

The Sun Also Rises

DURING MOST OF THE 1990S, IT SEEMED there was not even a glimmer of hope in the land of the rising sun. Japan, the second largest economy in the world, continually defied expectations for a rebound and remained mired in a devastating cycle of deflation. Global investors largely gave up on the Japanese economy and its stock market steadily sank lower. The global market sell-off in March saw the Nikkei drop to a new 20-year low of 7,834 points, well below its 1989 high of 38,916. Yet real signs of economic growth in Japan were emerging, even as stocks were plumbing new depths.

RAYS OF LIGHT

After spending the better part of the decade refusing to change, corporate Japan finally acted. Large Japanese corporations engaged in restructurings and layoffs. The semiconductor industry alone saw tens of thousands of layoffs last calendar year in a country long known for lifetime employment. Significant consolidation has also taken place, with Hitachi and Mitsubishi, for example, combining their chip businesses. Those that cut fat last year entered this year with improved financial positions, and they've been using that financial health to add muscle. Business spending in Japan rose an

unexpectedly strong 1.3 percent in the second calendar quarter, while chip companies were among the most noticeable spenders as they added leading-edge capacity at an unexpectedly strong clip.

Although deflation remains a problem, and in nominal terms the Japanese economy is still shrinking, even the economic picture is improving. The Japanese diffusion economic index showed a strong 81.8 reading in June – well above the 50-point level that indicates expansion, while the second quarter marked the sixth consecutive quarter of growth. According to the Financial Times, the Japanese central bank has also finally started non-sterilized intervention (printing

money and injecting new supply into the economy). For the first time, banks are also being seriously pressured to clean up their balance sheets, as auditors have been given the message by the government that they may actually be held responsible for their audits. Even the Liberal Democratic Party (LDP) looks likely to face more competition in the future, as politics-as-usual (and even business-as-usual) comes under increasing attack.

A NEW DAWN

With real reform beginning to take place at nearly all levels of Japanese society, I suspect Japan will post an unexpectedly strong performance over the next 15 years that will shock observers. In fact, I believe that the odds are good that Japanese stocks will be among the strongest performers in the years ahead. Yes, this sounds hard to believe. Following more than a decade of decline, it's hard for anyone to imagine such a rosy scenario transpiring, and for good reason. A corporate structure that once seemed destined to rule the world has instead turned out to be too big and slow moving to keep up with new times. What was once the world's strongest currency is now in disrepute, and what was once the world's biggest creditor has turned into one of its biggest debtors. Unemployment is at record highs, and confidence in government is at record lows.

Of course, all the above describes America at the start of the 1980s as accurately as it does Japan today. Where others see problems I see a stock market that has priced in those problems but is ignoring the potential of a Japanese rebirth in the same way America's capacity for reinvention was disregarded coming out of our lost decade of the 1970s. For technology, I suspect that Japanese IDMs are going to find the winds of technology integration favor them and that in the years ahead there will be wide acceptance of devices boasting convergence and connectivity features from Japanese companies. Proximity to a China market that could start living up to some of its hype will not hurt either. ☺

Stephen Brennan is an investor relations consultant with MCA, a Silicon Valley public relations firm, and a principal of Financia Captial, LLC, a San Francisco-based money management firm. He may be reached at sbrennan@mcapr.com or steve@financiacapital.com.

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