

Government Policies – Solutions or Problems?

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



- Why all the bank bailouts and government attention?
- President Obama doesn't "get it."

Next

Expected Move



Why the Banking System is Different

Why do the banks appear to be getting special government "breaks" and "bailouts?" The primary reasons for this are:

- US government administrative, legislative and Fed policies since late in the Clinton administration are the primary culprits for the problems in both the banking and housing industries. Isn't the government responsible for fixing what it broke?
- Simply put, credit is the life's blood of the economy. When the banking industry is stressed and lacks sufficient capital, lending contracts or stops. Not many businesses or entrepreneurs have the liquid working capital to function on a cash basis. Result? Business activity grows slowly or contracts and all that entails – across ALL industries. Business failures. Job losses. Severely limited entrepreneurial activity. Recession, perhaps depression.

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Is "boneheaded government policies" redundant?

Trend Capital Management, LLC

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In a nutshell, the banking industry deserves special treatment due to government culpability and the importance of the banking industry to the overall economy. The second point is sufficiently obvious that it requires no further discussion. It may be instructive, however, to examine how government policies created the current situation.

Late in the Clinton administration through the mid-2000's, the government pushed to increase the home ownership percentage in the US. That entailed lowering borrowing standards. The government, through Fannie Mae and Freddie Mac and through forcing banks to accept previously unqualifiable loans managed to get many marginal and below-margin buyers loans.

Of course, the government never asked if it was a good idea to string out lower income borrowers on credit or to introduce such risk to the financial system. What could go wrong? EVERYBODY knows real estate NEVER goes down in price.

In 2001, Alan Greenspan and the Fed began lowering overnight Fed funds interest rates to between 1-2% and left them there for 3 years. Greenspan tried to help the US economy recover quickly from the dot-bomb market decline that began in 2000, followed quickly by a recession. This policy qualified even more marginal buyers into housing, bringing a huge number of marginal and below-margin buyers into the marketplace, causing a surge in demand, increasing housing prices. In short, it created a housing boom generally built on marginally qualified and unqualified buyers.

Finally, with interest rates so low due to Fed policies, Wall Street got creative. To fund the mountains of capital required to support the borrowing, loans were bundled and sold in the market as RMBS's. However, few investors were interested in bonds paying under 4 1/2 to 5% or less, even at supposedly low risk. Therefore, the RMBS's were "tranching" and sold as some now infamous acronyms: CMO and CDO among others. These arcane securities offered a higher yield at supposedly no higher risk. Common sense alone says that's not realistic.

In order to meet governmental capital requirements and to mitigate risk, Wall Street outdid itself in creating Credit Default Swaps (CDS's). Effectively these were unlicensed insurance contracts that supposedly eliminated risk and were not required to appear on an institution's balance sheet if they purchased an "offsetting" CDS from another party.

Effectively, the risk was invisibly transferred to the banking system. Counterparty risk became important, as defaults on CDS's would ripple through the banking system. A sufficiently large counterparty such as JP Morgan Chase or Citibank failing could literally shatter the banking system. And it did, beginning with Bear Stearns.

US government policies broke economic law to accomplish goals, effectively breaking the banking industry and the economy. Yes, Wall Street had some bad actors, but they contributed, not caused. Now, the government needs to fix what it broke without increased socialistic control of the banks and economy. Or is the economic pain an excuse for a power grab?

No, President Obama Doesn't "Get It"

(Note: This was originally a blog I posted 2/25/09 on the *Kansas City Star's* "Dollars & Sense" blogsite (<http://economy.kansascity.com>) under "The Big Picture" subsection. I thought the message was important enough to repeat here.)

Don't you love it when someone tells you he/she "gets it," then proceeds to prove for the next ten minutes that he/she doesn't have a clue? In his discussion of the banking and credit problems during his speech last night, President Obama proved he definitely doesn't "get it."

President Obama described the many problems of the banking system in his speech on 2/24/09, completely ignoring the government's own culpability in the housing collapse and the credit crisis. The President then proceeded to explain what, essentially, the government was now going to encourage (read force) the banking system to do for the good of small business, consumers and distressed mortgage holders.

As the brilliant Harry Schearer used to say on Saturday Night Live, "Pardon me for thinking clearly, but" are private banks different from every other company in the barely-holding-on-to-capitalism US economy? Sorry, Mr. President, companies do not exist to "serve society" other than through the capitalist process. They exist to make profits for the sole purpose of improving the conditions of the lives of their shareholders. Those profits are earned (a wonderful word that's often completely misused by US politicians) by meeting the needs of their customers for less cost than the price charged to those customers.

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Asset Allocation Percentages CJ Current Suggested Ranges

Dow Theory Market Phase: BEAR
Appropriate Current Allocation: DEFENSIVE

<u>Asset Class</u>	<u>Conser- vative</u>	<u>Aggres- sive</u>
Money Market Funds	70-10%	55- 5%
<i>Long Positions:</i>		
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%
<i>Aggressive Positions:</i>		
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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Another example: Private pharmaceutical companies exist to make profits first. Period. Anything else is a utopian illusion, or at least secondary. They accomplish profits by creating and producing drugs that help their consumers solve or mitigate their medical problems for more than the drugs cost to produce and distribute.

The beauty of capitalism is that it takes advantage of the inner drive of substantially all human beings to improve their own condition; to aspire to live the life they wish to live. That entails work and risk, but can be very lucrative to those who properly assess human needs and proceed to meet them for a profit.

The USA became the greatest and most powerful country in the history of humanity because of this “inner drive” and capitalism’s ability to give it expression to the benefit of everyone. It’s the essence of Adam Smith’s “invisible hand.” Socialism does not

allow one to labor to improve one’s own condition; it allows one to labor for the benefit of those in power and those they favor. That’s why, so far, it has never succeeded in the long run. Who wants to be George Orwell’s “Boxer?” (The horse character in Animal Farm)

Take away the “inner drive” and America becomes a big version of China, the UK, France, or Germany. What makes us special would be gone; it may still be called America, but it won’t BE America. At least we won’t have to worry about that pesky immigration problem anymore; no one will be dying to reach this country.

Mr. President: there are plenty of things that do need to be fixed in this country. Please don’t “fix” the unique trait of America that allowed it to become the most peaceful, powerful and prosperous nation in the history of the world.

As Winston Churchill so famously said, “The inherent vice of capitalism is the unequal sharing of the blessings. The inherent blessing of socialism is the equal sharing of misery.”