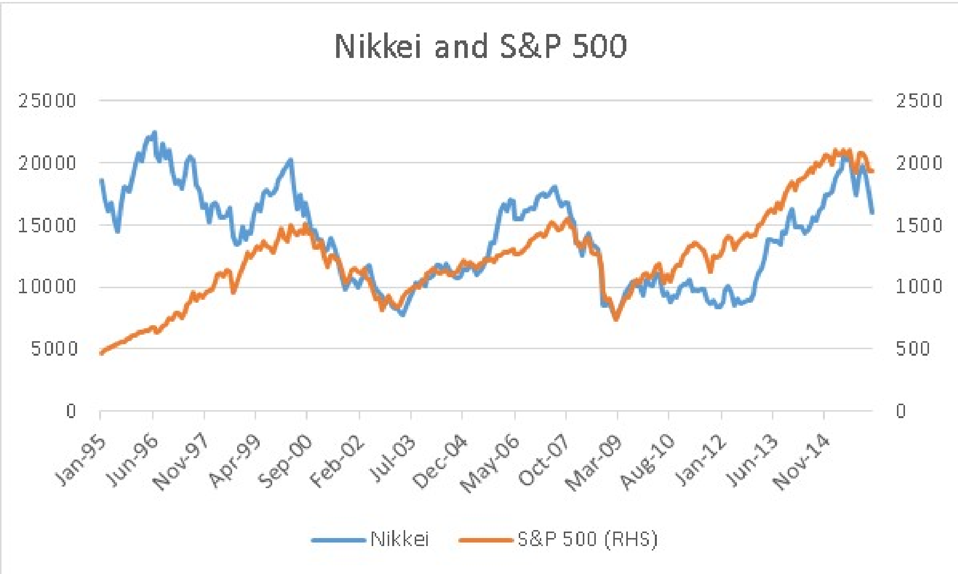
WHY DOES THE NIKKEI ALWAYS START FALLING BEFORE THE S&P 500?

Russell Clark's
Market Views

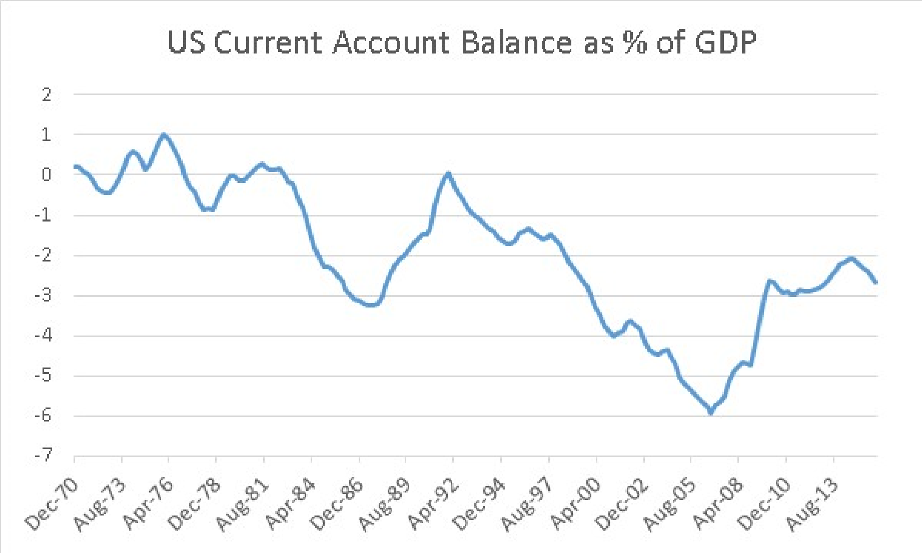
"One of the curious things over the last few years, is that despite the last two bubbles in markets being mainly US centred (dot com bubble and US housing) it has been the Japan based Nikkei that has peaked 3 to 6 months before the S&P 500."

One of the curious things over the last few years, is that despite the last two bubbles in markets being mainly US centred (dot com bubble and US housing) it has been the Japan based Nikkei that has peaked 3 to 6 months before the S&P 500. The Nikkei peaked in March of 2000, while the S&P 500 rolled lower in August of that year. The Nikkei peaked in June of 2007, while the S&P 500 peaked in October of that year.

