

Perfect Dow Peak & Vix Bottom



June 03, 2007

JAPAN

Nikkei:

Last month, I continued to publish a largely technical report, since the long-term and very bullish fundamentals that I covered in the 2001 – 2003 period remain in place. However, the intermediate term is murky, due to monetary and technical factors.

One year ago, the Bank of Japan tightened credit to deflate the speculative excesses in the market. That caused the decline to the 14000-area, where the low was identified in these pages. I have always labeled that decline as the 1st of a 3-legged correction. I have maintained that the move toward 18000 represented the completion of the 2nd leg (an advance that's part of a correction).

The 3rd and last leg, I have maintained, should take the Nikkei back toward 14000. Forecasting and identifying the

completions of the corrective points (the 3 "legs") is a technical matter. And, so, the May report reflected both the negative intermediate term indicators, as well as the bullish near term ones. From last month's report, then:

"Meanwhile, the stochastic (see bottom of chart) and other momentum indicators are over-sold and pointing upward. If a near-term rally were to fail, however, the dominance of importance turns to longer-term indicators, namely, weekly indicators."



The daily Nikkei chart **below** allows for a minor new high, to allow the index to again catch up to the Dow on a laggard basis. That it further does so on a laggard basis in terms of relative performance, aside from time, further suggests that the action is countertrend, since it is the Nikkei that is in the bull market versus the Dow, and not the other way around, as we see from all the Nikkei/Dow ratio charts that have been published in these pages since 2003.

However, the weekly Nikkei chart **above** indicates that such a minor new high would merely set up a dangerous pennant formation (connect the peaks of 2006 and 2007), which could cause a hard smash toward 14000, while the Dow crumbles.



Mid-cap Domestic Value stocks:

The following chart of the Topix 500 versus the Nikkei clearly shows support being reached in terms of the up-trend channel one sees, when connecting the 2001 and 2002 lows. There is an evident and basic support level at about .22 being approached, as well as the support implied by retracement percentage.

Therefore, the mid-cap value stocks are the safest and most immediately profitable way of investing in Japan or anywhere, when further considering that the Nikkei is itself

approaching firm support against the Dow Jones Industrial Average.



Conclusion & strategy:

From last month's report: "The out-performance of mid-cap Japanese domestic stocks versus other classes and international indices will continue and geometrically expand." The song remains the same.

NEW YORK

Dow Jones:

To confess, set the record straight and clarify where we are: To begin with, after starting the decade with perfection at the peak and bottom of 2000 and 2002 respectively, I have been wrong about the Dow since February 2004, when I felt the index had peaked. That date and level (10400) had been forecast at the low in October 2002, with 2 days.

Having said that, I have more recently identified the swift collapse to 12000, including the identification of its low at that level. The correct strategy was selected as well. This is important for present forecasting. Why?

Specifically, after having recommended long term puts only (18-months) earlier in the decade, I advised using a smaller amount of capital for 2 – 3 month puts, with the idea being that if the market were to do another leg up and those puts were to expire, the total loss would still be less than the incremental decline that would have been suffered in 18-month options.

After a very successful call for a swift collapse to 12000, which only required short term puts, this approach has been vindicated. This is even more so the case given the recent new leg up to the 13600-area, for the reason expressed at the end of the preceding paragraph. Last month's market report suggested that the Dow could back-and-fill toward 13000 but peak at today's levels to complete the advance.

The Dow has preferred to advance straight away, with setbacks along the way that satisfy pattern requirements (wave count) for a completed move. My approach has been to focus on the world and ignore New York, except for minor investments of one's wealth in put options. As regard this strategic approach, there are no regrets. If there were any regrets, all the profits from 11700 to 7200 and then up to 10400 would not have occurred, either. It's all based on the same worldview and Economic Long Wave (Kondratieff) Cycle interpretation.

