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The CJ Investment Newsletter

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Short-term Bull, Long-term Bear

Purpose

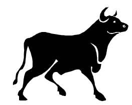
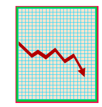
This is a reissue of previously disseminated information.

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
	

- Major technical indicators suggest we are in at least a "cyclical" bull market.
- Is the long-term trend bullish or bearish?
- What strategic or tactical changes should be made?

Technical Signals

Two major technical indicators have given indication that for the immediate future, the market trend is bullish:

- Dow Theory Bullish Confirmation – on 7/23/09, both the DJI and TRAN indices bettered their highs from early May. Prior to this confirmation, the TRAN had stubbornly refused to confirm the new DJI highs occurring in both June and July.
- Beginning 7/13/09, the DJI began a breakout rally that in a few days negated the breakdown of a head-and-shoulders formation. This is highly unusual. The movement of a stock or index after breaking through the neckline is usually a *breakdown*, not a breakout. The SPX, TMX (Dow Jones Total Market Index, previously the Wilshire 5000 Index), and RUT (Russell 2000) all had similar breakouts from their own head-and-shoulders formations.

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The Dow Theory Confirmation is a very powerful signal by itself, but when coupled with these unusual breakouts, strongly suggests that the market moves for the immediate future appear to be upward.

Prior to these breakouts, my charts heavily indicated that the current rally was getting tired and the market would likely roll over into a new bear market leg.

Investing with the Primary Trend

As I've said before, I consider Richard Russell to be the greatest Dow Theorist of all time. While he noted the Bull Market Confirmation and its power, he also pointed out that this confirmation may be indicating a continuation of the existing bear market rally rather than a change of trend into a primary bull market. Another way of describing this would be to call this a "cyclical" bull market within a primary (secular) bear market.

At this point, you may be asking, "What difference does this make?" Actually, it's quite simple and very important.

One of the most important investment techniques involves *investing with the primary trend*. If you position investments with the primary trend, any timing mistakes you make will tend to be corrected by the market moves themselves. If you add decent TA (technical analysis) timing techniques, you can beat the market, sometimes by significant amounts. If you position investments contrary to the primary trend, your market timing had better be very precise or you will tend to lose money, often, large amounts.

This tends to be true because of the manners in which primary trends and their corrections (movements against the primary trend) act. In general, movements in the primary direction tend to be smaller, consecutive and longer in duration. Corrections tend to be quick and violent. Which do you think is more likely to be profit friendly in the absence of perfect timing – long, smooth moves or quick, violent ones? Even with good timing analysis, why not stack the deck in your favor by playing the primary trend?

So, this investing thing is easy. All you have to do is determine the primary trend and invest in congruence with it. Make a few particularly good buys using TA to improve your profitability. Piece of cake. That's why everyone has made a fortune since Q4, 2007, right?

Determining the Primary Trend

Prior to the recent Dow Theory Confirmation, the primary trend was clearly bearish and had been so since Q4, 2007 by my reckoning. Prior to that, the market had been a bull since 2002 – Q1, 2003.

The point is (and this is a Dow Theory tenet) that no one can know the length or duration of the primary trend in advance. Additionally, it's not ever easy (or even possible) to determine when the primary trend will reverse, even in the middle or near the end of the move. Here's a question that will drive you crazy: How can you tell if a change in direction is a change in the primary trend or merely a correction of the existing trend? Let's not even discuss market segmentation, in which different market segments may be in their own bull or bear markets, regardless of the overall market trend. Maybe it's not so easy, after all.

Like many things, these trends are much easier to see in retrospect than in prospect. Still, the entire thrust of TA, including Dow Theory, is to "see where you are" in order that you might be able to see, even a little, what may be coming next. A Dow Theory Confirmation such as the one that occurred last week is a substantial step to telling us there is likely more market gains to come, at least for a while.

Now, the down side – or equivocation, if you prefer. There are other primary tenets to Dow Theory that keep the recent confirmation from being a wide-open upside signal:

- Values – Beginning with Charles Dow himself, Dow Theory has concerned itself with values. The only "cycle" Dow Theory concerns itself with is the cycle that takes the market from being overvalued to being undervalued and back again. According to the greatest Dow Theorists (Dow, Hamilton, Rhea, Schaeffer, Russell), bear markets end when the P/E on the DJI is about 10 or less, and the yield on the DJI is 6% or greater. Those levels have not been approached since 1982. Our recent bottom in early 3/09 wasn't even close.
- Psychology – The psychology of the market should be so black that investors would think you are crazy to consider buying stocks.
- "U" shaped bottom and "Lines" – According to Hamilton and all those following, bear markets end with "…dull volume, sideways movement, the market's indifference to bad news and failure to rally…" "Lines" is a Dow Theory term that denotes price movements for extended periods (weeks, perhaps months) within a 5% range. Also described as the "doldrums," this extended period of low volume sideways movement creates the

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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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- characteristic "U" shaped bottom all great bear markets so far have shown in their final stage. This "U" shaped bottom and lack of reactivity is a signature that sellers are finally exhausted and the market can find a bottom.
- Exhaustion of the Primary Trend – Primary trends, either bull or bear continue in force until they are fully expressed. Until the classic signals ending bull or bear markets are expressed, movements contrary to the primary trend are, by definition, corrections of the primary trend.

None of these signature events denoting the final stages of a bear market under Dow Theory has happened. With over 100 years of history and some of the most brilliant market minds of all time devoted to Dow Theory, do you think it's reasonable that many pundits are so ready and willing to call the 3/9/09 bottom the final bear market bottom in violation of Dow Theory principles? The Dow Theory Confirmation is not sufficient to override the remaining Dow Theory principles to call the bear market over. Ergo, we are still in a primary bear market, and we need to act accordingly.

Strategy and Tactics

Based on the commentary above, I don't believe this rally will hold, although I certainly could be wrong. There's a first time for everything, including a novel way to end a bear market. But it's not a good bet. It looks frighteningly like the huge rally that came after the first major downturn in 1929 – 1930.

My clients and I are positioned to weather a bear market well. Meanwhile, we will participate in the bull "correction" (although less fully than the indices) until the markets give me a significant indication of a downturn. We will then attempt to sell before the downturn moves too far. It's unlikely I'll try to capture the next bull "correction," except maybe for the most risk tolerant clients. Remember, one only "wins" in a bear market by preserving the most assets entering the next bull market. In that regard, my clients and I are doing well so far.