

Nikkei: Perfect
Gold/Silver: Perfect
Yen: Perfect
Dow: Delayed



October 07, 2007

JAPAN

Nikkei:

On July 7, with the Nikkei at 18,140, I again wrote that the market was headed toward 14,000, and that the entire yearlong move to and over 18,000 was counter-trend, while the ever-key bank stocks were correcting badly, almost across the board.

Now, as the following chart illustrates, after the forecasted fast collapse that typifies final declines that are pursuant to counter-trend new highs in markets, the Nikkei has bounced strongly and returned to a dangerous level, from which a final decline toward 14,000 may ensue.

More than being consistent with the contemplated Dow decline discussed in the next section below, the Nikkei's next collapse would be consistent with the resumption of the Yen's bull market (see Yen section). The Nikkei has sharply counter-trended versus the Yen, with the story being the negative effect of a strong Yen on Japanese multi-nationals. (Comments continue after the 3-year Nikkei chart here.)



Make no mistake about it. If the Nikkei achieves my downside targets, this index will be poised for a 2-year 50% bull move. The basing pattern will take some time, due to crosscurrents that involve the Yen and other world markets (see Dow, Shanghai, Yen below).

The most levered gains will come from the mid-cap stocks, but the broad and large-cap Nikkei index will have bottomed nonetheless, as well, as bit later (see 7-year, Nikkei 500 versus Nikkei ratio chart below, on page 3.

By observation, one may conclude from **the following chart**, which **divides the Nikkei 500 by the Nikkei**, thereby gauging the **relative performance and strength of the mid-caps versus the big-caps**:

- a clean and unbroken up-trend since the beginning of the decade, almost 8 years ago
- which means that mid-caps have been outperforming the Nikkei for that long

- this cycle's chart is consistent with a secular trend (multi-decade) of large-cap underperformance (mid-cap out-performance)
- after an explosive period, the mid-caps have been underperforming the Nikkei, for the past year and 8 months (beginning of 2006)
- during this correction, this chart of relative performance fell dramatically, in the typical 50% range (further dragging down small caps)
- a low in this chart now is consistent with a low in the Yen and a peak in the Nikkei (the latter is a matter of fact)



Conclusion & strategy:

Investors buy domestic value stocks, while traders may again short the Nikkei.

Note: In 18 years, save for short or intermediate term moves' timing, I have never been wrong about the Nikkei. That's analysis, not bragging. So, prepare.

NEW YORK

Dow Jones:



The 200-day moving average at the bottom of the daily Dow chart immediately above provided support to New York, as the Fed's ½-point cut was further celebrated with the announcement that the Koreans may be presenting something bullish to think about, on the otherwise dismal political landscape.

The Fed cut may have an effect longer term in terms of mitigating the future damage that is resultant of a recession, which the Fed may be worrying about and foreseeing. It does not prevent the other shoe from dropping in the intermediate term, however. The momentum of prior actions and circumstances must run their course.

The same daily stochastic above illustrates a bearish divergence, should the Dow decline from here (and it is turning over). As regards the 7-year weekly chart, and its stochastic at that chart's bottom, below, wave 1 may be said to have bottomed in early 2003, while wave 2 completed its correction during the 4th quarter of 2004.

In this scenario, wave 3 peaked just before the 4th wave's 10% correction, which concluded most recently. We would be in wave 5 to conclude the entire move now. As regards the weekly stochastic, it is over-bought, without any divergence. Non-divergence is the norm with weekly stochastic, as opposed to dailies.



When all is said and done, rate cuts, sub-prime stories et al, will not have mattered much, as compared to the resumption of the Yen's bull market. **When the Japanese spigot is turned off, the flow of capital will bottleneck and choke the New York market's capital addiction, until wheezing breathlessly. Cutting rates hardly improves the carry-trade story.**

The media focus is not on all this, because the background news for the Dow's recent 10% decline was on everything but the Yen as cause, except in these reports (I think).

Analysis and comments on the following VIX (volatility index) charts appear on page 7.



