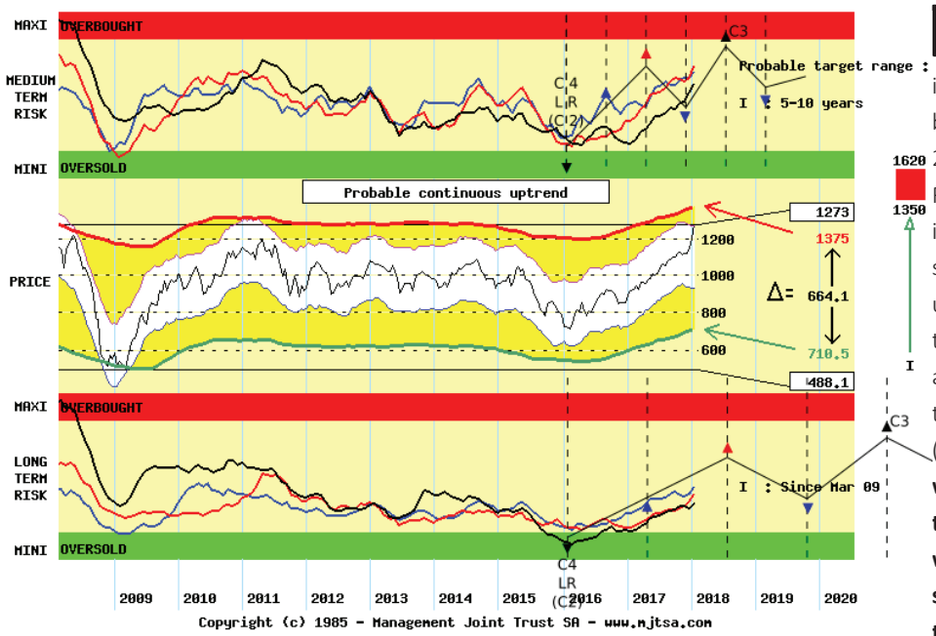
Emerging Markets still look strong towards late Q2, yet may underperform until March

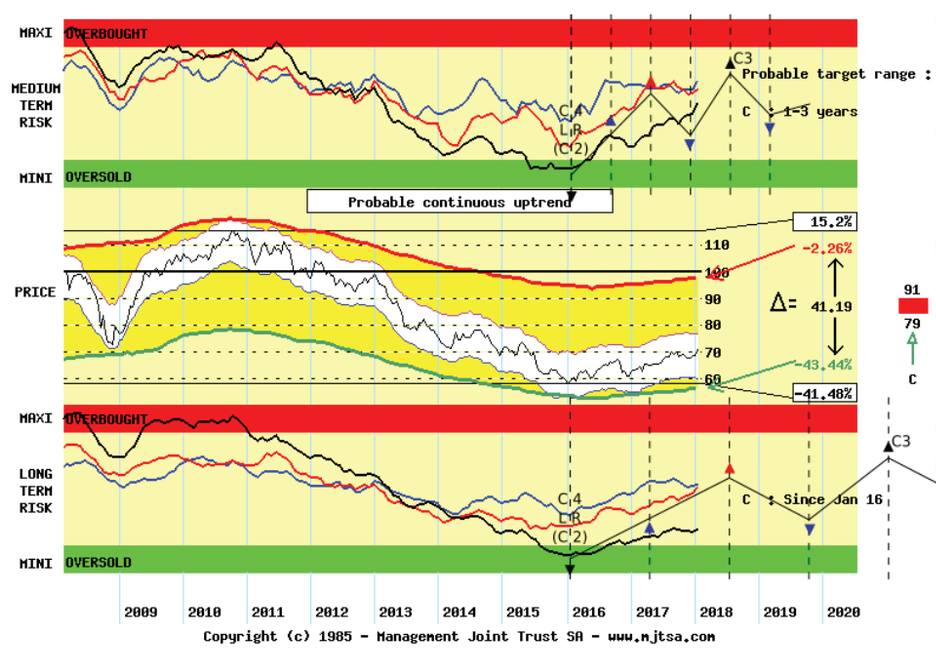
In 2017, Emerging markets beat all developed markets (even Japan). Also, since the reflation period started in early 2016, they have performed almost 80% in US Dollar terms. As with the Commodities covered in the previous article in this issue, one may wonder how long this winning streak can continue. Similarly, we believe that it may extend to mid-year, perhaps the Summer before it starts to retrace.

