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Bipolarisation of the market at crossroads.

New Growth Markets renewed selling pressure is shifting to rebound

Contrary to Japanese main exporters like Toyota or Canon continuously registering new highs, new growth markets which had registered near continuous selling pressure managed to stage a rebound and probably found bottom on the 12th October morning session. On the 11th October MOTHERS index broke the previous low registered on the 27th of July at 1076 but the following day closed at day's high. Index finally staged a 5 % rally on the 13th. However the TOPIX core 30 index which include the largest capitalized stocks was down most of the day and closed on a slight gain. Up to now the movement was totally reverse.

Strangely Nikkei 225 (among other major indexes) renewed its high since June low. However on the 12th of October the fall/rises ratio broke 70 % at 68,9 % pointing at clear oversold pattern, on first section 202 stocks registered new lows, on second section 96 stocks registered new lows. 11,9 % of TSE first section stocks and 20 % of TSE second section registered new lows. Today looking at Nikkei three new growth markets sections most stocks that had registered yearly lows were up.

In short up to now only the top 100 or 200 very large caps solely bought by mutual funds or foreign investors were up, all other stocks were subject to cash realization by individual investors. Individuals have 80 % trading market share of New Growth Markets, compared to that individual's market share for very large caps is no more than 1 %. In fact even excluding new growth market, stocks that can't be bought by institutional investors have been sluggish The number of stocks going up is really limited which explain why the buy/sell ratio does not go up; on the contrary the ratio goes down.

This case resembles year 1999 autumn Internet stocks bubble. At that time if it was not Internet or telecommunications related then it was not even considered a stock, equities were bought indiscriminately whatever the fundamentals. One cannot deny that some MOTHERS and HERAKLES listed stocks were overbought but apart from some key stocks earnings are quite positive therefore such a fall cannot be explained by fundamentals.
Since June 4th week individuals have been large net sellers on the cash market, of course long buying margin interest is important as usual but so far buying equals selling (survey of trading by investors type is only done for TSE first and second sections therefore this dos not relate to New growth markets). But excluding IPOs and capital increase the position on new growth markets must also be large net selling .
To speak clearly the bad supply demand situation is the logic response to unreasonable expectations (on top of the Livedoor shock losses buying to average down the cost aiming at retrieval has exhausted available capital). Settlement of long margin positions built at peak April month piled up with the North Korean nuclear test news, caught in the purchase board vacuum zone investors had to tearfully sell stocks to make up for the losses. Said in other words now is a chance to ride the adverse.

Should foreigners buying continue the previously mentioned 'dam theory' should extend to mid small caps.

Foreign investors are mostly global portfolio oriented and invest for diversification purpose and capital repartition. Repartition is usually 60 % stocks, 40 % bonds. Japanese equity market receives 10 % of this money flow. Capital scale is important therefore it makes it difficult to check stocks on individual basis and buying is rather engineered through basket purchase linked to MSCI index. In addition oil money usually focuses on large industrial groups.

As stated in part (1) consensus points at US soft landing and as global earnings continue to grow the very low yield gap (fixed income compared to equities yield) points at equity investment rather than fixed income. US equities have a historical tendency to show a bearish pattern during mid term election period but this popular saying was betrayed on the back of Dow new highs.

Foreign investors bought substantial amounts of Japanese equities. In the fourth week of September plus first two weeks of October foreigners bought 773,8 billion Yen. On a yearly basis this translate into 20 trillion Yen. Meanwhile Japanese individuals sold 970,5 billion Yen of stocks. All in all this is net selling. The fact that such selling appears while Nikkei 225 recovers to the 16,000 level would mean that Japanese investors expectations toward equities are very low indeed. Selling 5 % yielding equities for 0 % yielding cash seems incomprehensible for me when earnings are revised upward and dividends increase.

However there is hope in such an incomprehensible domestic situation: namely onshore Mutual Funds and industrial investors. They must scale up strongly their purchases. Large amounts of pensioner's money just cannot be parked in 0 yielding saving accounts. In addition from may 2007 M&A restrictions through share swaps will end. As part of their defence plans companies must use justifiable means to increase the level of their stock price. Said in other words they must use cash at hand to buy back own shares.

Economic theory tells us about the 'dam theory' originally mentioned by BOJ. First companies' earnings increase, then when this is reflected in employment and compensations consumption increases. Applying the same scenario to the stock market, foreigners bought continuously only the leading stocks, Profit realization should then turn to undervalued equities which can only mean small caps. As long as corporate value can be found in such stocks of course.