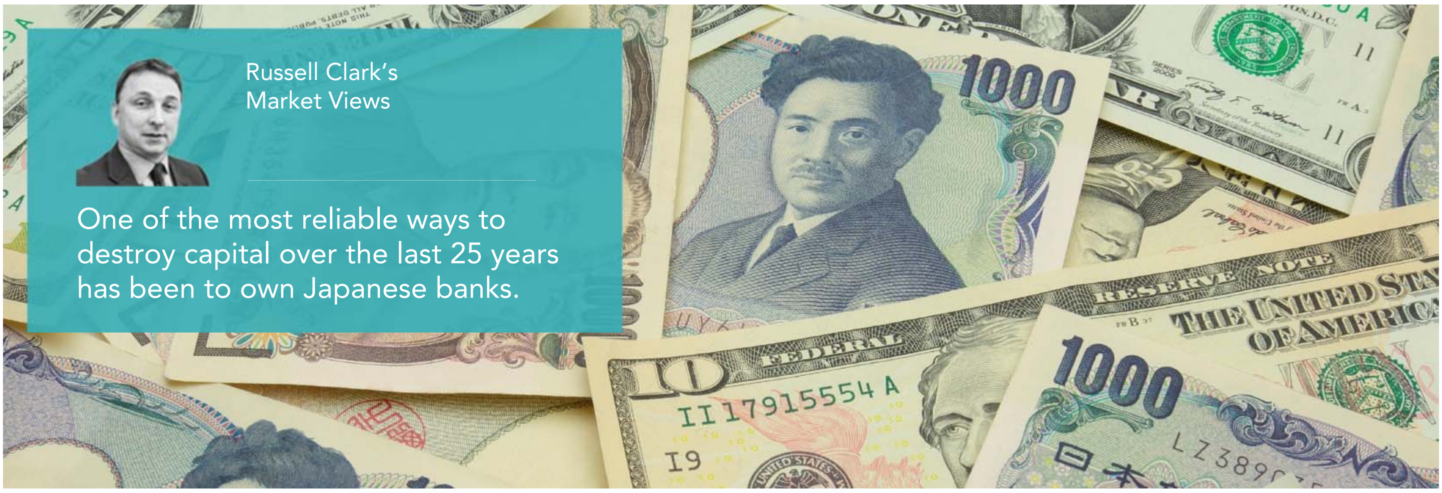
HORSEMAN
CAPITAL MANAGEMENT

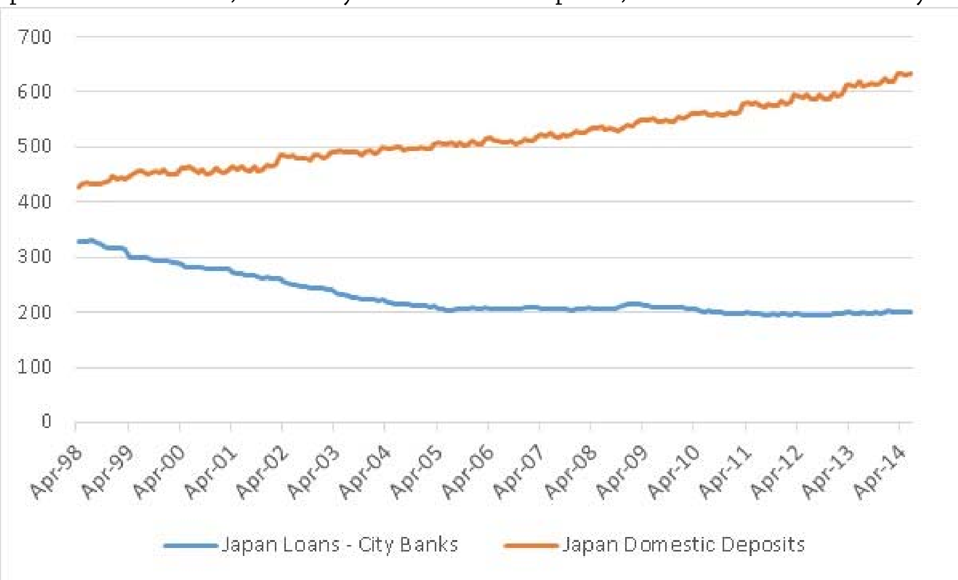
Market Views – **August 2014**

JAPANESE BANKS



One of the most reliable ways to destroy capital over the last 25 years has been to own Japanese banks.

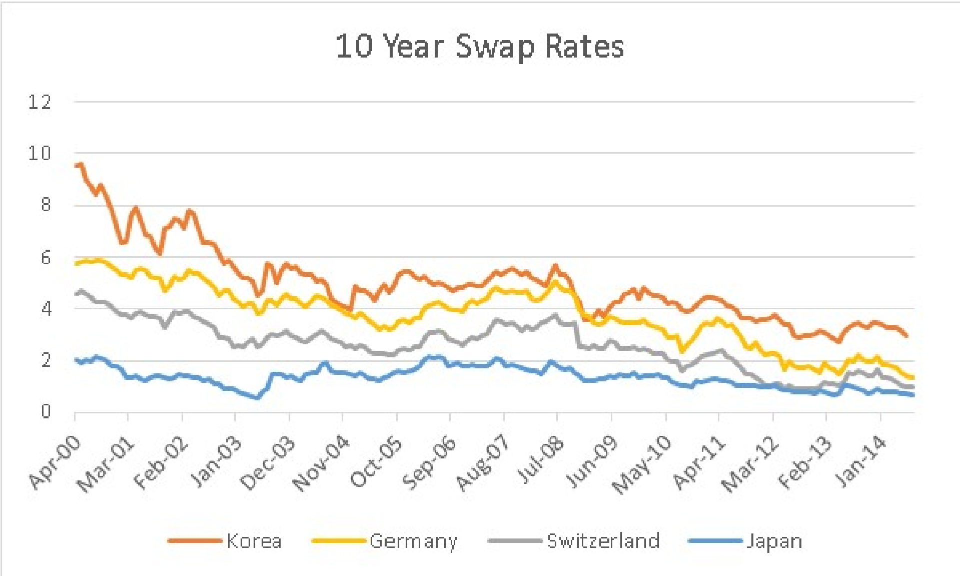
The big problem for Japanese banks is that, while they are awash with deposits, loan demand has been very weak in Japan.



