JAPAN ASIA INVESTMENTS
1001 BOUL. DE MAISONNEUVE O., BUREAU 950, MONTREAL, CANADA H3A 3C8
TEL: (514) 939-2221 FAX: (309) 417-0942
e-mail: sidklein@sidklein.com
www.sidklein.com

LET'S BE STUBBORN

- EVER PERFECT -

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SPECIAL NOTE:

October's commentaries included 6-page offerings, of such depth and length that are ordinarily the attributes of monthly market letters. SKWC's research and analysis spans the investment world, focusing on value investing in Japan, along with its economy and related factors, the US market in general, the Dollar and gold.

In each market, SKWC has offered internationally unsurpassed analytic forecasting on secular, cyclical, intermediate and even short-term bases. Following this week's market letter, in order to pursue special and timely projects, **SKWC will be suspended for 3 weeks, resuming in 4 weeks with the Nov. 30 edition.** The timing for such a break in publication is ideal, according to what SKWC sees transpiring in the short term, as described last week.

JAPAN:

BANK BAILOUTS AND PSYCHOLOGY:

To embellish a little further on proposed Bank of Japan (BoJ) policy, consider the dramatically bullish effect on stock prices of US Fed policy with respect to crisis management. Be it the '87 Crash or Russia, investors became conditioned to believe that the US Federal Reserve would underwrite all risk, thereby providing a green light to invest willy-nilly.

Misinformed Westerners have been crying about the proposed actions of the Bank of Japan, panning their decisions, whatever they may be, including those designed to enter the market and remove shares from the banks' books (see October 5, 12 and 26 letters).

This psychology only underscores the bearish mentality *du jour*, that is merely symptomatic of what will probably be known in the future as the greatest stock market low of all times and that is presently unfolding before everyone's eyes.

Negative psychology aside, however, and, simply put, given the above referenced US Fed policy, what do you think the effect will be of the BoJ's decision to buy tens of billions of dollars of stocks from the banks to underpin the Topix at 900, a level to which financial systemic stability has been referred as integral? What do you think the effect will be, given the already supreme **under valuation** of the Japanese stock market?

With so many equities trading with current assets in excess of total liabilities or sufficient cash to pay off long term debt (there are many "net cash" companies), doesn't the disbelief and distrust that is greeting unfolding reforms suggest to the sane that this 13-year bear market is winding down, in the "relatively near future"? Doesn't the present situation appear to be the perfect opposite of the arrogant and careless attitude of North American investors who bought technology stocks, in the face of all valuation models and money management disciplines, due to the apparent willingness of the US Fed to underwrite free market risk? Meanwhile, Japanese corporate executives and people in the streets are bearish. No one believes what is so plain to SKWC.

<u>BUT WHAT IS THE PSYCHOLOGY, REALLY (STOCKS - ECONOMY)</u>?

<u>ECONOMY</u>: Economically, as so often reported over the past year, the pent up demand in Japan could catapult that economy to drastically higher levels of growth than what anyone may be able to foresee at this time. Note, too, that Japanese companies have not crippled themselves as others have. They have not spent their cash to repurchase shares for the more immediate satisfaction of shareholders. Rather, there is a ton of corporate cash, contrary to what the misinformed Westerner believes, that will generate robust economic activity sooner than what people expect (tied to bank reform that will unleash positivism with respect to both investment <u>and</u> spending!).

As reported, SKWC nailed the low in the economy last January, amid all-time gloom (see first letters of the year). Since then, the economy produced 8 consecutive very positive Leading Economic Indicators reports, before finally having the string broken in September. SKWC has been reporting that the economy should be back on track by March – May, as SKWC expects that 3 indicators will join the long list of final lows. These letters have been mentioning the employment and capital spending indicators. Housing starts should be added.

<u>STOCKS</u>: Investment psychology, as gauged by **activity**, however, is different than what is found in the streets or the media (does the tape ever lie?).

Foreigners have been sellers of Japanese equities in all but 1 of the last 9 months. As reported, the Nikkei's recent difficulties have been the result of foreign selling. Americans account for 1/4 to 1/3 of all Japanese stock market trading and domestic woes in the US causes selling in Tokyo.

