STRATEGY NOTE:

EQUITIES

GLOBAL FORCES DRIVING THE SA STOCK MARKET

NEELS HEYNEKE
Senior Strategist
Nheyneke@Nedbank.co.za

MEHUL DAYA
Strategist
MehulD@Nedbank.co.za

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MSCI WORLD IN LATTER STAGES OF CORRECTION PHASE

Source: Reuters, Nedbank CIB

- Post the 2008/9 Great Financial Crisis, Asia was the next and potentially the final chapter in the debt super-cycle that started in the 1970's. As global interest rates converged to trade at record historically low levels the world's markets became highly correlated.
- In this environment the top-down macro approach is equally if not more important than the traditional bottoms-up approach. Global factors (capital flows, carry-trades, financial conditions) have become a dominant driving force – this is not just our opinion but a number of empirical studies published recently also prove this.
- Research by the OECD indicates that 70 percent of valuations are now determined by global factors and only 30 percent by local factors or company specifics.
- The corrective rally since 2Q18 is sub-dividing longer than we anticipated on the back of the FAANG stocks. **We however remain of the opinion we have seen the high in global equity markets for the time being as the disinflationary forces starts to gain momentum again on back of the strong dollar.** There is a very high probability that wave 2 is complete and the immediate outlook is bearish.

MSCI EM AND RELATIVE TO WORLD IN A WELL DEFINED BEAR

Source: BBG, Nedbank CIB

- As the dollar started to rally in the beginning of the year, the carry trade started to under-perform. It was the increase in the cost of dollar funding that forced international investors out of the carry trade and not necessarily where the money was invested.
- Unfortunately the EMs took on lots of dollar debt post 2008 and as the dollar rally started, the liquidity squeeze became a balance sheet problem for Turkey and Argentina. We believe the next dollar bull phase will trigger balance sheet problems in Asia.
- The EM index found support at the important neckline from 2011 at 1012 but remains in the well defined bear channel.
- **As long as the US dollar index is in its current correction phase the 1012 support is likely to remain intact.**
- The relative of EM/DM has broken down out of a flag formation and should eventually trade well below the 1Q16 low.

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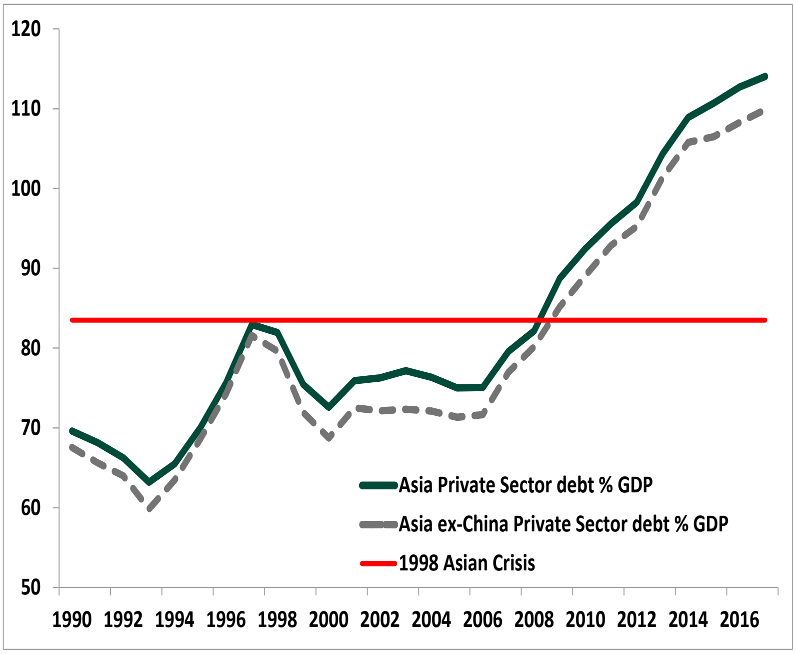
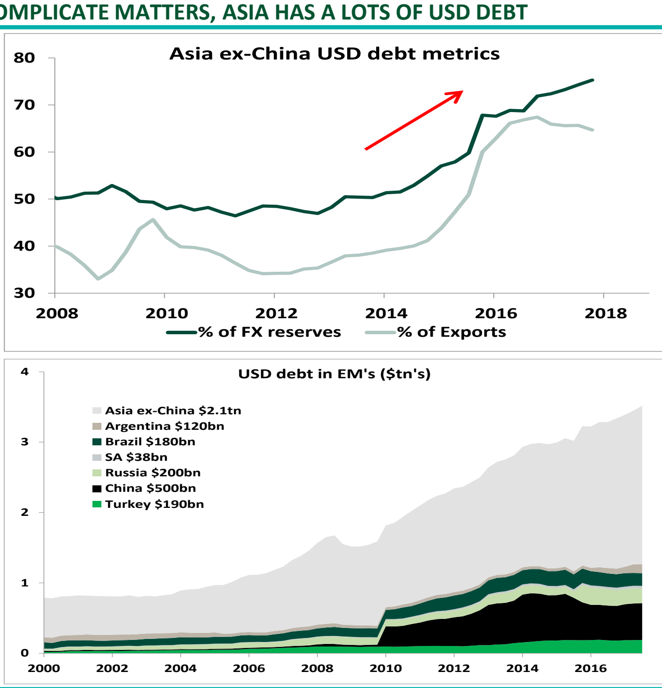
ASIA THE ELEPHANT IN THE ROOM, NOT TURKEY



