THE ROADMAP FOR 2017

JANUARY 2017

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SUMMARY

- Our long-term view remains that the investment landscape will remain challenging in this '**Post-Debt Super-Cycle'** world and we believe that the drivers of the markets will be more difficult to identify (2016 was proof of that). **We remain long-term dollar bulls** because we believe the system has lost its ability to create dollars without the debt creation provided by the shadow banking system. Last year also recorded the secular low in long bond rates – this was reflected in the shortage of money in the system gaining prominence over the deflationary fears. Hence, we have become long-term bond bears.
- Notwithstanding the above, our tactical view is a **reflation rally for the first quarter or two of 2017** (on the back of a **correction in the USD and global bonds**). This should bode well for risk assets like emerging markets and commodities. This year is likely to turn out the same as 2016, where the market was strong until August and then started failing.
- We believe the rally will not be not be sustainable because most of the **underlying weaknesses that have persisted for many years have not been addressed in a meaningful manner.** Examples are the growing global debt burden (especially in US dollars in Asia), low FDI, slowing global trade and capital flows (contraction in global dollar liquidity), symptoms of financial instability (credit growth in non-banking sector and shadow banking in China), growing inequality and the rise of populism against establishments (as reflected in Brexit and Trump).
- In this low-growth environment the investment landscape will likely be dominated by bouts of volatility that investors will have to capitalize on. In this type of world we will continue to use **our combination of Technicals and non-traditional fundamentals** (following money supply and financial plumbing) to guide clients in their investment decisions.
- Our fair-value models estimated forecasted value for the USD/ZAR is R13.20 and on SA 10yr government bond it is 8.30 (time frame of next one to three months). This is due to stabilizing $-liquidity. But our residual item (political premium) remains volatile, making forecasting difficult.
- **Tactical view:** Underweight US dollar, Cash ($ and ZAR), USD/ZAR. Neutral corporate credit (Global). Overweight bonds (SA and global), Equities (SA,EM and US) and EM FX. We expect a good performance from the interest rate sensitive sectors, retailers, as well as listed property.
- **Strategic view :** Underweight corporate credit , global bonds, EM assets in general. Neutral equities (Europe and SA). Overweight US Dollar and cash ($ and ZAR).

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SUMMARY OF VIEWS MATRIX

@ a Glance - Our Asset Class Views

		Underweight			*Neutral*		*Overweight*	
		-	-	-	0	+	+	+
Equities	***Levels***							
SA	*45700*				●		✱	
US	*2264*			●		✱		
Europe	*3300*				●	✱		
EM's	*886*			●			✱	
Fixed Income								
SA 10yr	*8.78*			●			✱	
US 10yr	*2.34*			●			✱	
Global	*1.46*			●			✱	
EM LCY	*6.77*			●			✱	
Corp HY	*3.51*		●		✱			
Forex								
USD/ZAR	*13.74*			✱			●	
US Dollar	*101*			✱			●	
EUR/USD	*1.06*			●			✱	
EM FX vs USD	*235*			●			✱	
Other								
Brent $	*55*			●			✱	
Gold $	*1197*					●	✱	
EUR & YEN ccy swap vs USD	*-47 / -77*			●		✱		
Cash ZAR	*357*			✱		●		
Cash $	*185*			✱		●		

Themes	Risk to our views
Over the long-term we expect returns from equities to be low, given where valuations are and as the world remains in a **balance sheet recession** only boosted from time to time by short-term reflationary actions by central banks (**ie fundamentals have not changed**). The **corrective/reflationary rally** we are expecting over the next quarter would bode well for equities in general. We expect **growth to outperfom value** during this period. A rally in global bond yields would be bullish for interest rate sensitive sectors. The contraction in global money supply in the **Eurodollar system** should continue amid stringent banking regulations, slowing global trade and capital flows. The impact of the contraction in global dollar-liquidity would filter through into markets via **the global carry-trade,** leaving the bond/FX market very volatile and dislocated from traditional fundamentals. The effects of **'financial plumbing'** should play an increasing role going forward. In South Africa the growth forecast remains weak. The lack of meaningful structural reforms should continue to negatively impact the real economy. We can expect another **volatile year for the rand and bonds**, caused not only by local forces but also by international forces through the global carry-trade and Eurodollar system. SA equities will most likely again be influenced by international themes. During the expected rally in 1Q17, we expect **growth stocks to outperform value** but for them to	Should a **disorderly rise in global interest rates** during 1Q17 (sparked by forced deleveraging in the highly geared bond markets) occur, a tightening of financial conditions would lead to the risk-on phase being short-lived. A **stronger dollar** would indicate a contraction in the global money supply, which would have the same effect as the abovementioned. **China** still remains a risk that we will be monitoring closely. There is a real risk that controlled financial tightening attempted by authorities may spill over into the real economy faster than expected. This would impact EM sentiment and commodities negatively, leaving our tactical call at risk. **Rising populism and growing uncertainty regarding world politics** is also a factor that has the potential to derail the reflationary environment that we are expecting.

● *Strategic (12 months)*
✱ *Tactical (3-6 months)*
→ *Increase*
← *Decrease*

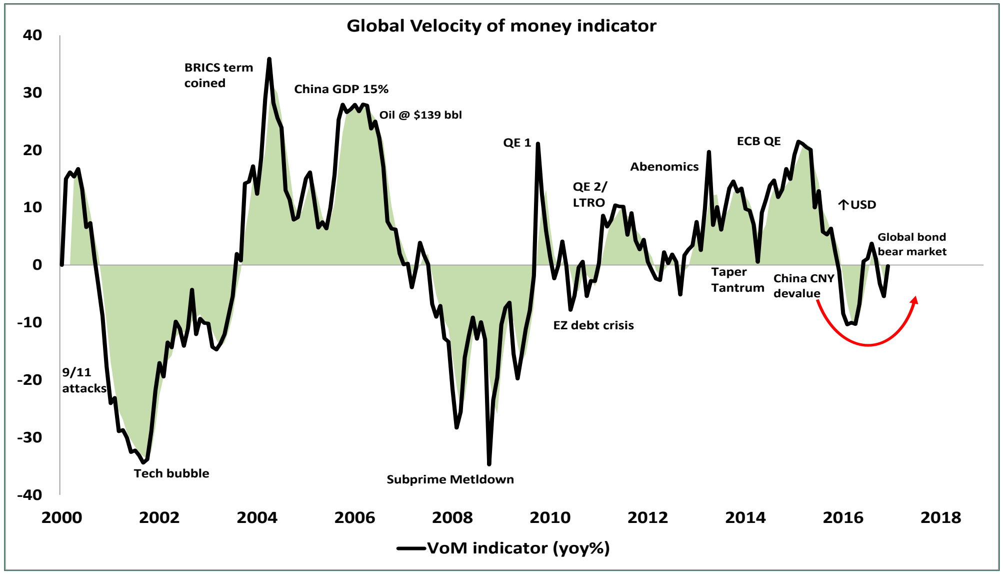
*Notes: SA = Top40 , US=S&P500, Europe= EuroStox50 , EM = MSCI EM, Global bond =JPM GB yld, EM LCY= EM GBI yld, Corp HY= CSI Barc HY, EM FX= Bloomberg EM FX carry index, Cash (ZAR)= STEFI, Cash (USD)= LIBOR TR 6m Cash index

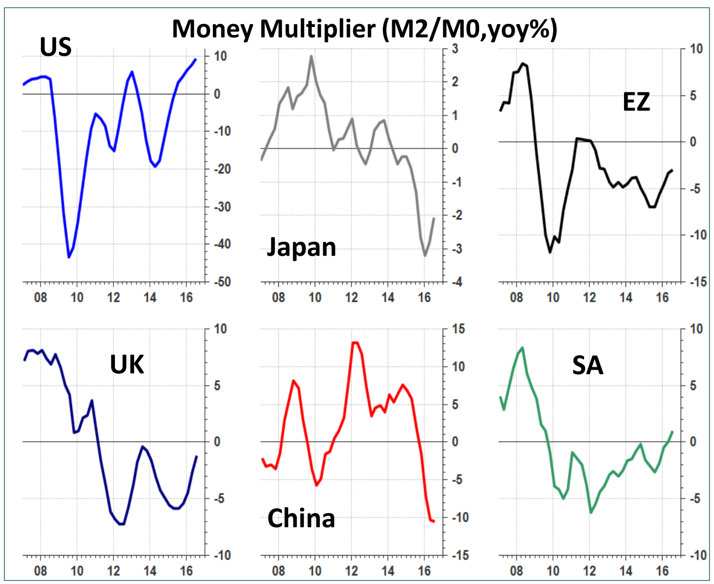
Source: Nedbank CIB

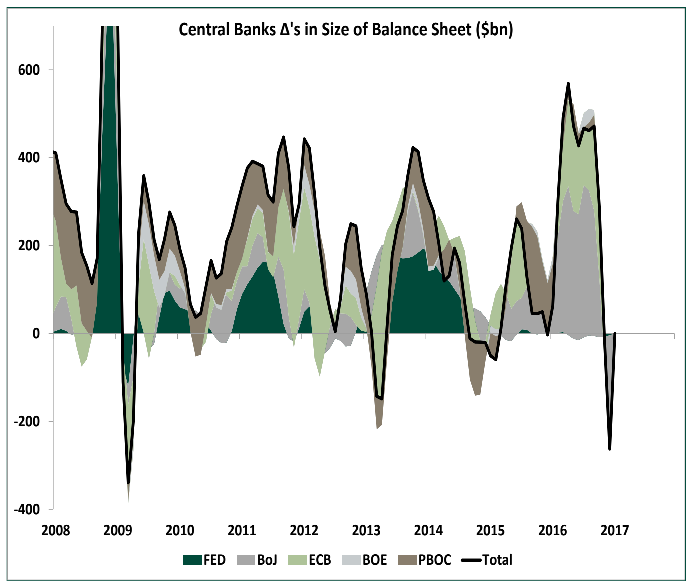
FEATURE CHART: GLOBAL VELOCITY OF MONEY (VOM) INDICATOR

CENTRAL BANKS CAN TAKE A BREATHER, BUT ONLY FOR A SHORT WHILE…

Our VoM indicator is a composite indicator consisting of variables that we believe are best suited to give us early signals to understand the credit creation process ('animal spirits') of the global economy. Those variables are changes in yield curves, corporate credit spreads, money multiplier spreads as well as changes in our global dollar liquidity indicators.