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



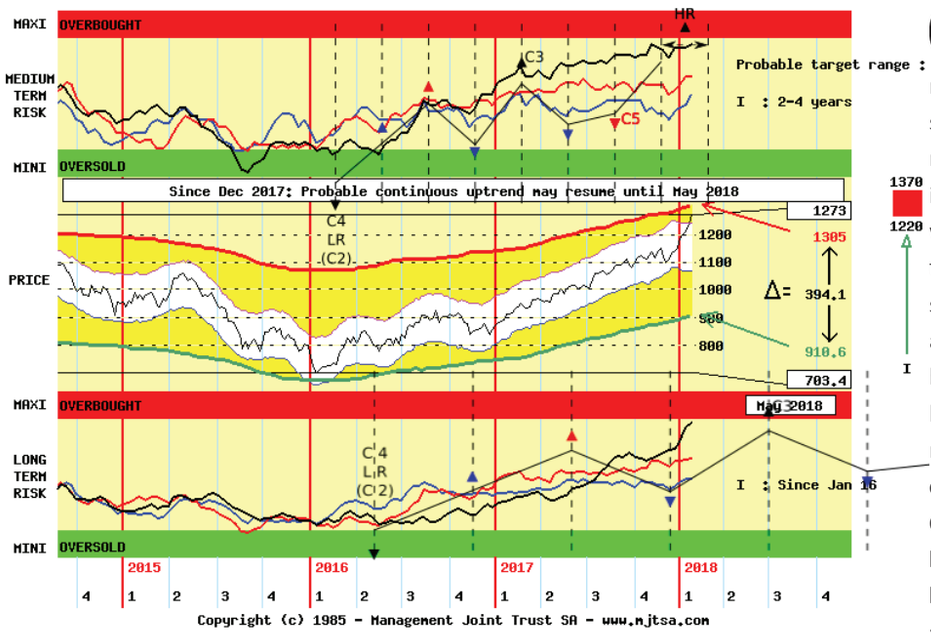
Like Oil, covered in the previous article in this issue, Emerging Markets first bottomed in late 2008 / early 2009, following the Great Financial Crisis, then rallied into 2011-2012, before they suffered a painful bear market until early 2016. Since then, they have been rallying up along with other reflation trades. On both oscillator series (lower and upper rectangles), **we expect this strong uptrend to continue towards mid 2018, when it should top out, and start correcting back down towards 2019**. According to our I Impulsive targets up (right-hand scale), **the upside price potential left for this last move is compelling, somewhere between 10 and 30%** (1'350 to 1'620 range; right-hand scale).

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



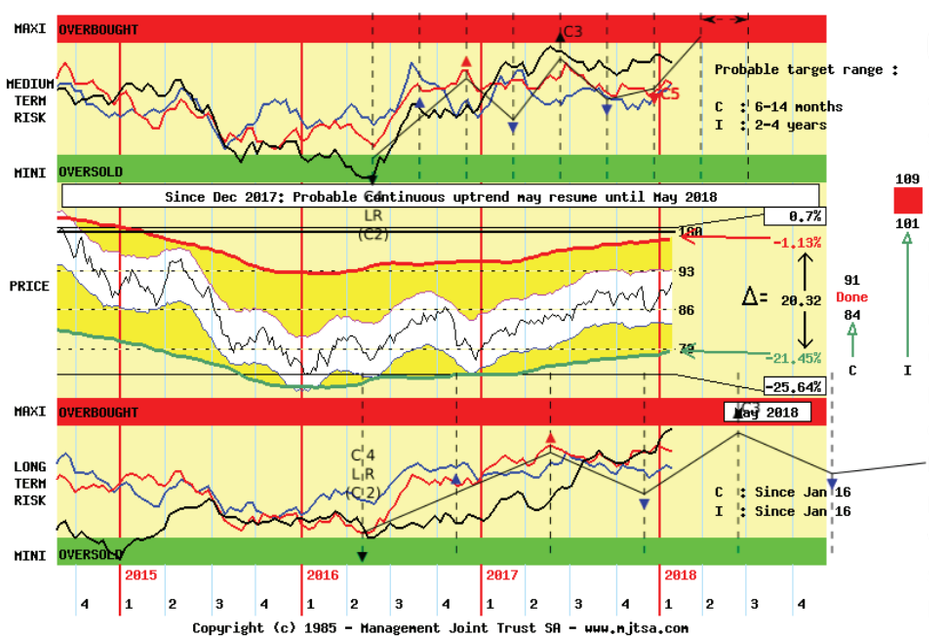
Vs the MSCI World Index, Emerging Markets also seem to continue to outperform, possibly until mid this year according to both our oscillator series (lower and upper rectangles). For now, and despite its two years rebound, the move is considered as just a correction. Once it subsides, from H2 2018, we would expect the ratio to reverse down, possibly into mid/late 2019. **The outperformance potential left towards mid year is still important according to our C Corrective targets up (right-hand scale), somewhere between 15 and 30%**. This is similar to our absolute targets above, which may imply, that Emerging Markets should be the main drivers of Equity performance as we approach the last stages of the current and long standing equity Bull market.

