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Hedge funds bullying Japanese indexes opening -another- opportunity gap.

Energy savings technologies, Japan rules the world (part 3)

Mid term earnings season has peaked.

March 2007 companies consolidated current earnings forecasts show a fourth straight year historic level. The 17th November Nikkei reported earnings to grow + 5,2 % for March 07 (E). This said based on the sole second half estimates current earnings are forecasted to decrease 3,0 %. Excluding financials and New Growth Markets Nikkei calculation is based on 1,378 companies sample. By the 17th of November 84 % of companies had announced forecasts. Sectors forecasting double-digit earnings growths are limited to machinery, non-ferrous metals, precision products, real estate, trading. Real estate and retail revised down earnings growth from previous +14,3 % to +7,4 %.

The market is not very responsive to say the least. This is largely due to hedge funds taking advantage of current domestic investors (retail and institutional) passivity. Said in other words it's bargain sale time. TOPIX far too much diverted from its 25 days moving average nor to mention the fact that advance/decline ratio had fallen to **66,27 %** (quite oversold) on the 21st November, loss appraisal margin ratio for the three main markets worsened to **- 11,15 %** on the 17th of November close (source: QUICK). From technical analysis angle Kiyoshi Kimura updated current mid term cycle (see *Kimura Dreamvisor Newsletter 22d November*) and extended it by a few weeks, for investors with spare cash it obviously triggers a buy opportunity. Although the next few sessions remain critical to gauge where we stand in current cycle I think the idea to focus on stocks which left unchanged full fiscal year estimates (downside revision for the second half) should yield the maximum efficiency for potential return.

What we write is what we think and what we think is what we do.

Energy savings technologies, Japan rules the world (part 3 please refer *to my newsletter 17th November 2006*)

China is also looking at Japanese transport infrastructures. According to Japan general economic research centre another core reason explaining Chinese oil consumption increase is private car owners increasing number. Back in 2003 half Chinese oil consumption was related to heavy industries such as steel, chemicals. However car ownership related oil consumption has now reached 15 % of total. Chinese industry is undergoing deep structural changes and slowly shifting toward high value added products plus service industries. Chinese cities are expanding and private sector demand will trigger new energy demand (hotels, office buildings etc.). Auto ownership fuel consumption increase is unavoidable. Chinese car ownership reached 20 million units and it is just a matter of time before this figure bypasses Japan and reaches US level. Any visitor in China can understand transport infrastructure equipments approach is wrong. For example access to Peking international airport is restricted to cars and rail infrastructure has not made any progress. Economic expansion urgency dictated road and airports development priority. But this in not China sole responsibility, US represent 5 % of world population but 30 % of world energy consumption, energy consumption per individual is twice the Japanese level. Lack of transport infrastructures is one reason. Road and rail infrastructures have totally diverging economic impact. In the end someone has to bear the huge investment risks associated with rail infrastructures. Of course rail just cannot compete with car industry in terms of individual customers satisfaction. Left solely to market forces any country transport infrastructure will inevitably trend toward road infrastructure. From the environmental angle road transport is the worst considering CO_2 emissions (everything equal rail energy consumption is 1/45th of road transport). In Japan since Meiji renovation (1868) rail infrastructures were developed under state leadership although economically difficult to justify it has benefited Japanese people. Worldwide Japan has no equal for rail infrastructures and this does mean transporting efficiently peoples and products. Even UK's London transport infrastructure is barely Tokyo's one third. It is true that Japan national debt burden has reached 20 trillion Yen and Japan national railways were ferociously critized as a culprit, this is understandable considering Shinkansen (Japan high speed train) was used as political tool. But some observers sustain that times have changed and argue that 20 trillion yen national debt is not that much compared to 'world level environmental responsibility'. Even if US environmental problems are becoming more severe the Japanese concept of having dense rail infrastructure for mega cities like Los Angeles or Chicago does not even exist. In the US energy savings focus on hybrid engines or Bio ethanol powered car engines. If Chinese economy expands to the level the vast majority can own a car so far so good but this remains to be seen. To revive Tokyo infrastructure experience heavyweight investors would have to take the risk and acquire huge pieces of land. This seems highly improbable therefore such large rail infrastructure can only be engineered through the state hand. For those reasons it is difficult to say whether China will adopt the US or Japanese model for transportation infrastructure. In the past Japanese city life was plagued by small living space and congested public transports but highly populated countries such as China or India are now reconsidering the values of Japanese cities development. From both environmental and economic angles Tokyo in the most energy savvy capital city worldwide. It looks urgent for China to review large cities infrastructures balancing growth and environment. Only Japan succeeded in increasing energy consumption efficiency by building extensive rail networks for large-scale cities. Tokyo city level infrastructures can become a source of inspiration for Chinese 11th 5 years economic development plan. Didn't I mention infrastructure sector as potential M&A target through HHS methodology? I did.

