The Sid Klein Comment
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Japanese and US Equity Trends: Cross of 1987 & 2000

Japan Asia Investments
Canada

March 25, 2007

NEW YORK

To provide context for the substance of this letter, included below are references to prior reports; they appear in blue:

The March 4 letter reiterated and summarized the 4th quarter's view's:

"However, monies that were committed as of September have driven the US indices. Therefore, fundamentals are suspended since committed money has to be spent. I added and remind that this is what happened in Japan in the 4th quarter of 1989. Exactly!

From the February 4th issue:
"I have often warned of this cycle's most unusual phenomena. The Dow (not only) has stopped being predictive and falls once the bad news is already in the market. This has two powerful effects: Firstly, it lulls investors into doubting or even disbelieving what they had rationally thought and what later will appear as have having been obvious. All the false starts hypnotize the investor into, "I'll wait for one more rally." This time the rally doesn't come. With all the risk to

the downside, with so little to the upside, the investor later bangs his head against the wall."

Technical analysis 101 suggests that the purpose of technical analysis is to intuit its correlation to prevailing mass psychology, as it responds to fundamentals. The barometer of market psychology here is the Dow Jones Industrial Average.

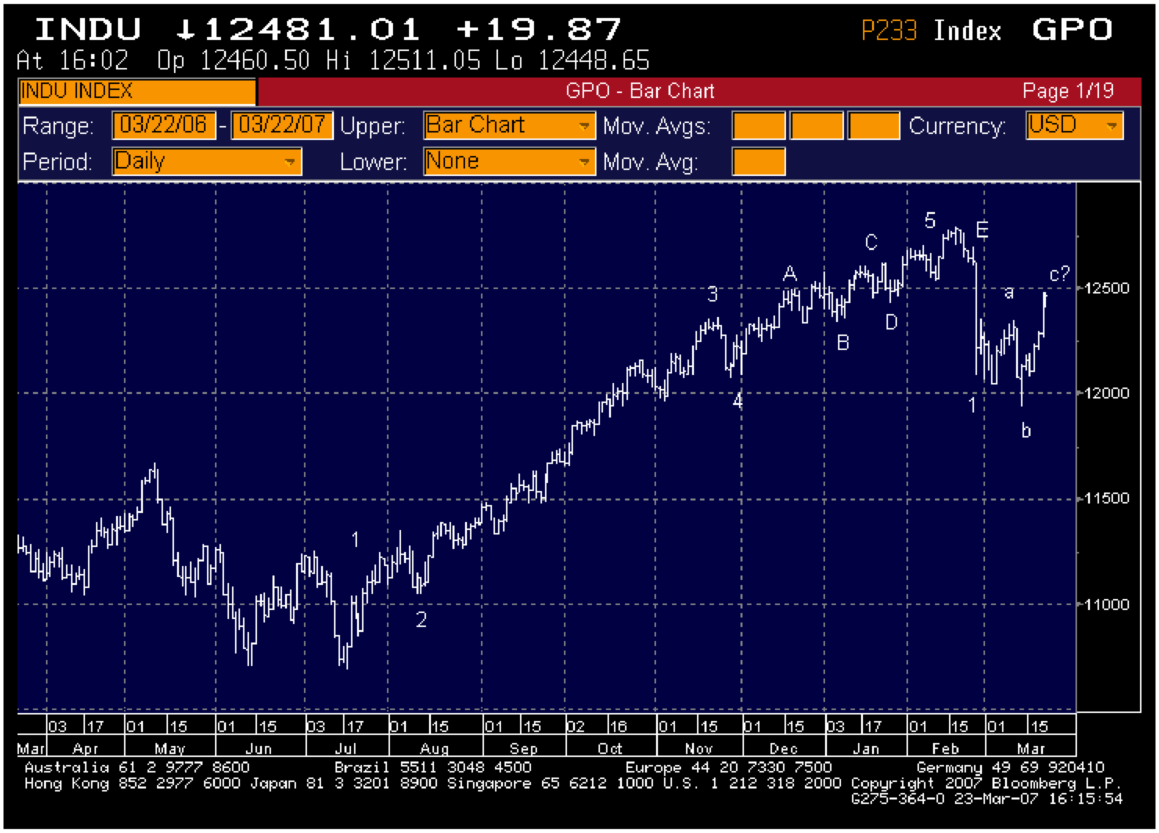
The Dow chart below reflects the Elliott Wave interpretation that was used to correctly forecast the sudden sharp reversal to 12,000. It was also used to identify that low perfectly and forecast a subsequent rally to 12,470. This too has occurred.

