JAPAN ASIA INVESTMENTS

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MIRROR, MIRROR; RIGHT AND WRONG

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SPECIAL NOTE:

Following this week's market letter, due to the continued pursuit of special and timely projects, **SKWC will again be suspended for 4 weeks, resuming in 5 weeks with the Jan. 4, 2003 edition.** The timing for such a break in publication remains ideal, in accordance with what SKWC sees transpiring through year-end, as described in the Oct. 26 report (all previous comments are available online) and what follows here:

JAPAN:

In reviewing the investment landscape in Japan, SKWC reviews the banking situation, the economy, equities and the Yen in tandem, acknowledging that many aspects of the global picture overlap from category into another.

BANK BAILOUTS: *WHAT CRISIS*?

The following serves to bolster previous commentary regarding the Japanese banking situation, with respect to which you are invited to review the Oct.26 and Nov. 3 sub-sections on the banks.

There has been a 3 trillion Yen reduction in non-performing loans as a result of write-offs and 1 trillion Yen of bad debt purchases by the RCC agency. Meanwhile, bankruptcies and debt forgiveness have not caused additional losses as increased reserves were taken last year-end (March). As well, write-offs are about one-half what they were at the same 6-month period a year earlier. The conclusion is obvious:

As SKWC has been reporting, contrary to Western hysteria, not only is the need for write-offs dwindling over time, but the write-offs are leading neither to forced sales in the system (that would drive asset prices lower), nor are they leading to lower earnings, as the reserves are more ample now than thought.

As discounted earnings declines do not occur, the write-offs will have set the stage for explosive equity price gains, creating the mirror image of what occurred in January 1990, when Sid Klein's Daily Fax identified the peak based on factors that were inverted to those that prevail today!

By Sep. 2004, bank shareholdings may not exceed Tier 1 capital. For that to be achieved, either the Bank of Japan (BoJ) will have bought 7 trillion Yen of shares from the banks or the value of the banks' shares will have increased by a like amount. Expect both to have occurred.

The BoJ has already begun buying the shares held by about 12 banks to remove crossholdings from their books but the BoJ has committed to buy only 2 trillion Yen worth of stock, for now. SKWC expects that amount to be increased, while the market rallies to facilitate the imposed (by law) criteria. Gov't (and BoJ) interests rest with dramatically higher stock prices. This is the reverse of 1990 when then BoJ Governor Mieno wanted, engineered and achieved lower equity prices to burst the asset bubble.

For good measure, expect too that banks will benefit from an extension of the period regarding tax loss carry-forwards from the presently low level of 5 years. This will speed the banks' reorganizations and favour profitability going forward.

ECONOMY:

The Oct.5th report on the economy was added to Nov. 3rd. Let's embellish the review of these previous comments (available online):

A survey by the Nihon Keizai Shimbun reports that the aggregate pretax profit of listed Japanese companies is expected to spike up **70%,** on a consolidated basis, for the fiscal year-end of March 31, 2003.

The trade surplus with Asia was up 336% in August year-over-year, and almost 25% in September. Its expansion continues even as surplus growth wanes versus Europe and the US, further making the case for Domestic Demand Oriented Value Stocks **(DDOVS)** as the single most conservative **AND** leveraged way of investing in Japan in Asia. The fact that Asian growth should be deficit-led bodes very well for Japanese companies and the Yen. This is one example of how the fundamentals that drive DDOVS are also those that are positive for the Yen. This also is an example of how the coming decade should be the mirror image of the last one when the stocks that advanced were those whose fortunes rested upon export, dollar-based, trade.

The Leading Economic Indicators have been positive in all but one month this year. Along with all the other factors cited in this letter, the stage is set for equity appreciation potential next year – particularly for Yen-denominated assets – that is extreme! **Several conservative equities should advance 200-300%**.

Along with the levels of the Wholesale Price Index (which was up 3 months in a row in October, with a .4% increase) and other deflation indicators that are clearly turning, in my view, the banking, macro and micro considerations in Japan have all lined up for a monumental year in 2003 in the correct equity themes. SKWC is as confident in its views as at any of the other Japanese market extremes, including those of January 1990 and October1998.

STOCKS:

The August 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.

"What can one save by waiting? What may one forego by waiting? The hottest region in the world is and will be **Asia**, led by trade deficits (see attachment). Who benefits the most? **DDOVS**! **Japan** is **Asia's** banker and exporter."

Since declining to the 8300 area, the Nikkei has rallied about 1100 points, closing the week 100 off the high. In tandem with the Dow Jones, the Nikkei has exhibited strength, suggesting that the final lows may have already been achieved. The 8000 level may yet be seen but, in keeping with the above quote, the point is moot. December should usher in weakness, regardless of whether it is to new lows or not. Again, the point is moot, certainly for **DDOVS**.

