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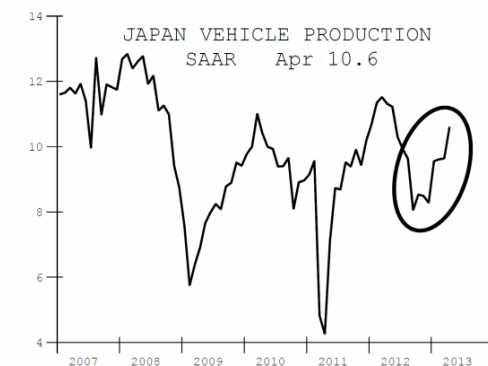
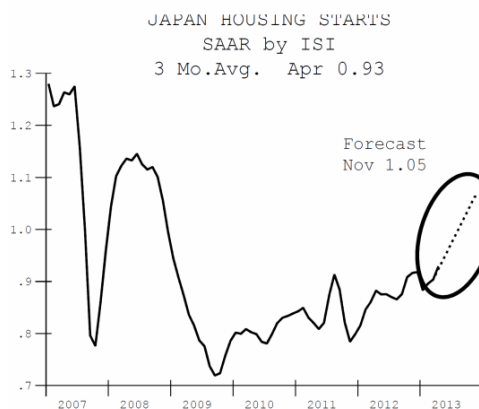
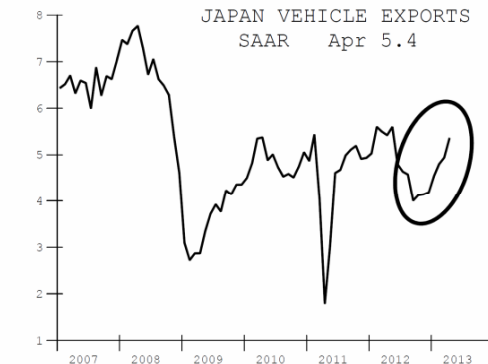
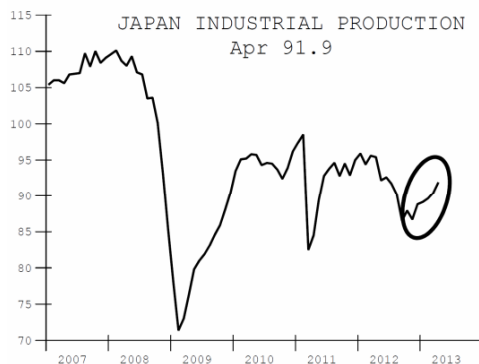
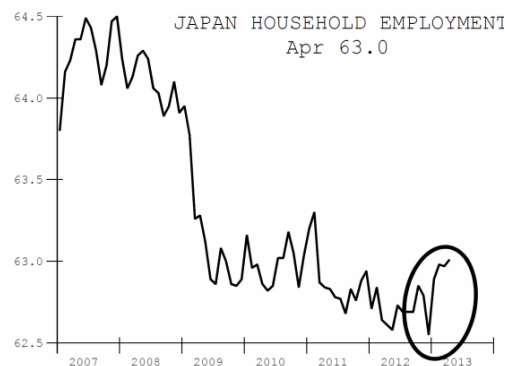
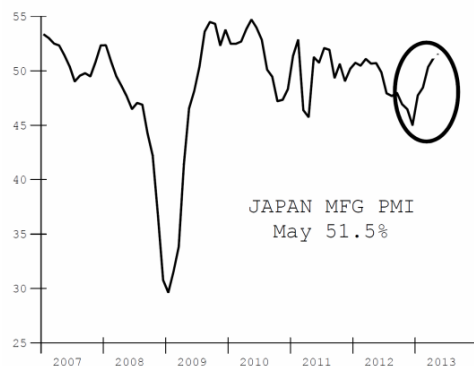
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*The policies of Prime Minister Abe and his team have clearly made an impact on the economy. If Abe's and central bank chairman Kuroda's resolve remains strong, then the recent decline in Japanese stocks will be a correction in an uptrend, in our view.*

## Abenomics is Working



*Charts courtesy of ISI Group; employment, housing starts and vehicle data in millions; SAAR (Seasonally Adjusted Annual Rate); industrial production indexed to 100 in 2005; Investments in international and emerging markets securities include exposure to risks such as currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability.*

