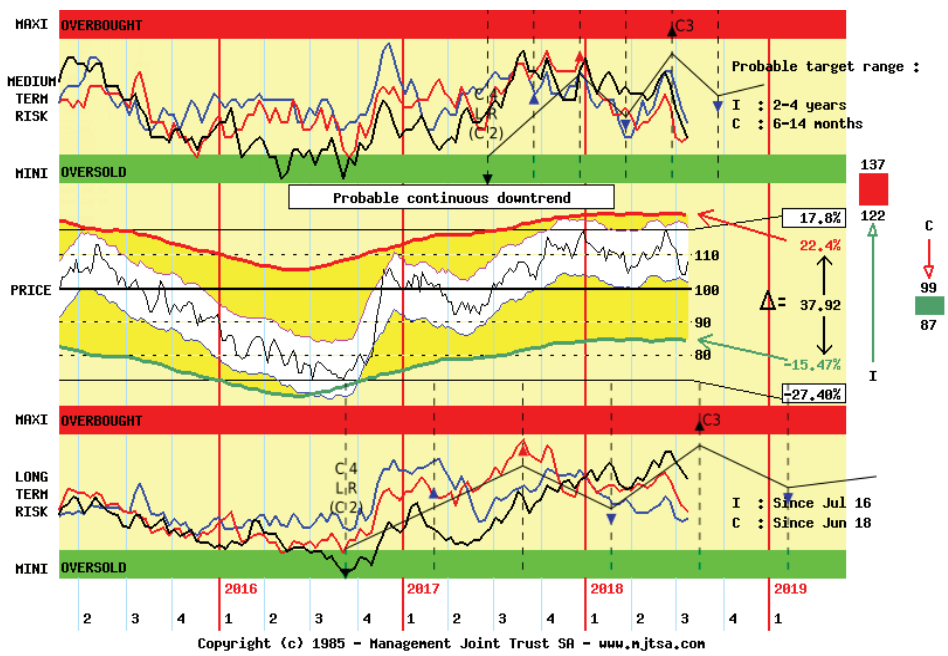
39 / MJT - TIMING AND TACTICAL INSIGHT

The current sell-off in commodities may find some support towards September, yet overall, commodities probably remain under pressure into H1 next year at least.

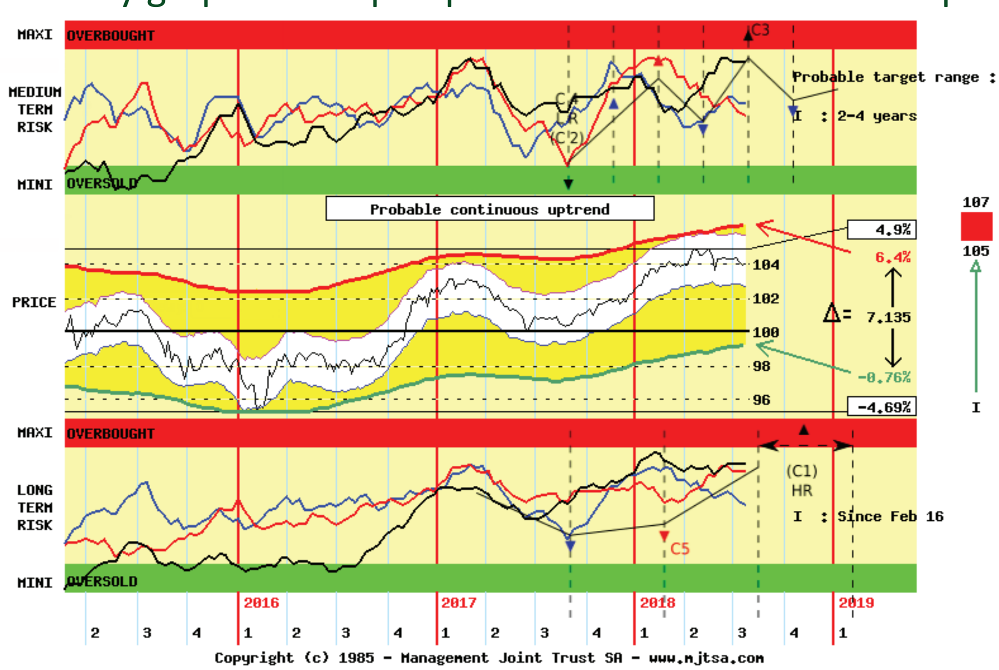
Commodities have accompanied the reflation trade up since 2016. Indeed, the oil rebalancing story helped kick start reflation in 2016, and more generally, since then, commodities have followed its fluctuation (e.g. H1 2017 retracement / H2 2017 re-acceleration). Currently, our cross asset scenario is turning quite defensive. We expect the global economy to start decelerating soon and believe that this deceleration is probably not factored into risk assets prices yet. On average, Commodities are in the high beta corner of the risk assets space and should particularly suffer if the deceleration we anticipate, actually materializes.

