

TOP TICK



October 1, 2006

JAPAN:

Multi-national financial institutions have slashed GDP projections for the US next year by .6% - .8% point. While China and India are relatively closed economies and should be relatively unscathed, the same can be said of the Japanese economy, although China and India enjoy greater policy latitude.

Still, as the third largest bourse and enjoying over 60% of Asia's GDP and market cap, Japan is the conduit for Asian equity investment.

Still, the selection of the right theme is the key to profit maximization and long-term risk minimization. While the August trade balance's 96% increase is an economic item that bodes well for the Yen, lesser Western trade must be factored into one's reasoning when allocating assets.

There is no shortage of Japan/Asia themes. I was the first to identify the low in Japanese land prices and have regularly reported on progress. Since then, I have harped on condo-related themes. Well, now, land prices have extended 16-year highs. As I have previously reported, land and property peak or bottom on lags to the stock market. This is because investors run to real estate when the

stock market fails, while bottoming later as stocks and the economy turn faster than the balance sheets and sentiment in the land and property markets.

I harp again here on the stocks that have been mentioned in these reports. Different equities have been recommended over two different reports. One stock was Dynacity (8901). It is a condo player the stock of which has been crushed by the confluence of a variety of one-time or end of cycle factors.

Land has bottomed in Tokyo. Recently, fewer condos were built than expected due to perceived increases to come in real estate prices. Dynacity has a heavy portfolio of condos in Tokyo. The government plan to move the elderly from their rural area homes to urban condos is a special factor. And as management problems resolve in the not-too-distant-future, focus will turn to improving earnings, how much is paid for them and, of course, a bottom in the land and property markets.

Japan is now littered with cheap stocks and sectors, in the same way that it was in 2000, when the Dow made its perfect peak. Precious metals, certain commodities and Japanese domestic value stocks are cheap and counter-Dow long term. They aren't all as cheap but Dynacity is an example of a stock that should double just to approach a more normalized valuation. Beyond that, it will advance another 10,000, and then another 10,000. When they're cheap, they're cheap. The idea is to have a bunch of them...with a bunch of patience. Such is the nature of value stocks.

Indicators:

The Nikkei is stalling at the **200-month moving average** (see 10-year chart on page 3), which, obviously, is a very long-term indicator. This means that this area is problematic, but it also means that it will make for greater support once the market has worked through long-term profit taking and breaks out to new highs and beyond.

On page 4 is the 1-year chart. The **daily stochastic** at the bottom of the chart is at the extreme overbought, but there is no divergence, so working to more fully re-test recent near term highs is likely (about 200 points from here). But that's not important. The Nikkei seems to have proven that critical support exists at 14,000. I reiterate that a re-test of that level may well be dependant on a Dow debacle..

Conclusion: As for that 14,000 support, note the **10-year chart** again and the beautiful neckline that you see at that level. If the chart were inverted one would clearly see the shoulders of a head-and-shoulders pattern. In any event, we are now also close in terms of time to the lows in a vast array of Japanese stocks. The November – December season of Western tax selling is soon upon us, so an 80%-100% invested stance is warranted, as most stocks will have made their lows by then (see the Yen comment at the conclusion of this report).

NKY ↓16254.29 +126.71
 At 03:00 Op 16169.00 Hi 16329.24 Lo 16157.98

Index **TAS**

Stochastics for **NKY Index** 1/12

Range **9/29/96** - **9/29/06** Period **Monthly** Base Currency: **JPY**
 Upper Chart: **Bar Chart** Moving Averages **200 200 1) News**
 Stochastics **%K/%D Chart** Periods: %K **14** %D **9** %DS **3** %DSS **3**



Australia 61 2 3777 8800 Brazil 5511 3048 4500 Europe 64 20 7380 7500 Germany 49 69 920110
 Hong Kong 952 2577 0000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2006 Bloomberg L.P.
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Stochastics

NKY ↓16254.29 +126.71
 At 03:00 Up 16169.00 Hi 16329.24 Lo 16157.98

Index **TAS**

Stochastics for **NKY Index**

1/10

Range **9/29/05** - **9/29/06** Period Daily Base Currency: **JPY**
 Upper Chart: Bar Chart Moving Averages **200** **200** News
 Stochastics %K/%D Chart Periods: %K **14** %D **9** %DS **3** %DSS **3**



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NEW YORK:

I recently wrote of the collapse in the housing market and the effects of adjustable rate mortgages on consumer confidence. What I didn't pass on (which has been making the rounds on the internet, I understand) is that when consumers don't meet interest payments, the lenders tack the deficiency on to the debt, and due to poor reporting requirements, borrowers don't necessarily learn of their depleting equity in a timely manner.

When they do find out, consumer confidence won't get off the mat.

Consumer confidence, at it did last year, sprung back to life before the nearly-coincident consumer spending indicator could come in line on the downside with the preceding collapse of consumer confidence. Again, this was a close call for the economy. Consumer spending lags consumer confidence by about only one single month. Then, the lag to the stock market's own significant collapse is minimal.

