

Nikkei Smash? IMPEACHMENT



May 06, 2007

JAPAN

Nikkei:

Looking at the 1-year chart of the Nikkei (immediately below), for those technicians who connect the lows of a year and of 6 months ago, the index appears to be approaching trend-line support, at the same time as it is approaching the 200-day moving average (a gauge of the completion of intermediate term profit-taking). Meanwhile, the stochastic (see bottom of chart) and other momentum indicators are over-sold and pointing upward.

If a near-term rally were to fail, however, the dominance of importance turns to longer-term indicators, namely, weekly indicators. Therefore, please note the chart that immediately follows the daily Nikkei chart on page 2 (this comment continues on page 3).

NKY 17394.92Y as of close 5/ 2

P233 Index TAS



NKY 17394.92Y as of close 5/ 2

P233 Index TAS



The 200-week moving average (bottom of page 2) is just under 14000, which is where long-term index players will have completed profit taking. And, in the case of that indicator, the stochastic is pointing downward.

Fundamentally, the long-term is sound, except that businesses refuse to adjust expectations upward, as foreigners had hoped and even expected, based on better-than-expected results this past fiscal year.

I reiterate, and please take special note: Investors rarely if ever grasp that a move to new highs could possibly be part of a correction, as I have been claiming. The significance is multi-fold. It causes investors to misunderstand the strength of the market, as regards how to allocate investment dollars in the present.

There is another major boo-boo that the mislabeling causes: When the correction ends, no one believes it. This is because the index will have declined from a slight new high, the 18000-area, in this case. Observing only a single decline down, investors wait for another shoe to drop and then wait...for nothing.

The first "shoe" was around 18000. Again, I believe the recent move upward to have been "corrective", not "primary"! Another analytic observation of critical importance is that the next move should be compressed in time, in relative terms. Why? Because a 3rd leg is the last and if the 2nd leg actually went back to the highs, as it did here, then the 3rd and final leg (corrections are 3-legged, as opposed to primary moves, which contain 5 moves, or "waves") is sharp or, as I write above, compressed in time.

Nikkei/Dow Ratio:

Inter-market relationships often show more clearly the points of entry or exit that an investor should be guided by. The obvious purpose for money managers is to better understand how to allocate funds earmarked for international investment.

The 2-year daily and 7-year weekly charts, respectively, on page 4 suggest the following: Looked at separately and together, we see very clearly and objectively that trend-line, neckline, percent retracement levels, **ALL** indicate almost impenetrable support for this inter-index relationship at 1.2.

I am not saying that the Nikkei will or has to fall to a level that is 1.2 times (or so) the Dow Jones, but if it did fall to that area, the Nikkei would become a screaming buy, if the Dow were near its own support. It certainly would mean switching indices, if one has not already done so anyway!

<HELP> for explanation.

P233 Index G



<HELP> for explanation.

P233 Index G



The following 1-year chart of the JASDAQ reflects recent new lows that underscore the increased risk assumed by investing in Japan via that index. Longer-term, yes, it's cheap and will do very well for today's buyers, but these stocks, generally speaking, will not be the immediate beneficiaries of investment in Japanese domestic stocks, including domestic value equities.

More disconcerting, however, is the pursuant 7-year chart (page 6) of the JASDAQ's ratio (relationship) to the Nikkei. Yes, we see neckline support, but the breakdown went farther than it should have.

By connecting the lows of 2001 and 2002 seen on page 6, a trend-line breakdown is evident. The 3-year bear market in the small-caps versus the Nikkei has been unrelenting. It is ending but, again, international money will continue to be drawn to the mid-caps. This stance is inalterable.





Domestic Value Stocks:

On pages 7 and 8 we review the Topix 500 and its ratio (relationship) to the Nikkei.

The 1-year daily chart immediately below reflects the recent low and how it held above last year's bottom, unlike the JASDAQ. The chart has formed a reverse-shoulder-head-shoulder bottom and has turned up, along with the momentum indicators, such as the stochastic, which appears at the bottom.

The pursuant 7-year chart is extremely bullish! Note how it has moved, and is moving, sideways into the 200-week moving average. As well, in this index's case, the momentum indicators are turning up, whether we're looking at 1-year daily or 7-year weekly charts and indicators. So, not only are long-term profit-takers virtually out of the way, this pattern is typical of one that takes off, relatively soon.