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



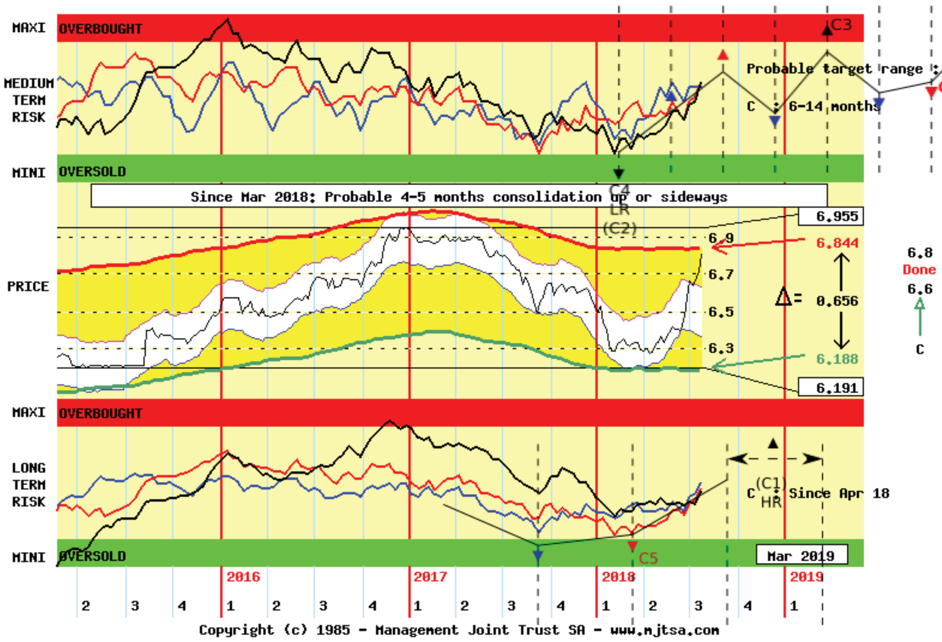
The Copper to Gold ratio has been an important commodity proxy for the reflation trade. Indeed, it benchmarks a pro-cyclical commodity such as Copper against a more Defensive one such as Gold. As shown on our long term oscillator series (lower rectangle), we did expect it to top out towards mid Summer, yet now believe, **that it may have started down earlier, and that an important correction period to the downside is probably already under way**. Our "C" Corrective Price targets to the downside (right-hand scale) suggest **that the ratio could fall between 10 to 20% over the next few quarters**, while our "I" Impulsive targets to the upside (10 to 20% higher) now seem less likely. At best, the risk/reward is neutral. On the market timing front, our medium term oscillators (upper rectangle) would suggest a bounce between September and October, while our long term oscillators (lower rectangle) imply further downside pressure towards late Q4 and early 2019.

TIP - iShares TIPS Bond ETF / IEF - iShares 7-10 Year Treasury Bond ETF
Weekly graph or the perspective over the next 2 to 4 quarters



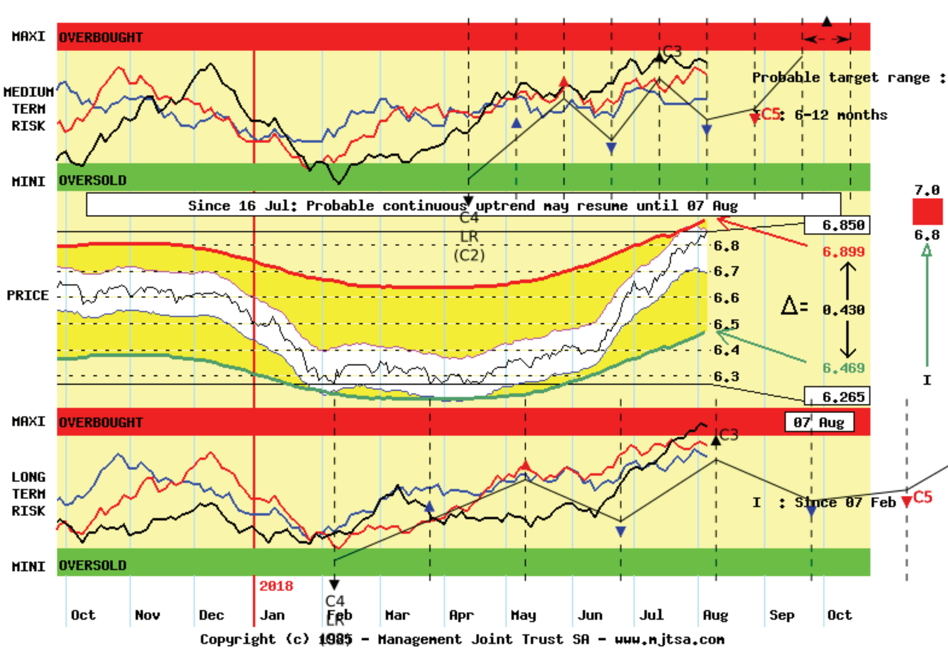
Rising inflation expectations have also accompanied the reflation trade higher since 2016. In this graph, we consider their market proxy by comparing the price of TIPs with the price of Treasuries of similar duration. When the ratio rises, investors are buying more Inflation Protected Government Bonds vs Treasuries. It implies that they probably believe that the inflation expectations currently priced into Treasuries are not high enough (and vis-versa, when the ratio declines). According to both our oscillator series (lower and upper rectangles), **the ratio should be approaching an important intermediate top, probably between now and the Fall**. On the target front, our I Impulsive targets to the upside (right-hand scale) may suggest 1-3% of additional upside potential. Yet, this is smaller than the C Corrective targets to the downside we can calculate, somewhere between 4 and 5% **(negative risk/reward over the next few quarters).**

