Kiyoshi Kimura Dreamvisor Newsletter Summary 19th of May

High time to target the market rebound

The buy/sell ratio is at 5 years low.

We are at the turnaround point of the short term 27 weeks cycle. Cycle points at the three years interval peak and lows for the Nikkei 225, numerous technical analysts stress this as a turnaround level for the market. The buy sell ratio has been at 60 % for four days in a row. On the 18th of May it went down to 64,3 % which is a low since September 2001. The buy/sell ratio usually decrease quickly when the wider market correct, this indicator is volatile and in itself not sufficient to point at a bottom but it does lay the ground for the rebound.
One of the reasons to assert we are very close to bottoming out is the fact that both TOPIX and NIKKEI falls from peak is 9,5 %.
Very recently oil money flowed into large international blue chips like Toyota or Honda which also led to margin selling but the fall rate is not that pronounced. Furthermore even for real estate, machinery stocks or other capital investment related equities from recent higsh the fall rate has been limited. Earnings are strong and mutual fund buying is important. The weighting of those stocks in the TOPIX is important so the fall is limited.
Looking at individual stocks chart the matter is very different. The mid to small caps fall has been much more heavy. For the MOTHERS listed stocks volatility is even more important and large upswings led to heavy selling. This looks more like a downside market.

On the forex front the US $ weakness is bound for a pause.

On a worldwide basis, putting aside commodities markets the risk premium has been on the rise again. Profit taking in BRIC's stock markets has been increasing. Usually this lead to a reverse fund flows in the US $ but as the unbalance between US and other export countries has been pointed at within G7 this led to dollar selling.
The yen/dollar exchange rate broke to ¥ 108 to rebound strongly thereafter to current 111 ¥ parity levels. The US CPI rose than expected leading to higher rates expectations and dollar rebound. On the other side the Yen rose strongly leading to postponement

expectations for the BOJ zero rate end policy. The Japan US rate differential will remain around 5 % for a while implying US $ buy back. At such a level Japanese earnings won't be much damaged.

The earnings season has reached a turnaround point, companies which earnings substantially underperform analysts estimates draw attention. This said a lot of investors are over focusing on these figures; for those companies forecasting 5 % increase in sales if current profit only show 1% rise this is due to mispricing of fixed cost increase.

For previous fiscal year estimates (05), sales were up 3,9 %, current profit + 1,9%, net profit + 12,5 %. When 80 % of earnings were finally published sales were finally up +8,5%, current earnings up 1,9 %, net profit + 12,5%. Most companies were too conservative publishing their earnings forecasts this led to upside revisions and stocks went up.

At end of fiscal year 05 (march 06) closing all industries cumulated sales were 440 trillion ¥, current earnings 28,8 trillion ¥. Fiscal year 06 forecasts give cumulated sales 463 trillion ¥, current earnings 29,1 trillion ¥. Although cumulated sales increase by 23 trillion ¥ current earnings only increase by 300 billion ¥, is this linked to cost increase? By analyzing previous fiscal year cost structure (sales – current profit) half are fixed costs and the rest are variable costs. I have made a quick calculation of companies' earnings sensibility to costs variations. If fixed costs increase by 1 % variable costs should increase tenfold (+ 10%). If fixed costs increase by 2 % variable costs should increase by 9 %. In any case the author of this report feels that companies forecast a rise of 6-7% for the variable cost. Obviously energy cost increase contributes a lot, however those figures seem overstated. In that case provided there are no large miscalculations in sales prices we should experience upside revisions later.

It looks difficult to expect foreign investors renewed buying for now but slowly and surely domestic money is shifting to risk assets, sahes buy-back operations should also increase substantially. In the near future the stock market should rise again.