

The Media is an Idiot: A Tale of Yen & Dow



September 06, 2007

JAPAN

Nikkei:

The August 6 interim update was entitled, "Japanese Bonds." The upshot was that when the Japanese close the store window, everyone goes hungry. I go into this again, and in some redundant length in the New York section.

Here, because of commentary that already appears in that section and in the Yen section as well at the bottom, I will simply largely on Japanese stocks. For that reason, there is little Nikkei analysis. It's simple; the Nikkei runs counter to the Yen, to the extent that it is a multi-national-driven index, along with all that that brings.

I could add, I suppose, that Nikkei enthusiasts in the media were riding a wave at and over 18000, when readers looked for a spike down toward 14000 that would be fast, due to the fact that the entire move to 18000 was counter-trend!

Additional evidence that I should have mentioned but failed to was the fact that Japanese bank stocks have been in a cyclical correction for a year, with many giving back half the gains of recent years! Soon, even the Nikkei will bottom, though making much net progress may take some time, as focus shifts to Domestic equities. The latter will have been driven by the Yen's dramatic reversal of fortune. The Nikkei is completing a correction violently, as long-since declining bank stocks lends support to the analysis that 18000+ Nikkei was countertrend.

This is the precursor to counter-cyclical behaviour, as the world sees Japan as moving with New York. The two haven't been in same cycle at all, and co-movements have masked that fact.

As you read through this report, you will find that the Yen's reversal brings with it a reversal in our markets of interest, one-by-one. But one at a time does not mean long lag times between these market reversals. In fact, everything is on speed now.

This brings me to Japanese domestic stocks, the last (and soon only) hurdle left to conquer. So, here we are at the beginning of a brand new cycle however late and, **again, there will have been a 3-month lag time between the low in the Yen and the reversal for the domestic Japanese issues.**

Having reiterated all this, allow me to put these stocks into 3 basic categories:

Domestic Stocks:

After having peaked exactly when the had, the Yen has now bottomed and is powerful, while en route to recapturing much lost ground relatively quickly. Past is prologue.

This class breaks down now into 3 categories. There are those who:

- Have pulled back within long-standing and/or very strong up-trends.
- There are those who have broken below intermediate term support levels, on very light volume.
- As with every cyclical correction in Japan, there are those who face elimination.

For the fund manager, the net affect of all this is that the strong and here-to-stay companies have a greater portfolio weight, just as beaten

down stocks take on a roll of lesser weight, much like the law of diminishing return. Meanwhile, stock gains will be accentuated by the Yen's bull market, the effect of which has been largely muted by the long countertrend equity bear market, thus far.

Soon the Japanese fund managers will be attracting a lot of capital from those who have sworn off foreign assets (that's what the Yen bull market is about, in the bigger picture), including the middle-aged and older investors who have started to buy since a while, to reverse the trend. They didn't buy Japanese domestic stocks, and they didn't buy the Nikkei either. **The foreigners did that.** Domestic investors buy when the Yen is strong, as they abandon foreign investment, which they do hold. This group controls the vast majority of Japan's savings, in the **11.5 trillion dollar** area. As per the above 3 categories:

- The first will be the first to offer switching opportunities after 80% mark-ups.
- These have dragged down managers' portfolios and can jump 80% with speed, but delayed and sporadic at first; the break of support levels on light volume doesn't affect their potential, merely the timing of the most robust price action of the pursuant rally.
- Fund managers should offset write-offs with first of the more heavily weighted strong stocks' major gains, after major resistance at long term levels

Conclusion & strategy:

Japanese assets of all classes are in.

NEW YORK

Dow Jones:

Is it terrorists, sub-prime bogymen, bankrupt consumers? No! It's the Yen!!! Hooray for the Bears, the Yen has saved the day. Hooray!

Over and over again I have warned, forecast, analyzed – I've done everything to emphasize and bang the drum that the turn in the Yen is all that would matter in determining the direction of every asset class we care about.

I will go through it and make it obvious.

There may be a terrorist event to blame market events on, sure. Of course, anyone who can read a chart knows that the deterioration that

ushered in the collapse in 2001 was without knowledge (?) of the "terrorist" event. And before making final lows in 2002, all the pre-9/11 losses had been recouped, as well.

