The CJ Investment Newsletter
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Economic & Market Assessment

Purpose

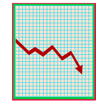
The *CJ* Investment Newsletter deals with the entire spectrum of securities investing, including cash (money market funds), bonds, equities and options. It will evaluate the overall investing environment and then discuss the relative allocations of these asset types, as well as strategies to implement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

- Understanding the market rally since 3/2009 depends partly on economic theory, especially, our old friend, Alfred Marshall.
- Gold dropped $77/troy oz on 2/28/2012, finishing at $1711.30/troy oz. Will it continue to decline or reverse and rally?
- How do the markets look technically going forward?

The Foundation of the Rally

I have been suspicious of the rally that began on 3/9/2009 since it started. If you've read me since that time, you've read many of the reasons I feel this way. I'm not alone, either. Some of the writers and market analysts are struggling much as I have with a market that has almost *doubled* since that time in nominal terms, at least as measured by the DJI.

Lord Keynes' economics notwithstanding, the man was both brilliant and witty. His quips are legendary. One that applies here is, "The market can stay irrational longer than you can stay solvent."

I've always been a "hybrid" investor as described by Victor Sperandeo in his books.

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I strive to cobble together fundamental, technical and economic facts and theories in order to assess as best I can the overall market(s) and the opportunities within them. I used to call it the "three-legged stool" until I decided that monetary theory (while still a part of economics) was so important to investing that it became the "fourth" leg of my stool. I might add that a four-legged stool is much more stable than a three-legged one.

Beginning with President Obama's 2009 stimulus plan and continuing up to the current time, the DC crowd has done the following:

- Drastically increased deficit spending
- Drastically increased the national debt
- Drastically increased the money supply
- Barely moved the economy or the unemployment rate

Oh, and just for grins, they haven't passed a budget for at least two, maybe three, fiscal years. I don't remember that ever happening before in US history. *Patience, reader. We're getting there.*

The Fed has allowed federal deficit spending through Keynesianly increasing the money supply and, therefore, lowering interest rates. This, in turn, has enabled the horrible and dangerous behavior exhibited by the legislative and executive branches. Yet, the economy has not "caught fire" after close to *three years* of these policies. So, what *has* happened?

Enter Alfred Marshall, one of Keynes' predecessors and an economist we have discussed in prior *CJ Newsletters*. Marshall, you may recall, is famous for primarily two things, at least in my opinion:

- The postulation of equilibrium in economies
- Marshallian "K" theory

The equilibrium postulation is certainly questionable, although not to "true believers" of Marshall, Keynes and others who ascribe to what is now called "Keynesian Economics." *Only* Keynesianism has been taught in our public schools since FDR decreed it in the late 1930's. Still, why would Marshall *postulate* a principle upon which a great deal of remaining theory depends if it could be *proven*?

Marshallian "K" theory, however, makes sense to me and I believe it to be one predictor of financial market behavior. It is called "K" theory because it was first described in Appendix K of Marshall's Principles of Economics. Essentially, Marshall states that any "excess" money not needed by the economy to perform the functions and transactions necessary for the economy will flow into the financial markets, effectively inflating them. And *vice versa*.

Now, we may be getting somewhere, reader. Since the Fed has effectively *tripled* M0 (the monetary base) since 9/10/2008, only a fraction of the money created has actually found its way into the economy. Thank God for that. Had that money actually been absorbed into the economy at the rate it was created, crippling inflation and interest rates would be still more monsters added to the list of economic monsters we are already fighting. Remember the 1970's?

There are a lot of details and mitigating factors involved like monetary velocity and money multipliers I won't go into here, but, if you're dying to know, contact me and we can open a dialogue. Still, since the economy has not gone into a self-sustaining growth phase, much of the money created by the Fed to support the enormous increase in the national debt needed to find a home. Under Marshallian "K" theory, that home would be in the finanicial markets.

This nicely explains why the markets have rallied with Fed easings since the fall of 2008, with a lag at the beginning. Much of the excess money created by the Fed to monetize the debt created by the enormous amount of deficit spending has found its way into the financial markets, therefore making them rise in spite of an underlying sick economy. More US$ chasing the same number of stocks translates to inflation in the financial markets – just as Marshall predicted.

I haven't yet researched this to make sure, but I imagine much of that money is being invested institutionally by the corresponding Fed banks. These also happen to be many of the large Wall Street (mega)banks that have been so villified for "creating" the financial crisis. Of course, the real culprits are Alan Greenspan, Ben Bernanke, and the US legislative and executive branches from 2000 through 2007. But they're politicians, so there's no way they are taking responsibility, no matter how deserved. *Ironic*.

