

Kiyoshi Kimura Dreamvisor Newsletter Summary 9th of August

FOMC decision to keep rates unchanged is positive news.

Market reaction was rather muted however...

As previously forecasted 8th of August FOMC meeting ended with rates unchanged. I believe that such decision can impact positively Japanese market in three ways. First thanks to the fact USA did not rush to tighten further the risk to fall in economic recession has been reduced for US economy. Second, Should the US tightening cycle gets to a halt at that level or even reverse to easing implies BOJ do not have to tighten further at that point. Bond yield has been going down, which is good for companies' earnings and economy. Third investors who have been waiting FOMC decision can now make decisions for capital allocation. The standstill for rates increases the relative attraction of equities, at least based on FOMC decision there are no reason to decrease further equities allocation.

Tokyo stock market reaction after FOMC was unusual. The Nikkei 225 was driven down 200 points led by futures selling. Some explained this through the possibility of further rate hikes by FOMC but this lacks substance. Main indicator US long term rates should have reflected such concern but this was not the case. Cyclical stocks should have gone up slightly on such news.

On the reverse Tokyo stock exchange cyclical stocks were sold from the week's start over concern on economic outlook, equipment investment related stocks were particularly hit hard. Electrical, machinery and non ferrous metals were sold off. It looks like hedge funds favored the worsening economic conditions scenario and took a bearish view leading to double weakness in both fixed income and equities.

On Tuesday there were some futures buy back but the machinery stocks rebound was somewhat weak further discounting the economy weakness scenario. This was repeated again on the 9th of August session and Makino Fry which recently made a public offer was sold off heavily. This company is one of the top manufacturing equipment makers. Main tool/machinery makers have been showing good earnings, however as April – June earnings showed only modest growth machinery stocks were sold off from the morning. Toyota which published excellent earnings finally ended in negative territory, probably impacted by the same bearish scenario.

However other Asian markets did not show weakness and the yen weakness benefit

should have proved positive for such stocks.

Market dullness without selling

August is traditionally a month when main indexes buy/sell ratio is close to zero but monthly volatility is high. In the past for example when market went up on mid season then downside reaction was quite large (like 1971 Nixon Shock, 1981 oil dollar buying, 1986 bubble start), on the reverse if market had fallen by mid season then the rebound was powerful (1991 Gorbachov shock, 1992 Sumitomo affair etc.). Furthermore market main players are entering holiday season and volume is usually the lowest registered yearly basis.

For now I feel there won't be a severe market fall as we came close to this year high on the 9th. This said volumes are low so there is not enough energy to challenge April's high. Market energy should rise again progressively after Obon holidays peak.

There is an expression stating 'market inactivity without selling', when the market has corrected from a peak price movements start to weaken and stock holding investors loose their willingness to sell. This is a stalemate as regardless of bad or good news prices don't move much. Business in the stock market is slack but prices don't go down therefore players need new factors to kick start the rebound.

On an economic viewpoint I am rather bearish. It looks inevitable that US growth rate is going to slow down and Japan cannot ignore such trend. However US population growth rate is roughly 2%, therefore if through housing bubble burst economic growth rate goes down that would be 1,5 % maximum. In addition the growth rate of Asian economies cannot slow fewer than 5 % on average and Asian countries are now more important partners for Japan compared to US. Japan is benefiting from Asian growth and will not slow down that much. It is advisable to consider positively earnings of Japanese listed companies benefiting from such Asian dynamism.

Current stock prices have already well discounted most negative factors I believe. The -3,3% negative yield spread shows stocks must be held against fixed income and earnings negative surprise has been more than discounted. Japanese EPS growth and stocks buy back policies (Toyota is a showcase) should be highly regarded I believe. We should censure executive management (JAL is a representative example) who don't have a clue about the high cost involved with capital for shareholders. An offer for public subscription dilutes shareholding equity; such an offense should only be tolerated if part of company's capital is timely used to buy back shares.