

THE CASE FOR BEING SHORT
JAPANESE EQUITIES

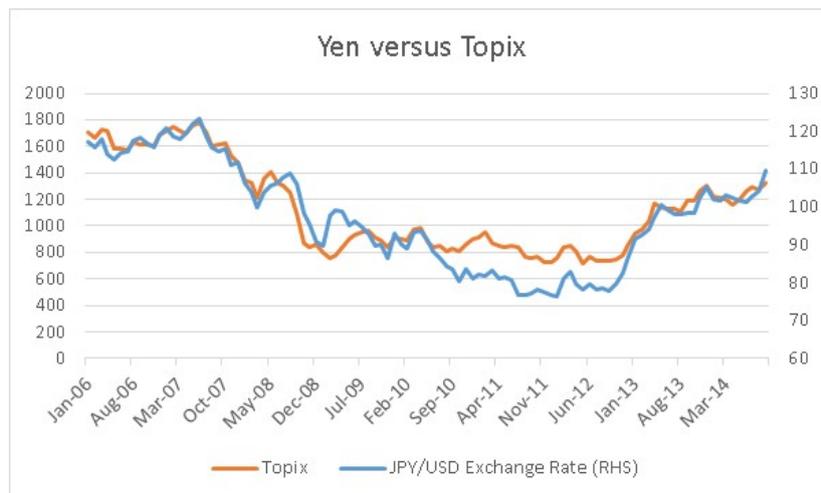


Russell Clark's
Market Views

“With yen devaluation offering little marginal benefit to the economy due to other competitive devaluations and the Japanese consumer who is concerned about rising prices, in my mind Japanese earnings are at risk of disappointment...”

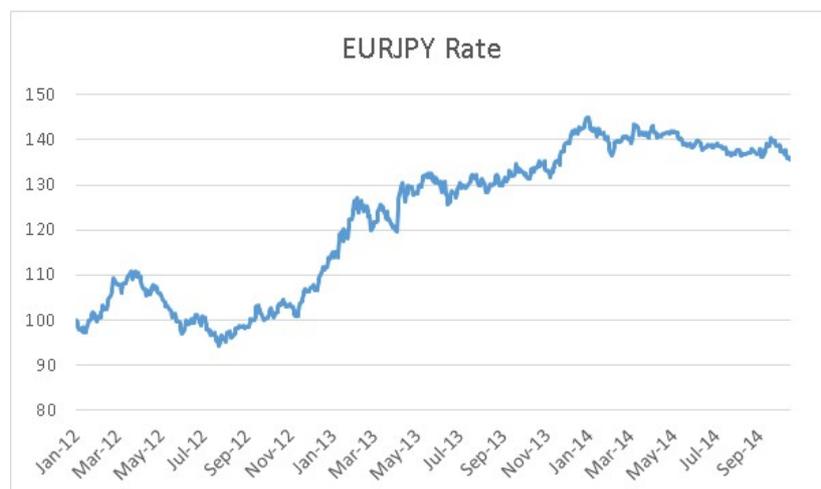
This note is written in conjunction with Shannon McConaghy.

Since the financial crisis, the yen exchange rate has been a big driver of the Japanese stock market, with yen weakness leading to higher stock prices.



Yen weakness has been driven by a much expanded Bank of Japan balance sheet.

