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Japanese Domestic Stocks & the Dow Report that Wasn't

October 19, 2007

JAPAN

Japan:

The October 7 report seems to have identified cyclical turning points within days, after having declared in that title that every single macro call is on the money, except for the turning point in the Dow, which was and is still seen as turning down, both according to the reprinted comments below in blue, as well as the more recent events this month. Please consider:

"By observation, one may conclude from the following chart, which divides the Nikkei 500 by the Nikkei, thereby gauging the relative performance and strength of the mid-caps versus the big-caps:

- **a clean and unbroken up-trend since the beginning of the decade, almost 8 years ago**
- **which means that mid-caps have been outperforming the Nikkei for that long**

- **this cycle's chart is consistent with a secular trend (multi-decade) of large-cap underperformance (mid-cap out-performance)"**
- **after an explosive period, the mid-caps have been under-performing the Nikkei, for the past year and 8 months (beginning of 2006)"**
- **during this correction, this chart of relative performance fell dramatically, in the typical 50% range (further dragging down small caps)**
- **a low in this chart now is consistent with a low in the Yen and a peak in the Nikkei (the latter is a matter of fact)"**

Simply, mid-caps are set to dramatically outperform the Nikkei starting right now (has begun), while small caps will lag, due to far greater price damage and the global investment mood, which presently demands liquidity.

Last December, seven Japanese domestic stocks were published in these pages, the update of which follows here. The first number (on the left) was the December 2006 price, while the number on the right reflects the equity's present price.

Gakken:	**270 Yen**	**338 Yen**
Tokyo Kikai:	**317**	**322**
Shinkawa:	**2125**	**2645**
Aloka:	**1100**	**1728**
Tohoku Pioneer*:	**1579**	***2200**
Dynacity:	**12,970**	**7070**
Nextcom:	**34,650**	**24,550**

Totals: 4/7 were positive over this period, and returned 3.4%. The Nikkei is slightly higher than it was on December 3, 2007, but it won't be by next week.

***Pioneer made Tohoku a wholly owned subsidiary, and shareholders were given the opportunity to tender, or sell at 2200 where the stock traded uninterruptedly for several weeks.**

A recent SKC report discussed the categories of domestic stocks, according to strength and size. The poorest and worst chance of survivability were those that were smaller cap or did not state financials with the zeal expressed by Big Bang, which actually took Japan higher in reporting standards than the West.

So, while the others are powerful and will yield dramatic returns once Japanese stocks get past yearend, those that haven't fared well should move significantly, while the strongest will rack up triple-digit gains. Only the worst survivability equities should be removed from portfolios, and preferably against offsetting gains.

Conclusion & strategy:

"Investors buy mid-cap domestic value stocks, while traders may again short the Nikkei." This group will react most powerfully and soonest (ahead of small caps, due to the general mood), of all Japanese stocks. This is the shelter during the international storm, as has been the case for decades (including this decade, until the Yen peaked).

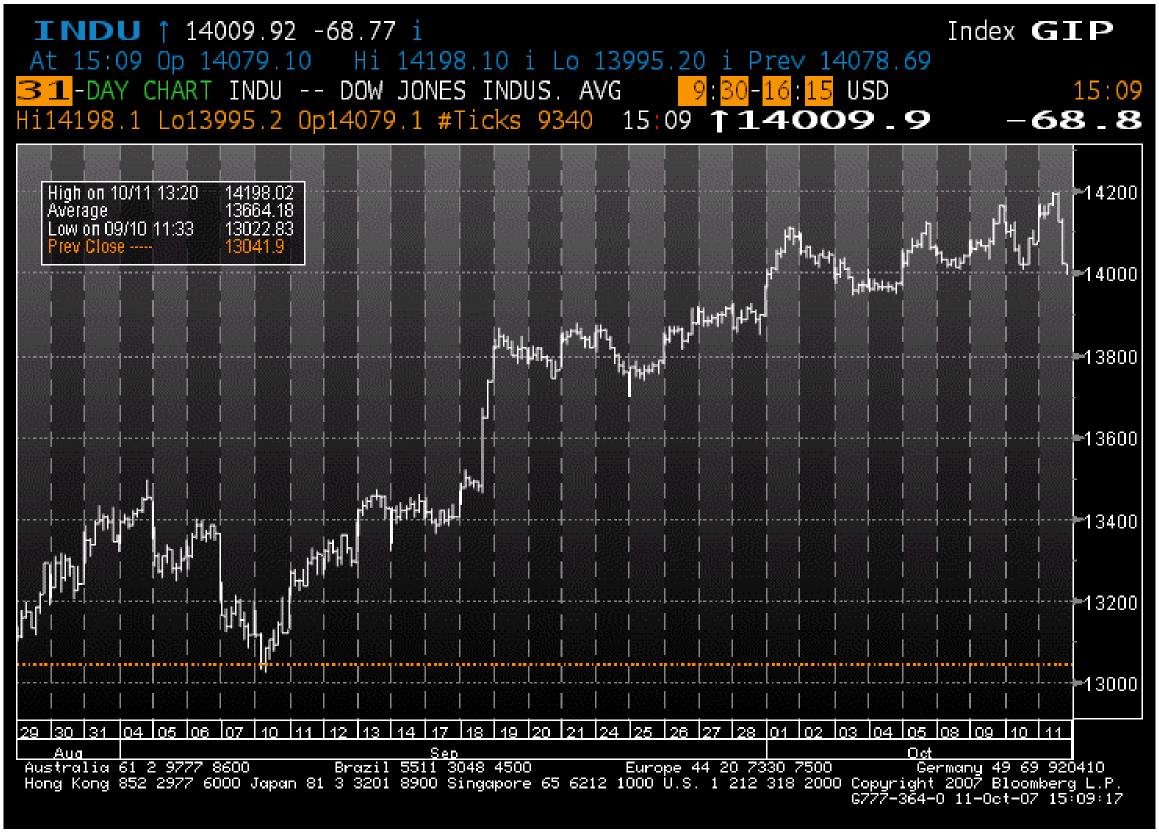
The seven recommended stocks contain two terrible losers, which should each gain dramatically, based on valuation, balance sheets and highest financial ranking. This bodes very well, since these two are obscuring strong gains cross the others.

