The Sid Klein Comment
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WE'RE GETTING THERE: PRECIOUS PRECISION REDUX?

October 4, 2008

JAPAN

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.

Also as per recent letters, cross-charts (inter-market relationships) are lead indicators, in my view. Therefore, with the markets destined for further collapse, it follows that the time to invest in out-performance is about now. This suggests that there are key turning points transpiring around the world. The key is to know how to create the best risk/reward plays for portfolio efficiency or, at the minimum, be aware of the need to shift global asset allocation.

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.

<u>Strategy</u>:
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?

<u>SHANGHAI</u>
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?

NEW YORK

The September 7 report was entitled "IT'S ROLL-OVER-UGLY!" It was both a description of how the market looked to me, as well as a command on my part to get the inevitable collapse to below 9000 over with.

My market call of "below 9000 in 2008" is mostly achieved, when you think about it. The Dow has already come within 1500 points, almost 4000 from the high of 1 year ago, and about 3000 from the 2nd quarter peak of 13000.

Simply put, we're getting there.

Days ago, on September 29, SKC's view was that October could actually have an upward bias that could set up investors for a terrible November-December. The Dow was down 6% when I wrote that, and only a delayed tape momentarily concealed the fact that it was down 7% for the day.

It was pointed out to me that I had failed to mention the bailout package in that in that interim report. Rather, I focused on how the

low could potentially be made over the coming couple of days, for the near term. I chose that route for two reasons:

Firstly, I wished to draw attention to the fact that a near term low would mean nothing (the Dow was up the next day by 500 points). Secondly, as so often discussed in these pages, the Americans (and Japanese) are the world's greatest insider traders.

Therefore, why mention the package? What would matter is the news manipulation for the end of quarter, and the beginning of the new month; hence, my discussion of a possible low for the first day of October (and quarter), or so.

The boys and girls who run the show have investors and managers running around like chickens with their heads cut off, trying to understand manipulated news, which includes the manifest and then temporarily resolved fears that govern the market.

In other words, it's all crap. You pay me to stay detached and report on news 6-9 months ahead of the pack. I don't need to be commentator #1 million on the same bit of headline foolishness.

Of course, the same headline may pertain to a special observation that is not in the news and which is important to investors. That is why I reported on the fact that the change in the short sale rules probably marked the turn in the relationship between Japan and the US, and why.

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.

VIX

To say that the VIX (2 and 10-year charts follow) has had a dramatic run-up would be something of an understatement. The volatility, uncertainty and fear in the market, has been extreme.

The 2nd quarter's bottom was identified in these pages, as was the ensuing peak in the 3rd quarter. Most importantly, the pursuant low, which preceded this stunning run-up was also forecast and identified.

However, this last peak was not anticipated, as I'd thought that the spike before it had marked the short-term conclusion of this move.

This time, it seems that the top truly is in. The 10-year chart illustrates a test of the twin peaks of 2000 and 2001. It is the 2nd chart on the next page, following the 2-year graph.


VIX ↑ 45.19 -.07 m
Index TAS
At 16:03 Op 45.22 Hi 45.52 Lo 41.51 Prev 45.26
VIX INDEX
Hide
TAS - Stochastic
Page 1/37
Range 10/03/06 - 10/03/08 Upper Bar Chart Mov. Avgs 200 Currency USD
Period Daily Lower None Mov. Avg
Events
%K/%D %DS/%DSS %K 14 %D 9 %DS 5 %DSS 3
45.19
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VIX ↑ 45.19 -.07 m
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At 16:04 Op 45.22 Hi 45.52 Lo 41.51 Prev 45.26
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TAS - Stochastic
Page 1/42
Range 10/09/98 - 10/03/08 Upper Bar Chart Mov. Avgs 200 Currency USD
Period Weekly Lower None Mov. Avg
Events
%K/%D %DS/%DSS %K 14 %D 9 %DS 5 %DSS 3
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Strategy:
The upshot of the comment at the bottom of page 5 would be that the market has bottomed for now or, at the minimum, that it has hit its peak negative momentum, which would translate into a top for implied volatility (option time premiums). Traders should stand aside in anticipation of a good entry on the short side for a miserable November-December drubbing. With the market and volatility at these levels, the risk for the short seller is to the upside, certainly if there is any involvement with premiums whatsoever.

GOLD

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.

Considering further the commentary on silver (next section), it would seem that SKC has found the range of precision on the precision metals again. The standard of precision enjoyed since the 1st quarter of 2002 has more fully returned.

