

Taiwan And The Carry Trades

Americans are blessed to live in a country with flexible, elastic definitions of reality. For example, the Supreme Court ruled in 1922 baseball was a sport, not a business, and therefore was exempt from the Sherman Act. Cool. The Federal Reserve can conjure trillions of dollars from the ether and declare it is not printing money because, you silly goose, the amount of cash in circulation has not been increasing. In addition, the Federal Reserve's Red Queen definitions of reality mean they are not creating asset bubbles outside of the U.S.

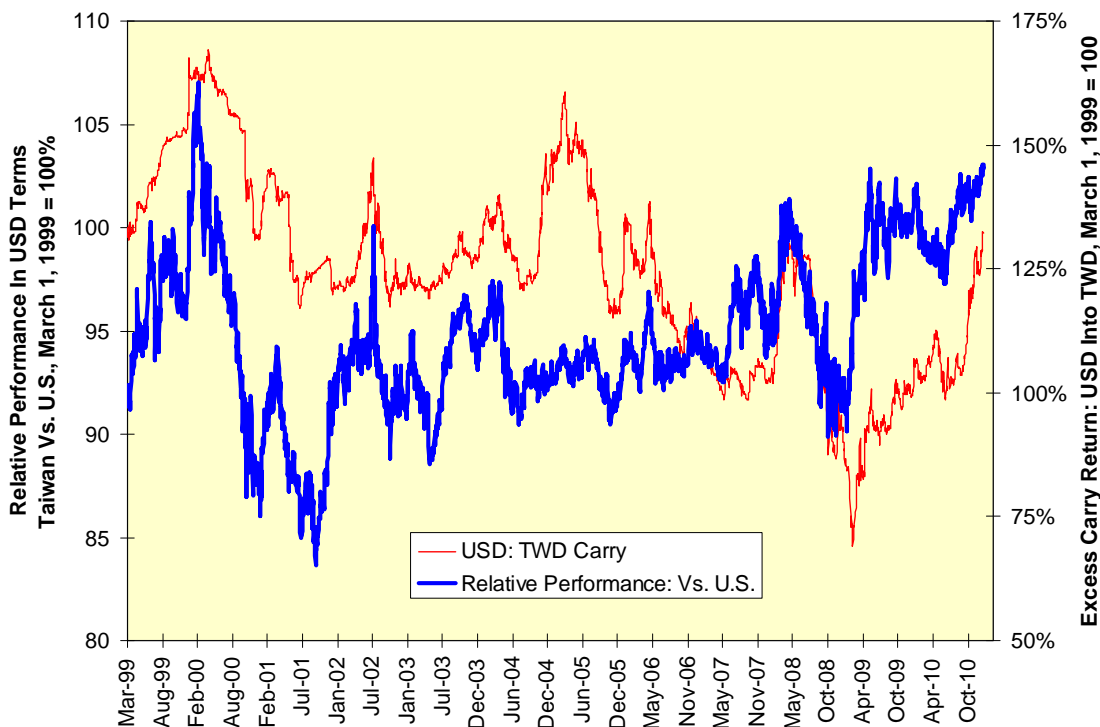
We observed *yesterday* the Peruvian markets are visiting the Inca sun gods without the benefit of an aircraft solely on the basis of the dollar carry trade. Let's spin the globe and have the dart land on Taiwan, which had been one of the great Asian economic success stories before mainland China became *the* great Asian economic success story and the convenient answer, along with hedge funds, to every financial question.

Oh, and while we are on the subject of reality, how about that 1972 Shanghai Communiqué stating there is one China and Taiwan is part of that China. Who expected that elegant piece of can-kicking to last this long? Certainly not hardened practitioners of realpolitik such as Richard Nixon and Chou En Lai; I am sure both thought they bested the other in this little finesse.