The 1-year daily VIX chart, which is the first of the 2 charts on the preceding page, illustrates:

- major long-term support
- perfect support at the 200-day moving average
- a completed 3-wave a-b-c pattern down
- a bullish stochastic divergence, should the market advance from here
- a long-term up-trend channel

The 7-year weekly chart and stochastic immediately above illustrates:

- an oversold condition
- long-term support
- a pullback after a breakout, which corrected toward but did not break the 200-week moving average

I have observed that recent tops have been marked by the VIX turning up, rather than continue to fall, during a move up in the market. I am referring to a 200-point move up in the Dow that is coupled with a turn up in the VIX, as opposed to a continued decline, as a realistic example (and which just occurred). There are obvious reasons to find, but the observation is just that. And, indeed, should the market decline from here this phenomena would have occurred again.

Conclusion and strategy:

Amid negative divergences and questionable economic fundamentals, the volatility is set to resume, with a resumption of the Yen's bull market. The 4th quarter may yet turn ugly. Either way, risk is defined and limited, since no stocks are held, and within an asset allocation model that is heavily weighted to our other markets and asset classes.

The Dow's pattern allows for a downside reversal to occur at any time, and the VIX background is entirely supportive of such a scenario.

SHANGHAI

If Al Greenspan can call a top in this market (now THAT'S a Chairman who could be a good strategist, eh?!), who am I to argue?

Seriously, I have covered this index in the past, in order to illustrate the utter mania to which the former Chairman very recently referred.

The action of the past 2 years offers a glimpse of the inordinate non-Japan risk that exists in Asian indices, as previous reports had underscored. Indeed, this index could get cut in half – when looking at the 200-week moving average (immediately below) – and hardly

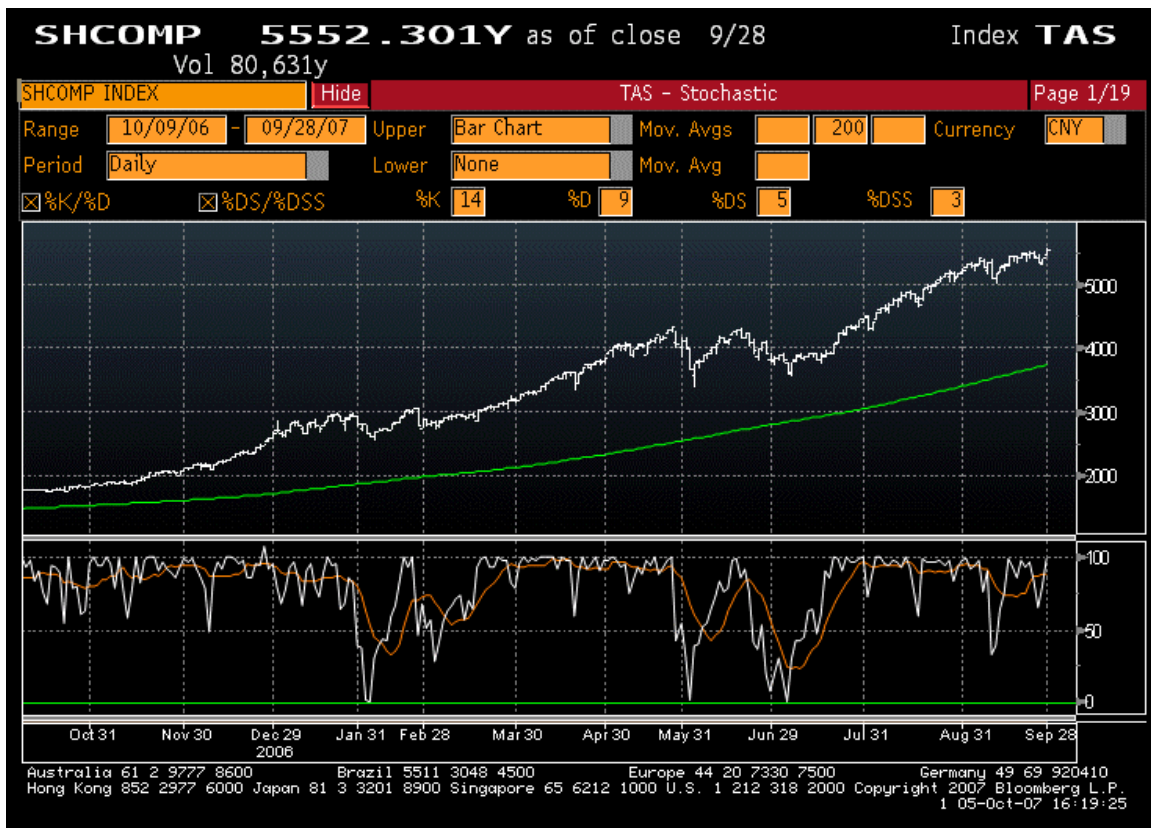
anyone would even notice in the future (for me, moving averages define where profit-taking has worked itself through the market).

