The Sid Klein Comment
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Squiggles

February 4, 2007

JAPAN

Domestic Stocks: From the December report:

"For investors in domestic equities, this will be a major turning point. An accelerated resumption of the Yen's bull market – perhaps ushered in by the next interest rate boost – will coincide with a flight of more than enough capital to such equities. The theme these days is whatever is (has been) countertrend to international markets, with historical consistency."

From the January report (in reference to domestic value stocks):

"In fact, they will not fall even as the Dow collapses and the Nikkei gets hit with a final leg to and revisit of 14,000."

As for the Nikkei, it's discussed lower down but, as for domestic equities, the above remain forecasts. Here I should clarify what I mean by domestic stocks not falling, even as the Nikkei falls to 14,000, this includes any rallies in domestic stocks that may occur before the Nikkei starts to fall.

I reiterate the above market calls because the market psychology has truly gone to extremes regarding the Yen. I believe that it's a good time for perspective, regarding the Yen which is the key, not just to domestic Japanese stocks, as discussed in the New York and Yen sections below.

Note the following, taken from today's Nikkei Net Interactive. It pertains to scheduled meetings of finance ministers and reflects today's mood (see Yen section):

"The talks may also touch upon the euro's sharp appreciation against the yen, which has European authorities fuming as it makes their cars, electronics and other exports less price-competitive overseas amid intensifying global competition."

This was followed by a quote of a Japanese official saying that he was unaware of it even being an issue.

Over many years, I remember that dramatic turnarounds have occurred around the times of meetings of finance ministers, such as the one above. There also, I recall ministers downplaying anything that could be misconstrued as anyone strong-arming or being strong-armed.

So, amid the diplomacy, dramatic volatility kicks in, ending with a bona fide trend change for the Yen that takes shape after an initial spike reversal. The Yen is central to several investment themes and, just as many are panicking, the currency may be preparing for a sharp reversal. So, perspective is good.

Nikkei: At 14,600, within trading hours of the low, I wrote that the Nikkei could fall to 14,000 intra-day and that that area would be the worst-case scenario that I could foresee for the Nikkei in this corrective cycle. Pursuant reports added that a rally phase could be and probably was within a corrective cycle.

The story in Japan is rather different than in New York, for the countless reasons given in these pages through these past several months. A bull cycle for the US consumer is destined to come to a sudden and a shocking halt (see New York below), while the Japanese consumer has only begun a major secular bull market, as is evident in retail sectors (see March and May 2003 special reports on Japan in the Past Reports section, or linked online at www.sidklein.com).

Last month's special studies showed that a return of dominance to non-big-caps is a matter of course. The studies also reflected the substantial profit potential that presently exists by seeking lesser risk. This will increasingly become the theme for managers and be certain that it will be a common headline: **"Tokyo trade today was dominated by foreign buying of domestic Japanese equities in search of lower risk."**

