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Breaking News: Most Economists, Journalists, Are Muppets

"I would appreciate it if all investors and trading participants would respond in a calm and orderly manner."

- Atsushi Saito, president of the Tokyo Stock Exchange, quoted in a front page Financial Times article titled 'Japan disaster scares markets', 16.3.2011.

"This is a stew of unfavourable circumstances that is ripping the guts out of global equity markets in a way we have not seen since 1988."

- Carl Weinberg, chief economist of High Frequency Economics, quoted later in the same article. The article's authors, Richard Milne and Javier Blas, suggested *en passant* that "the fear of nuclear catastrophe combined with the losses to life and property in Japan were exerting a suffocating grasp over markets". Perhaps Saito-San should have included 'journalists' in his request.

"The behaviour of financial markets over recent days confirms British Prime Minister Lloyd George's observation that financiers in a panic do not make a pretty sight."

- Satyajit Das, published on Naked Capitalism.

"If you get enough cold water inside you may stop the generation of steam and then life will get easier. Until then it is a bitch."

- Robert Kelley, nuclear engineer, quoted on Bloomberg.

In relation to Japan, is the Internet helping, or making matters worse ? Or perhaps the question should be: are modern media, by and large, pouring fuel on a fire with their salivating, non-stop, hysterical coverage of a human tragedy ? Or not ?

There was a disturbing echo from history when the BBC reported the words of a Sato Takero from Sendai who was responding to the Japanese emperor's address: "I was born after World War Two. This is the first time for me to see him on TV or through the Internet. It's something beyond imagination. If you understand the culture of the Japanese it is very, very rare for him to come out." As anyone who has studied the history of World War Two or Japan will know, when the Japanese emperor announced the country's surrender in a radio recording after the atomic bombing of Hiroshima and Nagasaki, that was the first time that most Japanese had ever heard their emperor's voice.

Putting the human dimension of this tragedy to one side, which we do not do lightly, most of the armchair physicists and armchair economists who have busily clogged the airwaves over the past week have made one fundamental error: government spending in the aftermath of a natural disaster will not create more wealth than was destroyed. If it were otherwise, Frédéric Bastiat would not have had to write the parable of the broken window (see our commentary of 1st March 2010, "Alice through the breaking glass"). As we wrote back then:

"In.. Bastiat's parable, a shopkeeper has a window broken by his son and is obliged to pay, say, six francs to fix it. Some onlookers reason that breaking windows is a good thing, since it causes more money to circulate – in this case, into the hands of a grateful glazier. But Bastiat points out that since the shopkeeper has had to spend six francs on getting his window repaired, he has been deprived from spending the money on anything else. The benefits of purchasing a new window are illusory, since they ignore the cost to the shopkeeper."

The original Bastiat piece can be found here. The broken window and the payment to the glazier are what is seen. What is not seen is what the shopkeeper might have spent his six francs on if he had not had to pay them to the glazier. To vault to the macro: government spending crowds out the more legitimate spending or savings decisions of the citizenry. (And the Japanese government, with debt to GDP at 220%, is effectively bust, whereas Japanese citizens are, in aggregate, rich. Japan is a classic example of what we have christened a CRAP economy – Citizenry Rich; Administration Poor. We note that this coinage has mysteriously failed to catch on. Perhaps someone at Goldman Sachs could give it a nudge.)

Larry Summers, formerly senior economic adviser to President Obama, told CNBC that the Japan earthquake and tsunami "may lead to some temporary increments, ironically, to GDP as a process of rebuilding takes place. In the wake of the earlier Kobe earthquake, Japan actually gained some economic strength." As Bloomberg's Caroline Baum somewhat acidly responded,

"Too bad Japan had to wait 16 years for another opportunity."

Whether clueless economists are triggering as much financial damage in the aftermath of the earthquake and tsunami as clueless journalists is an interesting question. Financial commentator Ian Orton of TheWealthNet recently indicated 'How financial journalists really can damage investors' wealth'. Fortune Magazine, as GMO's James Montier points out, put together a list of ten stocks described as 'Ten Stocks to Last the Decade': Nokia, Nortel, Enron, Oracle, Broadcom, Viacom, Univision, Schwab, Morgan Stanley, and Genentech. Any investor who had invested $100 into an equally weighted portfolio of these gems would have had, ten years later, just $30 left. In Montier's words,

"That.. is the permanent impairment of capital, which can result when you invest with no margin of safety."

Ian Orton asks what happened to the author of this article.

"Financial journalists don't die, or even fade away. They often move on to become consultants or get involved with public relations. Which is what happened in this particular case. The author is now [a consultant]" – and there may be a few superfluous letters in that last word. Ian makes a further point:

"Anyone, at least here in the UK, has to be authorised to do just about anything related to investments. The exceptions are, of course, journalists. Journalists can effectively advise, i.e. make stock tips, without going anywhere near financial regulators, through their published articles. Moreover, as a number of studies have shown, the media is one of the most important sources of advice for self-directed investors, especially affluent investors. So should financial journalists be regulated ?"

Even self-regulation would have been useful to prevent or dissuade some of the more ghoulish coverage of the Japanese disaster this past week, across all media. The problem with 24/7 rolling news is that it is hugely redundant and not to say repetitive, especially when, as has been the case with Japan's nuclear problems, genuinely new news has been thin on the ground. Memo to whoever is responsible for BBC's News Channel: breaking news, by definition, is something of a one-off, rather than an item that can be indefinitely recycled until another non-event surfaces – even when it's highlighted **IN RED IN CAPITAL LETTERS**. Then there are the jarring leaps by newscasters between coverage of the Japanese tragedy and lighter events closer to home. The part-satirical Hollywood thriller 'The China Syndrome' was undoubtedly ahead of its time, when it had anchorwoman Kimberly Wells (Jane Fonda) interrupting her investigative coverage of a suspect nuclear power plant in order to cover a zoo tiger's birthday party.

Assessing prospects for Japan as an investment vehicle are complicated by the unresolved problems at Fukushima, but it seems fair to suggest that if you liked "Japan" with the Nikkei above 10,000, you should probably still like it now. Manager of the Himeji Fund, Dominic McEwan, points out that many market participants are drawing a parallel with the Great Hanshin earthquake that beset Kobe in January 1995. In the following six months, the Topix index fell by 20%, the Yen/Dollar rate moved from 100 to 80 on February 18, 1995, but over the subsequent six to twelve month period, Topix rallied by 34% and Yen/Dollar returned to 105. The differences this time round: the Japanese financial system in 1995 was extraordinarily fragile, and as Dominic observes, consolidation has now occurred, asset quality is less of an issue, and capital bases are generally healthier. Whereas the price to book ratio of the market in 1995 stood at around 2 times, it now sits at 0.9 times. Since the scope for government policy initiatives was larger in 1995 than today, the broad if crude conclusion: sell JGBs, buy Topix would seem to be reasonable.

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