The CJ Investment Newsletter

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Party Time or Party Over?

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
	

- October 2011 was one of the biggest rally months in market history. Why? More importantly, is it based in reality and sustainable?
- Following up our discussion on the changing value of money, please look at the chart on page 3 and the discussion of what the chart means.

Party Time or Party Over?

Once again, I'm indebted to John Mauldin for his writings and the information he provides. Some of this information comes directly from his terrific new article, "European Summit: A Plan with No Details." Here's the URL: http://www.johnmauldin.com/frontlinethoughts/european-summit-a-plan-with-no-details I highly recommend your reading it for more information and a real understanding of what is happening in Europe and at least some of its means to you.

The major indices were generally up double digits in October. I seem to remember hearing that it was the best October on record prior to Halloween, but I'm not sure of that. Still, a market being up double-digit percentages in a month is a major event. See p4.

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"In the short run, the market is a voting machine, but in the long run, it is a weighing machine." - Benjamin Graham

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The rally would appear to be based upon various European governments changing the rules regarding the sovereign debt crisis in the Eurozone. Following are some excerpts from Mauldin's article referenced above (Mauldin's quotes in italics for easy identification):

"Lesson for all of us: Never assumes the rules are what you think they are just because they are written down, if someone else can change them. And, that is the final thing that happened at the [Eurozone] *summit. The banks 'voluntarily' took a 50% haircut. Voluntary in that Merkel, Sarkozy,* et al. *told them that the alternative was a 100% haircut."*

"And because the write-off was voluntary, there would be no triggering of credit default swaps (CDS) clauses. Because if it's voluntary, it's not a default – capiche? And that smooth move, dear reader, triggered a rather significant unintended consequence, which resulted in the market 'melt-up.'"

He then goes on to explain that CDS writers would likely short the stock of companies for which they wrote the CDS's as a hedge against loss should the event occur. Then: *"But as of yesterday, the risk evaporated: there would be no CDS event. So why buy CDS? Time to cover* [your shorts - CBJ]. *And then the shorts get covered."*

When shorts are covered, the purchase of long positions to cover the shorts usually causes the prices of the securities to increase as the demand/supply equilibrium price moves up. Quickly. Thus, the market "melt up."

There are serious down side effects to the government edict to force "voluntary" losses. Among them, as Mauldin explains, *"…now you can't hedge your sovereign debt. If you ever need that insurance, they (governments) will just change the rules on you, so why take the risk? Destroying the credit default swap market will make it harder to sell sovereign debt, not easier. Those 'shorts' were not the cause of Greek financial problems; the Greeks did it all to themselves."*

Hopefully, that answers the question as to why the market rallied so hard in October. It certainly makes sense to me. Thanks, Mr. Mauldin.

The next question posed above: Is this rally based in reality and sustainable? Given the above, technical reason for the October rally, I would have to say no to both questions.

The remainder of the PIIGS (Portugal, Ireland, Italy, Greece, Spain) are still in dire shape with their sovereign debt. Ireland, especially is asking for equal treatment as Greece – logically so. How long before the others petition for the same? France and Germany, who will be the "last people standing," do not have the capital and resources to bail out the remainder of the troubled Eurozone countries.

If you've dutifully read your previous *CJ Newsletters* (especially last month), you may have already guessed what's coming next, but here it is:

There are huge problems the strategies being used in Europe can't avoid – in fact, no purely financial strategy can avoid the manifestation of these problems.

- Despite the financial manipulations, the fact is that real capital was invested in those sovereign debt instruments. The government manipulations have effectively *stolen* that capital from the investors, meaning those *investors no longer have that capital to invest in other future projects* that could help genuinely expand and improve the Eurozone economies. The capital not wasted by the governments is still available to the society, if not the economy. The wasted portion is simply lost.
- It's also going to be very hard for a while (I hope a very long while) to get investors to purchase Eurozone sovereign debt of any kind if they know they will receive this kind of treatment from those governments. Would you trust someone with your property if you know they would not respect it and return it to you – at all, let alone with a decent return? Right, *Maestro* Greenspan? Sadly, like voters, investors, especially institutional investors, have short memories. I guess it's easier to risk other peoples' money than your own. At least we know sovereign debt is no longer "bulletproof," as was thought only a few years ago.
- Most, if not all, major world governments (including ours) still haven't learned that increasing the amount of currency does not increase the capital available. It merely dilutes the value of the currency – eventually – by dividing the available economic wealth, including capital, over a larger pool of counting units. See last month's *CJ Newsletter* for a long discussion of this exact point if you don't already understand this. That's like adding extra *oil* to a car engine, hoping to get extra distance from it instead of adding what it really needs – *fuel* – to generate motive force. *Economies needing to recover need capital, not currency.* Incredible that so many (even intelligent and educated) people believe this.

