The CJ Investment Newsletter

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Ignorance is NOT Bliss

Purpose

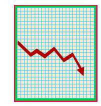
The *CJ* Investment Newsletter deals with the entire spectrum of securities investing, including cash (money market funds), bonds, equities and options. It will evaluate the overall investing environment and then discuss the relative allocations of these asset types, as well as strategies to implement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

- With all the different economic theories around, why were we all taught some form of Keynesianism in school after giving lip service to Adam Smith?
- How do we get persuaded to vote against our own best interests?

The "Aha" Moment

It's not often one gets a chance to give a US Senator an "aha" moment. I had such an opportunity in July of 2010 when I was in DC attending a conference. Sam Brownback was still a Senator from Kansas (now he's our Governor) and he would have a small coffee and doughnuts each Thursday for in-town constituents. I attended the one while I was there.

After the meeting broke up, I was chatting with the Senator and the conversation moved to a topic where it made sense to discuss a very special idea. I asked him, "Why do you think Keynes and his derivatives are the only economics taught in schools and state colleges?"

"I don't know," he answered.

I asked him to imagine he was FDR and it

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"When the people find they can vote themselves money, that will herald the end of the republic." - Benjamin Franklin

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was 1936, after The General Theory of Employment, Interest and Money, written by John Maynard Keynes, was published. I further explained that the world was in the throes of the Great Depression and, for the first time since Karl Marx, a respected economist was legitimizing governments' interventions in their economies.

Then I (more or less) said, "You (FDR) now have a respected, world-famous economist legitimizing the interventionist policies you and others wanted to use for years, probably decades. How would you insure such policies would continue to be perceived as legitimate?"

He said, "I don't know."

I asked him, "Do you think you might teach it to your kids?"

The look of insight mixed with discomfort on Senator Brownback's face made it clear I had indeed given him an "aha" moment.

You see, it's not about truth or accuracy. We all learned Keynes in school because his ideas give "legitimacy" to socialistic interventionist policies that give politicians more power over the populace. The bait was too hard to resist; what politician could resist such an opportunity to reach for more power? Since virtually all politicians run for office for exactly that reason (power), you can answer that question.

Before you think I'm being too cynical, ask yourself this: If this were not so, why aren't any of the equally brilliant economists that have competing theories that do not legitimize government intervention taught? Or talked about in the media? Remember, those previous thinkers' economic theories used to be called "Economics" prior to Keynes and The General Theory. Sadly, it also begs the question: What else was I taught that has much less to do with reality than the forwarding of the government's agenda? We all should examine the "truths" we've been taught. Test them; read about other ideas.

Why should you care about all this? Perhaps we should spend some time answering this question: *How do we get persuaded to vote for people and policies that do not promote our best interests?*

Economic and Political Power

In the US, unlike many other countries, our citizens have *two* ways of exerting power over their lives, and, sometimes, the lives of others:

- **Economic power** Through hard work (and some good judgment and luck) we can increase our economic resources, and, therefore, improve our lives.
- **Political power** By plugging into the political system in various ways, we can improve our lives by exerting power through our governments. This is the only option in far too many countries.

Unfortunately, only the former actually "earns" that improvement in our lives. As our founders stated in the Declaration of Independence, we believe we are endowed by our Creator with the rights of life, liberty and the pursuit of property (later changed to the pursuit of happiness). Government's proper role

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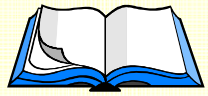

Recommended Reading

Some of these may be tough to understand if you aren't familiar with these concepts, but I really encourage you to read them. All are excellent. Footnote references in my text simply use the same number instead of "Ibid."

