
Hedge your bets when it comes to the yen

Currency

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Over the past years the yen has, as befits the world's second largest economy, acquired safe-haven status despite the perceptions we have about Japanese finances.

A combination of minimal to zero interest rates, before this became commonplace; appalling demographics with little immigration to boost the workforce; subdued consumer spending after years of negative or minimal inflation, have been masked or overlooked due to Japan's high savings ratio and the performance of its exporters. Most important in the second half of 2008 was the fact that its banking sector was in comparatively rude health.

At a time of rising risk aversion the yen attracted inflows to the extent that the currency rose the most of the 171 currencies tracked by Bloomberg, climbing 23% versus the dollar and 29% against the euro. For a UK investor it was this strength that rescued the performances of

our Japanese investments and allowed us to post broadly neutral absolute returns despite the stock market falling heavily.

However, this strength has turned into a weakness as it has emasculated exporters just when the economy needed them most. A strong currency and falling worldwide demand for their exports has proved to be a disastrous mix.

Japanese exports were cut by nearly a half in January, when compared to the figures in January 2008, falling by 45.75%. All areas were affected with trade to the US falling by 52.9%, while exports to Asia fell by 46.7% and to Europe by 47.4%. These figures are simply staggering but are substantiated from what we know about car sales in this country and the results recently announced by Sony and Toyota.

Against this backdrop, Japan is going to lose its trade surplus with the fall in exports being the primary cause of the 3.2% fall in the fourth quarter GDP. With trade and GDP data likely to disappoint, it is unlikely that our Japanese investments will be bailed out by yen strength this year.

If you want to maintain or introduce a Japanese weighting, then achieving this by a hedged method would seem the sensible route.