Yuan Renminbi per U.S. Dollar (USD/CNY)
Weekly graph or the perspective over the next 2 to 4 quarters



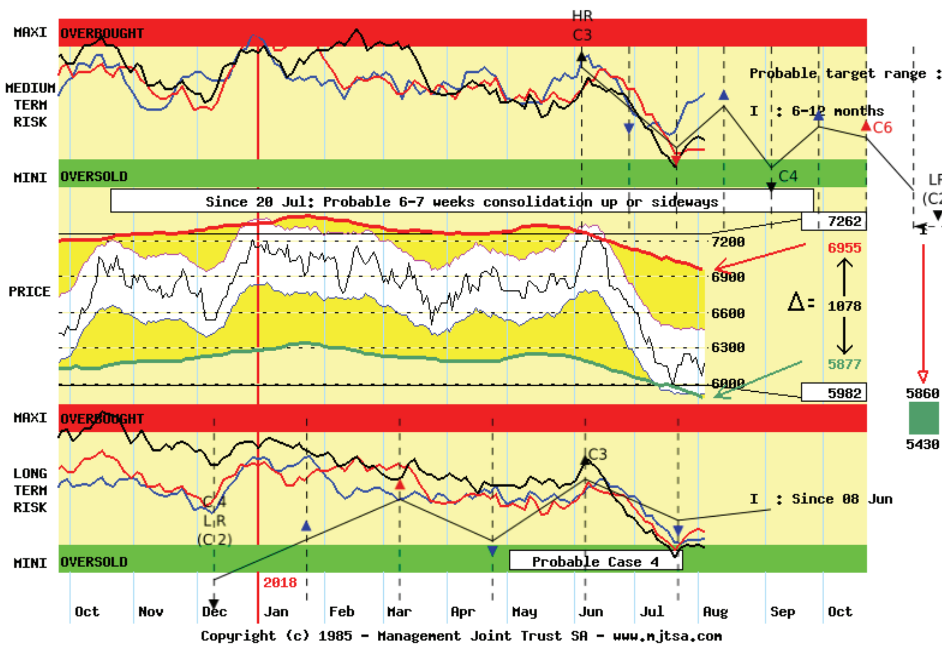
As we had projected in May, the People's Bank of China did let the Yuan weaken quite substantially over the last couple of months. At the time, we expected it to do so to counter a deceleration in its economy as the effects of the 2015 and 2016 increase in Total social Financing were starting to run off. We expected it to use the Trade War as an excuse to do so. Considering both our oscillators series (lower and upper rectangles), we believe this strong USD/CNY move will not be reversed. It may pause slightly between late Q3 and Q4, but in general, we expect the Yuan to remain under pressure vs the US Dollar into next year (upper rectangle). **While, a devaluation of the Yuan may be beneficial for the Chinese economy in the future, for now, the market is focusing on the causes of this devaluation rather than its potential impact. Indeed, despite a slight bounce during July, Chinese equity markets are still very much under pressure, along with Commodities, and we believe both should continue lower into September. They may then bounce towards October and perhaps November before their negative trends resume further, probably as USD/CNY rises again until Spring next year at least.**

Yuan Renminbi per U.S. Dollar (USD/CNY)
Daily graph or the perspective over the next 2 to 3 months



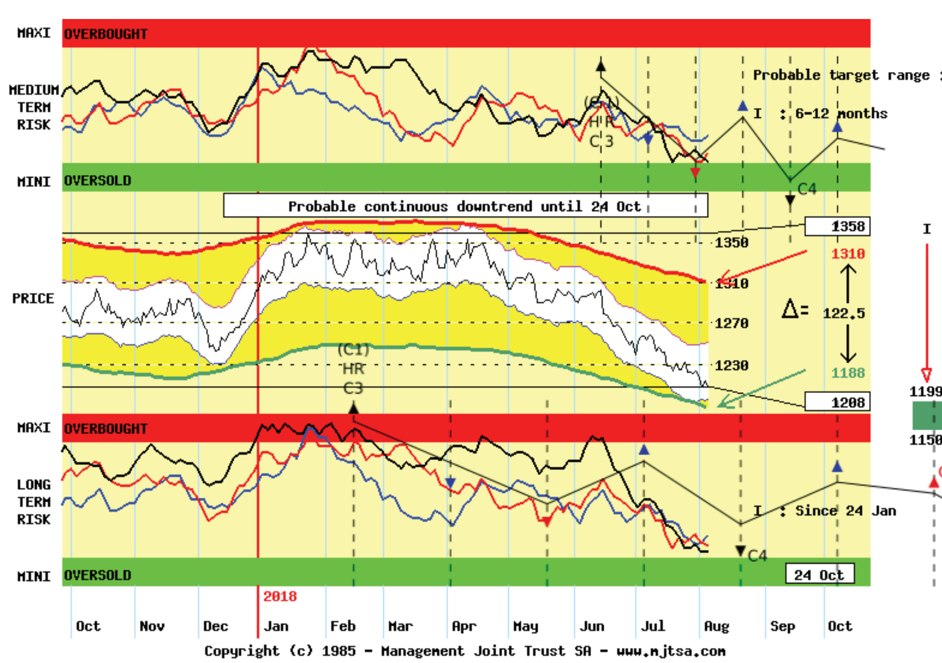
Shorter term, the USD/CNY exchange rate has reached the lower end of our I Impulsive targets to the upside (6.8; right-hans scale). As such, it has probably achieved more than 80% of its upside potential for now (i.e. in this initial leg up) and any further increase will probably reach exhaustion around the 7.0 mark (the upper end of our I Impulsive targets to the upside). On the timing front, our long term oscillators (lower rectangle) would suggest that a top is neigh, yet the model we show on our medium oscillators (upper rectangle) seems to be a better fit for the price pattern. **We would hence expect USD/CNY to continue slightly higher, probably into mid/late September.**