Finally, when connecting the lows at the end of 2002 and 2003, we see that the index is right at its trend-channel support, as well.

Making obvious where to best invest in Japan, now look at the Topix 500's ratio chart (relationship) on page 8. (Commentary continued on page 8.)

TSE2 4081.75Y as of close 5/ 2

P233 Index TAS

TSE2 INDEX TAS - Stochastic Page 1/19

Range: 05/02/06 - 05/02/07 Upper: Bar Chart Mov. Avgs: 200 Currency: JPY

Period: Daily Lower: None Mov. Avg:

%K/D %DS/%DSS %K 14 %D 9 %DS 5 %DSS 3



03/15/22	01/08/15/22	03/10/13/25/01/03/15/22	01/03/15/22	02/10/17/24/01/08/15/22	01/08/15/22	01/08/15/22	04/11/13/25/01/08/15/22	01/08/15/22	02/09/16/23/01		
2006 May	2006 Jun	2006 Jul	2006 Aug	2006 Sep	2006 Oct	2006 Nov	2006 Dec	2007 Jan	2007 Feb	2007 Mar	2007 Apr

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 920410
 Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2007 Bloomberg L.P.
 6275-364-0 03-May-07 13:08:47

TSE2 4081.75Y as of close 5/ 2

P233 Index TAS

TSE2 INDEX TAS - Stochastic Page 1/29

Range: 05/05/00 - 04/27/07 Upper: Bar Chart Mov. Avgs: 200 Currency: JPY

Period: Weekly Lower: None Mov. Avg:

%K/D %DS/%DSS %K 14 %D 9 %DS 5 %DSS 3



2000	2001	2002	2003	2004	2005	2006	2007
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Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 920410
 Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2007 Bloomberg L.P.
 6275-364-0 03-May-07 13:09:33

Clearly, unlike the JASDAQ's ratio (relationship) to the Nikkei, the chart is well ABOVE the trend-line support, when connecting the lows of early 2001 and 2002. In every sense, the mid-caps are the healthiest and the ripest for tactical asset re-allocation, for global investors.



The out-performance of mid-cap Japanese domestic stocks versus other classes and international indices will continue and geometrically expand.

Conclusion:

Japanese domestic value stocks are cheap, have favourable and well-timed patterns, while their relationship to the Nikkei suggests that they will benefit most from capital invested in Japan, as money managers seek value internationally. The international tactical shifts by hedge fund managers and others will be dissuaded by the Nikkei's closer relationship to the Dow, while not being enthused by the small-caps' relative performance to the Nikkei. These same managers will aim at equities that they believe might perform sooner rather than later, as might be the case with the small caps.

Strategy:

Buy mid-cap Japanese domestic value stocks.

NEW YORK

Dow Jones:

To the point: For nearly a year, I have espoused the belief that Nostradamus' anti-Christ will be impeached and that the violent Dow debacle will be blamed on global investors pulling out, due to "political instability." Of course, the sale of Dollars that has already begun shows the true attitude of international forces.

Moreover, as was the case in 2001 (please see first online report in the Past Reports folder, when the guy in the news was Osama Bin Laden – remember him?), the decline will actually be due to the economy, so an initial major support will only be betrayed thereafter.

Recently, when I correctly forecast a very swift decline to 12000, which did occur, I followed that comment up with a market call that that level would hold. I then advised re-entry on a bounce to 12460, using 2-months puts, since the decline in the Dow would accelerate, if the interpretation was correct.

Meanwhile, if incorrect, the incremental decline in value of very long-term puts would be greater than the amount risked in the 2-month puts. And so, the Dow crossed 12600, which negated the bearish view in the near-term. By that point, short-term puts were not worth selling, given the global risks.

Page 10 shows 7-year weekly and 1-year daily Dow charts, respectively. Based on critical trend-lines and momentum indicators, a few things become evident:

Firstly, the market is overdone and ripe for a correction. On the other hand, momentum indicators (stochastic indicators) don't collapse from overbought readings (where the stochastic is presently); they more commonly develop divergences.

Secondly, this jives with the fact that while the heart of this move is complete, it is not entirely finished. Backing-and-filling between 13000 and 13450 would complete the pattern AND create the referenced divergences.

