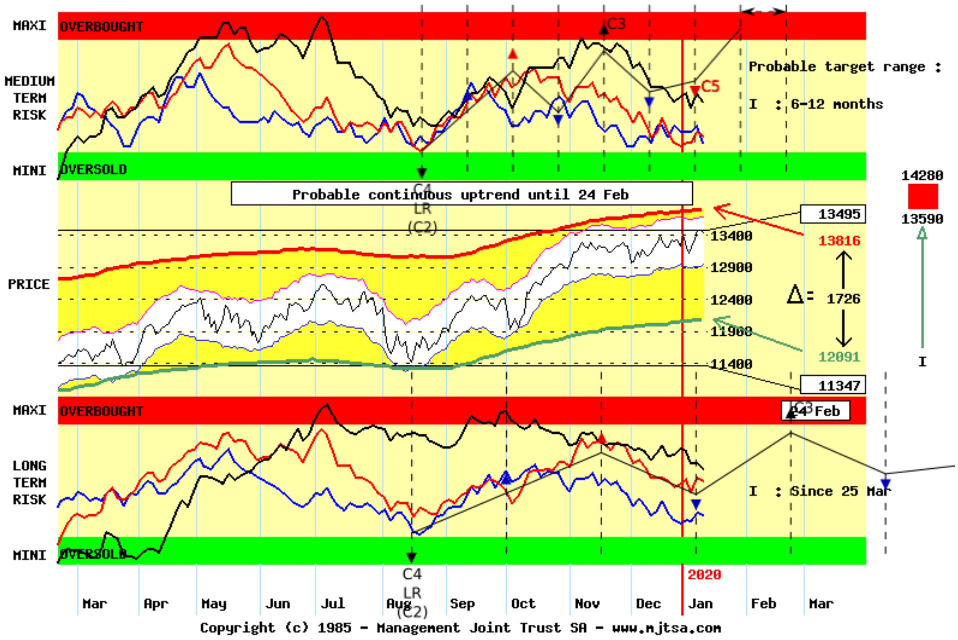
Similarly to the S&P500, the EuroStoxx 50 is also approaching an intermediate top on our medium term oscillators (upper rectangle), probably towards early / mid Q1. For now, the configuration on our long term ones (lower rectangle) is still very supportive, probably into mid Q1 in first instance and then perhaps into the Summer. **The upside potential here is still quite compelling, as our I Impulsive targets to the upside (right-hand scale) are pointing to the 3'900 – 4'200 range (or between 3 and 12% above current levels). From mid Q1, we then expect the EuroStoxx 50 to consolidate down into late Q1 / early Q2 before it probably resumes higher again into the Summer.**

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



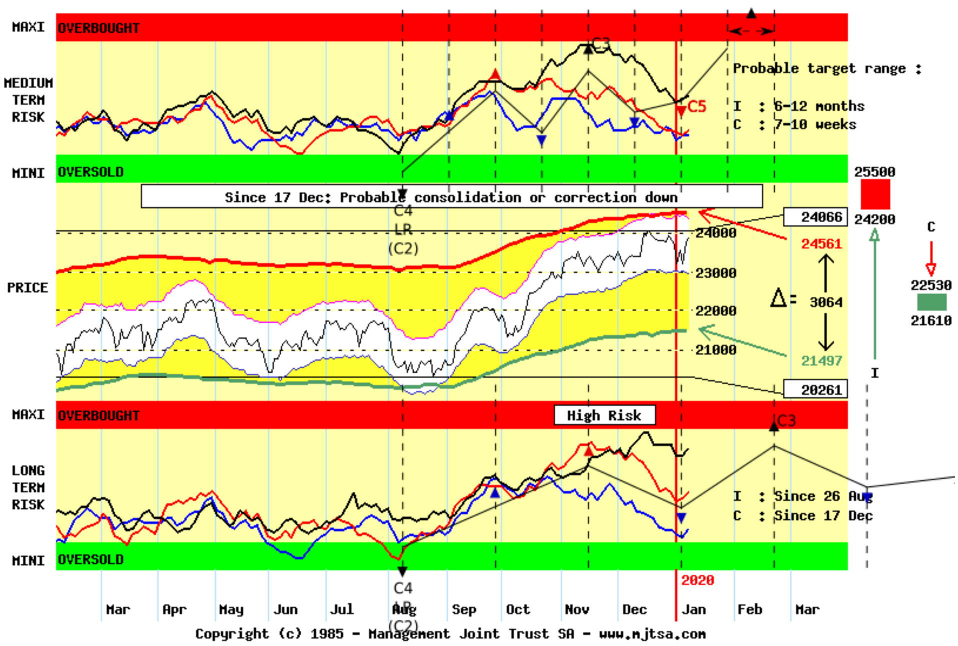
Despite having recently taken out its 2015 and 2017 highs, our oscillator series (lower and upper rectangles) are still quite low on this Daily graph of the EuroStoxx50. Indeed, both oscillator series would now suggest **a resume uptrend situation from these high price levels, probably into early/mid February. In terms of price targets, there is still some potential left towards our I Impulsive targets to the upside in the 3'850 – 4'020 range** (right-hand scale).

