Kimura Dreamvisor Newsletter summary 3rd of august

Will US stocks come near the 4 years cycle low point?

Stocks look cheap; there is a high probability for the downtrend cycle to end.

The US Dow has been showing a clear 4 years cycle pattern, the bottom usually come by autumn of a mid election year (this year seem to be the case again).Election will be held by November end, usually the best timing to buy at lows is just before an election. The technical advisors consensus is always to buy at such low and hold for one year to gain maximum profit. Said in other words until the low has been confirmed maintain holdings and start buying on downfall as the mid election comes close by, by experience now is the time to keep holdings in the waiting room.

I personally never really liked President Bush economic management and politics; I thought that ultra low interest rates and large current deficit would have led to economic problems and stocks meltdown however there are no signs of such economic worsening. The US economy is certainly slowing but demand remains strong enough to swallow further rate hikes. Even if GNP growth felt to 2% it would no worsen that much. Therefore I was way off what has developed.

Before stocks confirm a deep bottom market must fall a lot. Should the bottom be confirmed by October then second half of august to September should represent the peak of the fall. However looking at the short term technical indicators there is no signal that such a hard fall would take place. The fact that no surge of volume is taking place is rather a positive sign.

Looking at a compilation of the most representative S&P 500 and EPS charts : during the 1989 first quarter equity price was 300 and EPS (without taking in account special factors) was 25 therefore a Per of 12x, at that time long term rates were 9 % therefore normal that Per was low. After that rates went down but earnings kept growing and stocks went up a lot. By summer 200 S&P had reached 1500. At that time real EPS was 54, and 60 on the following year forecast therefore Per went up to 25x.

Then IT bubble burst and the 11th of September terrorist attack made stocks falter to 800 by the second half of 2002. EPS was then 39, including special loss it was 25. That was a typical reverse earnings market. But after that EPS rose back strongly and since has been registering a double digit growth for 12 quarters in a row up to present time. Current figure is 81 and forecast 06 is 85,8, forecasted 07 is 96. Current stock price level is 1278 which translate into a 14,9x Per and next year forecast give 13,3x (S&P basis).

Provided companies' earnings do not deteriorate further there won't be a stock crash.

Long term rates are not above 5%.Bond yield is not advancing but average EPS real growth rate is increasing. Therefore in such a case is not a real problem if earnings yield (100/Per) goes under long term rates. On an S&P 500 basis next fiscal year earnings yield is 7,5%, this level is already discounting earnings slowdown. Said in other words US stocks are cheap.

71% of the second half companies' earnings have been already above analysts estimates, it is already august therefore 3rd and 4th quarters earnings cannot disappoint analysts that much. Even if the earnings growth rate slows it should not lead to drastic downside revisions.

With such a background in mind, and provided no further negative factor appears, stocks wont go down much in the next months or so.

There are still worrying factors such as Middle East, Korea and oil prices but almost everyone is fully aware so panicking should not occur once more. On the rates front provided stubborn Mr. Bernanke does not increase rates 0,5 % on the 8th or the next FOMC meeting then a bear scenario should not happen.

Stock market is like Football and can change without notice and it may be too soon to forecast there won't be autumn market fall but looking at the rates, earnings and stock price balance I feel the scenario is not for a strong market fall. I personally consider the downside risk at maximum 10 %. And the Japanese market won't break June low as such type of fall has already taken place. The April June period traditionally favorable for optimistic players to step in finally ended painfully therefore the market has not yet accumulated enough energy. Tokyo market is going to consolidate a while with no surge in volume for the very near future.