

# **Cycle Bottoms: Dow Jones, Shanghai Composite, Nikkei**



February 8, 2009

## **Summary**

Financial markets have seen their extremes, insofar as peak negative momentum and cross relationships are concerned. Remember, I have found that the turns in the relative strengths of key markets, tend to occur a few months before the individual markets themselves in fact reverse (with peak negative momentum).

Equity markets are working off crosscurrents, as indicators become overbought, within a larger bottoming phase, in which there are perhaps too many who are willing to be heroic and call a bottom.

A key here is that a typical scenario is shaping up: After short term peaks are made soon, this sideways action will have created a market psychology that will have worsened, without any real net negative progress. In other words, by going sideways, the market will have gotten far more pessimistic, in expecting a wave of decline which never occurs. A reversal from this near term bullishness will certainly have set this up this background.

A typical scenario would then be widespread discussion and fear of 6000 in Japan and the US, before reversing to the upside. This ideal scenario would include minor new lows this quarter before reversing, as was the case last year. Treasuries in the Anglo-American world predictably burst and the most to hope for is a strong look-back rally, with such lower highs again being created by the misbegotten and short-lived idea that long term paper is a flight to safety. How misbegotten? Well, look at the Pound and Dollar. How reliable is THAT paper?

The precious metals are completing or have completed their first wave up in this new bull cycle.

## **JAPAN**

To prove that the economy is global and that even the Japanese can be touched, albeit for a day (January 30), Toyota halted production at 11 of 12 assembly plants. Another eleven days through February and March are also scheduled for suspension, according to Nikkei News.

The following 5-year weekly chart of the Nikkei on page 3 clearly shows a stochastic that would diverge and not confirm any downside, if a minor new low was made, this quarter. The 3-year moving average is 75% above the market, suggesting a rally can be powerful when it gets underway, but a better base is lacking (as exists in China).

The 200-day moving average illustrated in the 2-year daily chart (2<sup>nd</sup> graph on page 3) is about 40% above the market, and descending fast. With the stochastic spiking upward, a study of all the indicators together suggests to me that March, the last month of the fiscal year, will include the year's low, whether "orthodox" or print.

At the end of 2002 and the beginning of 2003, I wrote and shouted from the rooftops that the Bank of Japan's (BoJ) mass purchases of public equity held on the regional banks' balance sheets marked a low, because the world's greatest insider traders were the guys whose lead one ought to follow.

At the beginning of this week, such purchases (1 trillion Yen) were announced to recommence, amid cynical and disbelieving commentary, as regards to just how far reaching the effects would be on the economy. The timing is perfect and that's what I care about. The lead time to a low of about a month makes perfect sense, as yearend in Japan gets out of the way.

Domestics are buyers of their shares, foreigners have head for their domestic hills and the BoJ is buying bank-held public shares. A recipe for a dynamic low, very soon, *n'est-ce pas?* Most Japanese stocks and indices have long since bottomed against foreign indices (as well as the Nikkei). They are pounding the

foreign indices in Yen terms since over a year, as I have been reporting through 2008.



## Strategy

Japanese stocks will continue to outperform most anything, except perhaps China. In 2009, they are both relative superstars.

## SHANGHAI

The chart below is the 5-year weekly, while the pursuant graph is a 2-year daily chart's look at the Shanghai index.

Curiously, both the 200-week (3-year) and 200-day moving averages are nearby in the 2500 range, with both the weekly and daily stochastic overbought. This index has rallied around 30% off the bottom and showed itself to be the most resilient at the bottom, as well as the most robust off the low – clearly the global outperformer, as forecast in these pages through the 4<sup>th</sup>-quarter.



Furthermore, the following chart reflects a nice uptrend and a healthy basing pattern that is well ahead of any global market. My 2008 dog of the year is my 2009 darling of the year. A pullback will create the final 2009 entry opportunity.



## NEW YORK

The stochastic on the 5-year weekly chart which follows immediately below illustrates a very clear bullish divergence, when the Dow spiked to its 2008 low. I wrote a "Catch the Spear" with precisely such market behaviour in mind. A minor new low in the market, should one be forthcoming, will create an even great bullish divergence.

Having much in common with the Nikkei charts above, the pursuant 2-year daily Dow chart illustrates an index that is quickly becoming overbought, and at lower levels than the last time such readings were achieved. Again, this is consistent with a dragged out bottoming phase, where there is no real additional damage to the downside, but, rather, an accumulating frustration in the marketplace that coincides with fund managers' 1<sup>st</sup>-quarter-ending disappointments.



A new low would have plenty of news to choose from. All too often, however, the responses to such news are precisely what help stock prices, if only in the short-to-intermediate term. The California pension fund lost over \$70 billion from October 2007 through the end 2008 and is nearly bankrupt.

Also in California, \$3.7 billion of tax refund and welfare cheques are being delayed, while in Ohio the labour unions are being asked by their governor to make concessions to help with the financial crisis.

## **VIX**

In the 4<sup>th</sup>-quarter, I wrote of two "gimme" trades, one being silver, and the other being the VIX. We realized a 100% return on our VIX trade and are standing aside, reverting to tracking the indicator as precisely that, an indicator. Any dart above 50 would yield to a break to 30, in my opinion.

[However, in relating the VIX to the equity markets, a change may be afoot.](#)

Given the law of diminishing return, put premiums (short sales) have less potential the lower the market level, and, conversely, call premiums have greater potential the more off of the peaks a volatile market has fallen.

In other words, the VIX will undergo a period of rally, [WITH A RISING MARKET](#). Now that the VIX products are out, the markets will behave in such a manner that will have allowed the managers every opportunity to mismanage strategic combinations. SKGS exists to keep you forewarned.

Please scroll down to page 8.