In any event, today we see a completed advance. To reiterate the comments from the previous 2 reports, the decline to 12000 was based on the correct interpretation that a five-wave advance had completed, where each leg consisted of only 3 waves (legs). This very rare pattern only

occurs when a 5-wave pattern is concluding (see following chart on this page) and it further holds that such an advance, while marking a peak, also returns to the point of origin with speed, hence my ability to identify a swift decline to 12000. But as I've already reported, as a fund manager reminded me, such a pattern occurs in the 4th wave of the even larger 5-wave structure.

Simply, this means that, while indeed marking the conclusion of an advance, it marks the end of the next-to-last advance. In other words, the ensuing collapse would be and was the last correction, before the entire bull market completes and the bear market commences for real.

Therefore, this advance **IS** the last one, and all one is to do is time this rally's conclusion to again achieve identifying the bull market's peak. And this one is more glorious than 2000!

Continued after chart:



Even if one were off by a bit, at this point, one would not be off by much **no matter what**. Last month's letter warned that the advance would not be complete until there was some more rally to this level and that it would take about a month. We're there.

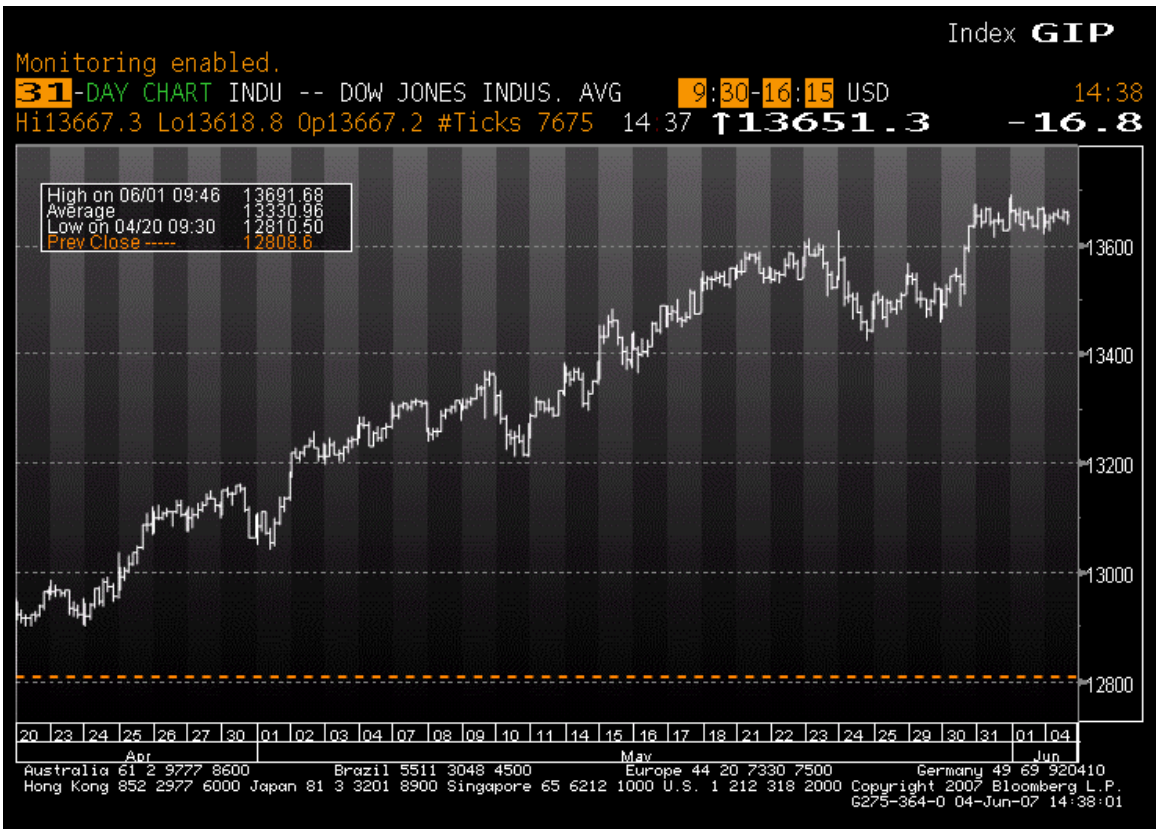
In the above chart, to avoid the overlapping of numbers and letters, I have placed the markings where they are. **In fact, however, "3" appears where wave 3 of 3 ends and "E", therefore, marks the end of that particular entire advance, as described and discussed above. Simply, that is where wave-3 ends.**

Now, if one wishes to have confidence about the entire advance being over, note the following chart (the 1st on page 8), which reflects the past 31 trading sessions. Five-wave sub-divisions abound. How much does one want?