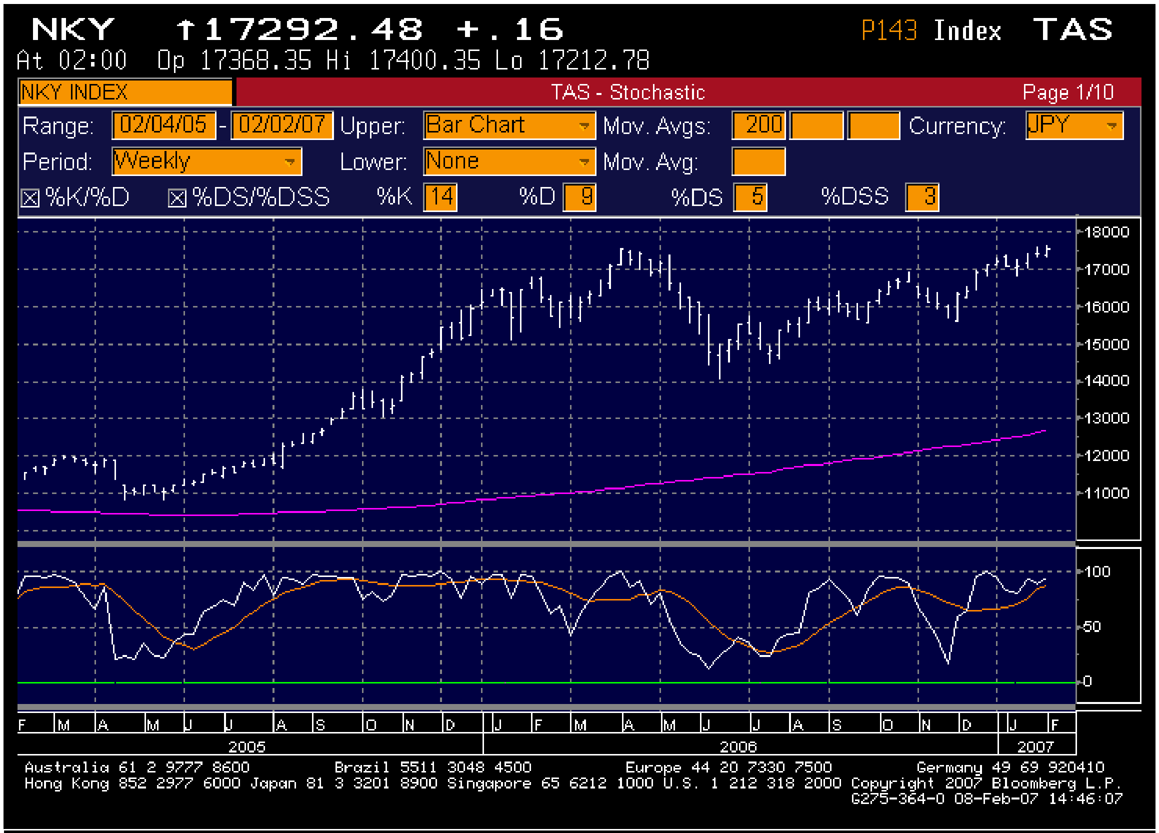
Admittedly, the major spark will come from the Yen. This will shift asset allocation to more Yen-based equity investment. The spark could be sharp, due to the extremes from which the Yen and domestic stocks are coming, although the latter have been firm since yearend.

I'm surprised by the Nikkei's last 500 points up. It has rallied and it has done so on the back of the same type of news that has recently driven the multi-nationals in New York, namely, "good earnings." The extent of the rally doesn't change my interpretation for the intermediate term, but it does re-confirm the larger bullish trend as being secular, since the Nikkei is poised to complete a corrective period and pattern that is consistent with a primary up-trend.

Strategy: 25% of our holdings are in Yen. Domestic stocks are the most levered and contrarian way of investing against New York and the Nikkei on Asia's major exchange. The Japanese market's capitalization is more than 60% of that of Asia's. I recommend no other stocks in the world at this time, other than select precious metal issues.

Conclusion: An interesting thing has occurred with the Nikkei's rally to a level a few points over its previous high. Particularly when simultaneously revisiting the Nikkei/Dow ratio chart (published last month), one can conclude that the Nikkei has "ample room to fall", to accommodate a significant and swift beating in New York.

As you can see from the chart immediately below, the Nikkei can decline to as low as 14,000. This way, 3 things are achieved. The low would still be the 14,000. Secondly, the Nikkei would be closer to its 200-week moving average, setting up a most healthy situation for its next leg to the 19,000 – 21,000 zone. Finally, a rally within a corrective phase that exceeds the high, the previous move to which is being corrected (such as this week's advance in Japan), signifies strength. The upshot of this is that if the Nikkei declines to 14,000, be ready to not doubt. Meanwhile, Japanese domestic stocks are attuned to the Yen and run counter-cyclically to domestic and international markets.