Thereafter, the Dow should initially hold 12000, en route to much lower numbers. And, yes, 11000 will also provide some support. Remember, however, that will also have been an almost 1500 point decline. The number of sizeable swings that will be enjoyed by traders, who know how to time premium (see VIX charts on page 11), will merely have increased.





The 7-year chart of the Volatility Index (VIX) (1st chart on page 11 above) clearly shows that support at 10 has been impenetrable. It also shows a bullish bowling pattern.

The 1-year daily chart that follows it shows (immediately above, just as clearly, a breakout from a down-trending pennant; this is very bullish. Both charts suggest support at 12. When weekly and daily indicators suggest the same conclusion, that conclusion tends to be reliable.

The upshot is that this indicator, the VIX, which LEADS the index, is in perfect harmony with the conclusions and interpretations drawn of the Dow, provided above. We see how violently the VIX spiked to 20. When the VIX doubles, coupled with the stock index decline, put profits are astounding.

I've been there. I've seen all the major and hairy debacles around the globe over the past quarter century. The combination is wild.

Conclusion:

The Dow is at a short-term peak but requires a decline (to 13000, or so) and another advance (13460, or so) to complete the topping pattern, while creating some customary divergences among the momentum indicators. Thereafter, "political instability" will be blamed for an ugly bear market to below 9000 in 2008, with hope-inspiring support levels every 1000 points.

Strategy:

Near-term traders can now play a swift decline to 13000 using small amounts and short-term instruments only - but be swift. This topping process should take us into mid-summer. Be vigilant because the implication is that we're not far off at all from the top of all tops. Once the topping process is complete, we'll revert to the use of long-term puts, with the view to selling ("writing") nearer-term options at the deemed support levels on the way down. Remember, the idea is to buy the lowest ANNUALIZED premiums, while selling the highest ANNUALIZED premiums.

CANADA:

Toronto & the Royal Bank of Canada

John Melikoff has not only been consistently excellent over the past year in New York, he has provided rare and insightful analysis on esoteric topics, or esoteric approaches to looking at things. Since my investors and readers are of such ilk, I thought to provide an excerpt from a section dedicated to the

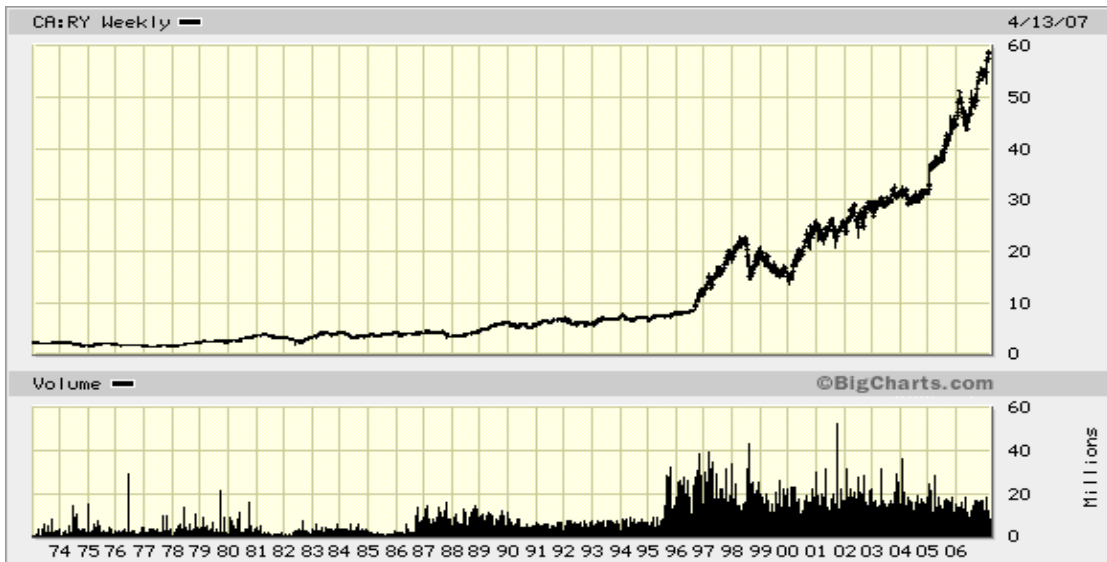
Royal Bank's turn of fate and its effect on the Toronto index, which is, ultimately, unsustainably higher than the Dow Jones 30.