DAX 30 Index
Daily graph or the perspective over the next 2 to 3 months



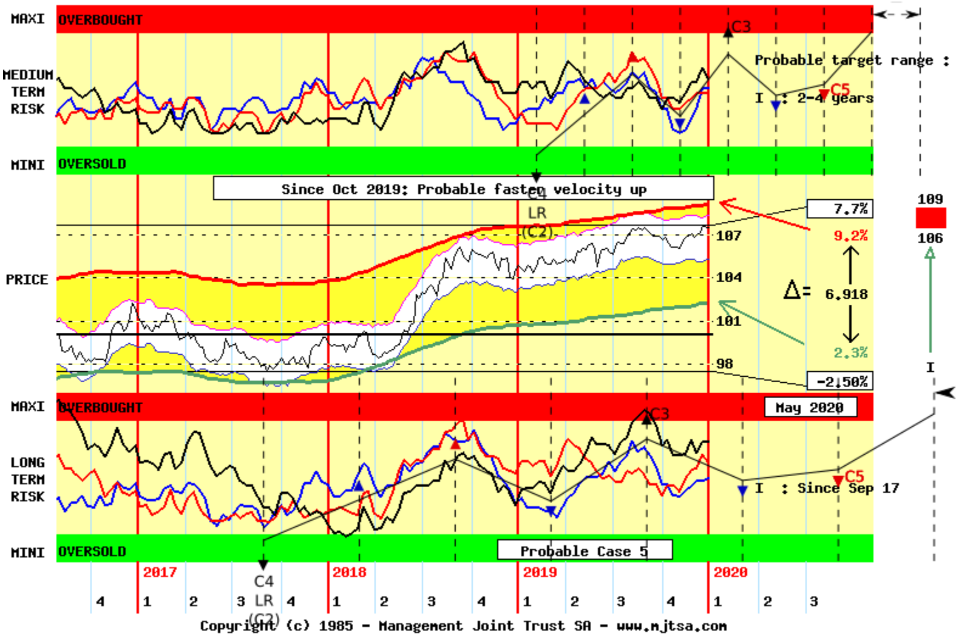
As a further example, we consider the Daily graph of the DAX30, where both oscillator series (lower and upper rectangles) are **currently in a resume uptrend situation with oscillators which are still quite low. This should lead the index higher into early/mid February**. Hence, the price action since November, which has been quite flat, may constitute a line consolidation before a last move higher. Our I Impulsive targets to the upside (right-hand scale) indicate that **the DAX30 could move up into its I impulsive targets range (right-hand scale), hence perhaps up to 14'000**. Following that, the DAX30 probably corrects down into late Q1 / early Q2 with downside potential between 860 and 1'380 points (0.5 to 0.8 times our historical measure "Delta", here at 1'726 points- middle rectangle, right-hand side).

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



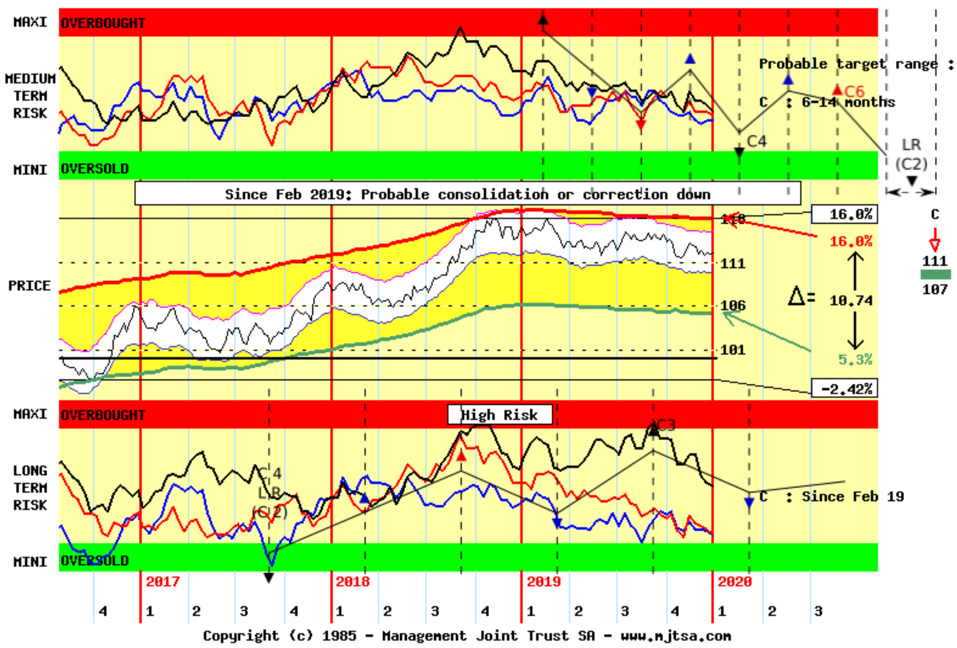
Looking at other developed markets, the Nikkei 225 is also showing a resume uptrend situation with low oscillators on both oscillator series (lower and upper rectangles). **Hence, a new leg up could be starting, probably towards early/mid February. Our I impulsive targets to the upside indicate further upside towards the 24'200 – 25'500 range** (right-hand scale), or potentially up to 6% higher. Following that, the Nikkei 225 probably corrects down into late Q1 / early Q2 with downside potential between 1'532 and 2'451 points (0.5 to 0.8 times our historical volatility measure "Delta", here at 3'064 points - middle rectangle, right-hand side).

S&P500 Index vs the All Country World Index
Weekly graph or the perspective over the next 2 to 4 quarters



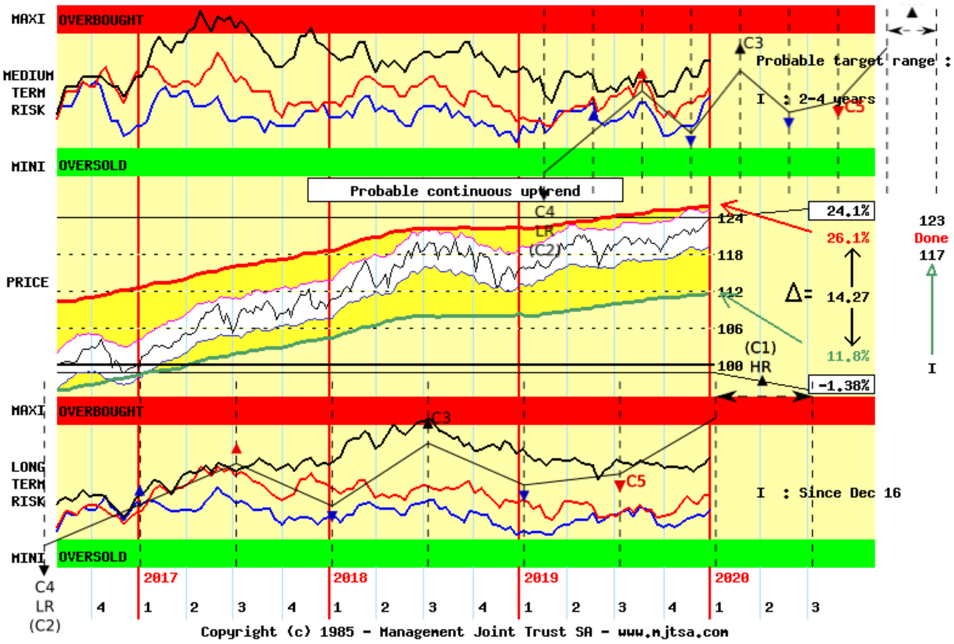
On a relative basis, the S&P500 has for now maintained its upside momentum vs the All Country World Index. Indeed, while our long term oscillators (lower rectangle) would indicate some consolidation into mid Q1, our medium term ones (upper rectangle) are in some kind of extension to the upside. **We believe this resilience is probably due to the strong performance (and important market cap. weightings in the S&P500 Index) of the large US Technology stocks.**

