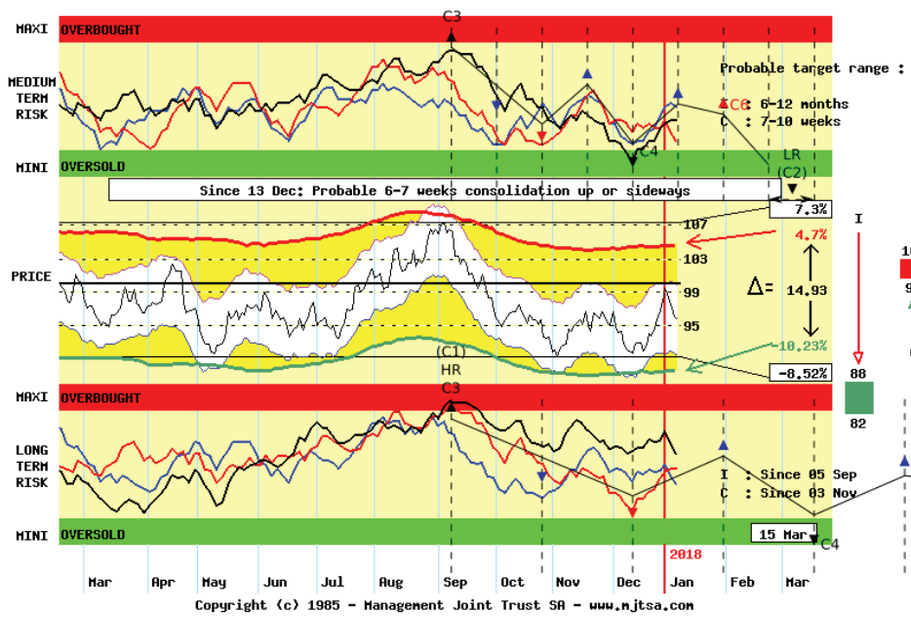
53 / Splicing the markets – Avoid negative USD correlations until March

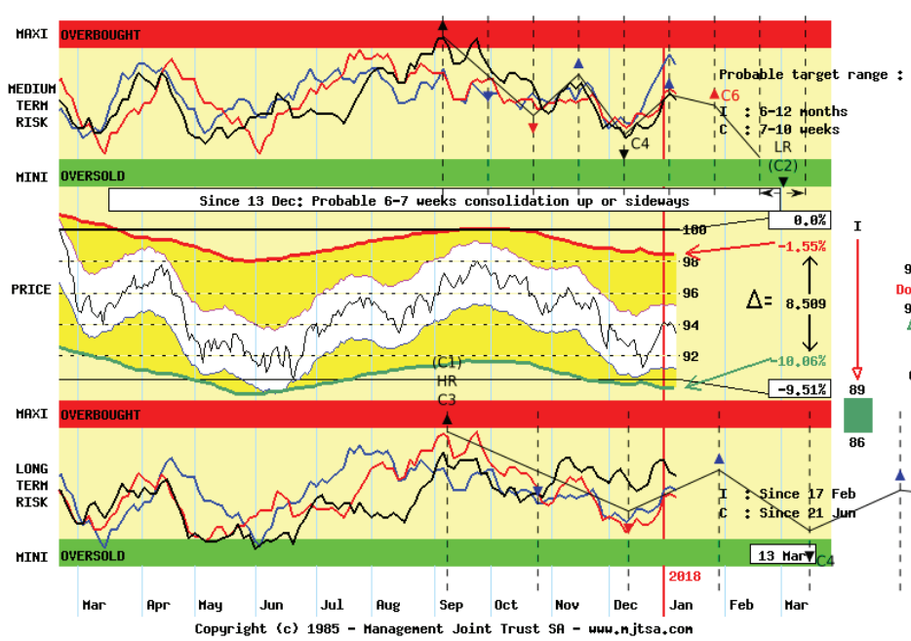
Throughout this edition of The Capital Observer, we have detailed our projection for a rebound in Dollar during Q1 (Note: the Dollar could then retrace down into Q2, and possibly accelerate up again in H2 2018). We will use this Splicing the Markets section, to highlight some of the trades we believe could be negatively impacted over the next couple of months by this initial Dollar bounce. Some of them may seem counter-intuitive at this late, and positive, stage of the Commodity cycle, yet they may be only transitory, and could deliver new buying opportunities towards early/mid March.

Gold Spot (USD/Oz) / DAX Kurs Index
Daily graph or the perspective over the next 2 to 3 months



