FRIDAY, FEBRUARY 23, 2024

Welcome to the Dividend Cafe weekly market commentary focused on dividends in your portfolio and dividends in your understanding of economic life. Hello and welcome to this week's Dividend Cafe. I am about to give you a very Japan heavy weekly Dividend Cafe, but I am not recording in Tokyo. I'm recording.

In Greenville, South Carolina I spoke at a Christian university last evening and now I'm heading back to California, but want to talk about a very significant event that took place this week and in a sense has been taking place over 35 years. And it has profound implications for U. S. investors. I like to get granular and niche at times with Dividend Cafe topics.

But I don't get that idiosyncratic where I am going into a topic that I recognize, even though it may be intellectually interesting. To me, and maybe to some listeners or readers is going to have very little relevance to most people. I'm talking about Japan because of the relevance. I think it has for anybody who's reading, listening, watching.

What took place to give specific numbers this week is that the Nikkei closed on Wednesday night. So going into. Thursday morning U. S. time at 39, 100 and that represented a new all time high for the Nikkei closing prices. And the last time the Nikkei had a closing high, Was December 29th, 1989. I was literally in high school and we were literally fighting still near the end of the cold war.

We had just had less than one year of the George Bush senior presidency. That is where the Nikkei last had its all time high until this week. Now, granted. It isn't like UCLA has won a Rose Bowl or anything through any of this period of time. You got to go back to the 1986 season for that.

But still you're talking about a very long period of time. To go from an all time high to a new all time high, 35 years in between. Now, most people are well aware that this happened and it did happen so quickly, violently, and suddenly that it is not a situation where just over time, it dropped this way, it dropped very quickly and there were certain rebounds that were quick.

I want to walk through these numbers, but more importantly, walk through what happened, why, what has happened more recently, and then where. US lessons fit into this. How do you go 35 years without a stock market moving higher? First of all, it is pretty much necessary if you're going to do something like that, to have been in a perverse bubble, significant.

Financial bubble overpriced assets that bring you to a point of that kind of financial and asset bubble that then burst and what had taken place to do a very brief historical overview is that the Plaza Accord in 1985 essentially The dollar had been overpriced. US policymakers were looking to counteract that and out of the Plaza Accord, which was really meant to aid with an overhype US dollar.

Caused the yen to rally like crazy. And you can say, okay it sounds like a strong yen would be good for the Japanese economy. But the problem is of course that Japan, unlike the United States, was virtually entirely driven at that point by exports. So the very strong yen. Was terrible for the Japanese economy and policymakers decided to fight against a strong yen in order to offset the recessionary effects they were facing.

By doing everything under the sun to weaken the yen, and which was primarily excessive amounts of monetary policy, very low interest rates, which then fueled an asset bubble and was able to drive a lot of economic activity in the property sector and the financial sector. Does any of this sound familiar?

So what happened is a ton of public investment took place. fiscal policy aided with and accompanied by monetary policy. And you ended up with some just utterly bizarre things happening initially to curb a strong yen, but ultimately leading to the feeding of this asset bubble. Let me give you an idea what we're talking about.

Commercial real estate prices in Tokyo, 1986 alone, one year Up 122 percent residential prices in Tokyo in 1986 alone up 45 percent one year stocks were at the Nikkei was at 13, 000 in 1986 it closed at 39, 000 in 1989 a tripling. of their stock market in three years. At one point, the per square foot pricing in Tokyo's Imperial Palace was greater than all the real estate in California.

And speaking of California, it's not just a reference point to the absurdity of their bubble, but because of the significant amount of assets, That and public investment that was driving asset prices higher, the Japanese. Investor class was forced to go offshore and bid prices up there, famously buying Pebble Beach, which is, of course, in Monterey Peninsula in Northern California for a billion dollars, buying Rockefeller Center in New York City.

And what were a couple of the most high-profile real estate transactions in American history that led to just spectacular losses. So then what happens is 1990 comes and the asset bubble burst because asset prices, when they get too high, drop and they dropped. Stocks were down 35 percent and then all of a sudden bank had to start writing down bad loans because the asset prices that were under girding the loans were dropping like a rock.

A hundred trillion yen of bad debts had to be written down. A deflationary spiral like we have never seen. These debts are being evaporated written down, but then asset prices are dropping further. And of course, the massive amount of losses that the banking system was taking were leaving the banks insolvent.

There is nobody interested in spending money. Consumption collapsed, but then the worst thing, and I'm going to come back to make a point of this with the US, is that the government made the decision as these banks were writing down these loans to prop them up by injecting more money from the government sector.

