The CJ Investment Newsletter

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Why TCM Client Portfolios are Positioned as They Are

Purpose

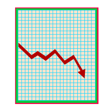
The *CJ* Investment Newsletter deals with the entire spectrum of securities investing, including cash (money market funds), bonds, equities and options. It will evaluate the overall investing environment and then discuss the relative allocations of these asset types, as well as strategies to implement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

We'll begin this month with an admittedly long quotation from *Endgame* by John Mauldin and Jonathan Tepper. Hoboken, NJ: Wiley & Sons, Inc., 2011. Pages 294 – 295:

> The future in many parts of the world – the United States, the United Kingdom, Europe, and Japan – is fairly binary. Either the forces of deleveraging will lead to a long and crushing deflation, or the policy responses will succeed in leading to devaluations and inflation. (The excessive level of debt may lead people to consume less, save more, and pay down their debts, which could lead to a deflationary dynamic like Japan has seen for the past two decades. Or governments may encounter too much success in their experiments with quantitative easing, money printing, and fiscal expansion. We are not certain which is the lesser evil.)
>
> If you believe in deflation, then you should seek investments that offer a high chance of return of capital rather then return on capital. Investors will seek a low yield with a high degree of confidence they will get their money back. If you believe in deflation, U.S. Treasuries offer

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great value. Unsurprisingly, the biggest proponents of deflation are David Rosenberg and Lacy Hunt. Both work at firms that manage a lot of money in bond funds.

The following list is only partial, but it highlights the best ways to invest if you believe that *deflation* will predominate:

- Buy treasury bonds.
- Buy income-producing securities.
- Buy the dollar. Cash is king in a deflationary environment.
- Sell equities.
- Sell homebuilder and selected related stocks.
- Sell selected big-ticket consumer discretionary equities. Frugality will lead people to spend less.
- Sell banks. In a deflationary environment, demand for loans falls, and interest rates fall. It is difficult for banks to make money in this environment.
- Sell consumer lenders' stocks.
- Sell junk bonds.
- Sell most commodities.

(*End of Quotation*)

I looked up how to do long quotes online (as well as how to cite sources [example precedes quote]) and the sources I reviewed indicated that's how this should be done in the modern, MLA style. Maybe I'm just slow, but the sources I reviewed were anything but clear about how to do this, so it may have been done wrong. I added the (*End of Quotation*) to insure clarity to you.

Two Scenarios

In the Conclusion chapter of *Endgame*, Mauldin and Tepper lay out the two diametrically-opposed scenarios which are the most realistic ways in which the endgame will play out:

- Massive deflation (if government policies fail)
- Massive inflation (if they succeed)

If you are interested in a fuller understanding of this and would like to read a well-researched, balanced current market and economic assessment, I suggest you pick up a copy of *Endgame* and read it yourself.

I believe *deflation* is the probable endgame. I would be surprised if anyone who ascribes to the Austrian economic school would pick inflation instead.

Natural Laws Can't be Broken

Austrian economics really *is* a science in that it believes there are *natural laws* at work in individual human economic behavior. It is the job of the economist/scientist to discover and *prove* those laws, and to determine when and how they should be applied.

The importance of *natural laws* is that, unlike man's laws, they *can't* be violated. Ever try to break the law of gravity? The laws of how chemistry works? What about moving faster than the speed of light? The history of science has been the discovery of the immutable laws of nature.

Some other economic philosophies believe economics is a man-made construct, subject to the whims of the people who want to bend it to their wills to serve their purposes. Sadly, this is clearly the prevailing "wisdom" today, since Lord Keynes gave governments "permission" to play in the economic sandbox in the 1930's. Governments had been denied that legitimacy (with a couple of exceptions – think Marx) by prevailing economic thought virtually since Adam Smith wrote *The Wealth of Nations*. Did you ever wonder if that long awaited legitimacy had anything to do with the rapid adoption of Keynesianism?

I've discussed many of the aspects of economic law and what the US and other governments are doing for years in the *CJ Newsletter*. There is no space to go into more specifics in this letter. What's important to understand is that *I believe the government's denial of money as a store of value/capital will eventually manifest consequences that can't be escaped*.

