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The Heart of the Countertrend Summer Bull Accelerates Soon

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IN SUM

With the shorter-term forecasts materializing quicker, this may be one of those periods when analysis could be better served with interim reports included. What follows updates/follows-up the last report's findings regarding where we are in this 3 to 6–month countertrend period.

The March 19, 2008 letter entitled, "Forecasted 1st-Quarter Volatility & Extremes Concluding" called for extremes in SKC's markets of interest.

"The monetary moves alone cannot solve the systemic problems that presently exist, but they do make a tremendous difference...on a lag. The momentum of the previous 6 months must play through to its early April low, whereupon the effects of all these who-cares-about-the-Dollar policies take hold on the Dow, in nominal terms. Heaven help the foreign investor, though. (Clue: Here too are other out-performance concepts to take to the bank.)"

From May 4, 2008:
"A multi-month countertrend rally in the Dow, coupled with a multi-month correction in the VIX means that a truly great planning period is upon investors in Japan, New York, gold and the Yen. It means that

long-term leveraged prices on the investments of choice will be there like a knee-high fastball.

"Starting with sizeable gains (catching the beginning these new global secular trends) goes a long way, but it remains true that the greatest damage lies ahead. Whatever trends and cross-trends began this quarter or last will remain with us for a very long time to come."

The basic theme has been that the January extremes in our markets would probably hold out toward late summer, with possible new extremes briefly by early April. The subsequent moves up and down this quarter have been identified and I am again reiterating a forecast for an acceleration of trends to commence now, within countertrend moves through to the fall.

JAPAN

The 6-month Nikkei chart below clearly shows why, coupled with the Yen, hedge managers will increasingly allocate to Japan-themed investments. Institutions are generally 3-6 months behind them, as they tend to wait for independant asset allocation recommendations.

When the common investor gages how New York is doing, he first thinks of the Dow. With Japan, it's the Nikkei.

With the index breaking out from a bullish reverse-head-and shoulders pattern, and over a critical neckline (at 14,000), after panicking in January, global investors may be looking at a 14,000 – 16,000 range quicker than they imagined.

The Yen is getting ready to advance again (YEN below), so the knee-jerk reaction to invest in the Nikkei first, may give way to hedge funds' accentuating investment in domestic Japan very soon.

For these managers, they are aware that the first quarter numbers place Japan way out in front of the pack, with every indication that this is something that is just beginning. And it indeed is.

While the Nikkei may rally 50%, the smaller indices could advance 100%. Further, there will have been the effect of a Yen bull market on investment returns. Global focus is on Japan; this time, 2008–2010.

The backdrop will also have included a failing US Dollar and a deteriorating Dow, certainly in currency-adjusted terms. The asset allocation shifts in the direction of Japan and domestic Japan could be

dramatic, given the nature of the beast and the fact that most funds did nothing to properly position themselves before the New Year.

Technical (Nikkei):

Domestic equities:

