The Sid Klein Comment
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2007 Extremes:

Dow, Nikkei, Gold, Silver, Yen, Dollar

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JAPAN

Nikkei:

When I identified the low just above 14,000 one year ago, I labeled it as an A-wave. This implied that a 3-legged correction was underway. Since that point and more recently, I have identified this re-test of 18,000 as a B-wave that is part of the correction. When B-waves actually make it this far toward the peak area, waves C are particularly abrupt in their commencement.

Simply, the downdraft should begin sharply, as we saw with the last decline to 16,500. The long term 200-week moving average is all the way back at 14,000 and the next dramatic upswing in the Nikkei should commence at levels much closer to that.

Recently, there have been Japan-oriented interviews and articles. They had a few things were in common. Here, I should remind that Westerners never understand Japan and this has remained true since that market became a specialization since nearly 20 years ago. So, however bold it may come across, I tend to remind that several major

secular and cyclical turning points of different kinds in Japan have been identified in these pages since 1989. Why?

I know what the prevailing ignorance is and that one should consider contrarianism as something other than a fad but, rather, an analysis of crowd psychology that feeds on the comfort of shared errors. So, before I share a view that I already know runs counter to the vast majority, I try to comfort the listener or reader by drawing attention to the lengthy trail of such market forecasts.

So, what is today's *ignorance du jour*? Well, firstly, there is the view that Japan has under-performed the New York. Secondly, the same folks have no answer as to how to best invest in Japan from here. Thirdly, foreigners decide the fate of the Japanese market. So, now let's review correctly.

The Nikkei has been in an up-trend versus the Dow since early 2003. Secondly, other Japanese indices (i.e. – Topix 500) have been in beautiful up-trends <u>versus the Nikkei</u> since 2000! And so, finally, as proved in these pages so often with these ratio charts and studies, domestic (Asia) demand mid-cap value stocks benefit, particularly since the foreigner never knows what he is doing. Seeking liquidity (or something whose name he recognizes, anyway), the foreigner reaches for the large-caps.

The media perpetuates the ignorance for a simple reason. The investment crowd represents the majority view, to state the obvious. The media sells by appealing to the majority, not serving it. So, whatever is the prevailing view, the vendors of limited expertise can only perpetuate it.

In any event, the song remains the same. These stocks benefit from a strong Yen. The Yen's weakness further masks their developing strength. The non-large-caps have been in a bear market since 2004, when the Yen peaked, but only after an initial 4-year bull run. Soon approaching is another period that mirrors the 90's, when the Yen was weak and Japanese stocks fell, although the Japanese multi-nationals moved higher and higher.

The reverse will again take hold as large caps tank and non-large caps thrive, with a rallying Yen, the ascent of which will be much faster than its decline has been since 2004 (see YEN below). Anyway, the foreigner is wrong, again. But the hedge funds will lead the stampede into the mid-caps, when the Yen reverses. Whether it's how to prepare for and

interpret the coming opportunities, or whether it's about how to invest right now, the foreigner has got Japan all wrong....again.

"The daily Nikkei chart below allows for a minor new high, to allow the index to again catch up to the Dow on a laggard basis. That it further does so on a laggard basis in terms of relative performance, aside from time, further suggests that the action is countertrend, since it is the Nikkei that is in the bull market versus the Dow, and not the other way around, as we see from all the Nikkei/Dow ratio charts that have been published in these pages since 2003.

"However, the weekly Nikkei chart above indicates that such a minor new high would merely set up a dangerous pennant formation (connect the peaks of 2006 and 2007), which could cause a hard smash toward 14000, while the Dow crumbles."

The above two re-printed paragraphs from last month are very timely. Note two major facts: Firstly, the minor flirtation with the (unorthodox) highs occurred and in the context of the cynical analysis that is re-printed above in blue.

Secondly, please note the clear, large and ever-ominous TRIPLE-DIVERGENCE that is evident at the bottom of the chart below. Moreover, that stochastic has crossed to the downside!

Conclusion & strategy:

From May's report: "The out-performance of mid-cap Japanese domestic stocks versus other classes and international indices will continue and geometrically expand." The song remains the same. It will become more audible as the Yen turns from depressant to rallying cry (except for some bankers). The December 3, 2006 portfolio of 7 stocks is up 9%, but, for Canadians in particular, it isn't visible, post-currency.

For those who want to short the Nikkei, the Dow is the pure way to do so and, besides, the rule of thumb is to have a "long list" of investments and a "short list"...and to not cross over.

Sid Klein

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