As repeatedly forecast, the foreigners are selling Japanese shares back to the Japanese right at the lows. Note that, along side this, Japanese individuals have been buying most of the past month, while banks, investment trusts (mutual funds) and non-financial companies have been strong net buyers, generally speaking, for most of the past 10 weeks! The exception has been insurance companies. This is understandable, given the pressure that low-to-non-existent interest rates puts on their capacity to meet promised returns.

Mizuho was down on news that it may write off 1 trillion yen of bad debts next year. In the same vein as the comments above, readers are reminded that in the mid-'90's projected write-offs were greeted with rallies, as they indicated that Japan "was aware of and dealing with its debt difficulties".

SKDF comments were quite negative on this attitude, pointing out that Westerners were paying no mind to two key points. Firstly, the total debt levels being recognized were about three-quarters of a trillion dollars US off the mark, according to the private estimates in which I had chosen to lay stake and, secondly, that write-offs are disastrous for stock prices at first, at least, as they imply forced asset sales in the system. Now, the same Westerner does not realize that the worst is all but fully discounted and that if forced sales do not even come through (as they may not be necessary), as a result of the write-offs, stock price explosions could be at the back-end to the initial reaction of price decline.

Of all the times that SKWC (or its predecessor, SKDF) warned not to listen to the crowd and that the opposite was about to occur in grand style, of all the occasions that these forecasts have been accurate to the week or even day, nothing will have been so stunning as what lies ahead!!!

NEW YORK:

The run-up to the short-term highs, without a volume breakout, creates no sufficient influence to change a conservative-minded participant to alter his stance. A risk-seeking trader could watch for a volume breakout (relative to the hour of day) to participate but, otherwise, 9000 is too close an overhead resistance for a recommendation to be involved any further. There is no change in the view that stocks could decline into year-end, dragging the Dow down to 6500-6800. Having forecast October's low, SKWC exited last week at the levels available now.

SKWC's research and views are emboldened by the finding that the "investment banks" are bullish. This information was happened upon accidentally but it is true that one could have simply made a living over these past 3 years at continually doing the opposite of whatever their consensus views were. Following SKWC's work would still have been the most accurate approach but, for those more comfortable with cynicism than knowledge, the former strategy would have been the next best thing.

NIKKEI/DOW RATIO:

This ratio has shrunk to 1.02, a level from which only the brain dead would not seek to profit, within the context of those purposes and means clearly outlined 2 weeks ago. This view is consistent with even the short term SKWC prognosis that the Nikkei should bounce as the Dow drifts lower (see JAPAN and NEW YORK sections).

DOLLAR:

Last week's market letter wrote:

"On Oct. 5, SKWC again forecast that the Japanese Yen was bottoming within a massive bull market, with the most likely stopping point a stone's throw away at .80. This has been achieved and readers should be **100% long** their Yen currency allocation, according to what they have deemed appropriate for their portfolios…

"Our favourite currencies, to which this section refers (Yen, Swiss Franc and Euro), are again held 100% long. SKWC has advised only holding Dollars (US or Canadian) to the extent that domestic currency is required to conduct one's affairs."

Well, depending on whether we are looking at the Swiss Franc, the Yen or the Euro, these, our favourite currencies, are very quickly up 200 – 300 points from the perfectly identified lows. In yet another market, SKWC has held the contrarian view, without regard for "investment bank" logic. In truth, the key to success is not being contrarian. It is being uninfluenced by or, better still, unaware of the pedestrian logic of the paid professionals. It just happens to amount to the same thing.

GOLD:

SKWC reported last week that $305 was no longer expected and that the $310 zone would hold. To quote:

"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 immediately proceeded to run up to $321 during this week past. With another well-timed forecast, we are on guard for the completion of this year's bull move into year-end, as described in October's commentaries.

An update on Golden Star: The most recent recommendation discussed an ideal buying zone in the $1.25 – 1.50 Cdn. range. The stock closed Friday at $2.10 and will probably have offered traders doubles more than once over this past year. Three months ago, the company reported record earnings and better than expected 2nd quarter production. It remains SKWC's favourite small cap for gold leverage, at the prices referenced in these pages.

CONCLUSION:

Everything is unfolding precisely as forecast last week:

"The recipe should again be Dow down, with the currencies and gold up, for the remainder of the year."

Let October's commentaries be your guide and, as always, feel free to write-in any questions that may come to mind.

Back on Nov. 30,

Sid Klein