In analyzing this move from the July low, there is an unmistakable 5-wave count (completing/terminating pattern). Between points 4 and 5 there is what I had referred to as a quinuple-3, which, by rule, returns to its point of origin suddenly. A quintuple-3, as I had called it, refers to 5 moves, all of which are comprised of 3 waves, as opposed to 5 waves for the primary moves (in this case up).

Primary moves are always comprised of 5 waves, except for this one exception, which is what made forecasting a quick collapse to 12,000 simple. *This one is actually in the manual;* one can understand and analyze the market psychology that would be the backdrop for this pattern; I hope that SKC has been of assistance in that critical process since the 4th quarter.

What followed that report was based on the following chart, which has been up-dated. Following the completed move up from the July low is an initial wave down, which is marked by #1. This is followed by one of the more dangerous corrective patterns (countertrend rally).

Specifically, I'm referring here to an "a-b-c irregular," which is "susceptible" to being a form that precedes a Crash, as it did in 1987 I'm one of those guys who knows the correct definition of a crash. It isn't just "falling a lot". I have used it at times that way too. But a Crash is an event that includes dislocations, including the incapacity to match orders, thus sending put premiums to utterly irrational levels, as an indicator of the public's fear for the system.



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INDU INDEX GPO - Bar Chart Page 1/19

Range: 03/22/06 - 03/22/07 Upper: Bar Chart Mov. Avgs: Currency: USD

Period: Daily Lower: None Mov. Avg:

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 920410
Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2007 Bloomberg L.P.
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From the February 4 report:

"The American savings rate is now negative for 2 years running and is at its lowest level since 1933, the time of the Crash and Depression. We're at the opposite end of where this secular bull market began which, in my opinion, was at 786 in 1982 (I joined the industry a month earlier). The savings rate could not possibly be more strained, if likened to 1933!

"…The effect is seeing declines in home equity to desperate levels, and desperation could set in, particularly as many assumptions for retirement purposes are for higher real estate and equity prices."

I also discussed the effect of the public seeing their new and deteriorating equity levels, reflected in 2007 statements for 2006. The public (home owners) had never been obliged to "post margin"; interest payments were simply added to principal. Often, home owners didn't even know about their true equity levels.

Such considerations added to my analysis meaningfully and were inspired by Nouriel Roubini. An excerpt from Mr. Roubini's recent comments appear here (http://www.rgemonitor.com/blog/roubini/183071**):**

Nouriel Roubini reported on March 13, 2007:

"The recent increased financial problems of H&R Block and other sub-prime lending institutions may thus be the proverbial canary in the mine – or tip of the iceberg - and signal the more severe financial distress that many housing lenders will face when the current housing slump turns into a broader and uglier housing *bust* that will be associated with a broader economic recession. You can then have millions of households with falling wealth, reduced real incomes and lost jobs being unable to service their mortgages and defaulting on them; mortgage delinquencies and foreclosures sharply rising; the beginning of a credit crunch as lending standards are suddenly and sharply tightened with the increased probability of defaults; and finally mortgage lending institutions - with increased losses and saddled with foreclosed properties whose value is falling and that are worth much less than the initial mortgages – that increasingly experience financial distress and risk going bust.

"One cannot even exclude systemic risk consequences if the housing bust combined with a recession leads to a bust of the mortgage backed securities (MBS) market and triggers severe losses for the two huge GSEs, Fannie Mae and Freddie Mac."