MSCI Emerging Markets
Weekly graph or the perspective over the next 2 to 4 quarters



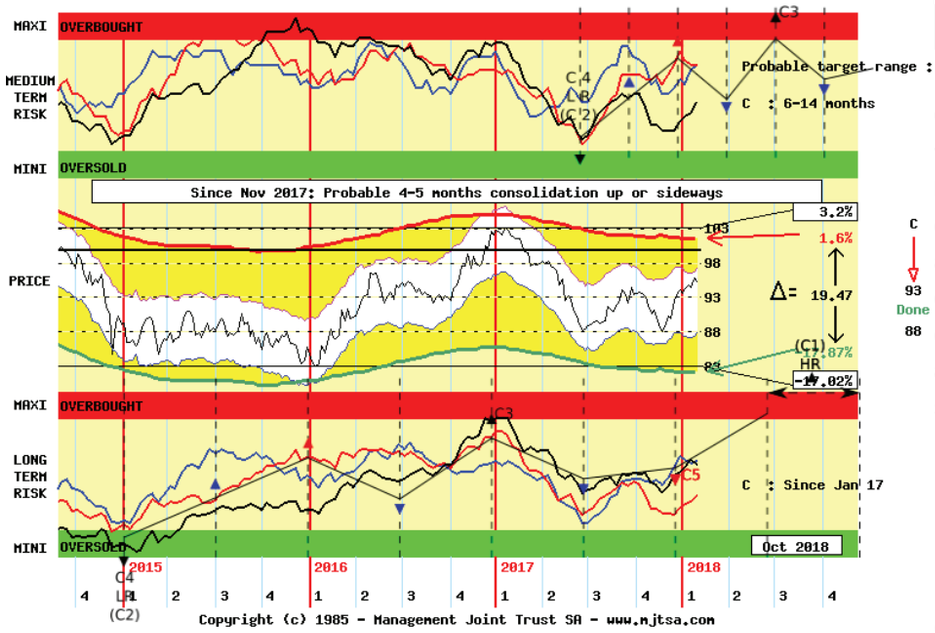
On our medium term oscillators (upper rectangle), the uptrend sequence we show is pretty much completed, and it is currently signalling a worthwhile intermediate top. Yet, momentum still seems strong and recently re-accelerated in December, which better fits the projection on our longer term oscillators (lower rectangle). Combining both, **we expect some consolidation in Q1, as has already started to happen over the last few days, before Emerging Markets re-accelerate up in Q2. A final top is expected towards late Q2 / mid year. Our I Impulsive targets up (right-hand scale) could justify a further 10% in upside potential**. This is towards the lower end of the potential we read on our bi-monthly graph above, and would constitute a more conservative scenario.