Dow Jones Industrial Index vs the All Country World Index
Weekly graph or the perspective over the next 2 to 4 quarters



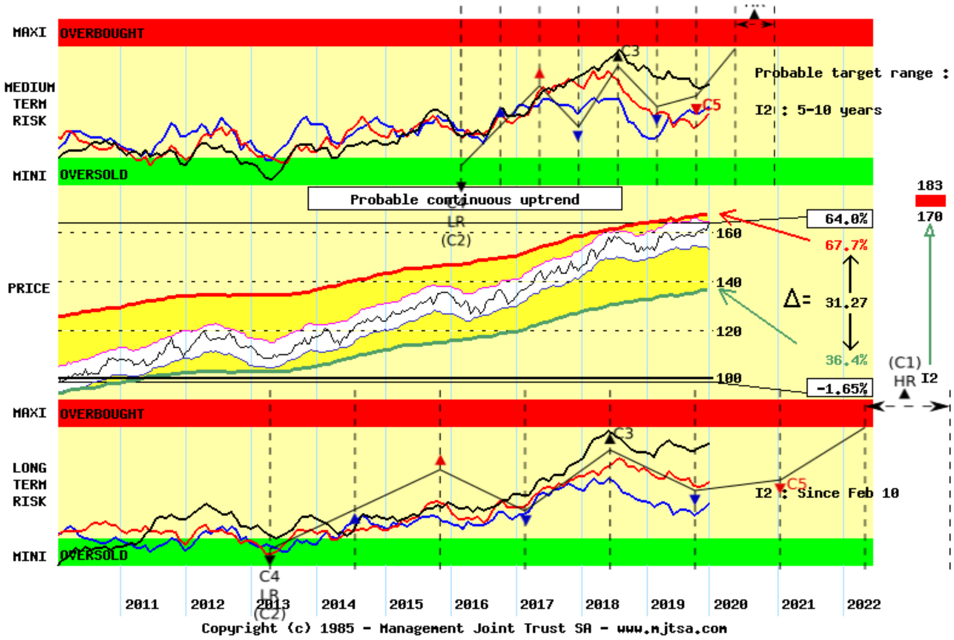
Indeed, if we compare the Dow Jones Industrial Index (price weighted and hence with less exposure to big US tech) to the All Country World Index, the ratio has been declining for more than a year. On both oscillators series (lower and upper rectangles), we expect it **to find support towards mid Q1 as markets probably top out. It should then bounce into late Q1 / early Q2. This also confirms the rather defensive profile of the Dow Jones Industrials Average vs World markets.**

Nasdaq100 Index vs S&P500 Index
Weekly graph or the perspective over the next 2 to 4 quarters



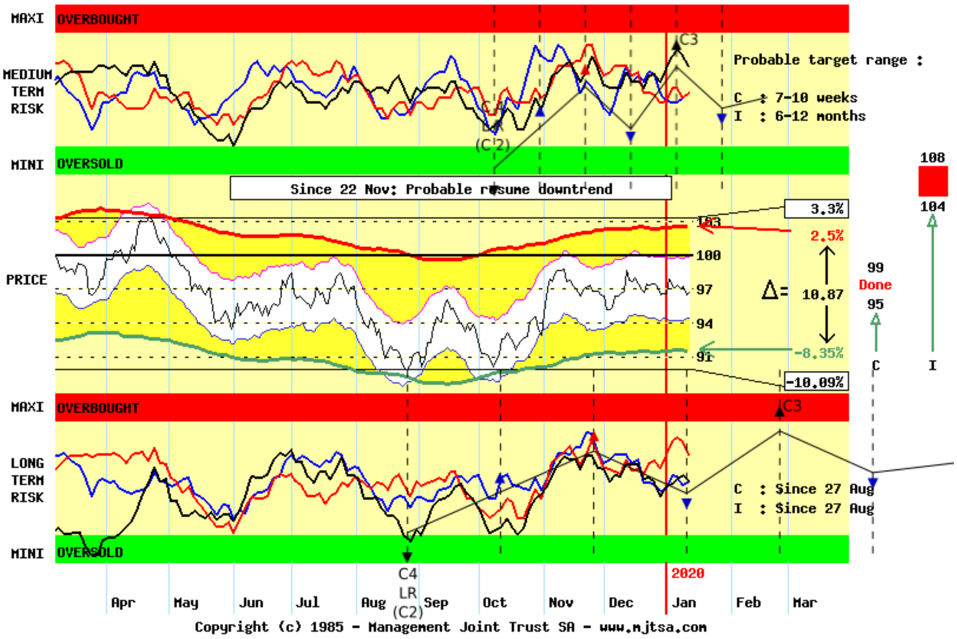
Following up on the various US Equity profiles, we now compare the Nasdaq100 Index vs the S&P500. **The ratio is still very strong** and our long term oscillators (lower rectangle) suggest that it could continue higher, possibly even into the Summer. Interestingly, on our medium term ones (upper rectangle), **we expect the Nasdaq 100 to make an intermediate top vs the S&P500, probably towards mid Q1**. It may then underperform into late Q1 / early Q2 (along with the equity market correction we expect, i.e. the Nasdaq 100 has a beta of circa 1.15), and then probably resumes higher again into the Summer.