The pursuant daily chart on the next page shows a completing pattern, not to mention a moving average that is distant, as well (albeit a moving average that is not as remote as on the weekly chart, of course).

So, the world is set to tumble, including the broad Nikkei, where a final decline remains. That index is what the ever-mistaken foreigners always look at, and I mention it again here because the mood will be one of desolation, when it appears to investors that absolutely nothing is working globally. The theme for global hedge managers is counter-cyclicality.



Please scroll down to page 9.



PRECIOUS METALS & DOLLAR (YEN)

On July 7, with gold at \$646.59, I reprinted the comment I had written when I had advised those so inclined to reduce gold to a 50% position, while looking to err on the side of being fully invested as soon as possible: **"This was based on the idea that the metal could drop to as low as \$600 or, and more likely, trade net sideways..."**

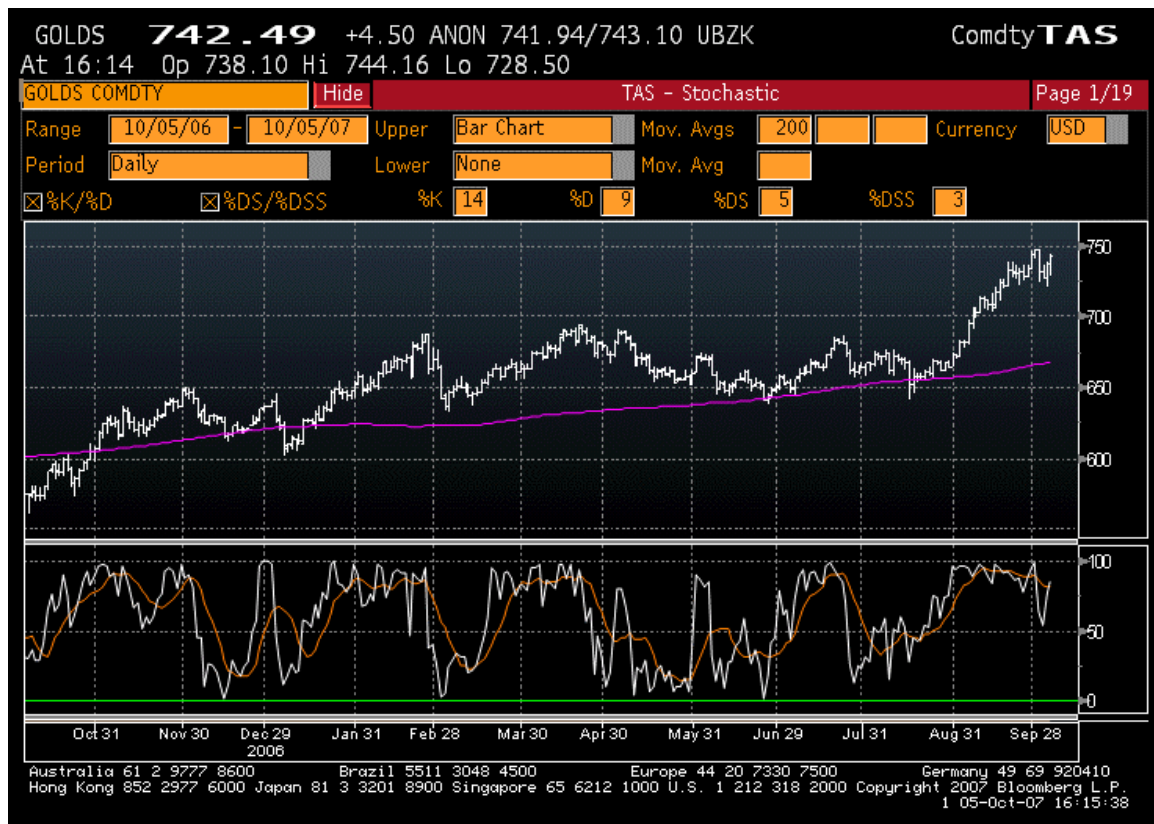
This reprint was from when I had advised reducing to 50% long and only for those who had wished to play the intermediate term. Since January 2002, I have played each intermediate move perfectly, but with the warning that the entire period that would follow the achievement of \$500 would no longer merit such activity, due to the extreme upside risk. Therefore, in deference for the possibility of sideways activity, I advised true gold holders to ignore any correction and remain 100% long.