So, I'll only mention in passing that anyone who thinks that a limping terrorist got away from carpet bombing may not be thinking as clearly as possible. The world's largest terrorist organization, the US "paramilitary", was in Afghanistan days after 9/11 before the carpet bombing began, according Time magazine CIA operatives (under anonymity, I guess). For good measure, we've even been promised that this fellow will never be seen because he will take on a different form before killing himself and oodles of people. And everyone would fall for it, too. That's the scary part. So, while this is all-important for those who yearn for all freedoms, let us now get to what will really turf the market, while blowing some Oussama smoke. Okay, I won't do that again.

Continuing with the short list above, yes, the consumer is what smart fundamentalists follow. They are aware of what I used to report on regularly and graphically. Namely, that **the lag time between the peak in consumer spending and a collapse in the stock market is virtually instantaneous**. I'll come back to this in a moment.

Obviously, there is the **sub-prime** story. It is such a good story that the media is transfixed on this perfect explanation for everything, and so much so that there's no need to investigate toward the root.

As the media has beaten that story to death, and because this report aims to offer what others do not focus on, I will leave it alone and try to understand what everything has in common and why on any given day the hypnotized miss getting it right. And investors need to be exposed to the story to make sense of it all. For those who like to be ahead of the curve, as one needs to necessarily be in order to make money (this is a competitive sport, after all), let's look at how one can know at each moment what is actually happening. Forgive the redundancy, however.

Look the CNBC screen. **Do you see where the Yen's net change on the day appears? Now notice where the Dow's change appears. It can be observed that the Dow does the exact opposite, all the time, and with like counter-trend volatility.** Am I the only one watching, or is sub-prime consumer terrorism too simple? No, wait. I'm the one keeping it simple.

I don't mean to be facetious, but humans really can be out to lunch. Of the other items listed in the first paragraph of this section, one is a ruse concocted by Kissinger, or someone, while the two others are vital, but miss the point, for investors who want a step on the others.

The reason why the **sub-prime fallout** matters to the market is that it affects the consumer who, in the US, has negative savings for the first time since 1932, as I have often reported in the past. The former affects the latter.

However - and here's the redundancy to help the media catch on – the reversal of the Yen and the resumption of its secular bull market is all that really matters. **As the carry trade reverses, there is no one to finance US assets and the basic underpinning of the consumer, therefore, housing included.**

I used to chuckle when folks would go on endlessly about the Chinese. Again, for the choir, it will take **15 to 20 years before China's GDP matches that of Japan.** And for now, it is still an imperialist state without the basic rule of law, upon which long-term successful economic and financial success is built. This includes contract law. That's history.

Japan is the world's top financier. The numbers are staggering. The US doesn't come close. And now, the cry has finally been heard from the financial world that Japan foreign currency reserves are astronomical and untenable. "What would make the carry trade unwind?" I won't hear that again...ever.

Markets are free and gravitate toward balance, and when they are imbalanced, the swing effect is only that much worse later, in trying to restore "harmony."

So the Japanese are cashing in some chips and, as proof, note the speed of its reversal from bear market to bull market. I had to be right because there was no one left to convince.

All hope was lost. But, alas, there is hope for Dow bears, gold and silver bulls, Nikkei bears and, finally and lastly very soon, Japanese domestic stocks.

Hooray, it's the Yen. We're saved, everybody!!!

Technical:

I forecast that the Dow should hold the 12,800 – 13,000 area, before commencing a more meaningful rally that would usher in the last chance to short the Dow. As the Labour Day weekend passed, I felt that the last squiggles were upon us and, indeed, investors are now, again, 100% short via Dow puts. Once we passed Tuesday, it made no sense to wait any longer. The risks were on the downside, with the short term forecast (and prayers) realized. The last chance to short the Dow, I called it.

The Dow can fall to below 9000 in a prolonged manner, as per 2001 – 2002. Or, the Dow can get there this month. It really depends on whether “they” (the “institutions”) have loaded up on delta hedges, in which case they might do “the terrorist thing.”

Delta hedges are when out-of-the-money (OTM) puts are bought so cheaply that the put values increase at a greater rate than the losses on the stocks that the puts are designed to hedge. The way to achieve low put prices is to buy the OTM short-term options, so that a crash becomes beneficial.