Copper Spot (LME, USD/ton)
Daily graph or the perpsective over the next 2 to 3 months



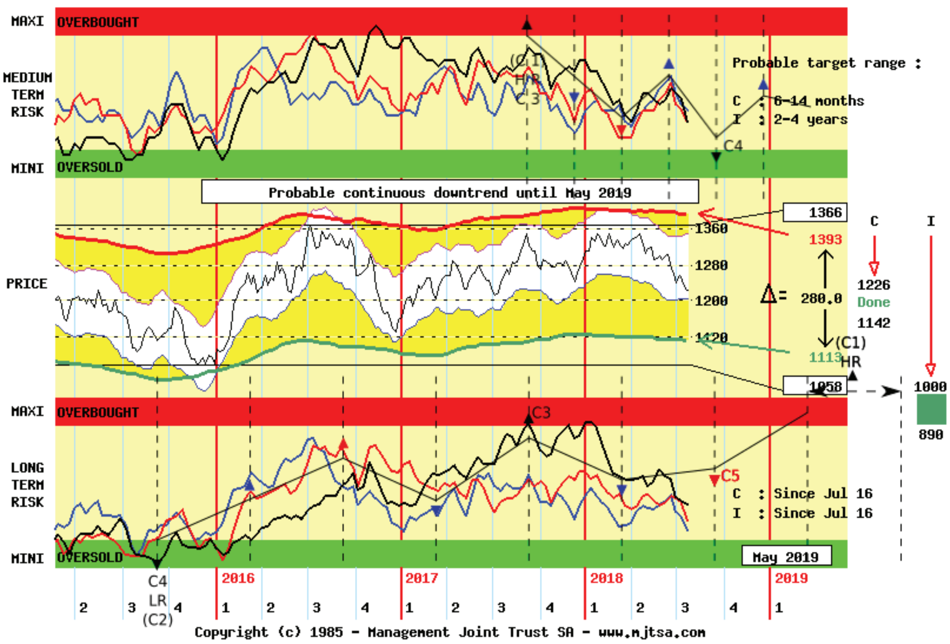
Interestingly, as the PBoC let its currency devaluate, most Commodity prices did not compensate, but rather followed the Yuan lower (rising USD/CNY). This highlights China's current dominance on the demand side of the commodities and especially the industrial metals markets. Hence, we believe that going forward, Copper should continue to follow the Yuan lower. While both our oscillator series (lower and upper rectangles) made an intermediate low in July. We now expect **Copper to resume lower again during August, probably into early / mid September** (upper rectangle). This timing would pretty much fit our timing for a top on USD/CNY (towards mid/late September). On the target front (right-hand scale), our I Impulsive targets to the downside are suggesting that **Copper could lose another 7 to 13% over the next month or so.**

