The CJ Investment Newsletter

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March, 2008 *One Hundred Twenty Third Issue*

It's Obvious

Purpose

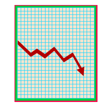
This is a reissue of previously disseminated information.

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**
	

- Six trading days ago, the US$X was close to 76. The US$X hit a new intraday low today (2/29/08) below 74, a sharp decline.
- All of a sudden, many pundits are seeing inflation. Better late than never.
- I still believe the US (at least) will go into recession shortly, if it isn't already there.

Inflation, Obviously

Recently, pundits on CNBC and other business reporters are starting to promote the idea that inflation is becoming a problem. One thing I say is, "Welcome to the party, Captain Obvious! I see you brought your wife, Pretty Obvious and your son, Mighty Obvious, and daughter, Really Obvious, with you. I think I saw your brother, Incredibly Obvious, and his wife, Quite Obvious, earlier, with their sons, Amazingly Obvious and Devastatingly Obvious. Is your Mother, Unbelievably Obvious, coming too?"

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Not to toot my own horn, but my clients and I have been *dealing with*, not just talking about, inflation since 2001, when we started investing in gold equities.

The key observation that made this possible for me was the realization of how the Fed really operates, as opposed to how the government and the Fed itself say it operates. It's blatantly obvious that the Fed is a political animal that has control of our money supply and is (as B-B-B-Benny Bernanke puts it) "charged with the dual mandate of maximum employment and protection of the value of the dollar." Perhaps they're "charged" with the dual mandate, but the sadly obvious reality is that only one Fed Chairman in my lifetime, and perhaps ever, dealt with the "mandate" of protecting the US dollar's value. That man was Paul Volcker. His President was Ronald Reagan.

The political pressure exerted upon the Fed Chairman by the President and other politicians, not to mention the media, is enormous. You'd have to be an idiot not to understand that "full employment" trumps "protecting the dollar's value" every time. Obviously, no one who makes it into the upper echelon of the Fed is an idiot, let alone the Chairman.

So, the business cycle is always over-primed in order to provide business growth and full employment. Eventually, the economy collapses from a much loftier height than necessary and recessions become more painful than necessary had the Fed simply protected the value of the dollar. When nearing a recession, the Fed primes the economy even harder in an attempt to fight off a recession, or at least delay it until the next election cycle is over. Obviously, in amplifying both the up and down sides of the trade cycle, the Fed destroys the value of the dollar in the process.

Forgive me if I sound angry and cynical. The United States of America is the shining light and hope of the world. She and her people deserve better than this from her leaders. We have shown the world the power of freedom and capitalism. Sadly, even as much of the rest of the world adopts our formula for success, we turn away from it. Did you ever wonder why "Universal Healthcare" isn't currently called by its original name – Socialized Medicine? Painfully Obvious. Would that we were as good at living up to our responsibilities as free people as we are at coming up with euphemisms to sell the populace of America another bad idea.

I've been providing statistics for years to back up the assertions I've made above. I don't want to bore long-time readers, but for the benefit of newer readers and because of recent developments, we will present some factual backup for those assertions.

The US$X has experienced a precipitous decline recently, dropping from about 76 on 2/20/08 to below 74 today. Here are some relevant facts:

- Long-term, money supply growth continues to outstrip GDP growth dramatically. Many more US$ spread out over a few more goods and services. Obviously, as long as this happens, the US$ will decline in value, causing inflation.
    - MZM, M2 and my calculated M3 are all at all-time highs. The 4-week annualized growth rates for MZM and M3 are 30.22% and 15.96%, respectively. The 52-week growth rates are 10.4% and 6.27%, respectively.
    - Monetary velocity for MZM and M3 at the end of 2000 were 212% and 139%, respectively. As of 10/1/07, they were 178% and 125%, a clear indication that monetary growth exceeded GDP growth over those 6 ¾ years.
- International reaction to our proposed "solutions" to the housing and credit crisis is negative, causing a decline in confidence in the US and a recent sharp selloff of the US$. The reasons:
    - The Democrats have a good chance of winning both houses and the Presidency. One of their stated objectives is to raise taxes, an anti-business stance, which will, obviously, further weaken our economy and exacerbate any recession.
    - At a bipartisan level, proposals to allow the government and the courts to change private contracts, such as real estate loans, violate all property rights precedents. Who would buy such contracts if they know they will not be upheld? Since when has the US started to treat its personal property rights like Venezuela or some other third world country?

There are those who posit that the increases in prices, especially for commodities, are more related to the growth of the world economy, especially China and India, than they are to inflation. This argument might hold water if the US$ were not losing ground to other currencies around the world. Obviously, since it *is* losing purchasing power relative to the basket of foreign currencies known as the US$X, this argument is not valid. The US$X has declined 38.9% from a high of 120.90 in 7/01 to 73.77 today. Obviously, the US$ is losing value due to inflation. The increase in

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Asset Allocation Percentages
CJ Current Suggested Ranges

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

Asset Class	**Conser-vative**	**Aggres-sive**
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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prices is not a temporary condition brought about by excess demand yet unmet by increased production.

Larry Kudlow has his own show on CNBC (Kudlow & Company) and is the most pro-American, unreasonably optimistic economist I've ever heard. I believe he would be considered a Monetarist economist, of the old Milton Friedman School. His main claim to fame was that he was on Reagan's staff when the "Reagan Revolution" to supply side economics happened in the early 1980's. I have no idea how influential he was in that process. Actually, I don't respect him much as an economist, but he has great expert guests on his show. He may not be worth watching, but they are.

Historically, the "acid test" for inflation has been the price of gold. If the price of gold is going up on more than a temporary and understood basis, you're dealing with inflation. I remember when I became aware of the brutally obvious, deliberate destruction of the US$ by Greenspan's Fed in the early 2000's, Kudlow used to argue that there was no inflation and that the Fed was roughly "pegging" the US$ to around $350/oz of gold. How's that working out for us, Larry, now that gold is knocking on $1,000/oz? Obviously, as gold reached $400, $500 and so on, that argument stopped. Still, Larry managed to find enough statistics to convince himself and others that there wasn't any inflation, even as his own best measure was screaming there was. I guess it's true; there really *are* none so blind as those that *will* not see.

To be fair, Kudlow has been beating the inflation drum recently on his show. Welcome to the party, Completely Obvious!

Recession & Stagflation

For several years, I've suggested that it was likely we would find ourselves in a "stagflation" situation similar to the 1970's. The Fed does not appear to be willing, even when it's looking ever more obvious, to stop blowing up the money supply and just let this recession run its course without further destruction of the US$. Obviously, when the likely recession sets in, we will experience the double whammy of recession (with its resultant unemployment) and inflation, or at least a stagnant economy with inflation. Commodities and tangible goods will become ever more expensive and there will be no resultant increased business activity from the increased revenues.

The market downturn, while not extreme yet, really looks to continue and give the classic signal of an upcoming recession. The DJI, TRAN, SPX, and WLSH are all down a little over 20% of the gains realized since Q1 2003. Historically, most corrections are between 33% and 67% of the preceding up move. Therefore, there appears more to come. My *CJC* Indicator suggests there is more correction coming, too. Such a large downturn would clearly signal a recession within 2-3 quarters, if not sooner.

2011 Update: I am no longer suggesting that 1970's "stagflation" is the likely outcome of government and Fed policies. The demographics of the 1970's and the current time are much different. This, plus my monetary supply work subsequent to QE and QE2 have convinced me that the most likely outcome is that of a deflationary recession/depression rather than stagflation. It might be meaningful for you to review some of my more recent writings to get a fuller understanding of why this is the case.