Source: DS

- Our **Global Velocity of Money indicator** and the **money multiplier ratios (M2/M0)** have started to improve and they are an indication of improved 'animal spirits' across the globe in our opinion.
- This means that the ability of the global economy to generate money supply has improved and that the financial system and economies are less reliant on central bank stimulus. That is, for the time being.
- The money multipliers globally (except for China), since late last year, are on the rise.
- **These improvements should be supportive of the reflation cycle that we are expecting over the next two quarters.**
- We will monitor these developments closely (in our monthly TechMentals chart book) to judge whether this is a sustainable trend and whether the deflationary forces in the long-term (that we are concerned about) have receded.

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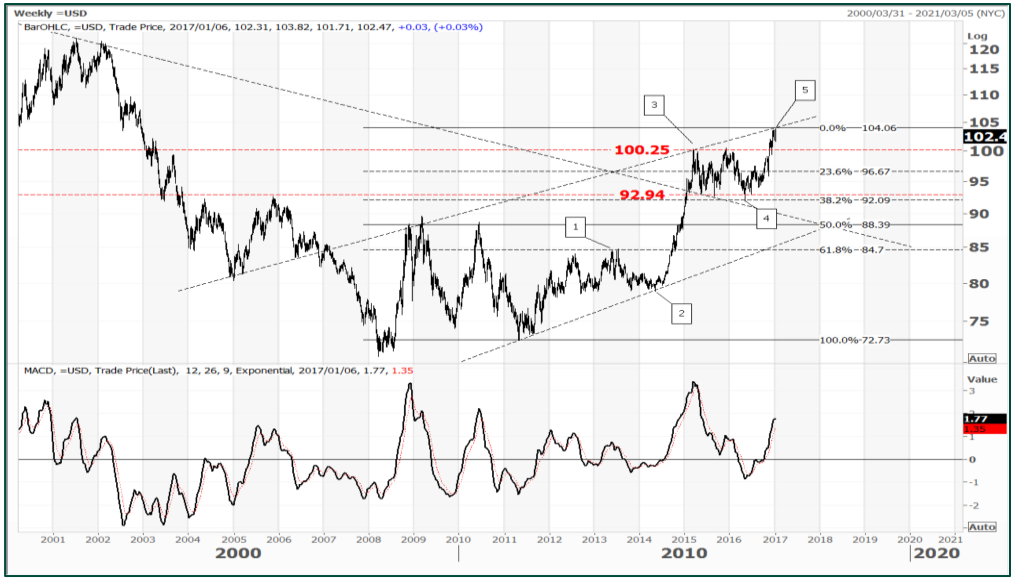
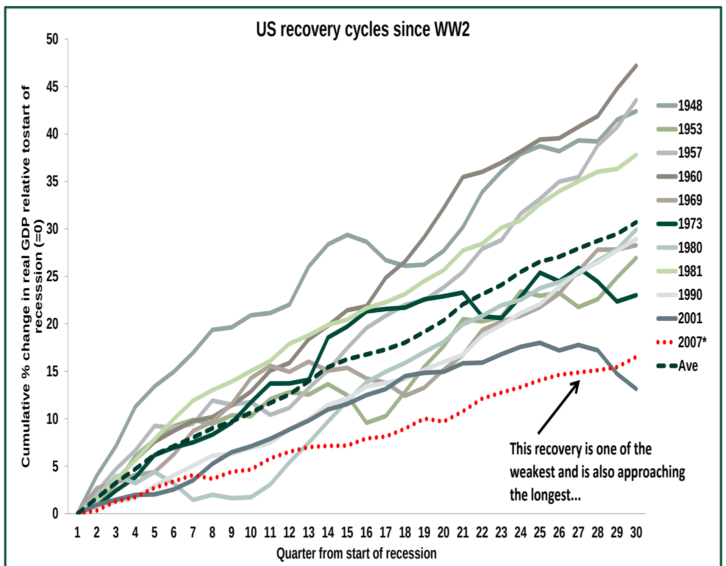
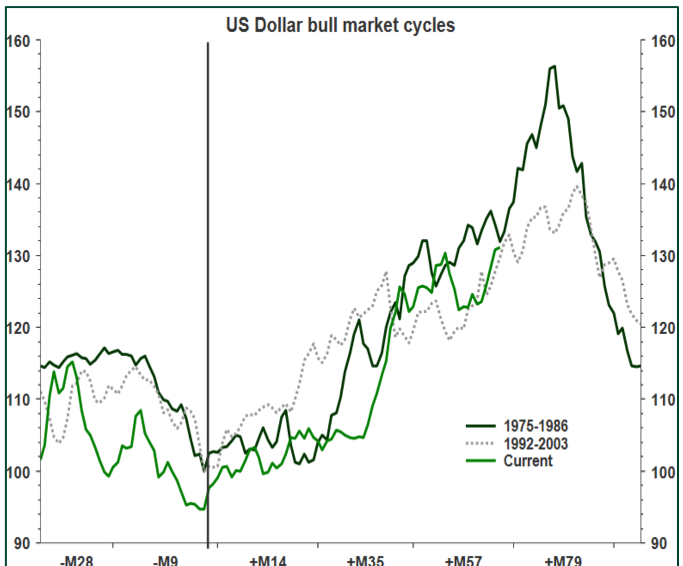
$-Index, US recovery cycles and USD bull market cycles

The dollar bull will encounter major resistance at current levels in our opinion





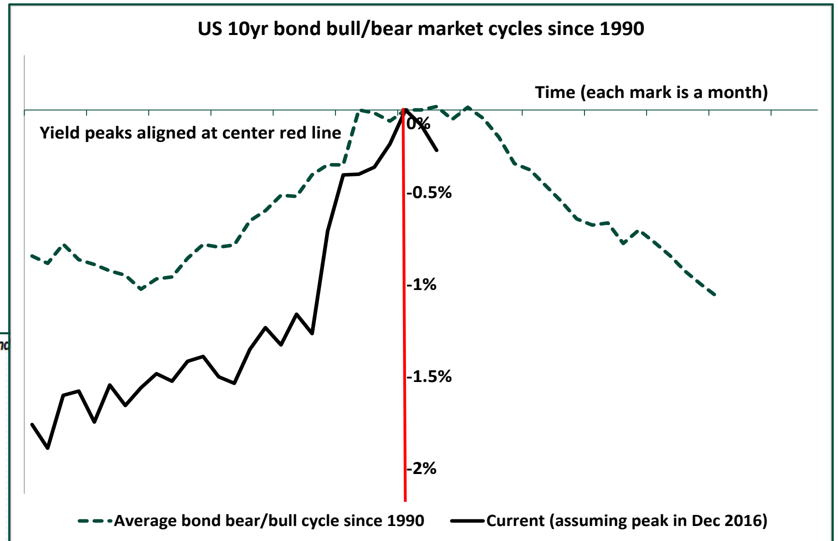


Source: DS, Thompson Reuters

- Comparing the current dollar bull trend with the previous major bull phases indicates that the bull trend is not complete, but a correction is on the cards.
- The dollar has rallied to test the top of the bull channel after a text book 5-wave Elliott-wave pattern. **Major resistance can be expected.**
- We expect the **dollar liquidity situation to improve marginally** over the next few months but we are highly sceptical of it being a sustainable trend.
- The current economic cycle is however long in the tooth and we believe that it will not take a major shift in interest rates to derail the US economy - **Wicksellian spread.**
- Dollar debt, especially in corporates and in emerging markets, remains a problem in our opinion.
- **Our long-term view remains that the repayment (or writing off) of dollar debt will shrink the pool of dollars, leading to a stronger dollar and higher interest rates.**

JPM Global Bond Yield and US 10yr bond bull/bear market cycles

The bond bear is over for the next few months



Source: DS, Thompson Reuters

- The global bond yield sold off to test the top of the bull channel from the late 1980s.
- The bond sell-off was quite severe. It was exacerbated by forced deleveraging that took place in the levered parts of the financial markets (ie risk parity funds, rising costs of repos and the shortage of collateral and bonds). For more see here https://www.bis.org/speeches/sp161115.pdf
- We are of the opinion that the major support line will remain intact for the next few months**. A rally to at least the neckline at 1.29% is on the cards, fuelling the risk-on phase that we expect.** The average of the bond bear cycles since 1990 indicates the market tends to peak now for a six month rally.
- Our long-term secular view, however, remains bearish. The Elliott-wave bull pattern since the late 1980s counts complete. Our fundamental bearishness on this stems from the shrinkage of the global money supply due to the increased regulations, deleveraging of financial markets (shadow system) and the real economy. **This shrinking money supply should be reflected in the price of money – ie rising interest rates.**

