



DISASTER IN JAPAN

Japan is not an emerging market and has few natural resources, so neither Newgate's Emerging Markets nor Global Resources Portfolios have any direct exposure to Japan. However, the destruction in Japan and subsequent rebuilding will have implications that are hard to predict.

Japan is an unusual country. It has high savings rates, which have allowed it to maintain high budget deficits and near zero interest rates for decades. These high savings rates (along with many other factors) will allow Japan to recover more quickly than a country that has to import capital. Due in large part to its high savings, old (and aging) population, Japan is a net producer and therefore under-consumes relative to its population and size of its economy.

As always, with any major event there are immediate, intermediate and longer term ramifications. A quick summary follows.

IMMEDIATE. We have already seen some of this. Liquid assets from Japan's private and public sector will be converted back to yen to rebuild. From a macro-economic perspective, export dependent Japan is hurt by the rising yen.

The immediate impact has been for investors to de-risk their portfolios, as prices for all assets, equities and commodities have declined. Even basic foodstuffs like wheat are down. Headlines suggest that it is because there is less demand, but we think it is just as likely to be a rebalancing by global investors.

INTERMEDIATE. Once the exigent crisis is over, after the nuclear issues are resolved, the focus in Japan will move from damage control and humanitarian relief to rebuilding. Japan has the wherewithal to rebuild, but will need building materials of all sorts, as well as additional oil and liquefied natural gas to replace the lost electricity generation capacity from damaged reactors. Several reactors have been rendered non-functional in the effort to prevent a core meltdown. That loss of electricity generating capacity can be considered permanent.

LONGER TERM. There are bigger questions to be addressed, including:

- 1) To what extent will this dampen America's appetite for increased nuclear power? We cannot answer that now, as it depends on what the damage will be in Japan. While fearing plant meltdowns, actual radiation leaks have been relatively mild thus far. The most likely scenario is a reduction in global demand for nuclear power. Germany has already ordered a shutdown of half of its nuclear power plants and China has suspended approvals on new plants.
- 2) Impact on the global economy. Probably bigger than most think, because Japan makes vital components for goods produced elsewhere. In theory, if Toyota's production is curtailed, other companies will sell more cars to meet demand. But if those companies buy components from the same company in Japan that Toyota did (a fairly common practice), many more companies, and not just Japanese ones, will be impacted.

MARKET IMPACTS. The expectation is that reduced GDP growth forecasts will result in looser monetary policies by Central Banks globally. From a sector perspective, the rebuilding of Japan will take massive amounts of iron ore, metallurgical coal, cement, copper and similar building materials. Natural gas continues to look better as a source of fuel given its abundance. Japan is likely to turn to liquidified natural gas to meet power generation needs. Opportunities for investment include not only gas exploration companies, but drillers, services, pipelines, construction companies and other related industries.

South Korea is a likely beneficiary, as it is a significant producer of heavy equipment that will be needed for Japanese reconstruction. China will likely also benefit, as it will attempt to fill any production gap created, especially in consumer electronics and similar products. ♦

M I N D I N G T H E F U T U R E T O D A Y TM

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