The CJ Investment Newsletter

Callom B. Jones, V Investment Adviser Representative

October, 2010 *One Hundred Fifty Fourth Issue*

The Wile E. Coyote Market & Economy

Purpose

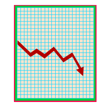
The *CJ* Investment Newsletter deals with the entire spectrum of securities investing, including cash (money market funds), bonds, equities and options. It will evaluate the overall investing environment and then discuss the relative allocations of these asset types, as well as strategies to implement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

- I'm sorry for the lateness of this letter. I've been very sick for virtually all of October, and literally unable to focus well enough to write.
- Some reasons why government spending eventually hinders and can collapse an economy.
- What the current market and economy have in common with Wile E. Coyote.

Wile E. Coyote

Perhaps you remember the Warner Brothers cartoons starring the Road Runner and Wile E. Coyote. For those that don't, the storyline is pretty simple: Wile E. Coyote (WEC) chases the Road Runner (RR) throughout the desert southwest of the US (perhaps even the Grand Canyon?), trying to catch him and make a meal out of him. Of course, he never does.

The comedy comes out of the many strategies and tactics WEC uses to try to catch the RR that backfire and end up injuring him. One of the most famous images is the many times WEC will be chasing RR on some path around a cliff. When the RR zips around the curve, WEC often can't follow and runs over the edge. He is unaware of his plight, so he runs

(Continued on page 2)

Trend Capital Management, LLC
9717 W 121 Terrace ▪ Overland Park, KS 66213
O (913) 897-7576 ▪ C (913) 568-9916 ▪ e TCM@TrendCapitalMgmt.com

(Continued from page 1)
in mid-air, pumping his arms and legs – until he notices there's nothing underneath him. Then he plummets what appears to be hundreds of feet to the bottom of the cliff.

That image makes a great deal of sense to me in the current market and US economy. I've been struggling to understand how, with a functional unemployment rate in the high teens and with a stimulus plan that hasn't worked, but did add over $1 TRILLION to the deficit and national debt, the US markets could still be rallying, especially the commodities markets.

Perhaps I'm missing something major. If I am, please tell me what it is and bring my thinking back to reality. With that level of unemployment, the Keynesian mantra of "aggregate demand" has to be lower than in the recent past and not likely to rally without significant employment increases, which also appear unlikely without increasing demand to drive the employment need. So far, both the Fed and the current Congress and Administration appear equally impotent in attempting to change this.

This is not a short discussion. However, I have written extensively about this in the past, so many of my readers will be familiar with the arguments about what should be done and why we are where we are. If you would like to discuss it with me verbally, just call. I'd be happy to explain what my thoughts and reasons are.

The main point is this: The economy and markets are like Wile E. after he's run off the cliff. We haven't started to fall yet, because we haven't looked down and realized there's nothing solid under our feet!

Government Spending – The Dark Side

While plenty has been written and discussed about government spending, especially with the "excessive" adjective – whatever that means – thrown in, my purpose here isn't to join that fray. Instead, I'd like to describe, hopefully in understandable terms, what the impact of government spending is upon an economy.

First, if you have a government at all, there will have to be some government spending. Since zero spending is not an option, the questions become matters of how much, for what purposes, and at what costs to the economy and society.

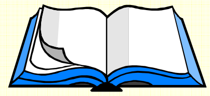
Concept 1: Government revenues (taxes) have to come from private (or government) earnings. This idea should not be considered controversial. In fact, it is actually common-sensical. The concept of earnings includes salaries, wages and profits.

This concept is critical to understand because of the impact upon prices in the economy. Simply put, taxes rob citizens and companies of buying and earnings power.

Let's look at a couple of simple examples of how taxation affects taxpayers:

- Let's say that a family of four needs $100,000/year to fulfill their self-defined needs. If the government robs them of 25% of their income, then the family needs to make $133,333/year in order to fulfill their needs as they define them. This can create hardships, depending upon circumstances, as the family tries to achieve this level of income. Obviously, higher taxation levels make the situation worse. In ALL cases, taxation lowers the ability of taxpayers to demand from the economy what their earnings would otherwise allow.
- Looking at a taxpaying company, taxes have a similar effect to that of the family above. If a company would want to make $1 million in order to provide the shareholders with a proper return on their invested capital (shareholders' accumulated earnings and profits, by the way), a taxation rate of 25% means that the company must clear pre-tax $1.33 million. Simplistically, that can be accomplished essentially one of three ways:

(Continued on page 3)



Recommended Reading

A friend of mine sent me an excellent article from Forbes.com: http://www.forbes.com/forbes/2010/0927/politics-socialism-capitalism-private-enterprises-obama-business-problem.html

So you won't be caught unaware, this article is entitled "How Obama Thinks," and is written by a Mumbai native. I don't have the knowledge to tell if what he says is "true" or not. If he is right, it explains a great deal about Obama and his policies. If he's wrong, he's wrong. Finally, there are passages that could be construed as critical of the President's policies. If you would likely be offended by such statements, perhaps this is not an article that would interest you.

Asset Allocation Percentages
CJ Current Suggested Ranges

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

Asset Class	**Conservative**	**Aggressive**
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.

(Continued from page 2)

- Sell 33% more products or services
- Charge 33% more for products or services
- Some combination of the above two

Often, reality demands that the prices charged for the services (especially if the company has a competitive advantage) are raised. This has the net effect of making the products or services offered more expensive to its consumers. In effect, the taxes levied are not levied on the company, but on the consumers instead. Thus, the origin of the saying: Companies don't pay taxes; people do. It's true. When politicians say otherwise, they are lying.

Concept 2: Government expenditures shift demand. What would have been demanded by earners is shifted to what the government demands – e.g. government wages, spending programs, building projects, welfare, etc. Total demand cannot increase, except temporarily through the issuance of debt instruments, although it can be diminished because of the additional costs associated with operating the government itself and its inefficiency costs. Eventually, government costs must be paid through taxation, even if the form of that taxation is inflation.

The above discussion doesn't even deal with the morality of the demand shift out of the hands of the rightful earners into government hands. This is especially egregious regarding purchases that some taxpayers may not support for a variety of reasons, but have no choice in the matter as the government controls the spending.

Concept 3: Fiat money is not necessarily capital or wealth. It should not be treated as such. Simplistically, capital is the concept of savings ("excess" goods held for future consumption) being redirected towards creating "goods of a higher order" (productive equipment and supplies plus support items) to be engaged in the productive process of consumer or other productive goods. Wealth, which overlaps somewhat with capital, consists of items of economic (saleable) value, which may or may not produce income or consumable goods.

What capital and wealth have in common is that they are created by both effort and by placing savings at risk. Fiat money, which involves nothing more than making a computer entry somewhere and/or printing otherwise worthless pieces of paper, does not. Not all the money created by the Fed adds one iota of capital or wealth to the society. Adding money to the money supply merely adds counting units to the existing supply of capital and wealth, devaluing the value of the money. This has huge ramifications beyond the scope of this discussion, not the least of which is robbing demand power from "savers."

Perhaps the most frightening thing about all this is that higher levels of government expenditures exacerbate all the problems described above. There is no free lunch. Higher taxation:

- Robs taxpayers of more of their legitimate earnings
- Shifts more demand to government and away from the rightful "demanders"
- Debases the currency more, when coupled with deficit spending and money supply expansion, further emphasizing the effect of the previous bullets.

Remember, you have some control over the level of government spending. It's called your vote.