The CJ Investment Newsletter

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The New Big Lie

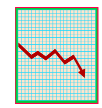
Purpose

The *CJ* Investment Newsletter deals with the entire spectrum of securities investing, including cash (money market funds), bonds, equities and options. It will evaluate the overall investing environment and then discuss the relative allocations of these asset types, as well as strategies to implement within them. Essentially, it reflects what I'm actually doing with my clients.

These letters are not sent "cold." Either I know you or someone you know gave me your name. Yes, this letter *is* a sales tool. It communicates how I apply my investment strategies, so that you can decide, without any sales pressure, if my thinking is compatible with how you want your money invested. If you're not already a client, I would like to discuss your *becoming* a client. Please call me for more information.

However, that's not its only purpose. Even if you never become a client, if you want this information, I want you to have it – for a while, anyway. My hope is that providing this information and teaching you what I think is important when investing may help you. Please contact me if you have any questions or comments. I'd love to hear your reaction to my letter.

Quick Look

Market	**Next Expected Move**
	

- CJ got an article published in the *KC Star*. It's attached at the end.
- How behavior affects inflation.
- Keynes vs. Hazlitt. Some things are real and predictable.
- Gold rallied significantly in June in spite of the increase of the US$X.

I think I've referred to this before, but the best way I can provide a vivid image where the market is now is by conjuring up the image of poor old Wile E. Coyote. In many of the cartoons he was in with the Roadrunner, he is chasing the bird around Arizona or New Mexico, up and around some cliffs. At some point, Wile E runs off the edge of a cliff and just floats there – until he looks down. Then he realizes there's nothing holding him up and he starts to fall. We're right at that point – floating because we don't realize there's nothing under our feet supporting us.

So far, the US government, the Fed and world business have managed to keep us from realizing what has to happen if you believe in economic fundamentals in any fashion whatsoever. The *New Big Lie* is

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> *"Diversification is for people who don't know where to put their money."*
>
> \- Old Market Proverb

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simple. *We are supposed to believe that a US$ is worth the same as it was 5 days ago, 5 years ago, 5 decades ago*. We are supposed to act as if the dollar has a solid, unchanging underpinning, even though we know it doesn't. At least some of us know.

It's well documented that public confidence in a fiat currency, like the US$, is its only real foundation. (A fiat currency is government issued money with no tangible wealth underpinning it, like gold, other precious metals, or other valuables. It, therefore, only has value by government edict, or *fiat*.) If the public acts like there is little inflation, prices remain relatively constant and inflation is low or nonexistent, regardless of government and central bank policy. This is where we are currently, although the signs of inflation are manifold. Government inflation stimuli of deficit spending and central bank (Fed) financing are clearly present, almost extreme. The trade deficit is also clearly present and dangerously high. Yet, for the recent past and for the time being, inflation is relatively tame due to public confidence in the US$, in spite of abounding evidence to the contrary.

Of course, there are many cross currents that tend to confuse the issue. With all the world's major currencies being fiat currencies, the US$ can sometimes appear to not be losing as much value as it truly is because other currencies are losing value also. Some faster, some slower. In fact, though, the US$ has lost almost 25% versus the basket of currencies in the US$X (US$ Index) since its peak in the first quarter of 2002, and in spite of its recent rally beginning early this year. This is actually quite a feat considering many of these countries are deliberately lowering the value of their currencies in order to maintain competitive prices on their export goods. Therefore, many currencies are losing value (inflating) concurrently. The US$ is just inflating *faster*, in spite of deliberate support from self-serving foreign governments.

In the 1970's, after at least a decade of similar government mismanagement of the US$ and stimulated by oil shocks originating in the Mid East (sound familiar?), public confidence in the US$ waned. People began acting like the US$ was losing value through inflation, which, of course, it was. However, with the lack of public confidence, inflation was not only much higher, but accelerated to a dangerous level. Those of you too young to remember this time are, in a way, lucky because these were not good times. In fact, they were some of America's darkest days. It may also help us understand why there is so much misguided confidence in the US$ since anyone under 40 would be unlikely to remember the lessons of those years, having been too young to have studied inflation in school or too young to care since they were still very young and being supported by their parents. Many young adults that have college degrees were not even born yet. There is a whole generation who has not experienced the pain a quickly inflating US$ can inflict on the populace and who don't recognize the warning signs "older" Americans do. They generally don't understand the *Big Lie*.

Keynes vs. Hazlitt

One famous market adage goes like this: *In the short run, markets can do anything; in the long run, markets will follow the fundamentals*. I've been watching and studying the markets intensely for many years. It's been well over 10 years since markets have even approached reflecting the fundamentals. I've spent years talking about technicals and fundamentals in these letters, trying to lay out cause and logical effect and in the process, exposing you to some of the greatest market and economic thinkers of all time.

Lord Keynes once stated, "*In the long run*, we're all dead." This statement is often quoted and considered exceptionally clever. I recently came across a rebuttal of this statement from the brilliant Henry Hazlitt:

"*There are men regarded today as brilliant economists, who deprecate saving and recommend squandering on a national scale as the way of economic salvation; and when anyone points to what the consequences of these policies will be in the long run, they reply flippantly, as might the prodigal son of a warning father: 'In the long run we are all dead.' And such shallow wisecracks pass as devastating epigrams and ripest wisdom.*

"But the tragedy is that, on the contrary, we are already suffering the long-run consequences of the policies of the remote or recent past. Today is already the tomorrow which the bad economist yesterday urged us to ignore. The long-run consequences of some economic policies may become evident in a few months. Others may not become evident for several years. Still others may not become evident for decades. But in every case those long-run consequences are contained in the policy as surely as the hen was in the egg, the flower in the seed."

I'll never consider Keynes's statement brilliant again.

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Notice how closely the description of national policy described by Hazlitt in the first paragraph describes what the US national policy has been since at least the time Clinton became President and probably since Alan Greenspan became the Fed Chairman in the late 1980's.

Hazlitt not only repudiates Keynes's "clever" wisecrack, he admonishes us, as the great teacher he was, to remember the laws of the universe still hold. Cause and effect are real. Nobody yet has found a way to repeal the trade cycle or other real economic laws. Just because forces have masked the ultimate result of US government policies which will both inflate the US$ and cause a significant recession doesn't mean they won't ever happen. It's a matter of when, not if. My clients and I are positioned for what has to happen. Are you?

Sticking with the Plan

I have put my clients' and my money where my mouth is, beginning about December 2000. Even with the rally in the stock markets since October 2003 and the significant decline in gold since January 2005, the *CJ Model* has managed to beat the major indices in performance since January 2001 (see page 4). Prior to the recent decline in gold and gold equities this year, the *CJ Model* was obliterating these indices. I believe it will do so again, too – sooner rather than later.

It is frustrating to see market cross currents run against you. Patience is not my long suit, although the market has taught me more patience than I thought possible. It has also taught me that I needn't worry about other people's *opinions* about the market, other than by trying to understand the overall market sentiment and direction reflecting those opinions as demonstrated by how others "vote" with their money. *I've learned that time alone will prove me right or wrong*. Opinions, mine included, are just that – opinions.

While I've become quite versed in technical analysis (TA), I prefer to invest by understanding fundamental trends and using TA for timing purposes only. TA alone has not shown itself to have a high enough success percentage for me to work exclusively in that arena. Gold has been such a fundamental trend, caused by the inflation of the US$ as discussed above. Investing in international bonds (box at left) is another trend which has been extremely profitable for my clients and myself, also based upon the inflating US$. This hasn't been reflected in the *CJ Model's* performance since these would not be considered "aggressive" investments, but the returns have been solid and real.