[1]"The Critical Flaw in Keynes's System," Robert Murphy, http://mises.org/daily/5464/The-Critical-Flaw-in-Keyness-System

[2]"Hutt's Crushing Blow to Keynes," Hunter Lewis, http://mises.org/daily/5477/Hutts-Crushing-Blow-to-Keynes

[3]"The Saver as a Voter," Ludwig von Mises, http://mises.org/daily/5471/The-Saver-as-a-Voter This one was written in 1957!! ***If you read no other article in this list, read this one!***

[4]"Chairman Bernanke, Is Gold Money?" Rod Rojas, http://mises.org/daily/5475/Chairman-Bernanke-Is-Gold-Money

[5]"Greenspan's Fatal Conceit," Jonathan M. Finegold Catalan, http://mises.org/daily/5467/Greenspans-Fatal-Conceit

[6]"Three Competing Theories," John Mauldin/Lacy Hunt, www.johnmauldin.com/outsidethebox/three-competing-theories

[7]"The Pretense of Medical Knowledge," Andrew Foy, MD, http://mises.org/daily/5462/The-Pretense-of-Medical-Knowledge

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would be to protect those rights *above all others*.

Of course, there are right ways and wrong ways to interpret our rights. We all should be entitled to what we earn or what our families earned previously and wished to pass on to us.

Being practical folks that believed in liberty, our founders chose free-market capitalism as the system that allowed the populace the most freedom and control over their own lives. They chose these things, because, historically, that system works better than any other does. Since the founders' time, none of the other "utopian" systems have proved as good.

Obviously, there is no perfect economic or political system because there are no perfect people. *Which is a really good point to remember when you place your "faith" in any government's benevolence.* We've watched many world governments define what its citizens rights are and how they should live. None of their "normal" citizens have ever lived as freely or as well as any "average" American citizen, ever. Of course, their "elite intelligencia" has – right off the backs of their citizens. As George Orwell said, "Some are more equal than others." Right. Those in those systems with only *political* power.

Any government worker, elected or not, should only have the absolute *minimum* of control over its citizens' lives in order to minimize the injustices that occur when government workers act badly, either as a one-time event or, as in the case of corruption or evil, constantly.

The governments' jobs are to *protect* us and our inalienable rights, not to *define* them. That was done over 200 years ago. Perhaps Thomas Jefferson, an original "Tea-Partier" said it best: "When the government fears the people, you have liberty. When the people fear the government, you have tyranny."

America has proved for over 200 years how powerful free-market capitalism is; it's still the only system by which a man or woman can improve his or her life through his or her efforts. Under that system, despite its flaws (because *people* are flawed), the US has created more wealth, freed more people (including those not even her citizens), and done more good than any country in history – bar none.

There have always been factions in our country that wanted to change the system – free-market capitalism – to one that worked more to their advantage. However, since the advents of socialism and progressivism around the turn of the 20th century, efforts to fundamentally change the relationship between governments and its citizens in the US and the world has been constant, and sometimes well organized and well funded.

If we fundamentally change our system to the point where our inalienable rights are no longer protected by our governments and, therefore, we can no longer improve our lives through our own efforts, the dream that was America will be officially dead a very short time after that. Let's examine the basis for the beliefs in non-free-market capitalism and the results achieved from turning away from that system.

Traction from Bad Economics

As described above, the tide really began to turn as socialists and progressives in world governments glommed onto Keynes' ideas as presented in The General Theory, published in 1936. I think because of the socialistic turn in America in the last few years and the problems it seems to have caused, especially the deficit and the debt-ceiling crisis, non-Keynesians are feeling the need to support the "other" economic theory that made America the envy of the world. Not to mention thoroughly examining the underlying support for the economic theory that made all these problems possible – Keynesianism.

From Robert Murphy, a well-known and respected Austrian thinker: "In his masterpiece, Keynes erects an impressive framework on one crucial assumption: left to its own devices, the free market can get stuck in equilibrium with very high unemployment."[1]

After setting up the argument, Murphy writes, "Therefore, it is absolutely critical to the Keynesian framework that the free market in fact *can* be stuck at less than full employment for long stretches. For if the classical wisdom of J.B. Say and others is correct — and the economy naturally moves to clear markets and achieve "full output" — then it is the Keynesian policy proposals that will lead to disaster, not the orthodox free-market ones."[1]

Without going through his entire economic argument, I can't get you to why Keynes was wrong. But, I'm convinced. Murphy points out *multiple errors* in Keynes's thesis, not the least of which is his *postulation* that unemployment can remain high in a free-market economy. Note the emphasis: Keynes could not support, much less prove his hypothesis. Properly viewed, the *facts* were only in alignment with
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his "theory' because of government interference. So, what's Keynes's answer? More government interference. Is that a socialist politician's dream or what?

