Kimura Dreamvisor Newsletter summary 4th July 2006

If April June earnings announcements go smoothly Nikkei should reach 16,500 by month's end.

On the short term conservative earnings revisions are made for first half..

Big events are on the pipeline for Japanese and US financial markets. As previously forecasted economic indicators and financial authorities comments were taken in a positive way by markets. Since BOJ Tankan was announced two days ago markets showed a typical deflation exit pattern.
The BOJ zero rate end policy has been ignored as Fukui said that tightening would be small scale and progressive. Even if BOJ is guiding on the upside short term rates the interval with the next rate rise is half a year with probably a 0,5 % target in mind.
Markets already discounted such move and US economic prospects are a much more important uncertainty factor.

US ISM was announced two days ago at 53,8 and considering that Wal Mart existing stores sales were only up by 1,2 % it shows that consumers psychology is going south, US production is also gently slowing down.
US market has been top heavy but provided there is no brutal slowdown Japan won't be impacted.

Japanese stock market has still a lot of positive elements on both technical and fundamental sides . Pending unforecasted new negative elements there is a strong possibility for the Nikkei to rise to 16500 by the end of this month. Technically speaking mid cycle (3 to 4 months) is approaching peak time. According to the 'Gap up' theory I outlined in a previous newsletter the only pressure left is stemming from margin trading.
Fundamentally speaking the fourth quarter earnings announcements started earlier and already we have companies changing their previous earnings forecasts. A short term review: industrial sector large corporate are forecasting 1st half sales up +3,9 % for this FY which is a +0,8 % upward revision compared to previous estimates although current earnings are forecasted to decrease by 6 %.Current profitability has been revised down 0,28 % at 5,78 % (previous forecast was 6,39%) but the previous FY second

half earnings was revised three months ago +0,7 % so this is a catch game.
Copper or aluminum type Raw materials price hikes for April-may were severe but new price changes for current FY may have been discounted at that point.
Service sector seems to follow the same pattern therefore in light of current economic conditions I expect earnings to rise above previous estimates as a whole.

What is very interesting is the noticeable improvement of non manufacturing sector profitability.

The DI (Diffusion Index) of large companies in the manufacturing sector has been trending at +20 since FY04. During the 1988-1989 period DI was at +50 therefore this may looks weak. However current profitability is kept at 6 %+ which is above the 5% level reached in the 88-89 period. Companies have cut costs dramatically and pulled out of unprofitable business fields. Compared to the overall economic background it can be said that current profitability improvement has been substantial. This should be highly regarded I believe.
Non manufacturing DI recovery pace has been lagging the manufacturing diffusion index but has continuously improved since 04 to reach roughly the same level. Current profitability ratio is at 4 % only but this is still a huge improvement compared to the 2% level reached during the 88-89 period. The upward trend in profitability is sustained and I feel that although non spectacular the service/non manufacturing sector looks attractive. Rather than focusing on economic recovery itself the topic of discussion will shift to 'how long the recovery will last' then the late cyclicals (services) premium risk looks attractive.

The manufacturing sector is sandwiched between growth expectations and excess liquidity.

The core theory remain that industries enjoying high growth rate invest in equipment. However it is difficult to maintain a high level of investment in the same business field. When industries start to cut prices to keep with a high new investments turnover ratio there is always the risk this lead to cut throat competition/ price war. The price war stops when weaker elements are ousted. Low margins lead easily to current losses. Dram industry is a typical example and only the surviving companies are in a position to take advantage of the next profitability cycle high.
Following an investment boom demand inevitably slows and it is impossible to avoid the

supply demand gap. Buying stocks on the back of an investment boom carries such risk inherent to expanding cycles (the key point being to buy at lows). The aftermath of equipment investment boom being unclear it is important to fine tune strategy.