Nasdaq100 Index vs S&P500 Index
Bi-monthly graph or the perspective over the next 1 to 2 years



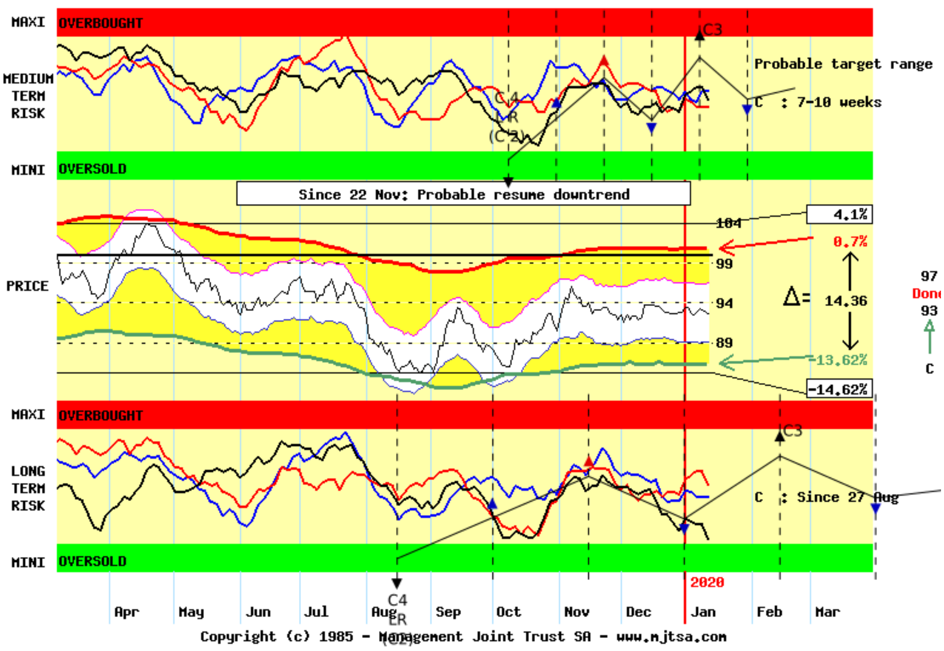
On our bi-monthly graph, the Nasdaq 100's profile vs the S&P500 is also very appealing. Both our oscillator series (lower and upper rectangles) suggest that following its mid 2018 intermediate top and subsequent consolidation, **the ratio is now getting ready to continue its outperformance, probably towards H2 2020 in first instance** (upper rectangle), perhaps even for another 2 to 3 years (lower rectangle). From a price targets perspective, our I2 Impulsive 2 extended targets (right-hand scale) would **still point to between 5 and 18% of additional outperformance.**

US Cyclical Sectors vs Defensive ones
Daily graph or the perspective over the next 2 to 3 months



We would consider that for now, and into mid Q1, Growth profiles and especially the Nasdaq 100 probably retain leadership on US markets. In the meantime, however, we believe it is interesting to compare Cyclical and Defensive profiles to get a sense of the shorter term sector rotation until then. We hence compare an equal weighted portfolio of cyclical profiles (US Industrials, Materials, Energy and Financials) vs a defensive one (US Staples, Healthcare, Utilities, Telecom and Real Estate). On both oscillator series (lower and upper rectangles), the resulting ratio suggests that **cyclical profiles could suffer some underperformance until late January, before they initiate a last rebound into mid/late February**. This would be in accordance with our scenario of the US10 Year Treasury yield (see p 19 in this issue of The Capital Observer) where we also expect some retracement during January and a further bounce during February.

European Cyclical sectors vs Defensive ones
Daily graph or the perspective over the next 2 to 3 months



We perform the same analysis in Europe comparing a cyclical portfolio comprising European Autos, Chemicals, Bank, Natural Resources, Energy and Industrials vs a more defensive one, which includes European Food & Beverage, Healthcare, Utilities, Telecom and Real Estate. The resulting ratio is similar, and here also, both our oscillator series (lower and upper rectangles) would suggest **some underpeformance for European cyclical plays into late January, and then a last bounce into mid/late February. Following that, defensive profiles in Europe and in the US probably outperform into late Q1 / early Q2 as Equity markets could consolidate.**

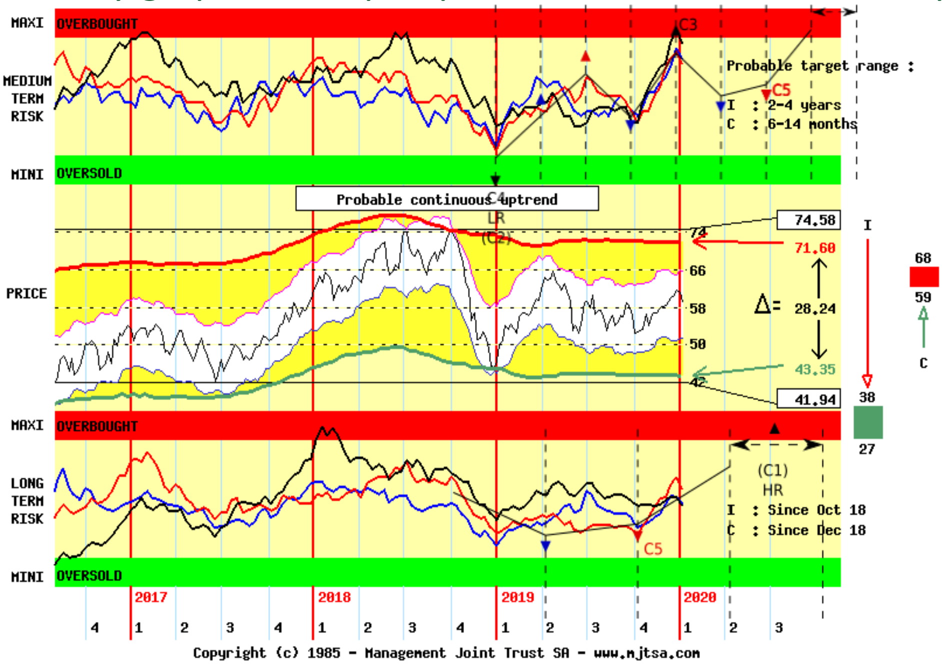
Concluding Remarks:

