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GREECE or JAPAN?
08/16/2017

Warren Mosler is fond of saying:

> "We fear becoming the next Greece; we continue to turn ourselves into the next Japan"

In the early 1990's Japan's stock market and real estate market collapsed. The Nikkei 225 index shot up 492% in ten years and hit a record of 38,915 on December 29th 1989*. That's 19.45% per year for 10 years. 28 years later (2017) it's around 19,500 – down 50% from its peak. What a ride!

Since Japan's bubbles burst, the Japanese 10-year government bond yield has dropped from 8% to 0%*. That's despite soaring Government debt, low unemployment and massive QE. Nine years after the collapse the yield was 2.50%* and I'm quite sure many "Experts" predicted that massive inflation and higher interest rates were inevitable. Instead of moving higher it moved to ZERO over the next 17 years!

We are now nine years removed from our Great Financial Crisis, and I'm starting to get déjà vu. Our stock market is up 300% (18% per year) from the March 2009 low*. We have high Government Debt, low unemployment, and massive amounts of money created through QE. I know many "Experts" are predicting extreme inflation and higher interest rates. I wonder if they noticed that the US 10-year bond yield is now very close to where the Japanese 10-year yield was nine years after their crisis. I believe we are headed lower, not higher. I think zero is a stretch, but 1% is a possibility.

Interest rates have nothing to do with Government debt, unemployment rates, money supply or Quantitative Easing. Interest rates have everything to do with inflation and inflation expectations.

The Central Banks of the US and Japan, as well as the ECB, have each adopted a 2% target for inflation. Despite all their efforts all three are failing.

July 2017 inflation	
US	1.40%*
Japan	0.40%*
Euro Area	1.3%*

The US Federal Reserve adopted its 2% inflation target in January of 2012, 67 months ago. They have met the target 4 times. Why have they had such a hard time reaching this goal? Globalization has taken the wind from their sails.

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GLOBAL SURPLUSES IN EVERYTHING

Globalization has increased the supply of and reduced the cost of Labor. Labor is the largest cost in making things and providing services. Inflation measures the relative change in price of goods and services. I could stop here but I won't. The world produces too much (relative to demand) of most everything. We have too much oil, too much food, too much steel and copper, too many cars. Can you think of anything we don't have enough of? If you can we will figure out how to make more. Humankind can be amazingly efficient and productive in providing for our needs and wants. Globalization, productivity and efficiency will all work to keep prices down.

Maybe we should rethink this 2% inflation target. The three largest developed economies are all showing modest if not spectacular growth, growing employment and little inflation. What's wrong with this picture? And more to the point for us at Cater Wealth Management how will this effect interest rate? I believe two things determine the interest rate on a fixed income investment, inflation and credit risk. Inflation and inflation expectations are drifting lower. If you agree with half of what I have expressed in this article you may agree. Credit risk is and will always be with us.

At Cater Wealth Management we do our best and have been doing our best in analyzing credit for more than 37 years. We believe we can identify the proper balance between risk and performance to maximize your income given your individual investment goals and risk tolerance.

