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## Shimoda Capital Advisors Limited

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### Japan – talk of earthquakes...

We maintain our bearish outlook on the world's financial markets, maintaining our calls on the Dow-Jones below 5,000, the NASDAQ below 1,000, and a major bank and property market collapse. These global factors have implications for a G7 member that's fallen on hard time – Japan. The largest exporter of capital in Asia, accounting for 60+% of the region's GDP, Japan has harnessed fiscal and monetary policy to embark on a decreasing spiral of economic performance to the point where systemic collapse is inevitable. We base our views on the following worrying factors:

- Old habits die hard – in this case old management, with 20-30% of university leavers being discarded by the workplace and living as long-term unemployed at home. This is the flowering youth that should be bringing new skills to the work-place, spending on consumer goods instead of saving, and breathing fresh life into a stagnant economy. In Japan, the politicians and business leaders cling to power, revert to traditional ways (a woman's place is at home!), so progress lags... Long-term, the consequences are disastrous, since Japan has the ability to neuter the youth instead of creating reactionary challenges to the system.
- Depopulation – the rate of growth in population should become negative in the next few years, since the youth has neither the confidence nor the economic well-being to start families. A negative growth-rate is also of concern since old-timers continue to live longer in Japan, accentuating the actual shrinkage at the 'start-up' sector of the population...
- Pensions – a corporate pension has typically taken a bath in the last few years – JGB's offer quasi-zero yield, Japanese equities have slumped (40,000 – 8,000 in 12 years), property investments have collapsed in value, and the poor performing corporate sponsor has often raided the pension fund till to cover its own losses (see the statements in the USA about GM, Ford etc. having to top up its corporate pension arm due to sustained losses..). Now add in – reduced workforce (see above), especially the young employees who will be contributing for their long working life, and the longer period for which an increasing number of retirees live and draw on their company pension, and voila, you have disaster awaiting!!!
- Sorry didn't I mention property? Well of course everyone bought in once the heady 1980's ended at the peak of the 'bubble' economy, so after Sumida pricked the bubble the house of cards collapsed and the banks, who readily financed the bubble, got left without chairs and the music had stopped..... Mind you, the government picked up a book by Keynes this decade and decided to cough-start the economy by funding massive additions to commercial real-estate, thus lowering yields further and adding to the office space overhang that should blossom in Tokyo and Osaka in 2003!!! And the old folk of course – 4 grandparents/2 dwellings vacate when they pass away, with 1/0 grandchildren taking up the slack, so demand for housing units dwindles...
- Oh, and the funding for the constructions projects – well let's increase taxes, borrow more, just in case there are any consumer yen waiting to spend in moments of upbeat rashness. In fact, let's borrow so much that the ratio of borrowing to GDP rises to the point where international credit ratings plummet - we now have a G7 with a domestic rating of single A, which also creates a ceiling rating for those poor

banks that you wouldn't want to lend to anyway... Naturally, a tax base of young workers and few retirees is always self-sustaining, but we've discussed this point, haven't we...

- And those poor banks – smitten by managerial permafrost in the face of massive problems, they have seen their funding cost rise (as credit ratings have plummeted), they have seen their esteemed asset base of property holdings/equity holdings/loan portfolios self-destruct, their ability to raise new capital diminish, by virtue of stock price drops of 90%-100% in 12 years. With the most important economic cog not grinding, consumer and corporate confidence dies very quickly... Collapses remain imminent!
- Finally, 1993 represented the 70<sup>th</sup> anniversary of the Great Kanto Earthquake, which wiped out a major part of Tokyo/Kawasaki/Yokohama. The earthquake comes back approx. every 70 years, so I loaded up the truck and moved with wife and kid to Hong Kong in 1993, to play the pre-handover game. My weekend home in Shimoda was part of a slow-motion train that was collided northwards into the Kanto plate, and we had regular jitters that are now recording 200 incidents per annum. 9 extra years of tectonic tension accumulating make for a good jolt when it happens, and considering a large proportion of Tokyo/Japan industry sits on the waterfront, on reclaimed land, just like the stock market (Kabichoo) district, expect some major dislocation when the big one comes!!!

Well, throw in global market malaise and you can see a non-to-happy investment outlook for the Land of the Rising Sun. As Queen Victoria found out to her chagrin, the sun does eventually set on an empire – Britain ceded dominance to America, should we look to China from Japan???

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