Kimura Dreamvisor Newsletter Summary 31st July

Timing is also important for value investment.

Short term investor's beauty contest.

There is a theory about efficient markets. Applying it strictly; all financial and stock related information is instantly passed to investors, investors correctly analyze the information flow which is in turn instantly translated into market prices. In such a theory one can forget about making money neither through financial & technical analysis nor to mention usual market insiders. As the market prices are supposed to perfectly reflect earnings expectations stock selection becomes meaningless.
True this theory looks attractive but so disconnected from reality that it looks totally ridiculous, however to put it the other way around it does prove it is possible to yield profits by using different analysis tools.
It is possible to make above average performance by making good use of technical analysis, information flow channels gap, understanding level gap, investor's mood existing gaps. This is exactly what justifies analyst's compensation
The most representative and widely know methodology is the value investors approach
To screen and buy stocks on the basis of low expected PER or undervaluation relative to net asset value is basically the tool used by well known Mr. Takeda Wahei.
Value investment approach necessarily wins over the long term. This is because better than average performance can be obtained by buying oversold stocks (using the return reversal effect). Such opportunity arises when short term players drive equities sky high only to sell them like crazy after.
Keynes called stock investment a 'beauty contest'. The game consists in forecasting the top beauty contender. The game does not relate to one being convinced he is the most beautiful but to gain the widest possible evaluation of one's beauty. To sum up 'let's jump on popular stocks bandwagon'. Not that a great economist like Keynes supported the short term trading pattern but he outlined the mechanism of stock excess buying.
In a word, as investors look for short term profit, the herd instinct is extremely powerful.
This is why, behind the scene, this creates an opportunity for value investor approach.
However value investors need very strong inner conviction. Turning his back on popular stocks he must research in depth and show patience for the stock to finally go up.

A prime requirement to yield a high return is to check charts and indexes.

Such tools and methodology do not always go right. Rather non efficient periods can last longer. Most of the stocks targeted by value investors are unpopular and illiquid, timing may be wrong and targeted stocks may revise down unexpectedly leading to heavy loss taking. Not that during economic slowdown or earnings downgrade there is always panic selling but performance may suddenly worsen a lot. 1999 autumn and current market since May 06 are perfect examples for small to medium size stocks. This explains why the value investor cannot create a constant and regular performance over time.

In the securities analysts July edition monthly professor Yamamoto Shinichi wrote an essay about 'financial indicators and stock price increase'. He screened all TSE 1st section stocks by PBR decreasing level and divided all stocks in 10 groups by 10 % increment market value. By rebalancing each group each year June end, from 1978 to 2002 the lowest PBR group yielded better returns (up to 60% low PBR stocks produced TOPIX above average return).

He searched why 60 % of the stocks produced above average return. Was it because ROA and ROE improved? By summarizing the key points he discovered that only the stock rise was above average, ROE, ROA and profit growth were all under average. Said in other words it was the group of stocks registering lower than average profitability which led the pack.

In short the left 40 % stocks that had above average PBR were those fully covered by analysts and investors the previous fiscal year. Those stocks group had lost potential to go up further and underperformed TOPIX.

As I previously said investors mostly go for short term profit and have a strong tendency to chase stocks winners in the beauty contest. It is evident that with such catch phrase as 'large upside revision',' high profitability',' high return over assets' those stocks focus analyst and media attention. However when the stock is bought above certain PBR level investment attractiveness melts down, new buyers decrease and short term players disappear altogether. Finally the stock enter downturn phase.

This said this time new growth market listed stocks were overbought (before the sudden crash) and value stocks PER & PBR rose to the market level average. Stocks that were previously up to 30 % cheaper than market average were bought up to the average and this explains why the fall was so deep this time. It looks difficult to escape the bear market without looking at both individual stock charts, market scale, market main indexes up to PER.