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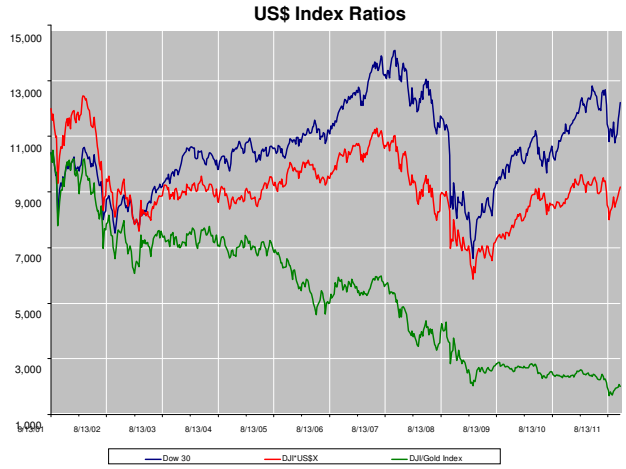
The biggest one-day rally happened on Thursday, 10/27/2011. The follow-through that Friday was anemic, at best. On Halloween, the markets and precious metals were down significantly. The DJI was down about 275 points. As of noon 11/1/11, the DJI is down another 280 points, although it may not finish there. The technical move may well be over. My guess is we resume being in a deflationary recession pretty soon. Time will tell.



The Destruction of the US Dollar

Please review the chart above. I know it's hard to read. Sorry – I still haven't figured out how to move these things from Excel to Word very well. The lines are as follows, beginning in 8/2001 and up to 10/28/2011:

- Blue – the nominal DJI
- Red – the DJI restated for the change of value in the US$ as measured by the US$X (US $ Index)
- Green – The DJI restated for the change in price of one ounce of gold since 8/2001.

Can we agree that an ounce of gold is worth an ounce of gold – forever? As stated many times in the CJ Newsletters, *gold doesn't change value, the currency in which it is priced does*. From an economic point of view, gold would only change value if the demand/supply equilibrium changed due to increased demand (some major new use for gold, for example) or a significant increase or decrease in the supply of gold.

It's pretty easy to understand what the graph is telling you – "the old gray Dow, she ain't what she used to be." Still, here are some sobering (rounded) numbers as of 10/28/2011:

- Nominal DJI – 12231
- DJI restated for US$X – 9182
- DJI restated for gold – 2022

That's *just* since 8/2001. No wonder we don't feel as wealthy as our nominal values would suggest.

What triggered my thoughts in this direction, especially after last month's *CJ Newsletter*, was a report I saw on TV stating that we are spending twice what we were spending in 1970 on a per student basis, yet test scores have been level, *i.e.* not improved. The report concluded that our current education system is less effective and more wasteful than in the past. Really?

If memory serves me, you could buy a new 1968 Dodge Charger R/T for about $4,000 – give or take a couple of hundred. The ballpark is right. Now, such a car could cost $27,000 - $46,000, depending on the options. That is about 7 – 11 times more than in 1968.

I ask you, if it costs that much more to buy a similar car – and, yes, they are similar – does it seem like we might not be spending as much on education as we think? This is one of the unintended consequences of changing the value of our money as a way to avoid levying honest taxes. Not to mention stealing from the Social Security "Lockbox" since before I was born. How sad, though, that even a person as obviously educated as the person making the statement still fell prey to assuming that "a dollar is worth a dollar." It's through such beliefs that our government continues to be able to secretly confiscate our wealth, with the Fed's help.

Sadder still that, while we would all probably want to spend the same amount in real wealth we spent forty years ago on education, we no longer can afford to because of what has taken from us and used for other purposes by our own government.

Quoting Lord John Maynard Keynes, whose theories created the economic foundation governments adopted, teach us and used themselves to help put us in the situation we are in today: *"Lenin is said to have declared that the best way to destroy the Capitalistic System was to debauch the currency... Lenin was certainly right. 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."*