Murphy concludes: "The entire system of John Maynard Keynes's *General Theory* rests on the claim that under laissez-faire, the labor market could be stuck in equilibrium with a large glut, for years on end. But Keynes devoted only a few pages to this proposition. His argument fails on both empirical and theoretical grounds. Absent government intervention, wages and salaries would adjust to clear the labor market. In the real world, there definitely is 'involuntary unemployment,' but this is due to government, union, and central-bank distortions."[1]

Hunter Lewis recently wrote in his introduction to WH Hutt's refutation of Keynes's theory, The Theory of Idle Resources, 1939: "The history of modern economics is full of destructive fallacies, beginning with the mercantilists, continuing through Karl Marx, and culminating with John Maynard Keynes. These false ideas have impoverished billions of people and caused no end of needless suffering. When Keynes published his magnum opus, *The General Theory of Employment, Interest, and Money* in 1936, a potpourri of fallacies supported by obscurity, shifting definitions, and other rhetorical tricks, many economists criticized it privately, but very few did so publicly."[2]

Lewis is a clear writer and thinker: "Keynes's argument may be simplified as follows. Full employment should be our goal. The market system will not get us there; it requires government help as well as guidance. This means, in practice, that government will continually print money, in order to reduce interest rates, ultimately to zero, and also borrow and spend as needed. Booms are good, even economic bubbles are acceptable. Recession and bust must be avoided at all cost."[2]

Lewis continues: "…Hutt pointed out the absurdity of this. One cannot create wealth simply by printing more money or by borrowing and spending funds which can never be repaid. Moreover, the real source of unemployment is some disturbance in the price-and-profit system. Government cannot possibly help matters by intervening in ways that further distort and disturb that system."[2]

As long as I'm quoting, let's go to the fountainhead, Ludwig von Mises. From 1957: "Protection of savers and of savings involves something very different from this – namely preservation of the very foundations of justice on which the capitalistic order of society is based and, consequently, of capitalism itself. The unprecedented increase in the standard of living of the masses in the capitalistic West is due to the fact that the formation of capital increased much more than the population. Real wages went up because... the worker in a modern, well-equipped plant can produce many times more than can a worker with primitive tools."[3]

Certain pols will hate this: "Capitalistic saving and investment cannot develop in lands where it is generally believed that the wealth of the businessman causes the poverty of the many, and where the successful trader is sacrificed to the predatory desires of the rulers and their representatives."[3]

And this: "The fact that every year the quantity of newly accumulated capital in the United States far exceeds the amount consumed in production and otherwise used up is due neither to the policies of the government nor to the doctrines propagated by the universities, the two political parties, and the press. It is a result of the fact that American capitalism still operates satisfactorily in spite of all the obstacles placed in its way under the misleading label of 'welfare economics.'

"Still the official political economists, self-styled 'progressives,' misinterpret this great success of entrepreneurial initiative. Prejudiced by their socialistic ideas, they seek to discover in every improvement in the standard of living of the masses a new argument for the continuation of the New and Fair Deal reforms and the related policies of inflation and credit expansion through low interest rates."[3]

From Mises's closing paragraphs: "The coming years will determine whether the United States… will succeed in managing its finances without inflation or credit expansion. The number of persons is not large who fully recognize the dangers of government's mislabelled "expansionist," monetary policy, and only a few politicians are ready to listen to their words of warning.

"The American 'common man,'… is supporting a monetary policy that threatens his economic future.

