The CJ Investment Newsletter

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Hard Lessons

Purpose

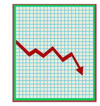
The *CJ* Investment Newsletter deals with the entire spectrum of securities investing, including cash (money market funds), bonds, equities and options. It will evaluate the overall investing environment and then discuss the relative allocations of these asset types, as well as strategies to implement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

- People will believe what they want to believe. Facts rarely change their minds once they've "made them up."
- The "Fiscal Cliff" looms. What really happens if they don't get a deal?

Hard Lessons

We're all human. That means that we all share many, if not all, of the strengths and weaknesses of *being* human.

Recently, I've become more aware of one of those human characteristics. *In general*, it appears that, once someone "makes up" his/her mind about something or someone, facts and solid arguments are no longer persuasive in changing that person's mind.

Sometimes, too, people will *assume* something about something or someone based upon what they *think* they know about their subject whether:

- What they think they know is correct or incorrect
- What they think they know is related in any way or not to the conclusion(s) they draw.

For instance, I remember watching a piece on some news show many years ago about one of my favorite all-time musicians, Bob Dylan. Apparently, Dylan had purchased

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* *Merry Christmas and Happy Holidays* *

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a farm in the upper Midwest and was living there at least part-time at the time of the story.

One of the most interesting things he said in the interview was that, when he moved there, the locals started asking him all kinds of questions about farming. Of course, he didn't know anything about farming. When Dylan asked some of them why they thought he would know these things, they responded that "he had written the song *Maggie's Farm*, hadn't he?" He was stunned that people would think he knew something about farming from having written a song that involved farming and farmers.

The power of preconceived notions…or, having "made your mind up." As an old boss of mine used to say, "So far, this is nothing but interesting conversation." So, it is. Why am I talking about this? Well, do you think politicians and political parties may actually *use* these human characteristics in forwarding their agendas and candidates? *Really?*

If so, there may be some implications, such as:

- If a politician can persuade enough people that he/she is a "good person" who is "on your side" (whichever side *you* are on, that is), that politician has an excellent chance of being elected, *regardless of his/her real character or agenda*.
- Once a politician/party has the support of the press, most "undecided" voters are no longer really undecided. Few are willing to do the individual investigation to find the real facts or perspectives themselves. They're too busy "leading their own lives."
- Those few become even fewer when faced with the prospect/responsibility of trying to convince those closest to them of the truth of their independently derived opinion. No one wants to pariah themselves to their loved ones. Most rarely have the internal strength to even try more than once.

Does this explain a whole lot of otherwise inexplicable historical events? For example, why *Hitler* was elected to be the leader of Germany? Why someone like *Mao Tse Tung* was able to take control of mainland China? *Mussolini* in Italy? Just to mention the most obvious examples? Obviously, this doesn't deal with those leaders who rose to power because of royal succession or some other inherited form of ruling power.

This issue is not a result of voter ignorance, although, God knows, there is a great deal of that. What it means is that, with sufficient timing, persuasive oratory, promises that won't/can't be kept and sufficient character assassination of your opponent(s), voters will vote for candidates and programs for which they would *never* vote if they had an adequate command of the facts, sufficient time to evaluate them prior to "making up their minds" and less peer pressure pushing them towards complying with the opinions of those to which they are closest.

It also provides a potential blueprint for the end of the United States, as it existed from 1776 to about 1970. Although it is attributed to two different men (Alexis de Tocqueville and Alexander Fraser Tytler), this quote is most telling: "*A democracy cannot exist as a permanent form of government. It can only exist until the majority discovers it can vote itself largess* (benefits – CBJ) *out of the public treasury. After that, the majority always votes for the candidate promising the most benefits with the result the democracy collapses because of the loose fiscal policy ensuing, always to be followed by a dictatorship, then a monarchy.*"

I really pray we don't have to learn that lesson the hard way.

Support from Elsewhere

As I presented the above portion of this letter to the mythical 3 member "*CJ Newsletter* Board of Applicability, Taxation and Common Sense" (CJNBATCS, pronounced "CJ NiBATiCS") that is kind enough to review my letter prior to publication to insure I don't completely embarrass myself – or them – with what I write here, two of the members provided the following feedback:

- "Why does this belong in an investing newsletter?"
- Have you read the November *Elliott Wave Theorist* yet?