All this jibes with the astronomical VIX level and its resultant option premiums. This has never happened before, as I’ve reported recently. Put premiums have always been contrary indicators. Unless the Dow rallies to 15000, it is more likely that the scenario here espoused is closer to correct (you think?). In this case, we would have benefited from an analysis that had not had a trend.

Whether we see a fall to 11000 and have another heart attack later remains to be seen.

Bear this in mind, however: One year ago this month, I wrote that mutual fund money was finally coming in off the sidelines and would therefore skew fundamental reality, in a manner similar to what had happened in Japan in 1989’s 4th quarter. Already committed money comes in and thereby ignores fundamentals. (Conclusion below.)



Conclusion and strategy:

Regarding the preceding line, I won't get into whether I was right, wrong or something in-between. I will tell you this:

Most of the money is in at 11000. Below that is panic time, as that is the point where the public is losing money (while getting nailed on their homes). And it can happen NOW! For heaven's sake, whatever you do, at least have no stock positions. Don't wait for greedy "confirmation." Accept it and liquidate anything that is still held.

OIL (special):

"The topping process is not at all complete but, with so little to gain vis-à-vis my target from the lows, those who have been long for \$15 - \$20, should liquidate this special situation. The technical indicators suggest that the best is behind oil."

The above blue-highlighted quote from the August 5 letter was only a day or two from being ideal. But cutting it that close is why a spike got going immediately that gapped oil lower, leaving me to write a follow-

up report only a day later, advising to use a bounce to over \$73 to pay good-bye to this special situation trade. Though at \$72 (down from \$78 a couple of days earlier), oil continued to fall to \$68, before the strong bounce, which would actually take it over \$75 (see weekly, daily and 31-day charts below).