Gold Spot (USD/oz)
Daily graph or the perspective over the next 2 to 3 months



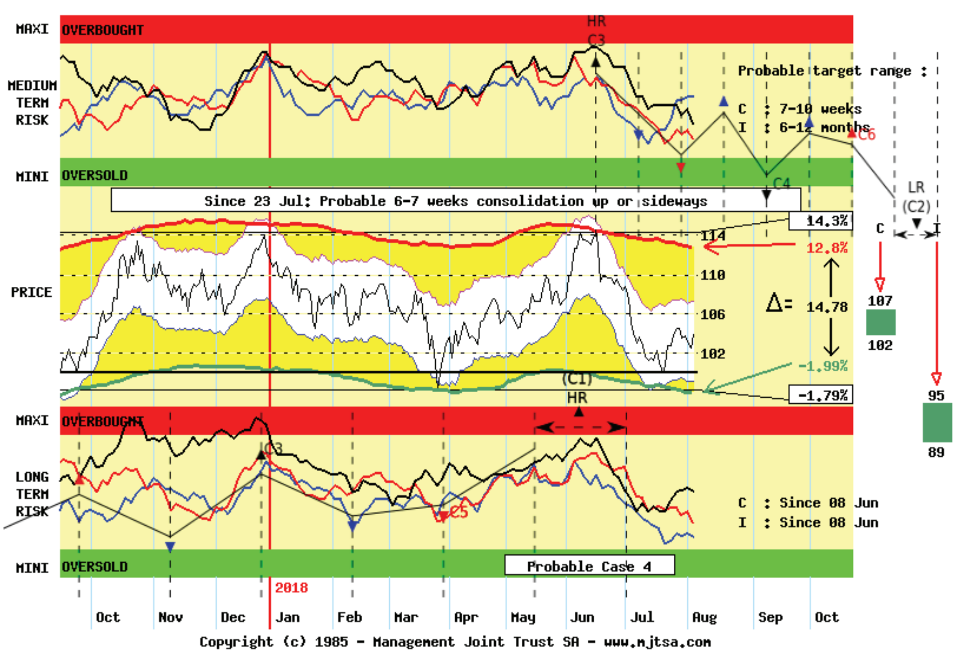
Gold has also been suffering lately, and its recent sell-off also matches the recent sell-off in the Yuan (rising USD/CNY). While our long term oscillators (lower rectangle) are suggesting that the move could continue lower into late August, our medium term oscillators (upper rectangle) would imply that **it continues down into early/mid September (similar to Copper). We will hence remain prudent until then**. Furthermore, our I Impulsive targets to the downside (right-hand scale) are suggesting **further downside potential towards the 1'199 – 1'150 range until then.**

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



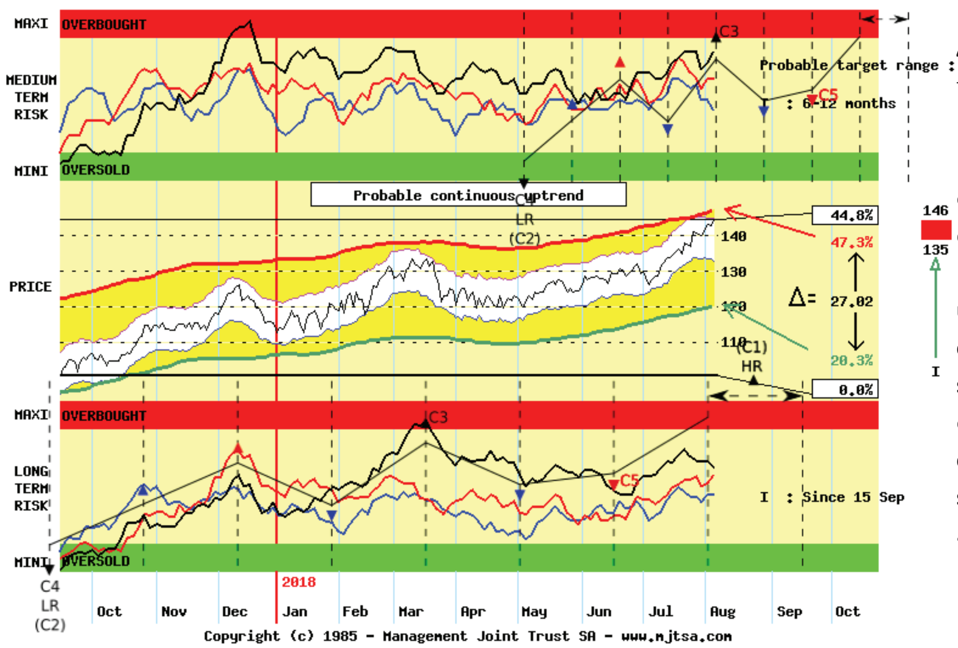
Long term, on both oscillator series (lower and upper rectangles), we are also expecting a low point on Gold towards late Q3. The bounce that follows may lead Gold back up towards year-end (upper rectangle) and then possibly higher well into next year (lower rectangle). Our **upside targets** (not shown here anymore given the recent sell-off) **are still above 1'500 USD/oz towards mid/late 2019. In the meantime, however, Gold will first need to hold above the support of its C Corrective targets to the downside, or above circa 1'142** (right-hand scale). Indeed, if these 1'150-40 levels break, the I Impulsive potential to the downside could be below 1'000 USD/oz.

Copper Spot (LME, USD/ton) / Gold Spot (USD/oz)
Daily graph or the perspective over the next 2 to 3 months



