The CJ Investment Newsletter

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Chicken Little Redux

Purpose

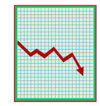
The *CJ* Investment Newsletter deals with the entire spectrum of securities investing, including cash (money market funds), bonds, equities and options. It will evaluate the overall investing environment and then discuss the relative allocations of these asset types, as well as strategies to implement 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.

The CJ Growth Strategy (back page) has been an ongoing aggressive growth model portfolio since 1/98. Its results continue to be tracked herein.

Quick Look

Market	Next Expected Move
	

- Fair warning. Most of this newsletter will contain bad news for the economy and the markets. I believe the new bear market leg I've been worried about since 4/09 or so is imminent, if not here.
- Mauldin, Prechter, and Russell are black bearish here about the market. I wish I could disagree, but I really can't.
- My technical indicators seem very bearish here.
- Two "fundamental" reasons the economy and market have rallied since 3/09 are:
    - Stimulus funds – now waning.
    - Investors' realization of profits in 2010 prior to the end of the Bush tax cuts in 2011.
- Gold may not be a safe haven here, unless one or more major currencies in the world collapses.

On those cheery notes…

Chicken Little Redux

I hate sounding like Chicken Little. It's risky (with regard to my credibility), could cost my clients money if I'm wrong and goes against my personality's "grain." Besides, nobody wants to hear it. We all have enough problems, don't we?

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Still, there is something to be said for having the courage of your convictions to stand up and speak what you believe to be what will happen.

Besides, in my job, I should act on what I believe in order to protect capital and attempt to make profits for my clients. I should be consistent between thought and deed. Probably the worst of all possible outcomes would be if I made the right call verbally, but didn't act on it. Knowing I should act often gives me the courage to speak out.

It helps to have people you respect agreeing with you. My big three – John Mauldin, Bob Prechter and Richard Russell are all quite bearish, perhaps even more than I am. Especially Prechter. He predicts the DJI will be below 1000 before this bear market is over – actually down to 400. The sad thing is he's been one of the most accurate prognosticators over time. So accurate that he's in the Trading Hall of Fame.

There are technical indicators everywhere indicating a market downturn here. From Bob Prechter in the June issue of *Elliott Wave Theorist (EWT)*: "*…two things strongly suggest that a new wave of bear market is in force. First, volume continues to expand on declines and contract on rallies. Second, volatility has soared since the market's peak. These two conditions attend bear markets way more than often than bull markets. We therefore maintain our opinion that the April 26 high was the end of the bear market rally that started in March 2009.*"

Other technical indicators:

- Virtually all major indices peaked a few weeks ago and the *CJC* Indicator suggests that further declines are more likely than a pause and resumption of the uptrends since 3/09. As it is designed, there are multiple signals confirming each other in the *CJC* Indicator.
- At the market peaks in late 4/10, there were bearish divergences in almost all *CJC* Indicator major index charts, which have now shown they were reliable indicators. This indicates that the rally since 3/09 was a bear market rally, not the beginning of a new bull market.
- Major head-and-shoulder top formations, many approaching their necklines appear in the indices. If the necklines are violated to the downside, it would be very bearish.
- Most major indices retraced up to 70% of the loss from late 2008 through 3/09. The recent decline has taken the retracement back to about the 33% level. Should the indices drop below the 30% retracement level, that would be quite bearish, indicating a retest of the 3/09 lows.

There are other bearish indicators, but you get the idea.

Where Fiscal and Tax Policies Fit In

One reason I missed the rally since 3/09 is that I didn't trust it. The underlying factors were all weak, so I felt the rally that began in 3/09 wouldn't have "legs." I was wrong. After the market rallied a few months from snapback forces alone, at least two new factors entered into the picture, both originating in Washington, DC.

