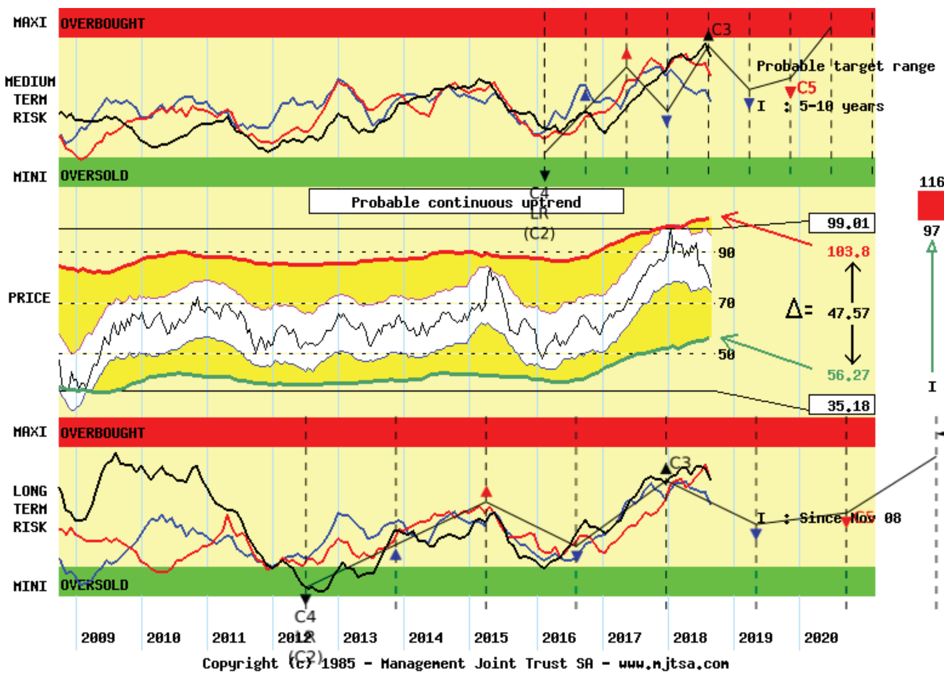
A Chinese hard landing is an increasing probability

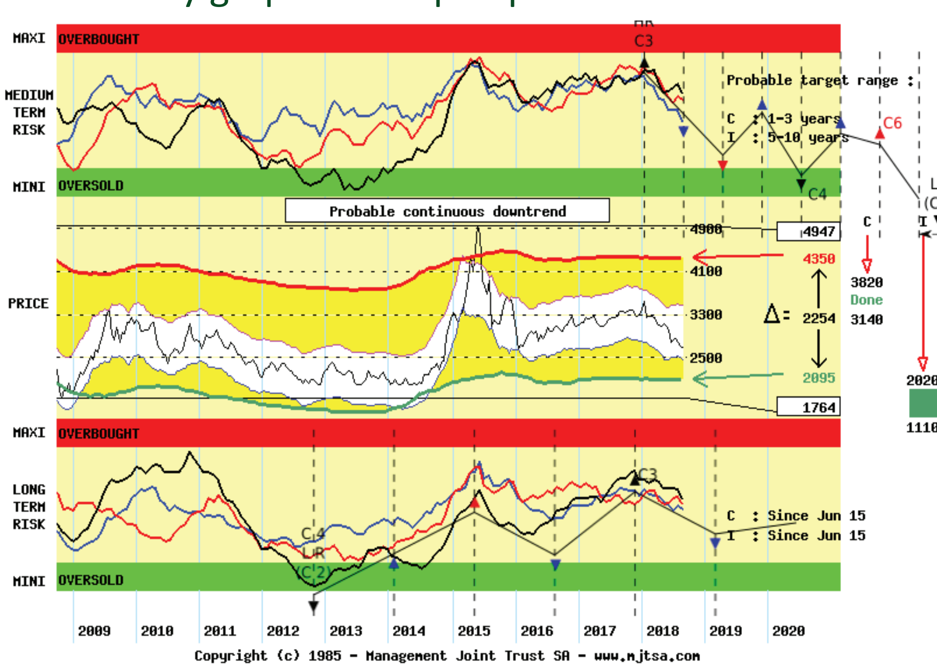
When an economy increasingly leverages to meet growth targets, at some point it will hit a rock. This may currently be happening to the Chinese economy. Since January, Chinese stock markets are down circa 25%. Can they really stabilize or will be the current liquidation continue? What happens to related trades such as Industrial Metals?