The literal taking stock of one's equity (in one's home) is just another possible major trigger to the collapse of the house of cards we call the stock market - especially if someone asks a critical question *before* going out for Christmas shopping!.

TECHNICAL:

Richard Russell has written about what we learn after many years of experience: that the probing of intermediate term peaks is how one would go about targeting a major cycle high.

Last month, I put forth that the market would love a Dow-makes-new-high headline, since it implies that everyone is making money. I felt that new year-highs and new all-time highs (the latter just points from here) would be denied due to front running. Please note that the S&P and NASDAQ are too far from highs to ever confirm. The fundamentals haven't changed, so let's focus on the technical aspect for timing of an intermediate term peak, to see whether this could be the final post-2002 top.

Indicators:

The three peaks in the **monthly stochastic** (at the bottom of the 10-year chart on page 7) that precede the most recent peak formed the most bearish of all stochastic configurations (when the level of the third peak in the stochastic is in between the levels of the first and second stochastic highs). As reported then, **this configuration occurred right at the very peak of the stock market this year.** According to the indicator, the Dow had to fall immediately or the indicator

would fail, by moving outside the parameters for such a (bearish) configuration. The market then fell a thousand points.

Today, this stochastic has returned toward its highs and a level that cannot be breached, which could and probably would occur if the market were up in October. Therefore, once again, by inferential reasoning, the market would fall almost [immediately](#). In fact, by turning down in October, the extremely tenuous and dangerous divergences in this very long term stochastic would be exacerbated.

On page 8, please see the 1-year chart. At the bottom of it is the **daily stochastic**, which has now diverged downward in the short term, consistent with a market making its peak at the [very beginning](#) of the new month and quarter. Sometimes, markets peak on the first day of the new month. Shorts who bravely stuck out the third quarter finally get run in at this peak. This reinforces the notion of a downturn in the monthly indicator and a double top in the stock market, now.

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Stochastics for **INDU Index** 1/12
 Range 9/29/96 - 9/29/06 Period Monthly Base Currency: **USD**
 Upper Chart: **1** Bar Chart Moving Averages **200 200 1** Neus
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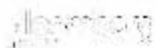
Stochastics

INDU ↓ 11675.71 -3.36 ↓ Index **TAS**
 At 14:30 Op 11678.99 Hi 11726.94 Lc 11659.66 Prev 11679.07

Stochastics for **INDU Index** 1/10
 Range 9/29/05 - 9/29/06 Period Daily Base Currency: **USD**
 Upper Chart: Bar Chart Moving Averages 200 200 1) News
 Stochastics %K/%D Chart Periods: %K 14 %D 9 %DS 3 %DSS 3



Australia 61 2 5277 9600 Brazil 5511 3048 4500 Europe 44 20 7300 7500 Germany 49 69 520110
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OIL:

Is stopping at this \$60 level, and it shouldn't break. At \$75, everyone wanted some form of oil play. At \$60, there are plenty of stories as to why fear lower prices.

There is surely technical overhead, due to the higher prices (over \$70) at which many buyers are trapped. Still, there is a lot of room between \$60 and \$75. In this past quarter, bulls and bears each took turns getting hammered. Since the market fools most of the people most of time over the short term, the coming quarter's casualty should be volatility itself. Oil's next major advance will only get underway once volatility has greatly subsided.

Once the market finds equilibrium, the stage will be set for the next major phase. Still, the low has been seen. It is possible that several commodities and the stock market have divorced (go in opposite directions).

Strategy:

In oil, one can bet on triangulation of the chart, as volatility gets hammered through the quarter. In other words, the swings up and down get progressively smaller (i.e. – the biggest move is the first one up) from here (yes, now). And even though the swings get smaller, there are a number of swings up and down from which to profit.

I'm 100% long June and December 2007 Dow puts 450 points ago, but the evidence smells the same as the last time the Dow was here. In that cycle too, I was 450 points early. And the indicators were profoundly similar.

PRECIOUS METALS & DOLLAR:

Gold saw the low at this most recent bottom and can now take off, or can more fully re-test toward its \$550 low. It's a coin toss. I believe the lows have been seen. Either way, long-term investors are (as always) 100% invested, while trading accounts that aim to capture intermediate term moves are also 100% long. So, for me, the next near term move is moot.

Silver is the same story. On the way up, silver will initially take its lead from gold.

The **Swiss Franc** has made another higher high versus the **Yen**, establishing it as the best of the paper currencies we cover. The divergence of it and the **Euro** tell of the true and building trend, which is the resumption the secular bear market in the **Dollar**. When new cycle moves (such as the next leg up) begin in the foreign currencies, the Yen, if history has taught me anything, is likely to

begin with an enormous bang. Perhaps over 2 ½ cents. An ambush, BoJ style, for instance. Who knows what the trigger will be.

Therein lies the investment impetus for a flow of funds to domestic Japanese equities. Macro is out. Western-related business themes are out. The bottoms-up search for Japanese investment by a pool of capital that is too large for it is on.

Sid Klein

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