The stimulus plan passed in the winter of 2009 did actually begin to influence economic activity, probably as early as late summer, 2009 up through the current time. It was not a well-designed bill (see the 2/09 *CJ Newsletter.*). The replacement of private spending with government spending was poorly designed and the entire bill was passed at a cost in debt we will be digging out from for years, if not decades. But, the bill did provide some economic stimulus – just not at all efficiently. It has not even come close to meeting the expectations showered upon the citizenry in order to garner support for its passage, especially with regard to unemployment, but they did manage to spend our kids' money enough to have some short-term positive economic effect. What relatively little effect it did have is now waning and will likely not provide future benefits past the end of 2010 according to what I've read that I believe.

Second, the rest of the Bush tax cuts are set to expire at the end of 2010, reverting to much higher tax rates in 2011. The Bush estate tax changes did manage to make it to 0% in 2010, much to the surprise of virtually everyone. The Congress was expected to put in a patch of some type to keep the estate tax in force, but it didn't happen.

Now, in the midst of a huge, extended recession, the Bush tax cuts are scheduled to expire (along with the estate tax changes) in 2011, restoring tax law to where it was prior to the bill's passage – meaning much higher rates. Worse, Obama, Pelosi, Reid and their supporters are threatening to pass additional tax increases *on top* of those scheduled to occur from the sunset of the Bush tax cuts.

Two questions immediately present themselves:

- Is it surprising that investors and businesses are realizing (accounting term for consummating) profits in 2010 rather than in 2011, when tax rates will be higher?

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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. I expect 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 if the dollar declines against foreign currencies due to Fed monetary policies.

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- What do these leaders think will happen to capital in the US (and therefore economic activity and therefore jobs and therefore tax revenues) if their plans are realized? (Hint – capital flows to where it can reap its greatest return, which won't be in the US if their agenda is forwarded. It will flow out to elsewhere.)

We haven't even discussed the Cap and Trade bill, which I believe will CRASH this economy and turn the US into a second world country if enacted, especially in this economy. (See the 7/2009 *CJ Newsletter*.) Actually, it would also turn the world into a "second world" world without the US to lead the world economy. The return of Jimmy Carter and the "national malaise" on a world scale. Sadly, the party in power fears they won't have as much power in January and may be desperate to pass the remains of their agenda while they still have the chance, regardless of the advisability or costs of it.

To the point, because of the waning of the stimulus and the impending tax increases due the beginning of 2011, 2010 has actually appeared better than its underlying conditions would warrant. Especially the realization of what should be post-2010 income in 2010 for tax reasons has given us the illusion that things are better than they really are. When the economy and the markets get "honest," it could be rough, even brutal.

Why Gold May Not be the Answer

From Prechter's 6/10 *EWT* again: "*…No one seems to be paying attention to the fractured picture on the precious metals complex, either. Silver, platinum, palladium and mining shares all made their highs two years ago. If runaway inflation were driving these markets, they would be moving together.*"

"*Perspective is important here. The March 14, 2008 EWT featured a historical study making the point that gold tends to go up during economic expansions, not recessions… In line with past cycles, gold rolled over and declined in 2008 as the crisis intensified. This is the opposite of what most gold proponents said would happen. Now that the economy has been recovering, gold has been rallying. This is exactly how our study showed gold generally behaves. If gold continues to follow past patterns, it should peak along with the current economic recovery and turn down along with it as well… the economy should be getting ready to roll over, taking gold with it. In other words, if you expect an economic collapse, you should expect gold to be lower at the end of it than at the start. This is not to say that gold cannot have a blowoff first, as oil did in 2008 before it crashed…*"

Prechter's thoughts are consistent with Austrian economic theory, which states that in a recession, all things other than the currency become cheaper in that currency. Mises and Hayek flesh this out well in their writings about the business or trade cycle. The only factor that could overwhelm this and force gold to increase in price is if a fiat currency faced the potential of a total collapse, that is, could become valueless because of its government and central bank policies. While that is certainly possible, I believe it extremely unlikely, even with the crew we now have in Washington, DC. The European Union is already taking the tough steps to insure such a collapse does not happen to the Euro. Still, it's possible our leaders may not know just how fragile the US$ is, given how much overhanging debt there is against it. For a while, it would appear the US$ would increase in value versus all goods and services, including gold.