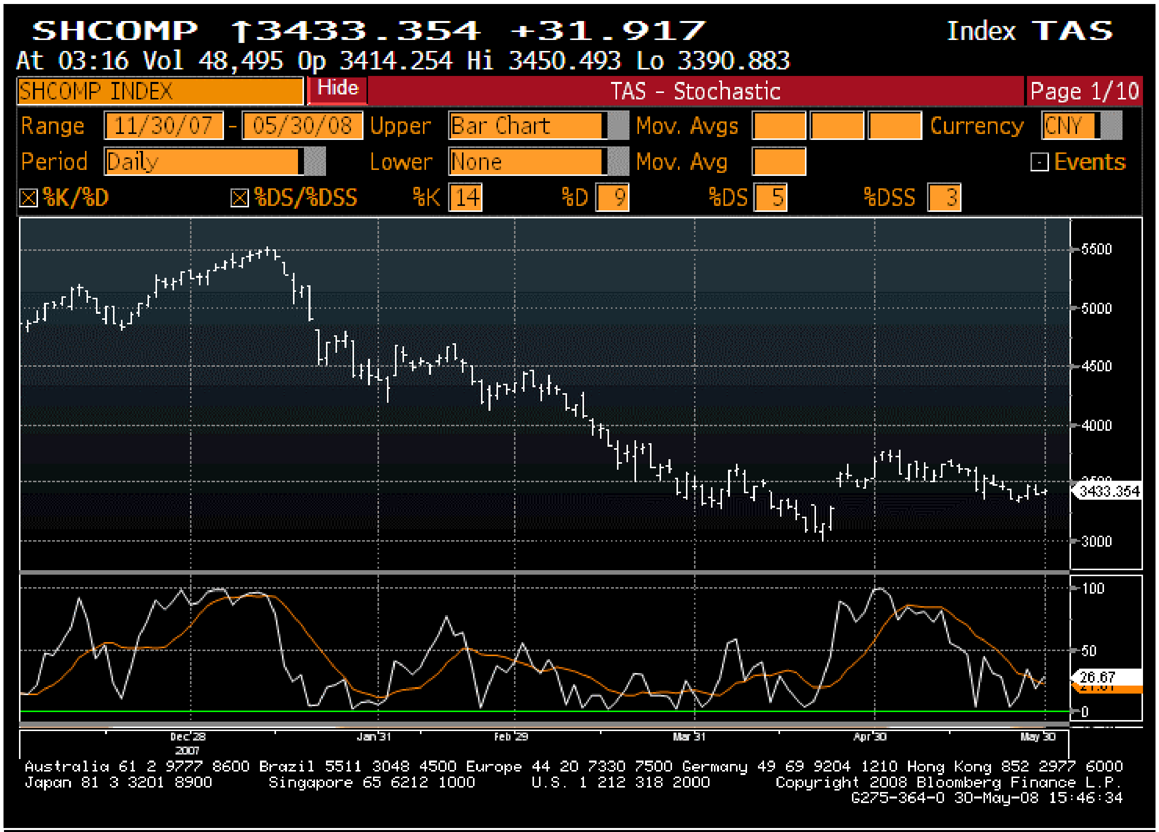
From the January 24 report:

"Because of the Nikkei's activity, high quality low valuation stocks have recently declined as much as 20% in just days or weeks. Not only have they fallen to ridiculous long-term (multi-year) neckline support levels but, aside from that and having more cash than debt in many cases, many have even fallen to price-earnings (PE's) level between 8 and 13!!! This includes companies at the BEGINNING of earnings cycles; and this is how stocks triple, as opposed to mere 80% mark-ups to more normalized valuations."

Strategy:

Long domestic value; leveraged out-performance plays of various themes and structures, involving all global indices, currencies and gold.

SHANGHAI



Summary & strategy

As with Japan in 1990, I have identified the peak and first bottom after a forecasted 50% decline.

To capitalize on the leverage of long term warrants, this time I structured a Japan-China out-performance play, which I forecasted would return 500%, and perhaps 1500% with proper adjustments, over the long life of the warrant.

After the warrant's valuation appreciation, having achieved return expectations as well as market targets, I recommended that adjustments be made. Since then, SKC has continued to be accurate in our markets of interest, including China.

NEW YORK

If the Dow makes a new short term low, I suspect that it will hold over 12,300, anyway.

The message, simply put, is that the market seems ready to accelerate upward within this countertrend period. The key message remains,

'that the Dow will trade between 12,000 – 13,500 for 6 months.' This is a period to bash premiums, and plan, including how to plan incorporating those forecasted lower premiums.

At this quarter's lows, I wrote of a whipsawing 6-month countertrend period, which is actually deteriorating foreign investor wealth. The Dollar decline may resume now, but a 1,000-point Dow rally may lie ahead, as well.

