The Sid Klein Comment

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"If it's Confusion, it's Revolution;

Where There's Confusion, a Man Who Knows What He Wants, Stands a Good Chance of Getting it."

June 30, 2008

Special Edition:

In deference for Canada Day and the July 4th long weekends, which sandwich this week, this month's report comes a little early.

JAPAN

As can be seen below, Japan has been the class of the league this year. Even as markets were falling, superior relative strength before the low was a forerunner of what was to come during this countertrend rally phase in New York, as out-performance has only widened further.

Technical (Nikkei):

Below are the 2-year daily and 10-year weekly charts on the Nikkei. Its superior performance relative to the Dow, for instance, is evident.

Both the 200-day and 200-week moving averages converged at the recent peak to repel the Nikkei. Note the strong neckline support at 12,000. This supports the argument that we have embarked on a new secular cycle, the inverse of the nineties. This time, the Dow spends 10 years in a downtrend, while Japan makes higher highs and higher lows.


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Page 1/37
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Domestic equities:

These have under-performed but they too have held above their January lows. Those that have fared best since then have illustrated up-trends, while others are simply at major long-term support levels, along which their stock prices are scraping.

In 2000-2001, the value stocks had stopped falling, and so were good out-performers. In 2001, despite 9/11, they started a trend that would carry many stocks to 100%-200% returns over a 2-year period, during which time the Nikkei was still tanking to 7600. It had followed an endless walk through the desert. This latest walk is four-years old.

Strategy:

Regardless what follows in world markets, this asset class will out-perform and enjoy the best and most sustained performance, when markets reverse, even if the latter's final bottom is not yet in place (simply, this group will start its up-trend sooner).

There exist multiple "recipes" for using the domestic value equities within global out-performance themes, so as to feel the security during bad times and leverage potential during pauses in the market upheaval.

SHANGHAI

This index was a major leader on the way down over the past 8 months, so its declines have been muted as compared to other markets.

Here too, the index has creative roles to play but, again, some themes are best mobilized after declines (like now), while others benefit from superior strategic opportunities and pricing after an intermediate-term peak.

The 2-year daily Shanghai chart below illustrates the drubbing it suffered over these past eight months, which quickly accomplished our 500% return target for our warrant.

The 10-year weekly chart beneath it reflects a market that is coming into neckline, moving average, Elliott Wave, and percent retracement support levels, all at once. This is why this market is suffering the least at a time when others appear much scarier.

The here-contemplated inter-market plays (long/short strategies) are where investment is simplest and offer the best risk-adjusted returns.


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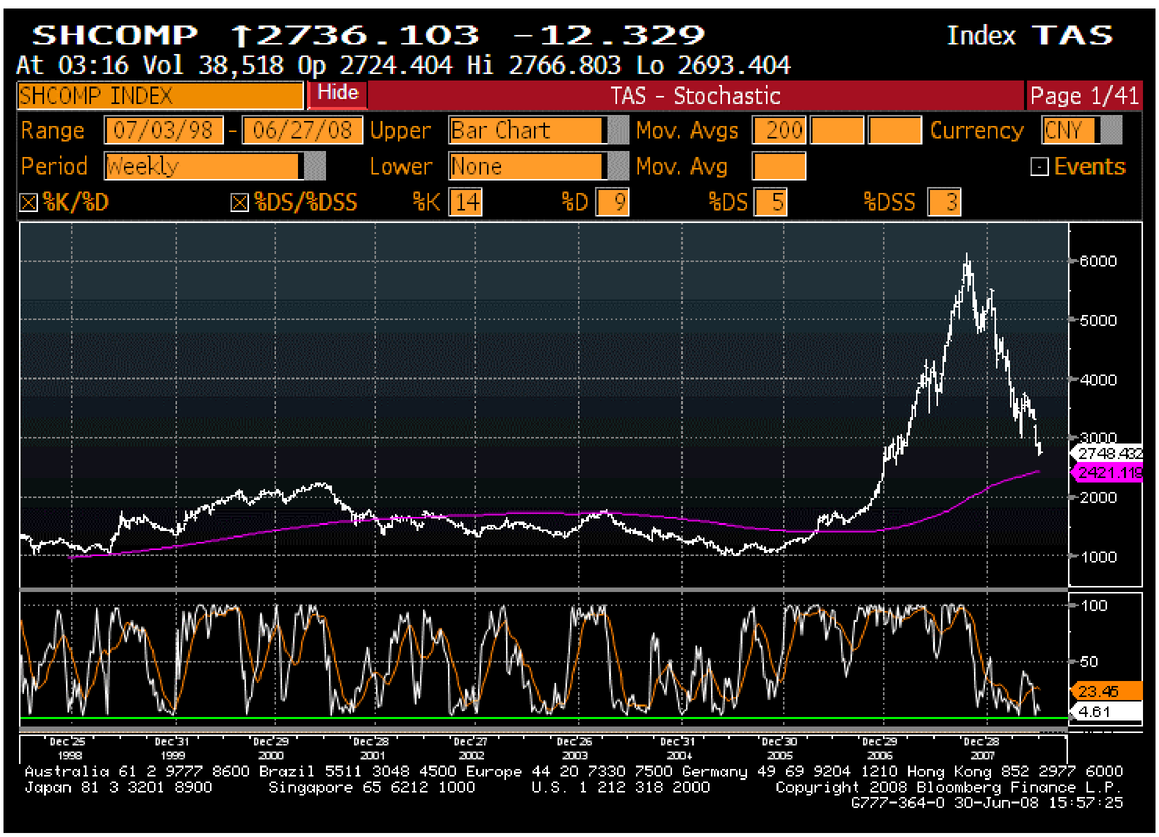
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NEW YORK

