

IMPEACHMENT & THE UNIMAGINED EXTREMES

(currencies, precious metals, equities)



July 07, 2007

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 versus the Nikkei 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:

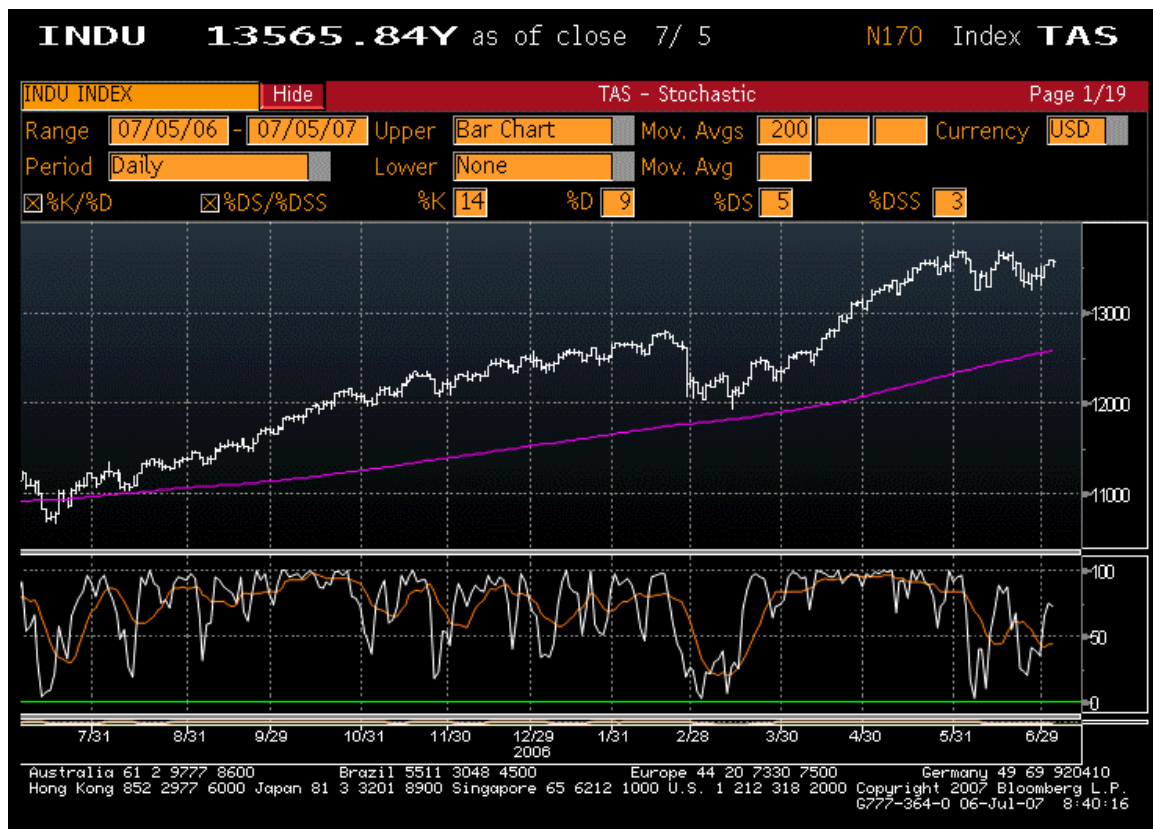
From May's report: "The out-performance of mid-cap Japanese domestic stocks versus other classes and international indices will continue and geometrically expand." The song remains the same. It will become more audible as the Yen turns from depressant to rallying cry (except for some bankers). The December 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.

NEW YORK

Dow Jones:

"The daily Nikkei chart below allows for a minor new high...", is a comment that holds true here for the Dow. A minor new high would put in place the ugliest of all triple-diverges and set the stage for an award-winning and all-debilitating bear crash that will disillusion investors for two whole generations, as is more likely the culture of aversion in Europe regarding equities after a bloodbath.



When market letter writers didn't think it fashionable, I wrote of the impeachment of Bush. Did I mention Nostradamus? Yes, but in a cute way, since rational minds may not give credence to clairvoyance. Did I mention that the "third anti-Christ" is supposed to have "bus" as middle letters, according to him? Or did I mention that this "ant-

Christ" who would be "replaced" was to have been a "pawn?" No, I did not.

What I did write was that the lengthy list of crimes would only be taken out of the drawer, once it would be time to do some PR work. Change the name on the door, say you're sorry, make no reparations (for a million dead lives?), but change the image. It's a winner, I tell you. Recent polls now give US politicians the right of way to proceed. They are loath to do it, since it lowers the esteem for that government but, as I write here, it is used to show righteousness...and continue on.

The following comments from the June report remind of how critical it is for hedgers and speculators to know how to time the VIX when trying to buy Dow puts. The Dow is the index of choice in these reports and discussion of the VIX is only in that context.

It is noteworthy that the Dow's all-time highs will not have been confirmed by a new low in the VIX, which runs countertrend to it. This has occurred before and the Dow did follow-through to the downside, without inspiration from a new low in the VIX.

After the two re-printed paragraphs below, note what the VIX (S&P Volatility Index) did indeed go on to do over the recent past.