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



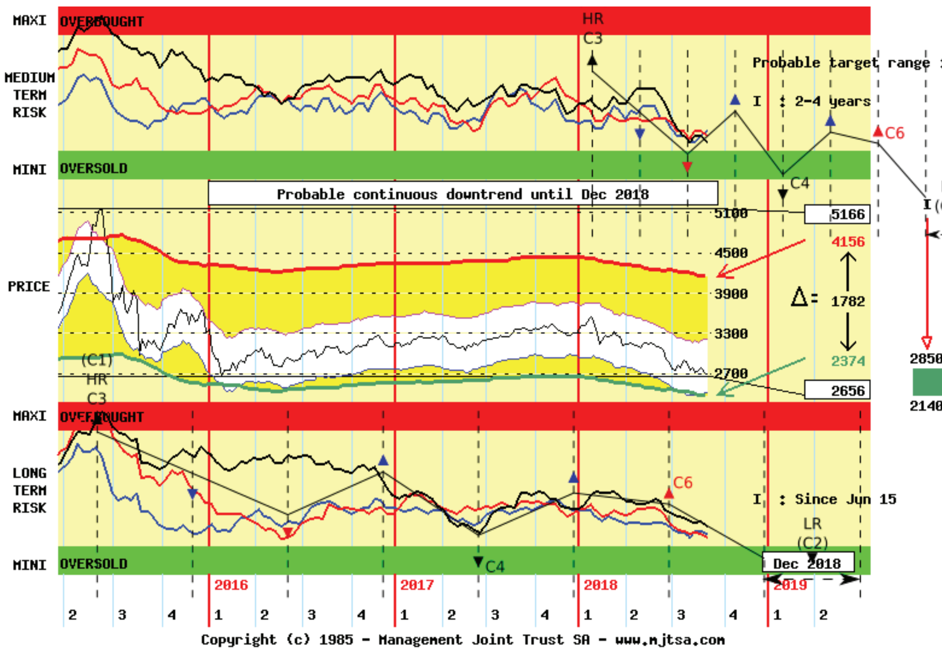
During the 2016 -2017 reflationary boom, the MSCI China Index doubled in price. This uptrend first started with a rebalancing of Commodity markets in 2016, and then accelerate up further with Growth themes such as the so called BATs stocks (Baidu, Alibaba, Tencent). Since January, the trend has started to reverse, and the correction down since then, at circa minus 25%, is quite substantial. Is there a bottom fishing opportunity here or will the sell-off continue? The sequences we show on both our oscillators series (lower and upper rectangles) suggest that **we are rather late in the cycle and that important tops were probably between early this year (**lower rectangle) and this Spring (upper rectangle). Our I Impulsive targets had be reached, not fully though (right-hand scale), yet the **C Corrective targets to the downside we can calculate indicate that initial support may be as low as the 61 levels** (0.8 times our historical volatility measure “Delta” – here at 47.57; middle rectangle, right-hand side – subtracted from the highest point of the graph, here at 99.01), **which is another 20% lower than today.** Our belief is that it is currently much too early to venture back into the Chinese market.

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



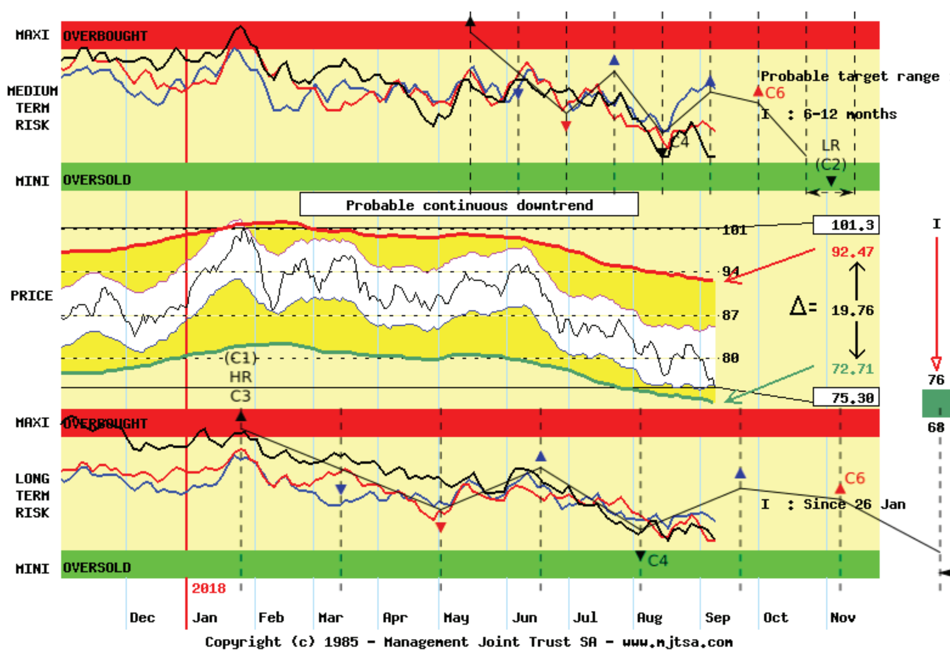
The configuration on China’s domestic markets in much more alarming. The 2016 – 2017 reflationary bounce still looks rather weak in comparison to the 2015 Bubble and subsequent Burst. We believe the trend is now resuming lower and that it has broken back down again below the support of our C Corrective targets to the downside (below 30140; right hand scale). Our I Impulsive targets to the downside now suggest that **it could reach below the 2’000 mark over the couple of years, probably even substantially below that.** Both our oscillator series (lower and upper rectangles) suggest that **the current sell-off could first last into Spring next year. Then following a bounce, it probably continues lower into 2020.**