So, zombie banks were allowed to stay, which meant that there was never a pivot into more productive economic activity because unproductive economic. Losses, basically the downside of what they had chosen to do, the mal investment was allowed to continue. So, they never allowed for a shift from unproductive assets into productive assets manufacturers lost their edge technology, lost its competitive advantage, and then that led to what really, we referred to as a loss decade beginning in the 1990s, but it really became essentially a lost.

three decades. Now you could say, okay the stock market, yeah, 35 years didn't move. But let me show you, there's a chart in Divinity Cafe this week. The nominal GDP of the Japanese economy essentially right now today is where it was when I graduated high school. 35 years ago, the nominal GDP has not moved.

There's been a little up and down along the way. At one point I know it had compounded at 0. 13%. I think the nominal is a bit higher now, but the real GDP growth is essentially zero. And how does that happen? There are other demographic elements in Japan, but essentially in the aftermath of the bubble bursting, you lost.

Your competitive advantage and debts had to be liquidated, but couldn't be liquidated quick enough to keep up with assets dropping debt ratios were unable to come down, leading to a total lack of vitality in the economy, the stock market, the Nikkei. Down 82% from 1990 until 2009. It's up 550% now from the 2009 low, which was obviously caught up in the global financial crisis.

So I'm cherry picking a low point there. It had gone from 39,000 to 7,000. It's now back to 39,000. It's at 550%. Foreign investors more recently have come back in, and that's largely related. To China's problems are becoming Japan's gains. The Nikkei was up 44 percent now over the last year, 15 percent in the last 90 days.

In the meantime, Shanghai is down 11 and Hong Kong is down 22%. So you see a lot of shifting of foreign capital out of competitive Asian countries into Japan. Their corporate earnings are way up by the way. Companies are leaner and meaner and their S they're a PE ratio is only about 16 times.

The S and P's is well over 20, 22, 23 right now. So, you have a reasonably priced market. You do have a very questionable currency. You still have zero completely fake bond market largely owned by their central bank, but along the way you've had. This utter collapse of asset prices and then economic vitality leading to 35 years.

Of stock market that was, when I said didn't move, that's not really fair because that's range bound, not moving as it's just up and down a little over 35 years. And lo and behold, whoa, 39, 000 is still 39, 000. No, this dropped like a rock, stayed down for a long time, dropped even further. And then now has just come back up more, more quickly over the last 10 years.

And then even then had years at a time where it was in, in total gridlock. But from one point to one point, it never went above that initial point, the 000 from December of 89 until this week. It's a stunning piece of history. I've been academically fascinated with it for a good portion of my working life.

There are more comprehensive academic papers. I want to write on this. And right now, that's a little outside of what I intend to do to wrap this up for your sake. So don't worry. I'm not going to bog you down with wonkery. I want to basically point out that asset bubbles feel good when they're happening and they're Hangover effect is worse than just the loss of the bubble.

That the hangover effect leads to more than just the value that was there going away, but it leads to collateral damage outside of the mere price of the underlying asset. Other asset prices drop when asset bubbles burst. Other economic damage is done when asset bubbles burst. And the attempt to manipulate using fiscal and monetary policy is always and forever the cause of bubbles and the cause of bubbles bursting and the cause of the hangover that comes out of that.

This is the story of Japanification. Different versions at different levels of severity are the story of U. S. policy and European policy, as I talk about all the time. But that issue, and this will be my closing thought for you, that issue of Not getting your resources in your economy, whether it's capital resources, capital investment or productive efforts, risk takers and entrepreneurs going into those endeavors that are going to create economic value when you are stagnating, it is often because you are not Resourcing what can be productive.

You are continuing to force resourcing to what is unproductive. This on the margin has happened far too much in the U. S. post financial crisis, and this above and beyond the margin, but in spades, is what happened. Congratulations to Nikkei being back to 39, 000. Congratulations to all U. S. investors willing to learn the lesson of Japan.

And congratulations to Dividend Cafe readers and watchers. for suffering through me speaking about this message again. It is not about Japan for me. It really is a global takeaway an evergreen investment understanding of learning from one of the most historically important economic events in history happens to have started when I graduated high school and be prevalent here throughout these decades of my adult professional life.

But even apart from that, in a hundred years, this will be one of the biggest economic events in history, what took place in Japan, that bubble is incomprehensible, what they went through, the bursting of the bubble was incomprehensible, and it is imperative that economic actors. Learn to want to escape boom and bust cycles.

Boom and bust are no way to have the healthy economic vitality we want in a free society. Thank you for watching. Thank you for listening. And thank you for reading the Dividend Cafe. Go to Dividend Cafe to see a couple of the charts I've talked about. And I will see you next week back in California.

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