Japanese banks have tried to fill in the gap between domestic loans and deposits by doing two things. They are buying JGBs and lending overseas.

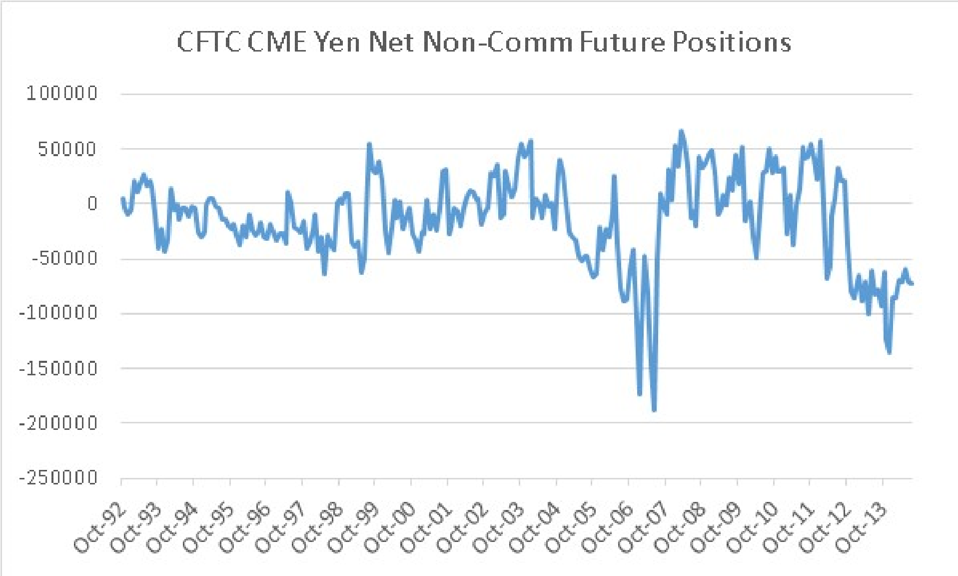
Japanese banks have traditionally been big holders of Japanese equities, so their share price tends to follow general moves in the markets, but they tend to outperform in periods of rising bond yields. This relationship still seems to hold.

For many years it was possible for bulls of Japanese banks to argue that Japanese yields were so far below that of other nations that they could only rise. Recent moves in the yields of other export dependent nations make that outcome look very unlikely.

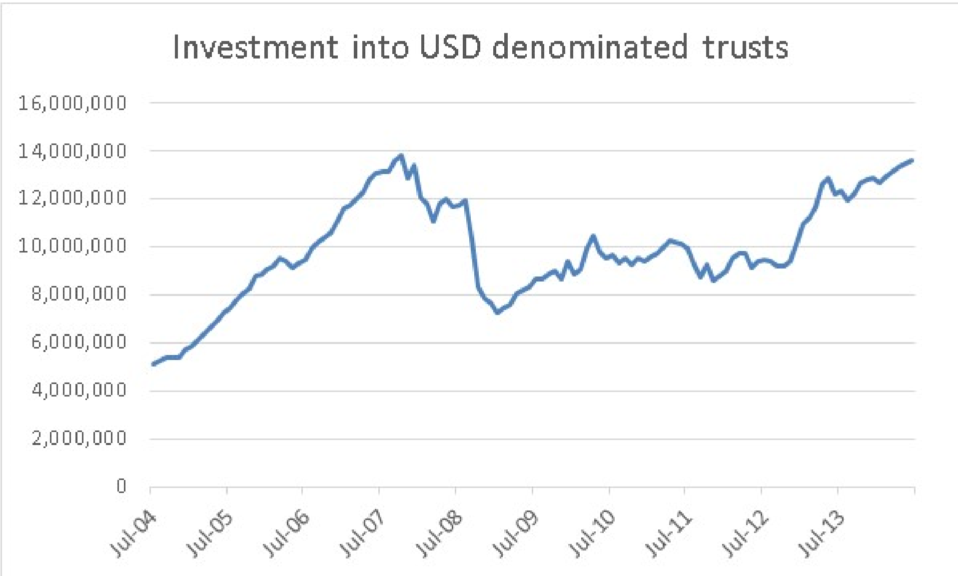


It has also been possible to be bullish of Japanese banks as they have offered a leveraged way to play a Japan rally driven by a weakening yen. The problem here is that the market has aggressively prepositioned presumed yen weakness. This can be seen in both the CFTC currency position for institutional investors and in the domestic Japanese retail investors' enthusiasm for USD investment trusts (toushin).

Future sellers are most aggressively short since 2007



Japanese retail investors are longest in USD since 2007.



Finally, Japanese banks have been aggressively expanding the loan books overseas, particularly into Asia.
http://www.bis.org/publ/qtrpdf/r_qt1309b.pdf
BIS quote Japanese banks as now being the biggest cross border provider of credit. As noted previously, Asia banks are now aggressively short dollars.

It is very possible that some sort of credit event in Asia will cause Japanese banks to not only book loan losses, but also to see the yen rally, and Japanese bond yields move lower. Any or all of these would be very negative for Japanese banks. The risk reward of shorting Japanese banks looks good to me.

INFORMATION

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