(The following quotes are all from the 11/16/2012 *Elliott Wave Theorist* Newsletter written by the legendary Robert Prechter.)

"… Obama was vulnerable on the basis of *facts*. So was Romney. But, swing voters don't bother with facts. They vote their *feelings*, and social mood influences feelings." p3.
"… it is natural that voters have credited President Obama for improvements in the economy since 2009. Yet, they have refrained from *also* pinning the weak recovery on him." p3.

"Positive social mood caused voters to feel good
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about Obama, which in turn prompted them to rationalize who was at fault for the slow-growing economy. Rationalization requires a basis in reality, and they had one: The economy was contracting severely as Bush left office, and began expanding five months after Obama took over. It seems that their good feelings about Obama prompted them to deem Bush at fault for what could be perceived as the lingering effects of the former downtrend…Of course, one could just as well argue that Obama, not the president who had been *retired* for nearly four years, was to blame for the slowest US recovery on record. But, objectivity doesn't matter much in this context. Many voters choose logic to justify their decisions which are in fact based unconsciously on mood." p3.

From CBJV: Please keep in mind that the "improvement" in the economy since 2009 *was purchased* at the price of *$5 Trillion* of *unbudgeted* deficit spending. People were "outraged" at Bush's legally *budgeted* deficit spending of about the same amount in *8 years* in 2008. Yet, few in the press have batted an eyelash at Obama having done the same in *4 years*. Please remember, at its *best*, deficit spending represents claims against future tax streams – that is *our future income*. *At these levels, it could collapse the economy and, possibly, the government of the USA*. Back to Prechter:

"One of the most useful observations in socionomic literature is that negative trends in social mood bring about polarization of opinion within society…In bull markets, politics tends to be middle-of-the road; in bear markets, radical positions gain acceptance, and the electorate becomes polarized." p5.

"Since 2000, when a new bear market started, the electorate has become more polarized… political views have shifted further right and left as well as up (toward liberty) and down (toward authoritarianism). The detractors of George W. bush and Barack Obama have been especially passionate. The big rally of 2009 – 2012 hasn't stopped the widening gulf…" p5.

"Although the return toward more positive social mood allowed Obama to win reelection, it wasn't nearly enough to unite the country behind its leader. If that's all the huge rally wrought, *the decline should lead to historic rifts in the electorate*." (My italics – CBJ) p5.

"The bear market in stocks has much further to go. The extremity of negative social mood that will propel the next stock market downtrend will all but assure much more extreme political radicalization, polarization, and fragmentation in American society – and around the world – over the next four years and probably beyond. If our analysis is correct that a Grand Supercycle bear market is in progress, and if our time forecast turns out correct that the first wave down of Supercycle degree will end in 2016, then the incumbents around the world who face reelection at that time will be ousted in landslides." p5-6.

And that, my dear CJNBATCS member, is why the first section of this letter belongs in an investing newsletter.

The Fiscal Cliff, Part 2

Last month, we discussed some aspects of the so-called "fiscal cliff" set up by Congress and the Administration, namely why prudent businesspeople would opt for the conservative course (NOT to lose money) in the presence of such uncertainty regarding tax rates and government spending levels. We also discussed why it seems so much harder for the parties to cooperate today than it has in times past.

I reiterate the following assertion from last month: *The governments created the problem, own the problem, and are the only ones who can solve the problem.*

The parties appear more dug in to their positions than ever. Compromise appears unlikely to me. The markets and market participants get yanked around like fufu dogs on leashes, depending upon who makes what statement and whether the statement indicates a compromise will be reached or if we will go over the "fiscal cliff." Personally, I'm finding it disrespectful to the American people and transparently self-aggrandizing by the politicians to be negotiating such an important agreement in the press. It won't be the first time I wish we could forcibly disband both parties and start over with representatives who care more about this country and its people than their personal and party's powers.