Shanghai Composite Index
Weekly graph or the perspective over the next 2 to 4 quarters



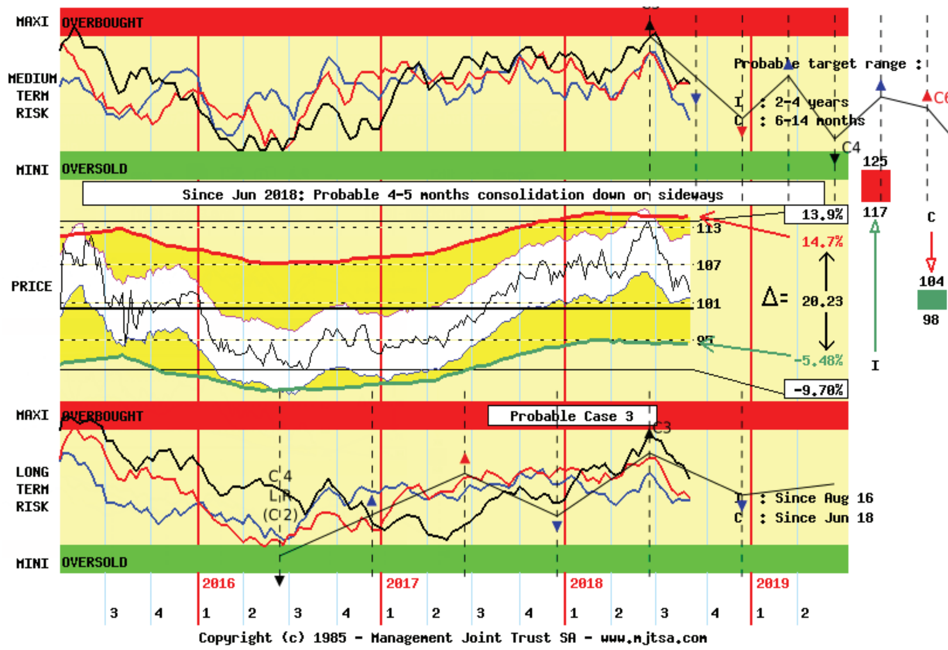
The Weekly graph is not much more reassuring. Both our oscillators series (lower and upper rectangles) are suggesting **that the current sell-off continues until early next year at least**. Our I Impulsive targets to the downside suggest that prices could reach as low as 2'140 until then (right-hand scale). This is **another 20% lower than today and hence the sell-off since January may only be half way through.**

MSCI China
Daily graph or the perspective over the next 2 to 3 months



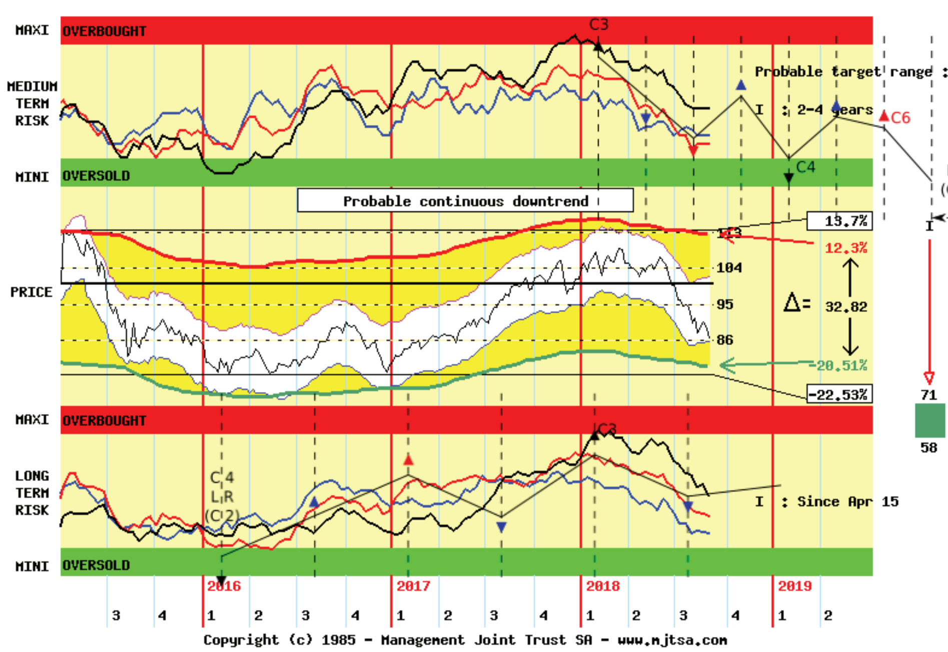
Focusing back on the MSCI China Index, and its shorter term Daily graph, we can notice that the intermediate bottom, which was identified mid August on both our oscillators series (lower and upper rectangles) is having trouble holding. Over the next couple of weeks, it may hold up and bounce, yet **the downtrend is still very much prevalent. We expect it to return in force, probably from late September into November and then probably towards early next year. Our I Impulsive targets to the downside (right-hand scale) would suggest 10% more downside potential for the MSCI China over the next 2 to 3 months.**

