

Nikkei in tug of war at 16000 level but key point remain: mood is improving slowly, Japanese individual investors and specialist funds hold the key.

Long term cycles overlapping, search for value continues.

For the great picture I would invite all professional buy side investors to read carefully Kiyoshi Kimura's Newsletter dated 15th of august regarding Japanese long term market cycles calculation. I have in great esteem his commanding strategic views on the market.

To summarize technically speaking and by fine tuning the different Japanese market cycles which overlap it gives high value added clues on the stance any buy side investor should take from now on. There is still the problem linked to the US four months cycle which is an obstacle for October but both Japanese 3 years and 18 months cycles point to the fact we have entered a new cycle. LDP election will also take place by the second half of September which will add volatility.

Recently TOPIX has been trading around 19,5x and this can be lowered to 18,5x considering the upward revisions and translates into expected 5,4 % yield which command a very low negative yield spread of -3,5 % (JGB 10 years at 1,9 %). Considering current economic cycle the case stresses to be equity long. Although earnings will not be as impressive as 2005 but external growth is kept at high level... This said both US and Japanese institutional investors are taking a very conservative stance toward economy. Growth oriented investors will not show up for a while however for bold equities buy side investors this is favorable timing. To summarize although upward potential seems limited for now, downside risk looks the same.

Therefore value based stock picking remain my mantra. You would notice that M&A activity has recently occurred with a repeat pattern across different sectors (cyclical or not). The logic is always A- Mature market B-external growth the only way to increase market share C-large Japanese universe of 'owner' type companies with little or no debt, substantial cash at hand but unclear growth strategy nor shareholders friendly policies D-fragmented capital with the main shareholder still at top management. Such type of potential target companies are plenty within late cycle service or retail sectors. I would not be surprised that further TOB offers materialize within this specific universe.

The contrarian logic suggests that companies with low brand name recognition (and

therefore low daily volume) are indeed interesting. A basic screening with PER x PBR = 30 or less and shareholders equity ratio above 30 % give out numerous companies. Consider for example the already red hot clothing fashion industry (which I mentioned previously).

For example companies such as (8067) Tomiya apparel on OSE second section look interesting in my view (as a target). Other mid size fashion related cash rich companies like Impact 21, Kyoto Kimono Yuzen Co will have to outline their strategy to use cash at hand, this said for the later shareholders equity return is already comfortable.

As said before I would specially consider the late cycle service industry for such 'potential' targets to be discovered in advance. The inevitable consumption tax increase looming ahead whatever the next cabinet has been already discounted in most retailers stocks and in fact this is additional reason for late cyclical to grow by acquisitions. Moreover within the mid to small caps universe retail + services usually weight more than 30 % in specialist portfolios.

By the way....

For the surprisingly good news I would point at the 1st-half births up 1st time is six years! According to data released Monday 21st of august by the Ministry Of Heath, Labor and welfare. 11 years ago I was personally convinced that the seemingly never-ending Japanese birth rate downward trend was something that could be reversed at some point 10 years after the bear market started. We speak of ultra long decennials trends here and it will take much more encouraging figures like this announcement to even think about a reversal!

Nevertheless keep this in the back of your mind as kick start of a new era is always contradicting previous assessments...