

Classical Insights

Global Investment Analysis Based on the Classical Economic Model

Classical Insights Bullet Points February 4, 2014

The recent correction has left quite a few stocks with meaningful upside. Here is my Japan coverage list with updated prices, estimates and targets: [Chart redacted]

Points:

1) In the table above, the median point for potential upside is now 33%. That's pretty good – especially given that the target multiples are nearly all 10x or less. I suppose in retrospect valuations may have been getting a little full prior to the correction. Many of my names were over their target prices.

2) A variety of data points suggest the current correction may be running its course. The Turkish lira has strengthened to 2.24 lira/US\$ from its low of 2.39. The yen has hit an area of strong support in the 100/US\$ level. The Nikkei has reversed the entirety of its move since early November – even though Q3 earnings have been coming in strong. The Nikkei is back where it was at the end of last April – 9 months ago – despite substantial earnings gains in the interim. The 10-year Japan government bond breakeven (now 1.105%) is nearing a strong support level at 1.08%.

3) Japanese brokers show up as extremely cheap now. I've been watching the Q3 results come in and basically they've all been the same: stronger than Q2 but not as good as Q1 or last year's Q4. Brokerage earnings show a very strong correlation with the evolution of the Nikkei: Commissions go up in quarters in which the Nikkei does well, and fall back down in quarters in which the Nikkei does not do well. What one is really getting with Japanese brokers, then, is a turbo-charged bet on the Nikkei itself.

It's worth noting that the brokers are one of the few sectors where managements don't provide earnings guidance. That's because the managements themselves really have no idea what's going to happen. For the most part I haven't been writing up the Q3 results for brokers because I don't see how I would change the models (except in a couple of cases, which I would like to tackle). The stories are still reliant on the Nikkei doing well – and spring tends to be the Nikkei's best period. In theory Q4 and Q1 (the March and June quarters) should generally be the brokers' best quarters. We'll have to see how they evolve. If the Nikkei takes off again this spring, some of the brokers could produce fantastic results.

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