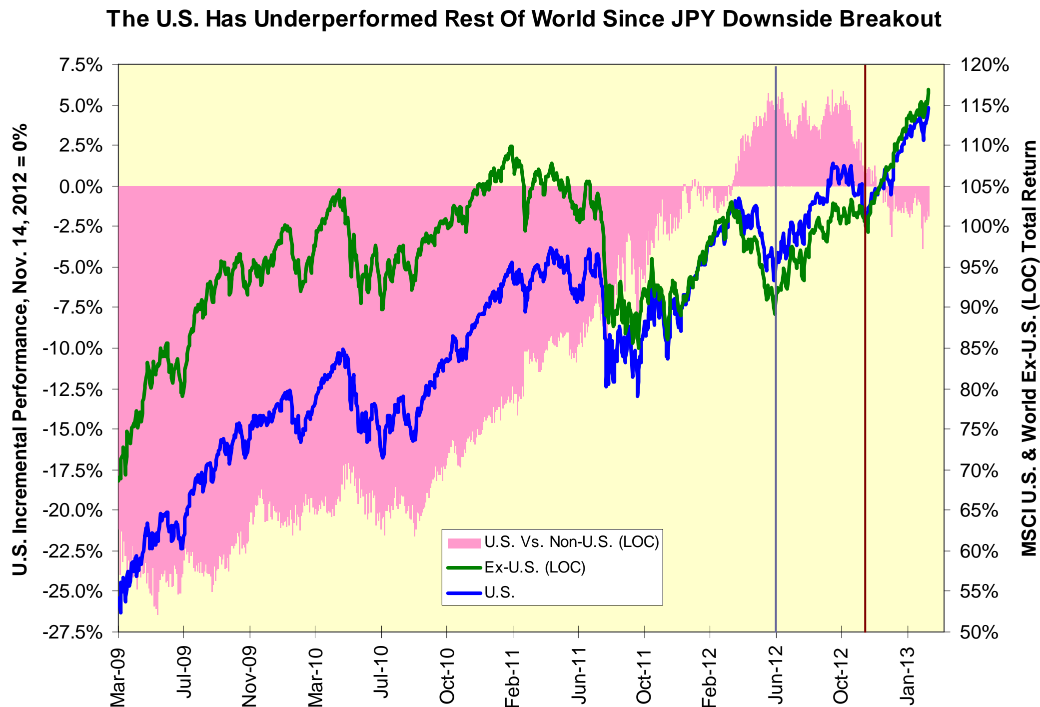
The Yen Carry Trade Makes A Comeback

The yen carry trade is making a comeback worthy of a garden variety vampire; I last pondered this issue one year ago after driving a proverbial wooden stake through the trade's heart in November 2010. Its resurgence has been a powerful factor in the global equity rally since mid-November 2012.

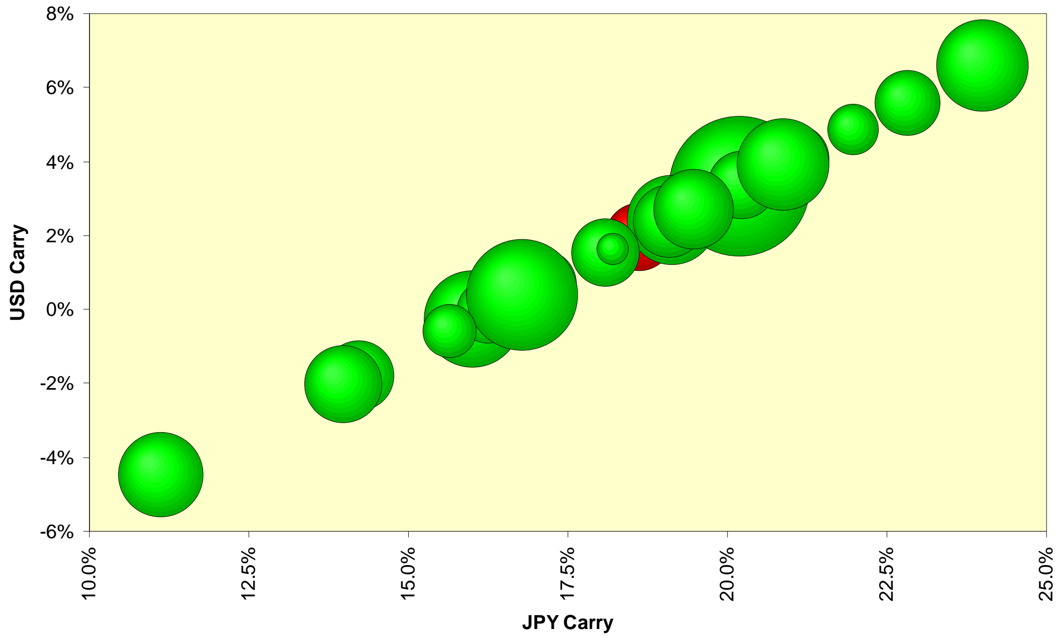
Japan's efforts to weaken the yen augmented the monetary stimulus already underway in the U.S. Let's compare the returns for the U.S. and World Ex-U.S. indices compiled by MSCI after two dates, the June 1, 2012 anticipation of QE3 and the November 13, 2012 downside breakout in the yen; these are marked with vertical lines on the chart below.



The average daily returns for the U.S. increased from 0.07% to 0.152% after mid-November; comparable figures for the World Ex-U.S. were 0.096% and 0.185%. These increases in return are different statistically at 54.6% and 67.0% levels of confidence, respectively. The two return paths were last this similar during the five months following the November 2011 expansion of currency swap lines by global central banks; both periods involved massive infusions of liquidity into markets from more than one source.

The dollar carry trade has remained more important since November, by a factor of almost three-to-one. That ratio masks the trend, however; had I run a similar analysis two years ago, the relative importance of the yen and dollar carry trades would have been far more disparate.

The betas between dollar and yen carry returns into a set of currencies and the equity returns for those currencies' home markets are depicted below. Only one market, the Czech Republic, is negative and is shown with a red bubble. The biggest winners have been Argentina and the Philippines. The markets with the greatest dual contributions from the two carry trades include India, Poland, Sweden and the Eurozone.



The growing (re-growing?) importance of the yen carry suggests even if the Federal Reserve starts to taper off on its present $85 billion per month money-printing campaign, the world will shift its funding over to the torrent of yen coming out of Tokyo. We would need to see both major sources turned off. Why in heaven's name would the world's central banks deliberately torpedo the one success, artificial though it may be, from all of their efforts of the past four and one-half years? If they take the punchbowl away, everyone dies financially, and who wants to be remembered for that singular sociopathic act?