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



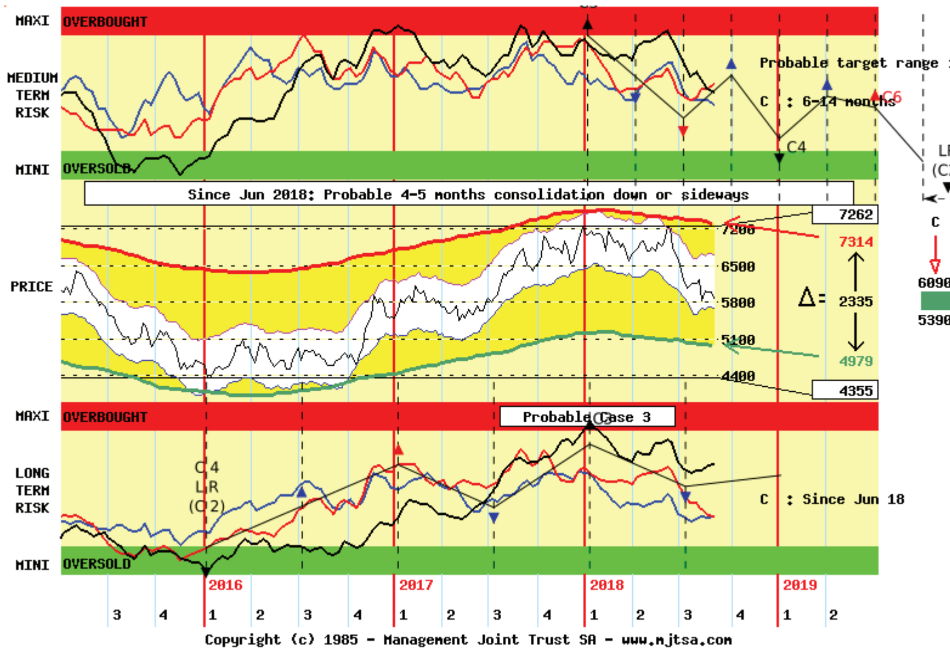
On a relative basis, the MSCI China topped out in June vs other Emerging markets. Up to then, it had been a rather defensive play in the Emerging Markets space. The reversal coincided with the acceleration of the Yuan's devaluation. Since then, **China seems to be leading the way in the current Emerging Markets sell-off.** Both our oscillator series (lower and upper rectangles) suggest that **it will probably continue to underperform until at least year-end, and then perhaps again into the Spring.** The ratio is approaching our C Corrective targets to the downside (right-hand scale) and may find some support 4 to 5% below current levels, yet if these again fail to hold, the next relative performance support levels are 15 to 25% below current levels.

MSCI China vs the MSCI World
Weekly graph or the perspective over the next 2 to 4 quarters



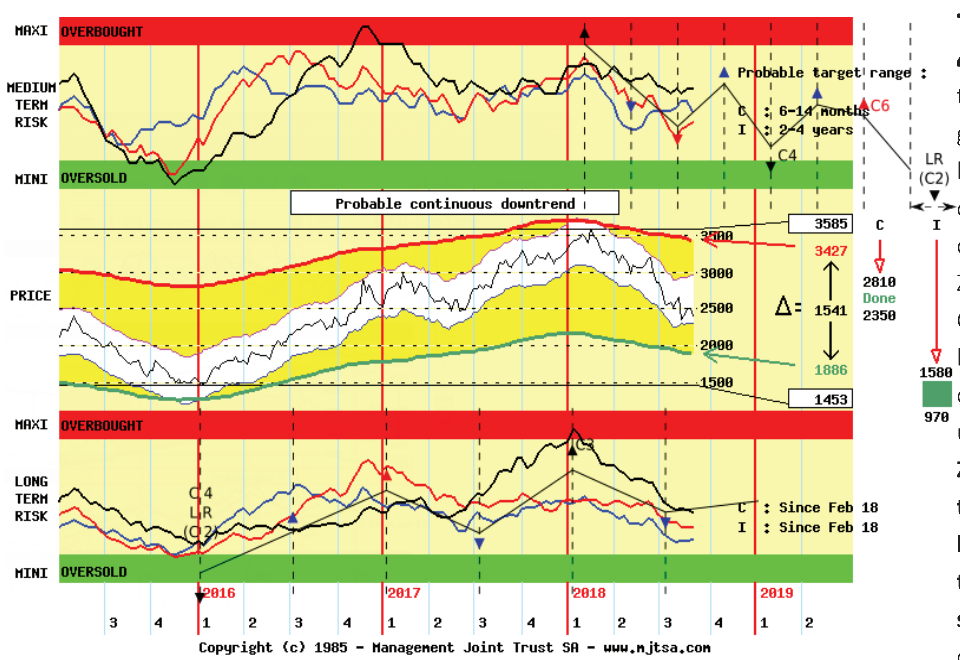
Against the MSCI World Index, the MSCI China Index is already in I Impulsive territory to the downside (right-hand scale). These targets are pointing to 20 to 30% of further under-performance over the next few quarters. Both our oscillators series (lower and upper rectangles) suggest than an intermediate low would have theoretically been made mid August. Yet, for now, it hasn't triggered much reaction. **More and more the move down since Q1 is looking like a orderly liquidation. It will probably continue relatively unscathed until early next year.**

