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Thank **G**od **I**t's **F**riday! March 9, 2007

No matter where you look, everyone seems to be blaming the "Yen Carry Trade" as the culprit for last week's selloff, and a strategy whose days are numbered. It's also being presented as if this currency strategy has only been in existence for a few months. Not so. Let us take the opportunity to outline how we view the existence of and future for the Yen Carry Trade.

Imagine you could borrow money at a ZERO rate of interest? Not just until January of '09 like at your local furniture store, but over the entire life of the loan? This has been the situation in Japan for over a decade: Japan's central bank has kept its prime lending rate at between zero and 0.5% -- practically free money!

Not surprisingly, many large investment houses have jumped in to capitalize on this opportunity. Why not take free money and invest it at a much higher rate of return, say in emerging market stocks, or even in US treasury bills? You cash in a tidy profit, and then pay back the Japanese loan with a teeny bit of interest. This scenario is known as the "Yen Carry Trade." Estimates of the funds borrowed range anywhere from $100 billion to $1 trillion. Nobody knows for sure.

Of course, you're skeptical of the idea of free money, and you should be because the risks, although hidden, are considerable. The biggest risk is that the Yen will appreciate in value. If the Yen you have to buy back to repay your Japanese loan has appreciated, your profit from the carry trade would shrink. If lots of other investors wanted to cash in their profits at the same time, the price of the Yen will be even further bid up and gains could shrink dramatically, or even turn negative.

Large differences in rates of return cannot persist indefinitely, especially in an era when funds can be transferred across continents at lightning speed. Risks and returns, interest and exchange rates eventually come into balance. Interest rates vary across regions. For example; Japan 0.5%, EU 3%, US 5.25%, Brazil 14.75% Risk varies too.

You don't have to fill out a loan application at the Bank of Japan to be participating in the rewards and risks of the carry trade. Stocks and bonds across the globe have been bid up in value as the carry traders search for places to invest their borrowed funds.

An important shift has occurred and it bears watching. The Federal Reserve stopped raising interest rates last year, and it appears that the next move could very well be a cut. The Bank of Japan, on the other hand, just increased interest rates from 0.25% to 0.5%. Small move, yet the borrowing rate effectively doubled, and the profitability of the carry trade was hit.

In the past 2 weeks the Yen has been rising in value, and the carry trade has started to unwind. So far, the trend has been gradual. The spread between rates remains wide, but a continuation of the new trend could have adverse effects on the Markets. The risks are catching up with the rewards as markets come into balance proving that money isn't free.

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	March 9, 2007	December 30, 2006	Percentage of Change
DOW JONES	12,276	12,463	-1.50%
S&P 500	1,402	1,418	-1.12%
NASDAQ	2,387	2,415	-1.15%
10-year Bond YIELD	4.589	4.71%	*When yield goes down, prices go up*

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