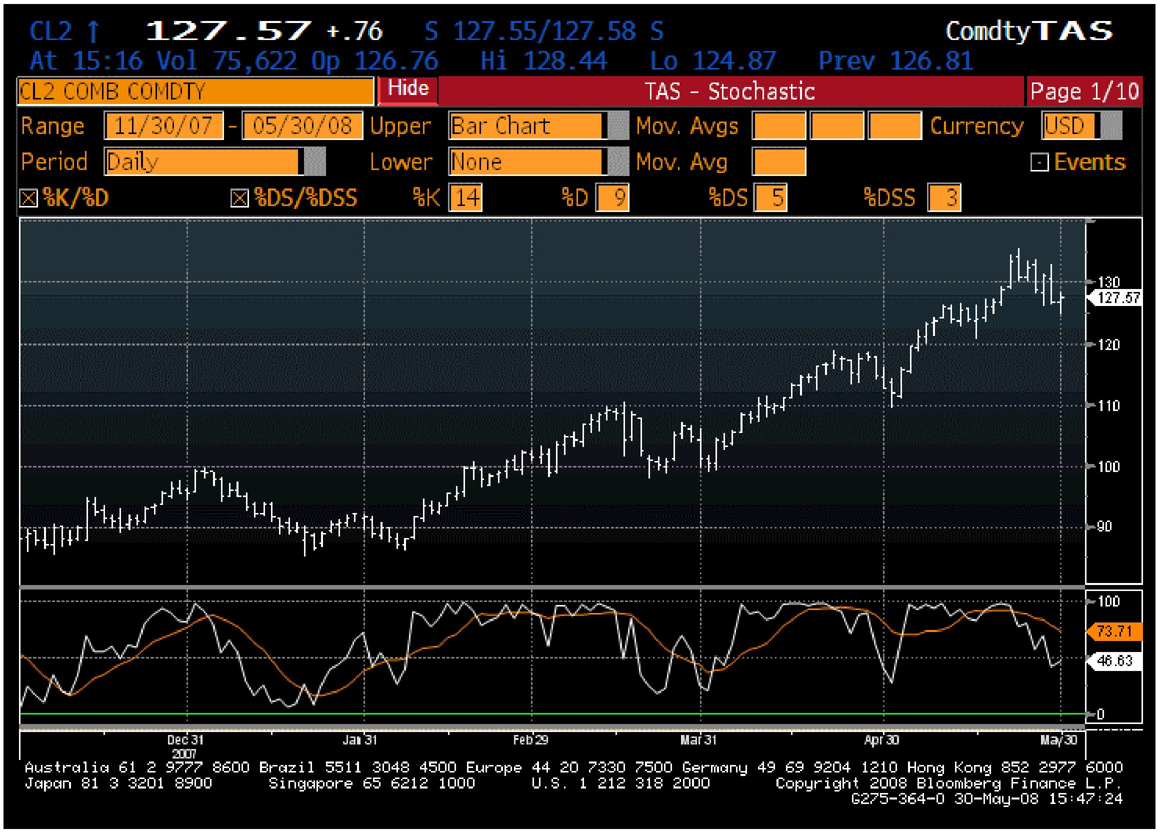
OIL

This is not an official SKC 'market of interest', but, well, everyone has to follow it now. Especially as summer travel begins. But, here's the rub: Higher oil prices will have meant an arrest of travel that will affect the 3rd-quarter numbers the most. This thing should be fully hitting the fan by September, consistent with prior letters.

As one can see below, oil has a steady up-trend with correcting indicators that allow for the advance's resumption at any time. Further, by the time divergences develop oil may be trading at $175. The economy will break down into depression at some point, but markets, now anyway, will advance.

With Greenspan's recent declarations about the economy before the flashing bulbs, can there be any doubt about it? I mean, really.

What can be better than the Greenspan indicator? He nailed the Shanghai, though it doubled first. (In such situations too, do these guys front-run, or can they really be that bad?)

