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NEVER FIGHT THE FED!
(PERFECTION)

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TOKYO:

ECONOMY:

The September Tankan Survey showed business sentiment amelioration across the board, as the Diffusion Index improved in all 4 categories of large and small manufacturing and non-manufacturing firms.

While the West sinks, Japan resurrects. Consumer spending rose in the calendar 2nd quarter. Private capital spending should also rise as private machinery orders indicators are bottoming. Deflation is bottoming as inflation indicators commence up-trends, the Western freak-out (about deflation) notwithstanding. While still not reversed, deflation is nonetheless consistent with falling lending and rising deposits. This is a positive recipe for bonds and the **Yen** (see Dollar section below), a recipe enhanced later by the oft forecast and discussed **Yen** repatriation and reversal in the economy.

Industrial Production is rising and indicators are up. Services, from entertainment to communication, are up. August's strong improvement in the sector was the 1st rise in 14 months. Communications and various services are rising sharply (imagine if this were a bull market!).

Employment indicators are putting in technical extremes that precede sustainable growth. These indicators are also heading into time cycle lows in 2003, simultaneous to profit indicators' time cycle lows due around the same time, all of this consistent with a stock market low that is (quite typically) achieved ahead of the economy.

It is true that indicators for services are positive, while negative for manufacturing. This is quite congruent with SKWC's forecast that this would in fact be the case, much as it was in our hemisphere before the Dow soared thousands of points over 18 years, as the US had shifted its economic base from manufacturing to services. As economies "advance", they become services - rather than manufacturing - oriented. Japan, as banker, etc., will be the principal services provider to Asia for decades to come. The Japan-ignorant Westerner thinks that Japan is weak because he is judging success based on his past memory of what made Japan successful (it seems that the Westerner just can't get **ANY** of his paradigms right).

Consistent with SKWC's views, the August trade surplus trends were unimpressive with Europe and the US but up ***336%*** year-over-year with the rest of Asia. Even trade with China improved, as Japan's deficit there fell 34%. We see once again why our sole theme is **Domestic Demand Oriented Value Stocks** (DDOVS), a theme that benefits from Asian growth, growth that is spurred by deficits that are caused by the import of Japanese consumer (durable, etc.) goods. Again, Japan is Asia's banker and exporter.

Marty Zweig repeatedly instructed investors to not fight the Fed. Bear this in mind: The panicked and Japan-ignorant Western press hysterically proclaimed to the world that the Bank of Japan (BOJ) had lost its mind when it signed up to buy stocks in a major way, as it was doing so to achieve ends that the government would not, due to its refusal to inject capital into the banks. Anyone who believes that the BOJ would not act harmoniously with government knows nothing about Japan (or the US, actually, in such a matter) and is merely projecting his already bearish psychology. **DON'T FIGHT THE FED!!!** Read on…

STOCKS:

Four years ago today, Sid Klein's Daily Fax (SKDF) followed up its forecast and identified the low in the secular bear market in Japan with precision, looking for a rally to over 20,000 within a year. It happened.

The last paragraph of the preceding ECONOMY section pointed up the fact that the BOJ will commence buying equities soon (no one has confirmed the exact amount as 'guesstimates' abound). Around $45-50 billion US of equities will be bought directly from the banks, it is generally guessed for now, over the next 2 years. As a matter of law, by September 2004, banks' Tier 1 capital cannot be exceeded by the value of stocks held.

Consistent with this, the BOJ has already indicated that they do not wish to see the Topix under 900 as that would be deemed destabilizing to the financial system. All taken together, the Fed is calling and guaranteeing a bottom. This will attract even more capital to Japan (repatriation notwithstanding) as investors getting banged in the West seek more defensive themes. SKWC believes that leverage is usually found right where one finds the least risk of loss.