Further, the market and economic "recovery" experienced since 2009 is a massive head-fake which caused people to *behave* as if new wealth was being created, when in fact, it was only the creation of tons of counting units (currency). As we've discussed at length in recent *CJ Newsletters*, some of what all that money creation actually does is spread the existing wealth/capital over a larger number of counting units, diminishing the wealth/unit of currency, albeit over time. Such manipulation *can't* create wealth or capital. *Capital and wealth have to be created through work, not printing*.

The other thing money creation on that scale does is allow the federal government and the Fed corresponding banks to effectively *steal part of your value/capital* because they get to use the money *first*, prior to its general dissemination into the economy. This has been discussed in detail in many prior *CJ Newsletters*. Think about it this way: there is no

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increase in capital while the government increases the currency (and spends it). As described above, this reduces the value/capital per unit. If you have the same amount of nominal money at the end of the process, your money's loss of value is no different than if someone had stolen part of your money at the beginning.

I'm unaware of anyone actually *proving* that deflation is the inevitable final outcome of these governmental manipulations. However, all the Austrian theory I understand clearly leads to that conclusion. No less a mind than Ludwig von Mises put it this way: "*The wavelike movement affecting the economic system, the recurrence of periods of boom which are followed by periods of depression(recession), is the unavoidable outcome of the attempts, repeated again and again, to lower the gross market rate of interest by means of credit expansion.* ***There is no means of avoiding the final collapse of a boom expansion brought about by credit expansion.*** *(My emphasis – CBJV) The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved*." From Mises's *Human Action*, Auburn, AL, Ludwig von Mises Institute, 1998.

I believe, based upon the above and the actions of certain politicians over my entire lifetime, that our government will surely ***NOT*** do the right thing until they are absolutely forced to by circumstances or the populace. They've been taught what I believe is the wrong economics by their predecessors, so, they would have to do something they don't believe in – a hard thing for anyone to do. Further, they would have to give up some or all of their control over *our* lives, and, God knows, they can't do that. Besides, what politician, besides a founding father or Ronald Reagan, willingly gives up power over the rabble? Therefore, we are left with the continued use of the failing policies used essentially since the creation of the Fed in the early 20th century.

TCM's Deflation Oriented Allocation

That means *deflation* will manifest itself until circumstances force the changes needed to restore (at least partially) real *laizzez-faire* to our system, real property rights to our citizens and real freedom to act morally in our own self-interests. Moreover, of course, politicians will have to stop buying votes by promising benefits to voters *using other citizens' money*. Deflation it is, at least until *some* of the governmental excesses are wrung out of the system.

Review Mauldin's and Tepper's discussion (above) of what to invest in and what to avoid in a deflationary scenario. Also, from the Trend Capital ADV2:

> All clients using the Trend Capital Wrap Fee Program will be put into tactically allocated models, which are invested using Trend Capital Management's own criteria that include elements of fundamental and technical based analyses. Trend Capital Management uses four primary investment strategies:
>
> - Aggressive growth for building capital (The CJ Model)
> - Dividend securities for income and potential capital growth
> - Income producing securities for greater income and greater safety
> - Cash and short-term money markets for greatest safety and some income

Because the potential risk greatly exceeds the potential reward, the *CJ Model* (aggressive growth) has been tactically allocated down to 5% or less of the portfolios until governmental and Fed policy begins to provide a real foundation for improvement and the economy actually begins to improve.

Dividend securities have been left alone at the levels that existed prior to the crash of 2008-9. They are monitored continuously and have continued to flow cash, making them worth the risk holding them, so far.

Income producing securities have been sold if TCM feels the risk outweighs the reward or if the cash flow diminished below the level expected or needed.

Securities sold from the categories above have generally been left as "cash" earning overnight Fed funds interest. Almost all client portfolios are between 20% – 40% "cash." While not sexy, as the money supply shrinks from the reverse multiplier effect, the value/capital per US$ actually *improves*, providing "returns" to clients not evident from only considering the *nominal* amount in the account. It is as risk-free as possible a way as I know to protect and improve client positions under deflationary conditions. About the only risk *not* protected by doing this is the risk of currency collapse, which I hope the government isn't crazy enough to let happen. If that happens, all bets are off anyway; we're talking survivalism then.

As you can see, TCM client portfolio allocations, while a little different, are consistent with those presented in *Endgame*, although TCM was using these strategies and tactics a good three years prior to *Endgame's* publication in 2011.