Kimura Dreamvisor Newsletter Summary 13th November 2006

Some hints to make a sound judgment.

Do not be troubled by rumours and noises and buy on dip.

Looking at slow-moving domestic situation Hedge funds turned sellers.

Bush republican majority suffered a heavy defeat but foreign exchange & stock markets took it quietly. US economy is slowing down due to housing bubble burst and high oil prices twin impact, nevertheless economic growth will keep on for a while. Consensus says that companies' earnings will stay high. US stocks buy back run at roughly 300 billion Yen per year, S&P 500 yield is 6,5 % per year far above 10 years treasury 4,6 %. That won't reverse easily. On a long term perspective Democrat victory is positive for Japan. Mid term elections results will boost Iraq policy change, appease Middle East situation and reduce terrorism plus unnecessary costs associated with it. Oil prices are settling down and new US administration has renewed energy to take on Far East strategy. I believe this is one step forward toward settling North Korean Nuke problem.

Tokyo stock market has been trading water since 26th October interim high. TOPIX has fallen 7 % since October's interim high. Meanwhile other main markets indexes are resilient; Japan's bearish tone comes out. Including futures led trading foreign investors buy when market is up and sell when market goes down (including futures trading) therefore there is a slight change regarding foreign investors stance toward Japan.
Let's have a look at the three main markets trend: up to the 27th October foreigners bought 1 trillion 400 billion Yen worth of Japanese stocks in 5 weeks time. On the other hand Japanese individuals sold cash 1 trillion 500 billion Yen and sold on margin 200 billion Yen. Oil price decreased and US soft landing made it easier for foreign investors to buy stocks. However domestic institutional + individual investors turned sellers to secure capital for the very large IPO's the like of Nomura Real Estate, Idemitsu Kosan or Aozora bank, in addition 6 months margin settlement has piled up. This said such selling scale cannot only be justified by capital rising, individuals continue to show negative stance toward equities. Looking at recent domestic investors inactivity and individual's consumption slowdown hedge funds turned to short selling strategies. However balancing oil prices, companies earnings, forex and foreign stock markets I don't think Nikkei 225 can durably break 16,000level on the downside. As no serious buyers materialize it just goes to upside down margin trading.

High arbitrage balance fear is unnecessary

Arbitrage balance has reached historic high at 5 trillion Yen. Observers' fear that a sudden futures price decline lead to massive and indiscriminate futures selling. When they read that n nervous individuals are unwilling to commit themselves. Hedge funds are typically riding any symbolic event to take action on futures. As an individual investor you should not be disturbed by such noisy background and buy at lows to sell at highs.

I personally experienced arbitrage within a foreign securities company; this story is excessively advertised. Arbitrage traders will always sell until current futures/cash spread is smaller than theoretical price (interest minus ex dividends). Currently Nikkei 225 futures interest spread is barely 20 Yen on a three months basis. Arbitrageurs' policy is always to shift to another futures selling position (this is called roll-over) in order to maintain arbitrage position. This is due to the fact that any unexpected income within increased dividends announced for the target stock can be expected with the actual cash stock holding

Traders aim at price distortion originated in futures and options specially when price movements become erratic. Arbitrage positions cannot be purposely destroyed due to current rapidly changing situation specially if anticipated dividend increase turns out to be dividend decrease.

Large IPO's rush will be over after Aozora bank listing. Large caps IPO's always generate holdings selling to free capital for subscription (this is especially true for institutional investors allocating assets by sectors). This time real estate and banking sector suffered from the musical chairs game. In addition consumer loans sector had all of a sudden to register a one-off special loss totalling 1 trillion 500 billion Yen due to legislation changes. In such sectors foreign investors holdings are high at 3 – 4 %. When foreign investors feel insecure they sell immediately.

However earnings and interest rates drive equity prices. Sooner or later investors will turn back to sectors offering a yield above interest rates. For current mid term earnings season autos, steels, machinery earnings are far above previous forecasts. During mid term earnings season market is not responsive even if earnings are positive. Stock prices are easily sold under true value during the season. Said in other words there are numerous stocks sold at bargain price. November to December period show usually the best return for those having bought stocks in the past 6 months and above. Quietly buying stocks sold under true valuation will generate generous returns in the second half.