NEW YORK

Savings and the consumer: In 1982, Paul Volker was the US Fed Chairman. Everybody in the market was in pain. The economy was in pain. Interest rates were 20% and, you know what? The American savings rate hit a peak over 11%. So, amid the gloom, there were savings to unleash. The trigger was a reversal in rates and the rest is history.

Today, we're at the other end of the spectrum. The American savings rate is now **negative for 2 years running** and is at its lowest level since **1933**, the time of the Crash and Depression. We're at the opposite end of where this secular bull market began which, in my opinion, was at 786 in 1982 (I joined the industry a month earlier). The savings rate could not possibly be more strained, if likened to 1933!

This is occurring as baby-boomers look to their assets to bail them out in old age. I have friends who are confident of their condos and other property values. There may be shocks to consumer spending like never seen before once something triggers the realization that folks are stretched beyond stretched. The market follows right behind that almost immediately.

While the economy squeezes out its last squiggles - just as the consumer squeezes out a dollar he doesn't have - I consider an intelligent observation made by market commentators. As home prices decline, those declines are not marked-to-market, as regards the mortgages of home equity loans. He wondered what would happen in the New Year when the effected public would receive their yearend statements. Their mortgage payments never increased (with equities, one would have to post margin to maintain equity).

The effect is seeing declines in home equity to desperate levels, and desperation could set in, particularly as many assumptions for retirement purposes are for higher real estate and equity prices.

Liquidity: The story is that as long as investors can borrow cheap Yen and buy US assets, liquidity will be ample. It's a funny thing. I've believed that ever since the new bull market in the Yen was signaled and began, that the Yen has been kept down artificially to allow the carry trades to unwind in a more orderly fashion. The next rate hike in Japan may well be the trigger and cyclical take-offs in the Yen are often first-day explosions. For all the markets covered in these reports, directly or indirectly, the turn in the Yen is the single largest story at this time.

Technical: Squiggles isn't a Bear's pet. It's a nuisance that has as its most irritating feature that it reminds the investor of the memories of being disappointed for so long. **Still, the following 1-year Dow chart reflects how quickly the Dow can lose 1500 - 2000 points, within a 6-week period or so.**

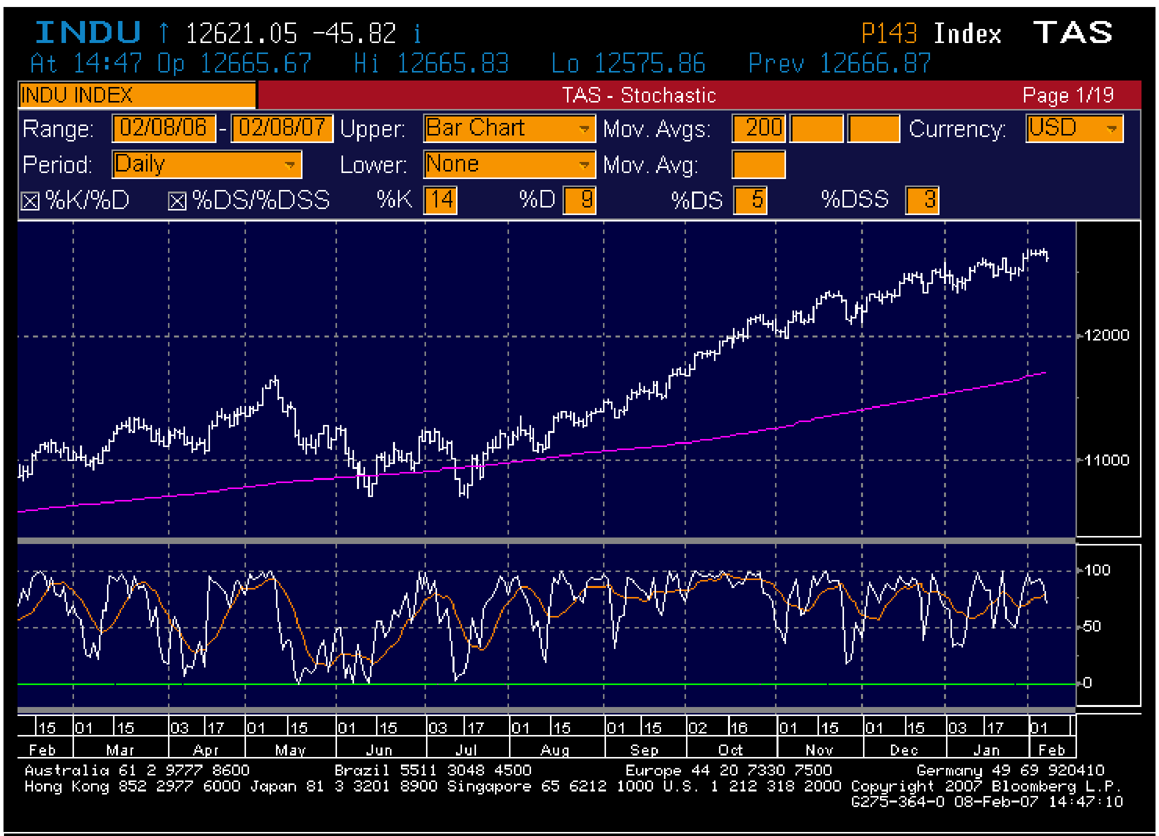
To break down the chart in Elliott Wave terms, the first move up ran from the low in July into early August. Then, wave-3, the second and necessarily principal up-move, ran from 11,000 in August to its November peak. Wave-4, a corrective move was the minor November decline back to 12,000. Now, then, by this interpretation, a few assumptions may be made.

