The CJ Investment Newsletter

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You May Not Want What You "Deserve"

Purpose

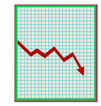
This is a reissue of previously disseminated information.

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
	

I originally published this article in 8/04. It's as important and relevant now as it was then. Only minor editing changes have been made to it.

Before you begin reading this month's letter, it's important that you understand why I'm wrote it. Economics, politics and investing are forever intertwined. Understanding politics and the implications of political policies is as important to solid investing as understanding how to read financial statements or technical analysis. Election results can dramatically affect which investments make money in the future, as well as the direction of the economy.

There is no *personal* judgment in this letter regarding your political viewpoint. As someone smart said, "You're entitled to your own opinion, but you're not entitled to your own set of facts." Political policies are also bound by the law of cause and effect. All policies will have certain positive and negative effects. I will discuss policies in terms of their effects upon our economy and investing and upon the society as a whole. I realize your vision of the "perfect" America may be different from mine. I hope the ideas I present here (and I believe to be true) and will be meaningful to you without being individually judgmental. I know they help me do *my* job better.

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You May Not Want What You "Deserve"

When a politician uses the word "deserve," what do they mean? To *deserve* means to *earn* whatever it is you are receiving or expect to receive. So, for example, how is it that people *deserve* health care they haven't paid for? The hard truth is, they don't *deserve* it unless they have *earned* the money to pay for it or have provided some service to society which *earns* them such coverage – like our military personnel. We, as a society may *choose* to provide healthcare, welfare, education and other social programs to citizens regardless of whether they have earned the money to pay for it. That is a perfectly valid societal choice we may make in order to have a healthier and more egalitarian society. But, those who do not earn it do not *deserve* it.

When a politician uses the words "you deserve," what she really means is that, if you vote for her, she will *tax (take)* from people who have resources (but not enough votes) and give that money or benefits to voters who do not have as many resources (but plenty of votes). This tactic only works because there are many more poor and middle class voters than rich voters. No; you're not mistaken. *The politician is buying the poor and middle class vote by taxing the rich.* If the politician was *honest*, she's say, "Vote for me and I'll take some of the rich folks' money and give it to you." Politicians use the term "deserve" in order to make income redistribution, a socialist policy, more politically palatable. It's actually charity, except in this case, the donors don't have a choice as to which cause they are donating. But the politicians do – and *they* use it to get elected.

Why does this matter to the economy and to investing? Because, in a capitalist society, the "rich" provide virtually all of the investing resources which the economy needs to survive and thrive. For example, say somebody makes $1,000,000 in a given year. After federal, state, local taxes and FICA have been taken out, she is lucky to be left with $550,000. Regardless of how you feel personally about the fairness of the tax load, do we agree that instead of having $1,000,000 to spend or invest after her efforts, she has a little more than half *of her own money* to use as she sees fit?

The "rich" like to invest to make more money. After all, how many people have "too much" money? When asked how much money was enough, the richest man in the world at the time, J.P. Morgan, responded, "I'll let you know when I get there." If this hypothetical person leads an expensive lifestyle, that may mean that little or none of her money would be reinvested into the capital markets, providing needed capital to fund new small businesses or business expansion. That means less job creation and less small businesses that may become big businesses, creating new "rich" people to continue to feed and expand the economy. Many worthwhile governnment programs are needed and must be paid for – like defense, roads, the judiciary system, police, and fire protection, but once government goes beyond what are called "basic services" virtually all other programs are certainly debatable as to cost and benefits derived.

Seen from a different direction, let's assume our rich person wouldn't use the $450,000 in tax to invest, but would consume instead. That consumption creates *demand*, which will trigger the creation of new businesses or expansion of existing businesses using investment resources provided by *other* rich folks who have the capital to invest. Creation and expansion translates to new jobs and a growing economy. It should be noted here that the government can and does create demand with some of its programs, but transfer programs such as welfare and bureaucratic waste are not stimulative.