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



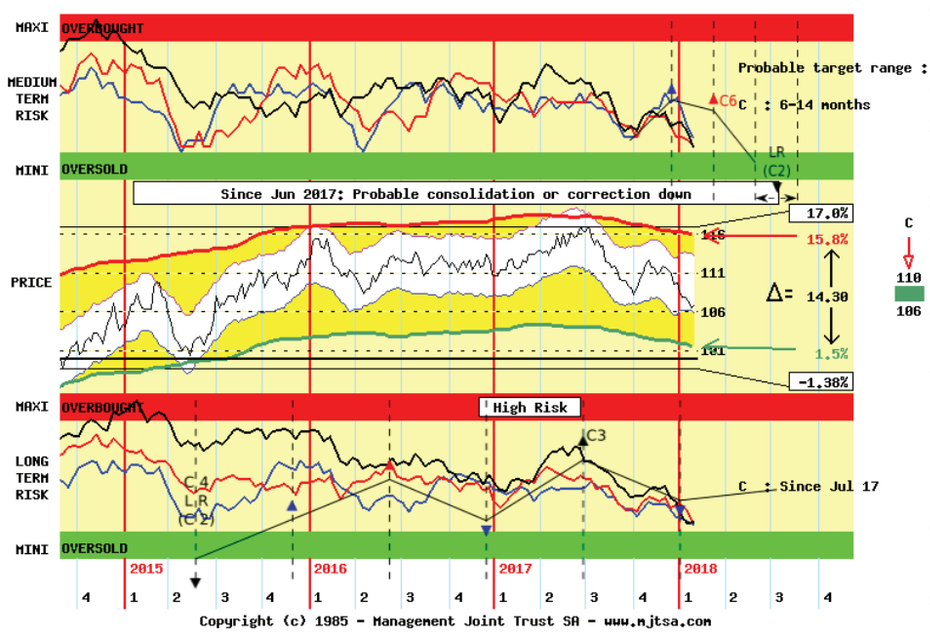
On a relative basis, vs the MSCI World Index, the outperformance potential seems more compelling. Indeed, the ratio has just made it above our C Corrective targets up and is now on path to accelerate up towards its I Impulsive up price targets to the upside (right-hand scale). They would point to **a further 10 to 20% of outperformance for Emerging Markets vs the MSCI World, probably until late Q2 / mid-year 2018** (the sequences we show on both oscillator series; lower and upper rectangles).

Emerging Markets Commodity Exporters (Brazil, Russia, Chile, South Africa) vs MSCI Emerging Markets
Weekly graph or the perspective over the next 2 to 4 quarters



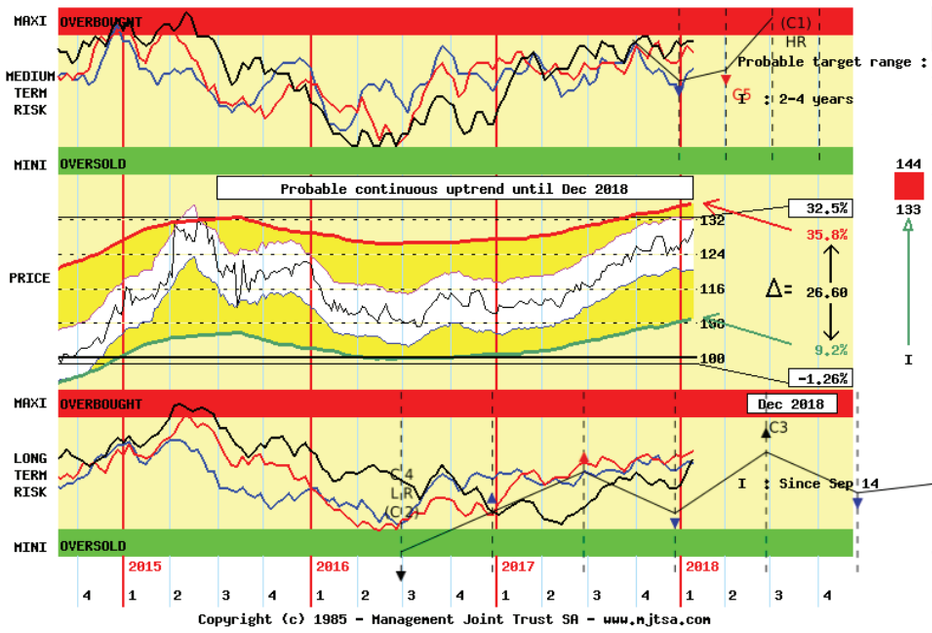
Looking into the different segments of the Emerging Markets space, **we first compare Commodity Exporting Countries to the MSCI Emerging Markets Index. For Commodity Exporters, the basket we are using is an equal weighted one between the market indexes of Brazil, Chile, Russia and South Africa**. Following a strong sell-off in H1 2017, the ratio stabilized in H2 2017, and more recently, since December, has been accelerating up. Our long term oscillators (lower rectangle) suggest that this rise could continue until mid 2018, while on our medium term oscillators (upper rectangle), Commodity Exporting countries may first underperform in Q1, and then outperform again in Q2. Combining both, **we expect a slight consolidation down on the ratio in Q1, before it re-accelerates up towards mid 2018. More generally, this would fit our scenario on commodities.**