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



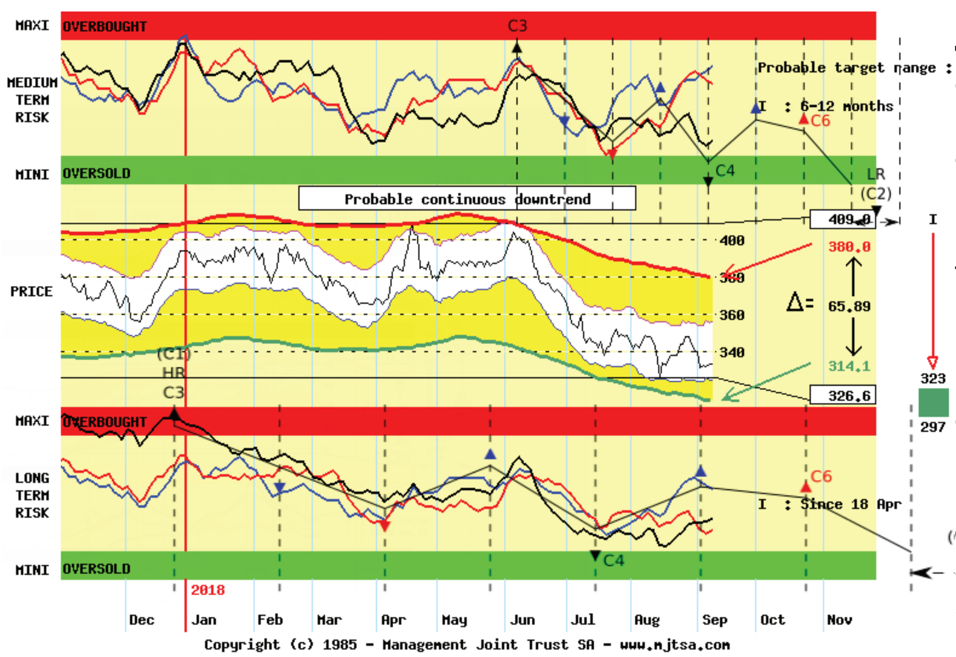
The price of Copper is very much linked to Chinese demand and the correlation of its price to the Chinese stock market is quite strong. Our long term oscillators (lower rectangle) suggest that it topped out in January, ending its strong uptrend since the reflation trade started in 2016. Our medium term oscillators (upper rectangle) now suggest that **the current leg down probably continues into year-end at least. Our C corrective targets to the downside (right-hand scale) suggest initial support towards 5'400. Below this level, the next targets to the downside we cn calculate are towards the 4'200 – 3'300 range.**

Zinc Spot (LME, USD/ton)
Weekly graph or the perspective over the next 2 to 4 quarters



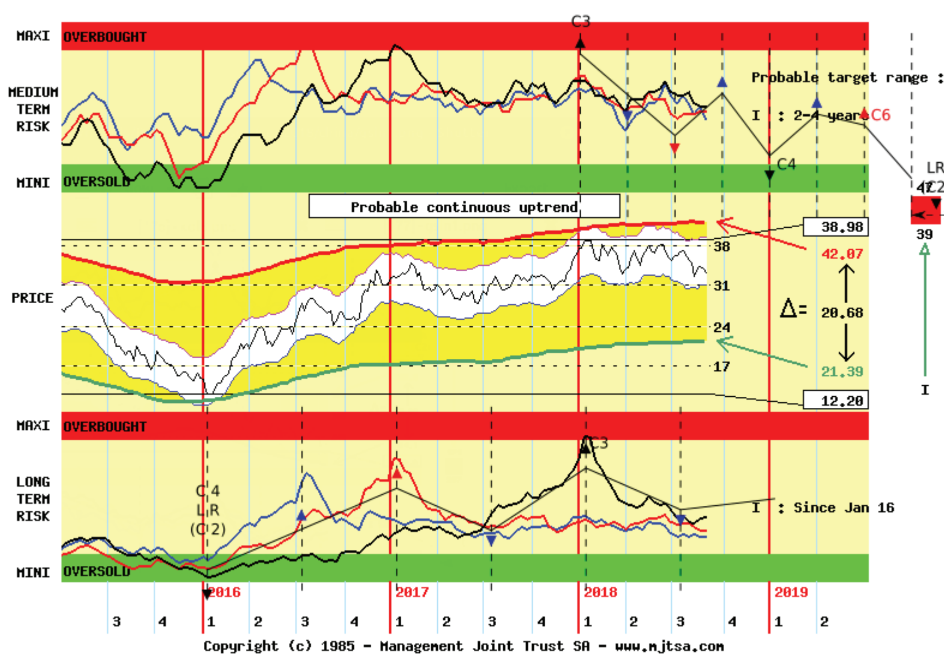
Zinc is similar to Copper and by and large, most industrial metals are also. Its Weekly graph is interesting here as it has already broken through our C Corrective targets to the downside (right-hand scale). Zinc is also more volatile than Copper, and in this case, it is leading the way down. Both our oscillators series (lower and upper rectangles) suggest that **Zinc will probably continue to sell-off until early 2019 at least, and then perhaps again towards late 2019. The downside risk is quite compelling** as our I impulsive targets to the downside (right-hand scale) are suggesting it could drop towards the 1'590 – 970 range over the next few quarters. This is **another 40 to 60% below current levels.**