In the face all that lies below and put option profits above, as someone who was there in 1987 and 1990 (Japan) and 2000 (New York again), I can warn with a very straight face that one should not complacently theorize about a boy crying wolf.

This will be pinned on Bush and the politicians who are all too happy to cause a decline on the Republican watch, while also alleviating the possibility of that same decline occurring when they (the Democrats) regain power. Bernanke will suffer the same fate as Mieno in 1990 and Greenspan in 1987. It's the rite of initiation for a bank governor, or something like that.

The pursuant 2 Dow charts (after the 31-day chart) on pages 8 + 9, clearly show how confined in terms of upside this index is, not to mention the overdone speculation that the pattern implies at this upper trend-line! Therefore, there is neither much risk in shorting (in terms of timing), nor much concern of upside potential, respectively.



Comment on VIX follows the VIX chart on this page:



The pattern of the VIX (above) indicates a higher low, while also reflecting a dead stop at, and pullback to, the 200-day moving average, up-trend buy-point, and neckline support level.

This isn't just a contrary indicator that refines the timing for entering a Dow short position, it also helps time the entry into put option premium levels. Having closely tracked the activity of the latter, I can attest that activity in very recent days and hours indicates the capitulation that one hopes to see against a **backdrop of little upward index progress relative to the size of put premium decline**, the occurrence of which invites the seasoned speculator and hedger with open arms.

Meanwhile, the weekly long term VIX chart immediately below (page 11), shows a bowling formation at almost impregnable support (12). And today's action is again lending great confidence to the notion that the last ingredient needed for feeling relatively safe in entering the short position is unfolding right now.



Conclusion and strategy:

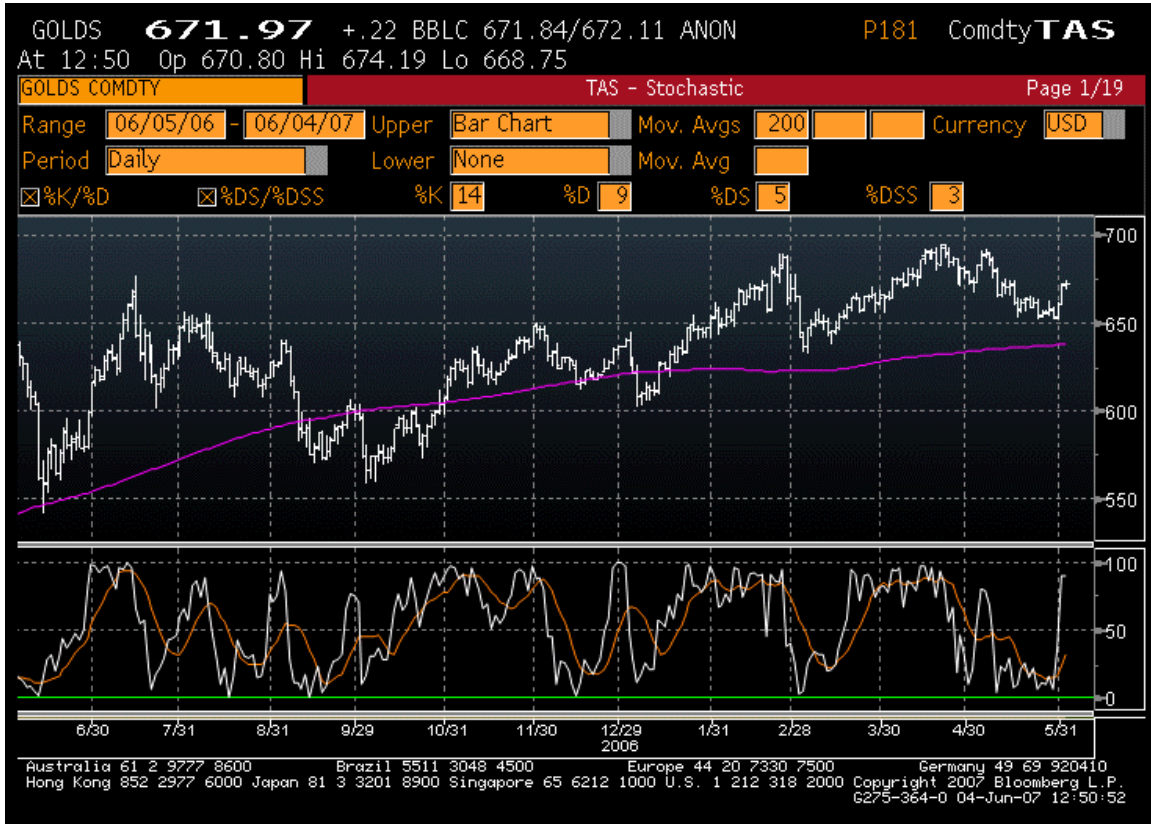
Everything points to a spring/summer peak NOW, right when dozing-off traders are preparing for the summer doldrums. Meanwhile, the pattern of the VIX screams buying December puts to start, trading after doubling capital, say, en route to building - and lengthening the time duration of - put positions, that will make fortunes for those who ride this bear market into the 8000's.

