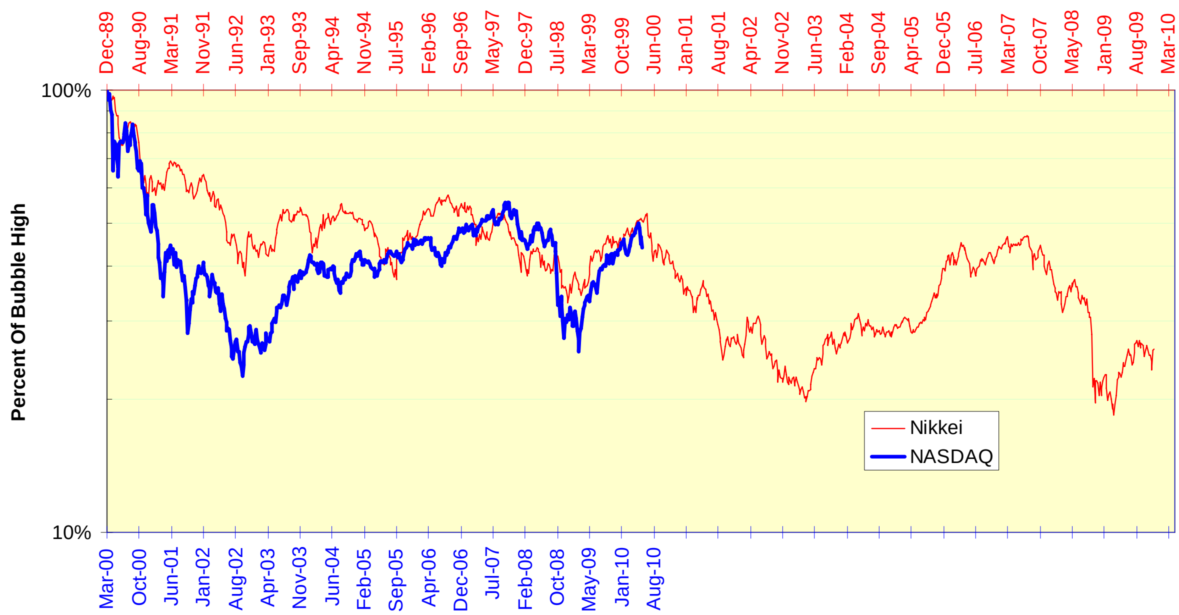
Comparing The Nikkei And The NASDAQ

Market analogs are great fun, but like all indicators in our arsenal we should be careful not to overuse them. I always caution overlaying one market cycle on the other; say the 2007-2009 bear market to anything from the early 1930s is going to produce an "eye-candy" result. Just as all fish and all birds have converged on the same shape to move through water and air, respectively, better, all market cycles have converged on the same shape in reflection of their one underlying constant, human behavior.

Yet certain market analogs demand attention when they are produced by common official policies in addition to the common impulses of common traders, even if those traders themselves are uncommonly good. One of these analogs with Japan, for interest rates at both the long- and short-term horizons, was introduced here last week. We can introduce another, the parallel between Japan's benchmark Nikkei 225 index and the NASDAQ Composite.

The chart below re-indexes the two markets to their respective bubble peaks, December 29, 1989 for the Nikkei and March 10, 2000 for the NASDAQ; data are displayed at a weekly frequency in local currency terms.

Should Two Bubble Aftermaths Look This Similar?



While correlation does not imply causality, this is a picture that can really get your attention if for no other reason than the NASDAQ stopped just short of a retracement high made by the Nikkei on the week of April 14, 2000, the very date that produced what was then the largest single-day point decline in the U.S. market. The NASDAQ's retracement needed to reach the week ending June 25, 2010 to complete the parallel in time.

While we cannot say anything certain about the future, we can say things for certain about the past, and unlike assorted baseball players, I am here to talk about the past: The NASDAQ has failed earlier in time and lower in price than the Nikkei did at a comparable point in its history.

Now comes the real ugly part: If the analog holds, the Nikkei punched down another 61.4% between April 14, 2000 and April 25, 2003. Had anyone actually been in charge at some Japanese equivalent of the Plunge Protection Team or whatever we are calling it these days, they would have tagged on another 0.4% to make for a perfect Fibonacci 61.8% retracement, one that would have set digital tongues a-wagging for many years to come.

Do I see the U.S. following this brutal path lower? No, I do not. Just as noted market commentator and can-do guru Josef Stalin said about police interrogation, "Beat, and beat again until you get the answer," the central banks have adopted the policy of "print, and print again until no too-big-to-fail bank ever fails again." The end result of all this will be bloated zombie banks and a transfer of wealth from the private sector to financial institutions, but we will avoid the sort of market calamities we saw in 2008.