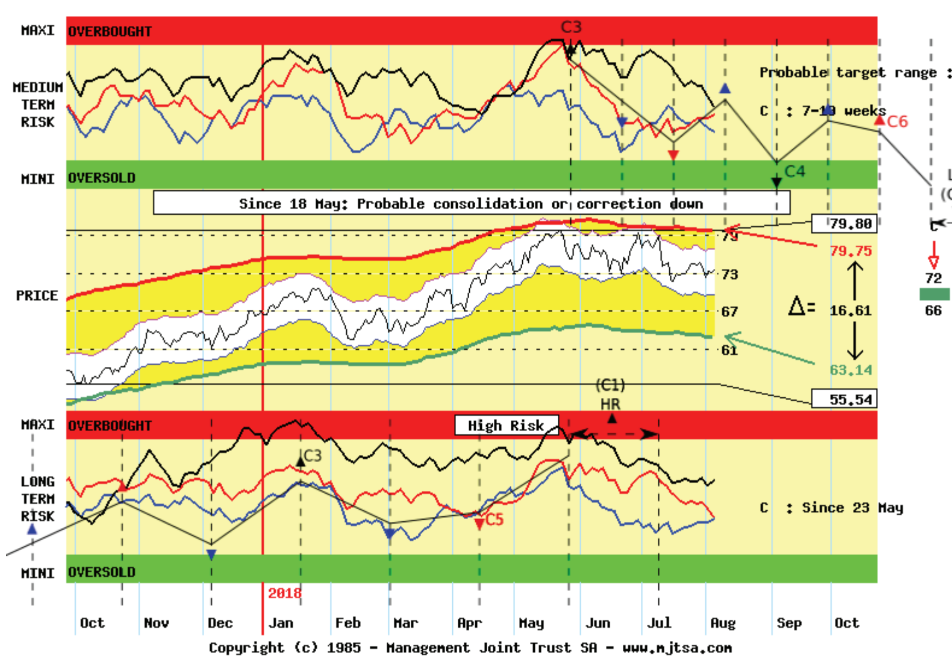
We now move back to the Copper to Gold ratio mentioned above and now consider its Daily graph. According to the model we show on our long term oscillators (lower rectangle), the ratio did indeed make an important "High Risk" top in June. Such configurations could easily justify a sell-off that could last 2 to 3 months. We hence believe that **the mid July low is probably only an intermediate one, and that the ratio will probably resume lower during August towards early/mid September** (as shown on our medium term oscillators; right-hand scale). On the targets front, the support of our C Corrective targets to the downside (right-hand scale) has been broken, and **the ratio could continue to Fall towards our I Impulsive targets to the downside, 10 to 15% lower than today.**

S&P 500 / HUI - Gold Bugs Index (NYSE Arca)
Daily graph or the perspective over the next 2 to 3 months



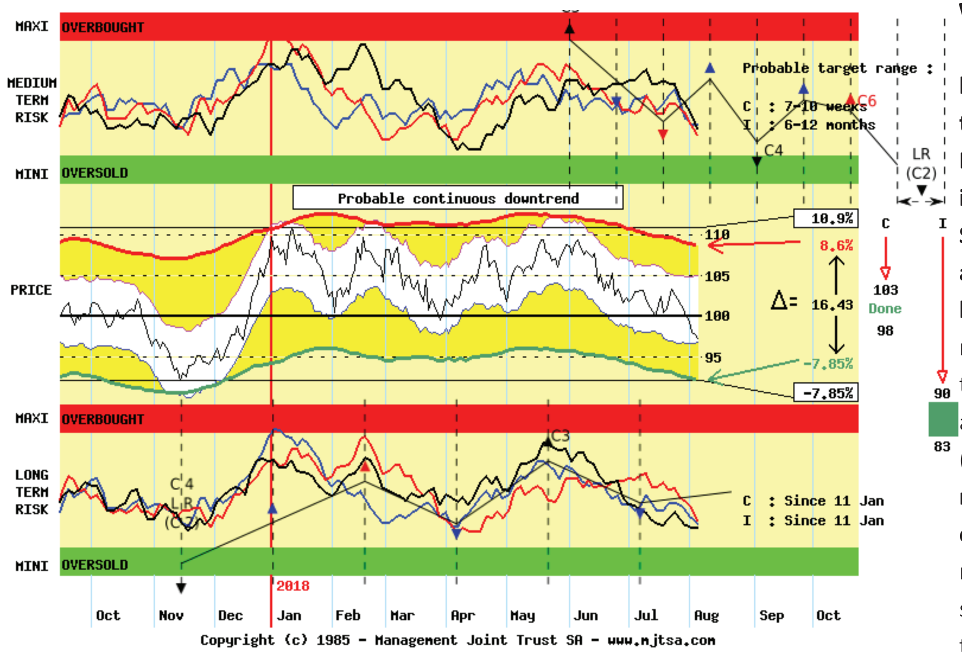
Another ratio, which we believe is quite interesting at the moment, is the comparison between the S&P500 and the HUI Gold Bug Index. While sell-offs in the market don't always correspond the sell-offs in the ratio (as in early February), **usually, sell-offs in the ratio do coincide with equity markets sell-off**. According to both our oscillator series **such an event could be happening quite soon.** Our long term oscillators are in a "High Risk" position (lower rectangle), while our medium term oscillators (upper rectangle), would suggest some consolidation into late August, at least. At the same time, our I Impulsive targets to the upside are exhausted and labelled "Done" (right-hand scale). **A sell-off in the S&P500/HUI would probably confirm a wider sell-off in the risk asset space. Industrial metals and Copper are very pro-cyclical and would be first in line to experience further drops in prices.**

