

# Mr. K: PART 2



September 17, 2006

## **JAPAN:**

The Nikkei has come into resistance at 16,000 and domestic stocks have been soft, on non-existent volume. This softness is consistent with and portends weakening global markets.

## **NEW YORK:**

### **TECHNICAL:**

The Dow's monthly stochastic was printed for a second time at this year's peak, with the comment that the market would have to immediately reverse, otherwise the stochastic would not confirm a major sell signal. The indicator was reversing from a triple divergence, which is the worst kind of reading.

The Dow fell 1000 points, and here we are today at a double top. The push toward new highs is to create the headline that the Dow has accomplished such a feat. After all, as my mentor had taught me, when something is at a peak, everyone is happy because everyone is making money. This is also why short

covering accelerates and exhausts itself often in new high territory. As regards today's Dow, there's too much front running to allow for that. The sentiment and background of the market condition is reminiscent of the earlier run at these levels in May.

The weekly stochastic has returned to the extreme of overbought. While the monthly stochastic is in a sell mode still, the daily stochastic has peaked with a triple divergence, if the market retreats from here. Regarding the VIX, the principal determinant of options prices, the chart, linked immediately below speaks volumes.

[http://bigcharts.marketwatch.com/quickchart/quickchart.asp?symb=vix&sid=0&o\\_symb=vix&x=57&y=15](http://bigcharts.marketwatch.com/quickchart/quickchart.asp?symb=vix&sid=0&o_symb=vix&x=57&y=15)

### **ECONOMY:**

There is only a brief lag time between consumer confidence and consumer spending...and not much of a lag between consumer spending and the stock market, which is capable of leading. Since real estate and banking are at the core of deep bear markets and recessions or depressions, I thought to include the following section.

### **REAL ESTATE/BANKS:**

In the past, I have written of the lag time that had existed in Japan between the stock market and real estate market peaks. The Nikkei had peaked in January 1990 but real estate rose as a "safe haven" into 1992. I wrote concurrently that the Dow peaked in 2000, while real estate has been rising to all-time new highs since 2002, as - you guessed it - a safe haven. Having taken into account what went on to happen to the Japanese banks (which bottomed last of all groups after 13 years), the conclusion I drew was that shorting bank stocks would make for a fine idea, when housing and real estate would roll over.

You all know the story. When periods of major financial and economic calamity strike, the banks reflect it the most. Mortgages, ect. But what if there was a faster bank bang for the buck. Thanks to John Melikoff's March 17, 2006 MARKET WATCH report, we may indeed be looking at a peculiar special situation: A world class Canadian chartered bank.

According to John's report, the Royal Bank of Canada is now largely a fund company that reports income from "investments" as being greater than that from banking. In fact, he writes, the bank is now the largest mutual fund manager in the country. The bank also seems to place its own stock into the different funds it manages, rather aggressively. Compared to US competition, the bank also charges much higher MERs. And, John added, the dividend no longer offers the competition to the 3-month T-bill yield that it once used to. Is this institution a scandal waiting to happen? In its reports, the bank openly writes of the

relationship between the stock market's success and its own profits. Japan revisited.

Once a model of banking internationally, the post-Trudeau era has opened up the industry to inordinate risk that can draw seriously on the national wealth down the line somewhere. We'll see. But for now, just trade this bank as any major investment house. Ultimately, John concludes that RY (in Toronto) is the Nortel of banking. Remember, CIBC has already had a fiasco. Once, all this would have been unheard of.

In any event, the stock's parabolic nature tells of the risks. (See chart by accessing the link immediately below.)

[http://bigcharts.marketwatch.com/quickchart/quickchart.asp?symb=ca%3Ary&sid=0&o\\_symb=ca%3Ary&freq=2&time=13](http://bigcharts.marketwatch.com/quickchart/quickchart.asp?symb=ca%3Ary&sid=0&o_symb=ca%3Ary&freq=2&time=13)

### **Strategy:**

Long puts, short banks.

### **PRECIOUS METALS & DOLLAR:**

I had thought that gold could fully re-test its lows. Then I thought that one should not bother waiting for it to do so, as the \$605 area may have been enough of a correction. Sure enough, gold has gone into a fuller c-wave, to express it in Elliott Wave terms. Either way, a question worth considering is whether gold and the Dow are setting up to actually move countertrend to one another.

In the final – or should I say *sole* – analysis, one should never sell gold or silver. That \$20 here or there can shake investors out of this massive secular bull market is ridiculous. If tricks are for kids, then fake-outs are for adults. There are always stories at the bottom that rationalize the price levels in question. Do any of today's stories make any sense to you, the committed long-term investor?

Remember the supply/demand stories and those of inexhaustible future Asian demand for gold, while Western vaults are largely empty? Good. Don't forget.

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