The Sid Klein Comment
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PAYDIRTY
NOW WHAT?

October 18, 2008

Summary

1. **The identification of the Nikkei's peak was achieved this year, though what followed was unforeseen (see NIKKEI below).**
2. **The forecast of a massive bull market low in non-big-cap Japan versus, well, EVERYTHING, was achieved.**
3. **The forecast of a crash from a here-targeted summit in Shanghai was achieved.**
4. **The 2007 forecast of a 2008 break of Dow 9000 has been achieved.**
5. **The view that gold would complete the 2007 forecast of $1,000 per ounce proved correct.**
6. **$20 The ounce in silver was achieved as well, before eliminating the position that had been reduced from 200%, which had been put on at $11.**
7. **The forecast of a massive reversal in the Yen was achieved.**

While we hit pay-dirt throughout the world, the sundry asset classes and investment vehicles by which to profit from them, the fight hasn't been a clean one.

To filter out the technical noise created by erratic markets or the world's largest insider traders, whether it was the Japanese or the Americans, the vehicle of choice has been long-term out-performance warrants, thereby creating an intrinsic hedge instrument that would further provide the leverage that would also allow a fund manager to invest less capital. On all fronts, precisely what the doctor ordered.

Or, at least, this doctor. My mandate has been to avoid calamity, find opportunity, and then maximize it. To wit, on clicking the link below, you are invited to judge the very last paragraph and sentence.

http://www.sidklein.com/Japanese_equity_markets_expert.html

JAPAN

Despite all correct Japanese macro market forecasts and analyses, there was one view that was patently mistaken. Here, I tip the hat to Bob Prechter whose long-term wave count was the correct one. Largely, it made but an academic difference, but it is true nonetheless:

The rally from 7,600 in 2003 was not wave 1 of a new bull market but, rather, the final corrective rally within an 18-year old bear market. In other words, this quarter's low in the Nikkei will be the end on an 18-year old secular bear market. Asia is the new powerhouse, with Japan as its financier and uncontested leader, in terms of GDP and trade.

I had identified the lows in 1998 and in 2003, thinking both times that it was the end of the secular bear market. I could be forgiven because I subsequently identified the ensuing peaks (2000 and 2007) but, this time, I felt that the Nikkei's low would be 14,000, with an overshoot possibility to 12,000. Clearly, that was wrong.

For macro players, due to the strategic approach recommended in these pages, it didn't make a difference. To that end, I draw your attention as always to the out-performance recommendations and analyses. (See out-performance commentaries throughout in this report.)

October 4, 2008 SKC report:
"Japan bottomed versus New York in the 1st quarter (see New York section), before the Nikkei rallied about 25% against the Dow. Now,

with the change in Western short sale rules (see September 24, 2008 interim report), a higher low has probably been completed.

"Surviving this environment in the best possible fashion will also probably have meant obtaining the best leverage. My past experience has me convinced that the search for safety will "stumble" upon the best leverage as well. Remember, everyone seeks safety."

Strategy:
"The Nikkei is finding its extremes now, but that isn't the way to play Japan, given the resumption of the Yen's bull market. The best way to play is via the out-performance strategies. Why assume risk, and without enjoying the leverage that could at least come along with it?"

Note: Non-big-cap Japan bottomed versus the Nikkei and the Dow a year ago. Versus the Dow, non-big-cap Japan, particularly when structured and denominated in the desired currencies [(not published); (see 2nd paragraph on page 5)] has erupted in wave-3 fashion to 10-year-plus highs!

As for the Nikkei's intermediate term chart, it is pretty much the same as that of the Dow. But just the Nikkei (see below).

SHANGHAI

Again from October 4:
"Last month's September 7, 2008 letter also contemplated a huge rally in Shanghai, with short term potential for another 10% decline to under 2000.

"The latter has occurred and China's risk is now clearly to the upside. Take note. Will I be as lucky in China as I was in Japan in the nineties?" Clearly, this view too is now being borne out, as this latest collapse in the world was not followed by like action in Shanghai.

NEW YORK

September 16, 2008:
"Then, I just reminded readers to focus on the bigger picture instead of any near term and minor move that might not even happen. My main message became my most repeated one: When this drop's next leg gets going, it is going to under 9,000, and when it gets there, it will have gotten there fast.

