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In Japan, foreign exchange margin trading (FX trading) by individual investors is quite active, and the scale in terms of notional amount exceeds foreign exchange trading by banks and other financial institutions. Individual investors tend to prefer contrarian strategies and carry trades, and exert an influence on the interbank market when such trades are closed. The growth in FX trading also affects the business models of banks and other financial institutions, spurring an increase in electronification and prime brokerage. As a result, there is an increasing trend toward concentration of trading volumes among institutions. Given the current status of both the domestic and global market environment, there is scope for further growth in FX trading, which will increase its influence on the interbank market.

Foreign Exchange Margin Trading and Regulations in Japan	<i>Tetsuo Yamazaki</i>	15
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Foreign exchange margin trading (FX trading) in Japan has appeared parallel with the liberalization of foreign exchange trading which resulted from the 1998 revision of the Foreign Exchange Control Act enacted in the context of the Japanese version of the so-called financial Big Bang. This period overlapped the dawn of online securities brokers, i.e., the age in which close affinity between financial instruments trading and information technology (IT) was widely recognized among investors. In just 20 years, FX trading penetrated among non-professional Japanese investors as one form of derivatives trading. Japan's FX trading market has rapidly grown into the world's largest such market. This paper explains the current status and characteristics of Japan's FX trading market with a focus on market size, business models of FX trading business operators and their financial standing, investor trading methods and profit/loss status, etc., and control and regulation by laws or other means. In addition, the paper describes the situation where the FX trading market and interbank foreign exchange market coexist through provision of liquidity in Japan. While FX trading has been playing a pioneering role in over-the-counter (OTC) derivatives trading in Japan, unprecedented efforts that cannot be found in conventional business practices are now demanded to ensure further growth of FX trading as a product available for trading by the general public. Therefore, this paper concludes by pointing out some issues that need to be addressed for the development of FX trading in Japan.

Retail Investors' Momentum Behavior : Evidence from Foreign Exchange Margin Trading in Japan	<i>Maiko Koga</i>	25
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This paper explores the behavior of emerging players in foreign exchange markets, namely Japanese retail investors whom are commonly called "Mrs. Watanabe". Using the data of foreign exchange margin trading on the Tokyo Financial Exchange, we find that they are momentum traders who pursue return from spot rate changes with a one to ten day horizon. Our paper provides evidence of Mrs. Watanabe having actively exploited profit opportunity from short-term fluctuations in exchange rates, not just holding a position generating carry return.

Disposition Effect and Loss Cut Rules : Analysis Using Retail Traders' Transaction Data	<i>Kentaro Iwatsubo</i>	35
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Foreign exchange margin trading (FX trading) has been booming in recent years. In Japan, FX trading is controlled by loss-cut rules. Under these rules, FX trading brokers are supposed to compulsorily execute offsetting transactions when total unrealized losses arising from a customer's investments exceed a predetermined ratio. This operation is intended to curb investor losses and reduce firms' financial risks. In contrast, some are opposed to this operation because it restricts freedom of investment. In this paper, we study the effectiveness of loss-cut rules. We find that a high probability of invocation of the loss-cut rules is found in investors who habitually, not temporarily, have a strong tendency toward the disposition effect and that such a tendency is diminished after experiencing a compulsory loss-cut. We also find that high leverage does not contribute so significantly to increasing the probability as the disposition effect. These findings suggest that the compulsory loss-cut system works effectively for investors who are unable to put a stop-loss strategy in action on their own initiative and that this system disciplines investors whose loss has been compulsorily cut.

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Do Regional Bank Managers Use the Valuation Allowance Account to Manage	<i>Toru Nakagiri</i>	65
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This paper investigates whether regional bank managers use the deferred tax asset valuation allowance account (VAA) to manage earnings around three earnings targets. Analysis shows that regional bank managers use VAA to manage earnings when pre-managed earnings are below or above the earnings forecast disclosed in the previous year's earnings summary (kessan tanshin). In addition, we think that those banks which have the most pessimistic attitude toward the realizability of deferred tax assets or whose earnings levels are lowest show more incentive in terms of earnings management. However, we find little evidence that these banks manage earnings via VAA more than those which do not have a pessimistic attitude toward the realizability of deferred tax assets or whose earnings levels are not low.

Insider Trading Regulation and Financial Cost of Seasoned Equity Offerings	<i>Katsushi Suzuki</i>	77
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Following an insider trading scandal regarding Japanese seasoned equity offerings, the authorities, investment banks, and Securities Business Association have taken several correspondences and "studied the situation and" enacted legislation aimed at preventing irregularities such as insider trading. The paper examines whether these remedies are working and found that the incidence of opaque insider trading and financial cost of equity offerings decreased after they were enacted. These results imply that these remedies achieved a successful outcome.

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