Kimura Dreamvisor Newsletter Summary 8th of June 2006/06/09

Selling climax, rise/fall ratio at 13 years low

The accumulation of bad news led to foreigners sell off

Japanese fundamentals have not worsened at all but when equities investors need to sell there is not much to be done.
FED's Bernanke declarations during the 5th of June panel discussion were relentless 'inflation pressures are alarming, action is to be taken to prevent them, as a normal consequence economy will slowdown'…But market participants only react to what they want to hear. Bond and forex dealers only took notice of the first part translating this into further tightening at the FOMC next meeting, the equity dealers read only the second part thinking economy slowdown.
Sell cyclicals, buy the US $.
Stocks were sold off on this basis since last Tuesday. Even professional investors were impacted by the bearish mood and eventually reduced positions.
Foreigners usually classify developing countries and Japanese equities as sensitive to US economic climate. Therefore when US mutual funds start sell-off, cyclical or global stocks are hit hard. Cyclical like steels, non ferrous metals, maritime transport, machinery, auto stocks are sold off whatever the strong earnings or relative value. Cold blooded investors are caught by surprise and start to follow the herd just to keep weighting in line with indexes fall.
The author of this report always believed that US rates would keep going up until the US saving rate recovers and that by consequence economy would slowdown. This said investors used to market friendly Greenspan declarations were probably shocked by Bernanke crudeness in saying it plainly.

But latent selling forces are weakening and I want to stress this lays the ground for a powerful market rebound. Putting aside margin selling, buying potential increase as selling forces lose energy. However hedge funds expanded today's volatility due to the 9th SQ session.
Today's buy/sell ratio is the lowest since the supply demand problem originated by East Japan Railway listing the 29th of November 1993 (buy/sell ratio of 50,5%) and goes even under the 1998 level. TOPIX is -12,1 % under 55 days moving average (11th of September terrorist attack was -16,4%) that's truly oversold.

The current fall marks the bottom of the three years cycle. The author of this report thought mid may would pinpoint at bottom, the low was in line with Livedoor's shock low of January 06 but the length of the correction was deeper than anticipated. Investors who took very long positions sold when US and Japanese tightening became evident. I read correctly the forthcoming correction for over valued foreign markets but thought that for fairly priced Japanese market than would be limited.

Timing is always delicate, the Livedoor shock margin call sell orders hangover led to panic selling on the new growth markets, Murakami fund shock piled over this and finally US market sell off made it a worldwide fall down.

The sell wave was two weeks longer than anticipated and Nikkei lost as large as 1000 points. According to Merryman cycle theory, the 4 months major cycle turned out to be 13-19 weeks. The author of this report thought the 19th of May would be the low based on 17 weeks cycle but finally the 20 weeks cycle proved the right one.

Furthermore there is a very important 3 years cycle for Japanese equities (previous bottom in April 2003). I consider as important the fact that Nikkei 225 usually hit low in October based on 8 years cycle, this year proved correct again but the usual low was delayed (for TOPIX that equals to breaking 1500) . Consequently my main scenario was bottom hit in may, strong rebound in June- July and correction in September with following bottom in October.

This said the fall was the largest for the 3 years cycle. Therefore even if bottom is touched in October, current low will form a double bottom pattern.

1982 is the closest comparison year for such pattern. High was touched the 30th of January at 7938, bottom was touched the 17th of march at 6889, the 17th of may index came back to 7619 and following low touched on the 1st of October at 8849.

Current fall has already reached -17,5 % and goes above the 1982 fall. If one believes in the cycle theory current timing is obviously a strong buy signal and not the reverse. When the market calm down rebound will take place in June- July. Exception made of Obon festivities period I am bullish at that point.