

Kimura Dreamvisor Newsletter Summary 28th September 2006

It may be premature but I feel we have bottomed out.

Looking at US equities bullish tone short futures positions had to be squared.

I was surprised by the 27th September market rise. Should TOPIX keep up with the 1600 level the mid term cycle which started the 14th of June have bottomed out and we have entered a new cycle. Should this prove right and even if there is some short term volatility October should prove bullish. If everything is normal then I believe that November should also prove bullish. Investors who consider technical analysis as important and who read behind the lines of investor's positions taking plus margin settlement cycles all believed that market would be weak up to mid October. Especially strong is the belief that Nikkei 225 8 years cycle bottoms out in the first half of October. Furthermore US hedge fund *Amaranth Advisors* huge loss on gas futures trading should have remembered professionals the LTCM hedge fund bankruptcy 8 years before. Concern is that Japanese equities could be impacted by funds having overplayed the optimist commodities strengths scenario. But US stocks show resilience; just before the Dow registered a new high the S&P 500 had already registered a new 6 year's high, this limited the downside risk for Japanese equities. Traders who rode the bearish scenario by shorting futures had to buy back in a hurry. This triggered the 27th September rebound.

However if TOPIX rose 2.7 % trading volume was barely 1.54 billion Yen, second section and JASDAQ rose only 0.5 %. Bullish sentiment did not spread to the whole market. Recent market low is exactly midway between June and September rebound, from a chart point of view this strongly testifies we have reached bottom, this said if there is no follow trough volume increase then bottom cannot be confirmed. Still next two weeks downside potential has been drastically reduced. It is advisable to forget about the bearish scenario which pointed at June's low renewal.

From a chartist viewpoint if potential weakness is excluded I feel we should look forward to the market rising. Economy is on the ascent therefore we can make a bold target figure for next year estimated earning per share. For now economy adjustments degree is unclear therefore this variable can be later adjusted. For now clearly new buying is solely concentrated on large international blue chips, this universe set apart

there is no new capital inflow.

Large cap blue chips are not very attractive from a PER basis, value in this universe is limited. Indexes (Nikkei or TOPIX alike) are currently moved by Investment Trusts or Pension Fund buying and I believe this will eventually roll out to small caps and new growth markets.

US housing starts fall scope is getting smaller

Current mostly discussed statistical index is probably US housing starts. But media do not publish enough long term statistics therefore this can easily lead to errors. Let's put it right:

US housing starts have been hovering around 1million 600.000 units on a yearly basis since 1970, during recessionary phases this indicator goes down; it once felt to 1 million units. Years 1975, 1982, 1991 were recessionary years. On the other hand during peak years we had: 1972 with 2 million 350 000 units, 1978 with 2 million 20 000 units, 1984-1986 with 1 million 800.000 units and finally year 2005 at 2 million 70.000 units. House buying is directly linked to long term rates level. Individuals are the decision makers and as home buying is on average 5 to 8 eight time's annual salary households make their decision taking into consideration necessities and payment capacity. The statistics oscillated violently between the 70's and 80's due to economic crisis like oil shocks plus boom and bust cycles. For the period extending from year 1991 to year 2005 housing starts showed a very regular and lasting upward trend as interest rates were stable.

In US economic history there is not a single example of housing starts falling this hard when US long term rates are relatively low and not particularly rising from bottom level. Therefore it appears quite normal questions were raised in relation to housing constructions being superior to real demand. Since year 2000 housing starts reached 2 million units level on a yearly basis and as house price increase accelerated Home Equity Loan (HEL) balance increased substantially. This is why observer started to talk about a housing bubble. When economy slows and by consequence house price goes down, loans become irrecoverable and consumption slows down. In addition HEL mortgage secured loans are not all related to house purchase; HEL interest is lower than unsecured consumer loans. Considering a 100 000 US\$ Principal HEL interest burden is light relative to income.

For current cycle house prices are falling, a rising HEL balance puts a brake on

consumption however I do not believe new house demand (plus housing starts) will fall that much (1 million 665.000 registrations in August). Probability for long term rates to trend higher in the short term is quasi null. In addition US population has increased to 300 million therefore compared to what it was 25 30 years before (202 million) the housing starts bottom line increased a lot.

I believe bottom is around 1 million 400.000 to 1 million 500.000. This level should be reached soon. It won't be long before bottom line increases again to 1million 800.000 - 2 million units. Even if house price fall by 10 to 20 % financial burden stays bearable, consequently I feel current downtrend will be short lived.