The Sid Klein Comment
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GLOBAL TURNING POINTS

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JAPAN

Today, the *Nikkei News* is reporting that the Liberal Democratic Party (LDP) will seek lower taxes for corporations and low-income earners over these coming years.

Several hours earlier, the news agency reported that foreign firms are scaling back aggressively since September, even in the face of "robust domestic operations", due to the pain at home.

"Executive Search Partners Co. estimates that 4% of the nearly 28,000 employees at foreign financial institutions in Japan were affected by restructuring in the 12 months through August. This pales in comparison with layoffs of 20% in the U.S. securities industry, according to a report issued by the human resources consultant."

This is consistent with the *"foreign idiot"* mentality, which, in this case, is akin (only in reverse) to a stock going up amid a background of worsening news, before it finally collapses (see more examples below).

Nikkei News also ran a report at about the same time that:

"The Financial Services Agency on Friday outlined less restrictive rules for calculating capital adequacy ratios that enable banks to omit unrealized securities losses."

On November 3, 2008, the *Nikkei News* reported:
"Japan's individual investors are plowing their money back into domestic-stock mutual funds, encouraged by the Nikkei Stock Average's new post-bubble lows as well as reacting to falling share prices abroad and the strengthening yen."

Please note that the cyclical bull rally to 18,000 on the Nikkei was marked by foreigners dominating daily trade, to the tune of about 25%, while domestic investors did not really participate during the period.

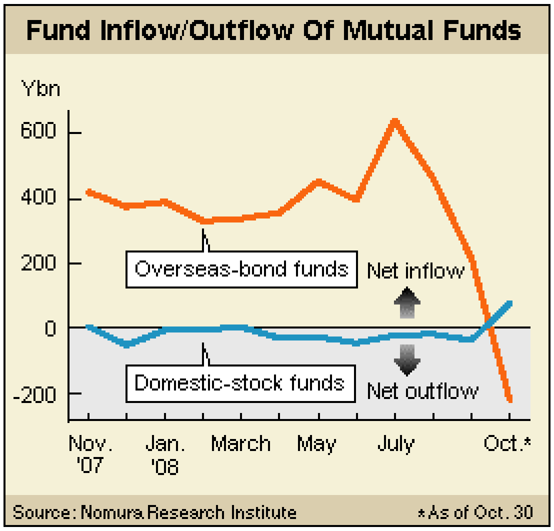
The article continued:
"There was a surge of interest last Tuesday when the Nikkei average fell briefly under 7,000," a Resona Bank official says.

The same article published the Nomura graph on the next page. It, and the commentary above, clearly shows that the tree has shaken the "foreign idiot(s)" (as I referred to Western investors throughout the nineties) out of the market, since the latter need to raise cash from markets to which they are not committed by mandate.

SKC has repeatedly discussed the unending cycle of Japanese domestic investors getting trapped at Yen lows by buying foreign bonds at their peaks. Then, they offload their foreign bonds, no longer able to stomach the currency losses.

At the same time, I have repeatedly reported of Japanese wealth and its approximately 40% of the world's savings and, specifically, that said savings are overwhelmingly in the hands of investors over the age of 50.

The significance of this is that they are the ones who favour their own domestic securities, and this is indeed reflected in the above referenced November 3rd article, coupled with the chart at the top of page 3.



On October 28, 2008, *Nikkei News* also reported:
"By launching stricter checks on the so-called naked short-selling of stocks about a week ahead of the original schedule, the government may be trying to show the markets it isn't sitting idly by as the Nikkei 225 Stock Average falls to around the psychologically key 7000 mark. According to local reports, the government is considering banning such trading practices altogether."

Two day earlier, the same news service reported that the government would now oblige investors to disclose massive short positions, and that:
"The envisaged rule would apply to deals that exceed a certain ratio of outstanding stock. The government is taking cues from the U.K., where short sales must be disclosed if they top 0.25% of outstanding stock of a company trying to raise new capital."

In the West, the onslaught of the various new short sale rules were to create the squeezes into which the "insiders" could sell. However, in Japan, such news is typical of the type of legislation and rule changes seen at extreme lows.

On the 22nd of October, *Nikkei News* had also reported that LDP officials were considering changing accounting rules that would be:
"…part of an additional package of economic stimulus measures…". "The lawmakers also want to create a government-backed body to purchase stocks."

The government and the Bank of Japan did the same thing at the perfect 2003 lows (see April and May 2003 SKC reports online, in the Past Comments folder).

Regarding land prices, they have been falling for 17 years. The major cities posted significant post-2003 gains, which has again made land unaffordable. "Again making prices unaffordable", may be a way of saying that prices are in wave 5 of 5, or 4 of 5 down in this secular bear market in land prices in Japan.