GOLD & DOLLAR:

I will expand more on gold and silver later on.

At the peak, I advised those wishing to do so to go to 50% long gold (referring to the gold portion of one's wealth), while understanding that gold represents 50% of one's wealth (or 40% + 10% silver).

This was based on the idea that the metal could drop to as low as \$600 or, and more likely, trade net sideways with declines along the way that would shake the tree a bit, as bulls would become impatient. The 1-year daily gold chart that follows immediately below is consistent with such a finding, and with a low here at \$650 that one could argue suffices as the completion of such a net-sideways correction.



However, the pursuant weekly long-term chart reflects why it is very possible that capitulation only occurs with a decline to a level very close \$605. And **consistent with this is the fact that daily momentum indicators are overbought, while the weekly ones have yet to hit bottom**. Remember, weekly indicators, unlike daily and monthly ones, are coincident indicators during a bear market.



So, my principal occupation has been to stress that this massive bull market in gold and silver is the prize on which one should keep one's eye, not any corrective period, and that such a period of correction would be a good time to exit all precious metal stocks, unless one had a true affinity for a particular equity, based on a special "feel" and grasp of the fundamentals. Why? Because when it hits the fan in New York, these stocks won't be exempt.

Such a corrective period is understandably related to the last vestiges of a Dollar bull that must yield to a Dollar crisis. So, gold lovers stay tuned and maintain it as 50% of one's wealth and lose the idea that gold is not the true currency, but that paper is.

For many years, I advised allocating according to currency, as opposed to what pays a higher interest coupon. Then, I went on advise gold as the replacement for paper currencies,

as of January 2002. That is when gold and silver made their higher lows.

Through this period, my position has been to maintain very overweight holding in Golden Star, to compensate for lesser holdings in the precious metals complex. I consider that stock to be loaded with leverage and potential, while providing unusual safety for that potential. Again, Golden Star commentary continues after the Yen charts.

The Dollar has been strong and the Yen's beating back to its lows has caused Japanese stock portfolios to suffer. The Yen has gone in the opposite direction of the Nikkei and will run in the same direction as the domestic stocks.

Nothing new there.

The following 7-year weekly Yen chart reflects a flat top pennant formation that is evident, despite not having drawn in the lines that illustrate so. This implies a real risk of a reversal that is sharp. Yes, I have written this before, but that is exactly where the risk lies. The carry trade can start to unwind at any time and everyone will not make it through the door at the same time. That is a global theme presently for more than one market, it seems.

