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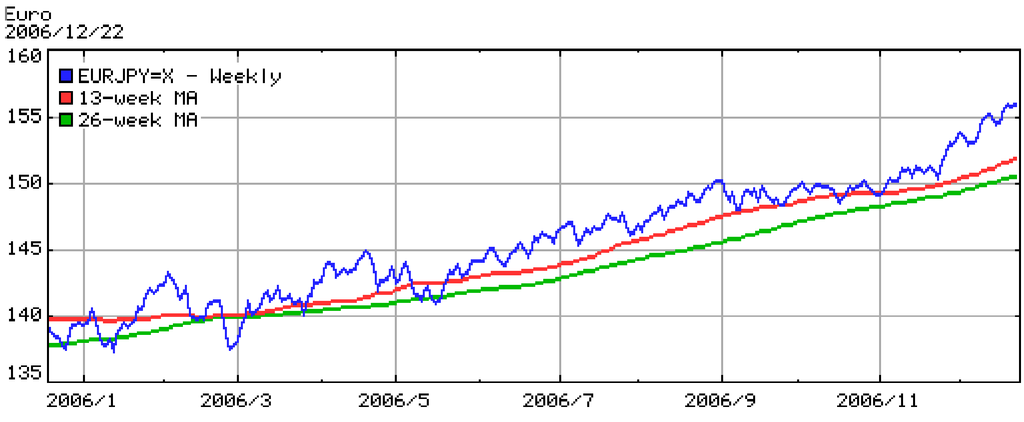
Tough choice for Euro based investors, easier for US based investors.

Increase mid size stocks positions now.

The weak Yen is godsend for Japan industries (manufacturing & non manufacturing sectors alike) boasting a high export ratio to Euro zone, all the better for Japan. Who cares about having a strong currency when inflation is not a problem (not yet at least)!

This said tough environment for the Euro based investor as Nikkei 225 YOY performance turns negative in Euros, on a year basis Yen based Nikkei 225 is up 4 % Euro based it is 7 % down. Most foreign strategists had it wrong on the Yen as usual. Current consensus for year 2007 is for Yen mild strengthening against US $ and roughly flat against Euro. You would argue that this is not a super positive environment for Euro based investors to actively buy Japan, I don't agree. Indeed the situation is funny as only Euro/Japan interest rates differential dictate Yen weakness and certainly not a sudden growth upswing in Euroland zone. Whatever economists say there is no growth in Euroland, on the reverse Japan is experiencing a global business driven growth (although domestic picture is different). In addition (see Kimura Newsletter dated 21st December) the probability for BOJ to tighten early in 07 took a beating recently but ECB should tighten further in 07 first quarter.

I personally despise very much ECB policy (Europeans are unlucky, ECB governor remain a Frenchman which says it all! I fully assume my views) and actually feel Japanese economy has much to gain by not rushing to tighten, on this subject I totally agree with Kimura San.



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There are other, less visible, reasons pushing in that direction: Japanese individuals foreign currencies deposits increased fast since 2003 due to quasi negative (or close to zero) real yields on simple Yen deposits. In addition the money shift toward investment trusts further strengthened this trend as foreign currency denominated high yield bond trust become the core receiver for maturity Yen deposits.

Japanese domestic money constant flow toward foreign securities investment (bonds and equities alike) adds pressure on the Yen. Between January and September 2006 foreign securities buying (equities and bonds alike) totalled 4,9 trillion Yen, 80 % of this total is engineered by Japanese onshore/offshore investments trusts and don't forget that individuals don't hedge. However as earlier mentioned, I believe the Yen will eventually strengthen by mid 07, the kick-start could be BOJ second shot just before, or after, next summer lower house general elections.

Time to take advantage of unpopular mid caps valuations **now**

November and December represent the ideal period to take aggressive positions in the mid to small caps universe as repeated again in Kimura Newsletter 26th December.Gaijin investors are away for Christmas holidays opening the doors for buying opportunities. I mentioned earlier that loss margin ratio already greatly improved showing individual's increased financial health. What is also interesting is that margin buying balance has gone down although the market has been trending higher, by the 22cd of December margin buying balance was down 31 % compared to December 05, individuals who took heavy losses are now reluctant to start buying again on margin which is rather healthy sign for the market. For example Nippon Steel or JFE holdings reached new highs on the 26Th of December but margin-buying ratio remains reasonable at 10 % each. This bodes well for New Year trading start. On the 22 of December long margin interest totalled 3 trillion 620 billion Yen which is roughly at par with October 05 level. This is positive for 07 first quarter supply demand balance.

No what to buy?

It is widely advisable to take an aggressive stance for oversold mid to small caps. On a seasonal basis, technical cycles basis and supply demand basis we have entered the ideal window.

Previous stock picks updates

We much insisted on the importance of water resources problems for China it is time to bottom-up select appropriate Japanese companies bound to take advantage of the situation. In my previous newsletter ‘Energy savings technologies, Japan rules!’ I mentioned briefly large cap (3402) Toray. Toray’s Mainland China’s business is expanding fast: for the first time since Toray started textile business in China back in 1994 they expect to register 2 billion Yen current profit. Toray is specially targeting water treatment business field. Toray has no less than 22 subsidiaries in China, 70 % of sales come from polyester and roughly 20 % come from plastics. Due to other Asian nations production increase Polyester is not profitable but Toray CEO expects water treatment to generate substantial income, currently water treatment represent only 10 % of Toray China mainland sales, this should increased to 25 30 % mid term. To sum up Toray is targeting a 10fold increase of its Chinese water treatment business in 4 years.

(7202) Isuzu Motors announced they would invest no less than 10 billion Yen to develop next generation diesel engine, hold.

Listed fund manager (8739) Sparx Asset Management stays my favourite within Japanese fund management industry but it is worth taking notice that recently listed (3233) Fund Creation Asset Management (another value style mid caps investment boutique part of the Fund Management group) strongly recovered after a false start since its IPO. (3772) Dreamvisor too remain cheap at this level.

As a conclusion a quick word on next Japanese savers money flows, a Vietnam equity fund boom is looming around. I keep a close eye on new products launched by Japanese onshore asset managers to meet individuals ever rising demand for high yields. After successive Chinese and Indian equities mutual funds waves here come Vietnam. Vietnamese equities are enjoying a bull market and VN Index (Ho Chi Min City stock market) reached 723,84 on the 11th of December and subsequently 800 on the 20th of December. WTO participation approval acts as a support but obviously Vietnamese market technical pits are still important. Foreign investors share has jumped from 30 to 49 % recently and Japanese savers are increasingly willing to channel money in Vietnamese equities. In addition fevers grips local investors, according to Hanoi based Saigon securities no less than 50,000 new trading accounts were opened in less than two months. In short a virtuous cycle in running gently in Asia with Japanese savers money channelled on a near continuous basis to Asian neighbours…

Pascal Jeannenot

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