This portion of his April letter updates a similar report that he had previously written. Read carefully (everything in this CANADA section beyond this point is from John's letter, in red):

So what is moving the Canadian market that is now trading at 13,509 or some 900 points above the Dow Jones Industrials (a record large differential). The good old Royal Bank, which is now by far the largest market capitalization in Toronto. In fact this historically most conservative stock in Canada is looking as if it is making the whole country wealthy. Unfortunately we have serious doubts about the fundamentals that are driving the Royal Bank.

**Royal Bank: Not an Internet Stock Just one that makes money buying and selling stocks!
We thought this stock was overpriced at \$50. We were wrong!**

Note How Dull the Royal was Until it Focused on Money Management



Portfolio Watch

We think the Harper government had little choice but to put a stop to the Income Trust boom before every successful operating company in Canada became a Trust instead of public stock. The Trust movement is

effectively anti-growth and the Conservative government was correct to be concerned. Trusts and Socialism are pretty much based on the same principle: distribute income

and don't worry how the income got created or how it can grow.

We are not blaming Canadians for their fascination with Income Trusts. The stock market had crashed in 2001 in Canada led by Nortel. Interest rates then plummeted. So Income Trusts were logical. But like any fad things can go too far.

We think this fad is actually going to cause further problems for Canada. Canadians have been transferring savings into these instruments and indirectly into bank stocks. The Royal Bank, for example, just reported a 38% Q4 income gain. Terrific results? What disturbs us is how they are generating the profits. In March the Royal announced that RBC Asset Management now managed \$75 billion in Canada and that a full 10% was in privately managed accounts. That means 90% is RBC Mutual Funds so the Fund family, which this quarter won the Lipper Award for being the best mutual fund family in Canada, must now have in excess of \$60 billion. Why are we worried?

We wrote about this last year when Royal was at \$50. It is now at \$58 as they continue to report superior earnings. We repeat our warning that we made last year, Royal Bank's profits are a result of a disguised chain letter. The bank continues to divert Canadian savings into their own stock.

How is this possible? Well, it is in fact happening. Last year we gave no specific example, this year we will. For example let's look at the RBC Canadian Dividend fund, managed, of course, by RBC Asset Management, and with \$8.66 billion in assets. Although it is technically a dividend fund, the dividend is only 8 cents per quarter, although they did distribute another 70 cents of capital gain for a total distribution of \$1.02, so the total realized return was 2.2%. And finally the fund appreciated from \$44.5 to \$49. So the RBC Dividend fund provided its owners a 10% capital gain in the last 12 months. We note that the Royal Bank dividend is 2.7% and the stock appreciated 21% in the last 12 months. It could be because the management expense ratio (MER) was 1.7% for a dividend fund that paid 0.7% in actual dividends.

And guess what? The largest position of the RBC Canadian Dividend fund is Royal Bank at 7.78% or \$670 million (about 1% of Royal's capitalization) of the \$8.6 billion in fund assets. Next is TD at 7.6% and then CIBC at 5.9% and Bank of Nova Scotia at 5.25%. ManuLife at 4.55% is stuck in before the BMO at a measly 3.89%.

Is this just a modern version of an old-fashioned chain letter? Your guess is as good as ours.

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PRECIOUS METALS & DOLLAR

Bonus – Oil:



Oil is at trend-line and moving average support. At the lows, I felt that this rally would be the last, with a double-top at \$80 being the maximum anticipated. The struggle to move higher is consistent with the notion that we're looking at a final rally. Of course, this already could be countertrend and, if so, a "stop" at \$62 might not be a bad idea, to lock in profits.

The 70's and today: A massive oil rally, wild asset speculation and the impeachment of a not-nice person; the 70's stock debacle was the worst since the depression. This one will lay that one to waste. Count on it. Protect against it. Better still, profit from it.

The average guy becomes rich.

The rich guy becomes a multi-millionaire.

The very wealthy become dynasties.

Gold:

The following 1-year daily chart reflects neckline and moving average support at \$650. In deference to a massive secular bull market and the view that a correction could occur to as low as \$600, the stance in these pages has been to reduce to 50% long, if one wished.

This move above the February peak might be another example of a move to highs that is actually countertrend. The upshot is that, here too, a decline could be sharp (compressed in time), thus fooling investors into believing that there is more downside to come than what there will be.

