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NET POSITIVE DEFLATION

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SPECIAL NOTE:

For the time being, due to ongoing special projects, SKWC will continue to be published the first weekend of each month.

JAPAN:

BANKING:

The big news is that one should expect the Bank of Japan to increase bank capital ratios, forcing the sector to accept capital injections as banks fall under the Bank for International Settlements' 10% reserve requirements. New capital ratios will also accelerate reorganization as deferred tax assets are given a greater period of time over which they may be used. As for how many shares the BoJ receives in exchange for the capital injections depends on the levels at which the shares are issued; the higher the market, the less the dilution, which is better for the longer term. Either way, government and Central Bank interests rest with higher stock prices.

In any event, non-performing loans was reduced by 3 trillion Yen during the fiscal first half as a result of write-offs, debt forgiveness, equity share exchange for debt and 1 trillion Yen of bad debt purchases by the Resolution Collection Corporation. Meanwhile, bankruptcies and debt forgiveness are not causing additional losses due to the additional reserves taken last March. Finally, write-offs at the end of the fiscal first half were about 50% compared to a year earlier.

ECONOMY:

Business sentiment has improved across all groups, including small and large manufacturing and non-manufacturing companies. Despite this, barely more than 10% expect growth of greater than 1% for the coming fiscal year.

Two indicators that did not join last year's turnaround were housing and employment. As forecast here, it appears that housing has indeed turned.

Meanwhile, the job/offers ratio is improving. A decade long triple divergence between new job offers and the number of employees makes one wonder if the New Economy is creating jobs. Perhaps supporting this view is the new-job offers to new-job applicants ratio, which is about 1. In general, job offers-to-jobs sought is about .55.

SKWC has also forecast a 2003 bottom for the third still-negative indicator, capital spending. Capital spending has an indicator in its favour. Due to restructuring, profits are recovering. As in '93 and '98, this recovery should prove to precede a recovery in sales in '03. The decline in capital spending is slowing. When improvement in manufacturing eventually results in sales, the market will already be much higher. Costs are falling more than sales. **Has Japan achieved "net positive deflation"?**

STOCKS:

Over half of the foreign investment community is underweight Japan, though the trend of increasing weightings has begun as a result of the devastating bear market in the US. Simultaneously, Japanese brokers (smart money) who have been sellers two-thirds of the time over the past 60 weeks, have begun to buy over the past month and a half.

One thing that we have had confirmed is the benefit to Domestic Demand Oriented Value Stocks (DDOVS), resulting from general Japanese market weakness. The majority of the DDOVS on our list never even fully tested the lows of the 1st quarter of 2000, when these equities generally bottomed (with the Nikkei around 20,000). In fact, favourite names have even rallied recently as much as 35% (!), during the 1,000-point Nikkei bounce off of the short term lows recently seen at 8,300. Imagine when the bull market begins. Those seeking safe haven will be joined by funds committed to re-weighting, resulting in 100 - 200% gains for DDOVS names over 12 – 24 months.

The Aug. 25 letter wrote: *"Still, a collapse in the **Dow**, coupled with certain seasonal factors could temporarily drag the **Nikkei** toward 8,000. Even in that scenario, consider this: The outside time frame **SKWC** gives for a low in the **Nikkei** is January 2003 anyway. On top of that, **New York**, the cause for any short-term delay in the coming eruption in **Japanese** equities, may be strong briefly as of October*". Indeed, as forecast, we are witnessing the mirror image of Jan. 1990. There is a good chance that lows presently being made, may not be broken during the course of the natural lifetimes of the readers of this report.

NEW YORK:

The Nov. 29, SKWC forecast: *"For the very short term (December), SKWC no longer envisions the 6,000's but, rather, say, **7,800**. One would then review that SKWC was both right and wrong, assuming, of course, that the cyclical bull market indeed comes through. As for the part that was wrong, missing 8,500 to 9,000, assuming that the December pullback comes through, constitutes 'no harm, no foul'".*

After forecasting and identifying the Oct. lows, SKWC correctly cautioned that 9,000 would be the maximum short term upside. For that reason, the Dow 8,500 level was deemed to be a resistance level from which one ought to profit by exiting the market. Of course, to keep perspective, we were looking for a low from which the Dow may rally for 15 months, probably taking the index over 10,000.

The forecast December low has been seen. However, the year's first week's excitement notwithstanding, 7,800 remains very possible (this month) before the real cyclical bull countertrend rally gets underway. As for an invasion of Iraq, just remember how the commencement of shooting was greeted last time with an immediate and stunning rally. The powers that be will be no less impressive in having lined up a scenario for market eruption that sends all the desired signals to the market with respect to the effect and role of the war on the stock and commodity marketplaces.

