



# Market Flash

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## JAPANESE PRIME MINISTER RESIGNS

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As the world press has widely reported, Japanese Prime Minister Yasuo Fukuda announced his resignation on September 1, after less than 12 months in office. Although the resignation itself was not a surprise, the timing occurred much earlier than expected.

Fukuda decided to resign when it became increasingly clear that his Liberal Democrat Party (LDP) had little chance of winning the next election of the lower house, the House of Representatives, while he remained in office. Fukuda and his party became unpopular based primarily on Japan's struggling economy, which is facing its largest growth decline in six years.

The LDP's situation became dire when the approval rating for Fukuda's cabinet failed to improve after the G8 Hokkaido Toyako Summit, which was held in July. The Prime Minister then shuffled his cabinet in August, naming former Foreign Minister Taro Aso to the post of the party's Secretary General.

This move also failed to boost approval ratings, and even the coalition party, New Komeito, began distancing itself from the LDP. Foreign Minister Aso is now believed to be a front runner to succeed Fukuda.

Investors realized that progress would be hard to come by with the LDP controlling the lower house and the opposition party occupying more than half of the seats in the upper house. Therefore, the market accepted the unlikelihood that a political solution would boost stocks.

Despite Fukuda's resignation, that stalemate still exists, and we believe that his resignation will have only limited impact on Japan's equity market.

The next opportunity for political impact on the markets can be better assessed after a new head of the LDP and a new Prime Minister are elected. However, the new Prime Minister will face the difficult task of improving cabinet approval ratings, as well as increasing support for the LDP, if they hope to retain their control of the lower house.

Therefore, we expect that the new Prime Minister will likely take on only short-term projects aimed at improving the image of the LDP, rather than larger-scale, long-term, projects.

We may well have to wait until after the next election of the lower house to see any positive political changes and experience the associated economic impact. The current administration's term will end in September 2009, and elections should occur before that time.

### Bottom Line

Regardless of the political situation, stock prices are typically a function of economic growth and resulting corporate profits. We expect to see a recovery in Japan's economy by the middle of next year.

Our view is based, in part, on the fact that Japan is one of a small number of developed countries that has seen minimal impact from subprime mortgage related problems. Thus, we expect the Japanese stock market to gradually improve in the mid term. ■

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