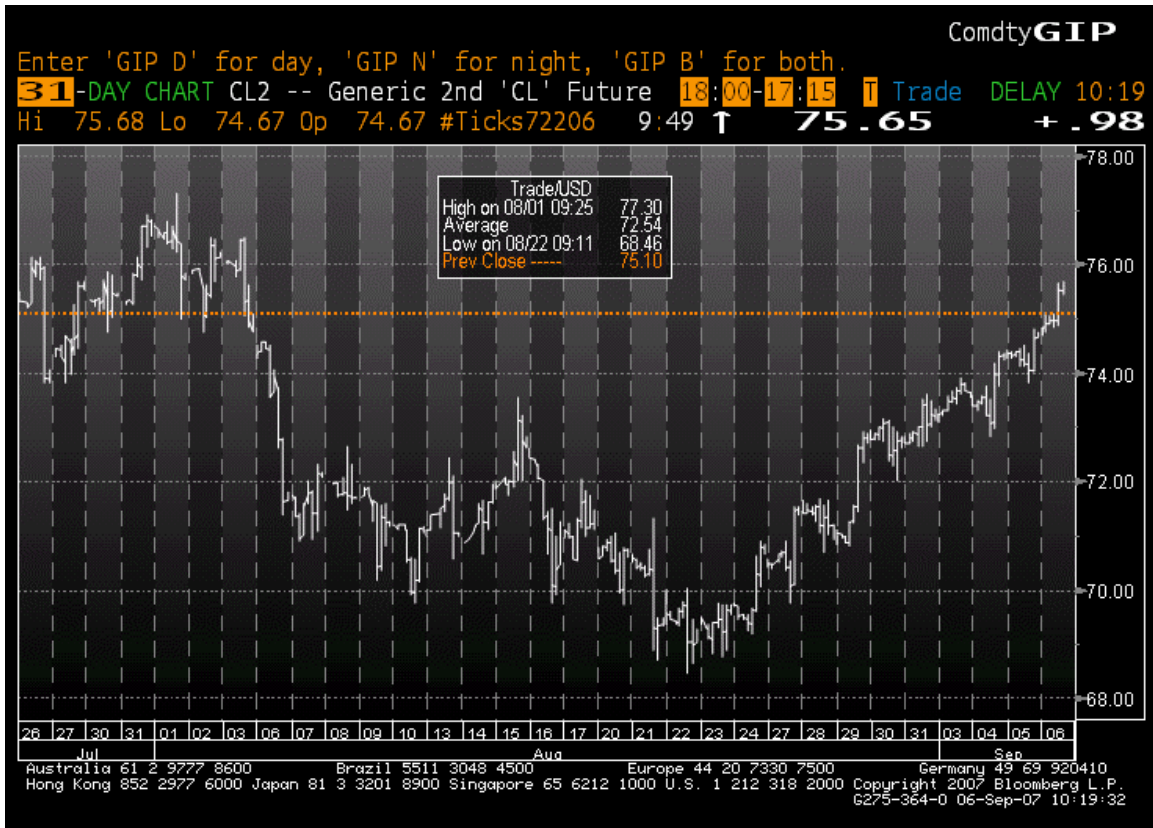
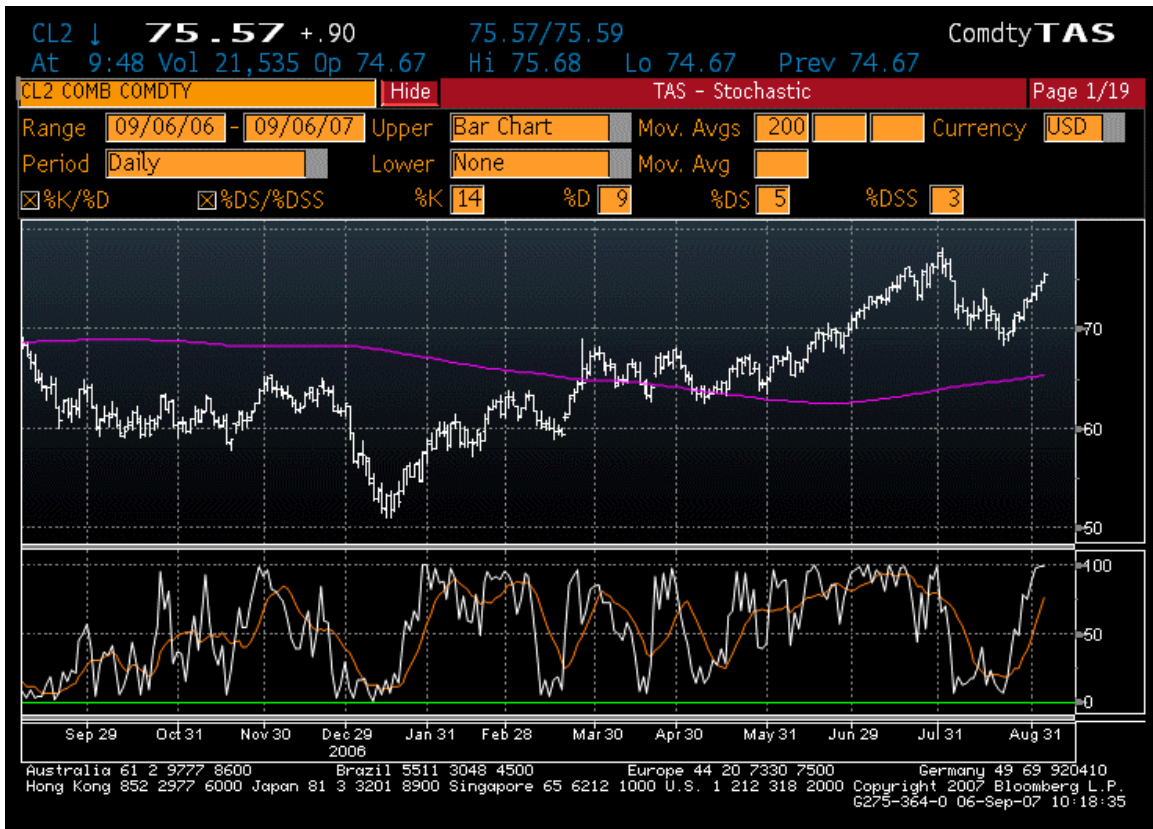
Strategy:

The conclusion in **blue** above says it all: We're out and done with oil. It is not a covered market, but merely a special situation; the job has been done. If someone wants to think about terrorist attacks, they can focus on all the other markets covered in these pages, since calamity would affect everything.