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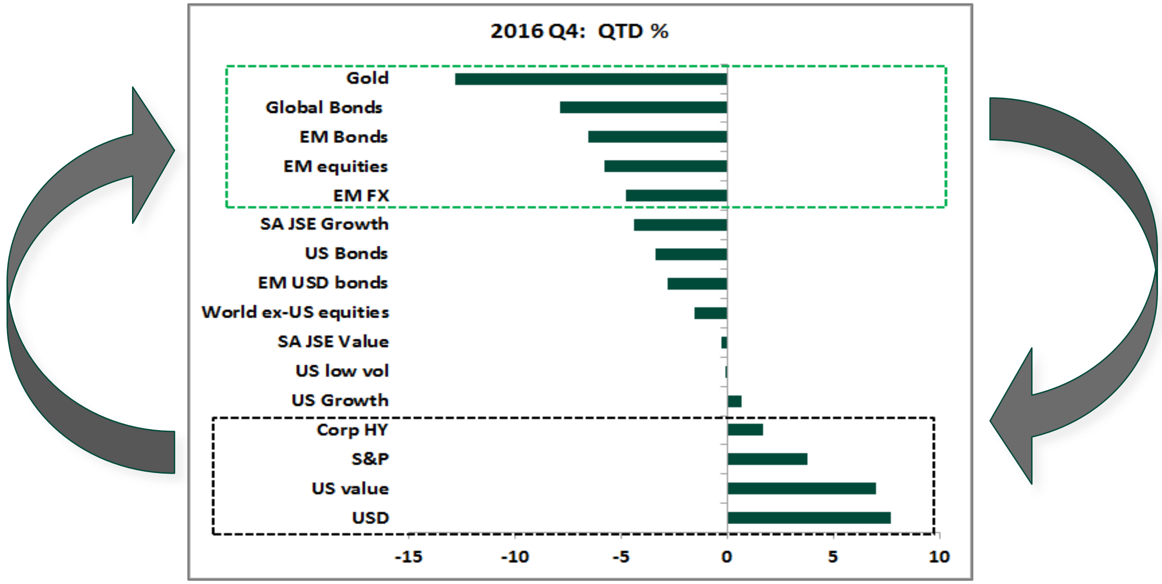
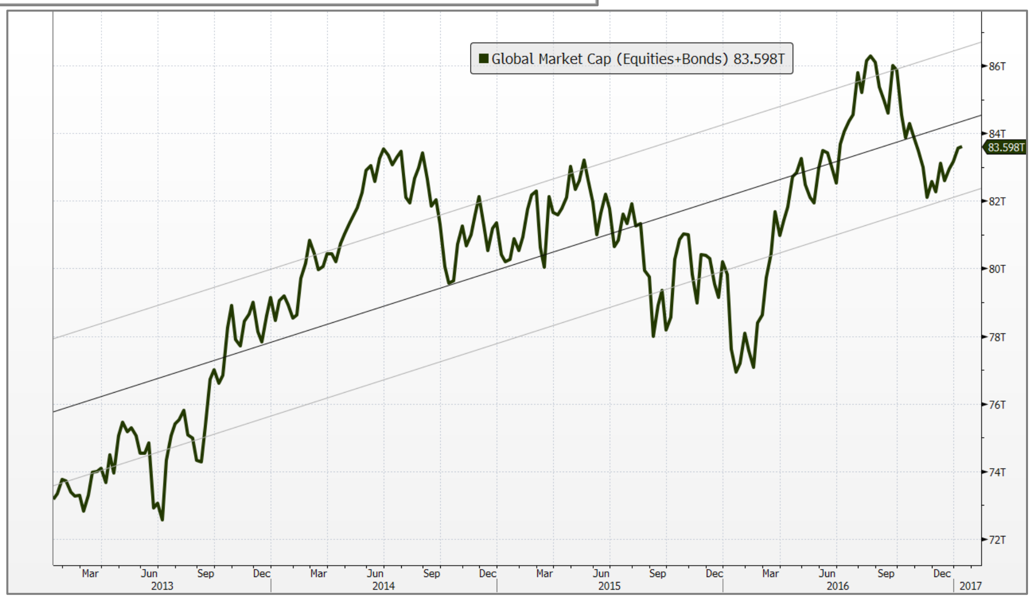
TACTICAL VIEW

1Q17 WILL BE ALL ABOUT A CORRECTIVE RALLY IN OUR VIEW



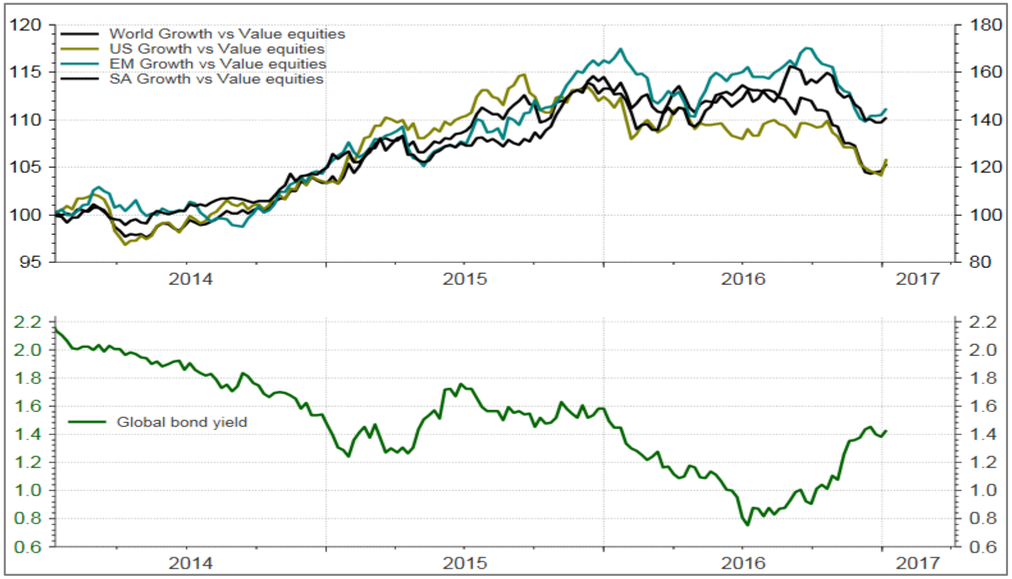


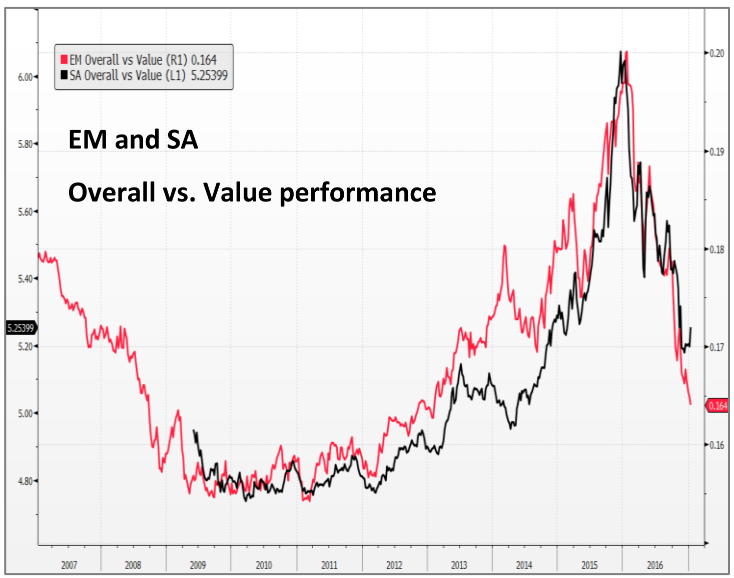
- Studying the last 10 years we see that the first quarter of the year is usually dominated by the **rotation** from the leaders to laggards (of the previous quarter).
- Since August 2016, the global total market cap (bonds and equities) fell and we expect the markets to retrace some of these losses.
- All the equity gains since the Trump victory were negated in the bond market.