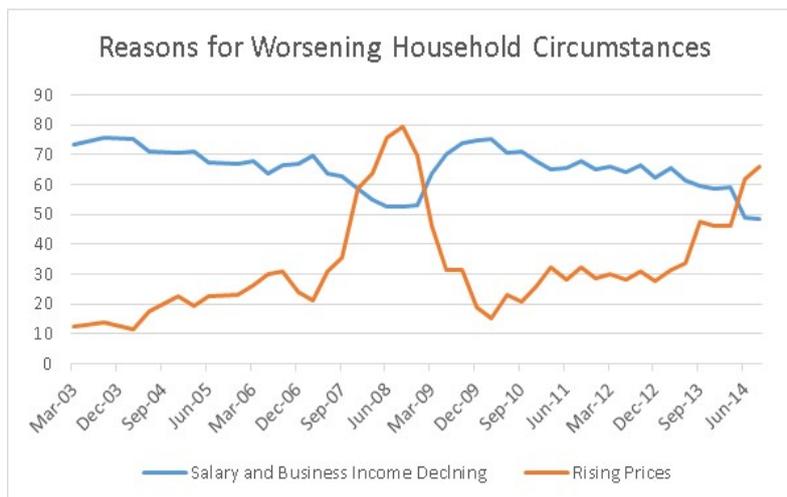
However Japan does not exclusively export to the US. Margin improvement for Japanese exporters is also dependent on key competitors not devaluing their currencies. While the Yen has weakened by nearly 8% since the summer highs against the dollar, it has actually strengthened against the Euro this year and is close to flat this year versus the Won.





This implies to me that Japanese exporters may see a boost in sales from the recent weaker yen versus the dollar, but are unlikely to see a material increase in margin, as European and Korean competitors have also had weak currencies.

According to the Bank of Japan Household Opinion Survey (http://www.boj.or.jp/en/research/o_survey/index.htm/), Japanese consumers are increasingly seeing the negative aspect of increased prices, driven by a weakening yen and increase in the consumption tax. This survey shows the percentage of people citing a reason that household circumstances are worsening. More than one answer is allowed. Comparing quarterly survey responses shows that typically Japanese households are concerned about falling incomes, but recently rising prices have become a much more pressing concern.



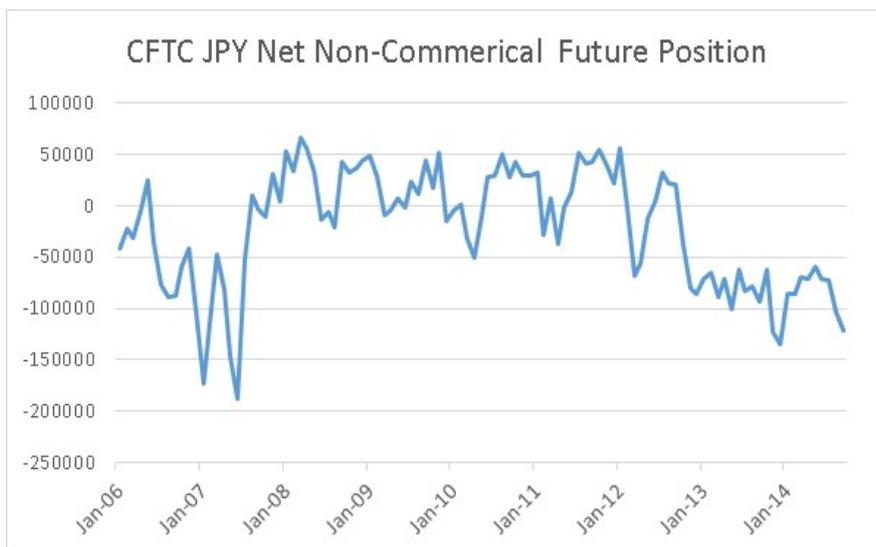
If the negatives of weaker yen creating higher prices are beginning to be perceived by Japanese consumers, the political will for further yen weakness may be less than the market perceives.

With yen devaluation offering little marginal benefit to the economy due to other competitive devaluations and the Japanese consumer who is concerned about rising prices, in my mind Japanese earnings are at risk of disappointment.



In 2013, Japanese stocks rose faster than the yen devalued, which is very bullish. This year however, Japanese stocks have tended to rise by the same amount that yen falls, implying there is little or no leverage to Japanese stocks from a weaker yen. That suggests to me that the market is extremely exposed to any yen strength.

The market is the most net short Yen since the financial crisis.



The risk reward of shorting Japanese stocks looks good.

INFORMATION

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