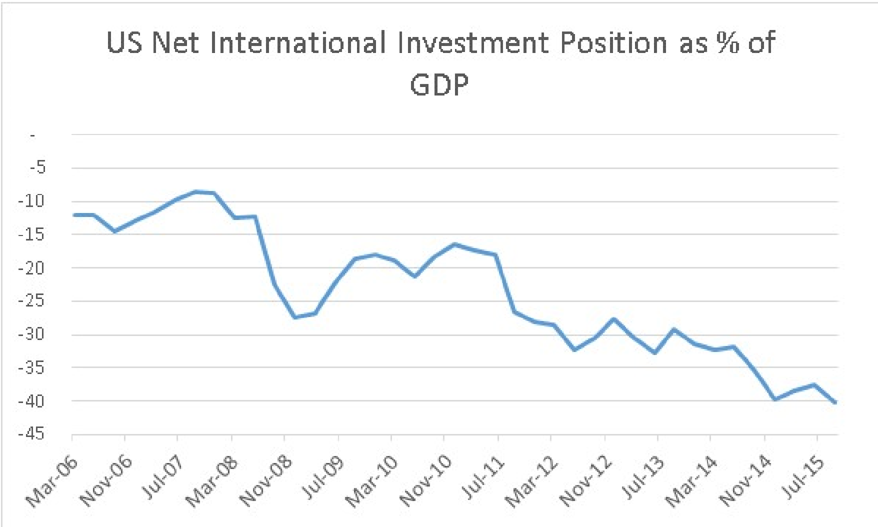


The question is why should this be the case? Most investors would argue that the US economy is larger than Japan, and its stock markets are larger and more liquid. Theoretically, the US market should lead the Japanese markets.

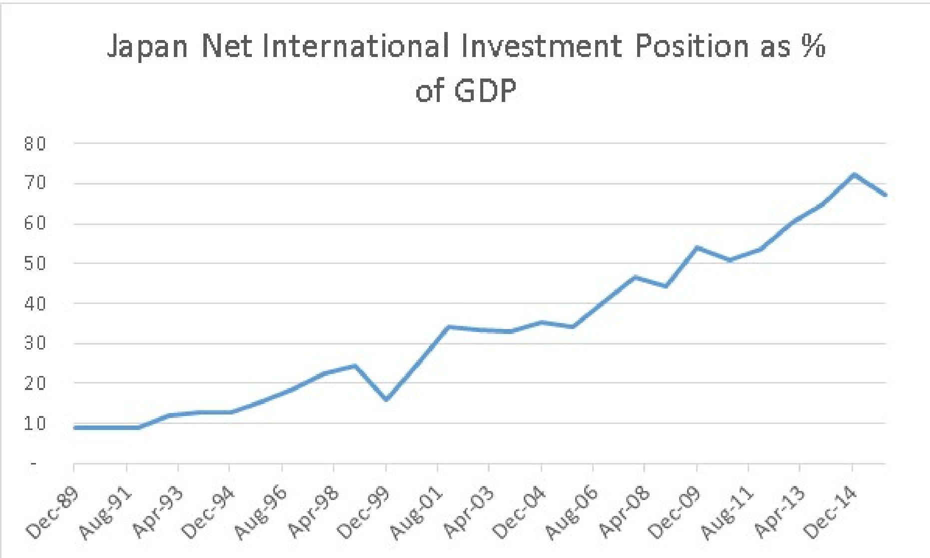
The reality is that the US does not fund itself. The US has been running a fairly consistent current account deficit since the 1980s.



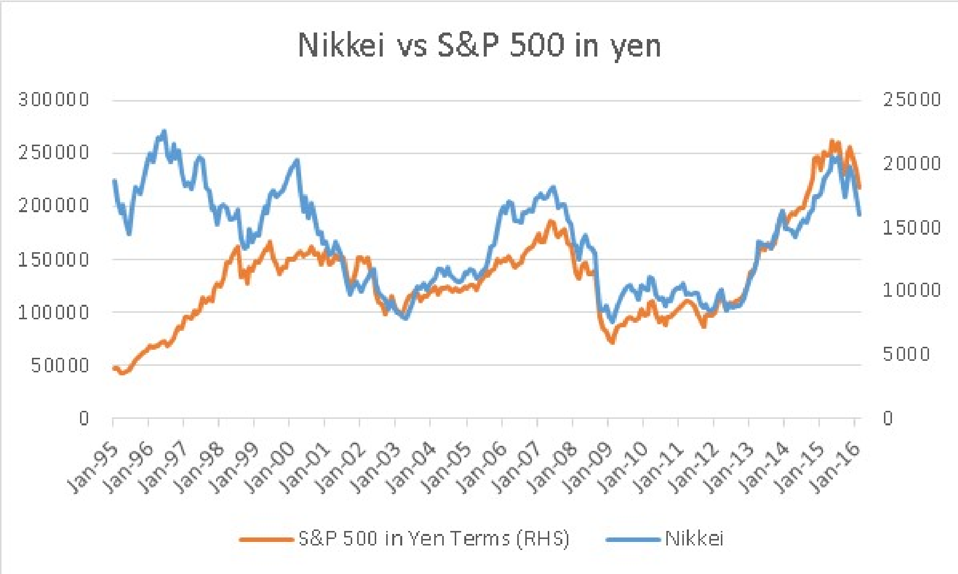
To fund this current account deficit the US has become the world's biggest debtor. The US net international investment position was extremely positive for most of the post war period, but over the last decade has deteriorated dramatically.