NIKKEI/DOW RATIO:

This ratio has again shrunk to about par. History will write this down as one of the simplest and most profitable ratio trades of all-time, whether it is used to speculate, hedge or to synthetically switch to a portfolio of Japanese equities from US holdings. The speculator will use this investment as a position (longer duration) trade.

DOLLAR:

The currencies have erupted since SKWC perfectly identified the October lows, reacting as forecast for year-end (see October's currency commentaries).

The Euro has rallied a whopping **10%**, while the Swiss Franc and Yen have spiked **9%** and **6%**, respectively. To this follow-up of October's comments and the extensive commentary made to date regarding the role(s) of foreign currency holdings in one's portfolio, SKWC finds nothing to add at this time.

GOLD:

The Oct. 26 missive reported: *"It is the updated and honed view of this service at this time that the present gold correction will take the form of an A-B-C-D-E contracting triangle, in Elliott Wave terms. Simply, this means that the metal should trade between $310 – 325, before resuming its greater advance.*

"Everything will probably be back to "normal", for now. The recipe should again be Dow down, with the currencies and gold up, for the remainder of the year".

Over the past 12 months, SKWC continued to offer impeccable timing, with respect to both bullion and gold stocks, regardless of whether analysis referred to the short, intermediate or longer terms (see "previous comments"). The commentary leading up to this recent burst in gold is no exception.

The Nov. 29 letter updated as follows: *"Indeed, gold took off from the $310 area toward $325 and is now trading within an A-B-C-D-E contracting triangle. The metal is pulling back to the 200 day moving average around $315, basis the December contract. From there, to complete what was initially anticipated, gold would rally to $340, taking out resistance around $333, putting in a meaningful intermediate term **bull trap**!"*

What we may conclude, then, if SKWC's record is to continue unabated, is that a bull trap of intermediate term nature has been completed, as the run-up over $333 concludes. In this preferred scenario, support now rests in the $320-325 zone. Alternatively, as SKWC has cautioned repeatedly, the secular trend is decidedly positive for gold, placing the greater risk on the side of not being invested. The accompanying comment was and is that a break over $350 could lead to a dramatic spike up toward $500 per ounce. It is not my view that this is the time for that scenario to manifest but deference to the secular trend is always an expression of wisdom. Therefore, one must strategize accordingly.

It continues to be the case that big-cap names trade at levels seen at meaningfully lower bullion prices. Smaller stocks are not exceeding highs that we may assume discounted higher gold prices. From the big-cap prices, we may glean non-participation on the part of large non-gold specific funds. The absence of gold funds to take advantage of lower gold equity prices is a sign of the effect of New York's bear market. Like DDOVS, these equities are firm but require a catalyst in the form of higher US stock prices. As the Dow rallies over the coming year, fund managers still shell-shocked from the bear market will buy gold equities, deeming them to be more defensive. Bottom line: A higher Dow will be accompanied by much higher gold stock prices as fund managers invest in liquid large-cap names. Newly created gold funds will stoke the gold shares' fires. It is wise to use weakness toward $325 to purchase gold equities.

SUMMARY:

Japan: SKWC has been letter perfect, forecasting and identifying every intermediate and short-term peak and trough, within the context of ideal secular and cyclical market analyses. The DDOVS coverage has provided additional performance

New York: SKWC has been letter perfect, forecasting and identifying every intermediate and short-term top and bottom, within the context of ideal secular and cyclical market analyses.

Gold: SKWC has been letter perfect, forecasting and identifying every intermediate and short-term top and bottom, within the context of ideal secular and cyclical market analyses. Gold equity coverage has provided significant additional performance.

Dollar: SKWC has been letter perfect, forecasting and identifying every intermediate and (virtually every) short-term peak and low, within the context of ideal secular and cyclical market analyses.

In all mathematical likelihood, no service in world has been able to record the forecasting performance of SKWC. Even if a service was able to match the here referenced performance in any of the markets above, the statistical probability of such performance being matched in all 4 markets is profoundly slim. The future will undoubtedly bring us down to earth a little. After all, that's what markets are for. However, readers may be assured that efforts will never wane. As well, the strategic planning and investment mixture will continue to be ever-humbly designed to allow for less than perfectly precise analyses, since expectation of the latter is foolhardy. Therefore, when such performance as 2002's is inspired, one must be grateful for the past and be more vigilant than ever with respect to the future. To that end, we thank 2002 for being so kind and begin 2003 with a humble respect for the vagaries of the markets over the short and intermediate terms.

Still, the precision of the past year's forecasting may be attributed to the same consideration that has decimated so many over the same period. Simply, one must have the secular story right! SKWC has had the secular story for each market right because years of planning and study with respect to this present phase of the Kondratieff cycle was focused upon it. What for us is evident and easily predictable proves shocking for those without perspective, seeking to explain investment disaster with the political follies of madmen.

2003 is here promised the same commitment to excellence with which SKWC has come to proudly imbue all its efforts.

All the best in this New Year,

Sid Klein