The CJ Investment Newsletter
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Dow 12000 Redux – Now What?

Purpose

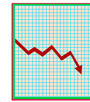
The *CJ* Investment Newsletter deals with the entire spectrum of securities investing, including cash (money market funds), bonds, equities and options. It will evaluate the overall investing environment and then discuss the relative allocations of these asset types, as well as strategies to implement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

- DJI 12000 – Wow! What's it mean?
- The US$X is below 80 again and trending down. The Fed is "printing" money again. One Result? Dow 12000, in part thanks to Marshallian K theory.
- Gold is down about $90/Troy Oz from its closing high in early January.
- Noting important recent developments:
  - The potential unconstitutionality of Obamacare by the Judiciary.
  - The Egyptian unrest and its effects on the markets.
  - Weather in Australia and Russia are affecting some Ag and metal prices.

Dow 12000: What's its Real Value?

Let's ask the question: How does DJI 12000 in 2011 compare to DJI 12000 in the late 1990's and early 2000's? Please review the graph on the next page. I know it's hard to read. Sorry, it's the best my limited knowledge of Excel and Word can do right now. At least it's in color!

What the graph does is track the values of the DJI, the DJI adjusted for changes in the US$X and the DJI adjusted for changes in the price of gold. The Chart begins on 8/13/01 (when I started gathering this data) and continues through last 1/28/2011.

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> *"The inherent vice of capitalism is the unequal sharing of the blessings. The inherent blessing of socialism is the equal sharing of misery."* – Winston Churchill

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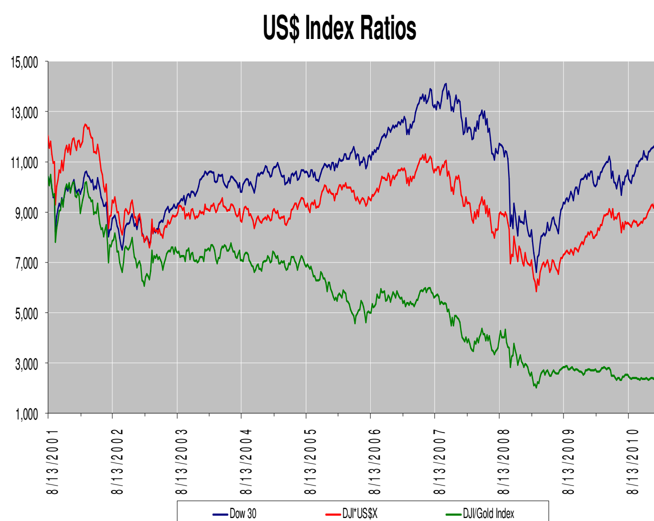

Blue = The DJI as reported
Red = The DJI restated for changes in the US$X
Green= The DJI restated for changes in the price of Gold in US$

Notice how the red line was higher than the blue for a brief period in 2001-2002. This was during the period when the US$X was actually over 100 during the early 2000's. Since then the US$ has lost value versus its basket of currencies. Effectively, while the DJI shows as roughly 12000, the loss of value to those other currencies makes it worth about 9240 – 23% less! On this basis, our "recovery" to DJI 12000 doesn't look so good after all.

At some point, I began reading about *competitive currency devaluations* – a means whereby countries/economies can get an "advantage" by making their currencies worth less relative to their trading partners' currencies. That's crazy, but a discussion for another day. I wondered: How can I do this type of analysis with something of *constant value*? After all, if many or all of our trading partners were also deliberately devaluing their currencies for trade cost advantages, those currencies certainly did *not* represent a measure of constant value.

I decided upon gold as my measure of constant value. You may ask how I could possibly do that. If you are a longtime reader, you already know the answer. If not, here it is: *An ounce of gold is an ounce of gold forever. It never changes in value. The currencies in which it is measured do*. You'd be surprised how few people think of that.

You also might be surprised how many people think, especially on a day-to-day basis, a US$ is a US$.

Since we measure things in US$'s that are not anchored to any form of constant value (since President Nixon took us off the gold standard), it's easy to mistake changes in price for changes in value. It's a big mistake, and one our government (among other governments) uses to propagate all types of lies to its citizens.

Here's the shocker: *the green line represents the DJI restated for the change in the price of gold in US$ since 8/13/2001. Its value as of 1/28/2011 is about 2545 – almost 79% less*!

There's your answer, and why you may feel poorer in 2011 than in 2001, even if you have more assets as valued in US$ than you did then – which most don't after the terrible decade of the "00's."

This is the direct result of policies of the congress, the presidency and the Fed over much longer than the last decade, although its been particularly egregious this decade, and particularly since 1/2007. It amounts to:

- Deficit spending enabled by the Fed monetizing the federal debt.
- The Fed manipulating the economy through money supply and interest rate policies – often at the behest of the congress and/or the administration.