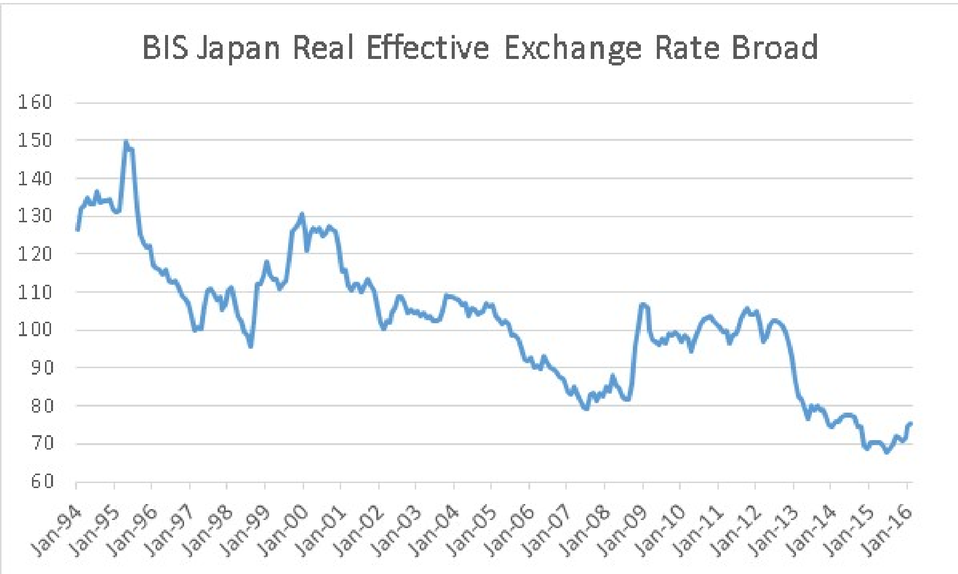
The biggest supplier for credit to the US, particular relative to GDP has been Japan which has seen its net international investment position swell tremendously over the last decade.



My view is that the Japanese are the world's biggest net savers and investors, and it is the movement of Japanese investments that cause the biggest moves in currencies and equities. If we convert the S&P into yen, we can see that Nikkei and S&P 500 tend to fall at the same time. That is the Nikkei and the S&P move together.



This seems to point to yen weakness being a good indicator of equity strength, as Japanese investors sell yen and seek higher returns elsewhere. Conversely yen strength is a sign that Japanese investors are repatriating assets and global markets are likely to be weak, at least in yen terms. If this is true, the most troubling aspect of such a theory is that Bank of International Settlement ("BIS") put the case that yen is trading still close to all-time lows on a real trade weighted basis.



This line of thinking provides a very simple model for the performance of the Nikkei and S&P based on the value of the yen. If we assume that yen can rally to 100, we see that the Nikkei traded around 14000 the last time yen traded at 100. This model would assume the S&P would then trade somewhere between 1400 and 1600. I am very interested to see if this theory continues to work.

INFORMATION

Issue Date:	23rd March 2016
Source:	Bloomberg, unless otherwise stated
Investor Relations:	Alain Zakeossian, Carol Brown
Email:	info@horsemancapital.com
Telephone:	+44 (0)20 7838 7580
Website:	www.horsemancapital.com

Business and registered address: Horseman Capital Management Limited, 9 Chester Close, London SW1X 7BE, United Kingdom. Registered in England and Wales - Company number: 04034280

DISCLAIMER