

Forecasted 1st-Quarter Volatility & Extremes Concluding



March 19, 2008

JAPAN

A 600-point rally off of the lows this week was accompanied by the news that stocks were rallying because of a WEAKER Yen. Boy, the media is something when they can't explain a move. The Yen has made new 10-year highs, so what are they talking about?

The following 2 Nikkei charts are from the [March 2, 2008](#) report. The first chart below was to indicate that the Nikkei was about to break the up-trend line and, in so doing, would complete the sequence perfectly spelled out in Elliott wave terms on the 2nd reprinted chart below.

As you can see by the previous report, and as implied by simply looking at this 2nd chart below, a concluding low was forecast by early April, the time frame for an anticipated low in the Dow. Let it be noted, however, that over the past decades, [it has been customary for the Nikkei to make its low in the last 2 weeks of March, during those years when the Nikkei had been falling, as it has been over the past 2 years.](#)

As the 1st chart on page 3 shows, the Nikkei has come through precisely with the forecasted decline implied on page 2 (wave count).



Technical (Nikkei):



The 1st chart on the preceding page fulfills the prognosis made on March 2nd, which expressed that forecast via the chart at the bottom of page 2 (again, reprinted from March 2).

Smaller Japanese stocks are in a world all their own. While the Nikkei will require a great deal of long term base-building, a likely sharp rally notwithstanding, small stocks are concluding a 3-4-year bear market with a Yen reversal that is almost 9 months old and which has skyrocketed beyond anyone's beliefs.

Who believed that the US would "allow" the Yen to rally so, carry trade and all? Certainly not the crowd, and the same crowd do not see the directly-related-to-the-Yen domestic stocks soaring in a new bull market. Countless value stocks are not only trading with greater current assets than total liabilities, or even more cash than total debt, but many now are even trading on low price-earnings multiples!

However, there is a still more significant point, perhaps. We are seeing assets (stocks, gold, whatever) collapse due to a need to raise cash. Well, while foreigners own Nikkei stocks in droves (they accounted for 25% of trading at the peak), **they DON'T own Japanese domestic stocks**. This was a key point for me when I identified their low in 2001.



You can see from the Topix small stock index immediately above that that index has been following the Nikkei to a great extent. But a look at the 10-year chart immediately below illustrates something very different. [The index is sitting on a massive 10-year neckline](#) (see chart below) and, while countless stocks are [trading at half book value and with PE's under 10](#) (believe it or not), this surely impenetrable support level will almost certainly yield to a rally to the 1400 area, en route to dramatically higher levels thereafter.

That 40% rally in the index implies rallies of **100%** for many stocks. Be certain of it. And I don't mean hold-your-breath-long-term. I mean it's taking shape now, while everyone is panicking!



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:

"Any strategy that uses Japan as the basis for out-performance – regardless the market – is a winner, both for hedging and pure profit purposes. That has been the case to-date, particularly for well-engineered strategies, and the future will accentuate this reality."

I have written that I would not discuss China further, but a 50% decline, or so, is being completed for early April, my forecasted time frame since the 4thquarter, for the completion of an initial global smash.

Structured out-performance warrants have performed superbly, as much due to the engineering as timing. I decided to no longer give away my investment banking work, but I will offer this clue: I have written (December and January reports) that the ratios in which indices are combined determine whether a structured product is more defensive or riskier, whether its onus is on the collapse of one market, or the strength of the other. During a period of anticipated major rally, as opposed to trading one's position, one can "modify" the ratios, by purchasing another warrant, which is long-only one side of the out-performance warrant, thereby adjusting the ratios to what the present market demands.

The out-performance warrants benefit from uncertain markets and fear. They are designed to be defensive. It is a matter of investment banking and premium and market forecasting expertise to capitalize on the concept's benefits.

NEW YORK

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.)



The Dow has done everything forecasted in these pages over the past 6 months, including a 1st-quarter hit and a low in early April. I had allowed for a still bigger collapse, but it seems that with panic setting in among retailer investors, the forecasted Dow 11,200 area will have held. Therefore, be on guard in all markets, including the Dow, for a reversal in the short-to-intermediate term, from the recent trends.

