

JAPAN ASIA INVESTMENTS

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PROGNOSES

(HONED, PRECISE FORECASTS: DOW, DOLLAR & GOLD)

Oct. 26, 2002

SPECIAL NOTE:

This week's letter hones the views expressed this month, with respect to the Dow, Dollar and gold. SKWC forecast and identified extremes in these markets as they were happening, offering special reports that included a cautioning of an unfolding, new cyclical bull market in New York. SKWC equally expressed imperfect clarity about the next major turning point in the Dow, as that bull market may have begun (from 2 weeks ago: **“Right at this moment, however, it is difficult to claim to possess any gut feelings regarding the next short or intermediate term Dow peak, except to say that there exists obvious resistance at 9,000.”**).

The short-lived, short-term market uncertainty is resolved.

TOKYO:

The August 25th report 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.”

THE SHORT TERM, BANK REFORM AND A NEW SECULAR BULL MARKET:

This past week, the Japanese market was stunned (supposedly) as conservatives and bureaucrats *appeared* to force Mr. Takenaka and his bank reform plan into submission. Mr. Takenaka, of course, is Prime Minister Koizumi's economy czar. The operative word above is "appear". If it was the shocker that the Western press claimed it to be, then why didn't the Nikkei tank this week? Frankly, I had been wondering how the bank reform that was evidently underway would proceed, given that my work suggested a low for the Japanese stock market a bit later on (see beginning of this Japan section).

Specifically, I am referring to the Sep. 20 bond auction failure that was amusingly blamed on the Bank of Japan's plan to purchase about \$50 billion of equities held on the banks' books. I wrote extensively (and described on RObtv, see homepage) that this plan was misunderstood and indeed represented the panacea (note STOCKS section of Oct. 5 letter). SKWC has also been very clear that only a fool thinks that there is ever disharmony between the Bank of Japan (BoJ) and the government. This is a show put on for the Westerners who will have sold their shares back to the Japanese at the lows, as forecast.

As for the fact that the plan about which everyone fretted but about which SKWC could only sing praises, what better proof do we need that we were and are correct than the fact that the market supposedly tanked because bank reform, replete with capital injections and Western style bank nationalization, was seemingly shelved. Years ago, when bulls were coming out of the woodwork to express their delight that Japan's problems were now well known and would therefore be rectified, Sid Klein's Daily Fax (SKDF) wrote that the public would storm parliament if there were ever any bank capital injections. SKDF's view, for years, was that the bailout would happen when the public would be made to beg for it.

The Prime Minister has got the bureaucrats and conservatives right where he wants them. The government and BoJ will unleash the reform plans that have already been discussed and covered in these pages, when it is strategic. Mr. Takenaka was not "forced" into anything this week and the Japanese are in greater control than ever. The plans will be announced when the market is lined-up best for their profit (again, please study the Oct. 5 STOCKS section message that describes the BoJ's activity as an insider trader, that is setting its own stock purchase prices!!!). When this occurs, the market may fire thousands of points upward with lightening speed!

DOMESTIC DEMAND ORIENTED VALUE STOCKS (DDOVS):

Guess what these stocks have done through this recent market decline that has spooked the Western press.

Nothing!

Your attention is again drawn to the commentaries of Oct. 5th and 12th to learn of the strategic Asian positioning of these companies and their supreme out performance vis-a-vis other Japanese and non-Japanese equities.

In addition, as a special feature, this week's edition of SKWC includes the following excerpts on value investing from the winter 2002 letter published by **Sherbrooke Financial Services (2001 Inc.)**. These passages, that commence immediately below and which conclude the Japan section this week, could just as easily have been authored myself with respect to **DDOVS**, as is evident by previous commentaries:

ASSET ALLOCATION

Modern portfolio theory has determined that adding an additional asset category can reduce risk while increasing the return. Consider that investing 100% of your funds in five-year guaranteed investment certificates will give you an after-tax return of 2.5%. With inflation of about 2.5% you will receive no return on your investment capital. This guarantees failure to your long-term investment plans.

We ensure that the geographic allocation of investments makes sense. Since Canada is a small part of the world's capital markets, it is often beneficial to have a significant portion of assets in foreign investments. Past history has shown that in most years, U.S. markets have outperformed Canadian markets.

