

## Japanese Ease Could Be Bullish For Equities

I concluded on [Tuesday](#) Japan's path of least resistance would be to continue the policies that have failed for the past fifteen years. It all sounds so nihilistic, but the implications for U.S. equity investors, a category I am fairly certain includes you, are very bullish if this is the case.

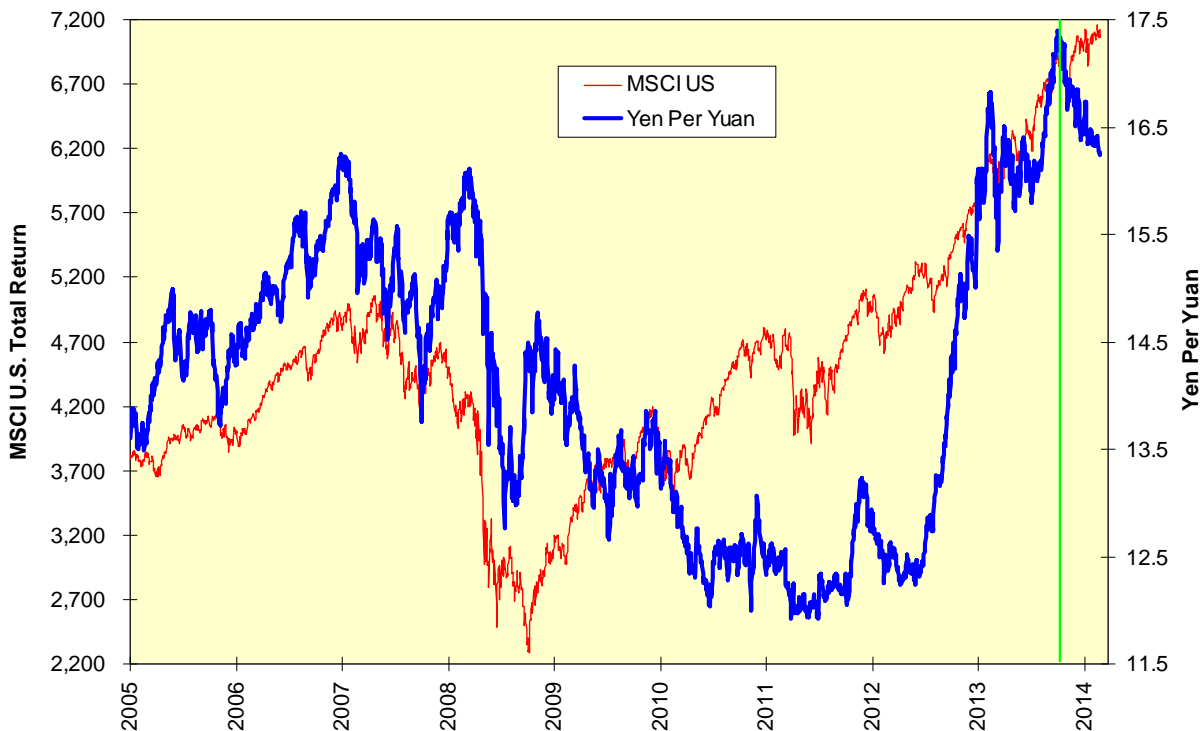
### Same Motives, Different Tools

The basis for this conclusion stem from our world of competitive devaluation. Just as "amateurs talk tactics but pros talk logistics" in the military equation, we live in a world where amateur commentators still regard a strong currency as a sign of national virtue while officials and politically powerful exporters angle for ever-weaker currencies.

When Japan declared war on the yen – and no, that is not a typo – in November 2012, it added its fuel to our QE3 fire. U.S. equities returned almost 42% between November 2012 and January 2014, at which point the yen stopped weakening despite increasingly negative real interest rates in Japan.