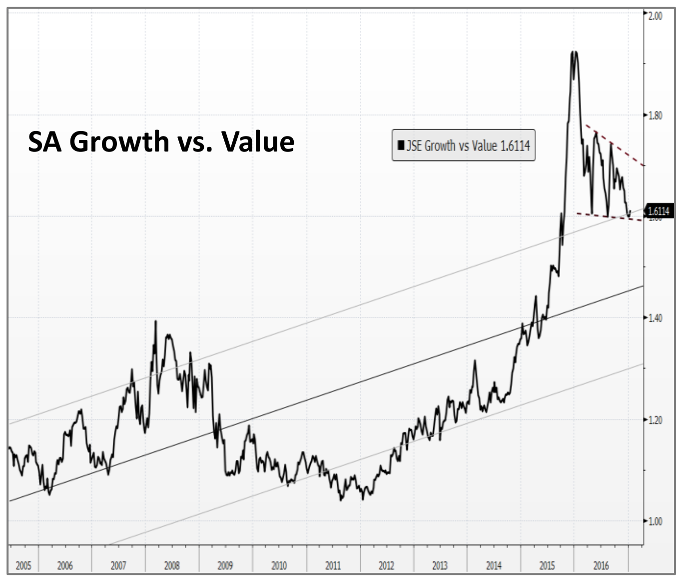
Source: DS, Bloomberg

Equity Theme: Growth vs Value

Factor tilt Growth/Value being unwound by rising rates





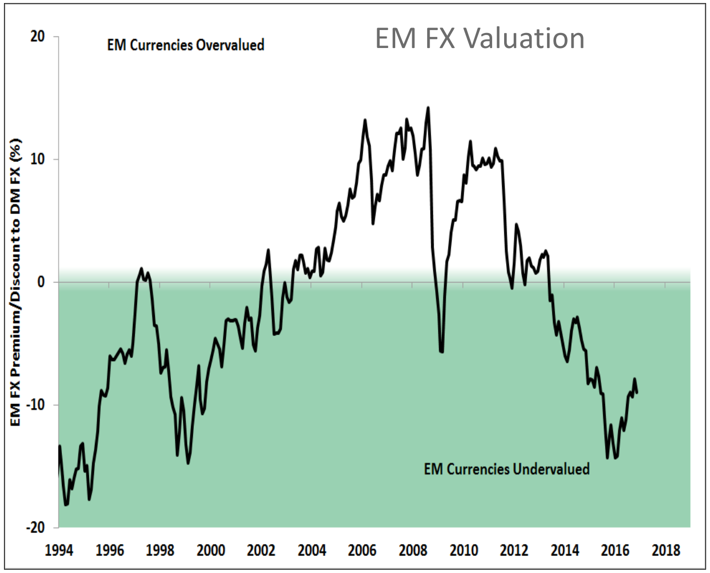


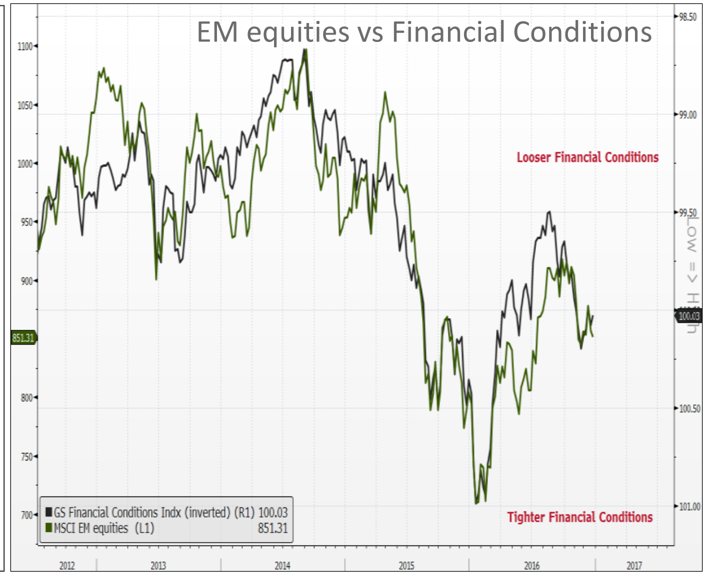
Source: DS, Bloomberg

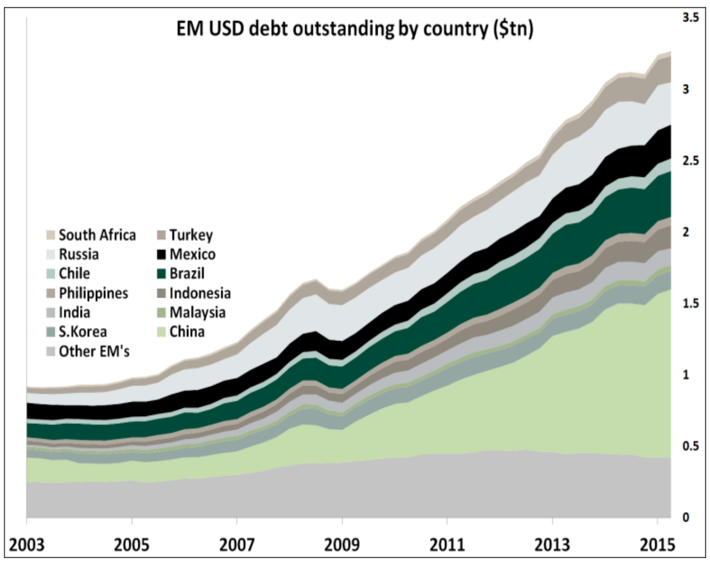
- As bond yields and the cost of capital started to rise from the middle of 2016, growth stocks started to underperform value stocks.
- **In SA the 'growth over value' relative is in a consolidation phase after the correction of early 2016. This consolidation is a continuation pattern, indicating that post an expected short-term rally there is more downside in this relative.**
- Last year, as evidenced in the EM relative, it was clear that commodity stocks were very cheap and it was just a matter of getting the timing right. This year the rally should be more broad based, thereby again lifting the indices. We think that 2017 will be more about identifying stocks than just about the timing on one sector.
- See page 15 for more information on value stocks we have identified that should outperform the market.

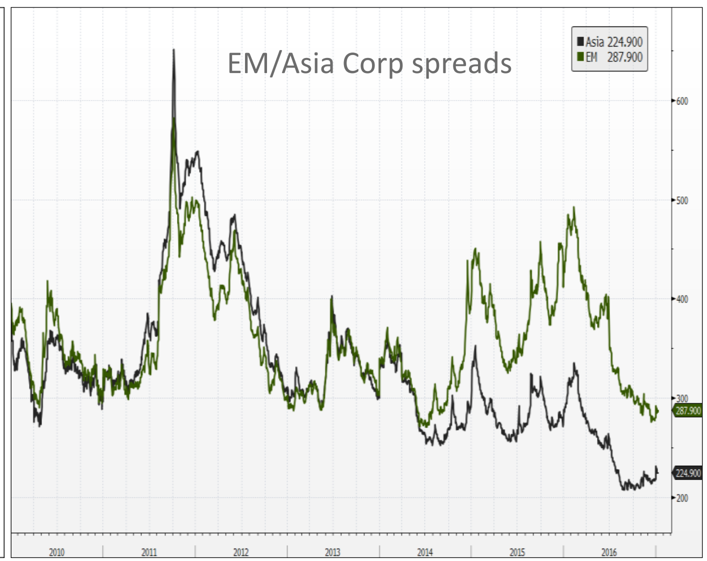
EM FX VALUATION, MSCI EM VS FINANCIAL CONDITIONS, EM $-DEBT

EMS SHOULD GET A BREATHER







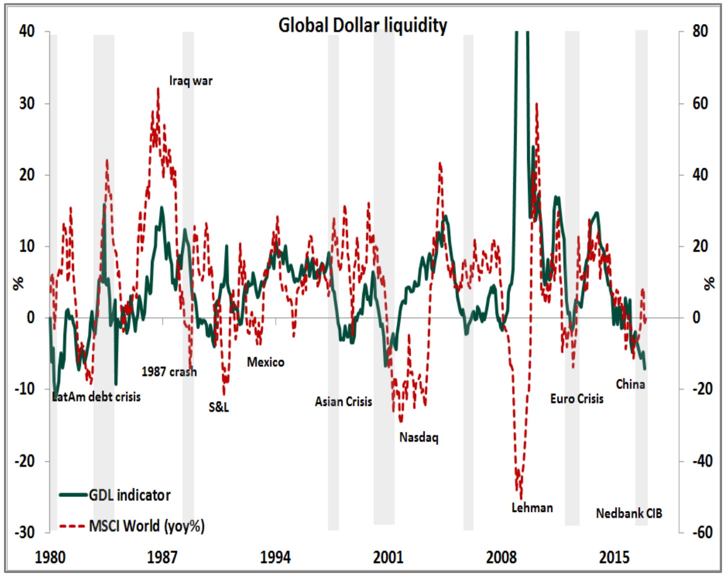


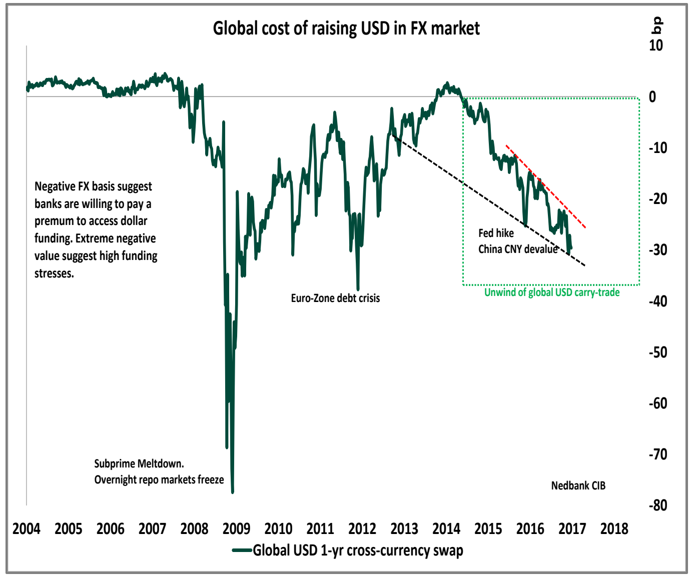
- We feel that the EM currencies (top left chart) is undervalued and a rally to the mean is likely in an environment where the dollar is correcting.
- EMs have attracted a lot of dollar-denominated debt. A weaker dollar should give the EMs some breathing space.
- In the EM complex, we believe that the outperformance of value over growth will continue as investors benefit from the weaker dollar (see previous page).
- There is a very strong correlation between EM equities and the GS Financial Conditions Index. **We expect financial conditions to get looser, which would bode well for EM equities in the short term.**
- **EM corporate spreads** have rallied strongly and we believe that spreads are too tight given indebtedness and slowing growth of many of these EMs.