Households only hold about 4½% of assets in stocks (while having doubled their Gov't bond – JGB – holdings over the past 2 ½ years) and about half what Americans do in equity mutual funds on a per capita basis. Meanwhile, value stocks offer higher yields than JGB's whose yields, in turn, are somewhat higher than US yields in real terms. All together, this is a recipe for a capital stampede into equities, as soon as the Gov't and/or the BoJ implement any of the moves here contemplated and forecast by SKWC to deal with the banking situation.

As value stocks are of companies that are sitting on cash that wasn't spent on buying back equity (as Westerners would have), the corporate backdrop for potential corporate investment is exciting, as well. This parallels the potential for spending, as pent-up consumer demand should express itself along with the banks' reversal of fortunes, compounding the profoundly bullish scenario here forecast.

NEW YORK:

NEW CYCLICAL BULL MARKET WITHIN SECULAR BEAR MARKET:

"…9000 is too close an overhead resistance for a recommendation to be involved any further". The preceding quote comes from the most recent letter (November

3), when the Dow was trading around 8500. After identifying the Oct. low to the week (the Dow came within 200 points of the "upper 6,000's", in terms of price), SKWC recommended exiting the market, with the firm belief that overhead resistance at 9,000 made hanging on an illogical proposition. Indeed, given the uninspiring volume configuration since July and the negative volume divergence since Nov. 21, that point of view brings no mea culpa with it from the author.

The Oct. 12 letter confirmed the low and immediately considered that a new cyclical bull market may have just begun. The Oct. 26 comment postulated, however, that a final collapse for the Christmas season toward 6,500-6,800 should be expected (from a level no higher than 9,000). *"Thereafter, New York should commence a <u>cyclical bull market that lasts through the 1st quarter of 2004"</u>.* That quote was what was consistent with both the Oct.12 view and that forecast being maintained here today.

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".

<u>NIKKEI/DOW RATIO</u>:

Recently, the ratio has consistently been trading around 1, a level seen around the time of the Korean War and the beginning of this year, as well as a level from which "only the brain dead would not seek to profit, within the context of those purposes and means clearly outlined" in the Oct. 19 market letter.

A critical point that should not under any circumstances be lost on anyone is that **New York's new cyclical bull market would be taking place within a very protracted secular bear market, making investing in New York very hazardous and unwise for the general public (non-professional)**. From the bird's eye view, it also means that the Nikkei/Dow ratio will be mushrooming, as the Japanese market is only now commencing a secular bull market that should know no end before that of any reader of this commentary.

<u>DOLLAR</u>:

We pinpointed the October lows and were rewarded with 4% gains, or so, in our favourite currencies. SKWC's coverage of the currencies is not for traders but, rather, for investors seeking to preserve capital. Therefore, SKWC has assisted readers to enter at different points in time.

Having said that, for now, the currencies are in short term corrections and, looking toward 2003, one should no longer expect the formula of a rising Dow with falling gold and Dollar prices to be maintained. Since a cyclical Dow rally would be deemed to be within the context of a secular bear cycle, each market should be considered more individually now.

As for the Swiss Franc, the Yen and the Euro, these currencies are in secular bull markets and corrections are opportunities for those seeking safe haven to establish portfolios consisting of the desired currencies and different asset classes, including **DDOVS**, along with the appropriate gold equities.

With current account and trade balances around 1 trillion Yen, Japan Inc. is self-financing. Coupled with a deflationary (for now) environment, printing money is more likely anywhere else on earth, a situation that is favourable for the Yen, all in all. Deposits, then, will remain firm, as will Gov't bond sales. So, the Yen is going to stay home or be repatriated.

While the US has recently reported its largest ever current account deficit, companies there are projecting lower profitability, all against a backdrop of collapsing nominal yield spreads between the US and Japan. Japan's current account and basic balance surpluses have been rising for just over a year and stand at record levels. Analyses of the respective balance levels (current account, basic balance and trade), coupled, as well, with the level of the spread between US and Japanese year-over-year Industrial Production growth rates, suggests that the Yen could rally **25%** over the coming year, as I anticipate.

GOLD:

SKWC reported on Oct. 26*: "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."*

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**! If gold breaks under, say, $312, the metal could already be en route to $300, within the context of the here anticipated intermediate term correction. Such a correction will occur, I believe, but from where exactly?

Short and intermediate term trading strategies may be based on the preceding by either selling at $340 or $312, for example. For how this may relate to an individual equity, let us look at Golden Star, SKWC's leveraged way to play the metal, via a small cap. GSC (GSS in the US) recently got stuck at $2.20 CDN and has traded down toward $1.90. A break in gold of $312 toward $300 could lead to a sharp percentage sell-off in GSC. Meanwhile, a run-up to$340 could cause GSC to double top around $3.00. Shorter-term traders using more leveraged instruments, then, must be more vigilant.

Happy Chanukah, Merry Christmas and a safe and joyous New Year's to all.

Sid Klein