I won't go into the details of the "fiscal cliff" here. There are plenty of other sources from which you can garner that type of detail if that is what you want to see. The 30,000-foot view of major provisions for individuals only is as follows, to the best of my knowledge:

- All the "temporary" "Bush tax cuts" will expire, in which case, income tax rates will return to the levels in effect at the end of the Clinton Administration. Top marginal income tax rate would rise from today's 35% to 39.6%.

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- *All taxpayers paying income taxes will pay them at a higher rate.*
- The corporate dividend tax rate of 15% would expire, making corporate dividends received by individuals taxable at their highest marginal tax rate.
- The capital gains tax rate would rise from today's 15% to the previous rate of 20%.
- The "payroll tax cut" related to social security (FICA) taxes paid by individuals, would expire, raising individual FICA taxes from today's 4.2% to the previous 6.2% rate.
- Lastly, there would be "massive" spending cuts that some say would particularly gut defense spending. Detail about these cuts is much less available in the press and from the pols than detail about the tax increases. I wonder why?

There are dozens of other changes related to both individual and business taxation that would radically change the income (and other) tax landscape in this country. I think it should also be noted that many of Obamacare's more onerous provisions, including entirely new taxes, begin to phase in much faster beginning in 2013 *regardless of what happens with the "fiscal cliff."*

Remember, this economic "recovery," weak as it is, was purchased at the cost of about *$5 Trillion* of deficit spending. I doubt we have Armageddon, but the effects of the tax increases scheduled would clearly wipe out the miniscule "progress" made since 2009 and more. It also clearly violates even the progressive Keynesian economic principles in which most of the government, academic and media economists believe should be followed, let alone what other, more conservative schools think.

The real danger here is because of Say's Law. Say's Law states: "Supply creates its own demand." Perhaps more understandably, this can be stated as, "Production (supply) is the source of demand." (For a more thorough explanation of this, please look at the 1/2009 *CJ Newsletter* or the 1/27/2009 *KC Star* commentary I wrote, "*Government is Just a Buttinsky*."

In the "fiscal cliff" context, applying Say's Law means that the increased taxation would cause many businesspeople and investors to be less willing to take risks, especially large risks, that would create the production of more products and services, expanding both large and small businesses, creating more jobs and, therefore, increasing both the amount of consumers and their individual capacities to consume.

Production (and risk) has to occur in order to increase aggregate demand and therefore, create economic expansion. The businesspeople and investors would be less willing to produce because the net return after taxes simply wouldn't be worth the risk undertaken.

In a painfully poetic turn, as the tax increases contract the "private economy," the forced spending cuts will also remove the artificial "stimulus" caused by the "government economy." Perhaps the saddest thing about the "fiscal cliff" is that, even if we go over it and it *doesn't* crash the economy, *the changes wrought will not completely close the deficit spending gap. The source of our biggest long-term economic problems will continue.*

I have managed client accounts conservatively since about 12/2007 fearing both what did happen in 2008-9 and the coming about of what is now appearing to happen. As described in the *CJ Newsletter* over this period, the risk/reward ratio over this period has seemed to me to be clearly on the side of risk, rather than of reward. If the market crashes again, as many smart analysts and I believe, the cheerleaders advocating always being in the market will get to relearn the old market adage: "If you don't keep it, you never made it." Client accounts are already defensive, although, if needed, they can become more defensive.

I admitted previously that I underestimated the power of the Fed massively adding to the money supply in a sustained fashion, as it has since the fall of 2008. I believe the market rallied since 2009 purely from:

- Massive deficit spending never before seen in the history of this country
- Enabled by massive money creation by the Fed, who bought the excess US bonds *legitimate* bond buyers would not
- Artificially lowering interest rates below "natural" market rates, a scenario favoring stocks over bonds in the long term
- And bringing Marshallian K theory into full bloom (forcing up financial markets prices) in a manner never seen before in US history.

In all fairness to me, many analysts were completely unprepared for Bernanke's Fed being willing to do what no US Fed had ever done in its history.

It would behoove everyone to remember those who brought about *all* of these problems over decades, not just the recent "fiscal cliff." It might also be important to consider who had the power to fix it, but doubled down on destructive deficit spending policies instead of changing course. How many out there believe doing even more of this in the future will help?