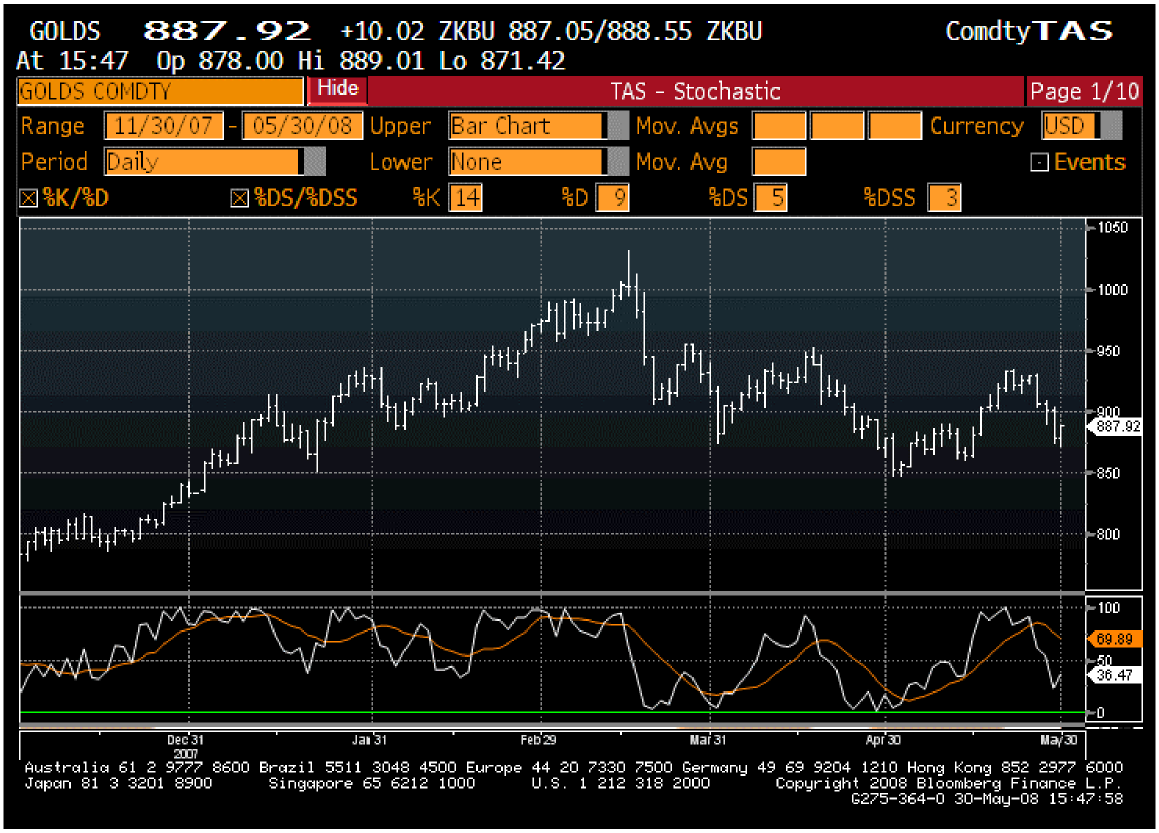


GOLD

Previous reports identified the initial low in this decline, which began only after having crossed $1,000 per ounce. I had forecast that that condition would exist so as to satisfy an exhaustion of the move, replete with public panic buying and specialist short covering.

Thereafter, I forecast $950, with a subsequent decline that would cost more time than price, though downside potential would be to $830, with $850 as a target.

As with the other charts in this report, outcomes and results suggest that no change in view is called for.



<u>YEN</u> (CURRENCIES)

The countertrend move in the Yen this quarter has been sharp, but only as a result of the extreme decline that it had suffered in so short a span of time. Still, the Yen is dramatically off this quarter's highs, obviously.

In any event, it's all but over, in terms of price, that is. It will take some time however before the Yen busts out to new highs. The Dollar/Yen chart below does point downward (in favour of the Yen) now, however.

A key theme in these reports this quarter has been the ongoing printing of US Dollars in exchange for goods and services. Printing by itself wouldn't do it, but since it is used to write off public debt as well, albeit indirectly (e.g. – credit card, mortgage related), the economy can be stimulated. Who's actually paying for it is not the discussion point here.

What we know and have already discussed is what can happen in such situations, such as Weimar and Argentina. The bottom line is one of concern with many and deep repercussions for the investment world. The critical period in which we live requires tailor made solutions,

because there are no reference points to those historical periods of crucial importance in any standard investment products.

Asset allocation and investment selection must be more precise than ever to maximize efficiency, reduce risk, and increase leverage as well, wherever possible.

Sid Klein