Although risk/reward is getting very stretched (this is no market for risk averse investors), we would still expect the current equity uptrend to grind higher into early/mid February. The S&P500 could reach towards the high 3'300s, the Eurostoxx50 towards 4'000. For now, the S&P500 is still leading world markets higher. We believe this is mostly due to its strong exposure to US Technology (i.e. other large US equity indexes such as the Dow Jones Industrial Average have been underperforming World markets for more than a year). This Tech leadership could continue into mid Q1 in first instance. Among other sectors, we expect Cyclical ones to suffer some underperformance into late January, before they initiate a last bounce into mid/late February. Following that, Defensive profiles should then take on leadership into late Q1 / early Q2 as equity markets may enter an intermediate correction.

57 / Splicing the markets – Update on Oil following the Soleimani's death Spike

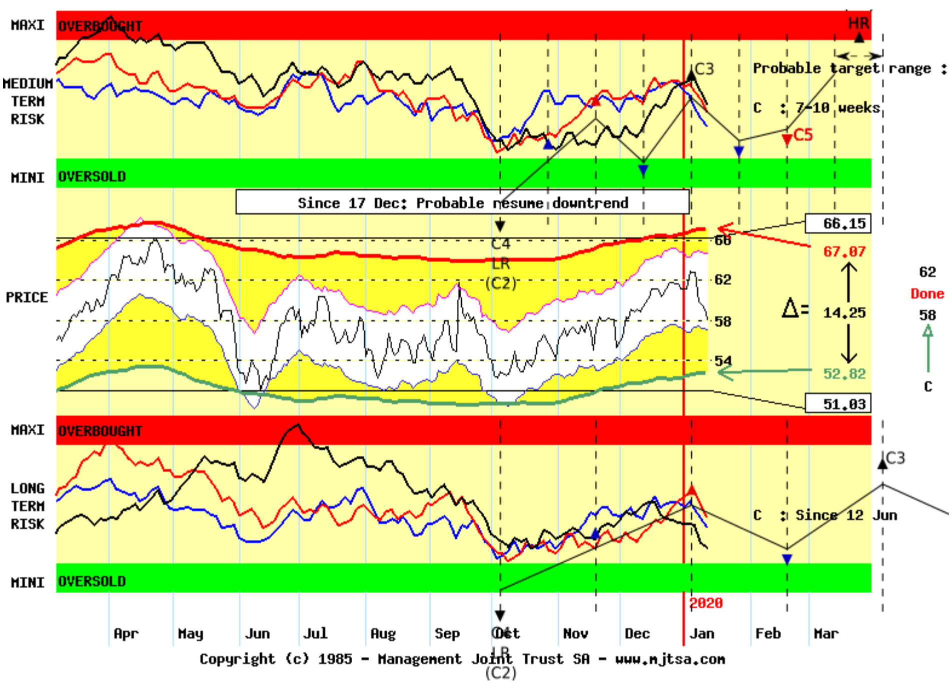
Since early October, we've been expressing our strong bullish bias for Oil into and during 2020. Last month, shorter term, we expected it to rise into early January, when it could make an intermediate top, probably followed by a couple of weeks of consolidation (i.e. on the US Dollar rebound we then expected). Following that, we expected Oil to resume its uptrend situation until late February / perhaps March in first instance. Although our timing was rather correct, the spike on Major General Soleimani's death was stronger that we could have expected. The subsequent de-escalation sell-off is also equally aggressive, we hereby briefly review our scenario on Oil and Energy going forward.

Light Crude WTI Oil (USD/barrel)
Weekly graph or the perspective over the next 2 to 4 quarters



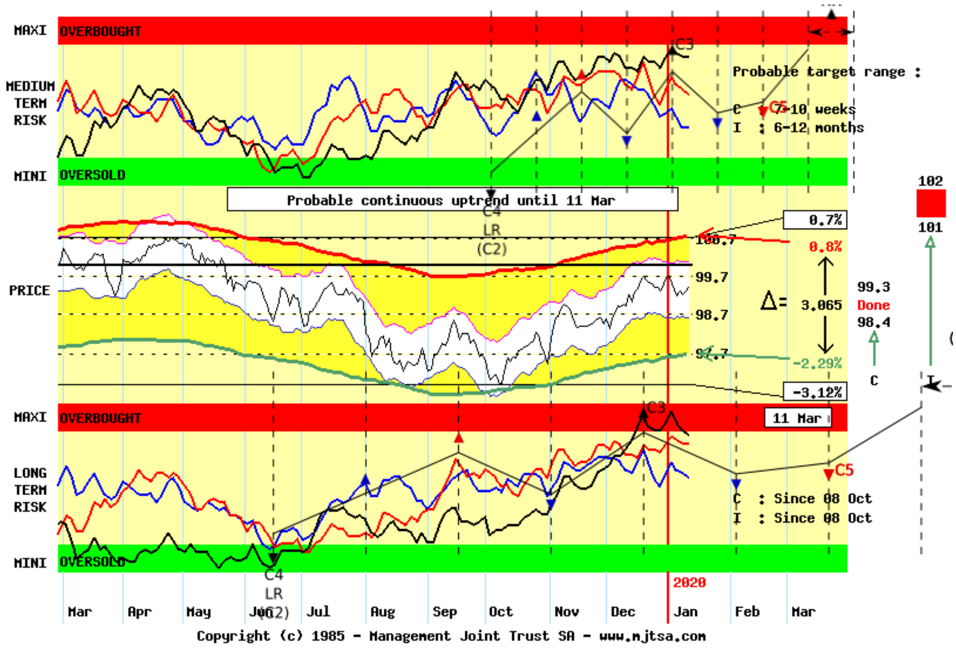
We believe that during last Summer, Oil built a base higher than the lows made in December 2018. This configuration is our view provides support for Oil to continue to rally into 2020, as shown on our long term oscillators (lower rectangle). Our medium oscillators (upper rectangle) are however more worrying, especially when put in the perspective of the sell-off which started last week, and when considering the risk of our I Impulsive targets to the downside (below 40 USD/barrel, right-hand scale). For now, we would favor a more measured scenario, where **Oil could remain under pressure during Q1 this year, but then resumes higher into the Summer. On the targets front, we believe the base made last Summer in the mid/low 50s USD/barrel (high 50s for Brent) should provide strong support**. During the Spring, we then expect Light Crude Oil to resume its uptrend towards the upper end of our C Corrective targets to the upside around 68 (right-hand scale), and, if/once it can break above these, continue towards the Fall to test its 2018 highs.