Source: World Bank, DS, Nedbank CIB

- The global dollar liquidity shortage has been at centre stage since the beginning of the year exposing only the weakest part of the global economy – Turkey.
- However a closer examination of global debt levels reveals that Asia has engulfed itself in debt since the 2008/9 GFC. It is not just the quantum but also the pace that is of a concern here.
- Asia ex-China private sector credit as % of GDP has mushroomed to 115%, surpassing the 1998 Asia crisis high of 88%.

TO COMPLICATE MATTERS, ASIA HAS A LOTS OF USD DEBT



Source: BBG, Nedbank CIB

- To complicate matters, Asia (ex-China) has also managed to issue debt in foreign currency terms , in particular in dollars.
- Asia's dollar debt as percentage of FX reserves and exports has grown substantially. Hence our concern, a slowdown in the global economy and a further contraction in global dollar liquidity will leave many of these economies vulnerable.
- Contagion risks from Asia into the rest of the world is only likely to materialise in the next wave of dollar liquidity shortages.

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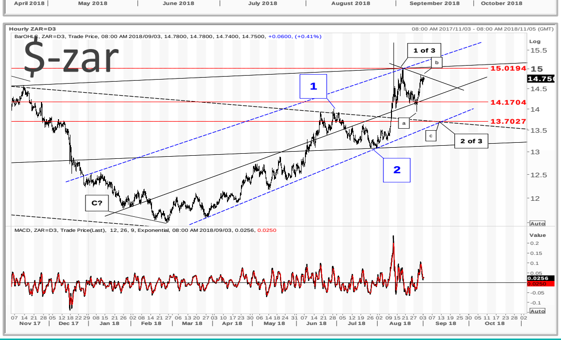
MSCI ASIA HAS BEEN UNDER-PERFORMING THE WORLD STOCK MARKETS

Source: BBG, Nedbank CIB

- The relative on this chart is the MSCI Asia (ex Japan) over the MSCI World (ex Japan & Asia).
- The Asian equity index has been in bear trend since the commodity cycle peaked in 2011.
- **This index is now testing the major support level of the risk-on phase during 2016 and 2017. We expect a rally from this support over the short-term and would only expect a break to the downside during the next dollar bull phase.**
- This pattern during 2016-17 is a text-book up-flag continuation pattern and should break to the downside. It is now down to get the road-map and timing right.