Firstly, by implication, we are in the 5th and final move up (of course, the intermediate and longer term cycle correction targets remain a matter of debate). Secondly, this final leg is taking the form of a quintuple-3. This means that there are 5 moves that are each 3-legged. This includes the 3 moves out of the 5 that are up. Moves up are ordinarily 5 waves. This type of formation necessarily corrects to its point of origin with speed, days. The point of origin for the 5^{th} and final move is 12,000.

Each move up, I believe, gets smaller and smaller, which runs counter to how healthier advances occur. The first move up within this final leg ran back up to 12,500. Since then, that rally corrected and the ensuing move within this completing pattern is already underway since early January. **Therefore, the idealized timing for a big collapse, in my view, is the March – April period. This view is further bolstered by the fact that we are in the minor wave-3, within the final 5th wave. It should be over in its entirety by about March 1.**

Strategy: The January report recommended that those not long 1-year puts use the January period to go 50% - 100% long. The thought for one going 100% long was/is that whatever is left on the upside is little and would be undone quickly. This would not damage 1-year puts that are timed for purchase at preferred premium (volatility) entry levels, too. The reason for going only 50% long was/is to simply see where these final squiggles take us.

They won't go far, it won't last long, and it'll reverse with speed.



Strategy: From the January report:

"The puts can be purchased in two increments, with the second one at the final minor high I envision but in which I do not recommend confidence."

This summarizes well what is written in this issue and to which nothing can be added.

PRECIOUS METALS & DOLLAR

Bonus – Oil (Chart on page 9): Oil did another wave down to complete its correction, after its last sharp bounce off the $58 - $60 area.

As you can see below, oil has now pulled back to its 200-week moving average, which means to me that long-term holders have also been liquidating. This is consistent with the alternate scenario that was discussed a few months ago (the November report reiterated and discussed the bullish oil story).

Namely, that after a 3-part decline – which is corrective in nature – oil could embark on its final primary, cycle move. **The 3-leg correction is now complete.** However, I also wrote that the final move might only be a double top. This is consistent with the notion of the liquidation by long-term holders/insiders, who know that the best growth days are behind them. Some reasons are economic, while others are military/political.

