JAPON INVESTISSEMENTS

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Technically strong market with short term upside potential from November 06 to January 07 as well argumented in Kimura Dreamvisor Newsletter 24th October 2006

Buyout funds day closing by (part 2)

Market rise has been notoriously futures led, that is expensive futures selling against cheap cash equities buying (in itself a positive fact). The 25th of October TSE published arbitrage led cash equities buying balance standing at 4 trillion 846 billion Yen up for the fifth week in a row and registering a high since April 1990. Most strategists believe that arbitrage led buying will remain high for a while, this is due to the fact that arbitrageurs finance themselves on the short term money market, as long as financing cost remain acceptable arbitrage led buying will remain high.

The core problem remains individual's exclusion from current Bull Run. Although long margin balance has gone down 40 % since current fiscal year's peak margin loss ratio (which is the standard barometer of individual's gains/losses) is still around -10 % for TSE 1st section and -26,4 % for Jasdaq. The core reason being individual's strategy to average down constantly on holdings (this is cold 'Nanpin kai'). However as long margin core settlement is mid November the situation should improve quickly.

Buyout funds day (part 2)

Nikkei financial daily scramble section published an interesting article on the 23rd of October ' Before the dawn of fund's age ' pointing at new money flow problems. The massive arrival of buyout and private equity funds, which I described previously, is awash with cash but lacks large targets in the short term. Texas Pacific Group and Blackstone group have now terminated fund raising up to 51 billion US $ (1 trillion 800 billion Yen). US KKR is now raising near 2 trillion Yen, KKR will probably assign 10 to 15 % of this money to Japan alone (roughly 200 billion Yen). If you add domestic buyout funds to this figure roughly it gives 2 trillion Yen for Japan. Further adding leverage buyout funds and this figure becomes 10 trillion Yen. For current fiscal year we had only two very large deals: Sanyo Electric and Skylark therefore some buyout executives are now concerned about 'too much money chasing too few deals'. As previously mentioned core deals are for parent companies chasing listed subsidiaries or selling out such non strategic assets, however earnings are quickly improving and most large electronic makers have just put forward non strategic assets sell-off. Large deals are scarce and competition heats up among professionals. This may lead to overpricing.

The Nikkei financial daily raises the famous example of (2596) Q'sai MBO, which took place in February. The founder and president retired in February and sold off family owned 64 % to specialist funds. By the end of June out of 10 fund names the winners were: NIF SMBC venture fund, Merrill Lynch, Nikko Principal investment. By the end of august NIF was announced as the core bidder. What is bizarre is that the stock rose only +0,8 % before fixing selling price announcement day at 1,920 Yen. Usually when TOB is announced price goes up at least 20 %, said in other words the market anticipated long before the TOB. According to NIF the bidding price of 1,920 Yen was 17 % above previous three months price trend. However comparing this to similar cases for the past year the stock usually rose + 41 %. Some sources were saying that the right price was 1500 Yen and no more. NIF had to call in another partner and they now are considering proceeding through LBO. The deal carries high risk considering borrowed money will weight on Qsai balance sheet. The paper's conclusion is that excess capital may lead to bubble type signs regarding those kinds of deals.

Now what to buy?

This very week numerous mid term (September) earnings are published, the 23rd of October TSE 1 section registered **45** new highs for the first time since May.

For example (6763) TDK renewed its current fiscal year high in anticipation of 30th of October earnings publication. TDK stock alone added 7 Yen to the Nikkei 225 that very day! Market is currently discounting in advance expected upside revisions. One strategy is to shift to less valued candidates as perfectly stated in the 'Dam theory' outlined in Kiyoshi Kimura newsletter.

Ethanol (green fuel) making inroads in Japan.

Ethanol (green fuel) is making waves in Japan too. The 23rd of October Japanese financial press mentioned Sun Microsystems founder Vinod Khosla who believes that natural energies business field is ripe for a full revolution (long term). The 20th of October OPEC announced production cuts above market expectations to support oil prices. Ethanol prices are closely linked to crude oil price therefore this will certainly attract again investor's attention in related stocks. Seemingly Ethanol is making deeper inroads into US (and Europe) as a proper substitute for gasoline. Archer Daniels Midland (ADM) is the largest producer of Ethanol, ADM stock is up 60 % since current calendar year start but down 20 % relative to its May peak. US Mutual funds started to buy Ethanol related stocks due to Bush administration new guidelines for replacement energies. Monsanto is also benefiting from transgenic corn increased production aimed at large scale Ethanol output. Dupont De Nemours is also researching ways of producing ethanol with vegetal oils. Said in other words ethanol related stock universe is progressively expanding. In the past 'political stocks' were a Japanese tradition but with US election nearing the same can be said regarding ethanol related stock. Democrat candidate Hilary Clinton made comments about reducing Oil/coal dependence by 50 % for the next 20 years laying ground for substitute energies like green fuel.

In Japan (7203) Toyota and (7267) Honda have been long engaged in mixed fuel engines research. The 16th of October Honda announced its first Flexible Fuel Vehicle marketed in Brazil. Toyota will follow suit next spring. German Volkswagen was the first to introduce Flex Fuel Vehicles in Brazil in 2003.

On a pure speculative front the 24th of October* (2107) Toyo sugar was bought on the back of potential ethanol play (immediately negated by the company CEO). Considering Japan is a worldwide leader for environment friendly technology it is just a matter of time before 'green fuel' related stocks pop out on TSE (large or mid caps alike).

*Disclaimer: hands out of such speculative plays!

For reference below are 25th of October TSE published P/E multiple of listed Japanese companies (consolidated level) for past fiscal year (march 06) and expected for march 07

	Previous fiscal year (03/06)	Current fiscal year (03/07) E
Nikkei 225 1st section	20,90x	20,45x
Nikkei 300 1st section	21,06	20,57
Nikkei 500 1st section	20,85	20,51
First section listed stocks	21,51	20,55
TSE second section	24,10	17,37
Jasdaq	38,15	22,00

TSE publish on a daily basis these figures therefore it is worthwhile checking them on a daily basis.

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