

## **Update: Japan, China, New York**



February 17, 2008

Not to get punk, but China and New York are each in (the) red, even if not for entirely the same reasons. I mean the US isn't going to go leftist. Not in this millennium, anyway.

### **JAPAN**

The Nikkei made a volatile test of higher lows, as did smaller Japanese indices. There is no confirmation of the cyclical lows but we can reiterate what the last report concluded, namely, that the flush out was historically consistent with Japan bottoms and consistent with the market forecasts made in these pages. All I can add about confirmation is, "Fine, we'll see."

What I can confirm is that Japan, and its non-big-cap equities in particular, is that it has bottomed versus the rest of the world that we care about and making low risk, high return long-term money.

### **Domestic Japan & the Yen**

Remember when investors said that the carry trade would last forever? It's similar to the fear that domestic stocks will never turn around. Meanwhile, I argued that the Yen was about to turn around. I also

argued the same for domestic stocks and that the latter would turn with the former on a lag, as they did in 2004.

Well, I was early with the Yen. I will have been early with the domestic stocks, as well. However, in the end, markets reverse and order is restored. And the longer distortions last, the longer and farther the reaction/response will have been. Is it ever different? Ever?

On February 5, 2008, [Nikkei News](#) reported that the: ["Yen's Rise Set Off By Subprime Shock."](#)

["Waning yen carry trades and declining investment in foreign-currency-denominated assets by Japanese individual investors is giving the Japanese currency new strength."](#)

["The yen has been rising more sharply since the beginning of the year, with the Bank of Japan saying Monday that the Japanese currency's trade-weighted exchange rate jumped to a 14-month high in January."](#)

["On Jan. 23, the dollar was at the 104 Yen level for the first time since May 2005. The Japanese currency has appreciated by about 20 yen in six months after hitting 124.14 to the dollar on June 22, 2007."](#)

The Nikkei News article seems to pretty much line up with past reporting in these pages, and what accelerated matters was the advent of the subprime shock, which collapsed the rate spread from 5.25% to 2.5%.

Who saw that one coming, eh?

So, the carry trade is yesterday's news and who knows how much is left to be unwound. Is there a currency volatility shock around the bend? The kicker is that the other currencies have been softening, underscoring my now long-held argument that the Yen would be the best fiat currency in the world for price appreciation. Its role in our currency mix was crucial, I have maintained, to round out with gold (50%) and the Swiss Franc (25%), while the Yen also represents 25%.

["Individuals' investment in foreign currencies is also declining. In December, the net outflow to foreign currencies through investment trusts came to about 120 billion yen, just one-fifth the amount in July 2007. Individuals are believed to have become insecure because of market instability. Another factor is that financial institutions became less aggressive in selling investment trusts after the Financial"](#)

Instruments and Exchange Law\* took effect at the end of last September."

The excerpt immediately above from the same Nikkei News report continued to lay evidence to my months' old arguments.

Domestic Japanese investors are into that cycle of theirs where they turn their backs on foreign currencies, aided and abetted, moreover, by well-timed laws\* that are no accident. Who wins?

Japanese domestic stocks. Every cycle has its day. The longer the wait, the longer the run. These years will be interesting.

The sun is shining over Japan. You just have to look past any remaining first quarter 2008 clouds that are last year's hangover.

## CHINA

On February 5, 2008 Nikkei News reported on the negative effects of higher oil prices coupled with the higher Yuan under the headline, "Socialist China Reasserts Control Over Private Sector." Generally speaking, the government has reasserted socialist principles where market economy philosophy wasn't working. As a result, PeteroChina on the Shanghai index was cut in half, almost in-line with the index, from top-to-bottom.

A major deal between China Eastern Airlines and Singapore Airlines was nixed by the government for similar motives, though I'm painting with broad strokes here.

Finally, there is major worker upheaval as employers get dirty in undermining government laws that were designed to protect the employment of long term workers.

So, multi-hour line-ups at the gas stations stall business, steel companies and workers are in disarray, and major international deals fall apart as the nation looks inward to deal with problems for which it has no historical reference.

The warning I always gave was simple: There is no long term history of success, where there is no history of and respect for the rule of law and the infrastructure for the settlement of legal contracts.

If you prefer, here's how the February 5, 2008 Nikkei News article concluded the story:

**"Amid the negative impact of rising oil prices and the higher value of the yuan, experimentation will continue without the benefit of precedent or guidelines."**

## **NEW YORK**

I refer to the recent reports as the guide. The Dow is adhering to the script but, whatever the shorter-term gyrations, the key to remember is that a major secular bear market has begun. The focus must always remain on how to hedge against and profit from the massive bear.

Similarly, since exactly 6 years, I have written of the massive gold bull market, with trading only appropriate at major intermediate term or cyclical turning points.

So, as with gold, I must reiterate that knowing **how** to benefit is the trick. It needn't be difficult, but it must be disciplined, not by the seat of the pants. Otherwise, as I warned 6 years ago about gold, and reminded recently regarding the Dow, even the investors who are of the correct long-term view will find a way of screwing it up.

Good fortune to all,

Sid Klein

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