With so little capital required to ignite a blast-off in **DDOVS**, how much better can it get for these stocks **THAT AREN'T EVEN FALLING IN THIS MARKET! <u>It would require a collapse to Nikkei 8,000 just to get triple-bottoms with the lows made all the way back in the 1st quarter of 2000, since which time most popular Western themes have fallen 50-90%</u>!!!**

The shares purchased will be held for about, or for as long as, 10 years (or until Nikkei 27,000?), eliminating crossholding unwinding, thus eradicating a selling pressure that has hounded the market for years, just as SKDF was all alone in the 90's in warning that it would (the same folks who believed in the '90's that I couldn't be right "because the government has recognized the problems", argue that I could not possibly be right now because Japan is such a basket case). To me, a Western investor is someone who can no longer tell what is a nightmare and what is waking state as the Japanese HAVE recognized and **ACTED** on the problems.

What makes matters still more amusing is that I repeatedly forecast in print years ago that the Japanese would implement measures that would effectively cause the repurchase of Japanese shares from the foreigner right at the bottom. As if all this weren't enough, these measures are also going to reduce the float of shares (by 7%?) on the market. So, not only are bank share holding limits going to be compliant, not only will crossholding unwinding become a thing of the past, the world's best insider traders (along with the US authorities) are even writing the laws that determine the prices at which the shares are to be purchased ("market" or "book"(?)…me thinkst they shall choose "market").

While the Japanese execute these brilliant, long-since forecast plans to buy at the lows, the Japan-ignorant---usually analysts---hallucinate that these are desperate measures designed to prop up the market before it goes in search of Atlantis. By the way, since we know not to argue with the market, even if we're demented enough to fight the Fed, have we not noticed that yesterday's Japan perma-bulls, who are today's Japan perma-bears, are only concluding negatively about the fact that bank stocks have soared since the BOJ's announcement? This business is about, prices right? As for the market, the price is right, or just about so…most certainly for **DDOVS**!

<u>NEW YORK</u>:

We have forecast, and are perhaps identifying the lows in, this market real-time, yet again.

Apart from strongly encouraging you to re-read last week's comment, SKWC can only add that the universe, as described in these pages, is unfolding exactly as forecast right at the August highs. The decline "into the 6,000's for early October" is completing. At the summer's intermediate term peak, SKWC warned of potential to 6,000, though the view was immediately softened, looking for the "6,000's" for early this month (see Aug. 25 and follow-up letter(s)).

Indeed, the way things are playing out, the upper 6,000's should support the market "in early October", now that the very guys who were bullish in 2000 are attempting heroism and warning of 6,000 in the Dow. As we've seen for almost 3 years, they come out of the woodwork to scare the public, right at short and intermediate term lows.

In the stock market, cash (funds, etc.) is about half of what it normally is at major lows (and the Dow's decline will continue until a **secular** low is made, so imagine what the cash levels will be then!). Couple that with the fact the index funds are not anywhere close to being unwound. The public is heavily involved in these funds and one would be wise to bear in mind the 13-year process in Japan with respect to the unwinding of crossholdings. The underlying assets and the reasons for their existence have nothing in common. That is so. Still, one may focus on the time it takes to unwind an investment entanglement of systemic proportions. One may also note the effect such unwinding takes on prices!

To understand North America's coming deflation is to understand Japan's decade-long debacle that was founded upon the collapse of real estate and the unwinding of leverage connected to it. Therefore, note the following sub-section.

REAL ESTATE**:**

As for the secular and cyclical trends in the stock market, the leverage in real estate has not even begun to be unwound and its effects on the stock market are therefore still resting, pregnant within the nightmares of unsuspecting bankers. Forget stocks. Can the public meet its home payments? Ah, and then there are, of course, the home equity loans sold to the public. The memory of the financial products of our time will burn in infamy in the minds of investors, along with that of the greedy (investment) bankers who fleeced them.

Previous letters have written of the coming collapse in real estate that has been a beneficiary of capital seeking "safe haven" during the initial bear market collapse. Now, as folks suffer difficulties with respect to home payments, banks must now prepare for a lengthy demise into financial abyss. In Japan, too, there was an initial 2-year lag between the collapse in stocks and real estate (1990-92).

As US banks are brought to their knees, the vantage point from which to view their Japanese counterparts will be somewhat less haughty. In fact, the West is beginning what the Japanese are finishing. This is creating a psychology whereby the Westerners cannot see clearly the brighter shades of green on the "other side". Green, by the way, means money and the Japanese seem to me to have most of it.

