

First Leg Up Ending Now



May 4, 2008

In Sum:

The following is from the [April 5, 2008](#) report. It belongs in this section this month precisely due to what has occurred since, all serving as the basis of today's analysis of what lies ahead:

"To follow-up on previous reports, the first quarter's trends in all markets are coming to an end, with perhaps one more move in the dominant direction, whether it makes a new low or high, as the case may be. Such a move may or may not fail. Failing, in the cases of the Dow and Nikkei would mean that the bottoms have already been seen. These New Year's extremes in ALL markets won't be surpassed for 3 to 6 months, in my view."

".....Specifically, as an example, ANY effect resultant from the massive printing the US Fed performed. This includes the printing away of obligations that belong either to the US public or government."

Markets did indeed revert back to the primary direction, while failing to make to new extremes, and confirming that the lows (highs) have indeed been seen for 3 – 6 months. This represents a glorious opportunity to plan for what will be even greater money making

opportunities, as global trends accelerate after this period's countertrend cycle.

The following reprint from the [April 15](#) interim report was immediately followed by an acceleration of global trends. This confirmed that the quarter's extremes had indeed been seen and, with it, the conclusions of the initial moves for this cycle, whether in global equities, the Yen or precious metals.

"The 1-year chart immediately below suggests to me that the low may have already been made, while the 31-day chart (2nd on next page) reflects a common pattern for a final small decline. Either way, be prepared to exit any remaining bearish strategies now."

This month, highlighted comments are in [blue](#), while reprints are in [red](#).

JAPAN

Global Trends:

From the [April 5, 2008](#) report:

"Further evidentiary support of that comes from the Nikkei's glaring relationship to the Yen. Unlike domestic stocks, the big-cap fundamentals find a weak Yen more endearing. The Dollar/Yen and Nikkei charts clearly have a great deal in common..."

Firstly, the Yen's countertrend pullback is why the Nikkei is doing particularly well for now. Soon, the focus will turn toward the major and long-term trends and non-big-caps will under-perform badly.

In part, this will also be due to the then-pending conclusion in the rallies in the banks around the world, and particularly in the US.

So, I reiterate for yet another month, that the activity in the Yen is still the prime determinant of what happens in all markets, directly or indirectly.

For this reason, this month, this section is found largely in the [YEN](#) segment at the end of this report. Comparisons and related Japan commentary appear there.

Economy:

As the Nikkei recently approached 14,000 on the way down, indicators and news were more regularly appearing in favour of the economy. The global mood was preoccupied, however. (That is yet again a reason why cross-charts reflect more truthful looks at the market and what to expect, [particularly during times of upheaval.](#))

Snippets of economic news include:

On [March 26, 2008](#), Nikkei News reported that 75% of employers surveyed have brought part-time workers to full-time status. The number jumps to 90% when accounting for employer intentions.

The survey was taken just before legislation to have part-time workers enjoy the same benefits as full-time employees.

The importance here is that consumer confidence and spending will be influenced positively, and we know that the stock market almost immediately follows confidence and spending. (This has been a principal theme for me regarding New York for some time.

The effects will be small at first but markets discount, and do so increasingly as market trends age. That is the cause of exponential portfolio gains through a bull market (and losses during a bear market).

It is also important because it continues to show the Japanese government's willingness to continue to use legislation to influence markets in the direction that suits their designs. [These days, the desire is for higher Japanese stock prices](#), including levels at which the government may favourably and in a positive environment divest itself of those holdings acquired as a result of the 2003 bank bailout.

I wrote in early 2003 that 20,000 would be seen before the government would have sold all or part of the stocks, over which they took ownership at the market bottom that their own legislation helped create! [These guys are good](#) and that's why I have written so often of the need to track the government's interests.

They do not consider it corrupt, since it serves national coffers' interests. So, perhaps they call their insider trading and manipulation, "social planning." (I'm not kidding.)

As written in these pages so often, only the US Fed is at the level of the Japanese as far as guileless government manipulation and insider

trading is concerned. In fact, no one there would deny it. In Tokyo, they'd sooner laugh about it.

In any event, we've recently seen a similar period, albeit on a much smaller scale. Sundry legislation passed over these past months that had negative effects on stock prices. The government seemed prepared to offer stock into the market at a time of negative legislation, borne of a desire to deflate leverage, including foreign over-speculation and over-ownership. The tree has shaken the foreigner loose, to a great extent. [These guys are good](#).