Light Crude WTI Oil (USD/barrel)
Daily graph or the perspective over the next 2 to 3 months



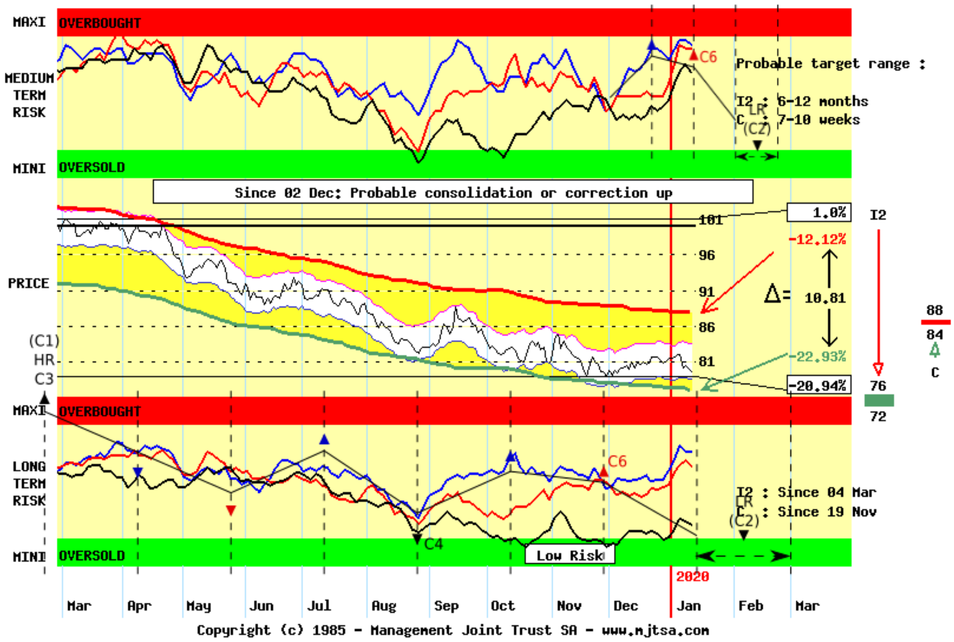
We look to refine this analysis by focusing on the Daily graph of WTI Light Crude Oil. For now, the configuration is still uptrending, yet it did make an intermediate top last week and is currently correcting. According to both our oscillator series (lower and upper rectangles), **WTI Oil should find support at some point between late January and mid February. It could then resume higher into late Q1.** On the target front, WTI did make it above the resistance of our C Corrective targets to the upside last week, i.e. above 62 USD/barrel (right-hand scale). This breakout would theoretically support further upside potential over the next 6 months, possibly towards our I Impulsive targets to the upside (right-hand scale) in the 70 to 75 USD/barrel range. **Again, we would consider that strong support lies towards last Summer's lows in the mid/low 50s. Any move below these would hence be very worrying. Yet for now, we would consider this outcome to be rather unlikely, and believe that the window of risk here is shorter than on our Weekly graph above. We would hence be looking to buy the dip on Oil within a couple of weeks.**

Inflation Expectations (TIP vs Treasuries)
Daily graph or the perspective over the next 2 to 3 months



Inflation Expectations (Tips vs Treasury breakeven ratio) are often very much correlated with Oil prices. Yet, these are probably less influenced by short term market dynamics. Here also, it seems that an intermediate top was made during December on both oscillator series (lower and upper rectangles). These suggest that **the current consolidation could last into late January / early February. Following that, these could resume higher into February / March in first instance. We would consider this graph as a further confirmation that the current sell-off in Oil is temporary, yet that it may continue into the 3rd, and perhaps the 4th week of January.**

S&P US Energy Sector vs the S&P500 Index
Daily graph or the perspective over the next 2 to 3 months