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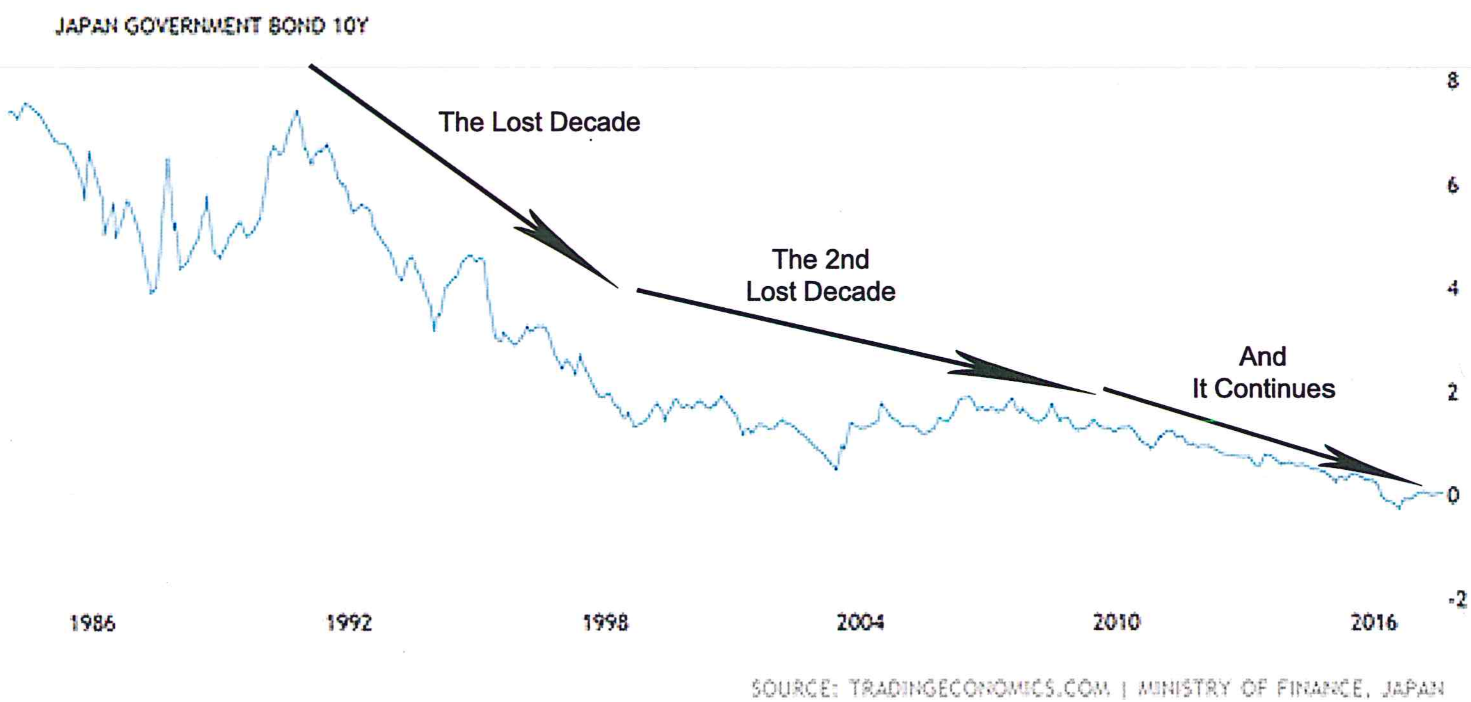
Late 1991 - Early 1992
Equity and real estate bubbles burst in Japan; Nikkei 225 peaks at 38,915 on 12/29/89. Aug 2017, 28 years later, it's 19,500, down 50% from it's peak.



June 2017	Japan	U.S.
Unemployment Rate	2.8%*	4.3%*
Net Debt Per GDP	135%*	75%*
Inflation	0.4%*	1.42%*

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Sources:

1. Nikkei 225 from 1980-1990
   Bloomberg LLC – NKY Index

2. JGB 10yr from 1989-2017 (Chart)
   https://tradingeconomics.com/japan/government-bond-yield

3. S&P 500 from 2009-2017
   Bloomberg LLC – SPXT Index

4.Inflation in July of 2017
   US: PCE deflator, BEA - https://www.bea.gov/index.htm
   Japan – Japan Statistics Bureau - http://www.stat.go.jp/english/
   Euro Zone – Eurostat - http://ec.europa.eu/eurostat

5. Net Debt/GDP
   CIA World Fact Book - https://www.cia.gov/library/publications/the-world-factbook/

This material contains forward-looking statements and projections. These opinions may not develop as predicted. It is our goal to help investors by identifying changing market conditions. However, investors should be aware that no investment advisor can accurately predict all of the changes that may occur in the market.