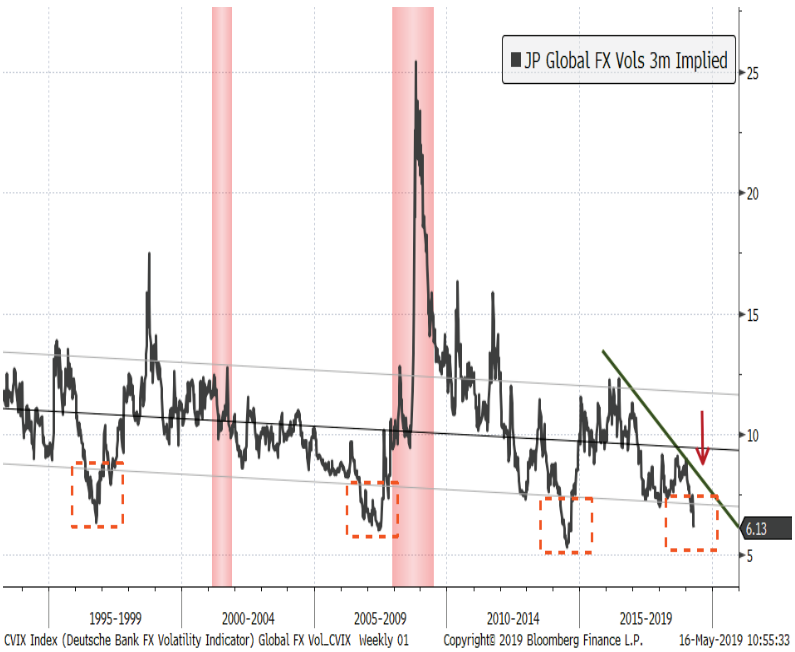
FX STRATEGY

WEDGES…EVERYWHERE!

NEELS HEYNEKE
Senior Strategist
NHeyneke@Nedbank.co.za

NEDBANK CIB

JPM GLOBAL FX VOLATILITY (3M IMPLIED): TRADING AT EXTREMES



Source: Reuters, Nedbank CIB

- FX volatility is unusually low in light of the uncertain macroeconomic environment of trade wars and slowing global growth.
- Studying the long-term charts of the major currencies (see below), it is understandable why this volatility index is so low. Most of these currencies are converging into wedges, waiting for a signal.
- But history warns that this is not the time to extrapolate the low volatility trend. Reversals from this low level in the past went hand in hand with major upheaval in the markets. In 1997, it was the start of the Asian Crisis; in 2008, it was the GFC; and in 2014, it was the start of the oil bear market that had a major impact on petrodollar balances and the value of the USD.
- The trigger is always difficult to pinpoint, but we can assume that it will be the geopolitical risks that are building.
- We believe it is time for clients to put hedges in place.

DXY: COMMODITY CYCLES PLAY A SIGNIFICANT ROLE IN THE VALUE OF THE USD

Source: Reuters, Nedbank CIB

- The rally in the early 1980s was because of a fixed exchange rate regime. This reversed sharply after the signing of the Plaza Accord in 1985.
- Since then, commodity and oil prices have played an important role in the value of the USD. As commodities rally, USD balances of producers increase and the value of the USD falls. Note how the USD rallied in 2014 when the oil price fell from USD120 to USD30.
- In recent quarters, global trade and the economy have come under pressure. China and the US have been doing the heavy lifting, and the market is waiting to see whether the business cycle can be extended. For example, the equal-weighted commodity index has gone nowhere since 2016.
- The quarterly MACD has been moving sideways for several quarters, something that happened only once before, in 1995, just before the trouble started in Southeast Asia.
- Everybody would like to know the trigger, timing and direction of the next major move, but the reality is that we don't. As pointed out above, all we know is that it is time to be on high alert.
- See our Global Macro Insight: "Trade Wars" and the Velocity of Dollars for more details on what are likely to be the consequences of this break out of the long-term bear market in the USD.

NEDBANK CIB

TECHNICAL STRATEGY NOTE

EURUSD: WORKING LOWER IN A WEDGE AGAINST AN IMPORTANT MID-POINT LINE

Source: Reuters, Nedbank CIB

- The long-term EUR chart (not shown here) is, for obvious reasons, the near inverse of the DXY, except that the EUR has not broken out of the bull trend since 1985.
- The short-term daily chart is converging into a falling wedge, with the breakout levels at 1.1262 and 1.1103.
- Several weeks ago, we had a strong view that the EUR would accelerate to the downside to test the previous lows at 1.04.
- The pattern is, however, starting to unfold as a falling wedge and should break higher targeting 1.15-1.16. A quick reminder that falling wedges are reversal patterns, and symmetrical wedges are continuation patterns.
- Only a break above 1.20 would indicate a major breakout, as discussed above.
- An acceleration through the (blue) mid-point line at 1.1070 would be very negative, as the falling wedge would then be a correction in the direction of the trend. This type of pattern is, however, extremely rare.

JPY: WILL THE 50-YEAR-OLD TREND REMAIN INTACT?

Source: Reuters, Nedbank CIB

- The USDJPY has been forming a wedge over the past five years against the resistance line stretching all the way back to 1970.
- In theory, the USDJPY should break up out of this wedge, as symmetrical wedges are continuation patterns and the market entered the wedge from below.
- A break above the (green) neckline at 120 would be the absolute confirmation of a major trend reversal.
- A break of this nature would indicate that capital flight out of the low-return environment in Japan is unfolding. This is something we will monitor with great interest, as it will likely have a major influence on asset prices in other countries, including the high-yielding SA market.
- The MACD is flat on the zero line, confirming the lack of trend.

TECHNICAL STRATEGY NOTE

SA TRADE-WEIGHTED RAND: ALSO TRAPPED IN A WEDGE

Source: Reuters, Nedbank CIB

- The trade-weighted rand is rallying within the wedge that has been forming since the start of 2016, targeting 61.46.
- If everything plays out according to the text book, this rally should complete the wedge pattern. Wedge patterns should, in theory, consist of five waves.
- The MACD close to the zero line confirms the lack of trend.

USDZAR: TARGETING 13.81 ON SHORT-TERM CHART

Source: Reuters, Nedbank CIB

- The USDZAR is breaking a support line at 14.17. If this break proves to be sustainable over the next day or two, it would project a move to 13.81.
- A break below the latter would project further downside potential to 13.07. We, however, ascribe a very low probability to this outcome.
- The overlapping price pattern since the 3Q18 high indicates that this is a corrective pattern in a bigger bull trend.