



## STRATEGY NOTE: THE NEXT DEFLATIONARY BUST IS UNDERWAY

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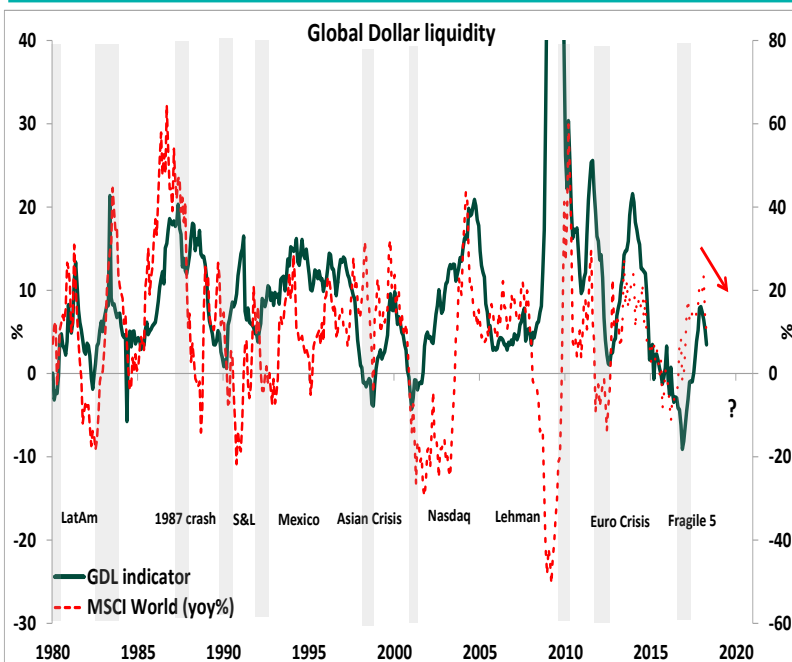
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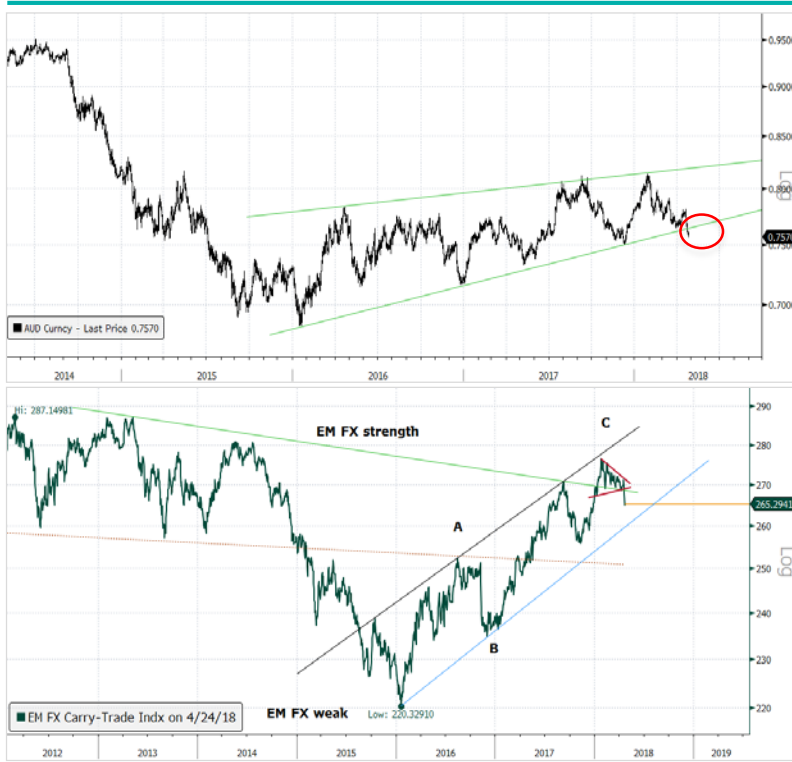


## IT HAS ALWAYS BEEN ABOUT \$-LIQUIDITY



Source: Reuters, Nedbank CIB Research

## CRACKS HAVE BEGUN TO SHOW IN THE CARRY TRADE PROXIES



Source: Reuters, Nedbank CIB Research

- In a world where the change in the credit (money) cycle is much larger than the change in the real economy it is absolute necessary to understand how changing liquidity drives the economy and markets.
- The **US 10yr** is against a major 30-year support and we do not believe a break higher will be sustainable. The rising **world risk-free rate** (discount factor) of the last 18 months is now taking its toll.
- For the first time since the start of 2016 (when the risk-on phase started), dollar liquidity has rolled over. Stock markets are highly correlated to this change in dollar liquidity.
- A **stronger dollar** (which is be a consequence of this contraction in global liquidity), would eat into the performance of carry trade returns.
- As with the short-volatility trade, the carry trade is a crowded trade and the unwinding should lead to meaningful moves in the market in our opinion.
- Refer to our note [“The Dollar Conundrum” of 23 March 2018](#) for more.

- We monitor the Australian dollar as [a proxy for the carry trade](#) as it is the preferred destination for this trade.
- The **AUD** benefitted from the carry trade since the start of 2016, but has now broken out of this bull trend.
- The **Bloomberg EM FX carry index** has broken down out of a wedge, and we believe the ABC corrective rally in EM currencies is now over.
- A break out of bull trend at 260 would confirm this reversal. We had to keep the option open for one more rally up in EM currencies as long as the wedge was intact (as wedges are extremely seldom reversal patterns). The probability of one more rally has now been negated.
- The **important break out levels** to watch for are:
  - USD Index - 91.05,
  - Euro-\$ - 1.2195,
  - \$-rand -12.30,
  - R186 -8.24%.

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