Therefore, to adjust positions, carefully read this timely reprint from the February 4 letter, with which we conclude this Dow report:

“Strategy:

Suppose you want to cut your risk in half and double your leverage too, and further suppose that you don’t mind profiting only little from a bigger collapse that occurs sooner, as you prefer to err on the side of caution, risk aversion and capital preservation, then an April – March Dow put spread is appropriate. It’s a matter of choosing the correct strike price...and the leverage is huge!”

As I subsequently confirmed, the idea was to purchase April 12,200 puts, while shorting the 12,100 puts. Since they trade as 1/100 options, this was an April/March 122/121 time-and-price put spread.

While risk averse, so as to allow for bigger positions for speculators, the strategy contained significant leverage, if the short side were to expire. (I simultaneously advised an April/March 121/120 time-and-price put spread, for those inclined to take a position 100 points lower, to focus on avoiding a March force-out from the position.)

At tomorrow’s close, the European-style puts (the latter are necessary when and for spreading) expire. Therefore, let us review:

Each of the above spreads were under **\$1.00** at purchase. Today, each spread closed just over **\$3.50**, aided and abetted by the lofty levels of the VIX (volatility).

If the Dow closes under **12,100 tomorrow**, you must sell enough of the April 122 puts to cover the debit created by the repurchase, which, effectively, is the in-the-money amount the clearing corporation and your brokerage firm will debit you on the short **March 121 put**. The number of puts that you will have had to sell will have been minimal and, so, with a drop under 11,500 – to offer an idea – the return

potential on what was a low risk option strategy in the context of short trading, is in the neighbourhood of 1,000%.

Similarly, if the Dow closes under 12,000 tomorrow, sell enough of your April 121 puts to cover the in-the-money amount on the short March 120 puts. Then hold the remainder of the April puts, to see whether we walk away with substantial gains, as presently is the case, or windfall gains.

GOLD

From the November 4, 2007 report:

“At the beginning of the year, I forecast that gold would cross and sail past \$700, perhaps this year, en route to \$1000 with speed. The upside risk is too much to exit without a re-entry plan, and no quality re-entry plan can possibly exist this time...”

“...this move up in the metals may simply have been an initial move that merely requires a short term correction, before a yearend eruption to \$1000.”

See page 11 for continued commentary.





The gold chart on page 9 shows the hard spike down today of over \$43. One cause is the hedge funds' need to raise cash. Another reason is the \$1000 target having been surpassed, and the leverage used to purchase the metal is now being wrung out of the system, as gold has completed its pattern. This plain to any experienced technician and Elliottician on page 10. That chart is a weekly graph and therefore does not reflect today's move. It's included here to reflect the extended pattern from which it got understandably nailed. Falling in one day, AS ALWAYS, panics and chases out and away weak holders who aren't in the right long term strategies. Same old, same old.

Another reason for the collapse may be that the Dollar, which has been taken out back and shot by the Yen, may enjoy a similar short covering and short-lived spike up (thanks, Bill), aided by the same hedge funds.

YEN (CURRENCIES)

From the January 24 report:

"In any event, bear this in mind as well: I was bullish the Yen at 117. It went to 123-124. I was told the carry trade

would never be unwound because the US authorities were in control."

Off the bottom, the Yen's bull is already almost 9 month's old, and it has given birth to a 20% return thus far, and destined to grow higher still. This is the reversal of fortune in store for the low risk domestic Japanese value stocks, and those out-performance strategies that focus on the latter as its denominator.

The 2nd chart on page 12 illustrates the new 5-year high in the Yen, as it crossed par. I haven't included the 10-year chart (next issue).

New high there too! No one believed SKC's view at 118, especially after continuing to be wrong (to 124), but would anyone so quickly argue now that the Yen is heading to 80, and then 60? Welcome to the forecasted new age.

Again, it's the best fiat currency for capital gains, in the world. After being drubbed by the Swiss Franc for so long, and with the famous US carry trade in the news on a daily basis, wasn't it all really obvious?

For someone who sees past today, perhaps?





Only hold things Japanese, and those bent on ties to Asian performance. Use same as the basis for out-performance.

Your welcome,

Sid Klein

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