The CJ Investment Newsletter

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Stimulus?

Purpose

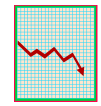
This is a reissue of previously disseminated information.

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
	

• The stimulus program currently proposed by the US House and President Obama will not work as hoped by its sponsors because too many of its clauses are not stimulative.
• The stimulus bill will reallocate wealth through inflation, effectively taxing (confiscating) from some taxpayers and savers as it benefits its recipients, whether or not the stimulus works as planned.

Money, Wealth & Capital

In order to understand how the stimulus plan or any government plan financed by deficits and inflation redistributes wealth, one must first understand the differences among money, wealth and capital.

Wealth is not money *per se*; wealth is houses, roads, cars, food, jewelry, electronics, gasoline – all of the myriad things that we acquire and use either currently or over the longer term to conduct our lives and meet business' and society's needs.

Capital is either the *savings* of consumer goods for current consumption (e.g. food or fuel) or the

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ownership of factors of production, that is, long lived assets used in the production of consumer goods or goods needing further processing to become consumer goods (higher order goods).

Money serves two purposes:

- It is a medium of exchange.
- It *can be* a storehouse of value.

Hard money (money backed by a specific quantity of one or more tangible assets, generally gold and/or silver) serves both functions and its value does not change over time unless the values of the underlying assets change.

Fiat money {money declared legal tender by governmental fiat (edict)} serves as an exchange medium, but its value may change over time depending upon the monetary policies of the issuing government. In the modern world, fiat money within a central banking system has consistently been inflated, and, therefore, diminished in value as a wealth storehouse.

Deficit Spending, Inflation and Wealth Redistribution

In a hard money system, there is only one method for a government to finance its activities; tax collection. Even if it borrows, those debts (and the interest) must eventually be paid by taxes.

In a fiat money system, the government has an additional payment option: inflation. The government can print money to pay its debts that are not backed by hard assets. They do not have to collect taxes to support the wealth of the money they print. They then use the newly printed money to retire debt or to "pay for" new purchases. This is the true meaning of inflation; the government is inflating (increasing) the money supply without having any backing wealth.

Of course, the effects of printing unbacked currency are greater than the government being able to buy things free. It's particularly important to understand at this point that *economic activity is measured in the currency of the region*.

As an example, let's assume the total wealth of the US (private and public) is \$100 trillion. If the government prints another \$10 trillion without assets to back it, how much total wealth will the US have? Somewhere between \$100 and \$110 Trillion, depending upon some monetary effects not germane here.

Because the wealth hasn't actually changed, but the number of measuring units (\$) has increased, the value of each measuring unit (\$) is diminished. In other words, each dollar is worth less and it requires more dollars to buy something than it did prior to the increase of the money supply. While economically incorrect, that is inflation in the common sense of the word.

Unfortunately, that is not the end of the effects. When the government prints the money, they spend it all themselves. They do not distribute the new money *pro rata* to the populace. Therefore, the wealth the money represents is used entirely by the government. When the new money works its way into the money supply, the reduction of purchasing power is collectively realized by the non-governmental holders, effectively diminishing their wealth by the amount the government spent. It happens over time, but the result once the new money is fully absorbed into the economy is described properly.

Talk about taxation without representation! Kind, politically correct folks would call inflation a stealth tax. Speakers that are more direct might call it stealing. By making your money worth less through inflation, they are confiscating your wealth without levying new, official taxes. The reason the government can get away with using inflation without a major outcry from the citizens is that we all tend to consider a dollar to be "worth" a dollar on a day-to-day basis. This belief keeps us from being as aware as we should be when our government is confiscating our wealth. It also doesn't help that governments refuse to teach children anything beyond basic Keynesian economics through high school.

When the government creates new fiat money without backing, they cannot create wealth through this process. They confiscate wealth from others without consent, avoiding the criticism that would accompany the levying of honest new taxes to fund their programs. Only awareness and outcry can make our government stop stealing our wealth using inflation.

Because inflation financing does not create capital, inflation financing will rob (pun intended) the capital markets of their ability to loan the capital confiscated to those worthy entrepreneurs and business projects that could be undertaken and truly would stimulate the economy, creating new jobs and wealth. The more the government takes, the less is available to deserving businesses and individuals.

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Asset Allocation Percentages
CJ Current Suggested Ranges

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

<u>**Asset Class**</u>	**Conser-<u>vative</u>**	**Aggres-<u>sive</u>**
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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Stimulus?

Please understand that there is some sound economic theory that says that governmental economic stimulus doesn't work, period. We discussed one of the major arguments in last month's *CJ Newsletter* with our discussion of Say's Law. However, let's grant that at least some forms of governmental "stimulus" have the potential for encouraging economic expansion. *All discussion following assumes some forms of governmental stimulus are effective to some degree.*

As of today, the total plan principal amounts to $819 billion. All amounts in this analysis are according to the *Kansas City Star*, 2/1/09, page A12.

On the plus side, construction projects or other projects that create *measurable* tangible or intangible wealth could be considered stimulative, if less so than private projects due to governmental inefficiency. By my calculation, the plan contains about $168 billion for anything that could reasonably fit into this category, if I'm really generous. A *maximum* of 21% of the bill could be stimulative in this way.

Tax cuts truly are stimulative according to every school of thought I'm aware of. However, much of what House/Obama calls tax cuts are actually transfer payments (discussed below), which are *most definitely not stimulative*. The actual tax cuts to real taxpayers amount to $33 billion or 4% of the bill.

Between them, the stimulus often recognized as effective amounts to maybe 25% of the House/Obama "stimulus" bill.

Much of this bill amounts to transfer payments, regardless of what the government euphemizes them to be. Transfer payments are cash or benefits government distributes to some citizens paid from other citizens' taxes. These normally consist of pure "welfare" and/or "tax credits" from citizens not actually paying taxes. By my calculation, transfer payments amount to $562 billion, or 69% of the bill.

Transfer payments are *never* stimulative because they simply move capital from one consumer to another. Worse, if the government is involved, the loss of capital through government administration costs is considerable. Transfer payments do not stimulate demand, as we discussed last month in the *CJ* regarding Say's Law. At best, they change what would have been demanded by the rightful owners to that which the recipients demand instead.

The rest of the bill (6%) is pork.

To have 75% of the bill not be stimulative certainly stretches credulity in the government that says we "desperately need" to pass a stimulus bill. As discussed in previous *CJ's*, they desperately need to fix the economy they, themselves, are responsible for screwing up. Republican, Democrat, Clinton, Bush, Rubin, Paulson, Greenspan and Bernanke. This is truly bipartisan; a major bipartisan screw-up.

Given the relative efficiency of capital use between the private versus the public sectors, perhaps executing the 21% that might work and suspending taxes assessed for the remaining $650 billion would actually be "change we can believe in" instead of just another leg of the inexorable march to socialism for the USSA – the United Socialist States of America. Elections have consequences. If this bill passes, we have only ourselves, collectively, to blame.