EUR/USD AND USD/ZAR REMAINS IN A SHORT-TERM CONSOLIDATION PHASE



Source: Reuters, Nedbank CIB

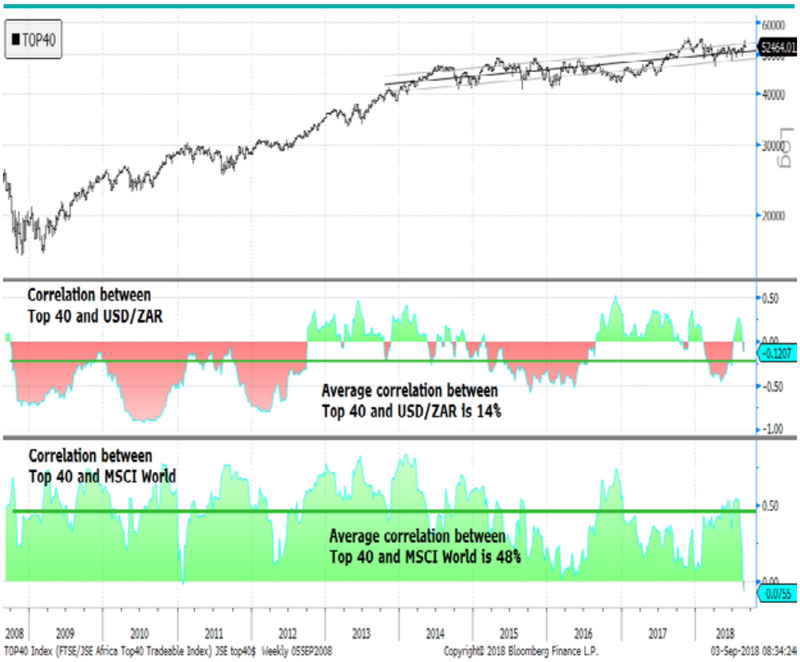
- The euro-dollar is busy with a major corrective wave and we expect several more weeks of consolidation.
- **A text book pattern would be if the euro corrects to 1.1567 or 1.1515 followed by a rally to 1.20. At 1.20 the A-wave and C-wave will be equal in length.**
- Post the completion of the C-wave we expect another major bear wave in the euro targeting a move to below parity.
- **The dollar-rand can rally to 15.00 during this B-wave before the C-wave down starts. A correction below 14.65 will indicate the C-wave is unfolding targeting 13.70.**
- At this latter level the A and C-wave will be equal in length testing the support line from 1Q18.

JSE TOP-40 (USD) IS UNDER-PERFORMING THE EM INDEX

Source: Reuters, Nedbank CIB

- The JSE in USD is a near mirror image of the MSCI EM but is trading below the neckline from 2011 and is targeting the 3029 support level.
- Our view is that the dollar will rally again later this year into 2019. This next dollar bull phase is most likely to trigger a break below this Rubicon support level at 3029.
- The SA equity market is under-performing the other EMs and we expect this to continue.

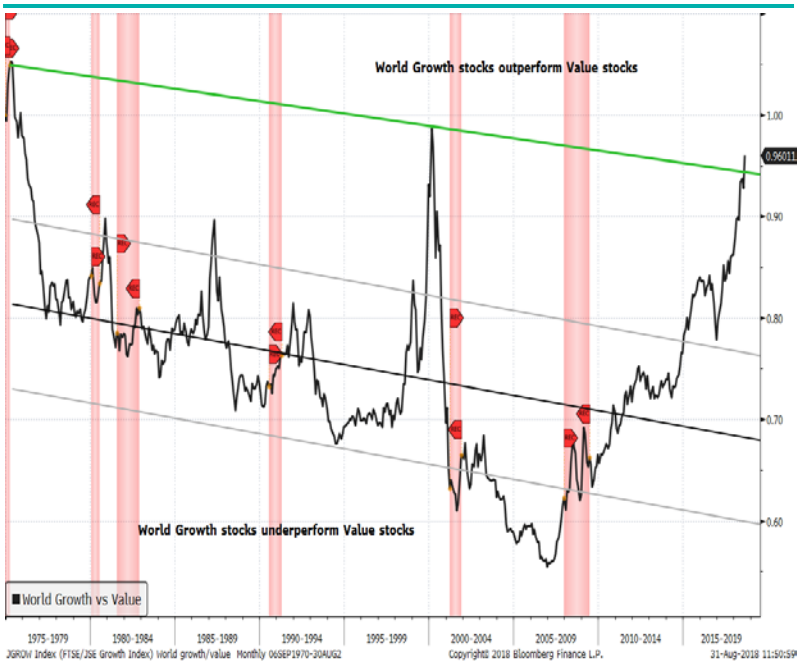
JSE TOP-40 MORE INFLUENCED BY GLOBAL STOCKS THAN A WEAK RAND



Source: BBG, Nedbank CIB

- **The belief that there is a strong relationship between the Top-40 and the USD/ZAR is unclear and is just a "belief" in our view**. There is a weak correlation between the returns of the Top-40 and movement in the currency (middle panel). Further studies such as PCA, granger causality and regression analysis that we have tested, also suggest this.
- Instead, we have found that the relationship between the Top-40 and returns from **global stock market** such as the MSCI World (bottom panel) is stronger. Changes in **commodity prices** also have a strong relationship with the JSE. This is even as the commodity weights in the Top-40 has fallen drastically.

