MARKET OBSERVATIONS
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Rising Sun

Japan has long been called the “land of the rising sun”. For decades, however, its economy and stock market have failed to rise in step with the U.S. Many factors have contributed to this outcome including challenging demographics, corporate structures and governmental policies. A milestone was reached in February when the Japanese stock market touched a high last reached 34 years ago. This drought likely is without precedent for a market that remains relevant nonetheless. In addition to the outlier experience of its stock market, Japanese bonds sustained yields near 0% or less for as long as any major developed market. A review of key variables may be informative for investment strategy ahead.

PERSPECTIVE

On the last trading day of 1989, the Nikkei 225, a leading Japanese stock index, reached an all-time high of 38,915. On that same day, the Dow Jones Industrial Average (“DJIA”) closed at 2,753. As shown in Chart I, the Nikkei recorded a stunning -82% price collapse from there, reaching a low of 7,086 on March 9, 2009. Over this long period and even with the bear markets of 2002 and 2008, the DJIA posted a price gain of +138%. From their respective 2009 lows to new historical highs this February, both the Nikkei and the DJIA have posted remarkable price gains, +454% and +497% respectively. But for the whole of 34 years, the Nikkei price gain was 0% while the DJIA gained +1,319%.

A long downtrend of yields since 1989 was experienced in both the Japan government bond market and the U.S. Treasury bond market as shown in Chart II. From respective monthly average highs in late 1990 of 8.0% and 8.9%, the Japan government 10-year yield reached a pre-COVID low of -0.3% in 2019 while the U.S. Treasury 10-year yield bottomed during COVID at 0.6%. Quite different, however, was the level of monthly average yields that prevailed in each market throughout this long period, 1.7% in Japan and 4.3% in the U.S. For the full six-year period of 2016 to 2021, the Japan government bond yield averaged 0% while the U.S. Treasury yield averaged 1.9%. A driving force in both markets was lower inflation, but Japan was challenged by deflation.

After the devastation of World War II, Japan staged a remarkable economic recovery, bringing it to a position of global competitive strength. Notable was manufacturing where success of the Japanese auto industry challenged U.S. dominance. Economic ascendency slowed noticeably in the 1990s, however, as Japan faced a range of systemic challenges, among which was an aging population exacerbated by strict immigration policies. While the patterns of economic growth for Japan and the U.S., as shown in Chart III, appear comparable, average growth rates are quite different. Since 1994, one-year rolling real growth averaged +1.0% in Japan and +3.1% in the U.S., and the economy of Japan actually contracted 28% of the time.

INVESTMENT IMPLICATIONS

Stock markets are markets of stocks, and individual stocks can perform quite differently than an index. While the Nikkei gained 0% over 34 years, Toyota was its own rising sun at +728%. This difference shows the return opportunities and the risk challenges that are inherent in either active or passive investment strategies. Countrywide factors such as real growth, inflation and interest rates play important roles as do company factors such as earnings and dividends. Understanding and assessing key variables are important for successful outcomes.

CHART I

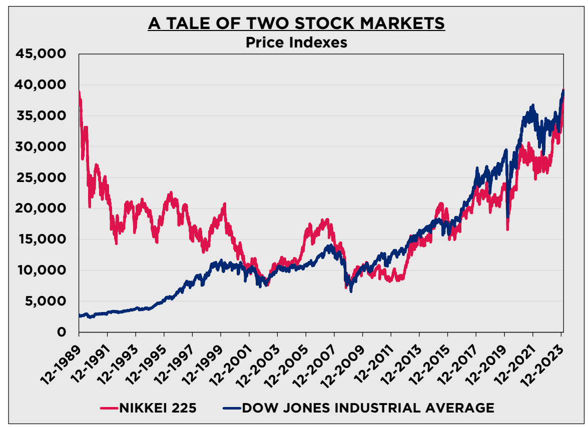

CHART II

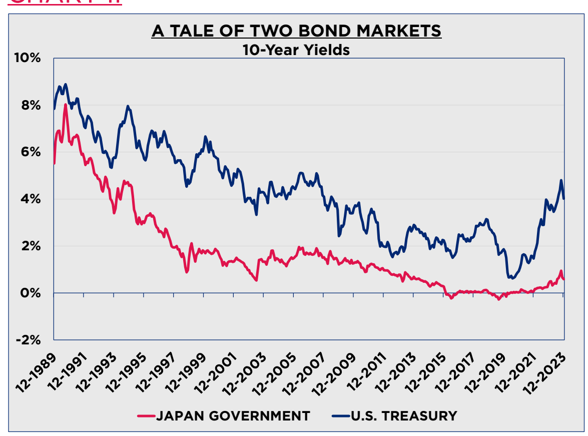

CHART III