The CJ Investment Newsletter
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Market Base or Market Top?

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 discuss the issues around the question: Are we at a market top or building a base from which to move to higher ground?
- The Seven Immutable Laws of Investing
- Why was 3/9/2009 a "V" bottom?
- The "value added" concept and inflation.
- QE2 and future QE's may destroy the future of our economy and America itself. See the Keynes quote below.

The Seven Immutable Laws of Investing

From James Montier via John Mauldin (www.johnmauldin.com/outsidethebox/the-seven-immutable-laws-of-investing/), here they are:

1. Always insist on a margin of safety
2. This time is never different
3. Be patient and wait for the fat pitch
4. Be contrarian
5. Risk is the permanent loss of capital, never a number
6. Be leery of leverage
7. Never invest in something you don't understand

My only comment: I couldn't agree with him more.

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"There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million can diagnose."
- Lord John Maynard Keynes

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Spin Zone

With apologies to Bill O'Reilly, my head is spinning with conflicting information and opinions. Before going into major specifics, I just wanted to comment that market technicals look OK to good on the surface, less so below. Technically, the markets generally appear to be tracing out a major top or a major base, especially gold the metal. We may only be able to tell which is which when (and if) the markets make a major move in one direction.

Market and economic fundamentals (especially government and Fed policies) are bad and likely to worsen. I have been unsuccessful in finding a reasonable explanation for the rally in the markets since 3/2009. The Fed has pushed M0, and, even with historically miniscule multipliers, all other money supply measures to all-time highs. While this makes nominal prices of all things, including investments, appear higher, this process makes their true value more difficult to ascertain. I will attempt a brief explanation later. Long-time readers already know why from previous *CJ Newsletters*.

In addition, the folks I read and respect the most are split on their opinions of what's going on. Richard Russell has now decided that the 2008 - 2009 decline was just a "massive" correction in an ongoing bull market. That would, actually, technically explain why a "V" bottom could have happened in 3/2009 with the enormous bull run following, something that's been confusing me for quite a while now. John Mauldin is still talking about "muddling through," although he is showing signs of fear regarding the markets at these levels, and, especially, the US debt, government deficit spending and Fed monetary policy. Amen, John. We should be afraid. Robert Prechter is still convinced the market and the economy will crash hard in the next couple of years. Enough to endanger the viability of the USA as a country – or at least a "free capitalistic" country.

On a personal note, I don't think I've ever been so frustrated. While my clients and I are making money, my desire to make money for my clients and myself makes me itch to take some more aggressive positions, especially in gold and silver. The last two particularly stick in my craw as clients and I enjoyed positions that profited from appreciation in gold and silver from 2001 – 2010. It's stressful and emotionally hard on an advisor to be on the sidelines while the market appreciates in this business. Still, cash and bear market positions were very comforting from 1/2008 though 3/2009.

But, my charts tell me there's still significant risk out there. The economy is still struggling. Washington leadership is lacking. The (nationwide) housing market is declining again as measured by home prices. Unemployment is still very high – recent policies have not helped that problem on any more than a temporary basis and at a tremendous increase in our national debt.

Finally, I've learned that when I'm about ready to capitulate on a belief I've held for a while regarding the market and if I go contrary to what my charts show, I'm usually wrong. But, that's not something that can be counted on 100% of the time, so I may "stick some toes in the water" to try to increase returns for 2011.

Inflation through the "Value Added" Lens

I recently had a discussion with a friend whose opinion and intellect I respect about the markets and the economy. I could not get him to understand why price increases over long periods, especially of commodity-type items, were not reflective of increases in value. Those price increases indicate a decline in the value of the currency. This is the real implication of inflation, as the term is commonly used.

Conceptually, does it make sense that a pound of aluminum, an ounce of gold, a bushel of wheat *have more value* today than in the past? There are special exceptions, as where a new use is found for something that increases its demand. But that is because of more of it being used and supply not having caught up with demand yet. Additionally, if a resource begins to become rarer, it may increase in value, unless demand for it wanes. Again, supply and demand.

