Kimura Dreamvisor Newsletter summary 20th July 2006

Chances that there won't be further tightening at the 8th august 2006 FOMC are 70%.

Yesterday US stock and bond market surged. FBR president Bernanke declared' we shall decide if further tightening is needed by monitoring prices and economic situation', market translated this by the high possibility that rates wont go up further considering the fact that economic slowdown had finally materialized. June housing starts were down 11 % and the real estate bubble has obviously started to deflate. Oil price fall despite Middle East renewed tensions was also a helping hand.

The US soft landing scenario took off and Tokyo stock market rebounded strongly. By regaining the lost ground in the previous two session's market ended in positive territory. Softbank recovered strongly, new growth markets MOTHERS was up 7%, JASDAQ 4 %. I do feel new growth markets bottomed out for good.

Usually when stock markets rise bonds are sold however on that very day bonds were bought. Bonds were bought on lower expectations for core FF rate rather than a change in each country long term balance.

So what will come out from the FOMC meeting the 8th of august? I personally believe that odds are for a status quo at 7/3.
I believe this can be explained by timing. Up to now FED raised FF rate 17 times and there is little doubt that the cumulative effects of tightening have put a brake on individual consumption and housing starts. Tightening impact usually lags 3 to 6 months and the previous rate rise effects have yet to materialize.
In the midst of derivatives market expansion and hedge funds huge assets balance there is always the risk that over tightening would lead to positions huge selling plus the risk of ballooning derivatives unsettlement. By this autumn the new FED president will have just one year in office, Greenspan went through the black Monday. To rush in raising interest rates is a dangerous bridge to cross, even hawkish Bernanke would not take such a risk.

Core job creation figures are weak.

Unless there is clear data showing economy overheating and inflation surge evidence I believe FRB have some leeway to study current situation. Although inflation has accelerated somewhat, prices increase have a strong tendency to lag economic cycle therefore if advanced leading indicators show weakness this problem should not be overstated.

The interesting point is that during the past 20 years if non farm payrolls 3 months average increase did not reach 150,000 (roughly equivalent to the working population increase) FRB never increased rates. Despite the fact non farm payroll increase reached only 126,000 FOMC increased rates in the previous meeting, this said other specific conditions were behind the decision.

Recently job creations felt to 108,000, ISM index, housing starts and private consumption showed weakness. Unless new strong indicators come out before the 8th of august meeting there won't be further tightening for now.

Oil price has sidelined recently and despite the renewed tensions in Middle East the barrel has fallen 5 $. Some sources believe that a barrel at 100 $ is not far away but most observers believe that with the economic slowdown the Israel Hezbollah conflict will not have a deeper impact. Provided oil price do not surge more from here inflation pressures will be kept at bay.

However even if further tightening is not in the cards for now that does not mean this cycle has ended yet .The sustained strong economic expansion has ended. Considering the economic cycle growth rates are trending down and there are concerns on companies' earnings. I believe the market is gently trending toward a 4 years cycle low. I also believe US could face quite severe downturn considering they are late in the cycle.

On the contrary Japan is located in the heart of Asia and Asia is the current world economic engine. Asia is also the top high quality products world plant. The economy absolute level is rather low therefore I believe that Japan economic cycle is different from America's. Furthermore US/Japanese stock price cycles are extremely different. I believe we should not worry as there are three typical weak cycles in a year followed by a very strong upward cycle for Japan.

The Elliott wave theory shows that a third upward wave should materialize next year. But after that opinions are divided : the Elliott wave theory is rather bearish with a two wave's downside correction, the other 3 years cycle theory point at a strong bull trend up to 2008.