Asian Growth Emerging Markets (South Korean, Taiwan, India) vs MSCI Emerging Markets
Weekly graph or the perspective over the next 2 to 4 quarters



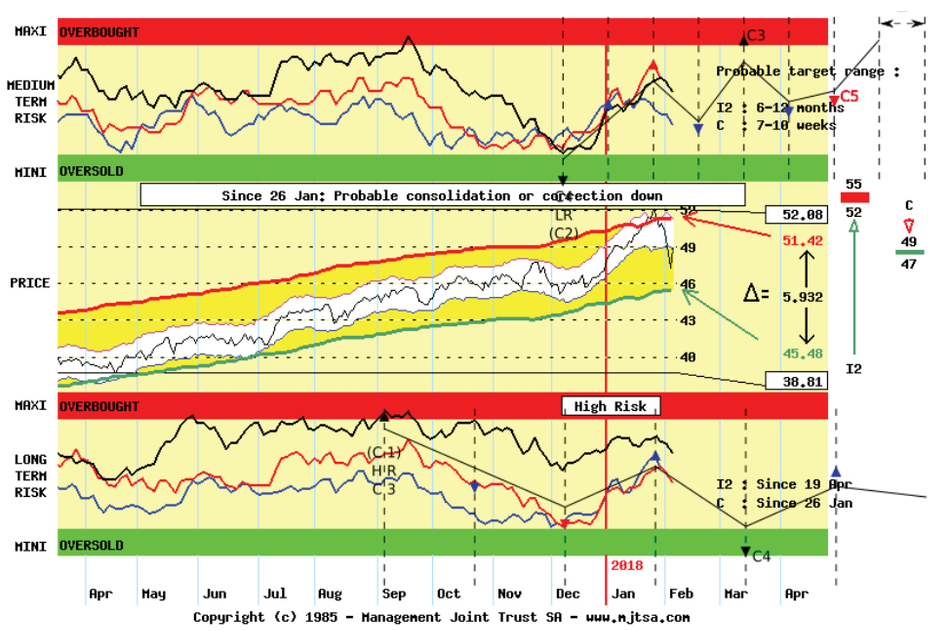
This equal weighted basket of Asia Growth countries contains the equity indexes of South Korea, Taiwan and India. It peaked out vs the MSCI Emerging Markets Index in mid 2017 at the same time Commodities bottomed out. Indeed, these Asian Growth countries are mostly Commodity Importers. The ratio has since been underperforming quite significantly (minus 10%), yet it is now approaching the lower end of our C Corrective targets down (right-hand scale). These levels should offer some support. Indeed, our long term oscillators (lower rectangle) would suggest that a **bounce is possible during Q1. That said, it should be short lived, as our medium term oscillators (upper rectangle) are due to resume down quite aggressively in Q2 2018 (towards mid-year).** Logically, this scenario would fit our scenario on Commodities in reverse.