"There is only one way to improve the situation. That is to try to explain these matters to the voter."[3] *I'm doing my best, Dr. von Mises.*

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Switching gears a little, Friedrich Hayek, the ONLY Austrian to ever win a Nobel Prize (for fleshing out the business cycle like no one else) wrote a brilliant book titled, The Fatal Conceit; The Errors of Socialism. (But what does that say about the Nobel Economics Committee when a hack like Paul Krugman has "won" a Nobel Prize? Guess the Nobel committee must have forgiven Hayek for some "errant [non-socialist] thoughts.") Two more articles on www.Mises.org dealt with the concept of "fatal conceit" put forward by Hayek. *To be clear, the "fatal conceit" is the idea that central planning can deal with* ***anything*** *better and more "fairly" than thousands or millions of uncoordinated individuals acting in their own self-interest using their own knowledge in a free market.*

From Dr. Andrew Foy, MD: "Mises and Hayek feared the unintended consequences of government planning, and rightly pointed out that such planning would necessarily block innovation and inject systemic risk into the system by preventing the market from routinely ferreting out poor practices.

"To be clear, Mises and Hayek did not believe that markets were incapable of error. In fact, they believed that market participants would continually make mistakes, but that these mistakes would be corrected more quickly in market conditions than under conditions where government made the rules and had a vested interest in ensuring a certain outcome. I strongly believe that the history of the last century vindicates these men and the Austrian School in general."[7] I agree.

As you likely know, I predicted as early as August 2001 that the policies of the Fed as led by Greenspan would distort and damage, maybe even crash, the US economy. (See the 11/2008 *CJ Newsletter*, "Greenspan's Legacy," on TCM's website for quotes beginning as early as 8/2001.) I wish I could tell you it's because I'm so brilliant, but it would have been easy for anyone who understands and embraces Austrian economics to see.

Greenspan denies any culpability. Let's discuss "Greenspan's Fatal Conceit,"[5] by Jonathan M. Finegold Catalan. From Catalan: "…Alan Greenspan was asked about his role in the creation of the 2008 financial crisis. He flatly denied any responsibility. Coming to his own defense, he pointed to his explanation of the financial crisis in a 2010 paper for the Brookings Institution, offering a challenge for others to disprove him."

In addition, Greenspan recently wrote a paper entitled "The Crisis," which he lays out his explanation of the financial crisis. One should not be surprised that it blames the collapse on many things, but not himself or the Fed policies while he was Chairman.

Why does Fed manipulation of interest rates through manipulation of the money supply distort the markets? We've discussed this in previous *CJ Newsletters*, but it boils down to a few concepts:

- Money is intended to be both a medium of exchange and a store of value (capital). Most people act on this assumption, including those who should know better.
- All other factors being equal, when the money supply is manipulated by the Fed, the capital value of each unit of money changes. The amount of change depends primarily upon the amount of manipulation and does not become apparent until the monetary change is fully absorbed into the economy.
- As the value of money changes, dealings for tangible and intangible goods become distorted since the unit of exchange (money) has more or (as applied by the Fed) less real capital value than the purchaser or seller thought. This makes economic decisions, already difficult, much harder and introduces a much higher incidence of uneconomic decisions (malinvestments).

The practical effect of Fed manipulation as they apply Keynesian principles is to create the business cycle – first an expansion due to the adoption of projects that *appear* economic assuming that the value of money remains constant and that market interests rates are at proper (unmanipulated) levels. Of course, neither assumption is true due to Fed manipulation. As more malinvestments are made, eventually a "tipping point" is reached where the malinvestments fail at a rate which pushes the false expansion over into recession. Hayek was the first to truly flesh out this process, earning him his Nobel Prize.

From Catalan: "The main cause of the recession is the fatal conceit of central bankers, including Alan Greenspan. They conduct their monetary policy following established rules, but without any consideration for the effects that changes in money can have on the underlying economy. That is, they believe they can intervene without having any repercussions on the economy except those they want.

"It was bureaucrats' and [Keynesian – CBJ] economists' ignorance of the true nature of markets that caused the recession."[5]