At the end of 2007, I stated a downside target for the coming initial cycle down of Dow 8,800.

After identifying the first quarter low as having bottomed, despite having forecast an initial important support level at 11,200, I wrote that a countertrend rally should ensue with a target range of 12,000 – 13,500. The bigger picture, I cautioned, was that the next downturn could be a market meltdown.

Indeed, having now achieved 11,200, the market may indeed rally, though to lower levels than previously contemplated, and not last very long. Certainly, this will be updated.

I was certainly incorrect in the near-term, but the attention in these pages included the consideration that none of the known ails would disappear, while, in fact, other sectors and sub-sectors would quickly slide into a lengthy and slow mudslide.

Despite little panic or significant mention in the media, banks had fallen to 15-years lows, and visions were already appearing before investors' eyes of Nortel and the tech meltdown.

This time, however, the issue is the financial system. That is the stage when calamity takes over, as the final stage of the K-wave is ushered in. This means that a now 75-year old economic cycle is in its last stage (in the past, cycles has averaged 55 years)!

Then, the market was looking at the prospect of higher European rates and a scenario, therefore, where the Fed is caught between a rock and a hard place, if it cares at all about the value of the Dollar (which, for political reasons, it may not). [Yet another reason why to remain 100% long gold, as part of a full 50% asset allocation of liquid assts in gold (and no fixed assets are recommended)].

It has been awhile since I've written of this, and now is an appropriate time:

The markets have been ignoring bad news for many years, always suffering its declines AFTER the well-known and discussed news at that time actually manifested itself in the market. In other words, one could actually wait to short until AFTER the scary news had already hit the fan.

As a result, I explained, declines would occur over a compressed time period. The speed catches everyone off-guard, as insider money has long since distributed their tradable holdings.

Immediately below, the 2-year and 10-year Dow close-only ("line") charts provide the cleanest looks at the mayhem (no intra-day "noise").

Whether we get a summer break in the market burnout or not, including a last-gasp-of-breath rally or not, the Dow is heading to under 9,000….and fast.

VIX

The VIX, as is evident on both charts on the next page have fallen into major neckline support levels, while the second chart, the 10-year VIX, also came into very long term moving average support.

The first chart on the next page is the 2-year daily. The upshot of both charts together is that an intermediate-term correction has completed in the VIX with a lot of upside before this is over.

Whether it stutters first or not, the key point is that there is a lot of room to rise…and that the equity market runs in the opposite direction of this indicator.


VIX 24.00 +.56 m
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VIX 23.99 +.55 m
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Synthetic Long/Short Revisited:

Amidst all of this continue to exist high risk-adjusted reward scenarios, involving the relationships between multiple markets. By investing in levered and long-term inter-market plays, uncertainty is turned into the lessened risk of intrinsic long-short positions, along with the leverage that allows an investor to invest less in the markets.