Goldman Sachs Industrial Metals Index
Daily graph or the perspective over the next 2 to 3 months



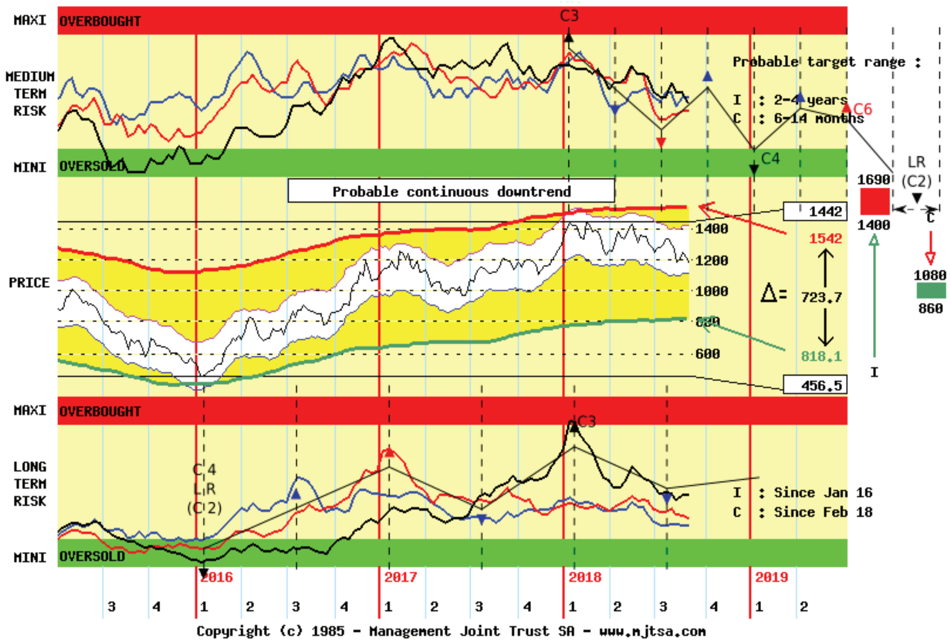
Shorter term, following their strong June to August sell-off, Industrial metals may be making intermediate lows on our medium term oscillators (upper rectangle). However, **by late September, we expect them to resume lower probably into late November / December**. Our long term oscillators (lower rectangle) would confirm that the trend resumes lower at the latest during October. I Impulsive **targets to the downside** (right-hand) point to a price target zone towards the 323 – 297 range, i.e. **a further 10% below current levels over the next couple of months.**

XME - SPDR S&P Metals & Mining ETF
Weekly graph or the perspective over the next 2 to 4 quarters