MSCI China / MSCI Emerging Markets
Weekly graph or the perspective over the next 2 to 4 quarters



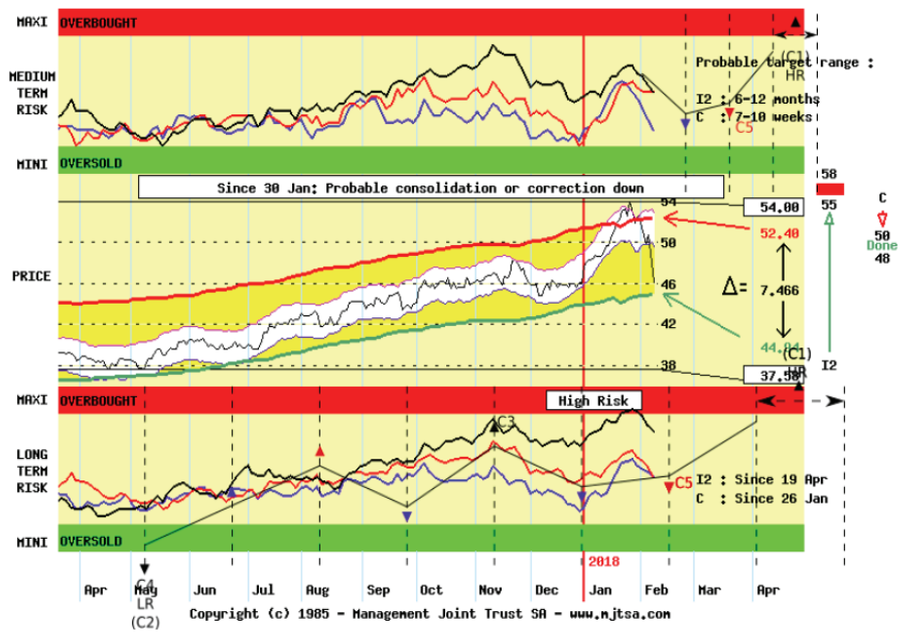
Last, but not least, we look at China, which is the dominant motor behind the current Commodity and Emerging markets boom. It has outperformed other Emerging Markets for both of the last 2 years, and still seems to be accelerating up vs the MSCI Emerging Markets Index. According to both our oscillators series (lower and upper rectangles), **it could outperform other Emerging Markets until mid year, possibly the Summer**. Our medium term oscillators (upper rectangle) may however suggest that, **in the meantime, a slight consolidation may materialise towards late Q1, before it resumes up once more**. Our I Impulsive targets up (right-hand scale) point to **possibly 10 to 15% of Chinese outperformance vs other Emerging Markets until mid year**.

EEM - iShares MSCI Emerging Index Fund
Daily Graph or the perspective over the next 2 to 3 months



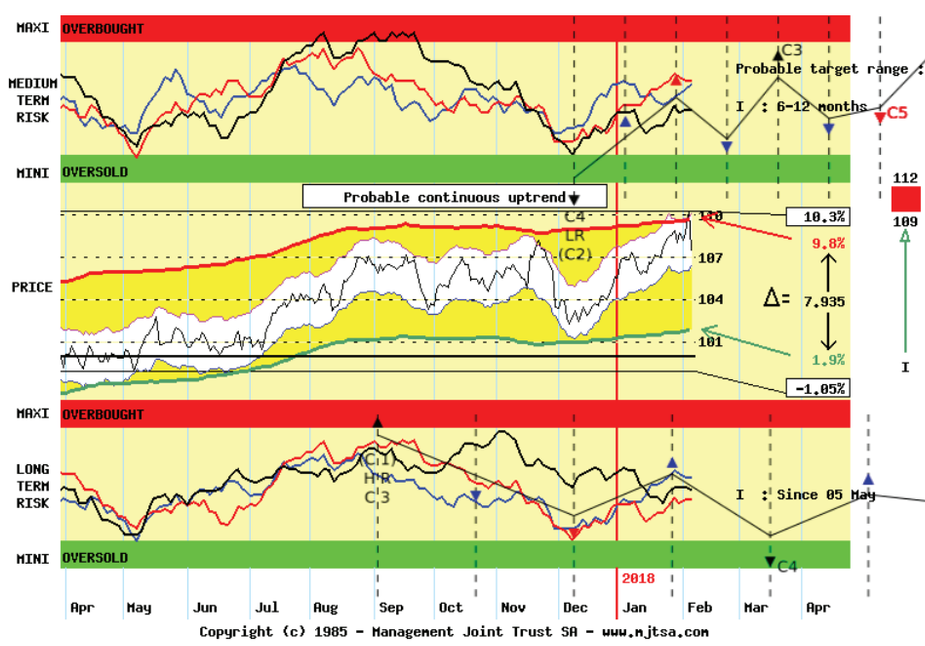
Shorter term, we now consider the EEM iShares Emerging Markets ETF, where our Automatic Messaging detected a "High Risk" situation (lower rectangle) the 1st of February. **Both our oscillators series would now suggest 3 to 6 weeks of downside price action, possibly into late February / early March**. Over the last few days, our C Corrective potential down has been reached in the 49 – 47 range. As with Global equity markets, we expect these levels to hold over the coming weeks (although we are slightly more prudent that on developed markets, given that we expect EMs to underperform during this period). If however, EEM does break below 47, the next levels of support we can calculate are into the 44 -42 range.