Strategy: As a special situation, a trader may go 100% long @ $57.50 on the March contract [use timing for specific entry(ies)]. The stop here is any close below the 200-week moving average. The target for now is $80 - $85. If oil gets away and runs to $65, then we'd have to look for pullbacks to hop in ($65 is price resistance and the 200-day moving average). Remember, these pages only attempt to capture intermediate term moves, if not the longer term ones. Hence, "special situations."

Gold (Chart on page 10):
From the January comment:

"Gold ($606.70) is in a triangle that, when breached to the upside, can catapult the metal as high as $800."

The November comment expressed full bullishness on both gold and silver (100% long gold, 200% long for silver). Gold was around $605.

Insofar as forecasting this year is concerned, however, some humility isn't a bad idea. Gold may stall when the Dow falls apart, particularly if oil's high is put in (around or just over $80?). Even in such a scenario, gold may trade in the $700 - $800 zone before blasting off and accelerating toward $2000 in a major Wave-3. Whatever the case, nothing changes our asset allocation anyway. 50% Positions can be traded at intermediate term turning points, and only for those who wish to tinker (see Asset Allocation below).

The Exchange in Tokyo is contemplating the listing of ETFs linked to the precious metals. The major liquidity and purchasers are in Asia and, as I've written so often through the years, there is a massive shift of wealth, power and dominance from West to East. Part of that, I wrote, would be the transfer of the gold assets to the East. Consistent with that, it makes sense to me, is to have such ETFs trade in Tokyo, the central and developed market of the East.

Silver (Chart on page 12):
From last month's report:

"Silver has returned to exactly where we want it for our preferred strategy ($12.20). Wait, and you wait for nothing. Buy in the morning, if you're not already 200% long (50% margin)."

Both gold and silver are up from lows that SKC again identified. This time there was less precision, but very close nonetheless. We remain on the right side of the fence, with ideal asset allocation.

Yen (Chart on page 11):
The Japanese Yen's slight new low looks a lot like oil's new low into the 50's. In both cases, the moves broke through a neckline resistance (oil chart down, Yen chart up, the latter representing a price decline). This may not be an accident. In any event, oil has reversed. Is the Yen right behind it? **I continue to believe that the moves in the other currencies, such as the Swiss Franc and Euro, are forerunners to the Yen's advance.**

The Yen will enjoy extraneous drivers, apart from interest rates and the effects thereof (carry trade reversal). The **Bank of China** is badly underweight Yen and, rather predictably, has expressed the need to diversify from the USD (the Chinese have already long-since declared the need and wish to diversify from USD into gold and other assets). The Japanese merely replied that the Chinese are welcome to buy their bonds. This more than anything, frankly, would be a cause for rates being held down in Japan.

I have often reported the emergence of the Yen as Asia's block currency. Even a pro-Chinese argument regarding currency is a major buy-Yen story. Again, they have to put their money somewhere (and holding each other's bonds forges political associations).
Strategy: Given the role our Yen position plays in our asset allocation, there is nothing to do. Like oil, with which it shares a similar chart, reversal can occur at any time, so why tinker? The issue of the resumption of the Yen's bull market is most significant. Firstly, it will alter the equity theme in Japan from multi-nationals (Nikkei) to domestic issues. It may turn off the liquidity spigot in New York (see New York above re: carry trade). This, above all, will send

investors looking for international equity alternatives. The Yen's advance will also be part of a backdrop that includes an acceleration in gold (and oil?).

Euro (Chart on page 11):