Then, on August 5, I reported: **"I see \$660 - \$670 as the bottoming area for gold. While the contemplated flush out toward \$605 is always possible, my preferred scenario since**

the intermediate peak was made appears to be playing out and completing, namely, a net sideways action that trades around \$650, so that sellers can put gold and silver into the strong hands of governments and other major long term players."

Since then, gold has broken out to \$742. An unblemished 5-year track record remains intact. Gold represents 50% of all liquid wealth (and I generally don't believe in Western fixed assets), 40% plus 10% for silver. Gold can be held on 50% margining to maximize return, while not engaging in the leverage and risk of futures contracts. Margin would merely be a way of capitalizing on the obvious and low-risk bull market (gold and silver are not going to be cut in half!).

As per the quote immediately above, the daily chart immediately below reflects the strong retracement, pattern, and conventional support levels at which gold held (moving average, etc.). Meanwhile, the pursuant weekly chart on page 9 reflects a powerful, smooth and easy pattern that is consistent with a massive secular bull market, which is what this is. Amazingly, also as forecast, it is equally amazing how investors find ways of screwing themselves up along the way.





Conversely, the following 31-day chart shows a completing short-term pattern. Whether it does manifest a slight correction is immaterial.

Please scroll down to page 12.



From the July 7 letter: "An analysis of the second chart on page 10, which is the 1-year daily silver chart, along with the long term weekly chart below reflect a safe entry at \$10, for which many will wait..."

"...The unsuspecting will miss it at \$11."

From the September 6 report: "The daily silver chart below (2nd chart) illustrates the spike down to \$11, while both the weekly AND daily charts reflect the great strength of the respective stochastic, which also represents the strength of a variety of momentum indicators, in fact."

I have recommended using buy points in silver to go 200% long. While \$11 has already been seen, \$14 appears to offer resistance, and at a time when indicators support a correction. Forget ever seeing \$11 again, but a little retracement may afford the previously nervous an opportunity to earn from silver what is so easily being afforded us.





The daily Dollar/Yen chart immediately above illustrates a bounce into resistance and toward the 200-day moving average. Meanwhile, the weekly chart immediately below reflects a bounce from the 200-week moving average. The crosscurrents have simply allowed for this Dollar-Yen bounce, after a dramatic 9% move.

The reality check now is simply this: Am I right that the only indicator worth following is the Yen? All of the woes to which others have related the recent 10% correction seemed placated with the recent 50 basis point decline in US Fed rates.

However, if the wake-up call is, "It's the Yen, stupid", then sub-prime and fund rates and all the rest will appear as gibberish when the true indicator (Yen activity) rears its ugly head. The Dollar has been in a secular bear market. But it's the Japanese who control 40% or so of the world's savings and Yen that determine the fate of US assets. Not the Chinese. Not the Fed. It's the Japanese.

As the Yen resumes its now recommenced bull market, the recent equity market pain will resume. Nothing has changed, unless someone hallucinates that lower rates makes the Japanese more willing to hold empty (printed) assets (see Dow section above).



Strategy, Conclusion & Asset Allocation:

From the August 5 report: **“Gold and silver should be held 100% long, since drops would likely hold above \$640 and \$12.40, respectively.”**

The weekly **silver** chart on page 12 shows the metal hitting up against short-term resistance, which is consistent with gold pattern. Meanwhile, the weekly stochastic seen there reflects a stochastic correction that may be said to have been completed with the forecasted completed spike down to \$11. All taken together, silver may be warming up for a minor pullback that sets the stage for an eruption toward \$20. Yes, 200% long sounds right, to bag the returns that represent this year’s investment goals.

Whether **gold** moves in lockstep is immaterial. The asset allocation remains unaffected.

100% Long Yen assets and Yen-denominated domestic stocks, within equity allocations. The Swiss Franc has been the best performer among the *real* paper currencies, while gold has done the best. The Yen and

the Franc each, comprise 25% of the wealth asset mix, the latter for capital gains in what I perceive to be Asia's de facto bloc currency, as I have written for nearly 10 years. Gold = 50% (or 40% + 10% for silver).

Happy Thanksgiving, Canada,

Sid Klein

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