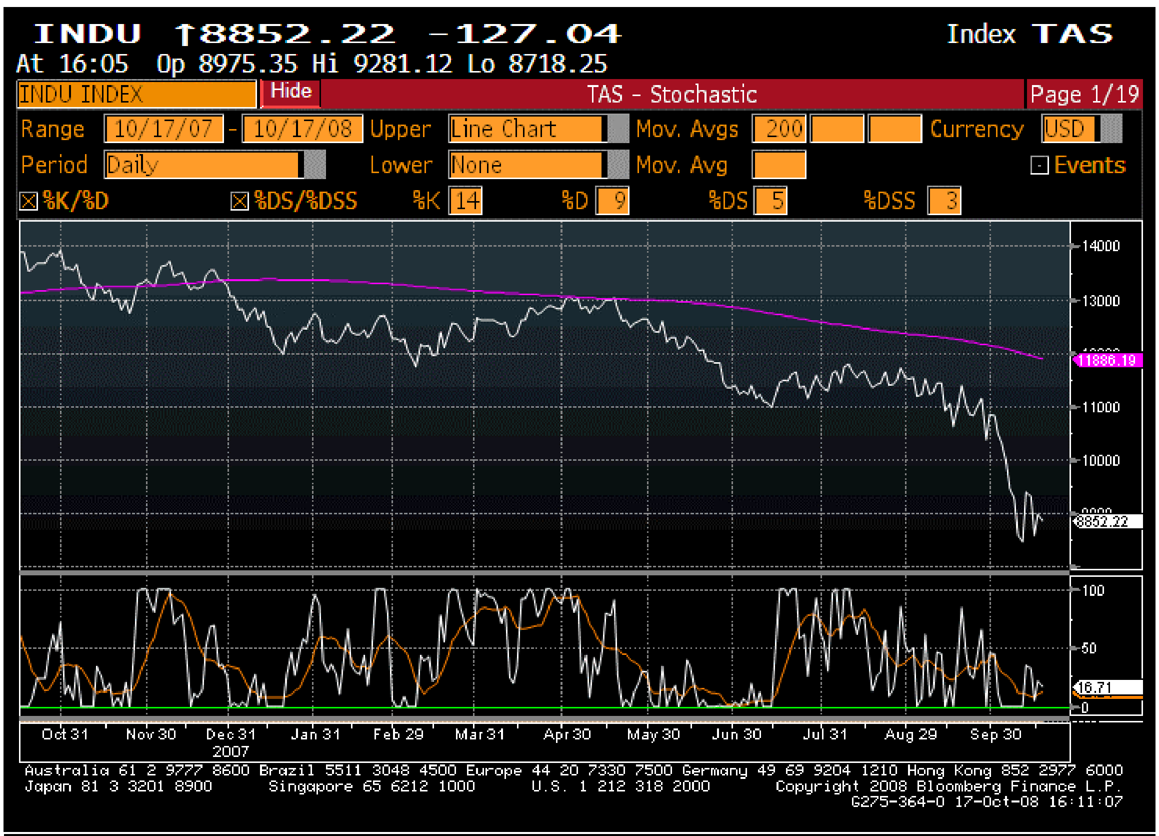
“There is nothing that so accelerates a decline, as a financial calamity. Fear for the system, and all that. My forecast of 9000 in 2008 may be achieved on the back of such fears.” **Fast enough?!**

October 4, 2008 report:

“Such a turn, of course, would be confirming a higher low in that relationship, since Japan already bottomed against New York 10 months ago, before rallying about 25%. Therefore, this would be marking an acceleration of Japan’s bull market versus the US.

“When New York peaked against Japan in mid-March, it promptly fell approximately 25% against the latter. Again, the heart of the bear market versus Japan has yet to unfold in a full-blown manner.

“With the changes to the short sale rules (see September 24 report), we can now look forward to that acceleration in a classic wave 3 fashion.”



OUT-PERFORMANCE

September 16, 2008:

“If the markets will have had a debacle coming its way over these last 4 months of 2008, then those lead indicators (global out-performance, or cross-charts) will have bottomed sooner. Duh.”

“When analyzing cross-charts, one must consider and denominate each component in different currencies. This provides the most efficient hedge bet, by incorporating one’s views on the currencies, with those of the world indices’ relative performance expectations.”

From the September 24, 2008 SKC report:
“Japan has been out-performing the US and other markets appreciably, since last week’s rule changes regarding short selling.”

“The competition in the industry will flow money into Japan and away from other markets. We have seen the spark to this trend change!”