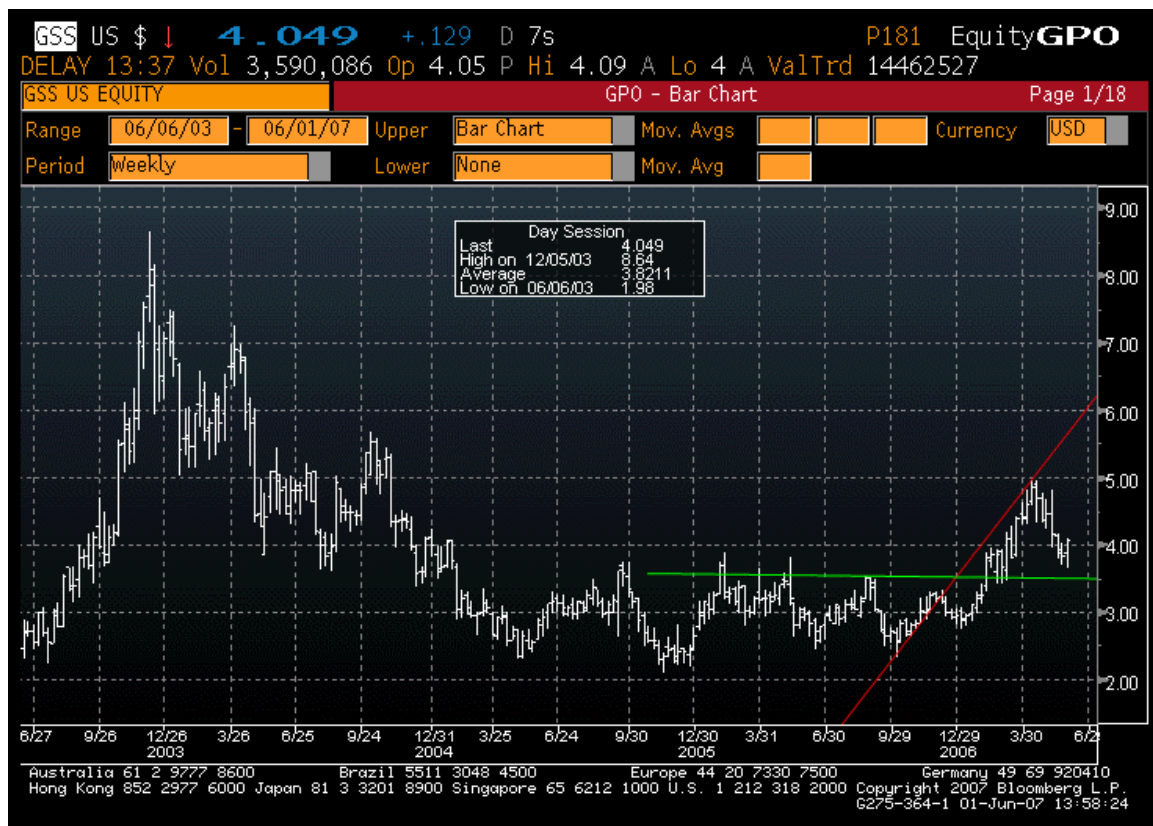
Meanwhile, the pursuant 1-year daily Yen chart illustrates the same story and leads to the same conclusion. It is always easier to draw conclusions when multiple indicators are suggesting the same finding. Unfortunately for now though - just as a strong Yen and strong mid-cap value stocks will provide a positive double whammy for investors - the not-yet-reversed Nikkei and the re-testing-of-lows Yen are providing a negative double whammy for us.



Strategy & conclusion:

Weekly and daily indicators are overbought. The reversal will be brutal in the Dollar and when it comes it will be tagged to political upheaval in the US, along with the unwinding of the Yen carry trade. International investors will be seeking a value haven that provides the requisite liquidity.

Golden Star:



"The balance sheet reads like a Japanese value stock, particularly if viewed as a gold company. Technically, there are long term resistant levels at \$10 and \$25. I maintain that both will be seen." There's your upside!