Now we have a *reasonable* explanation for at least some of the nominal rise in the financial markets since 3/2009. I believe it to be "true," or at least a substantial portion of the "complete truth." Others will disagree, guided by their own economic and political views. As described above, the rise in the markets appear to be built on a edifice of fiat money needing government support, as opposed to real ecomomic expansion, which could be self-sustaining. Money created with no underlying value is worth what was paid for it. In other words, this market rise was built on a false premise, not the additional creation of real value, as a sustainable rise has to be.

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The next big question: What does this all mean to us and to the short- to intermediate- to long-term direction of the markets?

Before exploring my technical assessment of the markets, it might be helpful to understand that, in my view, *the most likely next move in the US economy would be into monetary deflation, probably along with a continued or deepening recession*. I'm sorry to say that, but the Piper has to be paid sometime. Our government's Keynesian ideology for more than 7 decades has run up a bill we may not be able to pay. Bought a lot of votes with it over the years, though.

At some point, continuing monetary "stimulus" will become ineffective, like shocking a dead frog. The government has used the largest sustained combination of spending, tax cuts and monetary expansion in the history of man in the last three years, all to virtually no avail. There simply doesn't appear to be any more contraction left in the frog's muscles.

So, the underlying ability of the US economy to expand without healing the injuries caused by our own government and adopted economic philosophy can certainly be questioned. In order to heal:

- We need honesty and honor from ourselves and our government(s)
- We need stable money with predictable value
- We need our government to stop encouraging dependency upon it, instead of depending upon ourselves and each other
- We need the government to get out of the way of our citizens and let us do what we do better than any other culture in history: business
- We need the faith in ourselves and the patience to get through the painful adjustment period created from past sins

The Financial Markets' Technicals

Note: Virtually all the following observations are based upon my review of index and commodity charts using my proprietary *CJC Indicator*. Other factors will be supported with references.

DJI: All significant channels have an upward slope. The current level is mid-band for most bands. Longer band-defining averages all suggest tops during 2012, then declines. There is a major bearish divergence currently as the DJI has bested its 5/2011 top, but the underlying MACD is lower. Volume average to light by recent standards. According to *Barron's*, 2/27/2012 (called *Barron's* data hereafter), P/E on the DJI is 14.53 and dividend yield is 2.5%. Both numbers are closer to long-term historical tops than bottoms, although not for the late 1990's or 2000's.

There is a current Dow Theory non-confirmation between the DJI and TRAN.

TRAN: Most channels upwardly sloping. The TRAN tends to reflect freight activity trends. It's recent dip may suggest a decline in freight volumes, and, therefore, purchases, but it's too early to tell. The longest band-defining average indicates a top in the summer. Volume somewhat light by recent standards. *Barron's* data: P/E of 20.09, dividend yield 1.56%. Not inspiring for these types of firms.

SPX: Similar to DJI, except less slope to longer bands. Two longest band-defining averages will top in 2012. There is also a major bearish divergence currently, although it is less severe than the DJI's. Volume average to a little light. *Barron's* data: 15.7 P/E, 2.10% dividend yield. Comments on DJI data (above) apply here.

COMP: All channels upwardly sloping. Band-defining averages more mixed than the other indices, although longest and second longest will both be declining in 2H 2012. New high exceeds 2011 high. Minor bearish divergence. Volume normal.

Spot Gold and physical gold ETF's: "Blow-off" top from 7/2011 through 9/2011. Predictable decline followed, but not to expected levels. Downtrend broken, but band-defining averages trending down, especially 3 longest ones. Backwardation frequent recently.

Oil & Nat Gas: (Remember this is an evaluation of stocks of Oil and Gas producers, not the commodities). Still below two previous peaks of 2008 and 2011. Band-defining averages "lifting" through roughly Q2, then declining *en masse* for the rest of 2012. This is a volatile area where predictions are difficult due to massive ongoing government intervention.

Overall: Many broad market indices indicate a market that is "running out of gas" by Q3 2012. With growth sluggish, market will only advance via P/E expansion. This requires more money supply, "animal spirits" or both. Expect *massive* government intervention during an election year in order to buy votes. The Fed will *not* change course, no matter how badly needed, in order to prevent being accused of "tampering" with the election in 2012, as they were in 1992. If the market starts declining in the summer, Obama's reelection chances decline, but aren't erased. Stay tuned.

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