

Adversity makes a man wise!

Upside and downside both limited.

The 30<sup>th</sup> of October sharp fall may have surprised more than one. Deadly mix of US economy sudden slowdown plus strong Yen upward movement bring immediate effect for Japanese stocks generally considered either Cyclical stocks or Forex sensible stocks. Numerous hedge funds were long in Japanese equities playing Yen weakness. In fact they borrowed Yen from financial institutions and used for taking positions such as 'Yen buy / US \$ sell' plus Nikkei 225 futures buying, equalized profit and loss can be achieved in this way. Consequently when positions are settled simultaneously it is easy to figure out that arbitrage balance translates into immediate selling pressure.

But market cannot collapse one sided. In addition to large foreign institutions constant capital inflow I believe that own shares buy back plus investment trust purchases are expanding. The simple fact that there is lack of alternative investment when aggressively selling Japanese equities must be once again emphasized

Futures position squaring equals new position taking the like of shorting cash equities due to Yen strength. US Japan interest rate differential is still at 5 %, such gap gives scope for Yen to strengthen although I do not believe that there are a lot of players willing to make money by shorting 5,5 % net yielding Nikkei 225. I do not believe either money can easily been made selling futures at 16,000 leave again 17,000. Therefore short-term players wont go deep. Although US business is on shaking ground investors hesitate buying positively Japanese equities. These results in individual cheap stocks pick backed by specific incentives. 'Swing traders' willing to take only 5 to 10 % may consider there is a chance although in fact such trading opportunities are limited. I believe current market is full of accumulated frustration.

In fact investors who cashed in the recovery since June are those who don't think too much and bought continuously the leading large caps. These investors do not aim at securing quick short-term profit but rather they feel they can earn a decent return over the long term compared to other instruments.

On the other hand the feeling that trading looks 'biased' for now is widely shared in such a directionless market. Players currently over react to earnings announcements (bad or good). Even within this positive earnings announcement environment stocks having discounted in advance good earnings are sold on the actual publication and on the reverse stocks that were battered down are bough back. Short-term profit making opportunities are scarce. For Japanese individuals, amateur of such strategy, current market has little appeal. Only investors with deep common sense can succeed in such a market.

The best opportunities in Japan are within water and environment business fields.

Japanese population has now entered the real decline trend. Last year 1<sup>st</sup> of October census Japanese population was 127 million 778,000 a 22,000 decrease. For current year too the decrease will be around 18,000. Looking at the declining birth rate and population getting older this trend is probably going to last for 20 years (hyper long term trend). Therefore business opportunities cannot be solely domestic based.

This said for foreign countries populations is not either endlessly expanding. Takes China for example; the single child policy succeeded and it looks like by 10 years China will experience the same brutal ageing population phenomenon than Japan. I do not think that Chinese social security system can compare to Japan. For societies where the safety net is insufficient discrepancies between social strata will expand and inevitably create social unrest.

Consider immediate neighbour South Korea; the declining birth rate will soon become a problem too. According to last year's statistics birth rate was 1,08. This is not yet at Japan's level of 1,25 (although Japan's rate improved this year). South Korea is a Confucianism nation like Japan however the big difference with Japan is social norms. Precedence of age toward relatives is stricter than Japan, Korea maintains much more than Japan respect toward elders. Looking at South Korean current media stars it is quite clear that Korean level is higher on all aspects, intellectual, physical and aesthetic even if that is somewhat artificial. The self-pursuit of happiness is generous. Korean women who want to break free from the severe 'family' rules usually reject loss of freedom associated with birth. Seoul declining birth rate cannot be compared to Tokyo's.

Indian population will continue to soar for a while but I feel that with the spreading of medias like TV and the cast system restrictions by 10 years from now the country will follow the same trend than other developing countries. Population scale is indeed a pillar of growth however it is nonsense to look at growth solely depending on population scale.

Thanks to the development of telecommunications and transportation infrastructures developing countries will eventually produce same quality goods than developed countries and eventually the global arbitrage of workforce that expanded at relentless pace will slowdown. OECD global companies have cut workforces in developed countries focusing on high value added services at home and succeeded in cutting costs substantially by shifting workforce to highly motivated developing countries. Success examples are numerous US, Dell or Wal-Mart, Japanese Uniqlo. However developing countries are already bumping into resources restriction wall. Namely water, food and energy.

Adversity makes a man wise; this maxim means to improve your ability to overcome difficulties. I believe personally that, like Japanese auto makers who applied this maxim, securing a global position, new worldwide top leaders will emerge. Among contenders are Japanese environmental business born out of Japan's mad hatters and other painful diseases! Next will be water related business.