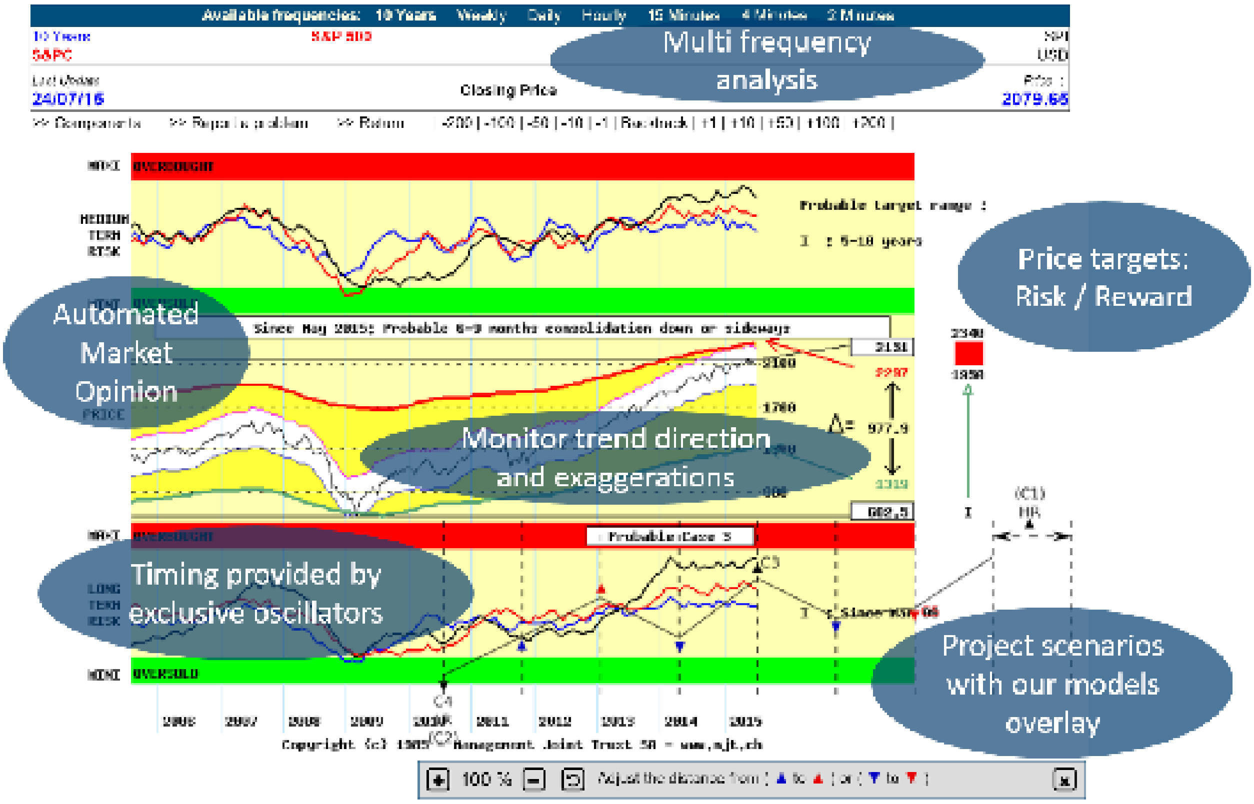
The US Energy sector has had a hard time rebounding since August, despite rates moving up (US Energy is very much deep value) and Oil grinding higher. With the current sell-off in Oil, it is currently retesting down again towards its late November lows. On our long term oscillators (lower rectangle), the ratio is already very Oversold and could soon enter a new Low Risk position. Yet, our medium term ones (upper rectangle) indicate **further downside pressure into early February. On the target front (right-hand side), our I Impulsive targets to the downside have been achieved, and the ratio is now eyeing our extended I2 Impulsive 2 targets to the downside, 4 to 8 % below current levels. Hence, while Oil is selling off, and yields probably also retrace short term (see p 19-21 of this issue of The Capital Observer), it seems that the US Energy sector could continue to retest lower on a relative basis over the next few weeks. A new bounce may then materialize during February.**

Concluding remarks:

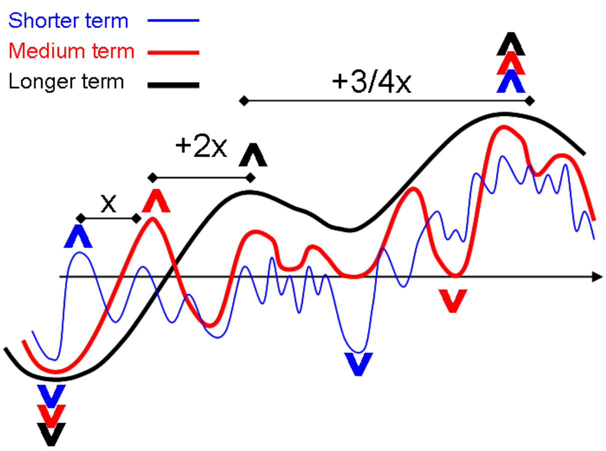
The current de-escalation sell-off on Oil is quite drastic. Yet, for now, we would maintain our positive medium term outlook on it. Indeed, both Oil and related Inflation Expectations could stabilize towards late January and then reverse up during February, perhaps March (possible targets into the mid/high 60s USD/barrel on WTI). We also believe that the base built last Summer, around the low/mid 50s USD/barrel on WTI, and towards the high 50s on Brent, should provide strong support, thereby somewhat limiting the medium term risk. Finally, considering the Energy sector on a relative basis, it could continue to slide lower vs the market into late January as Oil corrects, and potentially yields also retrace. We would then expect a further bounce of the ratio during February.

59/ METHODOLOGY

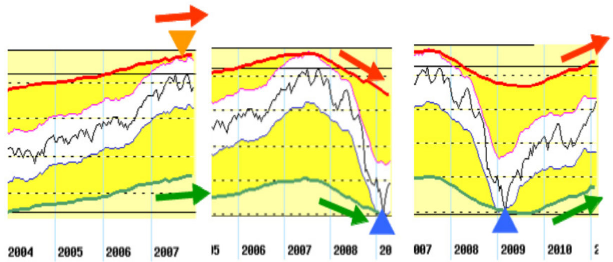
MJT's proprietary methodology uses Timing Oscillators to help investors position themselves either in an uptrend or downtrend. It will hence allow them to anticipate and project the future sequence of events. Coverage extends over 5'000 instruments, long term to intraday, across all asset classes. Relative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



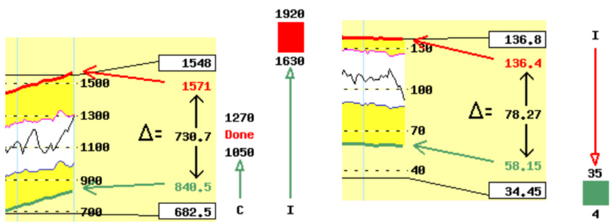
Timing oscillators: Different prices cycles are captured by our 3 Timing oscillators. Monitor how their relative positioning defines specific situations (Cases) to always know where you stand within the Trend (e.g. please see below the ideal Uptrend Case succession sequence)



