The Sid Klein Comment

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SHORT NOW!

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World Markets Interim Report

This month's regular report went out as an alert. Why? At the peak, my many years in the markets suggested to me that we had seen a double top in the Dow. For all the reasons that I had listed, it was a simple, observational, gut feeling. While I've written before that we're in crash mode, never was there such a bell ringing, as what the Bank of Japan had provided (discussed below).

The negatives listed last week are copied here:

- **World liquidity** being reversed, as a positive factor to a negative one (I can no longer write of the Argentina or Weimar effects).
- Higher rates, having hit markets around the world, caused a great deal of market capitalization and wealth to be destroyed.
- The **Japanese reversal to the selling of bonds**, from being a buyer of them, as a **multi-year trend of higher rates** gets underway at home.
- To exacerbate the above, new issues hit the market.

- The Dollar reversed.
- The tech stocks on the ropes, badly.
- Price earnings multiples ahead of future growth rates (in fact, the second half expected to slow).
- De-leveraging of hot money, as volatility increases (the cost of maintaining leveraged positions increases as volatility begins a new bull market).
- **As with Japan in 1999, the Fed Chairman was changed**.

I've bold-capped the key portions, given this week's startling news out of Japan (p. 3). Bernanke's jawboning is a mere trifle meant to throw you off the scent, by comparison. But there's something he said that was indeed crucial. No, I'm not referring to the part about possible higher rates to come. Please read the following from last week's letter, *very* carefully:

"To embellish, let's add that consumer confidence and consumer spending are reversing to plummet to levels dramatically lower than here, to such levels as what appeared at the end of the second quarter, correlating to a Dow of 7000 or lower…an area that has already been seen when priced in gold. The conditions that prevailed at the end of the second quarter (i.e. – these price levels for energy) have returned."

The key to Bernanke's commentary was (paraphrase):

"Consumer confidence has declined noticeably. This, in part, is due to energy price levels." This is huge! Consumer confidence and consumer spending go together, and the stock market's lag to these indicators is *very* brief! If that weren't enough, Bernanke cautioned that rates could rise anyway, as the key is fighting inflation.

Well, the above plays perfectly into the following excerpt from last week's June report:

"Finally, on another note, is the market worried about inflation, deflation, or both? Long bonds are pricing in a flight to quality (that'll have been a source of ironic regret), as well as slower growth.

"So, as Andrew Kramer of Kramer Capital Management in New York City has postulated, perhaps the market is expressing concern about stagflation and an analogy to the 1972-1974 period."

Poor Bernanke. Here's a man who everyone thought or hoped would print money forever, simply to buy US assets. But, then, reality hit home. He's not an academician anymore. He's the Fed. He has morphed from academician to bag-holder. Greenspan did the opposite of whatever he lectured. He appeared hawkish because he knew what to say, and the media played ball, no matter how much he printed when no one was looking, which, in the case of the media was always. Now, the media doesn't want to play ball with the new guy and he's going to take the hit for all the effects of Greenspan's deeds. Websites are already filled with Bernanke-bashing. Greenspan was a scumbag, and Bernanke should just quit and leave the legacy at the right doorstep.

Now, the major news that I referred to in the first paragraph above, which comes from Nikkei News' June 2, 2006 edition:

"Japan's monetary base plunged 15.3 percent in May from a year earlier, marking the biggest drop on record due to a sharp fall in the current account deposit balance at the Bank of Japan, the central bank said Friday.

"The 15.3 percent fall is the biggest since January 1971, when comparative data became available.

"The current-account deposits -- the sum of financial institutions' funds on hand that can be used freely -- plummeted 53.7 percent to 15,167.2 billion yen"

Make no mistake about it: They've rung the bell with three steep declines, with May's having been the worst. Don't miss this lifetime opportunity. The entire bullish case was the Fed printing of money, but Japan, which has greater monetary influence (believe it or not) has decided on the opposite. When did this become obvious to me?

May 19, 2006, shortly before 9:00 a.m. GMT. What happened then?

Daniel Mann and Dan Scott of CNBC World/Europe interviewed someone from the Finance Ministry, I thought, before realizing that they were evidently interviewing the Japanese Finance Minister himself. When asked about the effects to come on US bonds and other securities, he simply replied (paraphrase, though possibly a quote): **"That's the US' problem."**

So, today, there are shell-shocked bears who simply cannot believe that it's just this easy. After the collapse, it will have been all too obvious that the bears were now trained into thinking, "Oh, there's surely one more rally, to stop-out the *other* bears." When enough **bears** believe that, "There's one more rally", well, you've seen it.

CONCLUSION:

The massive sucking sound on world liquidity has many effects.

Gold and silver will correct in a largely sideways manner, before exploding toward $850, as forecast earlier this year.

The USD is bouncing on the Bernanke commentary, but the whole thing is ridiculously counterintuitive. With the Japanese holding the upper hand, regardless whether rates are raised or not, the USD will resume its secular bear market versus the Yen, imminently.

The Nikkei may have a sharp sell-off, but most of the damage has been done – certainly when compared to New York – and Japanese stocks themselves offer staggering potential now. Denominated in Yen, they offer an additional kicker. Further, our 50% position (25% of all wealth) in gold, soon to again be 100% (50% of all wealth), match perfectly together. This is SKC's asset mix. Gold and Yen-denominated domestic value stocks, provide the ideal mix, for both safety as well as leverage. What is safer than gold and what, besides Japanese domestic value stocks, have greater leverage? Gold alone will out-pace all major indices and maintain inflation-adjusted value…and then some!

Regarding the **US stock market**, this month's report wrote: **"The Dow is now in its countertrend rally phase, after its initial pullback of about 5.5%. After the dramatic run-up to the 20 area, just as violently, the VIX has almost collapsed back to 14."** This meant to short immediately. If you didn't do so, all that I can add is: Short now!

Sid Klein