

## You May Not Want What You “Deserve”

### Purpose

*This is (partly) a reissue of previously disseminated information.*

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.

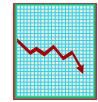
### Quick Look

#### Market

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#### Next

#### Expected Move



*I originally published this article in 8/2004. Changes have been made to add clarity (I hope), to deal with a couple of new important concepts and to keep it topical.*

Before you begin reading this month’s letter, it’s important that you understand why I wrote it. Economics, politics and investing are forever intertwined. Understanding politics and the implications of political policies is as important to solid investing as understanding how to read financial statements or technical analysis. Election results can dramatically affect which investments make money in the future, as well as the direction of the economy.

There is no *personal* judgment in this letter regarding your political viewpoint. Still, political policies are subject to the law of cause and effect. *All* policies will have certain positive and negative effects. I will discuss the effects of policies upon our economy, investing and the society as a whole. Your vision of the “perfect” America may be different from mine. Hopefully, the ideas presented here (that I believe to be true) and will be meaningful to you without being individually judgmental. I know they help me do *my* job better.

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Why do some politicians always talk about taxing “the rich?” (A deliberately vague term, I might add.) Perhaps the best answer comes from urban legend. Supposedly, when asked why he robbed banks, famous bank robber Willie Sutton replied, “Because that’s where the money is.” Any other answer is false justification and bloviating.

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### You May Not Want What You “Deserve”

When a politician uses the word “deserve,” what does she mean? To *deserve* means to *earn* or *merit* whatever it is you are receiving or expect to receive. So, for example, how is it that people *deserve* health care they haven’t paid for? (Original 2004 topic – CBJ) The hard truth is, they don’t *deserve* it unless they have *earned* the money to pay for it or have provided some service to society which *merits* them such coverage – like our military personnel. Any other use of the word *deserve* is improper and deceitful. We, as a society may *choose* to provide healthcare, welfare, education and other social programs to all citizens regardless of whether some have earned what’s required to pay for it. That is a perfectly valid societal choice we may make in order to meet currently fashionable social goals. But, those who do not earn or merit it do not *deserve* it.

When a politician uses the words “you deserve,” what she really means is that, if you *vote* for her, she will *tax (confiscate)* from people who have more resources than votes and give that money or benefits to voting groups who have more votes than resources. This tactic only works because there are many more poor and middle class voters than “rich” voters. *The politician is buying the poor and middle class vote by taxing the “rich.” Not altruism – Votes.* If the politician was *honest*, she’d say, “Vote for me and I’ll take some of the rich folks’ money and give it to you.” Politicians use the term “deserve” in order to make income redistribution, a socialist policy, more politically palatable to those who oppose socialism – in other words, to deceive. It’s actually charity, except the *donors* don’t get to choose which causes they support. Some politicians call this “fairness.”

Why does this matter to the economy and to investing? Because, in a capitalist economy, the “rich” provide virtually all of the investing resources which the economy needs to survive and thrive. For example, say somebody makes \$1,000,000 in a given year. After federal, state, local taxes and FICA have been taken out, she is lucky to be left with \$550,000. Regardless of how you feel personally about the “fairness” of the tax load, can we agree that instead of having \$1,000,000 to spend or invest after her efforts, she has a little more than half of *her own income* to use as she sees fit?

The “rich” like to *save and invest* to make more money. After all, how many people have “too much” money? When asked how much money was enough,

the richest man in the world at the time, J.P. Morgan, responded, “I’ll let you know when I get there.” If this hypothetical taxpayer chooses to forego consumption with her remaining after-tax income, those *savings* would (generally) flow into the capital markets (directly or indirectly), providing needed funds for new small businesses or existing business expansion. That means more job creation and more investment in small businesses that may become big businesses, creating new “rich” people to continue to feed and expand the economy. Many worthwhile government programs are needed and must be paid for – like defense, roads, the judiciary system, police, and fire protection. But, once government goes beyond what are called “basic services,” the costs incurred versus the benefits derived for virtually all other programs are certainly debatable. After all, politicians don’t act as if they were spending or investing their *own* money.

Otherwise, let’s assume our “rich” person consumes the \$450,000 in tax rather than investing it. That consumption (of her existing income) creates *demand*, which *can* trigger the creation of new businesses or expansion of existing businesses *provided, among other things, there is sufficient savings (investment capital) provided by other people.* Creation and expansion translates to new jobs and a healthy, growing economy.

