

The Fortnighter

May 3, 2013 - Issue #17



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One of the hallmarks of the equity markets is that they often react to news in exactly the opposite direction that we think they should. A classic example is when the stock markets go UP on less-than-stellar economic news. Why? Typically it's because slower growth leads central bankers to introduce more accommodative monetary and fiscal policy (i.e. easier money and lower interest rates). That, in turn, makes stocks more attractive relative to cash and bonds – and up go the markets.

As this issue goes to press, I'm on a first-time trip to Beijing and Tokyo. I can't think of any other equity markets (China and Japan) that are better examples of the market "conundrum" mentioned above.

China first.... Despite growth numbers that would put most Western economies to shame (we'd be happy to grow at 1/3 of China's typical GDP rate this year); China's equity markets have not been kind to investors as of late. A quick look at the FTSE China 25 Index for the past 3 years shows the index being down by about 10% - at a time when most of the world's stock markets were recovering nicely from the 2008 recession. Even if the Chinese markets had simply kept pace with their economy, one would expect them to be ahead about 25% over this period...

The performance of the Japanese stock market seems equally puzzling. After 20

years of essentially 0% returns (20 years!!) and annual GDP and inflation numbers that were close to that, the Japanese stock market is suddenly the world's darling and up about 25% in the past year.

So, what's going on? With China, 7.5% GDP growth is considered disappointing. And then there's the ongoing issues of lack of corporate transparency, corruption and the general worry that the Chinese economic miracle is simply a huge bubble.

With Japan, it's now all about "Abenomics" – and a belief that aggressive growth strategies recently introduced by Prime Minister Shinzo Abe will finally kick-start the moribund Japanese economy.

So, Japan is "hot" and China is "not" – but long term? Japan is a demographic disaster, with an aging (and shrinking) population, rigid systems and a massive debt relative to their GDP. Can government policy (and a cheap currency) really overcome such long-term, systematic problems? Conversely, China's growth may have slowed as of late but this is still a massive economy growing at 7%+ per year, flush with cash and with a government that has a long track record of "finessing" that growth. But the thing that I believe makes China so interesting is that it's still home to close to a billion people living on less than \$5 a day – and it's human nature to want to get ahead. The potential economic upside is still immense.

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