No. An ounce of gold is *worth* an ounce of gold. And, that is what it's worth, assuming no special cases or changes in circumstances as above. Forever. It's the same with any commodity.

One of the linchpins of his argument was how much cheaper many items in our society are than they have ever been in the past – and of higher quality. And, he's right. So, he reasons, newer items must be worth more than older, similar items. Cars. Houses. Electronics.

Not believing in Austrian economics, my friend didn't buy that Austrian economics predicts that, in the absence of an central bank, decreasing prices is the natural order of things. So, I had to find another way to explain my point to him.

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The key is the good's proximity to a raw commodity.

When I worked in the printing industry as an accountant, I used to prepare income statements on a "value added" basis. We would subtract purchased raw materials costs from net revenue to arrive at a "value added" revenue figure – the "value added" by the production process. Since the pass-through costs of paper and ink were so high, ratio analysis of other costs was difficult. By subtracting the RM pass-through costs from revenue to determine the revenue actually earned by the plant, ratio analysis and, therefore, cost control became more sensitive and effective.

If we look at goods that have minimal "value added," e.g. food, gasoline, oil, nat gas, other ag goods and metals, just to name a few, we see significant inflation, especially in recent years. Those items with massive "value added" have not shown the effects of inflation (yet) for three main reasons:

- Manufacturing efficiencies
- Much lower overseas costs of labor
- Unemployment in the US depressing domestic labor costs

You can get a 50" plasma TV for almost nothing because it has much more "value added" than raw materials costs. However, gasoline or food, goods much "closer" to commodity or raw materials states, are much more expensive – mostly because of the decline in the value of the dollar.

Moreover, by the way, also predicted by the tenets of the Austrian school.

The Fundamentals

Much of the fundamentals were covered in the "Spin Zone" section above, but I wanted to make a few more observations.

The first quarter of each year is marked by a phenomenon known as the "January Effect." Essentially, this is a term coined to describe the large influx of funds into the markets as a result of contributions to qualified retirement plans and delayed payment of previous year bonuses to (generally highly paid) employees. Some of these funds are used to purchase stock market securities increasing demand for a short period and (generally) increasing prices. By now, this effect, while not completely spent, is effectively over for 2011.

The continuing discord in Washington can't have any short-term positive effects on the economy. Even if the Republicans "win" some spending concessions in the process, it won't be nearly enough. The damage done by Washington to our economy, our national debt and our currency in the entire decade of the 2000's, but particularly since 2009, is enormous, if not life threatening. It will be years before we can undo the damage done, if it can be undone at all. No longer funny, our government has truly "spent our kids' inheritances." The 3/2010 *CJ Newsletter*, "Why Greece Matters" might be a good article to re-read now. God help both the "little guy" *and* the "big guy" now.

The Technicals

Major Indices Many of the major indices – DJI, SPX, COMP and DWC (Wilshire 5000) – have bearish divergences that have not yet been negated. The DJI and TRAN have bested their 2/2011 highs, positive signs by themselves, but have also formed a Dow Theory confirmation.

Precious Metals Gold the metal has broken to the upside out of a trading range (1330 – 1440) it had been in since 10/2010, in spite of a bearish divergence. Silver is on a "spike top" that has cracked through every band on my chart. Platinum and palladium are weaker, with bearish divergences being expressed. It could be argued that only the precious metals with monetary components are being aggressively bought.

US Dollar Surprisingly, the US$X looks to actually be bottoming here, at least according to my *CJC Indicator*. Should this actually prove to be the case, this would be consistent with topping action in the precious metals, although there would not be a 100% correlation between the two. Still, given how hard the Fed has worked to destroy the value of the US$, it's hard to imagine a major rally in the US$X. But, that's what the chart indicates. However, if there is a major downward move in the stock markets, the US$X should rally as it did in the 2008 – 2009 decline. The demand for US$ from a major selloff would certainly support an increase in the US$X.

The TCM Website Arrives!

TCM has a website now! It's only partly completed, but it does have some content (most of the last year's *CJ Newsletter* articles) and a way to email me via the site. And, more content is coming. Please check out www.trendcapitalmgmt.com and give me your reaction to it.