From the February 4 report:
Technical: "Squiggles isn't a Bear's pet. It's a nuisance that has as its most irritating feature that it reminds the investor of the memories of being disappointed for so long. Still, the following 1-year Dow chart reflects how quickly the Dow can lose 1500 - 2000 points, within a 6-week period or so.

"...a few assumptions may be made....This type of formation necessarily corrects to its point of origin with speed, days. The point of origin for the 5th and final move is 12,000."

"I reiterate that we are seeing a replay of 2000. The following is repeating (available online):

"Peak for Dow, Japanese tech stocks; low for Japanese value stocks:

"January 13, 2000: Happy Millennium. Now let us begin. The forecast Y2K short squeeze is over and the bear market in New York

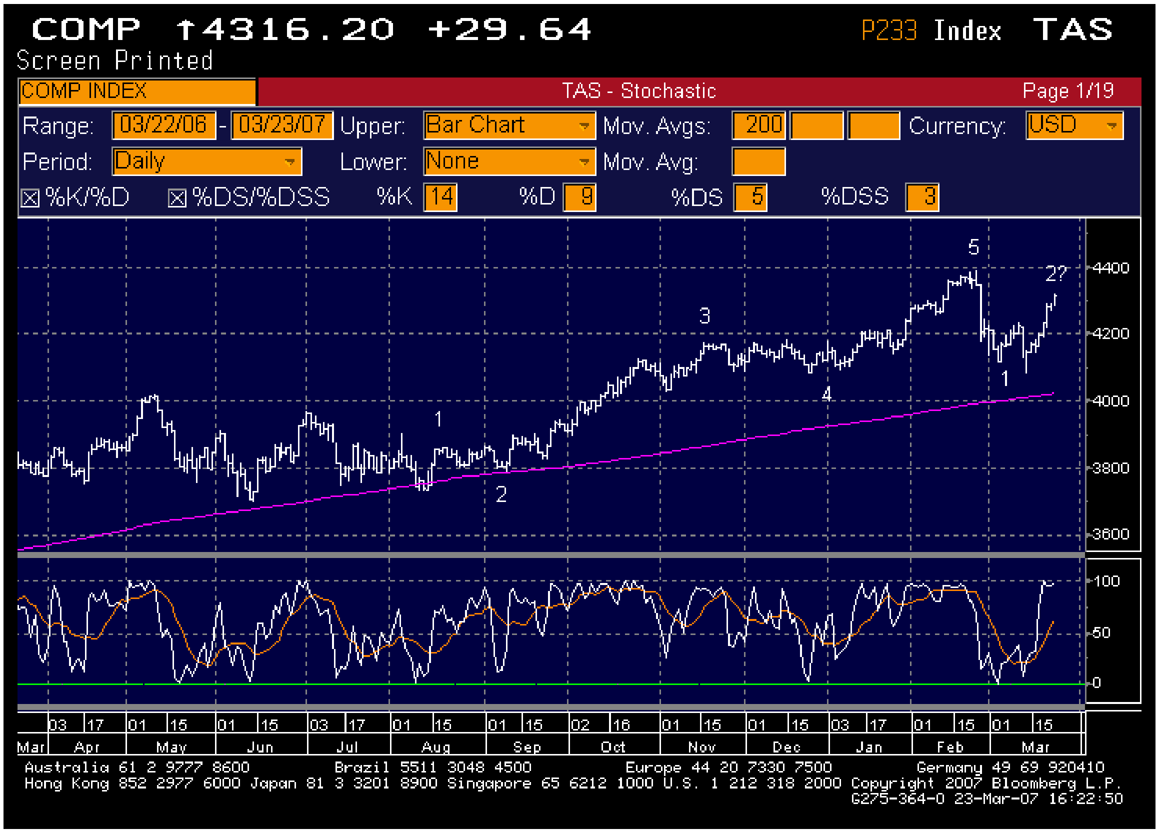
is free to begin. Japan will pull back with it on a lag as Westerners do the margin call thing. Its bull market vs. New York will accelerate, however, and many cheap Japanese equities in certain groups will actually rise (rotation) as the Nikkei is dragged down by the tech sector. For appropriate accounts, we are buying calendar put spreads (March/February) in New York.…"