Therefore, I write here again regarding the "cross-chart" inter-market plays, the sort of which have proven so profitable this year.

The reason one may invest dramatically less in global markets with this approach is because the investor is of the view (with me) that we are within the clutches of the economic K-wave's final cycle. This is so since my work product is the result of 25 years of training that has included special analysis and preparation for this cycle. Therefore, the investments are tailor made to the occasion, using the appropriate markets at this time.

Otherwise, one's investment programme may be a standard one, in which case the investor views the recommendations as stand-alone concepts and potentially good ideas for making money. In this case, there is no effect on the investor's allocations to markets, unless, at the least, he/she recognizes the merit in viewing such concepts as rainy-day weather ideas, to offer some counterbalance to the remainder of one's portfolio.

No matter what, the contemplated investment structures play volatilities against one another in such a manner as to create opportunity for lessened risk, as the result of global market pain; meanwhile, leveraged wealth creation scenarios stem from the attendant chaos. Simply, efficient would be a good word, in the sense intended by the Sharpe ratio.

And now?

Ideally, the objective is to capture mis-pricings in situations, as one believes there is counter-cyclicality between the markets in question.

Having selected the appropriate markets, the product is simultaneously long and short via a two to three-year warrant, the strike price for which is based on the underlying security, which is the difference between the indices, for example.

Finally, the last major ingredient is the fine-tuning of the ratio of the components. In other words, the final structure adjusts the "chart" of the product by rearranging the support and resistance levels for the underlying security, as a result of having redefined and restructured the relationship between the two markets in question. In this way, the investor enjoys a more precise and favourable economic bet, according to his/her views on the fundamentals.

Some structures (investments) are best priced *after* a decline, while others are best after an intermediate-term high. In every case however, the easiest profits will have been made sooner rather than later, <u>precisely when greater global portfolio insulation is and has been required</u>.

As I indicated at recent Shanghai lows (which were subsequently broken), adjustments were required to the position (Japan/China), since re-weighting the ratios between the indices is preferable to trading away the extensive remaining time premium which could otherwise be used strategically to maximize gain (not *writing* warrants).

Similarly, there are now meaningful opportunities in multiple markets that fit the desired criteria. Otherwise, there are those that are shaping up imminently.

<u>OIL</u>

Once upon a time, I published overlays of consumer confidence (CC) versus the Dow to illustrate the <u>almost immediate</u> effect of the former upon the later. Well, oil killed the summer season, after the predictably bad Christmas. CC's back has been broken, breaking to lows beyond the 2003 levels.

In itself, as per prior work, this suggests 9000 fast on the Dow.

So, when oil spiked sharply last week, the market saw that news story as the one to hang its hat on for a 400-point decline.

<u>GOLD</u>

The metal's price fell perfectly into moving average support and the fundamentals look good for new highs, too. Still, the 10-year weekly chart beneath it reflects the need to consolidate over a lengthier period.

For these reasons, I have had mixed views that left me uncertain where the next move would be, after identifying the previous short term turning points. Simply, I wasn't sure if we had another corrective leg down to go, or whether gold was just gong to bide time.

Having analyzed the patterns and indicators, I believe gold will now make a new high with a $100 run-up, before a more serious price/time correction.

Similarly, I believe silver (2-year daily chart at the bottom of page 9) will now run to new highs, before correcting around $6.50 from about $23.50.


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YEN (CURRENCIES)

The Yen has corrected enough and has come into serious support (resistance on the Dollar/Yen chart above). The secular bull market may resume at any time.

Our asset allocation was 25% Swiss Franc, 25% Yen and 50% gold. That never changed, though the strong view for some time has been that the Yen would be the best fiat currency in the world for capital appreciation. That has proved correct, but nothing changes the asset allocation mix for long-term funds anyway.

Nothing has been broken since 2002 with our asset allocation models, so why fix anything? This is a BIG cycle. Understand it. Be positioned with it.

When the lows seen above are broken, belief will finally set in that, yes, the Japanese Yen is ultimately going to 80, and lower.

Sid Klein

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