The strength in the Swiss Franc (not shown) and Euro are forerunners to the Dollar's unavoidable decline against the Yen as well (this ministers' conference is part of the "corrective" (alignment) process). The upshot really is that the US Dollar is in a major secular bear market, particularly when including its poor showing versus the precious metals.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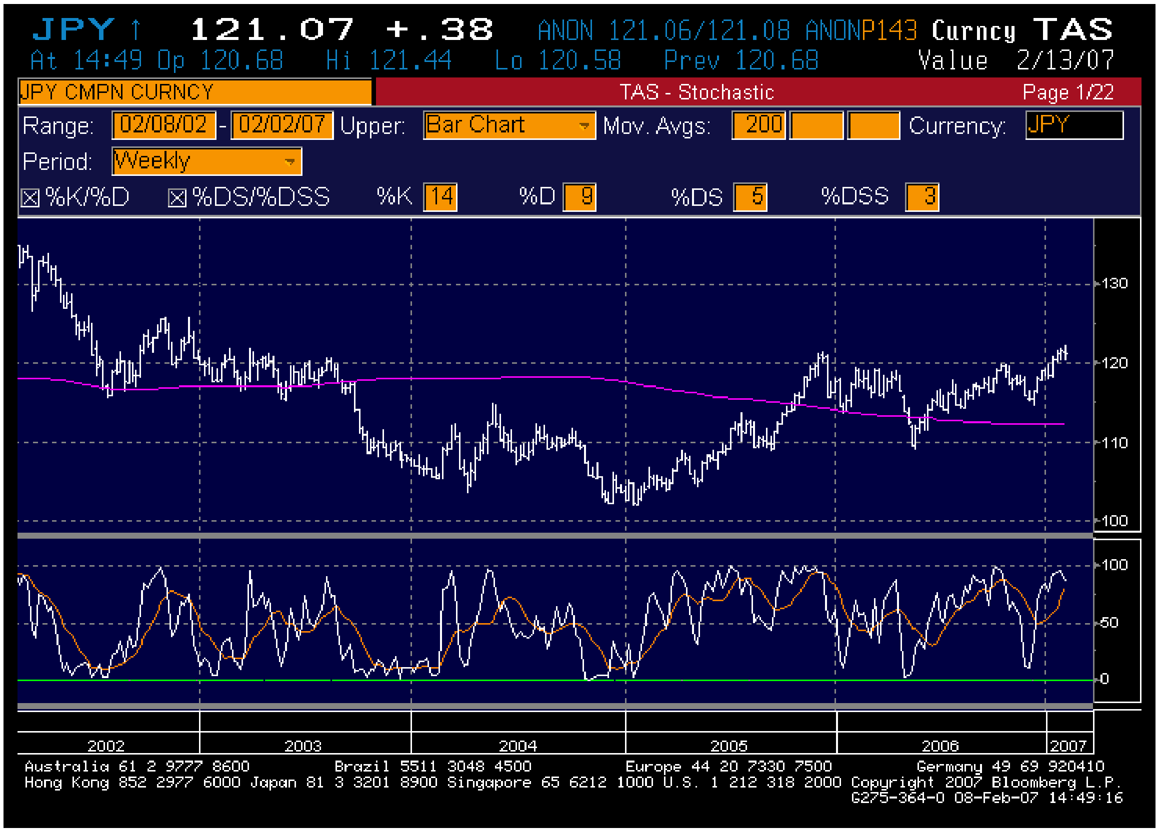
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Strategy & Asset Allocation: The most perfect summary would be to re-print last month's conclusion:

"Remain fully invested in gold, as downside is only to $580, anyway. Silver, however, has now provided a second chance for investors to benefit from my previously published strategy to be 200% invested. In other words, BUY SILVER ON 50% MARGIN NOW! Do the math; what are your returns on even a move to $20, which is a lay-up once the previous high at $15 is broken. One needn't worry about the metal's price getting cut in half. The short interest alone, guarantees against that. This is a wonderful opportunity for retail and institutional investors alike to benefit in a major way, with the risk as little as is great the reward potential!

"100% long Yen. My asset allocation continues to be 50% gold (or 40% gold + 10% silver), 25% Swiss Franc and 25% Japanese Yen. Don't expect this mix to change anytime soon. *Actually, I can't foresee when I would change it.* I have absolutely no doubt whatsoever that this is the best asset mix for this cycle and this exceptional period within the Long Cycle. None whatsoever."

Sid Klein

market letter are of necessity abstract and general. They must be modified, accepted, or rejected by individual subscriber/investors whose risk averseness cannot be known to Mr. Klein.