Either way, coupled with the spillover effect of the US' sub-prime crisis, nationwide land prices should be forming lows over the coming year or two.

As we were approaching the Nikkei's 18-year equity market lows, I wrote that the government was quite typically preparing to announce a spate of favourable news, as they have at all of the key lows of the past 2 decades. This letter only touches upon a few of the background factors for this historic turn in the Nikkei, and Japanese stocks in general.

Strategy:

Yen-driven and denominated Japanese equities bottomed a year ago, when measured against both foreign as well as Japanese export index-driven indices. In fact, the year-old low is already in a wave-3 acceleration to the upside. This is the basis of asset allocation…

Hedge Opportunities (Outperformance):

There is a great deal of outperformance profit opportunity in making synthetic, inter-market sector bets, while dramatically increasing efficiency. And that efficiency may be further levered by creating tailor made indices that the investor feels will outperform the comparative index.

SKC has reported over past few months that outperformance lows precede lows in the respective indices. This, I explained was consistent at this time with my worldview that markets would bottom before yearend. This meant to me that betting on certain hedges possessed a measure a safety relative to the leveraged profit opportunity.

NEW YORK

As I recently promised a closer review of fundamentals, so too will SKC include such analysis of the non-Japan markets. For now, I'll keep it technically brief again and straightforward.

When the Dow broke under 8000, I wrote that the index was hitting its low, with a probable higher re-test of the low before yearend. The hedge funds had to prepare for the liquidations, and the ensuing bargains would bring in the those buyers who are not hemmed in by seasonality, and are thereby free to act according to what should ideally be able what governs us all: the ability to take advantage of prices ant those times that prices are dictating action.

Every yearend it's the same: I issue warnings about some market or other, regarding the extreme year-ahead opportunity that was presenting itself (last year it was China), adding that the fund managers' constraints on investing should be used by those who may act freely, to take advantage of the extreme opportunities. In other words, I remind to not let seasonal factors obscure what should be the basis for a great start to the New Year. This is what managers want to know.

Sometimes, the high or low in question is in November, or December, which is a secondary opportunity, borne merely of the lack of selling or buying pressure, as the case may be. But the peak buying or selling was seen, hence the already experienced price extremes, in the case of either higher lows or lower peaks.

In the case of New York, the low is within a massive secular bear market and its principal significance is for hedge players.

VIX

Simply put, we nailed the peak at 75. The order to short was placed well in advance by readers since it was obvious that the following move up would be the last. For heavens sake, without explaining anything further about the mathematics, I'll gravitate toward a metaphor (no pun intended):

An airplane can fly only so high, since it has no capacity in outer space. Simple.

On the basis of the obvious, I provided an easy strategy for a short that one could ride down into the 30's. But, for experienced traders, I also gave the clue as to how to trade in such a way as to perhaps catch something closer to 80, on the day of the eventual top. Indeed, when the peak came, the high was 90.

Strategy:

Ride the VIX short (from 75 or higher) into the 30's, since I am not doing minute-by-minute updates in this letter, since it is not SKC's common mandate. But I will surely be there when we get into the 30's.

Simply, if it's not broken, don't fix it. Windfall profits await investors.

GOLD

With a 100% long silver position (hopefully en route to a 200% position), we remain un-invested in gold, waiting to see whether or not the metal can close under $700. I forecasted a final collapse into the $650 - $700 area, a zone that has already been attained on an intra-day basis.

Strategy:

We lie in wait.

SILVER

On October 25th, I advised going 100% long on an expected pullback at the beginning of the coming week. On Monday the 27th, the follow-up was that silver had slid to $8.75, before closing a tad under $9.00. So, let's just say we're long at $9.00.

The first chart on page 7 (yearly), illustrates the lengthy descent, as well as the extreme and quick profit potential that silver enjoys. The pursuant short-term chart provides an up-close look at the precise timing from which investors benefited.

Strategy:

Lie in wait to increase the position to 200% long. Windfall profits await investors in silver.

(Please scroll down.)

US DOLLAR

Is in a massive bear market that is going to take it to, well, ultimately, a pre-planned hell.

ASSET ALLOCATION

1. Gold: Ordinarily represents 50% of all liquid wealth. Presently, there is no position.

2. Silver: Ordinarily represents 5% of all liquid wealth, and, as a matter of choice, at the expense of the 50% gold holding (hence, 45% gold + 5% silver). We are 100% long, hopefully en route to a 200% position. This would mean that a manager would hold 45% gold and 10% silver, each of total liquid wealth.
3. When fully invested in the precious metals, the Yen and Swiss Franc each represent 25% of total liquid wealth. At present, there are available funds otherwise earmarked for the precious metals, which should be invested in these two fiat currencies.

SKC has consistently provided investors with the very best risk adjusted asset allocation since the 1st quarter of 2002.

Sid Klein