Earlier in the 3rd quarter, I wrote and reiterate here that sundry global opportunities in different asset classes were and are opening up in terms of intrinsic hedge investments (out-performance). It merits repetition:

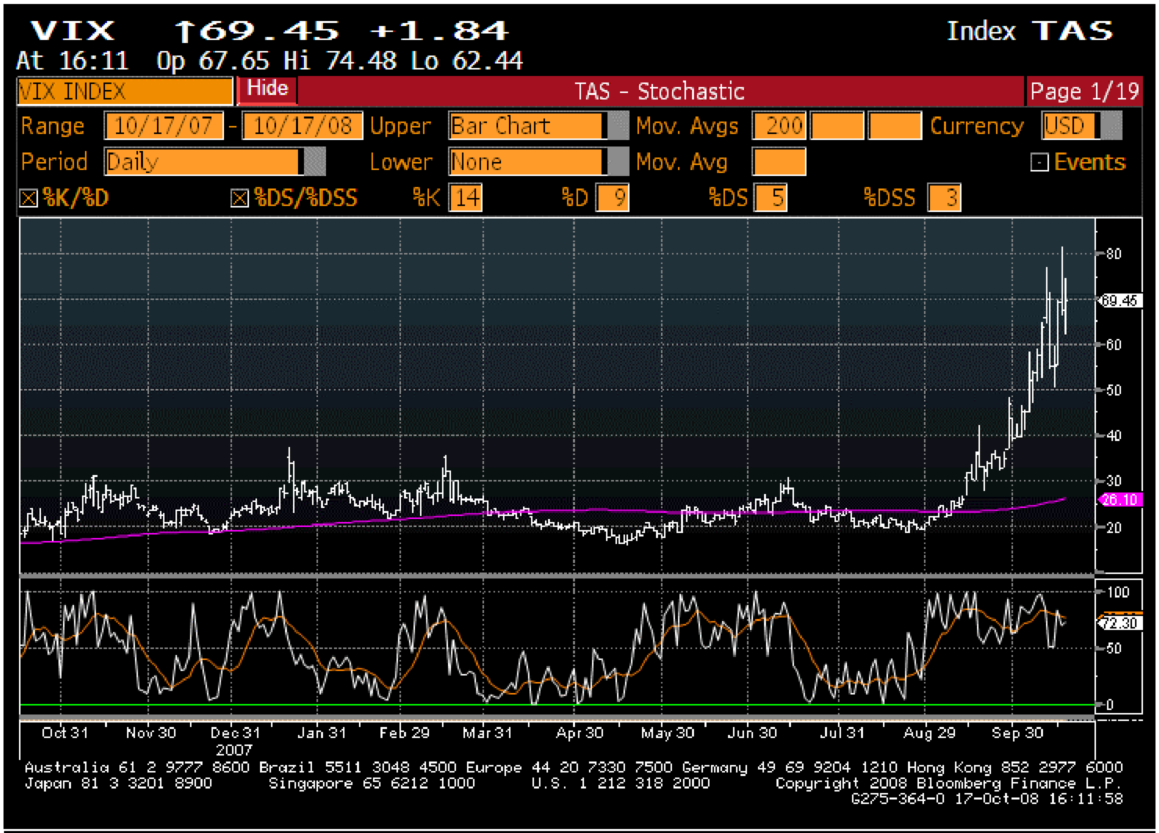
Non-big-cap Japan bottomed versus the Nikkei, as well as the Dow, a year ago. Versus the Dow, non-big-cap Japan, particularly when structured and denominated in the desired currencies (not published) has erupted in wave-3 fashion to 10-year-plus highs! **This does not even contemplate the appropriate and more realistic real-time ratios to be used.**

VIX

Strategy:

In the short-term (but, boy, what a short-term!) I had identified a completed 5-wave advance that I assumed was the end of a move up in the VIX and, hence, down in the Dow. In retrospect that 5-wave move was the completion of wave 1.