RELATIVE OF WORLD GROWTH OVER VALUE STOCKS CLOSE TO 2000 TOP



Source: BBG, Nedbank CIB

- World growth stocks relative to value stocks is now marginally above the resistance line from 1975 fuelled by the tech stocks trading close to the Nasdaq top.
- In a world where passive investment has become very popular because of the cost benefit, the concentration risk of the narrow leadership is a potential threat for a sbecause harp correction, especially in the large cap tech stocks.

EM AND SA GROWTH OVER VALUE, WAITING TO CONFIRM A TREND REVERSAL

Source: BBG, Nedbank CIB

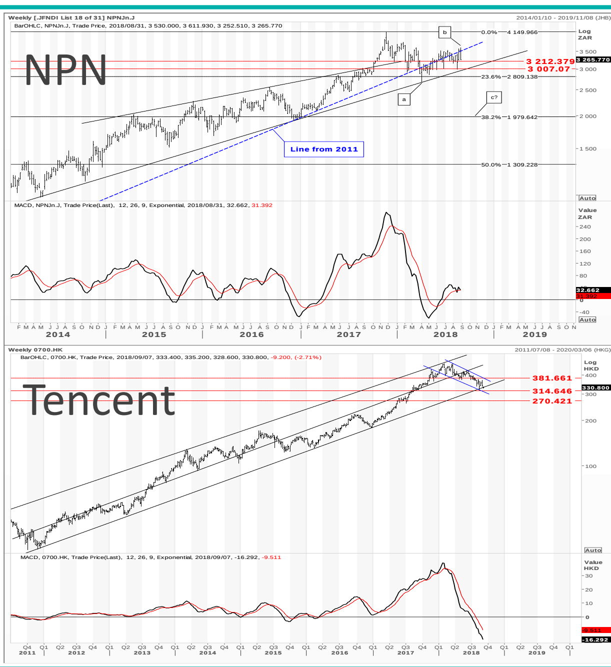
- The EM growth over value is losing momentum but has not taken out previous lows to confirm the reversal.
- The SA relative lost momentum late last year and is consolidating against the linear regression line and an important neckline.
- **A confirmed sell signal on both these relatives will spell trouble for the EM tech stocks and Naspers – leaving the growth vs. value stocks performance at risk.**

JSE INDI-25 CONSOLIDATING AGAINST AN IMPORTANT SUPPORT LINE

Source: BBG, Nedbank CIB

- The Indi-25 has tried several times during 2018 to break below the important neckline from 2013.
- The longer the market consolidates against this line the higher the probability that a confirmed break to the downside will materialise. A confirmed break below 73 070 will signal that the next major wave down has started.
- A break below 73 000 will target 60 556 which is the low of late 2016. At this level wave C will also be equal to wave A.
- The relative to the JSE All Share is likely to fall a bit further than we originally anticipated. Our view was and is that the large cap rand hedges will favour the Industrials over the All Share. This remains our long-term view but we are concerned that a major set-back in EM stocks can drive Naspers lower than we originally anticipated.

NASPERS AND TENCENT



Source: Reuters, Nedbank CIB

- The rally post the latest Tencent results has lost momentum and the price is again breaking out of the bull trend that has been intact since 2011. The MACD has now also broken convincingly below the zero line indicating the trend is bearish.
- A break below HKD314 targets a move to HKD270.
- Naspers was obviously supported by the weak rand, however as we have pointed out above, a weak rand only helps so much and then the global equity prices take over.
- The rally off the April (wave A) low in Naspers is too overlapping to be a bull trend and the share price has been failing to break back into the original (blue) bull channel.
- Naspers must however break below R3 000 to confirm a reversal out of the long-term bull channels. A break below R3 000 targets a move to R1 979.
- The MACD is rolling over and a break below the zero line and the previous lows will confirm that Naspers has further downside.