NEW YORK

Dow Jones:

The following two Dow charts are reprinted from this month's report, which was sent out only days before the peak. On the pursuant Thursday (a week ago), a reversal appeared to be taking place, but rather than sound the alarm about top tick (and all that), I chickened out, with the reasoning that the reversal was forecast anyway (see below), and that I might bring good luck by keeping my fingers off the keyboard.

In fact, the 2nd chart below (31-day) helped identify top tick!



Reprinted from earlier this month:

"The same daily stochastic above (page 4) illustrates a bearish divergence, should the Dow decline from here (and it is turning over)."

"When all is said and done, rate cuts, sub-prime stories et al, will not have mattered much, as compared to the resumption of the Yen's bull market. When the Japanese spigot is turned off, the flow of capital will bottleneck and choke the New York market's capital addiction, until wheezing breathlessly. Cutting rates hardly improves the carry-trade story."

Immediately below, we see how the Dow did in fact follow through!

Reprinted analysis and comments (blue) on the following reprinted VIX Volatility Index chart (October 7) appear on page 6, while the VIX chart with trend-line, which follows last (page 7), was printed yesterday, before today's turn up.

"The 1-year daily VIX chart, which is the first of the 2 charts on the preceding page, illustrates:

- **major long-term support**
- **perfect support at the 200-day moving average**
- **a completed 3-wave a-b-c pattern down**
- **a bullish stochastic divergence, should the market advance from here**
- **a long-term up-trend channel"**

"The 7-year weekly chart (not reprinted here) and stochastic immediately above illustrates:

- **an oversold condition**
- **long-term support**
- **a pullback after a breakout, which corrected toward but did not break the 200-week moving average"**

"I have observed that recent tops have been marked by the VIX turning up, rather than continue to fall, during a move up in the market. I am referring to a 200-point move up in the Dow that is coupled with a turn up in the VIX, as opposed to a continued decline, as a realistic example (and which just occurred)."

The following is the updated daily chart of the VIX. The argument is clear and obvious. It started to turn up with the Dow's last 200-point rally and, as a contrary indicator, that was a sign of an approaching peak, which is why it took off today from the up-trend channel line. (Today's rally in the VIX is not shown.)

<u>Conclusion and strategy</u>:

"Amid negative divergences and questionable economic fundamentals, the volatility is set to resume, with a resumption of the Yen's bull market. The 4th quarter may yet turn ugly. Either way, risk is defined and limited, since no stocks are held, and within an asset allocation model that is heavily weighted to our other markets and asset classes.

"The Dow's pattern allows for a downside reversal to occur at any time, and the VIX background is entirely supportive of such a scenario."

It seems that the secular peak (including every other cycle, necessarily) is in. This time for sure? Are they planning another crime of the century, or is there to be no disguise for this being about financial and economic calamities.

<u>YEN</u>

The following daily and weekly Yen charts and stochastic (at the bottom of the graphs), along with the comments from the regular October letter (in blue) serve as the update, as the key is simple: the Dow and Japanese mid-cap value stocks do the opposite of it, the former almost immediately. The latter is on a 3-month lag, which plays

into the typical November/December domestic stock lows. Many will be making higher lows, of course.

"As the Yen resumes it now recommenced bull market, the recent equity market pain will resume. Nothing has changed, unless someone hallucinates that lower rates makes the Japanese more willing to hold empty (printed) assets (see Dow section above)."

Conclusion: As I entitled the last letter, forecasts have been bang on, regarding the Nikkei, gold and the Yen. The title admitted to a "delay" in the Dow forecast.

It seems that even the delay is over. Now we're good to go, right across the board.

Sid Klein

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