"The pattern of the VIX (above) indicates a higher low, while also reflecting a dead stop at, and pullback to, the 200-day moving average, up-trend buy-point, and neckline support level.

"This isn't just a contrary indicator that refines the timing for entering a Dow short position, it also helps time the entry into put option premium levels. Having closely tracked the activity of the latter, I can attest that activity in very recent days and hours indicates the capitulation that one hopes to see against a backdrop of little upward index progress relative to the size of put premium decline, the occurrence of which invites the seasoned speculator and hedger with open arms."



Conclusion and strategy:

Everything points to a summer peak that will make investors wonder why they ever returned to the markets that they had sworn off after 2002. Impeachment and political instability, along with higher oil prices will be blamed as the triggers. Of course, the media will trot out the old stories too (housing, the bankrupt consumer, etc.). Don't expect anything original. Just the investor banging his head against the wall, "How did I do this AGAIN?" As another put entry point nears, continue to build put positions of longer and longer date than those previously held. Dow puts should be purchased whenever the VIX hits another buy point in its ongoing up-trend. This is at hand!

OIL (special):

As oil turned at \$80, I called for lower prices, but then turned bullish as the subsequent lows were being approached. Oil turned at the 200-week moving average (1st below), at which point I again labeled the chart as having a final leg up left. I wrote often that a final 5th-wave move in oil would probably proximate a double top. Now, however, I see a greater chance of new and higher highs than I had before.

Impeachment. Oil. Mid-East strife. The worst of all worlds: **The 70's with 30's consumer savings levels.** From the metals, to the currencies, to equities - I truly believe that no one will be exempt from the shock of the levels to which prices are going.



The following shows us how near \$80 now is, not to mention the strengthening momentum of the stochastic and oil's price.



GOLD & DOLLAR:

Near the peak, **I advised reducing to 50%** long gold [referring to the gold portion, which represents 50% of one's portfolio (or 40% gold + 10% silver)].

From last month's re-print: **"This was based on the idea that the metal could drop to as low as \$600 or, and more likely, trade net sideways..."**



Indeed, the 200-day moving average is supporting gold's price (see above) but, looking at the weekly chart that follows, one can see how gold may now indeed be preparing to complete its correction with a spike toward \$600.

A-B-C corrections are occurring in several markets, with the B-waves returning to previous highs. This creates a highly confusing situation for investors, who do not understand that **the B-wave masks the final decline, which then appears to be the beginning of a correction.**



The first chart on page 10 above shows why gold's next major advance would have a healthier beginning at something closer to \$600 and the 200-week moving average.

An analysis of the second chart on page 10, which is the 1-year daily silver chart, along with the long term weekly chart below reflect a safe entry at \$10, for which many will wait, particularly if gold's slide continues, as I suspect it will.

Of course, silver is stronger and will bottom first.

The unsuspecting will miss it at \$11. Anyway, once again, I offer an ideal number. We'll follow-up and see. Since this is a key cycle turning point from which surprising levels will spawn, those who have followed an unsurpassed track record in gold (and silver) in these pages since the beginning of 2002 may wish to pay special attention, as I again attempt to nail down the next major turning points for gold and silver.

Prepare too for a 200% silver position. It's not going to \$5.50 the ounce, for too many reasons to recapitulate here. Consider new highs at \$20. Well, do the math. Yes, a 200% position awaits us. Sometimes one uses a leveraged instrument (options). At other times a tight stop on a levered instrument (commodities) is appropriate. And other times, when it's a lay-up, the leverage is in the borrowing.

Please scroll down.



The following long term Yen chart reflects a dragged-out and completing wave-C, which is also bumping up into long-term right shoulder resistance. From last month:

“The following 7-year weekly Yen chart reflects a flat top pennant formation that is evident, despite not having drawn in the lines that illustrate so. This implies a real risk of a reversal that is sharp. Yes, I have written this before, but that is exactly where the risk lies. The carry trade can start to unwind at any time and everyone will not make it through the door at the same time. That is a global theme presently for more than one market, it seems.”



The above chart is Yen-bearish when it is going up, as the Dollar is going up versus the Yen.

The following charts of the Swiss Franc, however, reflect the opposite meaning. Here, moving up does correspond to an advancing currency. The manifest power of the Franc clearly shows the wisdom of maintaining an asset allocation that has focused on two fiat currencies and one real one, where the latter (gold) is most represented by the Swiss Franc, among the government paper out there (see STRATEGY on page 15).

The second chart on page 14 is the 1-year daily Swissy and, there, we can see just how smooth the sailing has been. To see the Japanese Yen so weak at the same time reflects just how bizarre and multi-personality-prone the financial markets have become. This is how keenly ready you have to be for *the unimagined extremes* that await us.



Strategy, Conclusion & Asset Allocation:

See if gold hits \$600 and silver \$11. But, whatever the case, our asset allocation remains 50% long gold (or 40% gold + 10% silver), while aggressively long Golden Star. The Japanese Yen and Swiss Franc each represent 25% positions. The 50% position in gold referenced here concerns the half position that is presently being maintained in the metal, which ordinarily represents 50% of one's total portfolio. Therefore, gold is presently a partial (half) position, and hence a driver for maintaining an aggressive position in my favourite (presently sole) gold stock position (Golden Star, GSC-T).

Good fortune to all,

Sid Klein

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