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The CJ Investment Newsletter

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Truth or Consequences?

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
?	?

- Floating on a sea of liquidity, the major indices rose with the liquidity increases.
- The "scrubbed" economic news continues noncommittal; however, the underlying data is less positive.
- Will QE2 be followed soon by QE3? What happens if the answer is no?
- The Elliott Wave (EWI) folks, including Prechter, are highly negative, as is Mauldin. Russell is "concerned."
- The Euro Zone debt situation is quickly becoming critical. Given our own debt problems at the national and large state level (CA, NY, IL especially), can the US be far behind?
- The KC Star published another of my articles, excerpted from last month's *CJ Newsletter*. It's attached.

Getting to the "Truth"

Please read the quote from Robert Prechter below. Think about how radical it sounds. Then consider that this was conventional thinking prior to the adoption of Keynesian economics by the governments of the western world. Later, their citizens also adopted this thinking – since it was the only economic theory taught in their schools.

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"Every government plan is short term, and each one makes things worse in the long run. When the markets start deleveraging again and the government begins to stare ruin in the face, the programs that temporarily buoyed the markets will fail, and the markets will make up for lost time on the downside." Robert Prechter, *The Elliott Wave Theorist (EWT)*, 5/16/2011.

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I guess we should consider ourselves lucky that our society at least maintained enough respect for personal freedom and respect for books in general that the older books that disagreed with the new government ideology weren't all burned or otherwise destroyed. People were, but, at least, all the books weren't.

Getting at the "truth" is doubly hard these days, if such a thing is even possible. Part of the problem is that truth is different than fact. To me, at least, "truth" interprets facts in a way in which wisdom or understanding can form. For example: The apple fell off the tree is a verifiable fact. Gravity made the apple fall to the ground is a theoretical truth. The second sentence provides a framework (theory, philosophy, paradigm) for understanding why the apple fell and opens the door to predictive thinking about the future.

Problems can present themselves when there are multiple interpretational theories or philosophies, however. Interpretation of facts through an incorrect or improper "framework" definitely doesn't lead to "truth." The hard part is in realizing when the "framework" you're using isn't providing "truth" anymore (and, perhaps, it never did) – and having the courage to look for and adopt one that will.

Unfortunately, *societal* adoption of "frameworks" (especially in the "soft" sciences and philosophies) is often more tied to religion, politics and leaders' agendas than considerations of accuracy or "truth." This was certainly the case as world governments adopted Keynianism, which allowed "legitimate" government interference in economies and rejected most established economic theory, which did not.

It seems to me that large parts of the difficulty in getting to the truth in investing, economics and politics boils down to a few major factors:

- Virtually all of the elected leaders and federal reserve leaders believe in descended Keynesian ideology, and they act accordingly. All data is evaluated through this lens, if at all.
- Government and Fed leaders are as resistant to change as the rest of us.
- Elected leaders would rather chew off a limb than admit they were wrong about anything. There are those (who can cite examples) that suggest government statistics (especially GDP) are being "massaged" in various ways in order to present the information in the best possible, but perhaps less accurate, light. All that messy contradictory evidence making the politicians look bad to the voters? Can't have that, can we?
- Most reporters, especially business reporters, also buy into the Keynesian ideas, so they are less likely to see errors in that thinking, even with overwhelming evidence to the contrary staring them in the face. In this sense, they are no different than the rest of us. We ALL have this weakness.
- Since many business reporters' jobs depend upon access to political, economic and business leaders, the temptation has to be ever-present to present what the leaders say in as positive a light as possible. "Go along to get along."
- Finally, few are willing to be the "heretics" and diverge in a meaningful way from "conventional wisdom." The personal and professional price someone might pay by taking such stances are, at the very least, quite daunting. Still, as Benjamin Franklin once said, "If everyone is thinking alike, then no one is thinking."

Luckily, money is one of the few motivators (along with love and alcohol) that can get some people to look for the "real" answers. Lose enough money using "conventional wisdom" and some, at least, look for answers elsewhere. The year 2000 set me on a path to find better "truths" than the ones I was getting from "conventional wisdom." Call me if you want more details on that story.

The Economy and the Markets – The Consequences

The primary disconnect that keeps me from believing we are in a new bull market has been laid out many times in previous CJ Newsletters: All the descended Keynesian policies of the government and the Fed haven't added any significant wealth to the economy, while they've added an *enormous* amount of debt. Why, then, have the markets rallied so hard since 3/2009? Certainly *not* the doubling of the wealth represented by increased capitalization of traded equities.