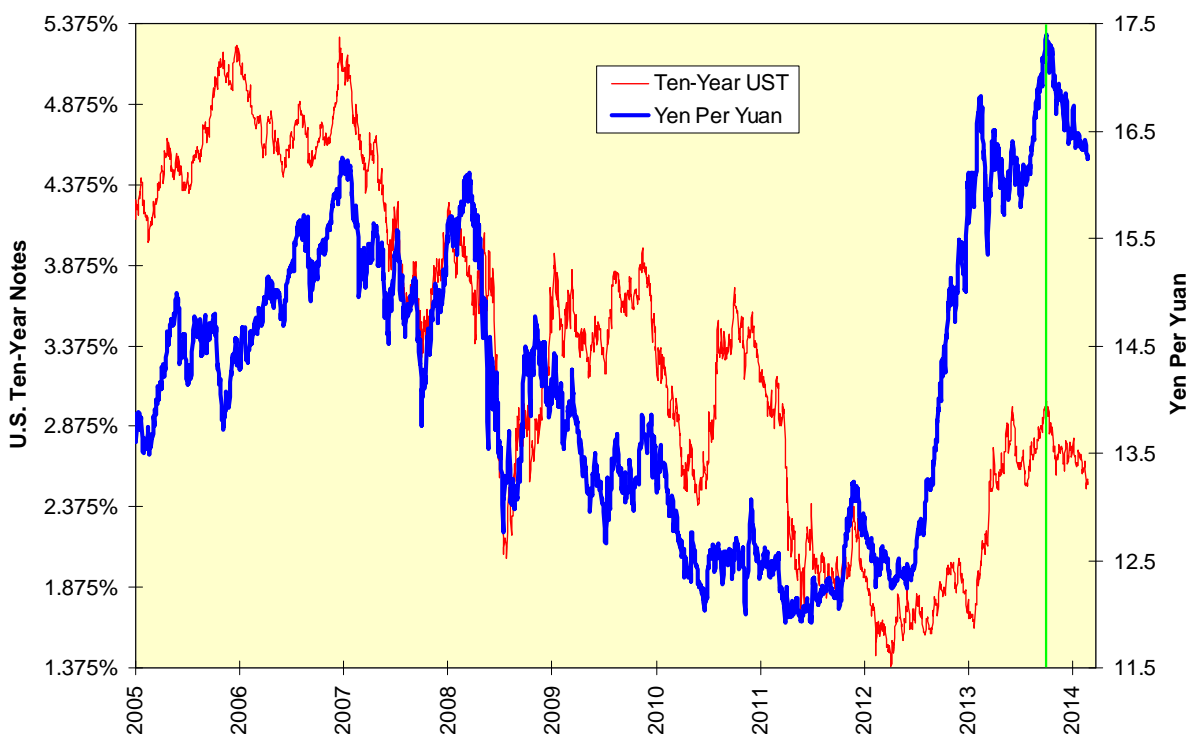
Part of the reason, and one certainly suggested by superimposing a line on January 2, 2014, was the reversal in the yen/yuan cross-rate. China was struggling with slowing growth and always has regarded Japan's acquiescence to calls for a stronger yen in the 1980s as the beginning of the end for their island neighbor.

### The Yen-Yuan Rate And U.S. Stocks



The engineered downturn in the yuan effectively was achieved by selling yuan for other currencies and watching those stronger currencies turn into purchases of U.S. Treasuries. As I noted in [March](#), the weaker yuan was more than offsetting the Federal Reserve's tapering. This shows up very clearly when we map the yen/yuan cross-rate against ten-year Treasury yields.

## The Yen-Yuan Rate And U.S. Notes



### Going Forward

To review the bidding, a weaker Japanese yen helped push stocks higher and a weaker Chinese yuan against both the yen and the dollar helped push Treasury yields lower and the yen higher. Now let's stipulate the Japanese are not the sort to let their currency appreciate without them having something to say about such an outrage. If Japan wants to arrest the yen's rise, offset the effects of its fiscally contractionary consumption tax and try one more time to reverse its long-running deflationary pressures, it will have to print more yen and hope someone, somewhere borrows them.

Those borrowers are likely to non-Japanese for the very good reason this has been their experience since 1999. Slack credit demand in Japan and the willingness of non-Japanese borrowers to engage in a yen carry trade can weaken the yen but do little for Japan's domestic well-being. What are overseas borrowers going to do with those yen, lend them into ten-year Treasuries with a real return hovering around 0.33%? No, if you are going to go through the trouble of undertaking a yen carry trade, go the whole route and step out along the risk curve into equities and higher-yielding bonds.