As others jumped on my gold interpretation, as has been the case with other markets, I began to suspect that the correction might take on a sideways look. This is evident on page 17. Also evident there is why I became concerned about a correction (also continued on page 17):



The 200-week moving average is all the way down at \$500 and, so, the move to \$1000 will be a lot healthier and easier with long-term profit-takers out of the way (with a convergence with the 200-day moving average). This would probably turn the stochastic (below) back up.

Why is gold moving sideways on a net basis, since \$600 and since I turned intermediate-term “concerned?” As I have explained so often, long-term buyers and smart money (private banks, etc.) require “corrective” periods, so that weak holders sell to them. The “tree shakes loose” the folks not destined to participate.

They won’t even be smart enough to chase it. So...



Golden Star:

I have recommended holding a very leveraged gold play, to compensate for any reduction in the precious metals portfolio. We have NO precious metals equities apart from Golden Star, which I view as a “value/growth play.”

Therefore, its role is to compensate, safely and with leverage, too. By consistently buying through a bottoming process, and as the stock has broken out over \$4.00, we have been well rewarded, with expectations

of much higher prices yet. The triple-bottom and reverse-shoulder-head-shoulder since 2005 combine with a bowling formation that suggests a head of steam being built up that, as the 10-year weekly chart (2nd chart below) indicates, could be explosive. Again, as so often warned, this stock rallies against other gold plays; it feeds off of others selling mistakes.

Long-term buyers and holders welcome gold and gold equity weakness, as an opportunity to take advantage of the supply created, without which they could not establish the required positions.



“The balance sheet reads like a Japanese value stock, particularly if viewed as a gold company. Technically, there are long term resistant levels at \$10 and \$25. I maintain that both will be seen.” There’s your upside!

These reports on Golden Star saw the breakout as a matter of course, as I put it, given the base that had been built. Then, when it broke over **\$4.00**, it was plain that the “neckline” over which it had broken would now, and quite typically, be support; a neckline for a stock serves as a springboard, as part of an accelerating pattern. Please see December 3, 2006 and February 17, 2007 letters.



The Japanese Yen is bottoming. Yeah, I know, this is getting to be a bore.

The Yen is at major resistance (see 1-year daily chart on page 19, immediately below) at the same time and it is worth noting that the Finance Minister (or Deputy Minister, I cannot recall) made a point of noting that it is untrue that the carry-trade is expanding. He cited futures exchange's reports and other relevant data.

But, since when are the Japanese boring? When anything Japanese is boring, you can be certain that that will be made up for in spades. That's been true through the years in all classes of investment. It doesn't matter whether the study is of the currency, bonds, stocks or different equity classes.

The Yen bottomed 4 months ago (see daily chart immediately below) and the stochastic, like other momentum indicators, is now pointing down (Yen-bullish).

It is worthwhile reminding that domestic stocks tend to take off a few months after the Yen's low.

Everything in this report that pertains to anything Japanese is entirely consistent with a low in the Yen and, above all, a take-off in the Japanese mid-cap value stocks.

The 7-year weekly chart of the Japanese Yen immediately below shows a crucial divergence in the weekly stochastic (as with other momentum indicators not shown here), as the Yen made a clear new high above 2006, while the stochastic failed to get up to the previous year's high.

This is very bearish for the currency, which is in a flat-top-pennant formation, the upshot of which is the high probability that the rally in the Yen is likely to be as violent as it will be big.

Everyone will be caught off guard and, yes, the media will come out of the woodwork to make the carry-trade the news *du jour*.



Strategy & Asset Allocation:

The song remains the same, so we stay the course and simply re-print....

“For our purposes, we’ll assume 50% long gold and silver positions, while aggressively long Golden Star. While gold and silver represent 50% of our portfolio (in terms of currency denomination), the Japanese Yen and the Swiss Franc represent the other 50%, 25% each. These figures assume no partial positions, which is presently and temporarily the case with the precious metals.”

Special note:

Not to be full of myself, but despite what follows below, based on the several esoteric and even not-so-esoteric market calls and indicators used in their interpretations, it appears that my work is still making the global rounds.

I don’t do this for my health and stealing property is precisely what someone is doing by forwarding another’s work. Such a person is not “exchanging information” or “doing a favour.”

That is something one has to do with one’s own property.

Good fortune to all,

Sid Klein

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