STRATEGY NOTE:

EQUITY STRATEGY

STOCK MARKETS THE NEXT VICTIM OF $-LIQUIDITY SHORTAGE

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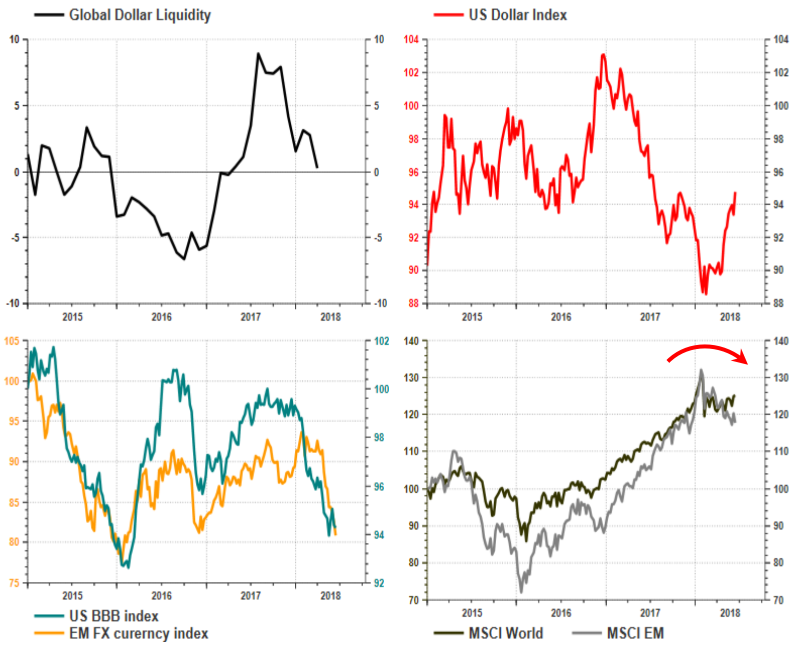
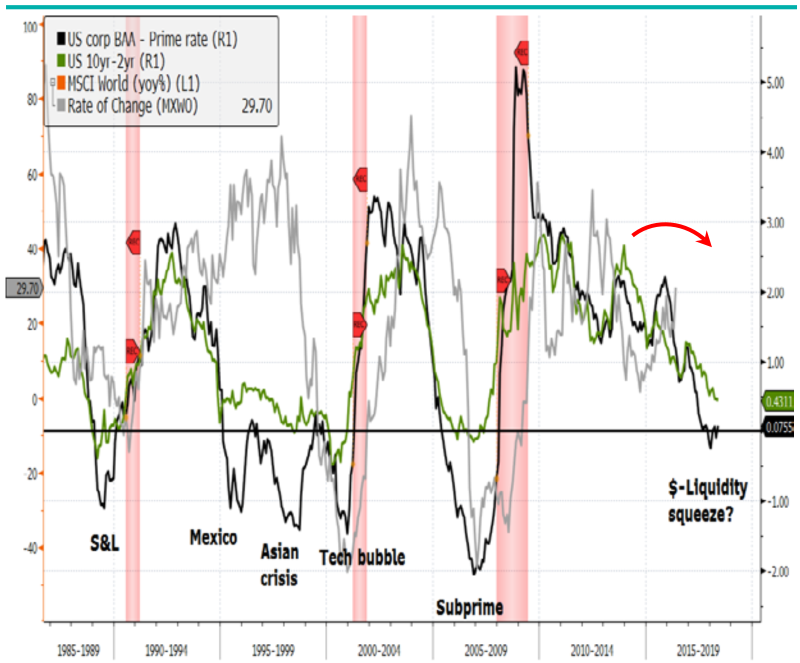
SEQUENCE OF EVENTS – ALL ABOUT THE US DOLLAR