FXI - iShares FTSE China 25 Index Fund
Daily Graph or the perspective over the next 2 to 3 months



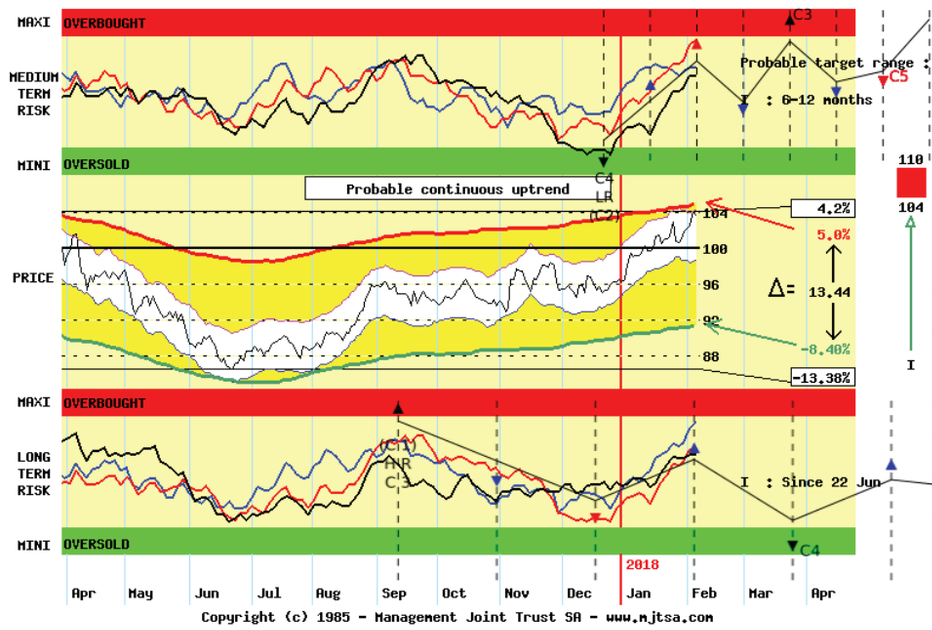
We now focus on China and the FXI iShares Chinese Large Cap ETF. A "High Risk" position was identified on our Automatic messaging on the 1st of February (lower rectangle). **Such situations usually trigger several weeks of consolidation, possibly until late February / March** as shown on our medium term oscillator series (upper and lower rectangles). During the recent sell-off, China was quite resilient and held nicely above the lower end of its C Corrective price targets down between 50 – and 48. **Going forward, we believe these levels will hold** (although we are slightly more prudent that on developed markets, given that we expect EMs to underperform during this period). If however, FXI does break below 48, the next levels of support we can calculate are into the 44-42 range.

MSCI Emerging Markets / MSCI World Index
Daily Graph or the perspective over the next 2 to 3 months