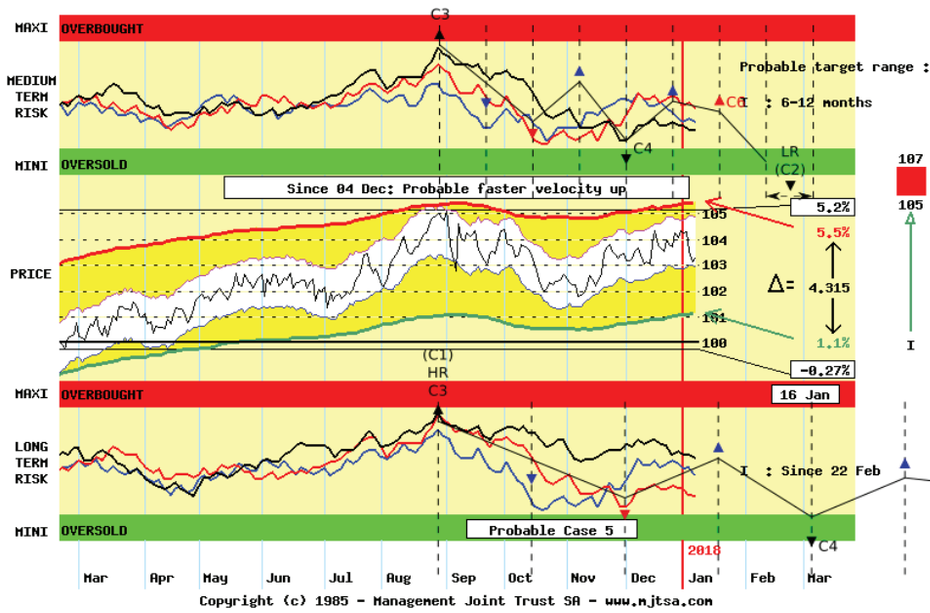
We will start by comparing Gold, which for now is strongly negatively correlated with the US Dollar (this correlation may shift to positive as the year advances) and the Dax Index, which we believe should strongly benefit for a stronger Dollar in Q1. The ratio is done on a currency hedged basis (like to like comparison of prices, no currency effect). It topped out in September, just saw a sharp rebound in December, and according to both our oscillator series (lower and upper rectangles), should roll-over again during January and then accelerate down towards late February / March. **Favoring European markets and avoiding Defensive assets over the next couple months, is one of the main focuses of this monthly issue.**

EWC - iShares MSCI Canada Index Fund / SPY - SPDR S&P 500
Daily graph or the perspective over the next 2 to 3 months



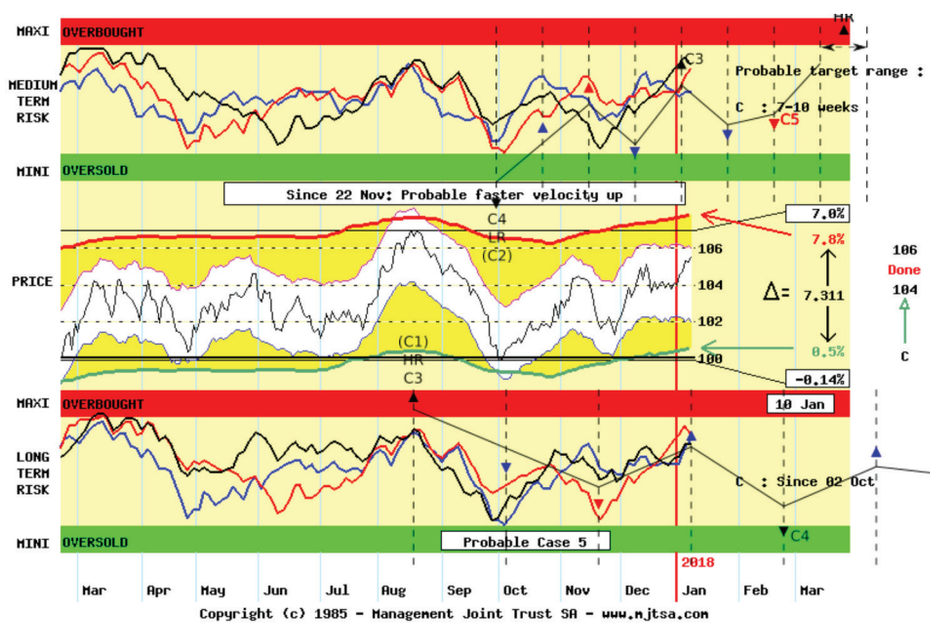
Similarly, we now compare the Canadian market EWC ETF vs the SP500 SPY ETF. It shows a dynamic, which is very similar to the one above. A top in September, a bounce in December, and from what we can judge on both our oscillator series (lower and upper rectangles), a roll-over phase in January **and a new sell-off towards late February / March. We will hence avoid all USD Commodity countries ETFs over the next couple of months. March may then present a new buying opportunity.**

SCJ - iShares MSCI Japan Small Cap / EWJ - iShares MSCI Japan Index Fund
Daily graph or the perspective over the next 2 to 3 months



On the back of a stronger Dollar, developed international markets should outperform US ones during Q1. We would hence favor larger, internationally exposed companies, and sectors, in these markets (especially in Europe and Japan). We hereby compare the Japanese SCJ Small Cap ETF vs the Japanese EWJ main market ETF. Inversely to recent Dollar weakness, it has re-tested up in December. Yet, now, on both our oscillator series (lower and upper rectangles), the ratio could be getting ready to resume down towards late February / March. **Our view is hence to avoid Small Caps ETFs outside of the US over the next couple of months.**

S&P 100 / IWM - iShares Russell 2000 ETF
Daily graph or the perspective over the next 2 to 3 months



On the contrary, we would tend to favor domestic profiles in the US. These are usually more abundant in the small cap universe. We hereby compare the large Cap S&P100 Index vs the Russell 2000 ETF. The top happened in mid August, then the ratio bounced in October, and then again in December. On both oscillator series (lower and upper rectangles), **we would now expect this Large Cap. to Small Cap. Ratio to retrace down, probably into mid /late February.** This ratio is skewed slightly to the upside vs the others. It also seems to lead them by a few weeks in its timing. It could be good one to monitor come late February to signal renewed USD weakness (or not).

Concluding remarks

On the back of the US Dollar rebound we expect over the next couple months, we would hence avoid Defensive assets and Commodity related geographies. We would also favour large International Companies in Europe and Japan, and smaller domestic companies in the US. Coming March, we may decide to reverse this market positioning, especially if our global markets scenario then favours a late stage Commodity blow-off in Q2, rather than a dull Distribution phase.