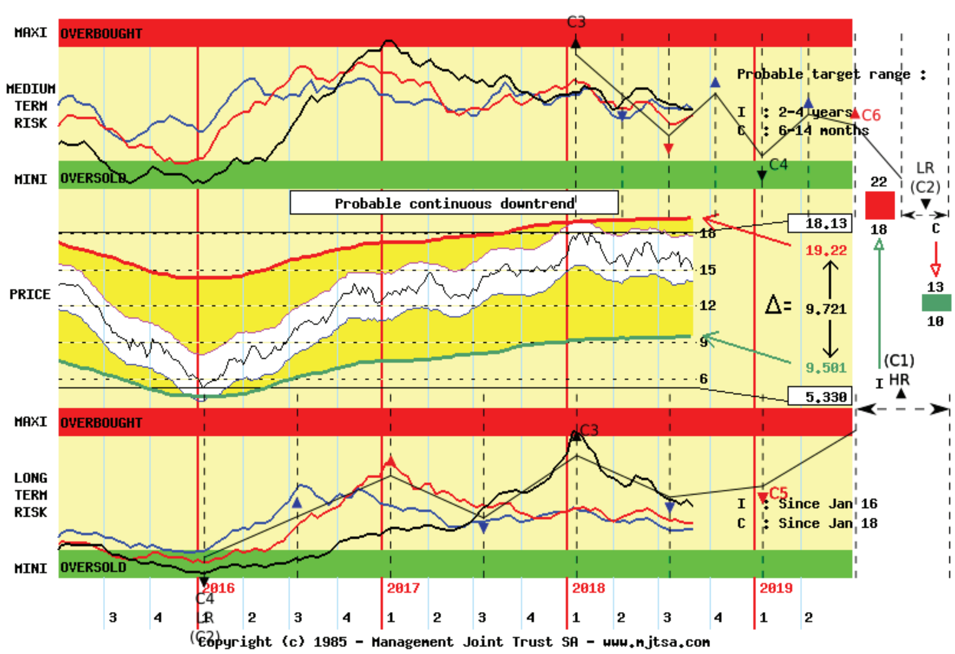
Related sectors in the US are also starting to reverse. The US Diversified Mining sector, for example, topped out in January on our long term oscillators (lower rectangle) and has started to reverse. Our medium term oscillators (upper rectangle) suggest **that it may now continue lower, probably from end Q3 into year-end. Following that, a further downtrend sequence could materialise until end 2019.** Our I impulsive targets to the upside (right-hand scale) have been pretty much achieved. Given the scenario we are considering, we don't think they will be retested. **The initial C Corrective targets to the downside (right-hand scale) we can calculate would suggest support towards the 28.5 – 22.5 range** (0.5 to 0.8 times our historical volatility measure "Delta" – here at 20.68; middle rectangle, right-hand side- subtracted from the highest point of the graph, here at 38.98). **That is circa 15 to 30% below current levels**. Beyond that, our next level of targets would suggest a full retracement of the 2016-2017 reflationary move.

STEEL – Steel Sector Index (NYSE Arca)
Weekly graph or the perspective oevr the next 2 to 4 quarters



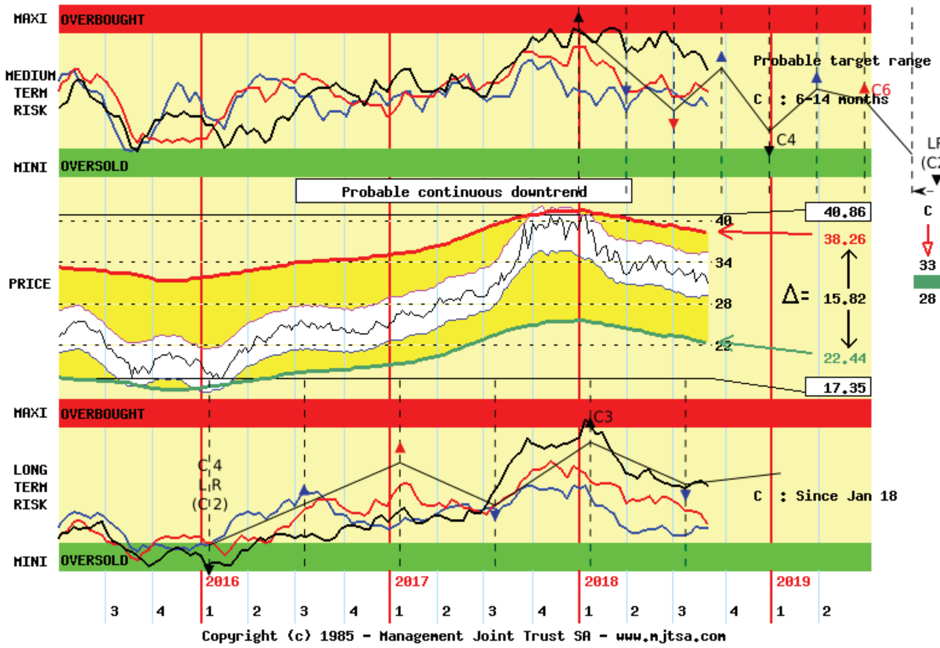
Other related US sectors are slightly more advanced. For example, steel producing companies made a top in January on our long term oscillators (lower rectangle) and have probably topped out for this cycle, while the sequence we show on our medium term oscillators (upper rectangle) is already descending. **We expect it to resume lower from late Q3 into year-end, and then perhaps once again into late 2019. Initial support will be found towards the lower end of our C Corrective targets to the downside (right-hand scale) around 860. This is already almost 30% below current levels**. Beyond that, if/once these levels are broken, US Steel companies may retrace all of their 2016-2017 reflationary gains.