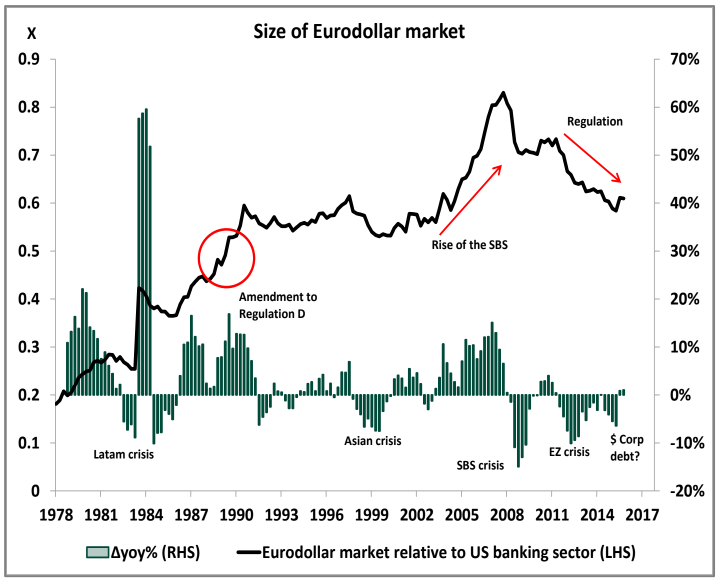
Source: DS, Bloomberg

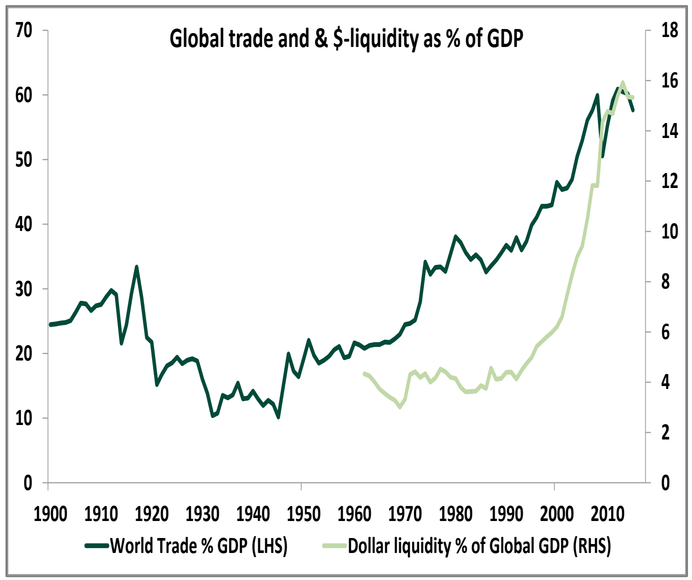
$-LIQUIDITY, GLOBAL $-BASIS SWAP, EURODOLLAR AND GLOBAL TRADE

GLOBAL DOLLAR SHORTAGE REMAINS OUR LONG-TERM THEME









Source: DS

- For our tactical bullish view on the dollar to become sustainable, many major trends have to reverse:
- Our **global dollar liquidity** remains in negative territory. For this indicator to improve foreign dollar reserves have to increase and/or the US must run bigger trade deficits - not something President-elect Trump probably wants to hear.
- The **trade-weighted dollar cross-currency basis swap** is at the bottom of a well-established channel. If our view plays out we expect a rally within this channel.
- The **Eurodollar** market has been shrinking and must reverse trend. This is unlikely without the relaxation of the new banking regulations or Dodd/Frank (which would boost the shadow banking activities).
- Unfortunately, the long-term trends since the 1980s (when **global trade** increased post the fall of the Berlin Wall) are busy reversing. With the changing social mood and the strong personalities in control of many countries we are sceptical whether this trend can increase again.
- **These factors are all dollar-bullish in the long-term, should they occur.**

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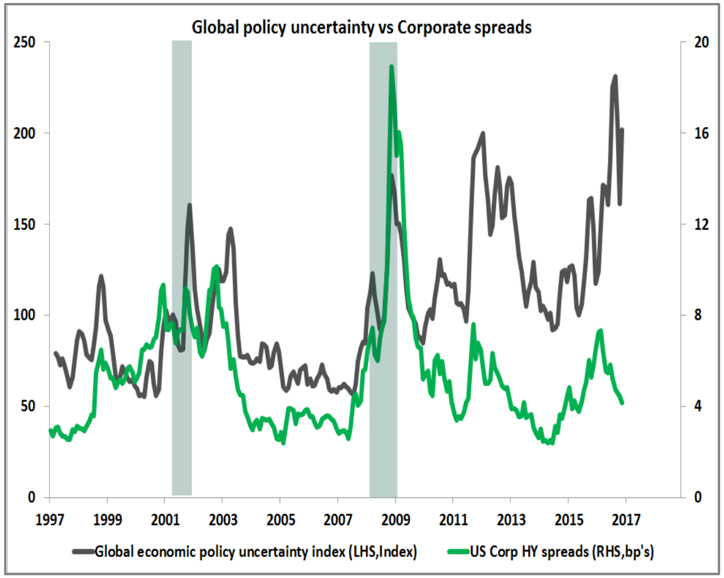
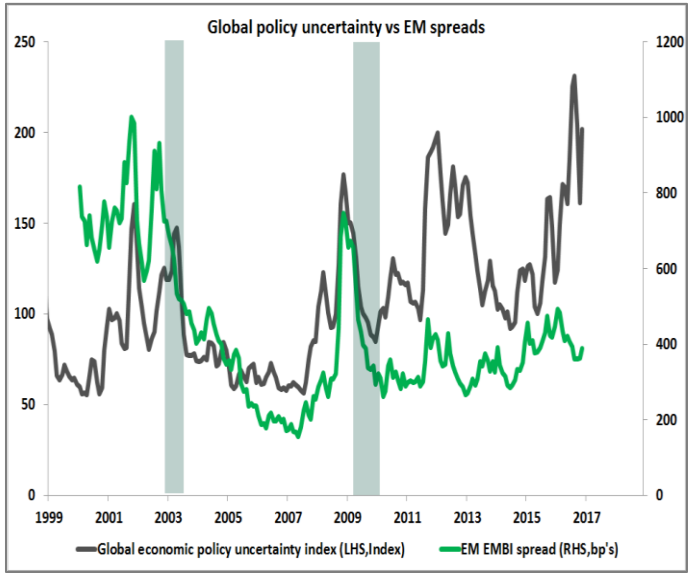
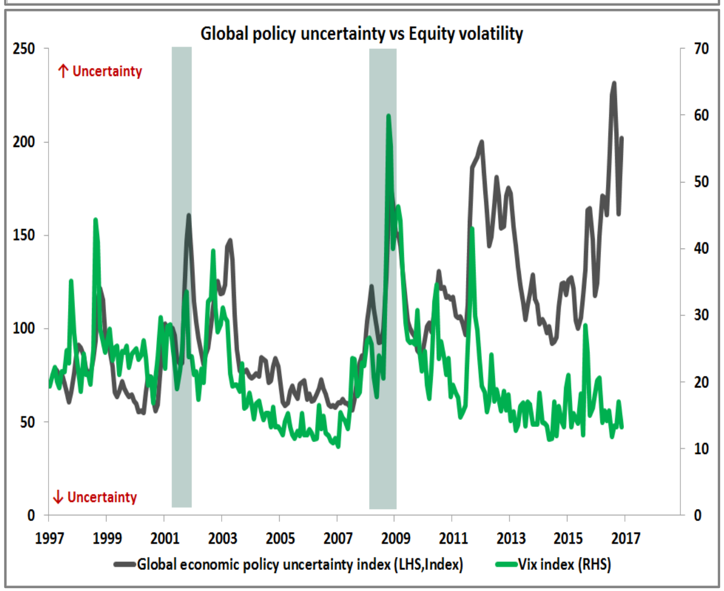
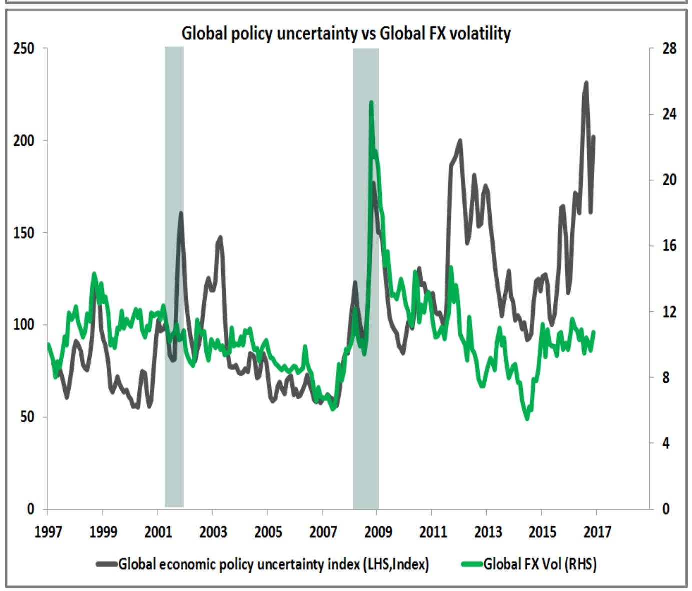
Global policy uncertainty vs volatility and spreads

Are spreads/volatility too low or is political uncertainty too high?