"Tech out, value in:

"April 14, 2000: …It certainly is not good for hot stocks that, sure enough, have been deflated by margin calls needing to be met. This latter phenomenon has also hit Japan. We now see why I have consistently cautioned to shun the Softbanks of the World and stick to "domestic demand, undervalued, under-owned, non-new-economy Japan". Especially with March 31st year-end out of the way, we are seeing the results…"

Strategy: "As you can see from the first chart below, the Dow might just be about finished on the downside, with a spike up toward 12,470, or so, possible...A spike reversal up in the Dow and down in put option premiums and time premiums is possible, but it's just as likely that it would reverse on a dime and give only those who are the most prepared a chance to buy puts at good prices."

Yes, whether the Dow or NASDAQ, patterns are similar (below), with tech being out, while value is back in. Just like 2000. Everywhere. That's the big picture.



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COMP INDEX TAS - Stochastic Page 1/19

Range: 03/22/06 - 03/23/07 Upper: Bar Chart Mov. Avgs: 200 Currency: USD

Period: Daily Lower: None Mov. Avg:

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Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 920410
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Conclusion: Therefore, a collapse to 11,000 through April is playing out as forecast, with the possibility of an all-out Crash to 9,000 possible immediately, as opposed to later this year (small “c”). 1-Year puts would return 1000% - 2000% without a big “C” crash, simply due to magnitude and trade-able swings in volatility, but under rare circumstances such as these, there is an alternate approach that seeks to achieve the same result, using a small fraction of the capital.

The only drawback would be if the market crashes straight through to levels well under 11,000, as put option contracts of somewhat less than 1-year duration would need to be sold, albeit at hefty gains. Profits are greatly altered by timing, due both to the volatility of the Dow as well as the Volatility Index’s own vagaries, which is a major component of option pricing and, as a result, leverage.

So, the market allows for something specifically tailor-made to this letter’s forecast, but when referencing sophisticated strategic approaches, details must be carefully communicated. The past week is ideally placed in the context of the preceding paragraph and thus reflects the hazards and extreme opportunities of the day.

Therefore, even if one were to correctly say that the ideal top was tomorrow, for instance, that wouldn't be enough to guarantee coming within 20% of best prices. Intra-day, the price swings are very big for most options now; they are huge for 1-3 month options of certain strikes.

Don't be surprised by *anything,* including a multi-hundred-point downswing to kick off the week. There will be swings that will be tough to play, unless already in.

Summary (preceded by the following March 4 postscript):
"I've continually been bang on with precious metals, the Nikkei and, finally, the Yen again. In covering as much as this report does, it is easy to get something wrong. But even there, one may consider the track record of reversal, after being wrong for a while. A track record of explosive gains, after perfectly identified turning points to get back in sync with that market (index or stocks). In any event, all the cyclical turns previously forecast our now in place, with lots of room to run. All are on-board."

Everything is clicking now and this validates my macro worldview, as well as timing. The Japanese stocks recommended on December 3 have outperformed, the Yen has reversed (critical to all our markets and investments), the Dow appears to be in crash-mode and ready to reward any and all past efforts to short it, in spades.

Finally, Golden Star has made a long-term brake-out to the upside, as recently forecast regarding this stock that I had referred to as my favourite gold name and the only one I would hold during this period of inordinate equity risk. My rationale has been and remains that this stock is off-cycle and actually requires market or precious metal weakness to shake stock loose into waiting strong hands. That is why I've recommended it for so long and have waited so patiently (average about $3.25 - $3.50)

Everything is now working and if this includes the analysis of New York above. When the potential rewards are so staggering alongside favourable probabilities, the question becomes why not to short the Dow. The foreigner is not coming back, as forecast so often, regarding the currency and the stock market.

Profit growth, alongside the greatest systemic risk since 1929, guarantees an unaffordable squeeze, triggered by the foreigner who needs to at least spread risk. That "squeeze" is compounded and

caused by the public's reactions to reality. That "squeeze" also demands attention to, or preparation for, the greatest opportunity for windfall gains since 1987.

Sid Klein

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