When Japanese Investors Got It Right

I have to admit to widely divergent and often inconsistent opinions about Japan over the years. I am of an age where I can remember, "Made In Japan" was synonymous with the shoddiest claptrap you can find today in places that make Wal-Mart look like a Rodeo Drive fixture. But I also remember their long-running economic miracle of the 1960s-1980s, their devotion to quality control (I have a lot of Sony home electronics), their ascent to status as the world's second-largest economy and stock market and all of those late-1980s books about how we should be more like them.

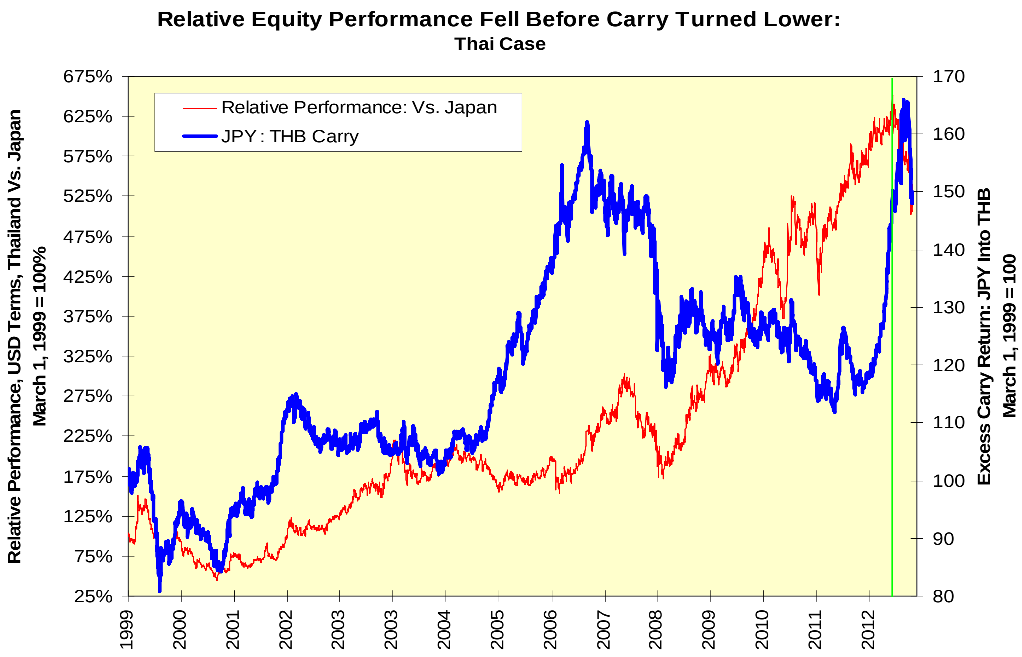
I also remember when Japan's investing habits drove our Treasury market and the misplaced fears they would abandon it en masse should the dollar keep depreciating against the yen. One of the telltale signs of Japanese activity in that bygone era was aggressive buying of Treasuries; American investors tended to tiptoe into the market as new highs were being made, but Japanese buyers were a tee-it-high-and-let-it-fly bunch. I asked an old classmate who was working for a Japanese bank why this was, and he said, "They send a telex to some junior guy on their U.S. bond desk saying, 'buy bonds.' So he buys all of the bonds." Dude!

Two Early Unwindings

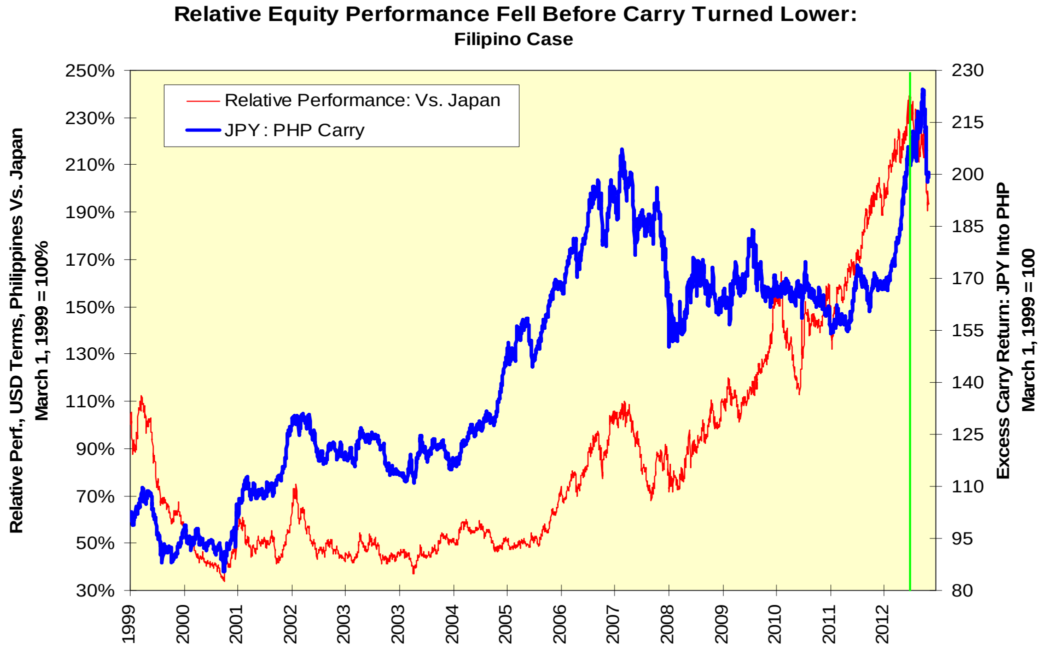
Their celebrated group cohesion produced some greats bubbles-and-busts in the quarter-century following; my opinion of their behavior shifted to a derisive tone of wondering why they always bought high and sold low, as if that was uniquely Japanese.

However, it is time to give some credit where it is due. When the Abe government and the not-so-independent Bank of Japan decided they could stop the running count of Lost Decades before it reached three complete ones by destroying the value of the yen, Japanese investors wisely swapped yen for other currencies and helped push global markets higher in the process via the yen carry trade. That was the easy part. The hard part came next: They started selling their gains in markets such as Thailand and the Philippines; this allowed them to sell high in bull markets and swap appreciated baht and pesos back into depreciated yen.

This can be illustrated easily by mapping the relative performance of Thai and Filipino equities vis-à-vis Japanese equities in U.S. dollar terms against the excess carry returns for borrowing the yen and lending into the baht or peso, respectively. Thai relative performance peaked on February 5, 2013, marked with a green line on the chart below, but the JPY:THB carry trade did not peak until May 14, 2013.



Comparable dates in the Filipino case are February 22nd and May 22nd.



Negative-Sum Game

One of the odd aspects of this behavior is Japanese investors, perhaps led by the legendary Mrs. Watanabe, created a classic negative-sum game: As individuals attempted to maximize their welfare, they unwittingly created a rapid exit out of the Thai and Filipino assets that forced these markets lower and minimized the welfare of those who had yet to exit.

What about the dollar carry trade, not illustrated here? Thanks for asking: U.S. investors treated these stocks and the currencies the same over time. Americans lent into the baht and peso to buy these stocks and then shed the currencies along with the stocks after mid-May.