As reprinted above, I persistently wrote that the collapse to below 9,000 would be swift but, because of the VIX’s short-term misinterpretation, I had expressed the view this month that short-term option traders would do better to stand aside, since the risk was to the downside in the VIX. ***It would mean nothing for EVERYONE else.*** **(Concludes on page 7.)**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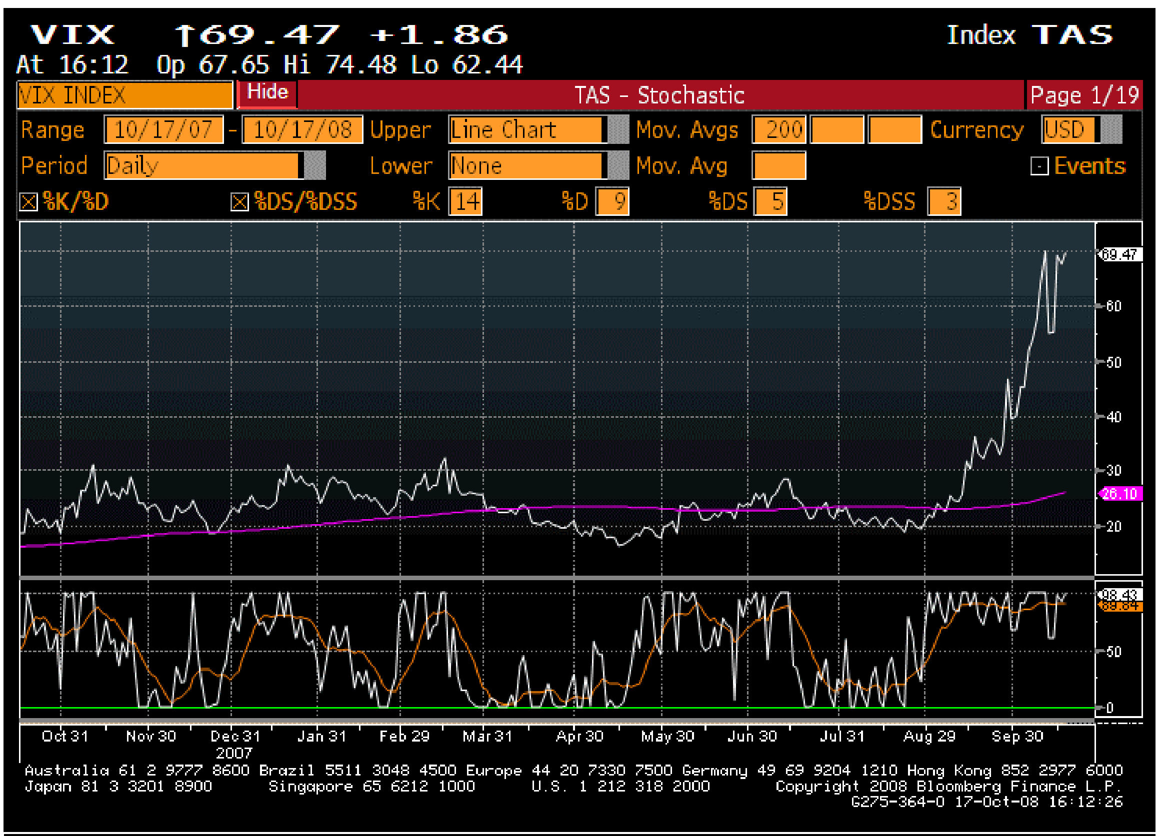
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The first chart on page 6 includes the VIX's intra-day movements and reflects a dangerous stochastic divergence (one, so far: the triple-divergence is the most dangerous, where the second point of divergence is lower than the first, and with the third point higher than the second, but, of course, lower than the first).

However, please note the second chart on page 6. It is a close-only chart of the VIX. Easier to read and more revealing, eh? When I look at both charts, I see two things: Firstly, that the peak this week was 80 and, secondly, that subdivisions can easily take it back there and even cross intra-day to 85 (we may suppose).

However, when everything is taken together and - this must contemplate what must inevitably happen mathematically – consider that closing prices must be our basis (since this report cannot help with super short-term trading), with all this as our context:

SHORT THE VIX AT 75 AND HOLD FOR EASY PROFITS THIS QUARTER, RIDING IT DOWN INTO THE THIRTIES! Gentlemen, stick in your offers.

GOLD

October 4 report:

"Last month's regularly scheduled report (September 7) advised scaling out of 50% points of one's position on a break above $900 at any time. By this, I explained, a fully invested long term investor could go to 50% long, while traders so inclined could remove their 50% position, thereby scaling back to zero.

"I argued and maintain that gold may have a final leg down to the $650 - $700 area. Following the daily 2-year gold chart below is a 31-day graph of the metal, and it clearly illustrates the break above $900, along with its violent subsequent reversal."

Strategy:

Yet again from the October 4 letter:

"We'll see whether gold crumbles in wave-c fashion, to shake the tree loose of weak holders. If so, we'll try to catch what they drop."

Well, just look at gold's close-only chart below. The preceding market call is perfect and a smash into the $650-$700 zone appears likely.

The title of the October 4, 2008 report was: **"WE'RE GETTING THERE: PRECIOUS PRECISION REDUX?"** The first part of the title referred to the imminent collapse in the Dow to below 9,000, while the latter part, well, boasted of a return to near perfection in identifying gold's movements, a trend of performance to which readers have grown accustomed since the first quarter of 2002.

The red-highlighted excerpts in this section speak for themselves. So, having scaled out of gold at excellent levels, prepare to catch this pop fly in the above-discussed $650 - $700 zone.

SILVER

I had again sought to establish a 200% long position in silver, in the $10 - $10.50 area. Based on gold's action, I decided to hold off, writing that there was no rush given the latter's performance.

In other words, what is there to lose if gold is actually falling? So, we have stood aside and are waiting for what could be a monumental opportunity in both outright investment, as well as out-performance structures.

Sid Klein

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