KOL - Market Vectors Coal ETF
Weekly graph or the perspective over the next 2 to 4 quarters



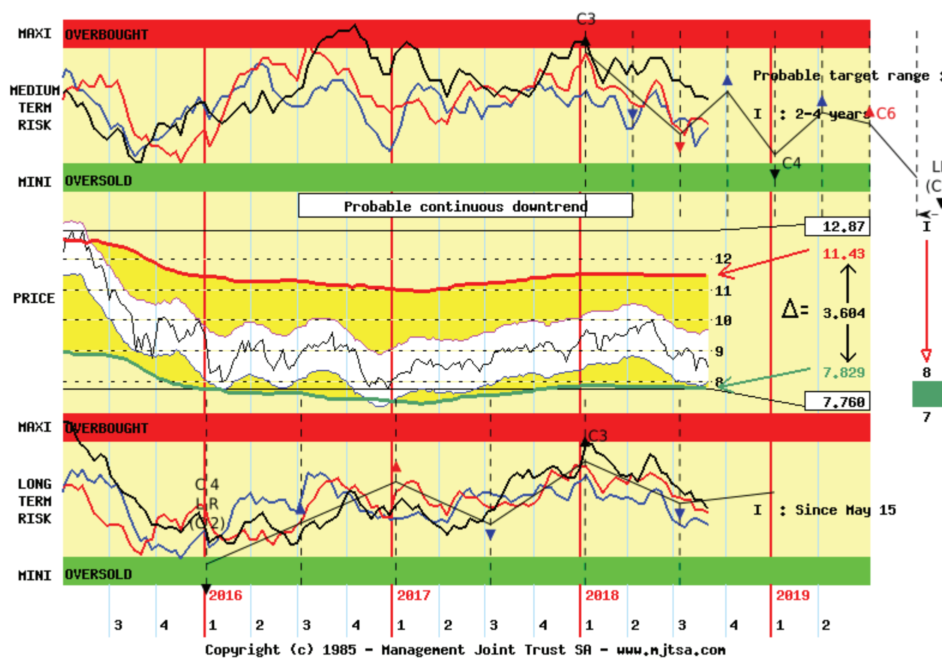
Similarly, Coal producing companies also started to reverse down in January following the top which was made on our long term oscillator series (lower rectangle). On our medium term oscillators (upper rectangle), **we now expect them to move lower until early next year at least, and then potentially again into late 2019. Initial support could be found towards the lower end of our C Corrective targets to the downside around 10 (right-hand scale). That is circa 35% below current levels.** Below that, the next level of targets we can calculate would probably reverse the whole 2016-2017 reflationary uptrend.

LIT - Global X Lithium ETF
Weekly graph or the perspective over the next 2 to 4 quarters



Given the strong growth momentum in the Alternative Energy, Electric Cars and in mobile phones penetration, the Lithium theme had gathered strong upside momentum during the reflation trade. As with other mining products, it topped out in January on our long term oscillators (lower rectangle) and has since been correcting to the downside. Our medium term oscillators (upper rectangle) would suggest that following an intermediate bottom towards early Summer, which hasn't triggered much reaction, **the Lithium theme should now resume its downtrend probably towards year-end and then probably once again towards late 2019**. Our C Corrective targets to the downside (right-hand scale) have pretty much been fulfilled. If prices break below their lower end, out I Impulsive targets to the downside would point to a range between 20 and 14. As with other sector we mentioned above, **an acceleration of the downtrend over the next couple of months could lead to a full retracement of the 2016-2017 uptrend over the next few quarters**. This is rather bad news for this popular investment theme.

ICLN - iShares S&P Global Clean Energy Index Fund
Weekly graph or the perspective over the next 2 to 4 quarters



Alternative Energy is a typical Growth theme that has a strong exposure to China. Similarly to other sectors above, it is currently retracing its 2017 upswing. Both oscillator series suggest **than an intermediate low was probably made this Summer, yet that for now prices are continuing to drop**. As shown on our medium oscillators, **we expect Alternative Energy to continue lower, initially towards early next year and then possibly once again towards late 2019.** Our I impulsive targets to the downside (right-hand side) suggest than the sector will probably see new secular lows by then. Unfortunately, this may also be a warning for other Growth oriented sustainability themes.

Concluding remarks :

The sell-off in Chinese equity seems far from over. The downtrend is especially clear on the Chinese domestic market where the Shanghai Composite could continue to slide towards the 2'000 mark by early next year, and perhaps even lower, later on in 2019. All attempts to bounce during the Summer were rapidly retraced, and we now expect that from late September at the latest, Chinese equity markets could accelerate down again into November/December. Chinese equities also seem very weak vs both other Emerging Markets and the MSCI World Index, and in general the sell-off in Chinese Equities looks more and more like a panic liquidation. The Chinese equity sell-off is also impacting all related themes. Industrial metals such as Copper or Zinc have started to accelerate lower, the US Diversified Mining, Steel or Coal sectors are gradually reversing down, and growth themes related to basic metals or China, such as Lithium or Alternative Energy, are also selling off. We see little respite for most of these themes until at least early next year, and probably until end 2019, and believe that their downtrends could see further acceleration during these periods. We would hence avoid any investment themes relating to China and Industrial metals over the next few months and probably the next few quarters, i.e. don't try to catch a falling knife.