The Carry Trades

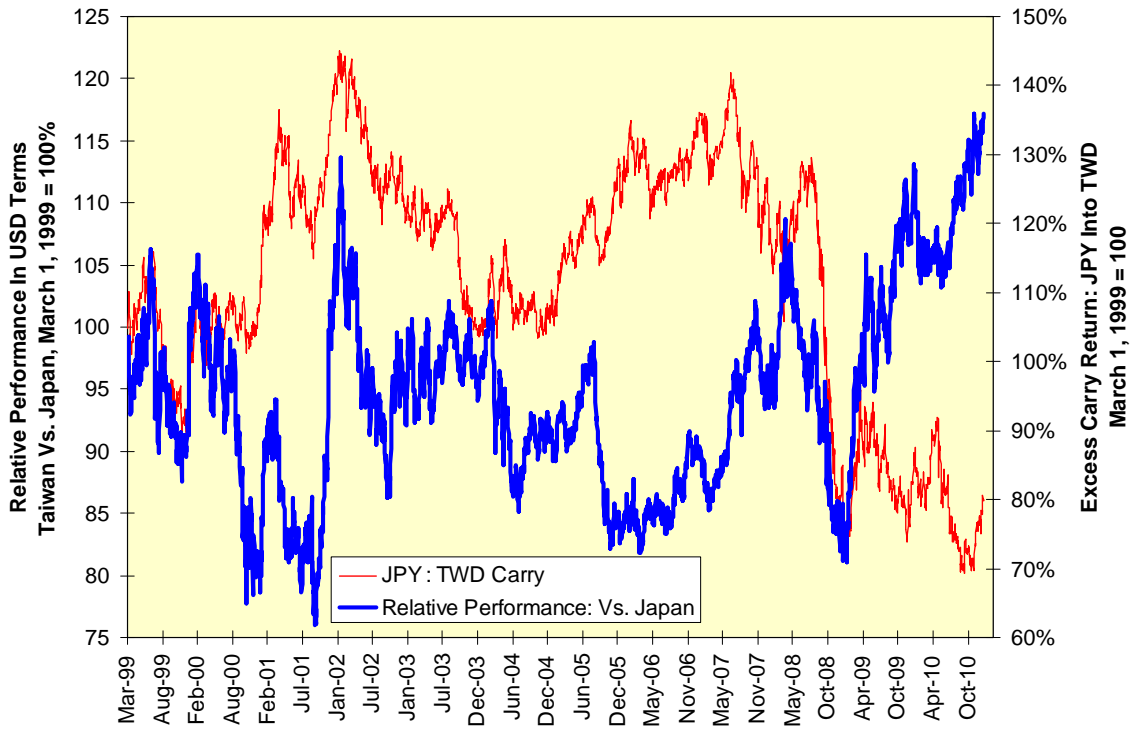
Now let's get to the meat of the issue, and that is whether the relative performance of Taiwanese stocks to U.S. and Japanese stocks, all measured in USD terms, are related to the excess carry returns from borrowing in either USD or Japanese yen and lending into Taiwan dollars. First, the red, white and blue: For almost eleven years, the rise and fall of Taiwan relative to the U.S. has followed this excess carry return, with the link becoming increasingly strong after the March 2009 initiation of money-printing. Pack up your dollars in an old kit-bag and fly over to Taiwan.

USD Carry Into TWD Matches Relative Stock Performance



Now let's repeat the exercise with the relative performance of Taiwan to Japan, an Asian success story of even earlier vintage. While there used to be a link between the stock markets and the currency markets that disappeared after March 2009. Japan started to lose the free-money race to the bottom with the U.S.; moreover, while importers of Japanese goods have "must-do" purchases of yen, our out-of-control current account deficit relieves dollar borrowers of the worry they will hit a wall of dollar repurchases.

**JPY Carry Into TWD Diverged From Relative Stock Performance
After March 2009**



The yen carry trade is not a factor; the dollar carry trade is. These are facts and if they do not conform to some self-deluding central banker's definition of reality, so be it.

Is there an ETF you can use to take advantage of this money sprayed up into the stratosphere and landing off the coast of China? Of course; there is an ETF for everything. You might want to consider the iShares MSCI Taiwan index fund or if that is too pedestrian for you, the IQ Taiwan Small Cap ETF.