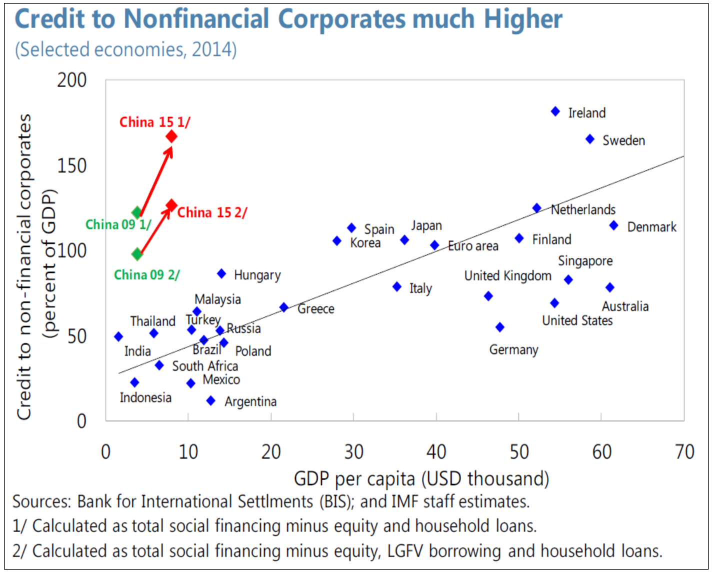
Source: DS, Bloomberg, Baker, Bloom & Davis

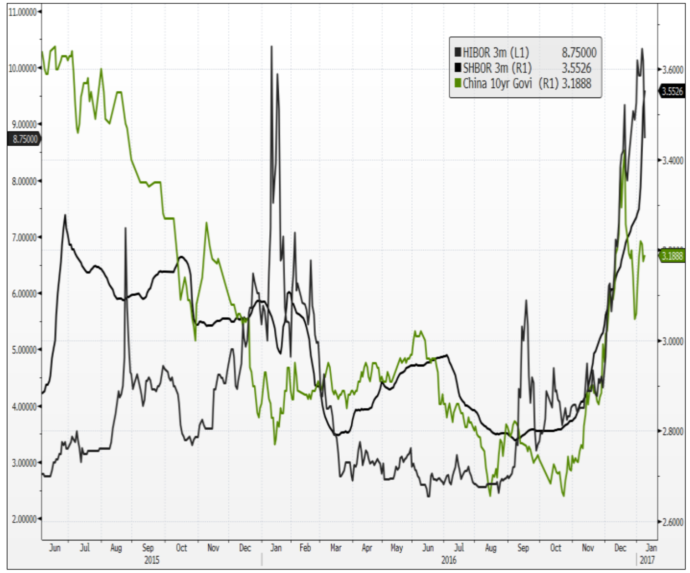
- Since the GFC, the global political scene has been very volatile and policy uncertainty on the rise. Traditionally there has been a very high correlation between policy uncertainty and market volatility. In 2016, economic policies and the political surprises had a lacklustre impact on various measures of risk (equity/bond/fx volatility). **Central banks efforts to contain market volatility seem to be working but we are not sure how long this dislocation can continue.**

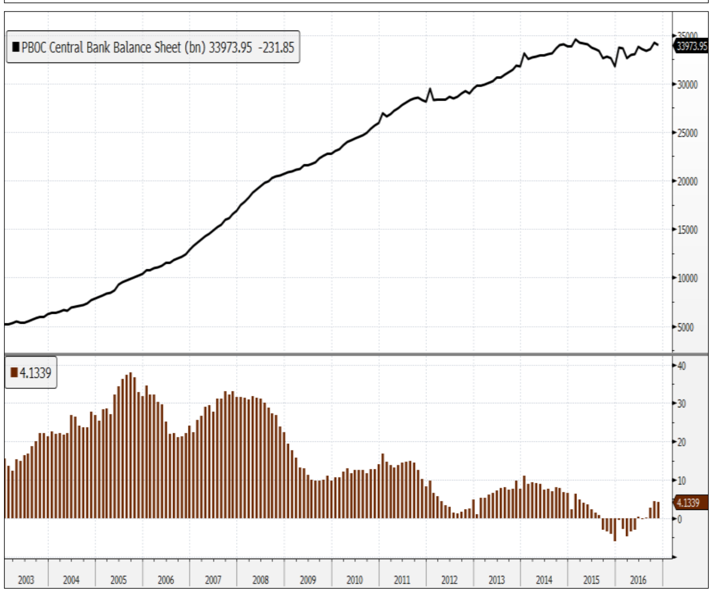
Political events to watch in 2017
20 January 2017 USA Presidential Inauguration
31 January 2017 Russia EU Economic Sanctions Renewal Deadline
March UK Proposed Data for Triggering Article 50
March Netherlands General Election
March US debt ceiling Extension Expires
March-April Italy Potential General Election
23 April/7 May French Presidential Elections
May G7 Summit in Italy
July G20 Summit in Germany
September/October Germany Federal elections
October/November China 19th Congress Communist meeting
December South Africa ANC Party Conference

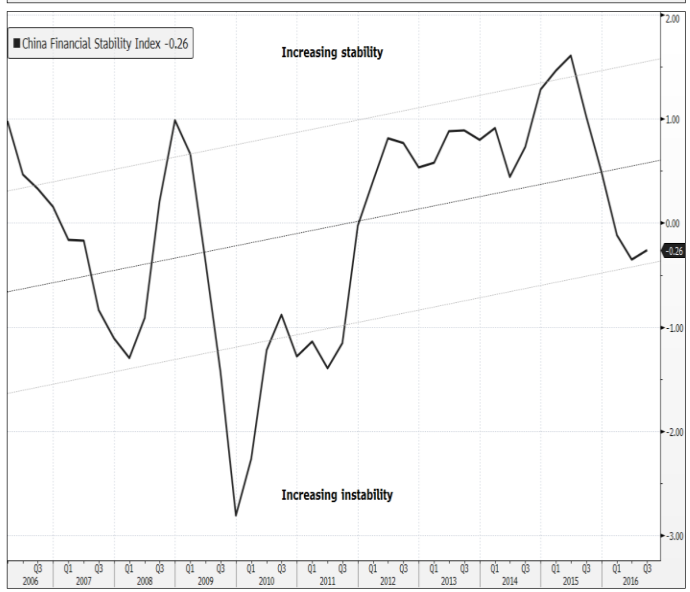
China Nonfinancial Corps, Interest rates, PBOC Size of balance sheet and Financial Stability index

China is most probably the biggest fault line in 2017







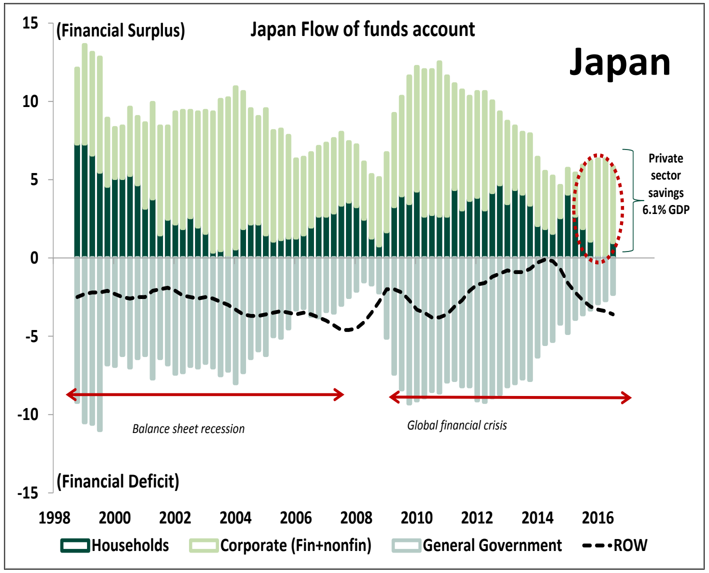


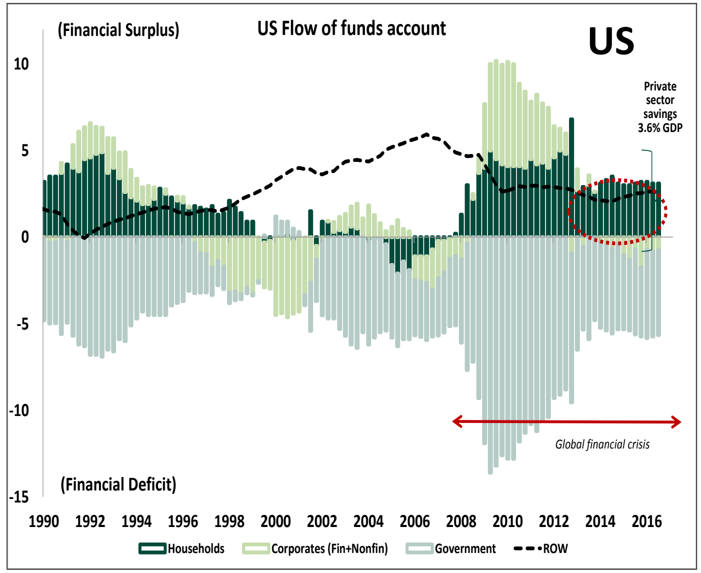
- China has written the latest chapter in the debt super-cycle. The regulators are now however trying to slow down this debt growth as signalled by the latest regulations introduced (increase in collateral requirements). The tightening of restrictions follows earlier measures to reduce leverage in the shadow banking system in a controlled fashion.
- **Chinese corporates have a lot of dollar debt.** The global dollar shortage has been placing pressure on the Chinese financial system. Tightening monetary conditions as reflected in the rising interbank rates, capital outflows and liquidation of US dollar assets are due to regulations and a slowdown in the PBoC balance sheet. Tightening monetary conditions have yet to make a major impact on the real economy. We believe that eventually it will and the consequence will be restricted growth.
- **We feel that Chinese corporate spreads are too tight**, given the struggle to raise dollars to service the dollar debt.
- **The Chinese debt situation is most probably the biggest risk to our bullish view on world markets.**

