

March 11, 2011

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## JAPAN'S EARTHQUAKE

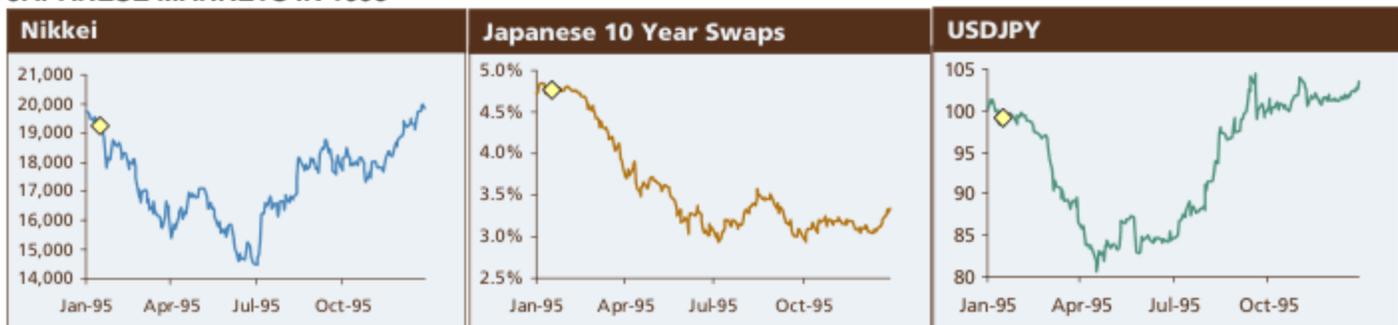
Japan experienced a massive 8.9 magnitude earthquake on Friday just before Japanese markets closed for the day. Our thoughts and condolences are with the people of Japan. However, we also wanted to take a moment to reflect on implications for financial markets and below are some initial thoughts.

### Parallels to 1995

Japan's last major earthquake, the Kobe earthquake, occurred on January 17, 1995 in the Hyogo Prefecture. The earthquake caused approximated ¥10 trillion in damage or about 2.5% of Japan's GDP at the time. Unsurprisingly, equity markets sold off and interest rates rallied in the months following and did not ultimately turn until July of that year. However, the Japanese Yen strengthened about 20% driven in part by repatriation of capital to deal with rebuilding efforts.

While it would be easy to draw parallels with 1995, there are also significant differences as well. At the beginning of 1995 policy rates were 1.75% and debt to GDP was around 90% providing room for stimulus. Now, with policy rates at 10 bp and debt to GDP around 225%, policymakers have less room to maneuver. And for investors expecting a repeat of 1995 in the currency, JPY strength was aided by aggressive trade policy rhetoric that weakened the US dollar. Today, the US's primary focus from a trade standpoint is China and the CNY. Furthermore, while we expect repatriation to occur, the FX exposure is likely already hedged to some degree limiting the impact on the currency.

## JAPANESE MARKETS IN 1995



Source: Bloomberg.

### Where does that leave us?

In thinking about what to do from here, it's important to separate the near term from the long term. We are maintaining our long term bearish stance on JPY although recognize that very opportunistically there could be some strength in the near term more on the perception of a repeat of 1995 than the reality. Furthermore, any rally could be (very) short-lived as the BOJ has moved up their meeting from Tuesday to Monday next week and could make comments about currency intervention. We believe any strength would be an opportunity to add bearish JPY positions (please see Rebecca Patterson's note today on her thoughts on the earthquake). Similarly, we believe the risks to rates are to the upside longer term and would also view any rally as an opportunity to enter positions. Within equities, the earthquake is likely to create selling pressure near term, particularly as the market is up 16% from 2010 lows. However, once some of the initial news settles, we believe there could be opportunities in companies involved in the rebuilding effort such as glass, construction, timber, and waste management companies. We are also keeping a close eye on developments in Japan's nuclear grid.

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