Kimura Dreamvisor Newsletter Summary 30th November 2006

Trend is definitively up for next year…

As forecasted we had a nice rebound but market to remain top heavy for now.

Stock market obviously found immediate bottom. Advance decline ratio had gone down to surprising 66,3 % with 400 stocks registering new lows. After a mini selling climax and several bottom search attempts market naturally recovered. This is in line with the rapidly changing 27 weeks cycle I consider as important, which also prove that mid term cycle bottom was hit during November's second half. No negative news on the earnings front therefore the quick recovery was overdue.

There are a lot of observers would look for a chart confirmation but main indexes showed abnormal patterns since the 20th November's closing. On the 20th a bear window opened and the 21st of November a small bear angle (named black line in Japanese candlesticks theory) broke the low. After 22d November's low confirmation, a holding line ('wrapping the foot line') completely encompassing the foot line appeared the day before, usually this shows immediate bottom has been reached. However on the 24Th market showed a negative downside pattern. By chance prices recovered at close (mini foot line) but the following week on the 27th market tumbled to a new low. A new wrapping line materialized which finally brought bottom → recovery expectation. However on the 28th expectations were betrayed again and market felt only to close at day's high later. Finally for the last two sessions the bull window materialized ending November on a bullish tone. Such a complex phenomenon did not occur since year 2002 historic bottom configuration. New low possibilities have almost disappeared now.

I am looking forward to new developments and I expect December to test previous October's high. I am specially looking at TOPIX, in the end TOPIX mid term cycle low proved to be the 27th of November and not previously expected September's second half. If this view proves correct we have now entered the rapid rebound phase. Further we are still half way in the three years cycle, which started in June. That leaves strong upside potential. Consequently I believe TOPIX will try previous 1672 high before the end of current fiscal year (70 points upside potential left and only 600 Yen for Nikkei 225), if there is enough energy we could even try the 1700 level. Next year the market should trend upward in a narrow range.

Discounting in advance news and events flow: Nomura and Daiwa will announce own earnings forecasts compilation next week and figures are expected to be above companies' conservative announcements. In addition the new companies handbook version will start selling in two weeks time. Investors already started to guess fiscal 2008 earnings! Further as well advertised already company's law will change next year and allow shares swap mergers, which mean companies are rushing to introduce defence strategies. In the vast majority of cases this mean either tightening stock supply /demand quickly therefore increasing stock price level. In the end it's good for stock market. But we also have to consider next year's world economic growth will slow down and it remains difficult to chase stocks higher on growth prospects.

I believe there three good reasons why US stocks can't go down.

US administration is forecasting 2,9 % growth next year but looking at recent indicators I believe the growth rate should rather be 2 %. Most BRICS depend on US demand for exports; if US demand slows BRICS will experience slower growth. Japanese growth rate should be around 1,5 % but world demand should expand 3 4 % compared to current calendar year. Therefore I believe companies having large foreign sales ratio will register earnings increase. Natural resources and materials prices hikes could also partially become a problem in 2007.

Some are concerned about US stock market fall should US economy slows but I do not believe prices can go down substantially (provided there are no totally unforeseen new elements). I see 3 main reasons for that; first companies earnings show resilience, second long term rates should remain low and finally large US companies buy back programs already reached the astounding 40 trillion Yen level. Having retrieved that much from the market stocks can't fall that much!

Extracting S&P500 earnings and dividends forecasts from S&P home page gives average earning at 87,59 US $ for fiscal 06 and 96,13 US $ for fiscal 07. Back in fiscal 04 average earnings was 67,68, 76,45 in fiscal 05. Earnings growth is slowing down but every year S&P500 average EPS adds 10 points. US stocks are currently trading at 16 times 07 earnings implying 160 points advance on a year basis. Provided there is no IT bubble burst or funny balance sheet misstatements then next fiscal year EPS could decrease 5 points at most. Based on 90 US $ EPS Pe multiple fall to 15x a 3 % fall compared to current level's If Pe multiple goes down to 14 that mean 1260 level 10 % lower than current level. However a 500 US top class companies package yields 7,14 % so stocks won't go down easily.

Today's industrial production announcement supported Japanese equities rebound. The indicator was above market expectations triggering added concerns about a BOJ move in December. I don't think this is a real concern.

I personally just increased my own BOJ tightening possibility by 10 points but I believe BOJ won't tighten this year. I believe BOJ is perfectly aware of forthcoming US slowdown therefore there is no need to rush rising rates at that stage. Should BOJ governor Fukui improperly rush tightening then his participation in ex Murakami's fund will come back with revenge. It is easy to figure out this would become the whole BOJ loss. Something to avoid.