In any event, since not all legislation is of similar consequence, the main bit of knowledge to glean from this is that examples or even a preponderance of legislation that affects the market in the same direction should be taken as a clue as to where the government wants it to go. And that - in the Japanese world - is the equivalent of, "*Don't fight the Fed.*"

Finally, the fact that there is such abundant consumer spending potential (due to 2003 legislation, previously discussed), as evidenced by the government's capacity to push on and off buttons in the stock market, implies that the economy has the steam and staying power that is consistent with a secular bull market.

Meanwhile, the Japanese sit loftily as the New Power's* financial services provider. It came to be the Americans. Now, the Japanese. Tomorrow, the Chinese (but that's not for a long while). (*From now on, the *New Power* is simply synonymous with *Asia*; I don't go for acronyms.)

On [March 19, 2008](#), Nikkei News reported that the quick and minor break of 12,000 was due to credit fears in the US. This was implied by the report that stocks had reversed 3% on "eased fears."

As I've written in the past, if 14,000 were to be broken, the next level would be 12,000, but that it would not last long. I explained that I had to write of the mathematical probabilities, due to the Nikkei's very long-term history of overshooting, briefly, and with subsequent strong rebounds to start the new bull cycle.

In fact, such lows have often manifested as v-shaped reversals, particularly when viewing the price activity on a longer-term basis. These were factors to consider in weighing probabilities regarding

what to do next, and that provided some clarity of vision during January's global loss of perspective.

Regarding the Nikkei, I identified the low in 2006 and subsequently forecast the rally, the peak of which I identified 500 points early in 2007. Allowing for an overshoot*, I forecast and identified the low in 2008 (*see chart on page 6; YEN section).

Regarding the overshoot, it is noteworthy for hedge funds on the prowl that those entering the Japanese market are considering global performances, year-to-date. These latecomers are seeing Japan as the winner, and hedge funds move meaningfully...when they finally awaken.

Therefore, please see the YEN section at the bottom for a truer look at the Nikkei, from a Dollar-based investor's viewpoint. That section contains much of what ordinarily appears in this section.

Meanwhile, the chart on [page 6](#) provides a look at the Nikkei that includes the period since 2006, of course. It also makes supports the view that "things Japanese" are the most price-leveraged and safest equity class in the world, currency included. If the investments are favourably-affected by a weak Yen, then so much the better. Meanwhile, a strong long-term Yen bolsters portfolio gains.

Strategy:

Also from the [April 5, 2008](#) report:

"The secular trend is quite obviously up for the Yen, so non-big-cap Japanese equities are the prescription. Foreigners don't own them to sell and, when buying gets going, these deeply under-owned stocks will be ripe for the savings of the Japanese investor, who hasn't even begun to buy. This is so despite being well past the point of having any interest in foreign currency assets."

"High valuation (and even low PE) domestic equities will rally 100% - 200% over the next 2 years, led by those stocks that have recently been the first to reverse with 50% moves."

The above is starting to be borne out by sizeable movements off the bottom for many stocks. While others remain largely unmoved, the prognosis is that those that haven't yet moved meaningfully will do so and perhaps explosively, when they take their respective turns benefiting from rotation. This is typical.

In any event, I believe that the initial moves up in the equity markets are ending but after pullbacks, the rallies will resume.



