Kimura Dreamvisor Newsletter Summary 7th November 2006

Equity holders win!

Global workforce arbitrage power

Speaking about cycles counting: 3 years average cycle ended in June and we have entered a new 3 years cycle, first stage of this cycle was confirmed by mid term part which ended by 26th of September. The point is: have we confirmed or not this short-term cycle bottom? Looking at stocks daily trading this is my impression however short term cycle pattern change easily, which leave open the possibility of a bottom confirmed after 23rd of November. By that time if we confirm intermediate low it is recommended to further increase positions. This is due to the fact that the first stage of a new 3 years cycle is usually quite bullish. Theory says that upside potential is 20 % from next bottom. 3 short-term cycles constitute a standard 1-year cycle and normally high point is achieved at second or third short-term cycle stage. This is especially true of the first year within a new 3 years cycle; it is very rare that initial short-term cycle register a high followed by the low.

Is such logic proves right then we should easily break on the upside previous cycle highs: 16,900 Yen for Nikkei 225, 1670 for TOPIX. If we cannot break on the upside then this reveal a serious macroeconomic problem. Happily I believe we are totally safe from such concern.

A lot of people are concerned about current economic cycle as US has entered slowdown stage and current Japanese 'Izanagi' economic boom is showing some weaknesses. For equity investment too the stance is quite severe. This said the best economic indicators are companies' earnings and this can be compared to mining and industrial output indicators. Clearly corporate earnings profit trend is strong and this makes a difference with mining and industrial production index. This pattern is even stronger in US relative to Japan.

Reasons are: number one, developing countries demand is continuously rising. Number two; the worldwide arbitrage of production facilities between low cost countries and developed countries is advancing. This borderless positive environment makes possible same time output increase and prices lowering thus margins are expanding continuously. When unemployment rate is low within developed countries there is always the tacit threat to move to lower cost countries, consequently wage pressure remain low. Labour's relative share is continuously going down. In a normal situation the labour's relative share rise would put pressure on corporate profits, however the potential reservoir of cheap labour force has transformed this.

Before a real slowdown materializes positive earnings will continue.

Due to the domestic labour bottleneck high earnings areas shift to cheap factories areas and no one could ever critize management for swapping high labour costs for cheaper alternatives. Nevertheless domestic closure of plants and delocalisation to foreign countries is always treated like evil by the medias.

If a company is really going through life and death crisis it sounds normal to decrease labour force at first stage. Although it is painful for those fired it is equally painful for those remaining, as they have to make up for the job of those eliminated. It is said that it's hell for those leaving as much as for those remaining. This said in some cases it could be heaven for those staying; namely when salary increases above former level. In the end main beneficiaries are shareholders.

Everything is owed to the IT revolution. Companies that were prompt to introduce IT reform could adequately reduce the workforce. Companies transcend national borders without hesitation provided the same work can be done with same information's and materials in foreign countries. The impact is particularly important for industries like electronics able to gain from market scale economies. For highly profitable companies executive staff such little fate changes make large differences economically therefore wealth disparity has greatly expanded.

World's largest retailer Wal-Mart was able to focus on the needs of falling purchasing power old middle class and low wage Hispanics or coloured classes, Wal-Mart could then secure a world class position by sourcing cheapest products on a global basis. If people can afford to buy such products then they will pour in. I do not think Wal Mart business style has gone well because impoverishment problems were settled or do not exist in Japan.
Like it or not but global workforce arbitrage is progressing in Japan too. Profits can endlessly be secured from 'arbitrage opportunities' provided same quality services or products are offered. Japan's Uniqlo brand mark is a representative example. Direct or indirect labour costs are high, if those can be swapped for foreign workers it will de done sooner or later. However the skills and knowledge wall exist and I feel this further increase chances to keep profits higher over the long term. Before a real slowdown materializes labour contribution rate will stay low and profits kept at high level.