Either way, our $1,000,000 earner can only stimulate the economy to the tune of $550,000, instead of the full $1,000,000 she earned. Government programs tend to consist of consumption rather than investment because they are supposed to be nonprofit, and therefore do not create new investible or consumable assets. So, our millionaire's stimulative impact on the economy is severely limited by the taxes she pays. The higher the tax load, the less impact the rich will have on the economy. Put simply: Higher taxes lead to less capital and demand in the economy which leads to less business activity and jobs. It also works in reverse: *Lower taxes lead to more capital and demand in the economy leading to more business activity and jobs.*

The intriguing paradox is that the government actually receives more tax revenues a few years after reducing the tax rates because of the increase in business activity and more jobs (nee taxpayers). While this has been proved by history more than once, politicians and other persons with "agendas" will often deny this truth. When you think about it, you may prefer the *job* you would get in a thriving American capitalist economy rather than the benefit *the government decides* you "deserve" from levying higher taxes on the rich.

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Asset Allocation Percentages
CJ Current Suggested Ranges

Dow Theory Market Phase: **BEAR**
Appropriate Current Allocation: **DEFENSIVE**

Asset Class	Conservative	Aggressive
Money Market Funds	70-10%	55- 5%
Long Positions:		
Bonds & Bond Funds	30-60%	40-60%
RD Stocks	0-10%	0-10%
Growth Stocks	0%	0%
Gold Equities/Funds	0-20%	10-30%
Bear Market Funds	0- 10%	5-20%
Aggressive Positions:		
Shorts and/or Options	0%	0- 5%

Notes:
Income generating portfolios may not conform to the above guidelines. If income is the primary purpose of a portfolio, income needs are met *first*, then other allocations are made.

Up to 50% of bond/bond fund positions should be in international (non-US) bonds. Such bonds will provide higher interest paid on the face due to the additional *perceived* risk of foreign bonds, as well as providing hedging gains as the dollar declines against foreign currencies due to Fed monetary policies.

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Business Taxes

Business taxes. Is this a great thing for politicians or what? Some politicians virtually drool when they talk about taxing "big business." Everybody wins, right? The government gets money, keeping your taxes lower and no "people" (aka voters) are taxed. What really happens when businesses are taxed?

First, businesses *can't* be taxed. Only *people* can pay taxes. Since businesses are legal entities only, they have no money to be taxed. All of the money or assets businesses have were provided by people buying their products or services, loaning them money or investing directly into the business. Eventually, profitable businesses pay taxes from revenues, that is money charged to their customers. Profitable businesses are the only ones that stay in business, so *businesses have to treat taxes as product costs and build them into the price of their products*. In other words, business taxes are nothing more than product costs to consumers.

Is this bad? Not necessarily. It depends upon what your goals and values are. However, business taxes are *regressive*. The additional product costs are not only passed on to their "rich" customers, but also to *all* customers equally based upon their consumption. That means that $3 pack of cigarettes that is 75-80% taxes is proportionately much more expensive to poor smokers than to rich smokers. That $20,000 car that is 10-15% taxes (my guess) costs the poor buyer proportionately much more than the rich buyer. All the basics of life – food, clothes, etc. are proportionately more expensive to poor consumers than rich consumers. If you're a politician running on the platform of "looking out for the little guy," this is an incredibly hypocritical tax policy. It sells well, but really hurts the "little guy" in the process.

The Wrap Up

We've discussed two major ways politics affect our lives through tax policies. These are just the start of understanding why I pay such close attention to the political landscape. Taxes, legal matters, reporting requirements, monetary policy, among others are ways in which the economic and investing environments are shaped by the elections we take for granted. Of course, there a multitude of other issues our politicians make decisions about in our names as our representatives. Many are politically charged; others are mundane.

Every tax levied by the government affects investible capital and demand negatively. We discussed only two. Things like estate taxes, double and multiple taxation of dividends, and others not only deprive people of what some would consider rightfully theirs, but also prevent people from adding needed capital and demand into an economy where people are complaining not enough jobs are being created. Ultimately, we all need to realize that government can indeed "kill the golden goose" that is the American economy. We saw this actually happen in the late 1970's and early 1980's until Ronald Reagan and his group were able to pass ERTA (Economic Recovery Tax Act) in 1981. Less chained with taxes, the American economy began to recover and eventually led to the prosperity of the 1990's, in my opinion.

Your vote counts for a lot. You can make your life better or worse with it. Use it wisely.