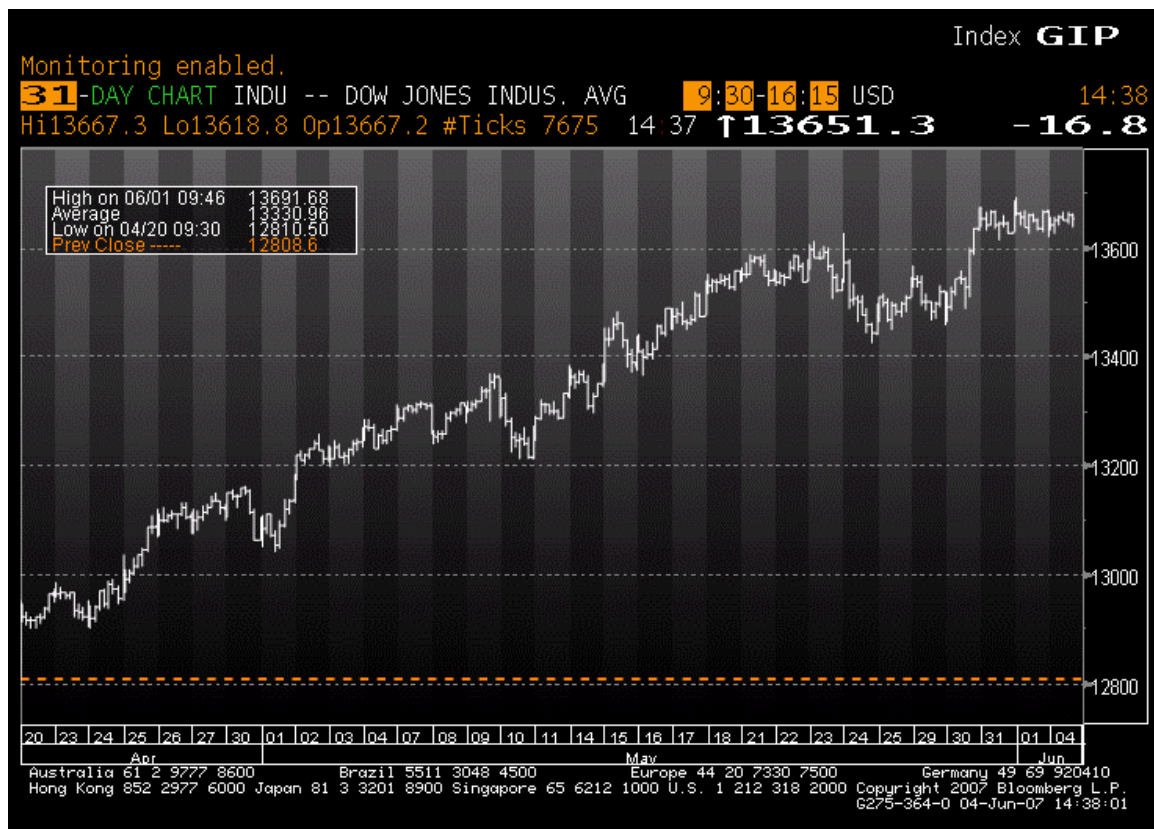
The profits you earn will be a function of how long you hold it for.

This stock rallies during bad times for gold, as smart money uses that condition to accumulate the desired volume of

shares. The breakout has occurred as per the comments made through last year, including the December 2006 report and the February 2007 letter.

This is the only non-Japanese stock I have recommended and recommend, and profits should be huge. Buy, and buy aggressively if you haven't already done so!

My average price is around \$3.00 and now that it has pulled back a little for those have not participated, please note the 5-wave advance off the recent low, as evident from the following 31-day chart.



Golden Star can be accumulated through this corrective period in gold, which, in the bigger picture, is itself nearing an end.

Strategy & Asset Allocation:

The song remains the same, so we stay the course and simply re-print....

“For our purposes, we’ll assume 50% long gold and silver positions, while aggressively long Golden Star. While gold and silver represent 50% of our portfolio (in terms of currency denomination), the Japanese Yen and the Swiss Franc represent the other 50%, 25% each. These figures assume no partial positions, which is presently and temporarily the case with the precious metals.”

Good fortune to all,

Sid Klein

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