

JAPAN ASIA INVESTMENTS

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JAPAN'S BANKING CRISIS IS OVER: SECULAR BUY SIGNAL REITERATED

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Nikkei: 8424.51

April low: 7603.76

JAPAN:

Summary:

“Since our last report, the Nikkei touched down at the 7600 level and, consistent with the New York forecast here, feels to me to have now put in its secular low...”

Perhaps adding to our lengthy list of timely Japanese forecasts, the previous SKC report contained the preceding quote, to mark what SKC believes to be the end of the secular (13-year) Nikkei bear market. The unfolding, now matter-course-resolution of the banking crisis, may be confirmation (see “Banking”).

Stocks:

In 1988, Japanese stocks began their bear market, as evidenced by the advance/decline line (more stocks going down than up), despite the fact that the Nikkei only peaked in January 1990. Today, we have the inverse atmosphere for stocks. The type of value stocks that these reports have favoured, bottomed 3 years ago, while others made their lows about 4 ½ years ago in 1998.

Anecdotal evidence of this is a review of the portfolio fashioned at the beginning of 2002's 4th quarter for certain investors which, as of 2 weeks ago, was up 38% annualized, while the Nikkei was down 8%, also annualized.

The bank stocks have been the principal cause of the here referenced Nikkei "aberration" and once it becomes still more evident to foreigners that the banking crisis is effectively now over, foreigners will lead the way to dramatically higher stock prices for already strongly advancing Japanese shares. Indeed, foreigners were stock buyers from mid-April – mid-May and American buy orders for Japanese shares have been in an up-trend since last summer. This suggests strong long-term demand for Japanese stocks, as foreigners began the buying programme of Japanese stocks while at about only a 50% normal weighting of Japanese shares, based on the Morgan Stanley Capital Index.

Banking:

Bank of Japan Share Repurchases

Last month's comment (right at Japan's secular bottom?) seems to have hit the nail on the head. Disposing excessive publicly traded share holdings at a great pace, the banks removed about 6 trillion Yen of common stock from their books last year. No doubt, this has simultaneously played into the ongoing resolution of the non-performing loans (NPL's) crisis, as NPL's were removed by a similar amount (see "Debt Crash" below). Helping the situation, major sales of excessive, publicly traded shareholdings to the Bank of Japan are expected to continue this year.

Debt Crash

Last month's comment on this topic seems to have hit the nail on the head, as well. Disclosed bad debts declined about 22% last year or 6 trillion Yen. Is it any accident that the gross amount was just about the same amount of Yen of publicly traded shares that the banks sold off from their books?

Further strengthening the NPL's resolution programme, as regards loan-loss reserves for questionable borrowers' unsecured loans, as much as 33% has been budgeted for such difficulties.

On what has been another note of concern for the marketplace, the nationalization of banks as a result of the conversion of preferred shares has been made all but a non-consideration, due to the terms that have been set that would allow for such conversions. SKC never considered nationalization as a concern (April 10, 2002 RObtv interview may be viewed on homepage, www.sidklein.com).

"Special Accounts"

The old bad debts are being put into separate accounts for disposal. New management is not responsible for old mistakes and public funds are paying off yesterday's debts (and corruption).

In the 1990's, Sid Klein's Daily Fax reported that public funds wouldn't bail out the banks' debts and those responsible, until the public would stop opposing such an eventuality. Rather, the preferred scenario was that the public would beg for it. With 90% of Japanese in a recent poll complaining that the government had not made any progress with the banking crisis, we may say that we came to that point. The correct grasp of Japanese bureaucratic psychology has again been reflected in this market commentary and its previous incarnations, with an unusual degree of accuracy.

Taxation:

Diminishing deferred tax assets' (DTA's) valuations will ultimately force the extension of the 5-year limit on loss carry-forwards. This would then also accelerate restructuring. The government is forcing banks to give less value to their DTA's in determining their core capital ratios. This has already forced institutional acceptance of public capital injections, thereby improving the quality of their assets. All this has been forecasted in past issues of SKC. Now that it has occurred, many commentators view these developments negatively.

In fact, that DTA's were refused at a major bank that was forced to accept public capital injections, has given confidence to depositors and investors that the banking system will be safeguarded. This is a conclusion that has always been strenuously supported by SKC, even as the rest of the misinformed Western world lost its clarity about the nation that holds about \$12 trillion US in savings. The misinformation continues.

Yen:

Banks' loan portfolios may soon start to reflect better margins, as a result of higher interest rates. This, of course, is Yen-positive. This will be bolstered by what SKC has described as an impending movement of funds out of 0% savings deposits, as a result of significant tax changes that trigger the move (see March 31 comment) and the realization that low risk equities with significant appreciation potential, offer the highest real dividend yields among the major nations. The perception of a matter-of-course resolution of the banking crisis will play no small part in the process (see "Banking").

Finally, as the Yen has greatly under performed the Euro in the trashing of the Dollar, owners of Yen have much to gain in a narrowing of the two currencies' performance gap. Helping this process even further along is the US' 5% current account deficit and the Federal Reserve's willingness to let rates fall, even if growth should be maintained, a policy not seen in at least 40 years.

Trade:

Japan's April trade surplus with Asia was up over 30%, year-over-year. This continues to be favourable news for the preferred investment theme of this market letter, **DDOVS**. It should also be noted that this figure includes Japan's trade deficit with China. SKC continues to forecast higher Japanese trade surpluses, to the further benefit of the Yen.

Psychology and Leverage:

With what this commentary deems to be the now matter-of-course conclusion of the great Japanese banking crisis of the 1990's, the following excerpt from last week's summary report takes on added timely market significance:

"90% of respondents to a recent survey felt that hardly anything constructive has been done about the banking crisis. This extreme number reflects the extreme low in the stock market as there is no one left to sell, the profound potential for investment once that psychology even begins to reverse and why those immune to crossholdings and foreign ownership have done so well".

Conclusion:

The secular Japanese bull market's early stages may actually be the favourable backdrop and wild card for the Dow's present recovery. Japanese spending arising from severely pent-up demand, ignited by tax reform, will fuel the secularly countertrend cycle bull market that is underway in New York.

Sid Klein

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