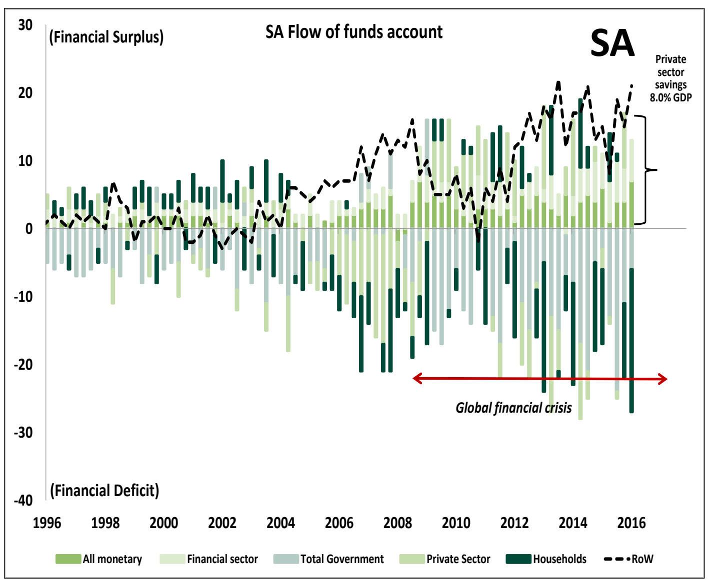
Source: DS, Bloomberg, IMF

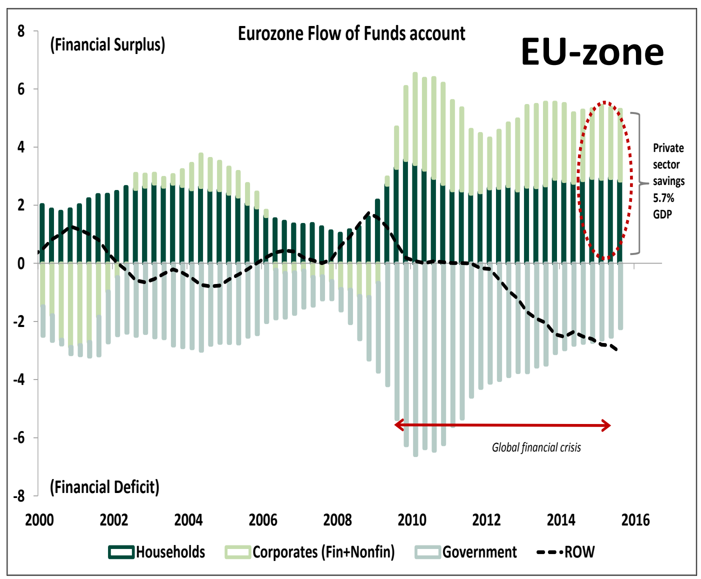
Flow of Funds

Tax cuts and deficit spending will not be the silver bullet so many expect









- Many of the world's governments have been running deficits (grey below the zero lines on the charts) since 2008, yet the economic recovery remains below trend.
- Fiscal spending will most probably have a bigger impact than monetary stimulus, but Japan is proof that a country cannot spend its way out of debt.
- Evidence of the "**Paradox of Thrift**" is playing out. As every sector in the economy saves, the economy will be starved of demand and therefore shrink. The government normally then takes over to counter this trend, but at the moment the fiscal multiplier is unfortunately unusually low and crowding out is a major force that results in below trend growth.

Source: DS

SA Markets: JSE ALL SHARE (51,215), ALBI yld (8.84%), SA TWR (63.80)

WE EXPECT A BULL IN BOTH EQUITIES AND BONDS, BUT EQUITIES SHOULD OUTPERFORM

- The **JSE** corrected along with the other global asset classes since August 2016 but the important (red) midpoint line remained intact. The market has started to break up, indicating a move to **54,200** and then on to a new high. The JSE in $-terms is on its way to test the (red) neckline.
- The **SA 10yr yield** is on its way to test the linear regression line from 2004 at **8.24%.**
- The **$-rand** (not shown) is projecting a move to **12.60**, but the **SA trade-weighted** rand is testing important resistance levels. A break above **64** projects a move to **70.70**. We expect more rand strength against the dollar than against the crosses.
- The **ALSH/ALBI** relative is turning up from a support line. The SA equity market underperformed during 2016, especially in 2H16. We expect equities to outperform bonds during 1H17.

Source: Thompson Reuters

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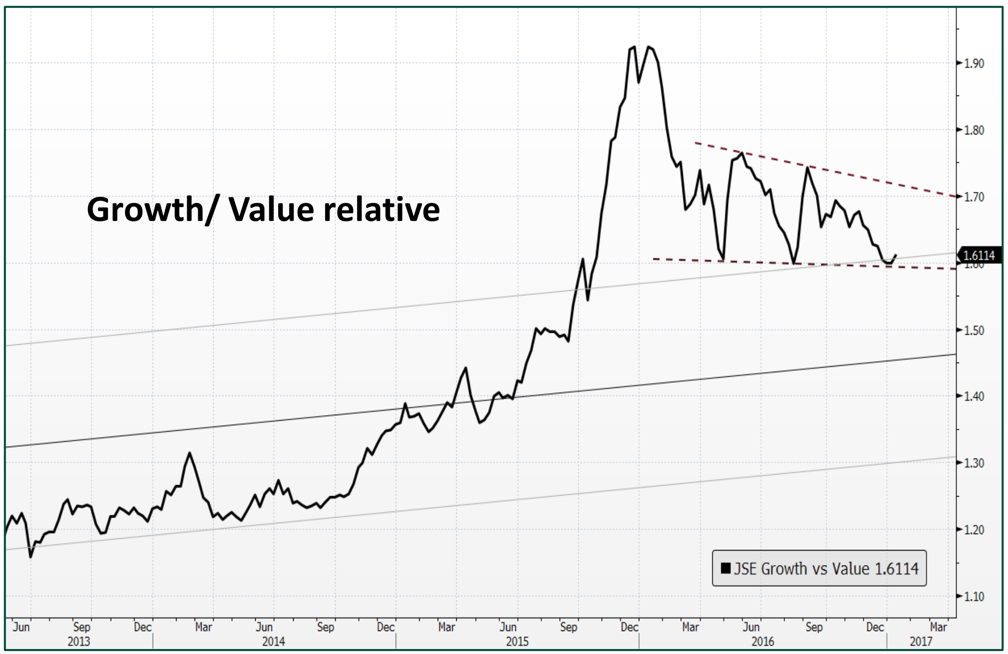
JSE Growth and Value Indices

Growth/Value over performance in ST but Growth/Value underperformance in LT

- Since the risk-on phase started in early 2016 and since resources started to rally, the value index has been outperforming the growth index. Over the short term the relative is likely to rally to the top of the wedge ,with Naspers likely being the driver. This rally is to complete the 5th wave within the wedge pattern. However, the current set-up indicates further underperformance of growth vs value.
- The relative is currently still one standard deviation above trend level and we would expect a move back to at least the linear regression line.
- Below is our picks and puts on the list of the top 10 growth and value stocks.
- For classification of the JSE Growth/Value stock please visit the link from the JSE: Style (Value and Growth).
- For more details on our stock selection please see : https://www.nedbank.co.za/content/dam/nedbank-crp/reports/TechnicalAnalysis/2017/Jan/BottomUpEquitySelectionModel_170109.pdf



	Stocks from our Growth/Value theme	OW	UW
Growth stocks	Naspers Ltd	X	
	BHP Billiton PLC		X
	Cie Financiere Richemont SA	X	
	British American Tobacco PLC		X
	FirstRand Ltd		X
	Steinhoff International Holdings NV		X
	Remgro Ltd	X	
	Mondi PLC	X	
	Aspen Pharmacare Holdings Ltd	X	
	Standard Bank Group Ltd		X
Value stocks	MTN Group Ltd	X	
	Sasol Ltd	X	
	Anglo American PLC		X
	Standard Bank Group Ltd		X
	Growthpoint Properties Ltd	X	
	Bidvest Group Ltd/The		X
	Redefine Properties Ltd	X	
	Mediclinic International PLC	X	

Source: JSE, Bloomberg

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JSE Banks, Industrials and Naspers