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



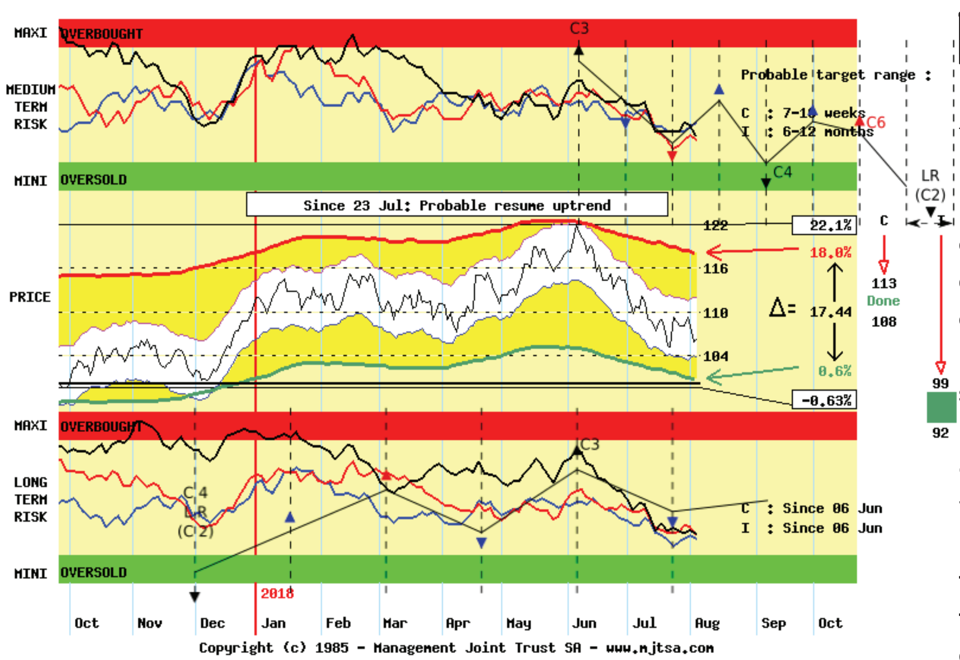
We now turn to Oil **(Brent), which up to now has resisted better than Copper and Industrial Metals**. Yet, it also reached a High Risk position on our long term oscillators during May/June (lower rectangle), and **we now expect it to move lower, probably from early August into early September** (upper rectangle). This corroborates our views in the last 2 editions of The Capital Observer, where we expected Oil to reach an important top at some time between midyear and mid Summer. The consolidation period we expect could last between 3 and 5 quarters (or well into 2019). On the target front, our I Impulsive targets to the upside (right-hand scale) have pretty much been achieved, while our C Corrective targets to the downside would suggest **initial support around 66 USD/barrel**. Below these, I Impulsive targets to the downside would calculate between 50 and 60 USD/barrel.

XME - SPDR S&P Metals & Mining ETF / S&P 500
Daily graph or the perspective over the next 2 to 3 months



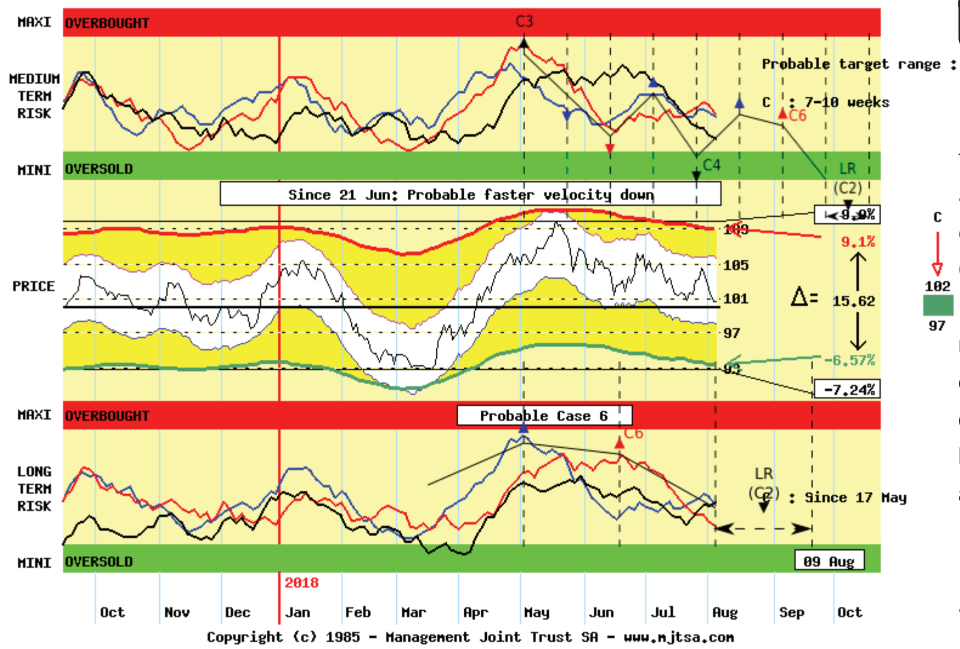
We now compare the various commodity related sectors vs their respective markets, in the US and in Europe. **US Metals & Mining is very pro-cyclical and vs the S&P500, it probably reached an important top between late May and early June** (lower rectangle). It has now started to correct lower, and following a weak bounce since mid July (upper rectangle), **should soon resume lower, probably until early September at least**. The ratio has recently broken the support of our C Corrective targets to the downside (right-hand scale). This opens the door to further underperformance, possibly 7 to 15% below current levels. **The risk/reward for US Metals & Mining vs the market is hence quite negative over the next few months.**