DJI 12000 – Is This a Recovery?

Good question. Let's examine some likely/probable reasons for the recovery of the markets:

- Recovery from a dramatically oversold position in 3/09.
- QE1, QE2 and Marshallian K Theory.
- Fed actions have forestalled, but not eliminated, the deflation that *should* accompany recession/depression.
- There likely has been some real recovery.
- The US is still thought to represent an equal or better return/risk ratio for investment versus the world in general.
- Foreign capital continues to flow into the US from a seemingly unlikely source: the trade deficit.

Regression towards the mean. In 3/09, the markets had fallen over 50% since their late 2007 highs. Regression towards the mean is a concept that states that as values move away from their moving averages, they tend to move back towards those averages with greater drift from the averages creating even more pressure to regress back to the mean.

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I'm not sure of the theoretical underpinnings, but I know some or most of the best investors apply this concept regularly. If this concept is valid, the extreme deviation from the moving average in 3/09 would provide a significant amount of *initial* "snapback" pressure to market prices.

QE1, QE2 and Marshallian K Theory. While I disagree with Marshall's postulation of equilibrium in economics, his "K" theory appears to make sense theoretically and appears to work in reality. The K theory states that if an economy has funds (money) in excess of what it actually needs to do the basic "blocking and tackling" of the economy, the "excess" funds will move into the financial markets, inflating the prices of those investments without real merit. Without going into a lot of detail, blocking and tackling constitutes essentially the basic functions of producing, selling/promoting, distributing and consuming consumer and production goods.

Looking at the diminished levels of consumption in the US economy since at least the crash of 2008-2009, the economy would need less, not more, money to do its blocking and tackling. Yet, with the advent of QE1, *which added 150% to the size of the M0* (the monetary base), where would that money have to go? Right. The financial markets. Could this create an "unfounded" recovery in the financial markets? I don't know. Nevertheless, the "fuel for the fire" is certainly there.

At this point, bullet three (above) regarding forestalling the deflation inherent in recessions would appear to be obvious given the increase in M0 since fall 2008. It's worth noting, however, that the multipliers and monetary velocities of all currency measures have dropped precipitously since then, so much of that money has not been absorbed into the larger economy. Thank God. The resultant inflation (in the common sense) might have collapsed our economy completely. Still, this very fact seems to give even more credence to the K theory argument regarding the increase in the markets.

There likely has been some real recovery. On the other hand, I reviewed the P/E ratios of the major indices as published in the 1/31/2011 edition of Barron's. To my surprise, P/E's for all the indices except the Dow Utilities were substantially lower than they were a year ago. Therefore, despite the increase in prices of the securities within those indices, the index components have grown reported income faster than their prices have increased. There can be many reasons for this, but, certainly, we can't ignore that there has been an increase in some economic activities since at least a year ago. It's frustrating that this activity has not yet translated to increased job creation, which would likely lead to a true, generalized economic expansion that would benefit substantially all US citizens.

US Reward/Risk Ratio. Given the problems with the EU and other places around the world, it's not surprising that investors worldwide would still consider the US a safer, and perhaps more profitable, place to invest than many other places. Capital flows to where it is most profitably grows – or at least to where it is *perceived* to do so. Along with China, Australia, Canada, Brazil, and a few other resource countries, the US would be considered such a place.

US Trade Deficit. This is kind of a "geekish" point, but with the consistent trade deficit the US runs, there are many US$ in foreign countries looking for places to be put. Clearly, investing in US$ denominated investments are places to consider. Given our recent and long-term government policies, it would not be surprising to find countries putting US$ into stocks, commodities and other investments besides US Treasuries, the traditional spot. Yields on Treasuries have not been attractive for a long time, so other investments for the US$'s held makes sense.

Gold, Silver and other Precious Metals

Finally, gold and silver, along with their ETF's and mining equities (henceforth called simply "gold") have appeared to form a top and have retreated from tops occurring around year-end 2010. I have been expecting this for some time, as my writings show.

One of the "problems" with charting is that it will often tell you "what," but not "why." "Why," if it is ever known, has to be discovered by means other than charting and may not become apparent for some time after the move begins. In shorter moves, it may not become apparent until after the move is over. Still, "what" is better (and often more profitable) than "nothing," if not as satisfying as "why."

I intend to watch the declines in "gold" for evidence the decline is over and an investible bottom has been reached. ***Preliminary*** targets are between $1200/oz and $950/oz, but the development of the chart and non-chart factors should be considered. It's generally more profitable and less risky to recognize a buying or selling opportunity when it happens than to try to predict when or if it will and miss. In addition, it may take some time for this to play out. Please be patient.

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