So why not focus on where the technicals are not fighting us. That is the case with the Yen, gold, the Dow, etc. Oil is no longer a technical friend. No need to try and attend a party that doesn't have music that's easy to dance to. That's good news because that would not be a story that is consistent with terrorism, though it would make the oil interests even wealthier.

Please scroll down.





PRECIOUS METALS & DOLLAR (YEN):

Technical (gold):

In deference to a massive secular bull market that we have been long since the higher gold low at \$280 - \$285 in the first quarter of 2002, I never went below 50% long, and only for those who wished to trade.

I exited alright, but didn't really improve that much by returning to 100% long for all investors and traders, as the correction that was correctly forecast many months ago did indeed bear out the thought at that time that the consolidation would be sideways, despite respecting the possibility for a flush-out to \$605.

I believed in a sideways correction because Westerners still don't get it. In fact, in the aggregate, they're still largely out to lunch.

By noting that gold is in a trend that is accelerating within a long-term perspective, 25 years of experience told me that it was time to focus on the strong hands of true long-term holders. Such a phase allows for "the transference of wealth and power from East to West." I have been writing about this for years and the domination of gold purchases by the Indians and Chinese has been bearing supportive this analysis of a sideways correction.

Importantly, sideways action conceals selling climaxes and such analyses invites the most trained eye.

Imagine that gold sold off to \$600 instead of completing its correction by moving sideways. One could easily envision gold stocks selling off. One could easily imagine junior gold stocks selling off heavily. Well, they did!

With that metal sell-off happening in an "emotionally repressed way" (sideways action connoting Eastern accumulation), the visibility of the completion of that metal sell-off was only evident for those following those stocks, and those who remained unmoved by any intermediate term weakness in gold. The fear of investors was, "What happens when gold drops too?" But the crowd had it backward. The selling pressure on a weighted basis went unnoticed.

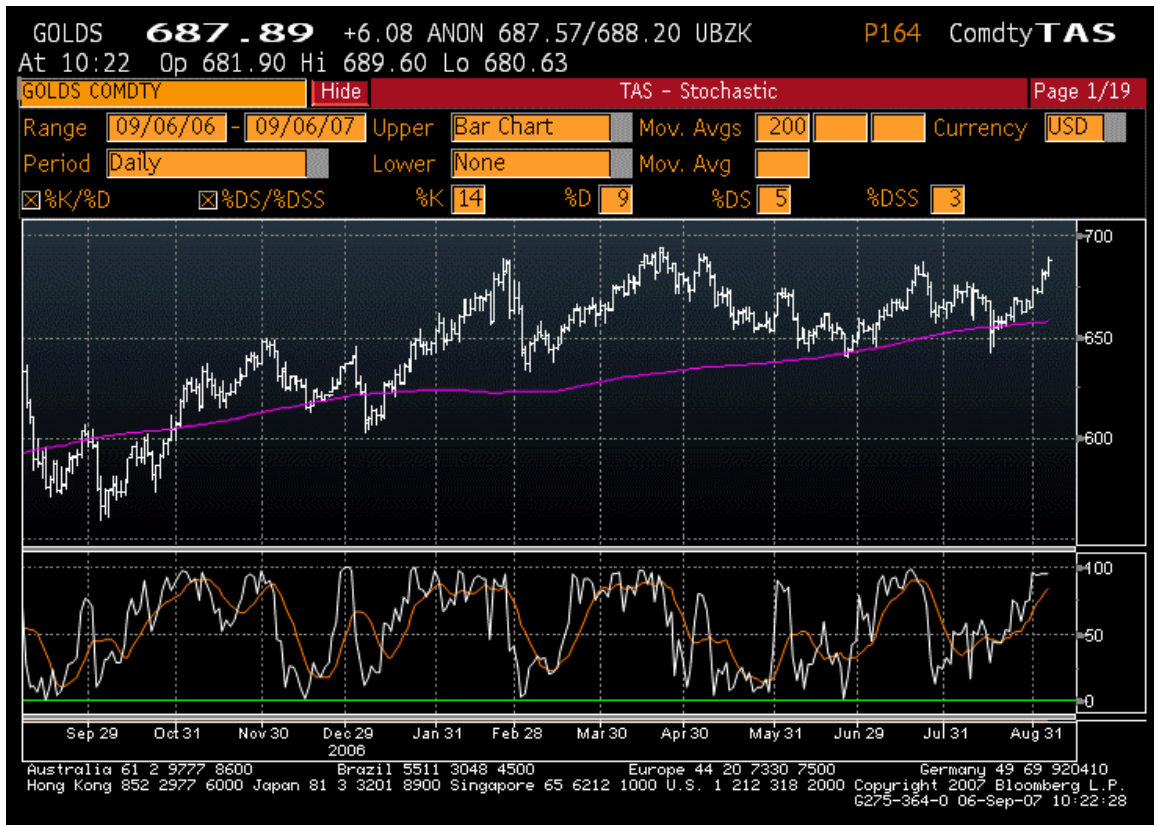
If another shoe drops during the unfolding stock market debacle or Crash, remains to be seen. However, while investors have sought answers in parallels with 1929 and other periods, to determine what