Source: Reuters, Nedbank CIB

- **The current sequence of events playing out globally and the resultant turmoil being experienced in the financial markets was not an exogenous shock, but was predictable in our view.**
- $-Liquidity tightening since March has led to US Dollar strength and triggered the unwinding of the carry trade –We believe the best way to understand the changes in global macro liquidity is through the lens of global $-Liquidity and the US Dollar.
- **In a world where central banks control both the quantum of money (i.e. QE) and the price of money (policy rates) we must warn readers to keep an open mind to the changes in global macro liquidity as it is not just traditional monetary policy that matter –this has become very evident over the last three months.**
- It is highly unlikely that the equity market will not be influenced by the higher cost of capital. It is not if but when the equity market starts to respond to this and we believe it is imminent.

CORPORATE SECTOR YIELD CURVE INVERTS SPELLING TROUBLE FOR STOCK MARKET



Source: BBG, Nedbank CIB

- The sovereign and corporate debt yield curves are obviously highly correlated to each other and the stock market.
- The corporate curve is starting to invert which indicate the cost of capital for corporates is now higher than the return on capital.
- **Corporates are highly geared and we are concerned the next phase of a contraction in global $-Liquidity and rising real rate (term-premium) will infiltrate the stock market.**

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OMINOUS SIGNS FROM THE WORLD'S MOST IMPORTANT FINANCIAL INSTITUTIONS

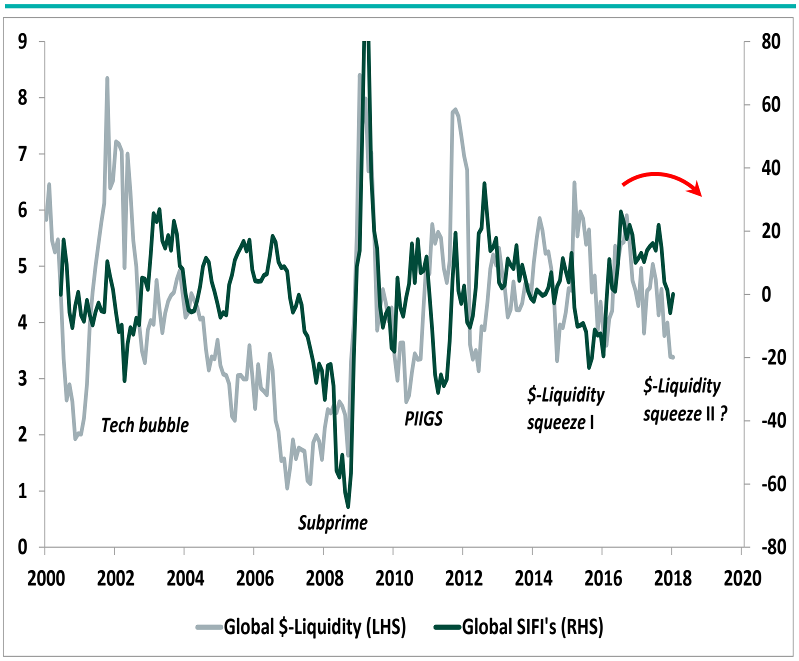
Source: BBG, Nedbank CIB

**G-SIFI's = Full list can be found here: Largely consists of the world's largest Banks, Insurance Co's and Pension funds.*

**Liquidity conditions beneath the surface= rising shadow rates, LIBOR, falling petrodollar balances*

- **We believe in today's highly interconnected and heavily leverage financial system the FSB's Global Systemically* Important Financial Institutions (G-SIFI's) are important to monitor.**
- A market weighted cap index of the FSB's G-SIFI's has decoupled from the S&P500 and the Nasdaq since the beginning of 2018 , losing 18% or $850bn of its market cap value. We do not believe this decoupling will be sustainable. Either the rest of the equities must come under pressure or the financial sector must rally.
- We have been sceptical of *"global synchronized growth"* narrative in the market. The recovery was credit fuelled and with the financial conditions tightening beneath the surface the strains are being reflected in the performance of these financial institutions.