Strategy:
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. To wit…

(The SILVER section continues on page 9.)


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Period Daily Lower None Mov. Avg Events
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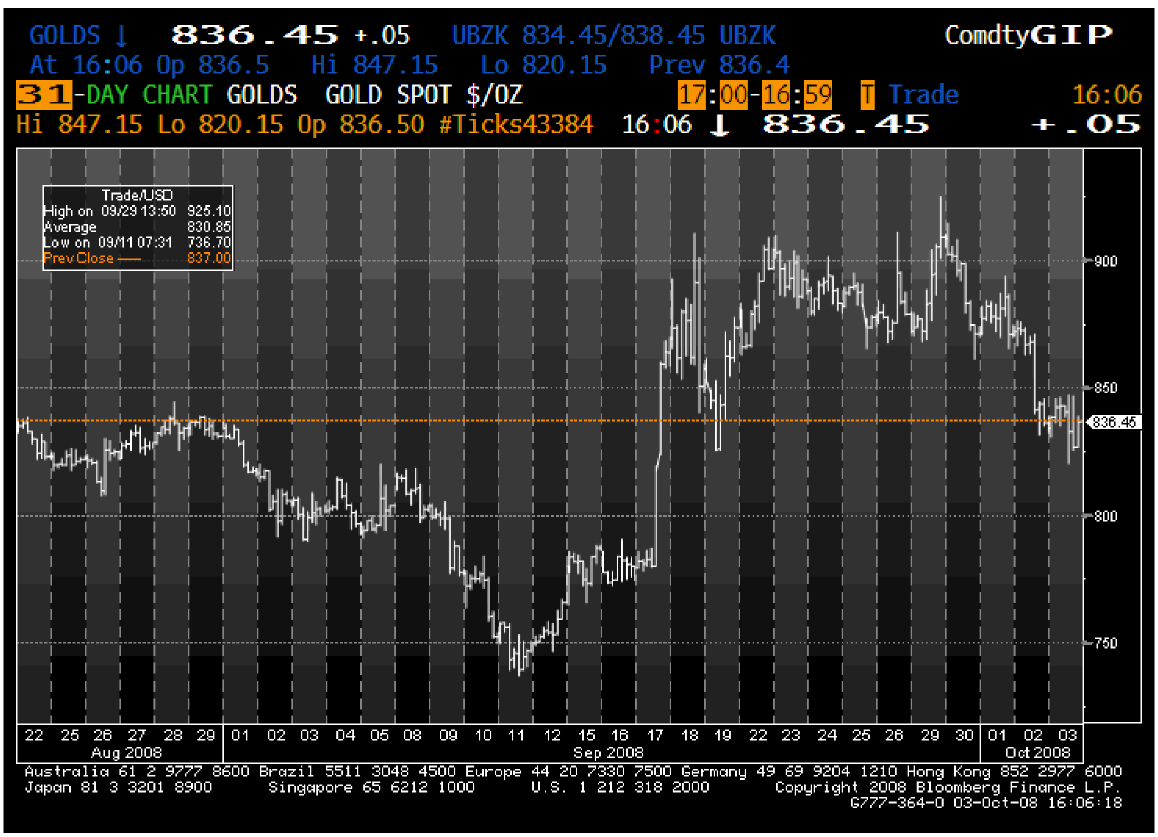
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SILVER

On September 16, I recommended a 100% position in silver in the $10 - $10 ½ range. The next day, the low was $10.53 before spiking that same day to $12.1725. The metal continued its spike toward $14, before reversing sharply this week. The above-discussed range may yet be revisited, in order for us to be able to establish a 200% position, as we have in the past in most timely fashion. We hope to pull that rabbit out of the hat again.

To reiterate prior analyses, there are times when one buys a levered instrument that is premium-based (options) while, at other times, a contract which inherently provides leverage is more appropriate (futures). But then there are items when buying on margin in the cash market makes the most sense.

Well, the idea of silver ever dropping to $5 makes no sense. So, get ready once again for a 200% position. I'll make the same comment here as the last time we were at these levels, when we executed what we aim to do again:

This position and trade alone can make an investor's year.

US DOLLAR

The September 7, 2008 report highlighted the view that the US Dollar had peaked. A review of the Yen the Dollar, the Korean won and anything we looked at graphically or discussed would illustrate the exactness of those views.

Below, we only take a look at the Yen, trusting that this satisfies the argument.

Japan, China, New York, gold & silver, and the Dollar: I hope that SKC's September was a value-added month for its readers and investors.

Until next,...

Sid Klein

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