

STRATEGY NOTE:

FX STRATEGY

TAKING A BREATHER

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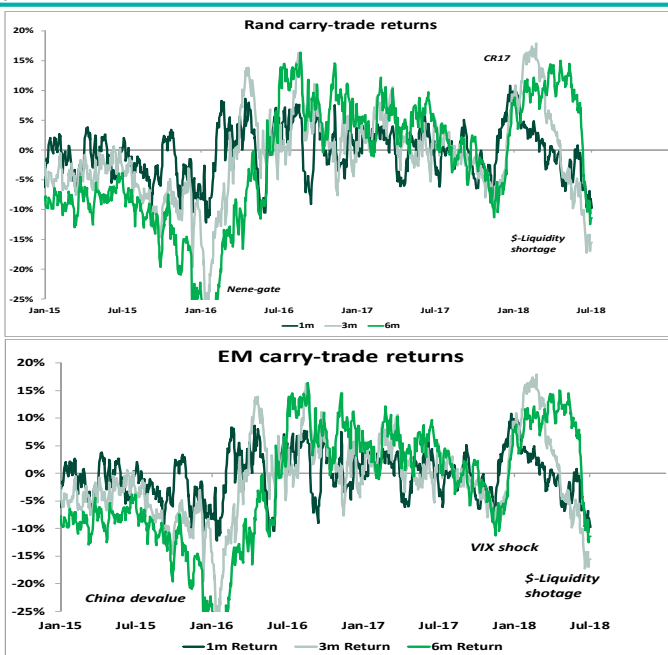
\$-RAND: BEARISH MOMENTUM STALLING FOR NOW



Source: Reuters, Nedbank CIB

- We maintain the view that the **5th wave** is materializing for the \$-rand and that this will likely be a level from which we can expect a **correction** phase to commence.
- 'First port of call' for the \$-rand will be **13.52** and should the \$-rand break on **first attempt**, it could trigger a deeper correction to close to **13.05**.
- However, if we **fail to break below 13.52 and consolidate**, this will be a bearish indication for the \$-rand.
- In our view, this will also imply that the new trading-range for the \$-rand is materializing (i.e. **13.52-15.36**), which is depicted by the channel marked by the red dotted lines.
- We are **very cognisant** of global trade war risks escalating, concerns regarding the slump in the Chinese yuan and Fed QT, however, we are holding to our discipline of analysing price action and global \$-Liquidity which are pointing to a brief period of a possible consolidation/correction phase.

RAND/EM CARRY-RETURN DEEPLY INTO NEGATIVE TERRITORY



Source: BBG, Nedbank CIB

*Realised returns from long ZAR (short USD) positions.

- Since the rand is one of the most favoured carry-trades, we use the 1m, 3m and 6m realized returns of the USDZAR as a **proxy** to analyse the 'pain and gain' endured by investors.
- **We believe that de-risking** from the EM carry-trade has hurt USDZAR carry-trade returns (high beta, highest percentage foreign holdings of local bonds) and the realized returns are now deeply into negative territory (close to Nene-gate levels). This **suggests** that investors have **de-risked** or have become **neutral** on the ZAR carry-trade.
- For the rand to **weaken further** we would, in our view, have to see the **US Dollar break above 95 index points** and **negate the signs from Chart 4**, i.e. 2nd derivative of our Global \$-Liquidity indicator in search for a bottom. We only expect this in the later parts of 2H18/1H19.
- As long as the US Dollar struggles to break above **95 index points**, this should support our view mentioned in Chart 1.
- In our view, the '**tipping of balances**' lies with the US Dollar index, more specifically the 95 index points level.

BREATHING SPACE FOR EM-FX ON THE CARDS



Source: BBG, Nedbank CIB

- The **Bloomberg EM FX carry-trade index** continues to be in the bear market which started early this year, marked by the **resurgent US Dollar**.
- However, the MACD has potentially bottomed, rising from an important support level which has been in tact since 2015. This suggests a period of consolidation or a correction.
- This could only be confirmed if we break into previous lows at 248, with the possibility of further upside potential close to the 38.2% retracement levels, close to 254.
- Although we believe that the trend is still lower, a period of consolidation or a correction in the US Dollar, will likely help EMs like the rand regain some losses.

GLOBAL \$-LIQUIDITY



Source: BBG, Nedbank CIB

- Lastly, we would like to point out to our long-time readers that while we are expecting a short-term reprieve in risk-assets (tactical), we **reiterate our view** that the world will suffer from a \$-Liquidity shortage and that the US Dollar will continue to reign king.
- **Longer-term:** we believe that our Global \$-Liquidity indicator (dark green line) will eventually fall to zero/contract, amid the slowdown in dollar creation (global trade, protectionism, QT, China credit cycle slowing etc.).
- **Short-term:** 2nd derivative of our global \$-Liquidity indicator has lost a lot of momentum to the downside and is possibly bottoming. Fundamental reasons are not clear as yet, but it could be more technical (i.e. potential positioning squaring ahead of the summer break in the US/Europe).