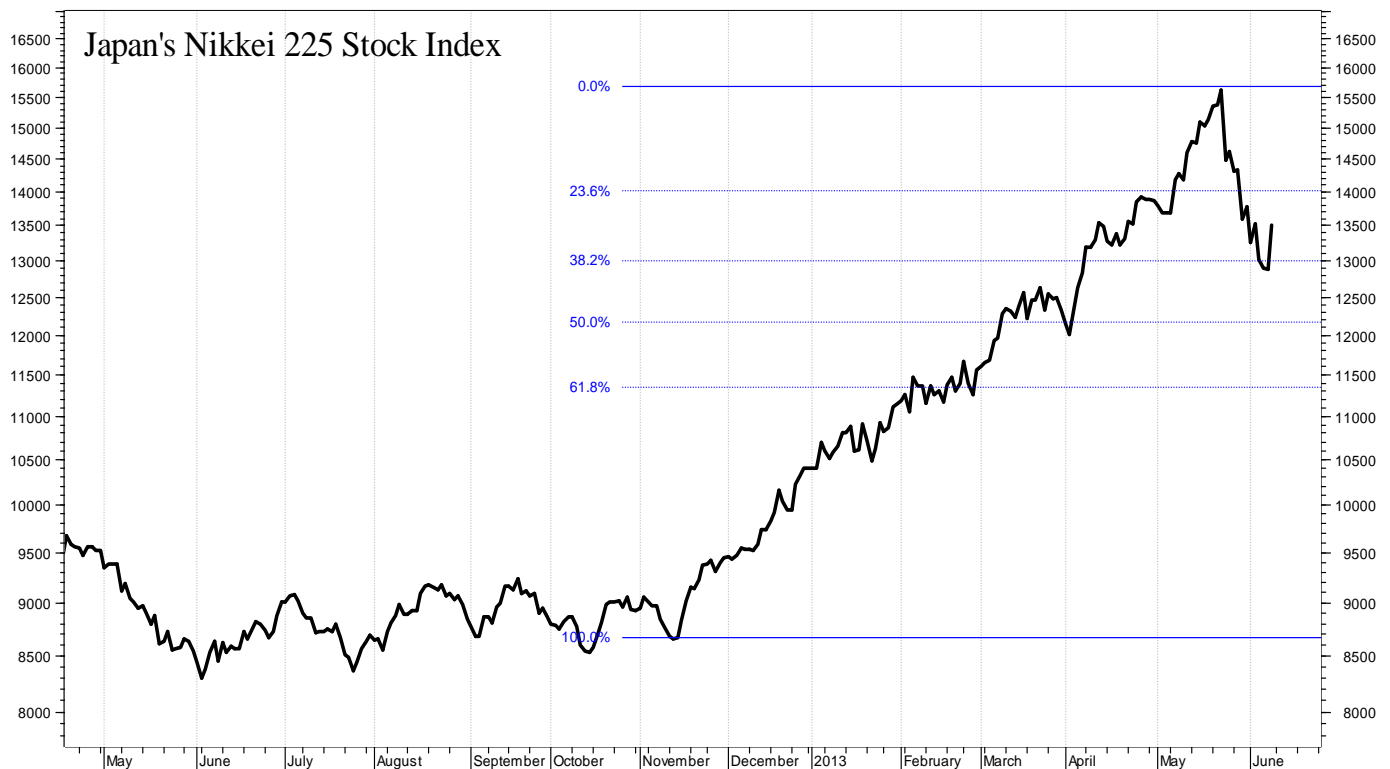
The charts above show that the policies of Prime Minister Abe and his team have clearly made an impact on the economy. Indeed, first-quarter annualized GDP growth has been revised upward to 4.1% from its preliminary reading of 3.5%.

The stock market's initial strong reaction, reflecting the positive case, has presented a challenge for Japanese bulls. As our Weekly Chart shows, the Nikkei rose 80% from November through mid-May. As we wrote two weeks ago, economic change brings market volatility, and that volatility has been high. For the first time since Mr. Abe launched his policies, the markets are testing his resolve. The Nikkei, which reached a closing high of 15,627 on May 22<sup>nd</sup>, fell 17.6% in 12 days, only to bounce to 5% during its first trading day of this week.

When the range of potential outcomes from such a radical change in economic policy is great, then the range of forecasts for earnings and markets will also be wide. We think this is the fundamental cause of the price volatility. There is also a technical cause: short-term momentum investors. These investors were attracted by Japan's strong performance in the first five months of 2013, only to be forced to unwind positions when prices fell.

If Abe's and central bank chairman Kuroda's resolve remains strong, then the recent decline will be a correction in an uptrend, in our view. If we are wrong and Abe and his team lose their nerve, then Japanese stocks have further downside potential. We are overweight Japan, and from a risk-management perspective, we need to be sensitive to the size of the overweight given both Japan's outperformance and recent volatility, but from a fundamental perspective we remain optimistic.

### THE WEEKLY CHART: JAPANESE STOCKS ARE TESTING THE LEADERSHIP'S RESOLVE



We showed a chart of the Nikkei 225 two weeks ago, but it has changed sufficiently that *we think* it warrants another look. Our chart shows the retracement levels for the Nikkei's 80% November through May rally. The Nikkei holding between the 38.2% and 50% retracement would suggest to us that the uptrend is intact. So far, this is the case.

*Past performance is no guarantee of future results. Information provided in this report is for educational and illustrative purposes only and should not be construed as individualized investment advice. The investment or strategy discussed may not be suitable for all investors. Technical analysis is based on the study of historical price movements and past trend patterns. There are also no assurances that movements or trends can or will be duplicated in the future. Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 75% of the total US equities market. It is not possible to invest directly in an index.*