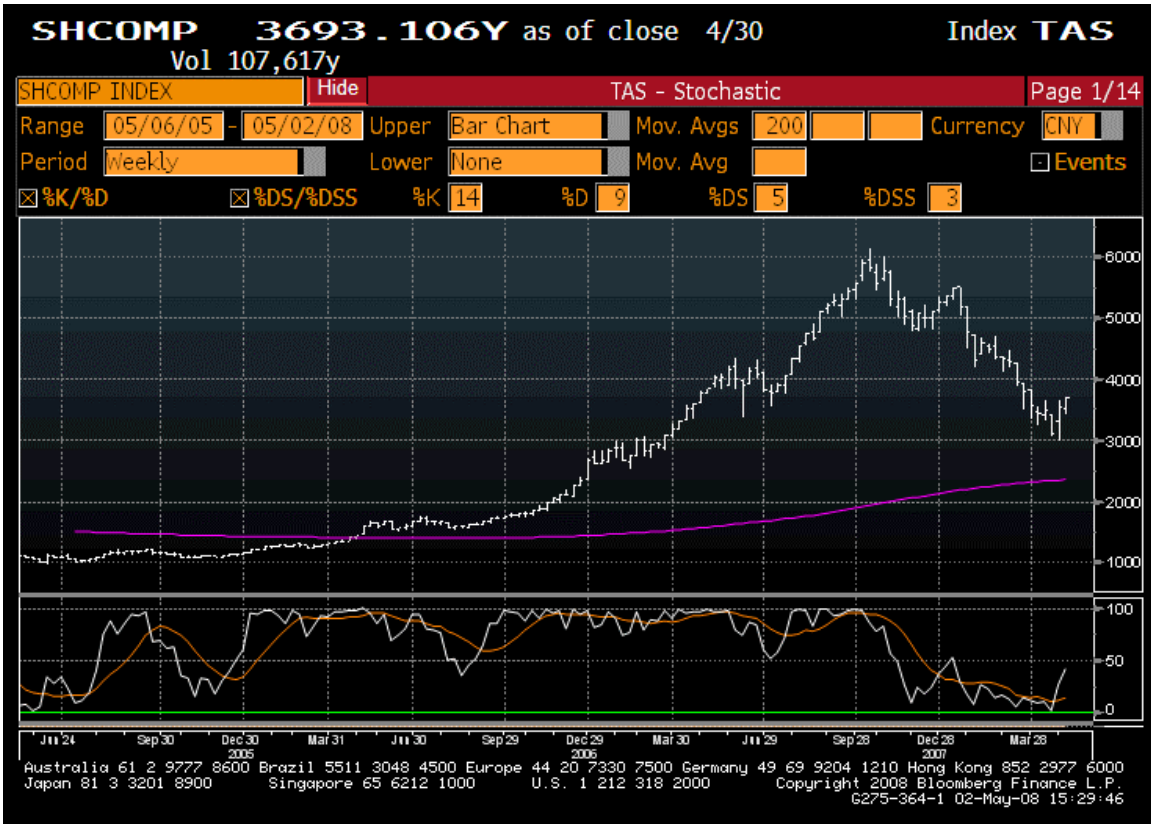
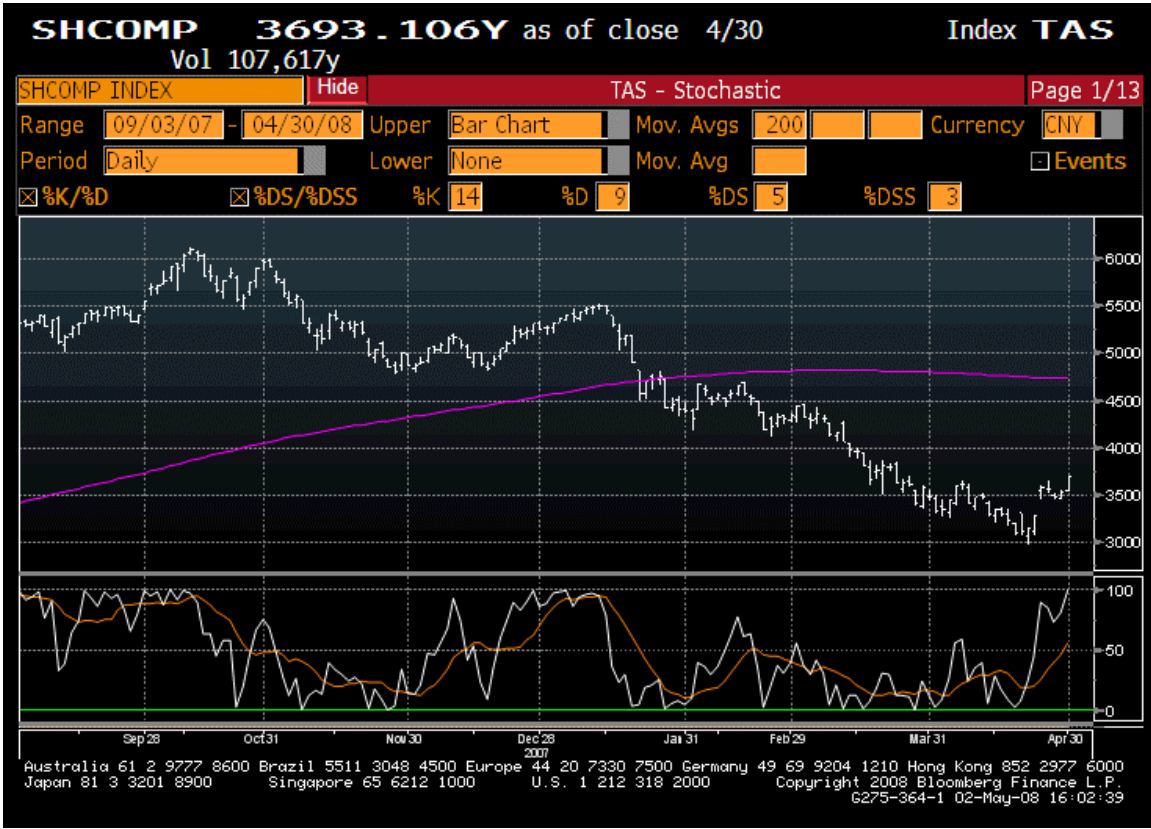
SHANGHAI