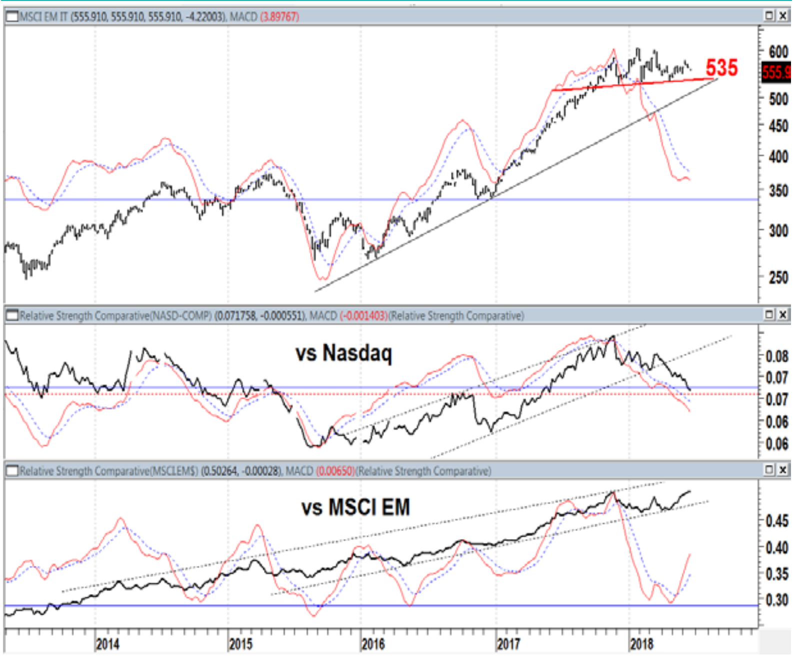
FALL IN GLOBAL $-LIQUIDITY IS LEAVING G-SIFI'S VULNERABLE



Source: DS & Nedbank CIB

- G-SIFI's are heavily dependent on USD funding since the world operates in a USD based reserve currency monetary system. Hence the correlation and causal relationship between our $-Liquidity indicator and the performance of the G-SIFI's. The answer always sits in global $-Liquidity conditions and the value of the dollar.
- **Why should our SA clients be concerned about G-SIFI's?**
- Broadly speaking the G-SIFI's have been intermediaries/funders of the carry-trade that EM's have benefited from hence our concern for SA assets.
- The rand and the SA bond markets have already re-acted to the unwinding of the carry trade and the equity market will be next, the next slides will address the EM and SA equity markets.

MSCI EM AND EM INFORMATION TECHNOLOGY



Source: Reuters, Nedbank CIB

- From 2011 to the end of 2015 the dollar was in a bull market and the EM markets across most asset classes under-performed (see middle panel vs. Nasdaq).
- During the 2016-2017 risk-on phase the EM's out-performed but that ended in 1Q18. a break below the red-dotted mid point line will open substantial downside potential.
- **The EM tech stocks are still out-performing the other EM equities (bottom panel) but a break below the neckline at 535 will most probably call a top in this relative as well.**

