6/ Mapping the markets (part I)

General comment

Last month, early November, we were short term defensive. We expected a slight consolidation on equities into mid November, further flattening of the yield curve (until mid / late November), and at the same time, further downside re-tests in related trades, such as Yields, the Dollar, Financials, Small Caps or Value. We also expected Oil to see a short dip, yet believed that it was well positioned towards year-end. Generally, the themes above did see some correction down until mid / 3rd week November and have since started to regain strength. As we write this summary, it appears that these themes, along with risk assets more generally, may continue to move up over the next few weeks, possibly on the back of the US Tax Bill that was passed early Saturday morning by the Senate, and the erroneous ABC report about the testimony of Mr Flynn.

Looking into Q1 2018, we are still very positive on US, European and Japanese equities, probably until February and perhaps March in first instance. We also expect the Dollar to strengthen and the yield curve to make a steepening bounce, probably from now into mid/late December, and then once again from early January into late February / March. Value trades should benefit, and Growth and Defensive trades should finally see some underperformance. We even expect some kind of consolidation on Bitcoin from late December to early 2018.

Our longer term perspective for 2018 is that markets for most Financial Assets are maturing. As mentioned above, we expect a last reflationary push to happen until circa mid Q1 2018. Following that, during the Spring equity markets will start to distribute, but will probably hold until mid year, while we see a last Growth extension during Q2 2018. This last growth extension should benefit long duration assets such as the Nasdaq, Emerging markets, China and Industrial metals, the Euro and Asian growth currencies. By mid 2018, however, we should reach a top on all risk assets. The correction that follows could last 1 - 1.5 years and defensive assets such as Gold, Treasuries, the Dollar and the Yen should strengthen substantially during that period. Obviously, we will continue to monitor this scenario over the next few months and search for confirmations or possible caveats.

Equity markets

Volatility

Following its bounce during November, VIX could resume lower until mid/late December, and then possibly into February/March.

World markets
p 11, 14, 15, 29, 32, 39, 41,42

Over the next few weeks, major equity markets should resume their uptrend, first into mid/ late December, and then following a slight consolidation into early January, until February and perhaps early March.

Regional picks
p 32, 39

Over the last few weeks, US markets have outperformed European and the Japanese ones. We believe that over the next few weeks, reflation trades should re-accelerate, which should benefit the US Dollar. European and Japanese markets could come back quite strongly, first into late December and then into February/March. Towards late Spring of 2018, we would expect between 5 to 10% Upside potential in the US, between 10 to 20% in Europe and Japan.

Emerging markets
p 33, 34

China and especially Commodity related countries are our favorite Emerging markets towards year-end and early 2018. Last month, we expected them to underperform until mid / late November, along with reflation trades. Now that reflation trades seem to be re-accelerating, we are favoring them again over Asia Growth such as India or South Korea.

Relative Sectors
p 13, 24, 25, 30

Last month, we had expected that by mid / late November, the market should rotate back to reflationary sectors, such as Industrials, Materials, Energy or Financials. We expect this rotation to materialize over the next few weeks.

Profiles/Themes
p 22, 30

Similarly, from late November, we had expected that rotation shifts back from Growth, Min Vol and Defensives to Reflationary and Pro-cyclical themes. We believe this shift back could materialize during the first half of December, and could then accelerate in January, probably towards February and perhaps even March.

Interest rates

US rates
p 11, 23, 35

Yields should make a further attempt to the upside, first towards mid December and then following a few weeks of retracement, accelerate up again from early January to February early March. We believe 10Y Treasury yield could see new highs in Q1 2018, towards 2.6 - 2.8 %.

The US yield curve spread
p 20,21

As we expected early last month, the US yield curve reached an Oversold condition late November and may now start to bounce, first into mid/late December, and then again from early January to February, perhaps March.

7/ Mapping the markets (part II)

Other countries
p 21, 35, 40

Yields and Yield curves in other developed countries are following similar dynamics as in the US, yet with a slightly more positive tilt. In Europe and Japan, 10Y yields and the Yield Curve have held up much better than in the US. Last month, we expected them to see a period of retracement during November, but now believe that they could resume their uptrend during December towards mi Q1 2018.

Credit
p 36

Early last month, we saw High Yield retrace with other reflationary assets into mid/late November. The retracement actually turned into a brief blood-bath until mid November, but has since stabilized. We believe High Yield could continue to stabilize during December and will attempt a last move up in Q1 2018. We may then see marginal new highs, but longer term, the tide has probably started to turn.

Rate Differentials

The US vs Eurozone and Japan short term and long term rates differentials have been moving up again since early September. These may retrace some from mid December to early January, but in general we are still positive for US rates vs their Eurozone and Japanese equivalents until February/March.

Tips

The ratio of TIPs vs Treasuries has seen a nice bounce since September. It should continue upwards towards mid December, may retrace briefly into early January, and then move up again towards February/March. On an absolute basis, TIPs are following Gold and other Bonds. They could sell-off until mid December, then bounce a bit towards early January and then sell-off again towards February/March.

Commodities

Oil
p 16, 33, 34

We still expect Oil to reach into the high USD/barrel 60s, even the low 70s towards end December/January.

Industrial metals
p 16

Along with China, Industrial Metals have consolidated during November. We now expect them to resume their uptrend, probably until February/ March in first instance. LME Copper could reach into the higher 7’000s / low 8’000s USD/ton by mid next year.

Gold & PMs
p 12, 13, 28

Gold and precious metals have held up until late November. We believe they are now resuming their downtrend, first into mid December, and then again, following a slight bounce into early January towards February/March, where they may test the USD 1’200/oz mark. Following that, Gold should resume up for the rest of 2018.

Agriculture

We believe that Agricultural commodities remain the weaker commodity segment, probably into year-end at least.

Foreign Exchange

Dollar Index
p 31

As expected last month, the US Dollar did retrace down into mid November (and even slightly more). We believe, the Dollar could start to bounce in December, and then following some retracement late December/early January, move back up again towards February/March.

Euro
p 14, 31

EUR/USD came back quite nicely during late November, but now seems to have failed to retest its early September highs. We believe, it should resume its downtrend towards mid December and then possibly again towards February. The 1.15 - 1.14 zone should again offer worthwhile support. EUR/JPY and EUR/CHF sould also consolidate during December, probably at high levels. Then EUR/JPY may re-accelerate up from January, while EUR/CHF may wait until February, perhaps even March to do so.

Yen
p 40, 41, 44

USD/JPY should start to resume its uptrend during December. Following some retracement late December, USD/JPY should accelerate up again from early January to February/March. Indeed, during Q1 2018, we believe the Yen could weaken across the board vs all major currencies. We expect USD/JPY to rise towards 118 in Q1 2018, perhaps even more.

Sterling
p 15

The Pound still looks rather strong vs all other majors into Q1 2018 next year. In the meantime, it may correct some vs the Dollar during December, but could then remain relatively strong during Q1 2018. Given our scenario, it should also strengthen vs the Euro.

Oil & Commodities currencies

Their performance should balance between a stronger Dollar and stronger Commodities as the reflation trades re-accelerates towards year end. We expect them to gain slightly against the Dollar as Oil attempts to reach 70 USD/barrel .

Asian currencies
p42, 43

During December, the Dollar should bottom-out vs INR, KRW or TWD. It should then bounce until February/March vs these “Asian growth” currencies.