From the April 5, 2008 report:

"At this time, fitting into everything else I see in the world for this long-since forecasted time frame, a terrible and nearly 50% debacle is completing in the Shanghai...now. The strategic possibilities are several."

During the 4th quarter I believed that the index could decline 50% and, in the December 2, 2007 letter, I advised tailor-made 2-year out-performance warrants, believing they would return **500%**. I believed that strategic adjustments during the life of the warrant could substantially improve on returns.

First things first: The index declined 50% sooner rather than later (which always seems to happen when planning conservatively, albeit with implied leverage) and the 500% appreciation prices occurred with unusual speed, for a 2-year warrant.



After the 50% decline, SKC reported the low to perfection, as is seen at the beginning of this section in red, as well as the charts immediately above). Such precision is precisely what allows substantial returns to become windfall gains, when making adjustments to or against a leveraged long-term investment that is in a highly profitable position.

NEW YORK

As forecast, and as is customary, markets rally once the negative story and psychology is overdone, so as to allow the bullish factors to take the spotlight. The bullish story today is that the big caps still enjoyed double-digit growth.

When the financials have their runs end, however, the stock market will suffer the heart of the axiom: First the financial weakness, then the economic weakness (then war).

Also from the April 5, 2008 report:

“...As with the previous comparison, there is much to glean, not the least of which being that the Yen is the grand determinant of what ALL markets do. It was a repeated view for many months in these pages that the secret to the moves in everything would be the Yen.”

This was partly an introduction to Dow charts denominated in Yen and the value of its comparison to a local currency Dow chart. This month, such discussion and analysis is found in the [Yen section](#).

Similarly, I discussed the meaning one can give, and the foresight that may be provided by analyzing the Dow priced in gold. Here the discussion focused on the effects on the printing press. This month, the [gold section](#) contains such discussion and analysis.

VIX:

Approaching the lows, I used the VIX to forecast approximate Dow turning points, by determining the correct correlations between the VIX and Dow, both as regards their respective price levels, as well as time lags. It further became evident that psychology was indicating that the public had lost enough rationalism for now (VIX measures the S&P's volatility.)



The 3-year VIX immediately above shows a collapse to a long-term neckline. It also shows an encroachment upon my 200-week moving average indicator.

The -year VIX chart on page 10 includes a break of the 200-day moving average (the understandably common such indicator), which implies to me that the VIX will have required multi-month base building.

The latter observation is consistent with my analysis of the Dow: The market, I wrote, will trace out multiple a-b-c patterns as part of a larger correction that keeps the Dow range bound between 12,000-14,000. Such broad range trading before an utter collapse occurred in 2001. (What sort of excuse will the terrorists provide this time?)

Strategy:

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.



GOLD

While repeatedly forecasting \$1,000/ounce, I reminded that it would be upon crossing that barrier that a 5-wave count would be completed, as public enthusiasm would peak in the short term with a celebration of the breaking that milestone. Then,...

From the April 5, 2008 letter:

“When gold got hammered more than \$40, I felt that the move was all but over and that a counter-trend bounce within a countertrend decline (also known as a “b wave”) would commence toward \$950.