Our Canadian banks are not immune either; no, not at all. Has anyone noticed the yields of our big bank stocks? The market isn't stupid; that particular intellectual quality belongs to the forecasters who can't get their "paradigms" right. Remember the "new paradigm"? The financial media always looks good, though. They just alter whom they quote.

For our part, you have been reading the correct Kondratieff/Elliott Wave interpretations since 1983 (see **June 30** and July 6 comments, with particular emphasis given to the former by serious market investors)! If you've been a follower of SKDF/SKWC commentaries through the years, you have been in the correct investment classes.

<u>DOLLAR</u>:

The media can't for the life of them figure out whether or not Japanese shares are favoured by a strong or weak **Yen** and which is good for the economy. Why? This is due to the fact that their (negative) psychology determines how they interpret events. Simply, they make up their minds first and fit in those interpretations that vindicate their irrational and Japan-ignorant fears.

Many are praying for a lower **Yen**, while others point to **Yen** repatriation (a firmly held forecast in these pages) and a strengthening Japanese currency as proof of governmental panic. Since analysis earns more than prayer in the capitalist world, SKWC merely points to the **Yen** bull market and the **DDOVS'** advance with which it is naturally coupled!

Further supporting the case for the **Yen** and **DDOVS** is the view here that the much-publicized difficulty with the recent bond auction will have been proved to be an aberration (mostly exaggerated perhaps to help stem a tide of repatriation into the Yen!), as real interest and dividend yields are actually the highest among the major markets, causing Japanese retailers to return more exclusively to their own bond markets (particularly in the face of mounting foreign currency losses), joining foreigners who have generally been net buyers of Yen assets this year (see STOCKS section above).

As gold (see next section) could pullback toward $305, this would be an ideal time frame for a rally (bounce?) in the US Dollar. The Euro bottomed 2 years ago, though many don't appear to be aware of that, based on their investment planning/allocations. From its lows, the Euro rallied **24%** (!) and, so, a correction from these levels toward .93 would be no big deal from a long-term perspective. Don't be surprised, however, if the foreign currency pullbacks such as those contemplated here never occur, as major trends tend to be virtually uni-dimensional once they take hold.

Similarly, the other currencies with which these pages have been preoccupied, may partially retrace gains simultaneously. This includes the Yen whose potential is to, say, .80, only slightly lower than here. Even if it did occur, 84 could be seen first. Bottoming, however, is what it is doing. From its lows, the Yen's rally was also profitable (**17%**) and this coming (unfolding) buying opportunity will have occurred simultaneously to the final great buying opportunity in Japanese equities.

This is a recipe for explosive gains potential for those acquiring Yen-denominated shares. This is doubly so for investments that benefit from the same fundamentals that drive the Yen higher.

This, of course, is the case for **DDOVS**!

GOLD:

From the perfectly forecast and identified August lows in gold, the metal rallied, and indeed caused dramatic run-ups in, certain small caps. The sole recommended name on August 19th was Golden Star. That comment is quoted here:

"…GSC (Golden Star, Toronto) stock has a 52-week low of 0.57 and 52-week high of $3.79. GSC closed Friday at $1.77. For those who would only wish to bottom-fish for this highly speculative situation, a buying zone may exist at $1.25-1.50…"

Immediately following the above comment, the stock fell to a level only slightly above $1.25. GSC (all quotes in Canadian currency) then promptly rallied to $2.25! Now, we prepare for more buying opportunities as gold looks ready for another decline to the $305 area (the Philadelphia Gold and Silver Index has been weaker than gold, confirming the suspicions about the metal expressed here). If it occurs, that would be fantastic for long-term investors. We would surely visit the list of names put out Sep. 8th (for consideration only at appropriate gold level-related buy points). The base would be complete for a blast-off to over $350, the ultimate break of which will yield to dramatically higher levels, en route to $500 per ounce and beyond.

By the way, Japanese imports of gold in August were up over 80%, year-over-year. One month should not be analyzed here but we remind that what is good for Asia is good for gold! How superb it is that our ideal portfolio is---and has principally been for 33 months---filled with gold, non-Dollar assets and Japanese Domestic Demand Oriented Value Stocks!

I trust you have enjoyed this week's special report and, more importantly, it is hoped that you will know the greatest possible benefit from it.

Sid Klein