## US LONG BOND

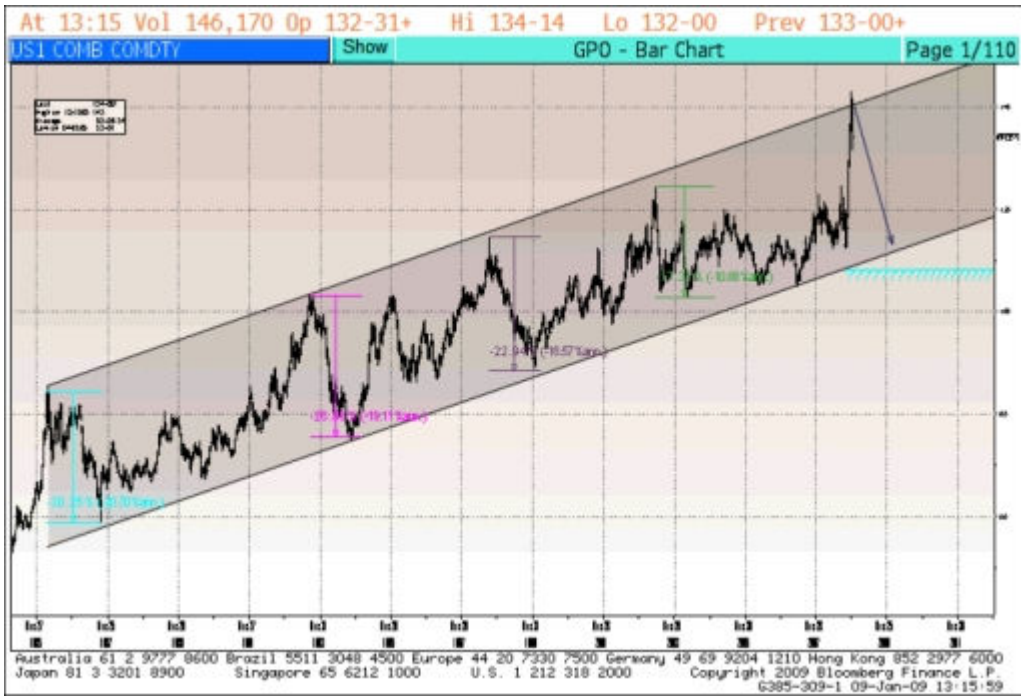
This was easy money, down from 140. Who'll be the idiot to ever again pay 130? Who knows? But let's stay tuned-in, shall we? The easiest baskets of bonds to short were fashioned when the Gilts (not shown here) and the US long bonds were at their manic and unsustainable highs, but that short duo has burst, as described previously. But what the heck, let's stay tuned....just in case.

Frankly, I believe the Chinese are now going the other way, though.

The 1st chart on the next page was posted by [Prieur du Plessis](#) on January 13, 2009 @ 8:52 am, with the comment immediately below, [in blue](#). The 2<sup>nd</sup> chart on the next page is an up-to-date look at the long bonds.

"In the chart below, please note the very simple channel in long bond futures going back to the beginning of the bull market. Prices seem to top every 5 years and, right on schedule, they've topped again."





## GOLD

With the Comex heading toward bankruptcy and foreign markets opening to take its place, the song remains the same, and as written in these pages since going online over 7 years ago: There is a massive shift of wealth and power from West to East.

We are 100% long gold forever because gold's next cycle is going to \$3000 - \$3500, as already reported here. At the recent Davos conference, the chairman of Barrick shared the same forecast, based on the possibility of the Chinese turning their paper into gold. (That beats walking on water, no?)

Not having reported on it sooner: Investment demand for physical gold spiked 121% in the 3<sup>rd</sup>-quarter.

For now, the metal has peaked. The stochastic are overbought on both the 5-year weekly and 2-year daily charts below, respectively.

Downside is to \$800. Who cares?





## SILVER

From the November 25, 2008 report:

"...I am now moving from 100% to 200% long silver, basis tomorrow's average price. The chart above illustrates the perfection with which the initial (100%) position was established\*. Coupled with a short VIX position from 75, we are well positioned for a rebound in asset prices."

"\* Approximate average price for 200% silver position: \$9.21."

Like the VIX trade - the other "gimme" - we are in an 80% profit position, sitting atop a 200% long position, with the metal up 42% as at Friday's close. We are selling a 100% position (one-half our total holding) at Monday's opening. The 200-day moving average is being kissed, right at critical resistance, with both the weekly and daily stochastic very overbought (see 5 and 2-year charts below).



## YEN

In 2002, my currency mix was a combination of Euro, Yen and gold. The Euro was eventually replaced with the Swiss Franc and gold became a fixed 50% position, once the \$500 level was traversed. At that point, and as forecast, I took the view that the currency mix should be such, since the yellow metal would be in a bull market versus all currencies.

Last year, I made it clear that the Japanese Yen was by far the world's best fiat currency for capital appreciation and, indeed, since that time, out from the period known as "the carry trade will never be unwound", the Yen has beaten the crap out of everything.

What's a carry trade, when Weimar knows that all it has to do is print, to "unwind?"



## POUND

The Pound lost about a third of its value against the USD over a 6-months period, as can be seen on the 2-year daily chart below. So, does anyone want to see what it did against the Yen? (It must be getting tough to by a TV in London.)

That's what happens when you discard M3 and print money like there's no tomorrow to not pay your debts.

Throughout Europe, the monetary union has already left half in depression, amid riots.

Closer to home, the US military reports that collapse in Mexico is nearing. The plans accelerated under Bush are coming to fruition.

I get a feeling that the great Anglo-American partnership has ideas about a new global currency that makes debt repayment unnecessary. Don't you?



Sid Klein



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