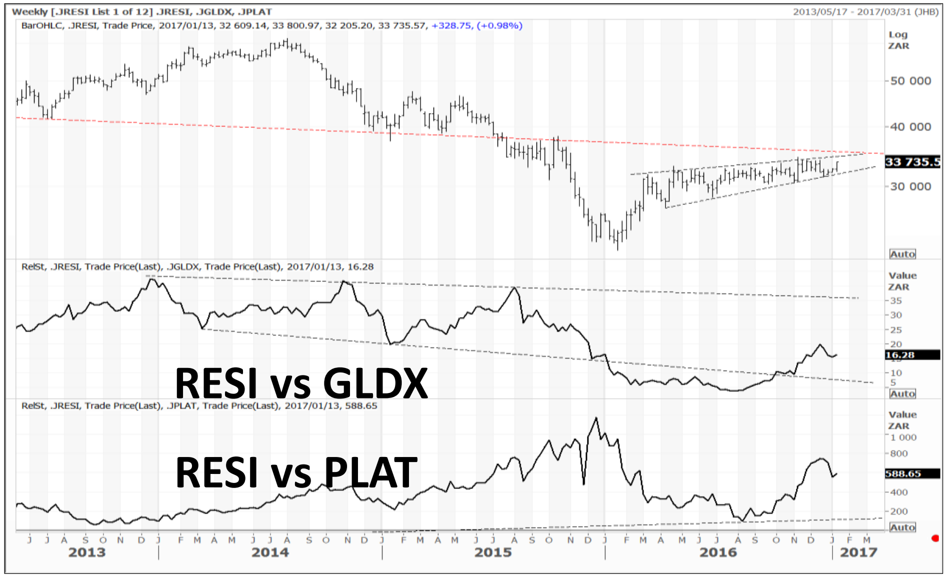
Banks are losing momentum, Naspers will again be the driver of the Indi in our view

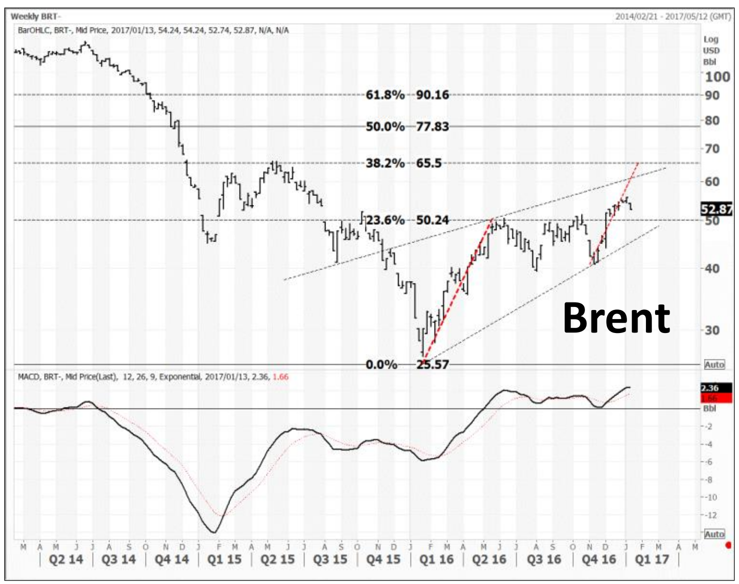
- The overlapping price action during 4Q16 on the **bank index** indicates that the index is losing momentum. Subsequently, the relative of banks over life offices has broken down, indicating that banks will underperform life. If our view of a strong equity market is correct, it would boost life offices.
- **Industrials** is still the driver behind the All Share and is now close to an important resistance line at **66,600**. A short-term consolidation phase is expected but we believe it is just a matter of time before the market breaks through this resistance.
- **Naspers** must break **R2,284** to break an important neckline and move back into a previous bull trend.

Source: Thompson Reuters

Other Tactical trades: JSE Resources, Gold & Platinum, Brent & Sasol

The Resource index is losing momentum



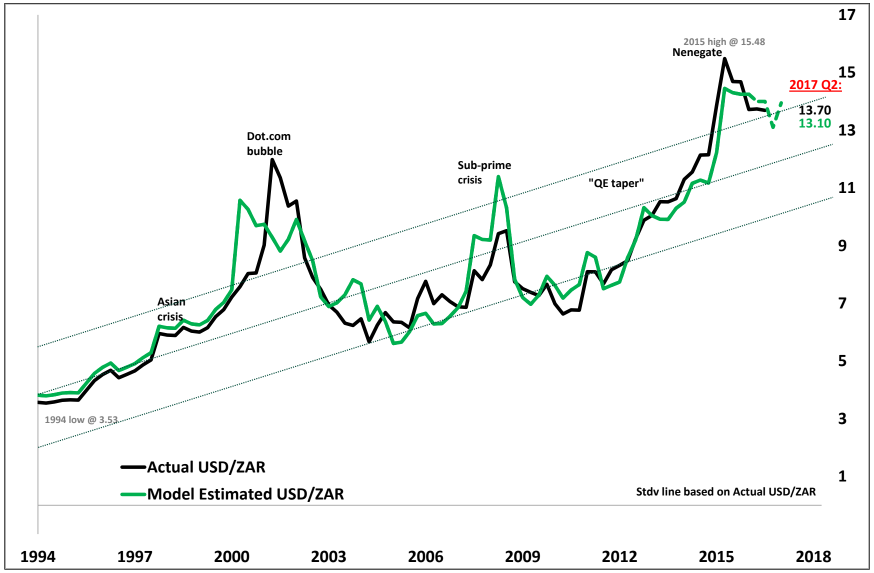


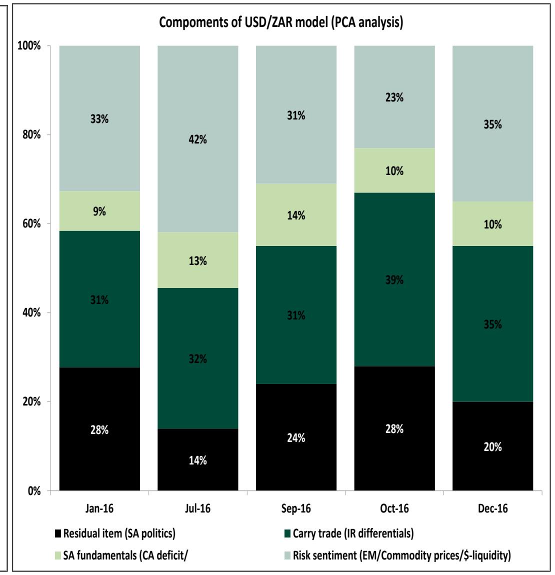
Source: Thompson Reuters

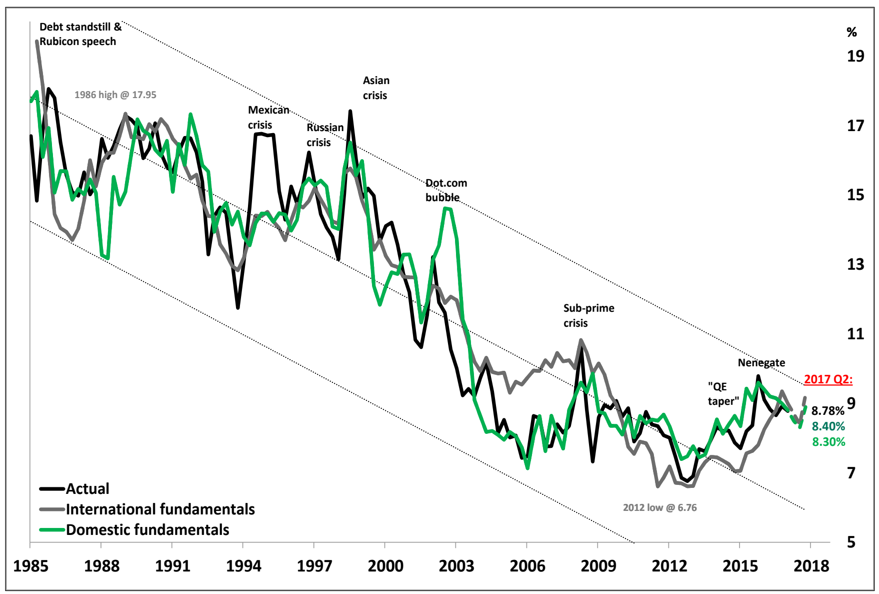
- The **resource sector** is grinding higher but the overlapping nature indicates that the trend is losing momentum. Since the start of 2H16 we have preferred the big diversified miners over gold and platinum. We expect the opposite to play out now, and expect more return from gold and platinum miners when compared to the diversifieds.
- **Oil** is on its way to test the 38.2% retracement level, which is also the point where the two major waves up will be equal in length. The rally in oil should also be dollar bullish as the higher oil price adds to the petro-dollar balances which in turn boosts the Eurodollar system and global dollar liquidity through higher FX reserves.
- **Sasol** could benefit from this and a break above **R413** would project a rally to **R500**.

Our Fair-Value models: USD/ZAR and SA 10yr Generic Government bond

Stable $-liquidity environment in the ST is having a positive impact on our FV models







Source: DS, E-views econometric package

- Our forecasted fair-value for the **USD/ZAR** over the next one to three months is **13.20** - based on improving EM and commodity prices. Global dollar liquidity conditions have also stabilised for the time being.
- Our forecasted fair-value for the **SA 10yr generic government bond** from a SA fundamental view is **8.30%,** while from a international fundamental view it is **8.40%**. SA's strong correlation with the US yield curve and term-premium is the main driver of our model.
- Volatility in the residual item (political premium) of our model is likely to continue which will make forecasting difficult.
- Going into the second half of 2016 we expect dollar liquidity conditions to tighten. This would not bode well for SA FX and FI.

THANK YOU

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