A point that should not be missed, however, is that government “*demand*” is actually done with *our wealth*. *No government can create wealth*, although they can certainly print money – and do. *Wealth is something of intrinsic value created from human effort.* Fiat money is, *at best*, a medium that makes exchange easier. Misused, fiat money debauches the currency, taxes secretly (through enabling deficit spending) and distorts market pricing mechanisms, making markets dysfunctional even without manipulation. Even Lord Keynes said: “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.”

Government “*demand*” is acquired through the confiscation (taxing) of the wealth *earned* by the people. Therefore, taxes *redirect* wealth created by the populace into *demand* its creators may not have chosen. Government wealth consists of either confiscated *wages, profits, and, sometimes, savings or property.* Additionally, there would be *no wages* without profits. No profits; no business; no wages.

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Either way, our \$1,000,000 earner can only stimulate the economy to the tune of \$550,000, instead of the full \$1,000,000 she earned. So, our millionaire's choices impacting the economy are severely limited by the taxes she pays. The higher their tax load, the less impact the "rich" will have on the economy. Put simply: Higher taxes lead to less savings, less capital creation from investment and lower consumer demand in the economy – and, consequently, less societal wealth. All of these lead to less business activity and jobs than would happen without the high tax load.

One new political buzzword is "investment." My 1973 Webster's Collegiate Dictionary definition: "the outlay of money, usu. for income or profit : capital outlay; also : the sum invested or the property purchased." Seems pretty clear a lot of politicians, especially in the last 20 years, have decided to "alter" the definition of investment for their own purposes. One example: *Investment in infrastructure*. This is Orwellian doublespeak because:

- The government can't own "investments" because *they use our assets to "invest."*
- *They are taking no risk.* The government can't lose money. *It's our money they used.* If they lose our money, they simply tax *more* of our money later to replace the "loss."
- With the exception of toll roads and user fees (which don't cover actual costs), there is no expected "income or profit."

No ownership. No risk. No return. Whatever it is they are doing, they are *not* "investing." Don't even get me started on "investment in human capital."

**When you look at the big picture, you may prefer the job you would get in a thriving American capitalist economy rather than the benefit the government decides you "deserve" from levying higher taxes on the "rich."**

### **Business Taxes**

Some politicians virtually drool when they talk about taxing "big business." Everybody wins, right? The government gets money, keeping your taxes lower and no "people" (aka voters) are taxed.

First, businesses *can't* be taxed. Only *people* can pay taxes. Since businesses are legal entities only, they have no money to be taxed. All of the money or assets businesses have were provided by people buying their products or services, loaning them money or investing directly into the business. Eventually, profitable businesses pay taxes from profits, that is, money charged to their customers, net of costs the *government*

*decides* are legitimate. Profitable businesses are the only ones that stay in business, so *businesses have to treat taxes as product costs and build them into the price of their products*. In other words, business taxes are nothing more than additional product costs to consumers, effectively raising consumer prices.

Is this bad? Not necessarily. It depends upon your goals and values. However, business taxes are *regressive*. The additional product costs are not only passed on to their "rich" customers, but also to *all* customers equally based upon their consumption. That means a \$6 pack of cigarettes that is 75-80% taxes is proportionately much more expensive to poor smokers than to rich smokers. That \$25,000 car that is 10-15% taxes (my guess) costs the poor buyer proportionately much more than the rich buyer. All the basics of life – food, clothes, etc. are proportionately more expensive to poor consumers than to rich consumers. *If you're a politician running on the platform of "looking out for the little guy," this is an incredibly hypocritical and deceitful tax policy.* It sells well, but really hurts the "little guy" in the process.

### **The Wrap Up**

We've discussed major ways politics affect our lives. This is why I pay such close attention to the political landscape. Taxes, legal matters, reporting requirements, monetary policy, among others are ways in which the economic and investing environments are significantly affected by elections. Elections we take for granted. Of course, there a multitude of other issues our politicians make decisions about in our names as our representatives. Many are politically charged; others are mundane.

*Every* tax levied by the government negatively affects investible capital and demand. Things like estate taxes, double and multiple taxation of dividends, and others not only deprive people of what some would consider rightfully theirs, but also prevent people from adding needed capital and demand into an economy where people are complaining not enough jobs are being created. Ultimately, we all need to realize that government can indeed "kill the golden goose" (capitalism) that is the American "secret" to success and greatness. I believe current Washington policy is clearly taking us down that road. Will enough voters see the danger in time to elect people who will stop the car and turn it around before it's too late?

***Your vote matters. You can make your life better or worse with it. Use it wisely. An uninformed vote can be worse than no vote at all.***