European Basic Resources Sector (STOXX) / Dow Jones STOXX Europe 600
Daily graph or the perspective over the next 2 to 3 months



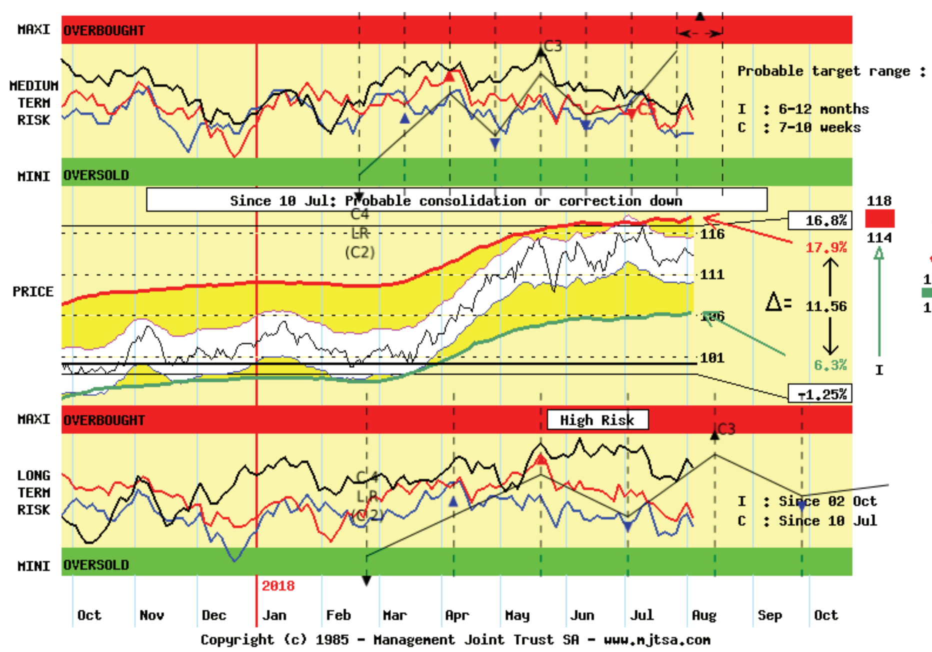
European Basic Resources also topped out vs the market in early June (lower rectangle), and it has since been underperforming. **It has also broken below the support of our C Corrective targets to the downside** (right-hand scale), **opening the door to our much lower I Impulsive target down, some 7 to 15% below current levels.** Our medium term oscillators (upper rectangle), would suggest that the current bounce dies out soon and then **the sector resumes lower vs the market, probably until early September.**

XLE - Energy Select Sector SPDR Fund / S&P 500 Index
Daily graph or the perspective over the next 2 to 3 months



US Energy has resisted slightly better vs the market since May. Yet, our long term oscillators (lower rectangle) would suggest that we are now in a downtrend, and that this downtrend could continue well into September. Our medium oscillators (upper rectangle) would **imply that the recent bounce has probably died out, and that US Energy now underperforms vs the market probably until mid/late September at least**. On the target front (right-hand scale), the move lower since May, is for now still labelled only as a correction.

European Energy sector (STOXX) / Dow Jones STOXX Europe 600
Daily graph or the perspective over the next 2 to 3 months



Interestingly, European Energy has been stronger vs the market than the US Energy sector. For now, it is still holding on to an uptrend. Yet, according to both our oscillator series (lower and upper rectangles), the sector should reach an important top vs the market over the next couple of weeks. Risk/Reward is also stretched given that our I impulsive targets to the upside have already been reached in early July. Hence, **from mid August at the latest, we expect European Energy to start to underperform, probably towards mid/late September** and towards the support of our C Corrective targets to the downside some 3 to 7% below current levels.

Concluding remarks

The reflationary trend since 2016 in the commodity space probably reached exhaustion this Spring, and we believe it has now started to reverse. Many of these trades, and Industrial metals in particular, had been strongly correlated since 2016 with stronger Chinese growth momentum. That said, this trend may also be reversing as the effects of strong fiscal stimulus in 2015 and 2016 are gradually fading, and the reality of the current US vs China trade war settles in. The current Yuan devaluation is symptomatic of this deterioration, yet it is really its underlying causes that are concerning. These are leading Chinese Equities and Industrial Metals to sell-off. Following an intermediate low in mid July and a weak bounce since then, we expect Industrial Commodity trends (Oil, Copper, Industrial Metals and related sectors) to weaken again probably from early/mid August, until early and perhaps even mid/late September. Following that, we would expect a late September, October bounce, before these Industrial Commodities resume lower from November into next year. Gold on the other hand may bottom during September and start accelerating up as markets gradually enter a more risk-off environment from early/ mid Q4 into next year.