We've discussed many of these factors over the past two years or so, but the two I find most relevant and convincing are:

- *Marshallian K theory* – the idea that money supply in excess of the monetary needs of the economy finds itself placed into the financial markets.
- *The troubles in the Euro Zone* – specifically, the PIIGS and the imminent debt crises related to these countries, as well as a few others. These troubles would make any reasonable investor look elsewhere to invest capital. The US markets, while still chancy, have been less risky – so far.

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Contrarians and people who look for accurate, not conventional, answers write about – and back up – the things that liberal/Keynesian media do not discuss for the reasons described above. Not to get too judgmental here; some of the conventional reporting is really reporting what they believe. Still, to ignore or to willfully fail to report important statistics or concepts that bring the "conventional (government and Fed) wisdom" into question could be considered a breach of the public confidence in the implied independence of the press. Examples:

- "…the Fed accommodated Speculators with a trillion new dollars, bringing down the denominator of the Dow/$ ratio and making it *look* as if the bear market rally is stronger than it is." Prechter, *EWT*, 5/16/2011.
- "The economy is not accelerating; it's been slowing. The credit crisis is not over; in fact, the worst of it lies ahead." Ibid.
- Sub-prime and Alt-A debt defaults have exceeded dramatically the optimistic estimates used in the TARP and other government bailout programs. Sub-prime "severities" are averaging 75% currently. Home prices are dropping and foreclosures are accelerating – and it's taking months longer to sell the foreclosures. Consequently, personal and business losses are much larger than originally anticipated.
- Bank stock price losses are huge, in spite of the increases of the indices. "But no one is focusing on them because their direction is down, contradicting the investment community's overwhelming upside bias. It also contradicts the main theme of the market rally; that the Fed's QE programs are driving the recovery." *Elliott Wave Financial Forecast* (EWFF), 5/6/2011
- My personal calculation of the DJI/my gold index shows the "actual" value of the DJI relative to the constant value of an ounce of gold to be 2337 compared to the nominal value of 12442 on 5/30/2011 – 81% less. EWT shows the Dow/Gold ratio to have declined from about 40 in 2000 to 16 as of the middle of May – an 84% decline.
- "It's clear to us that Fed policy has played a role in the surge in most markets… The end of QE would remove vital support the markets have enjoyed and could lead to a serious correction in most asset classes, including precious metals. Renewed confidence in the dollar would likely return, and dollar rallies usually lead to declines in gold and silver." Doug Casey, *Big Gold* (BG), 5/2011.

There's a lot of discussion about the ending of QE2 by the Fed at the end of June. My "considered" opinion is that, if the Fed actually ends QE2 at all, the markets, commodities and economy will drop significantly within a quarter or so, having lost the ocean of liquidity that kept those prices afloat and rising. I believe Bernanke will institute a QE3 policy, even if he doesn't call it that. I do not believe he has the philosophical belief or the personal courage to do the right (non-inflationary) thing for the long-term good of the country – if he even knows what that is.

But, if I'm wrong about Bernanke and the Fed, here's what happens: the markets decline precipitously, including commodities. Perhaps gold and silver hold their own, perhaps they don't. I'll wait to see before moving. The already weak (and weakening) real estate markets get worse. The US$ actually increases in value versus foreign currencies and commodities as we will be in a deflationary depression/recession.

And, that's where, if we want to keep America as a free society and capitalist economy, we have to be. Painful as it could be. If the federal government raises taxes to pay for aid, business bailouts, and the stuff they usually do, it will worsen the situation. If they use deficit spending instead of taxation, it will be worse and could cause the collapse and end of the US$, along with the collapse of the entire world economy.

They've pushed the economy to the breaking point; at this point, they *MUST* stop trying to avoid the pain we must suffer as a result of their policies dating back to FDR – both Democrat and Republican. Our politicians have bought the votes of the poor and middle class with deficit spending all the way to the breaking point. The rich no longer have the combined wealth to pay the debt. Besides, if you impoverish the wealthy to pay down the debt, who then has the money to finance new business? The government? By definition, that is socialism, not capitalism.

Anecdotally, insanity is sometimes defined as doing the same things over and over and expecting different results. So, tell me this: *How can following the same policies that put us here since the 1930's save us now?* If that's not insanity, what is? That's what the government wants us to believe – and to support. We let them talk us into taking "Deadman's Curve" at 90 mph, when we could only get though safely at 50 mph.

"Some people see the signs. Others do not. Some decide to get out while the getting is good. Others do not. Incident by incident, trigger point by trigger point, people see signs. Most people ignore them. 'It can't happen here.' Most times, it doesn't. Sometimes, it does." Gary North, *Reality Report*, 5/28/2011.

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