will happen with the gold stocks during such a crash, the answer this time might simply be to look at the US Dollar. And it is possible that the latter is only a bit in front of a gold stocks' positive turnaround.

Remember, though: The Dollar's turn down versus the Yen may be only be a "bit" ahead, in terms of time for the gold stocks, but there may be a world of difference in terms of price. The key to all investment class timing is the Yen, and I have been writing this ceaselessly for those who would listen.

Similarly, I wrote, a reversal in the Yen would be sharp and swift, suggesting that spikes could be viscous, regardless the asset class. This includes gold stocks. Until this phase of crash ends below 9000 on the Dow, nothing is safe in US equities. But that may not take too long.

So, it is also true that gold stock purchasers should sleep with an opportunistic eye open.



Strategy:

Keep the eye on the prize. Gold \$1000, silver \$20. We've haven't been wrong yet with these macro trend analyses (since 2002). So, now just stay long.

Technical (silver):

The daily silver chart below (2nd chart) illustrates the spike down to \$11, while both the weekly AND daily charts reflect the great strength of the respective stochastic, which also represents the strength of a variety of momentum indicators, in fact.

Please scroll down.





Strategy:

Let's keep it simple.

I wrote that silver would break down to an "in-between" number. Simply, on breaking \$12, many traders would wait for \$10. In other words, the low would be \$11, or so. The reason for this common occurrence is that traders set stops at key levels and then wait for the next major stop. The "in-between" number is where shorter-term traders are gone and will now have to chase higher prices, as the lower target never materializes.

Sure enough, silver spiked down to \$11 (see chart immediately below) and I hope that readers were well reminded of this letter's oft-repeated strategy to **go 200% long at levels under \$12**, since this metal is en route to \$20, with \$5 - \$6 posing almost no threat at all to our 200% long strategy.

As discussed here often: There are times to use leveraged items (options), other times to use vehicles that are leveraged due to the contract size (futures), and times for margining, as the risk/reward situation merits the carried debt. Silver is in the latter category.

Technical (Yen):

The comments on Japan and New York clearly spell out the truth about this currency and its relationship to ALL investment classes, including the determination of what happens with each of them. I have forecast this long enough, so I am not allowed to not be humble. On the other hand, it is true that ALL forecasts in these markets have been tied to the Yen, thereby creating a domino effect that will only become more evident and pronounced. What does this mean specifically?

The Dow's crashing waves are beating up against the shorelines of every financial story. Each and every forecast has already come true, is coming true in ever more pronounced ways, or is about to come true. Here, I refer to the Yen's own reversal (which is the cause), the Nikkei's dramatic reversal, the Dow's unfolding reversal, gold and silver's bullish resumption and, finally and lastly (see Japan above), domestic Japanese value stocks. The latter bottoms on a 3-month lag to the Yen.



Asset Allocation:

My asset allocation remains happily stuck at what I believe to be the best global mix (as it has for a long time, after slightly adapting over the past recent years, due to excessive movement in other currency).

All liquid wealth (and all wealth should now only be liquid) should remain:

- 50% Gold (or 40% gold and 10% silver)
- 25% Yen
- 25% Swiss Franc

This is a wonderful time to own the Yen, gold...and silver!

Good fortune to all,

Sid Klein

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