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**Subject:** Eye On The Market: Desperately Seeking Shinzo

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**Attachments:** 03-18-2013\_-\_Desperately\_Seeking\_Shinzo.pdf

**Inline-Images:** image001.png; image002.png; image004.png

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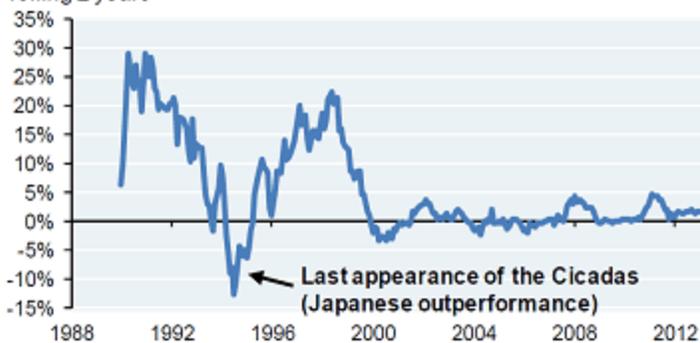
### Eye on the Market, March 18, 2013

**Topics:** The possible economic and investment impact of Japan's monetary and fiscal bazooka; and the latest round of historical revisionism in Europe

**Desperately Seeking Shinzo.** Pressures from low growth, stagnant corporate profits and lost competitiveness have apparently reached a breaking point in Japan, not just economically, but also politically. The Shinzo Abe Administration differs from its predecessors, and appears intent on breaking the cycle of deflation. As mentioned in our 2013 Outlook, while there are structural problems in Japan, aggressive monetary and fiscal policy could move those issues to the back-burner as far as markets are concerned in 2013. This looks more like a "trade" than a long-term investment, but for investors able to hedge out the Yen exposure (given Japan's intention to debase it), Japanese equities may continue to perform well for a while longer, even after the Nikkei rally since last fall. Like the cicada which lives underground for 17 years and then emerges for a short, vibrant period above ground, 2013 is a year in the sun for Japanese equities after 2 decades of underperformance. The attached note walks through the details, with a review of the Japanese economy, its equity markets and proposed efforts to revive the deflation-fighting techniques that Japan used in the 1930's.

#### The benefit of being underweight Japanese equities

Cumulative outperformance of MSCI World ex-Japan vs MSCI World, rolling 2 years

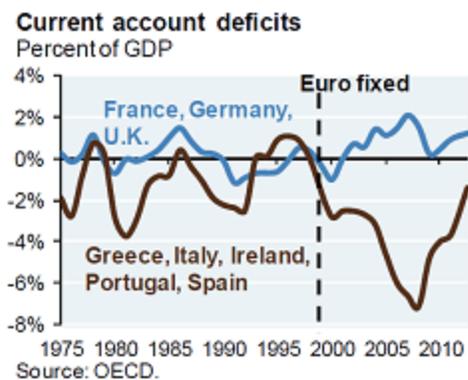
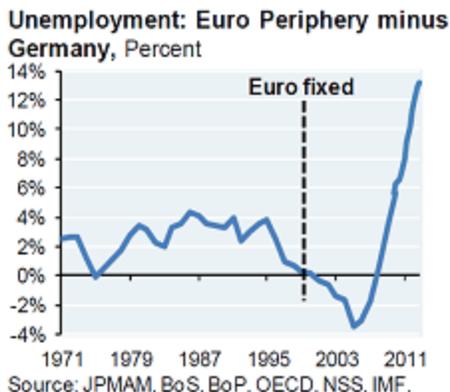


#### US Dollar and Local currency total returns by region

	Year to date		2007-2012	
	USD	Local	USD	Local
S&P 500	10.0%	10.0%	15%	15%
MSCI Europe	5.8%	9.2%	-5%	-4%
Euro Stoxx	2.7%	3.8%	-17%	-17%
MSCI Japan	11.5%	22.6%	-22%	-44%
Nikkei	9.0%	20.9%	-7%	-33%
MSCI EM	-1.0%	-0.3%	36%	39%

Source: Bloomberg. Data as of March 15, 2013.

In the U.S., the private sector is doing OK, with household demand, housing, production and employment all running at a solid pace. In Europe, to me the event of the week wasn't the proposed confiscatory tax on Cypriot bank deposits (given the uniqueness of the situation), but the bizarre comments from the former President of the Euro Group about the threat of war as a justification for continuing with European austerity. Remarks like this are part of the Creation Myth of the Euro, and seem to ignore the fact that if there *are* rising regional tensions, you don't have to look very far to figure out where they are coming from in the charts below. More in the attached PDF.



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