TECH HEAVY WEIGHTS (NPN AND TENCENT) FAILED AGAINST RESISTANCE LINES

Source: BBG & Nedbank CIB

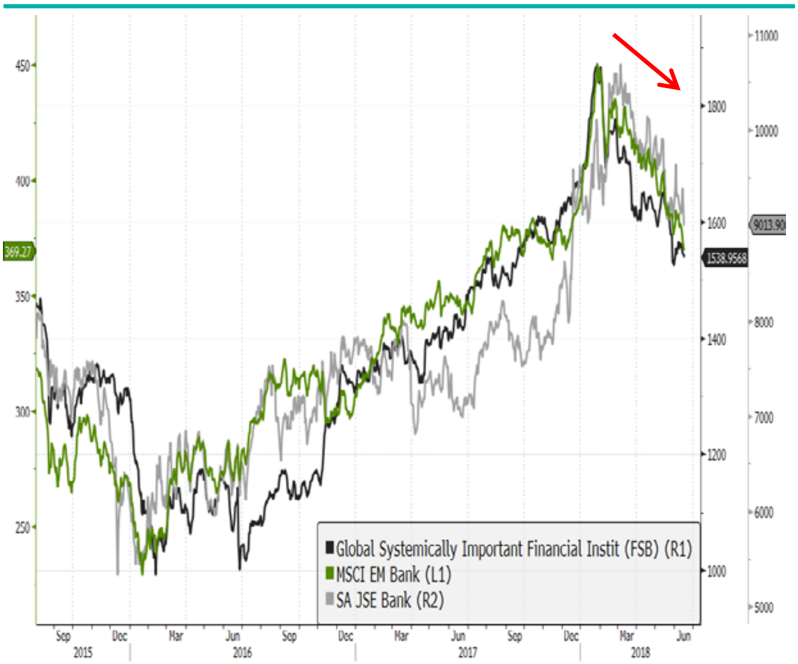
- As the unwinding of the EM carry trade spills over into the equity market the IT-stocks will become vulnerable because of their weightings in the MSCI EM index and amid passive/ETF investment strategies.
- As with the SA rand and bonds, it is not the underlying fundamentals that drive the market. The global flows and the market being caught on the wrong foot is the driver.
- **Both Naspers and Tencent turned down from very important (blue) resistance lines**.
- We can expect these shares will now target the bottom of the bull channels that has been in place since 2014 at HKD329 and R2842.

JSE ALL SHARE WEIGHTED INDEX (J403) TESTING AN IMPORTANT SUPPORT AT 12093

Source: Reuters, Nedbank CIB

- We cannot shout wolf until the index breaks below the line through the previous highs at 12093.
- **If we look at what is happening globally we believe it is just a matter of time before the market breaks below this level targeting 11329 with an extended target at the 4Q16 low at 10782.**
- The SA equities over bonds (bottom panel) has just completed an ABC rally post a 5-wave structure bear market from November 2017 to the 2Q18 low. We expect bonds to out-perform equities over the rest of the year.

SA AND EM BANKS VS. GLOBAL SYSTEMICALLY IMPORTANT INSTIT'S



Source: BBG & Nedbank CIB

- The global trend of selling banks is also working its way into SA banks and we believe there is further downside potential.
- As stated above we are negative on the equity market but to soften the blow we would recommend holding the following sectors and stocks:
  - **Resources** should out-perform with Platinum beating gold and IMP over AMS.
  - **Defensive rand hedges** we would recommend are BTI, CFR, Mondi and Bidcorp, but not MTN or Sasol.
  - **Health care** is close to support and so is Remgro.

JSE TOP-40 IN $-TERMS, HAS BROKEN OUT OF THE BULL TREND

Source: Reuters, Nedbank CIB

- **The JSE in $-terms failed against the trendline through the tops and has subsequently broken out of the bull trend.**
- This break targets 3400 with an extended target at 2953.
- At this stage most of the damage in the EM markets is coming from the EM currencies. But as stated above we expect this to move into the equity market over the following weeks.

$-RAND, BUSY WITH AN ACCELERATION PHASE

Source: BBG & Nedbank CIB

- We have been $-rand bulls with a year end target at 13.10. The market has accelerated through our target levels without stopping at any resistance levels. Every correction we called failed to reach our target both in level and duration.
- **At 13.94 the dollar is testing a previous high.** If this resistance breaks the market is likely to target 14.57. At this level wave 5 will be a 161.8% Fib extension of wave 1 to the top of 3.
- We do not expect a break above 14.57 unless the USD index breaks above 95 on a sustainable basis or should our global $-Liquidity indicators move into negative territory as they have merely slowed down at this stage.
- **The important support is now the lower 13.50's.**
- For more on the rand please see FX Insights "RAND: ALL ABOUT THE "L" WORD – LIQUIDITY"