“Indeed, from slightly lower levels, gold rallied to just under \$950. I was surprised by the speed of the ensuing decline after completing both moves, however. It suggests that these moves down and up are part of a larger decline (multiple a-b-c sequences).

“Those looking to lighten up on the tradable portion of one’s gold holdings (a minority position, in the big picture of asset allocation) may do so in the \$930 - \$960 area. Gold’s downside is to \$830. Like most times, however, expect much of the correction to take place with the passage of time, as opposed to depth of decline. So, gold too fits the model of a countertrend move for 3 – 6 months.”

The charts on page 11 reflect the kind of gold reporting that has been provided since the first quarter of 2002. Gold hit \$950 and then, with surprising speed, collapsed to \$850. In keeping with the past 6 years, over which time no other service has provided more precise coverage so consistently.

In any event, to create “larger a-b-c corrective patterns”, gold could and should rally from here but become something of a volatility basher as it kills time, with an upward bias. Anyway, at these prices, gold is a safe long-term investment. (See asset allocation, at bottom.)





See page 13 regarding charts on this page.





The 2nd chart on page 12 covers 10 years of the Dow priced in gold. Only this quarter did the Dow priced in gold bottom (the 2002 lows were smashed a long time ago, although not in local currency terms).

It shows how much room to rally exists, while the pursuant 1-year chart (immediately above) reflects a pattern the initial move of which may be over. This whole story relates to the Yen, gold and how to best price the Dow (and other investments, as well).

I have discussed often and at length about the relationship between the Yen, gold and how these impact upon the prices of other indices, while looking at how to tailor make the most strategic and opportune investments, having analyzed same.

In these asset classes (and cross-charts) rest the best ideas for global strategic out-performance, the importance of which cannot be overestimated since such positioning can provide the global hedges and opportunities that could not otherwise exist.

How better to invest in one's worldview, than to have the investments tailor made to reflect the fundamental and financial interpretations that the investor maintains?



The 10-year chart of Golden Star immediately above illustrates progressively higher lows in 2001, 2002, and then in 2005, 2006, 2007 and 2008. All the while, through the long-term up-trend, the stock price has been correcting into higher and higher neckline supports. The long-term potential is huge, as I continue to dub this stock a “value growth” play.

YEN (CURRENCIES)

I turned bullish on the Yen at 118, so I ended up being off by 6 Yen, and several months. The reality, however, is that the Yen spent **2½ years** rallying, only to break the multi-year low within **6 months** (see 1st chart on next page). The forecast for a swift and dramatic turnaround, whenever it would finally come was proved accurate.

The April 5, 2008 letter reported on the true value of the Dow to the international investor, and how it is best ascertained by analyzing the charts of the index when denominated in Yen or gold.

Chart #2 on page 15 is a 1-year look at the Dow. Meanwhile, the pursuant chart on page 16 is also a 1-year chart of the Dow, but denominated in Yen. I discussed in the original letter how much worse the performance was in Yen.

What are the portfolio and financial/economic consequences of the Dow meaning less in local currency terms?



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Managers looking to get into the market should examine the 1-year Nikkei chart immediately above, with the Yen chart on this page. I had forecast 14,000 for the Nikkei, but when considering the Yen's advance during the Nikkei's flush out to 12,000, the 14,000 target was only missed by about 3%.

Please scroll down.





The Yen-denominated Dow (immediately above) rally is right at neckline resistance, while the local currency Dow (1st chart on page 18) hit the 200-day moving average and seems to have squeezed into a wedge (not drawn), which can reverse 500 points [this week](#).

Since this potential exists, I certainly know that whatever the depth of time and price of this decline, even though it is a part of a larger countertrend rally period, it is good to be positioned according to the bearish view.

Similarly, all equity markets are down from a short-term point of view and, consistent with that, the Yen's recent 10% decline should now yield to a bounce.

Gold is the ultimate gage of wealth, but as a determinant of equity prices and so much else, as goes the Yen, so goes everything else....whether good or bad. That forecast has proved accurate since a long while now, so why change it?

Nor has my asset allocation for this "epoch" of:

- 50% Gold (or 45% + 5% silver, depending of investor temperament)
- 25% Yen
- 25% Swiss Franc (or Euro, for those for whom the Swissy is insufficiently liquid)

A prosperous week to all,

Sid Klein

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