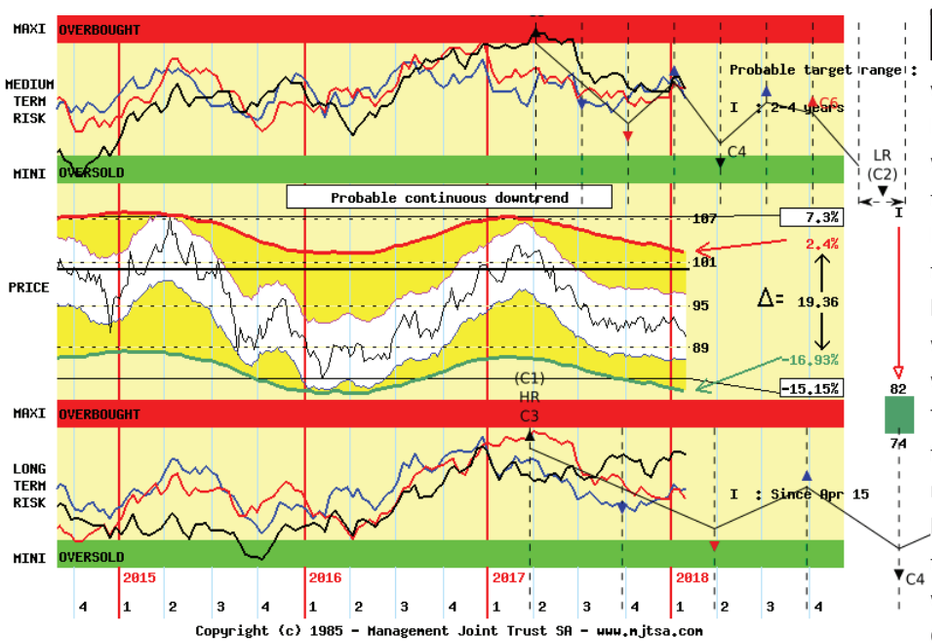
We now compare the Emerging Markets to the MSCI World on a daily basis. Our medium term oscillators (upper rectangle) would suggest that we have reached an intermediate top and than we may expect circa 3 weeks of Emerging markets underperformance. Our longer term oscillators (lower rectangle) would offer a slightly more negative scenario with a correction period (Emerging Markets underperformance) that could last into mid March. Our I Impulsive targets up (right-hand scale) have been pretty much achieved. **When calculating the risk inherent to a potential correction, we would expect 3 to 5% Emerging markets underperformance over the next 3 to 6 weeks** (or minus 0.5 to 0.8 times our historical volatility measure "Delta" at 7.935%; medium rectangle, right-hand side). **Indeed, Emerging markets have resisted better during the recent sell-off, yet the consolidation we expect on Commodities during Q1 should help reverse this trend over the next few weeks.**

MSCI EM Eastern Europe / MSCI Europe
Daily Graph or the perspective over the next 2 to 3 months



We perform the same exercise in Europe by comparing the MSCI Europe Index to the MSCI Emerging Eastern Europe Index. The picture is quite similar as the one above. Again our oscillator series (lower and upper rectangle) would suggest **3 to 6 weeks of Emerging Eastern Europe underperformance. The underperformance potential** we can calculate using our historical volatility measure "Delta" (middle rectangle, right-hand side) **is between 6 and 10%** (minus 0,.5 to 0.8 times "Delta" at 13.44%). Again, it is interesting to note that following its outperformance vs European Markets during the sell-off, Eastern Europe should underperform them during the next few weeks, possibly the result of a consolidation on Commodities, or a rebound in the US Dollar, or both.

EM Currency Basket vs Dollar Index Weighted Components
Weekly graph or the perspective over the next 2 to 4 quarters



Finally, we look at Emerging markets currencies vs developed market ones. In the Emerging basket we have equal weighted the Real, the Rand, the Rubble, the Chilean and Mexican Pesos, the India Rupee, the Won, and the Taiwan Dollar. For the Developed basket we have used the Dollar Index weightings and components. This excludes the US Dollar from the equation, yet it is more the Emerging vs Developed currencies relationship, than the Dollar strength, that we are trying to monitor here. On both oscillator series (lower and upper rectangles), **Emerging Currencies should remain weak vs Developed ones until late Q1. Following that, in Q2, they may bounce, before they resume lower from the Summer into year-end. This comparison fits our scenario on Emerging markets and Commodities quite well.**

Concluding remarks

Emerging markets have had a great run over the last few months, and recently during the sell-off they held up better than developed market. That said, we believe the tide is turning, at least momentarily. We expect them to correct down vs developed markets over the next 3 to 6 weeks, possibly underperforming between 3 and 5% during this period. Following that, from late Q1, Emerging Markets should accelerate up again and outperform developed markets probably until late Q2 / mid year. This is in line with our bullish projections on commodities for Q2. During this later period, China and Commodity related geographies should be the leaders in the Emerging markets space.