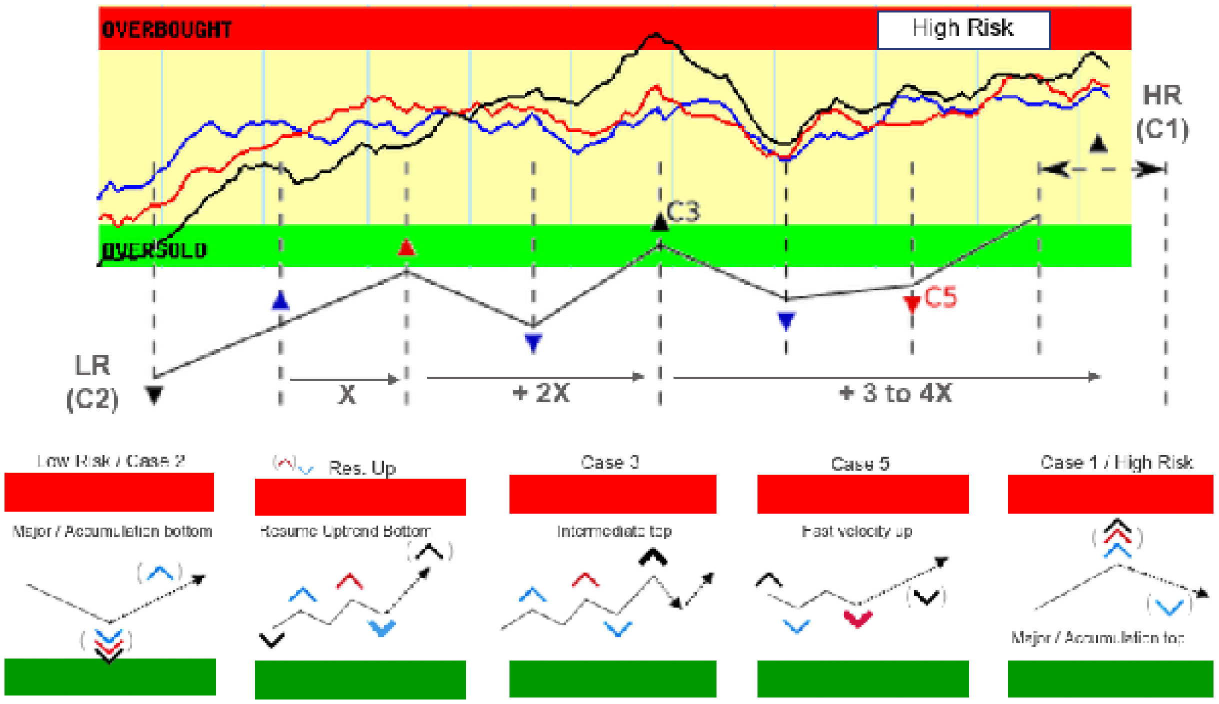
Trend direction: the direction of FinGraphs' large envelope will help you decide either to apply an uptrend or a downtrend model. Contacts between the wider and thinner envelopes will help you anticipate and confirm market turning points (e.g. S&P500 bi-monthly, extracts from the 2005-2011 period).



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).

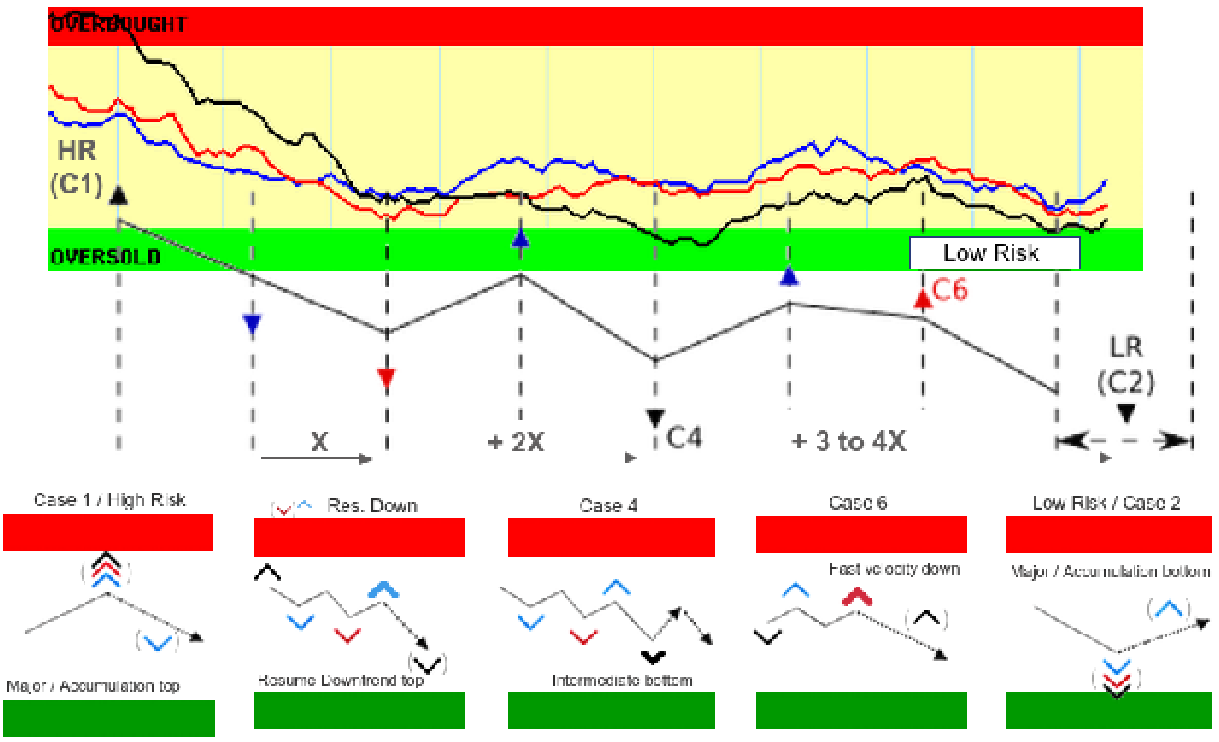


Ideal Uptrend Model



(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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MANAGEMENT JOINT TRUST SA

Diapason Commodities and Currencies
20 North Audley Street
London, W1k 6WE
UK
+44 207 290 2260

Management Joint Trust S.A.
Rue de Hesse 1
P.O.Box 5337
1211 Geneva 11
Switzerland
+41 22 328 93 33

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