Japan based ETF (follow up)

In *my newsletter dated 10th October* I briefly went through Japanese market linked ETF's available to European retail investors.

Euroland or US listed Japanese ETF universe is still in its prime infancy (nor to mention Japan herself). Compared to that US ETF market has considerably expanded to the point it could prove somewhat dangerous. Dow winning streak is partly due to investors pouring money through S&P 500 linked ETF. Should the Dow go south it could hurt! Just for November start no less than 800 new ETF registered with US SEC. According to ICI, 290 new ETF were already marketed by September end. If new products keep on being launched at such a pace then a year's total is above past 13 years total! There are even ETF investing into buyout specialised asset managers. In the future the same phenomenon could materialize in Japan but we are still far away from this. Speaking about the subject State Street Global Advisors has just listed two new Japan linked ETF on AMEX responding to solid demand for Japanese products? 'Street Tracks Russell Nomura Prime Japan' (JPP) and 'Streets Tracks Russell Nomura Small Caps Japan' (JSC). Wisdom Tree asset management started to market Japanese ETF back in June and Power Shares capital management submitted a request to SEC too. Do not rely on me to advise on such funds, as I am a value-based investor.

Now what to buy?

A word on the Yen

Yen weakness has reached new highs against major currencies but also Asian currencies. Nikkei recently made large headlines regarding Yen effective exchange rate setting a low for 21 years! This is easily explained by global investors borrowing in Yen and 'carry trading' in high yield currencies .Yen effective exchange rate against major currencies reached 100.3 in October, a level not seen since the Plaza agreement in September 1985. The fun side of it: Eastern European countries and Spain (for example) recently launched Yen denominated mortgages bypassing the foreign exchange risk Yen weakness always benefited Japanese exporters and Asian nations including South Korea started to express concern about the unfair competitive advantage given to Japanese exporters.
In my view the real risk lies with the Yen being -extremely- oversold relative to <u>its real purchasing power parity</u>. True: Yen foreign exchange effective rate volatility has been declining historically however at some point I believe it will self revert and not necessarily waiting for BOJ to increase rates.

Luring US investors through ADR listing

More Japanese large companies should list ADR to lure US investors, Japan is considered a laggard. According to JPMorgan securities there are already 849 ADR of both listed and non listed Japanese companies. ADR is the sole possibility offered to US retail investors to buy Japan. Recently large US trust banks appeared as major shareholders through ADR holding mostly in electronics and auto sectors. Foreign investors hold more than 50 % of some large Japanese global blue chips like (4901) Fuji Photo due to ADR. Japanese financial observers are quick to conclude this acts as a support for stock price: Fuji Photo closed at 4,500 Yen on the 22 November (up + 15 % YOY) meanwhile Nikkei 225 declined 1 %. ADR listing target are both US retail and institutional investors. However ADR listing translates into SEC complying disclosure which is a lot of paperwork some Japanese companies cannot afford, which is why unlisted Japanese companies ADR number is increasing fast.

And Japanese retail investors through IR

On the domestic side IR is another tool to lure Japanese retail investors . Daiwa Investor Relations and Keio university recently published research showing that additional IR effort have a leverage effect on stock price. Mid to small caps would benefit from increased IR.. As already mentioned several times Japanese individuals favour mid caps, large global stocks individual's holding is pretty limited. Said in other words there is large upside potential to expand Japanese individuals shareholding through stronger IR effort.

Previous stock picks follow up

(7522) Watami

Watami foods announced estimates for full fiscal year: current consolidated earnings at 20,6 billion Yen (+10 %) and sales at 98,7 billion Yen (+19 %). Originally Watami forecasted consolidated current earnings to rise + 39 % at 40,5 billion Yen, the downside revision is due to increased staff costs. This is a pretty conservative estimate and perfectly illustrates what I already mentioned for second half. However net consolidated earnings are forecasted to grow +33 % at 1,4 billion Yen and home nursing business is expanding nicely. The logic beneath my suggestion remains intact.

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