STRATEGY NOTE:
BONDS AND FX STRATEGY
APPROACHING 'RUBICON LEVELS'

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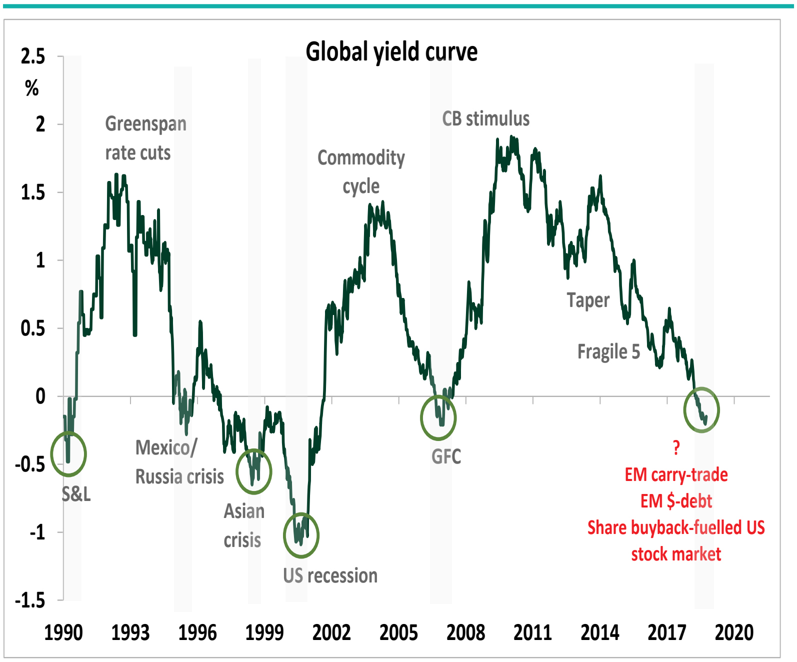
GLOBAL BOND YIELDS ON THE MOVE AMID TIGHTER GLOBAL FINANCIAL CONDITIONS

Source: BBG, Nedbank CIB

- The first half of 2018 was dominated by tighter global financial conditions amid **the contraction in Global $-Liquidity**, which resulted in the stronger **US dollar** weighing heavily on the performance of risks assets, particularly EM assets and, of course locally, on our currency (-15% YTD vs USD), bonds (+60bps YTD, R186) and equity market (-8% YTD, Top40).
- Global bond yields are on the rise again, led by the US Treasury yields, which as we have highlighted in numerous reports, is the **world's risk-free rate**.
- The **JPM Global Bond yield**, after being in a tight channel, has now begun to accelerate higher. There is scope for the JPM Global Bond yield to rise another 20-30bps, close to **2.70%,** which is the **'Rubicon level'** for global financial markets, in our view.
- If the JPM Global Bond yield rises **above 2.70%,** the cost of global capital would rise further, unleashing another **risk-off phase**. Our view is that 2.70% will hold, for the time being.
- We believe the global bond yield will **eventually** break above 2.70%, amid the contraction in Global $-Liquidity.

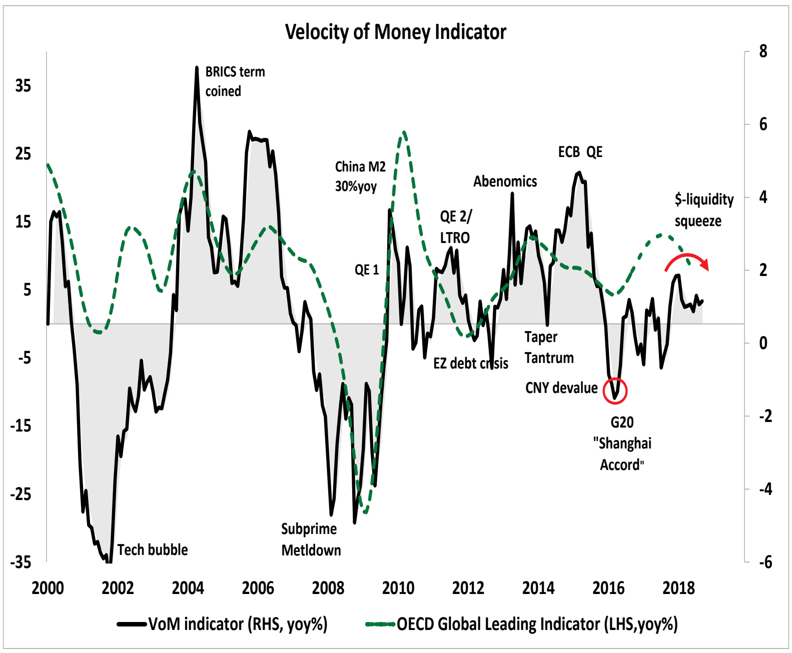
GLOBAL LIQUIDITY CRUNCH NEARING AS GLOBAL YIELD CURVE FLATTENS/INVERTS



Source: Spread between 1-5yr to 5-10yr maturity buckets of JPM Global Bond index, Nedbank CIB

- **A stronger US dollar and the global cost of capital rising is the perfect cocktail, in our opinion, for a liquidity crunch.**
- **Major liquidity crunches often occur when yield curves around the world flatten or invert.** Currently, the global yield curve is inverted; this is an ominous sign for the global economy and financial markets, especially over-valued stocks markets like the US.
- The US economy remains robust, but we believe a global liquidity crunch will weigh on the economy. Hence, we believe a US downturn is closer than most market participants are predicting.

GLOBAL VELOCITY OF MONEY WOULD LOSE MOMENTUM



Source: Nedbank CIB, VoM indicator = Changes in global yield curves, bank stock prices, corporate spreads, money multiplier and commodity prices;

- The traditional velocity of money indicator can be calculated only on a quarterly basis (lagged). Hence, we have developed our own velocity of money indicator that can be calculated on a monthly basis.
- **Our Velocity of Money Indicator (VoM)is a proprietary indicator that we monitor closely.** It is a modernised version of Irving Fisher’s work on the Quantity Theory of Money, MV=PQ.
- We believe it is a useful indicator to understand the 'animal spirits' of the global economy and a leading indicator when compared to PMIs, stock prices and business cycle indicators, at times.
- The cost of capital and Global $-Liquidity tend to lead the credit cycle (cobweb theory), which in turn filters through to prospects for the real economy.
- **Prospects for global growth and risk assets are likely to be dented over the next 6-12 months, as the rising cost of capital globally will likely weigh on the global economy’s ability to generate liquidity – this is already being indicated by our Global VoM indicator**

SUPPORTS TO HOLD, FOR NOW…

Source: BBG, Nedbank CIB

- As the JPM Global yield targets 2.70%, we believe local bonds will remain under pressure, targeting close to the 9.40% level. We, however, believe 9.35% will not be breached.
- We expect the rand to consolidate around **14.70**, potentially targeting **15.00** in the short term, but we **do not** expect weakness above 15.00 to **be sustained.**
- **In the next phase of Global $-Liquidity shortage**, we expect local bonds to climb above 10%, targeting 10.50%, and the currency to breach 15.00, targeting 15.80.