WHAT IS VALUE INVESTING?

Value investing is the art of finding and selecting securities that are selling for less than their intrinsic economic value. Value companies often sell at low prices relative to earnings or book value. Their stock prices may be lower than a few months earlier or cheap compared to competitors. But low price alone does not necessarily indicate a bargain. Value managers must do extensive research to identify quality companies with good prospects.

Value stocks are often unpopular, out of favour companies with some sort of perceived problem that makes them unattractive to most investors. Conversely, growth stocks are popular companies, priced at a premium for their anticipated exceptional earnings growth.

While popularity can and often does change over-night, unpopularity can take time to reverse. A value stock may seem like its going nowhere for two years, when all of a sudden, the company is recognized by the markets, and the investor is rewarded.

The main risk of a value strategy is that the anticipated price increase never happens or takes longer than expected. A stock that is already cheap however, should be less vulnerable to market down turns. As we are currently experiencing a global economic slowdown, this cushion provides some real protection.

The primary risk of a growth strategy is paying a premium in advance, in anticipation of future earnings that may not meet expectations. We have seen that when technology companies are unable to meet their optimistic revenue and earnings projections, investors can't dump them fast enough and prices plummet. Since these companies are priced at large premiums, the fall can be dramatic.

VALUE INVESTING ON AVERAGE DOES BETTER THAN GROWTH INVESTING

As recently as the first quarter of 2000, it seemed as if growth investing was all that mattered to investors. The euphoria that swirled around Internet stocks culminated in the Nasdaq Composite Index's 85.6% rise in 1999. Many money managers quite correctly, were concerned that valuations often based on sales, not earnings, could not be justified.

How could this happen?

Part of what skewed conventional wisdom in favor of growth stocks was the decade-long bull market, combined with new online investing technologies that fostered a quick profit mentality among investors. That environment made value investors, whose investments often take years to reap benefits, seem obsolete in a new age of day traders.

But the proof is in the numbers. As of the end of the third quarter of 2001, the Nasdaq Composite Index was down 70.8% from its all-time closing high in March 2000. Taking a longer term perspective, research shows that large value stocks have done better than large growth stocks in five of the past seven decades (the exceptions are the 1930s and the 1990s).

As bearish sentiment continues to surround technology stocks, many investors are refocusing on fundamentals such as corporate earnings. Money managers that invested in value stocks, or companies with share prices that look cheap relative to measures such as profit or cash flow, are outperforming managers that invested in growth stocks, or those expected to realize the largest growth in earnings.

For the one year period ending September 30, 2001, our model balanced portfolio is up .67%, while the TSE 300 is down 33.1% and the S&P 500 is down 26.6%. Our core investment philosophy is that stock prices are ultimately driven by earnings. Markets will eventually respond and value will be realized. Patience is in fact a virtue.

The above is the Winter 2002 edition of the "Wealth Management Journal", authored by: **Sherbrooke Financial Services (2001 Inc.)**, www.slf.ca, 937-6392.

NEW YORK:

SHORT TERM:

The Dow erupted over 1300 points off of the low that had been forecast for the week of Oct. 7. By rallying to the mid-8000's, the index had left too little upside potential for which intelligent traders would hang on and so, initially, the market pulled back sharply. Given the negative volume divergence as the Dow crossed 8300 on the way up, the proximity to the 9000 resistance level referenced at the beginning of this letter and the negative short term view (see below), it is reasonable to exit at present levels (Dow 8444).

INTERMEDIATE, CYCLICAL, SECULAR TERMS DOW FORECAST:

SKWC has written on several occasions that a cyclical rally would commence in New York, within the context of a secular bear market. On each occasion, the example given was that of the Nikkei's cyclical rally off of 14000, within a massive secular bear market. To forecast from where or when such a cyclical bull move would commence, SKWC has been taking into account 2 principal, technical considerations:

PRICE: Almost 3 years ago, SKWC forecast that a 50% decline in the market would occur before the secular bear's first phase would be completed. Initially, then, Dow 6000 was anticipated. However, as reported this month, the 50% decline has already been achieved in the more meaningful, capitalization-weighted, broad-based S & P. With this it was theorized, in the Oct. 12 letter, that the cyclical bull move could begin.

TIME: SKWC has also been writing about the most likely fit for time cycles. In this context, we have been considering the historical relationship of past US presidential elections to the market. SKWC has remarked more than once that the indices should rally for about 15 months, yet be down for most of the election year itself (2004). It has been gnawing at me, then, that we would bottom so soon. Sure enough, in weighing all the evidence, the pieces of the puzzle have now come together to conclude as follows:

CONCLUSION: The Dow should fail to achieve 9000, topping in the very short term, if it has not already peaked. The rally, for the prudent, should be deemed to already be over as the index resumes a drubbing to the **6500 – 6800** zone for the Christmas sales season (bah, humbug). Thereafter, New York should commence a cyclical bull market that lasts through the 1st quarter of 2004. This fits with what technical indicators are suggesting, while also being consistent with the price and time considerations immediately above.

WAG THE DOG: Believe it or not, the war/terrorism story will again be taken off the shelf to serve its intended purpose. As repeatedly evidenced in our "previous comments" folder (summarized 2 weeks ago, also see Feb. 23, 2002), SKWC was the first anywhere, to my awareness, to write of the "Wag the Dog" effect. Others have attempted to copy this, only to draw incorrect conclusions (like in the Sergio Leone movie, never play with another's dynamite).

IMPORTANT: It is wrong to conclude that the military story was principally used to help win the US mid-term elections. As only SKWC has written, it has been used to deflect from the economic and equity bear markets! Having reiterated this, understand that the misinterpretation of the "Wag the Dog" effect has actually help play a part in the propagandists' decision to defray attack. A post-November elections attack, particularly if it is within only a month, will actually give credence to the sincerity of the action. This would reinforce the notion that the threat was genuine and thus related to the economic and market woes of the world. In turn, this sets the stage for the cyclical bull market forecast above, as the "enemy" is defeated.

Having analyzed SKWC, have you again read tomorrow's newspapers?

NIKKEI/DOW RATIO:

Please note the importance of following and making use of this ratio, as per last week's commentary. The ratio closed the week just over 1.03, the level used for entry at the beginning of the year.

DOLLAR:

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.

The Swiss Franc and Euro are examples of what SKWC has forecast and written about so often. When the US Dollar's decline was correctly deemed to have bottomed for the short to intermediate term, SKWC warned that the currencies would correct with mostly sideways action, as is the historical nature of currencies. This message has been oft reiterated.

The upshot was that the dramatic gains that have been seen in those currencies that are our preoccupation, would not correct sufficiently in terms of price for those not yet invested to be able to diversify out of Dollars, if they had not already done so and are anticipating equities' style pullbacks. Also as forecast, only the Yen, for reasons particular to the Japanese situation, would perhaps retrace some worthwhile percentage. Again, that correction, however, is here deemed complete. As anticipated, the currencies' corrections have been in the form of **time**, rather than price.

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.

GOLD:

SKWC has forecast and identified every noteworthy peak and trough zone in gold, since going long. At the most recent peak, the commentary held that we could now expect a correction to the \$305 zone. Upon arriving at this destination, SKWC wrote, we would revisit the lists of gold stocks contemplated in the Sep. 8 letter.

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.

CONCLUSION:

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.

Oussama and Saddam; yup, that’s it. I guess you have to be careful whom you hire in the Middle East.

“From ghoulies and ghosties
and long-legged beasties,
and things that go bump in the night,
good Lord,
deliver us”

anonymous Scottish prayer-
circa 1300

In many lands, the halls and planning rooms of the decision-makers are as the disenchanted castles of the undead.

I wrote that.

Happy Halloween

Sid Klein

THE COMMENTS ABOVE ARE BASED ON DATA BELIEVED TO BE ACCURATE BUT NEITHER ACCURACY NOR COMPLETENESS CAN BE ASSURED. NO RECOMMENDATION TO PURCHASE OR SELL SECURITIES SHOULD BE INFERRED AND READERS ARE STRONGLY ADVISED TO CHECK WITH FINANCIAL COUNSEL AS TO THE APPROPRIATENESS OF ANY TRANSACTION FOR THEIR ACCOUNT. BARRING THE AUTHOR’S EXPRESSED PERMISSION, READERS ARE PROHIBITED FROM COPYING OR SHARING THIS LETTER BY EMAIL, FAX OR ANY OTHER MEANS.