The CJ Investment Newsletter

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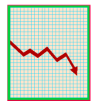
So What?

Quick Look

Market	**Next Expected Move**
?	

- We try to gain perspective on what the massive money supply injections have done, especially to market valuations, since the years 2000 and 2008.
- The charts referred to in this letter appear on page 3, to minimize a reader's need to "flip back & forth" on the paper version of this letter.

So What?

Recently, I've been talking to some of the more important people in my life. "We" were discussing the distortions and misrepresentations inherent in the stock markets due to massive amounts of money injected into the money supply by the Fed, especially since they began QE in 2008.

I asserted to them that the money supply has been increased so much that the market averages represent massively less actual value than they did even just a few years ago. This letter will provide evidence towards proving that. Why don't we start less than 15 years ago, with tech market peak beginning in 2000?

Surprisingly (to me, at least), many of them reacted by saying, "*So what?* More is better regardless, right?" These are smart people, and yet, they don't understand the implications of what the huge Fed money injections have already done to misstate our accumulated wealth. We will provide evidence of this herein. Fed policies have also introduced massive risk into:

- Market stability
- Market value
- Value of the US$, including the risk of its utter collapse and/or loss of its reserve status in world commerce
- Economic stability
- Difficulty created in conducting free economic exchanges, introducing greater capital loss error into economic transactions.

I realize that tackling this topic again may bore some readers as we have discussed it many times in different ways, even in the last year. I had intended to strike out in a different direction this month, but clearly the message itself is being missed, let alone its importance. Certainly, some of the problem must be my communication skills. Thus, I decided to try once again to explain the problem and its (apparently) hidden dangers.

What our own government is doing to our money, whether intentionally or in ignorance, may be the biggest threat to the United States since the Civil War, although it would appear like the Great Depression.

The relevant question: ***How do you protect yourself from a danger you don't see and have little control over?*** Our ONLY peaceful control is through the election process. If we don't understand, how will we know enough to elect people who won't propagate the current destructive system?

Enough. Please review the charts on page 3 before reading further.

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* Merry Christmas and Happy Holidays *

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The Charts – Visual Evidence

The old saying is that a picture is worth a thousand words. Let's hope these charts are worth ten times that – *each*.

These charts show the weekly data for the DJI and the SPX, two of the most important averages in the world. The DJI (30 giant multinationals) at one time represented 20% of the entire US economy. It still represents a huge piece for only 30 companies. The SPX is comprised of 500 of the largest publicly traded companies in the US.

The raw data (nominal or "as reported" values) on these charts are intended to show the last three major market tops in both of these indices. The nominal data is shown in weekly Japanese candlesticks (open, high, low, close). The blue lines are the weekly closes divided by an index of M2 money supply that started on 12/27/1999 with a value of 1 or 100%, if you prefer.

M2 is the largest money supply still reported by the Fed. It represents the money supply amount in which most of us "live," that is, the money supply we actually access when we are paid and purchase things, including investments. M3 was actually closer to where we live than M2, but the Fed decided it was "too expensive" to collect and report M3. This happened around the time Ben Bernanke became the Fed Chair. Given the course that Bernanke has taken since becoming the Fed Chair, I'll leave you to decide as to WHY they really stopped reporting M3 in 2006, after using it over 25 years since 1981.

Most readers will recall the explanations of inflation appearing in the *CJ Newsletter* over the years. We will not review that here, but if you are unfamiliar with the concepts, especially the one involving the "scales of justice," please contact me and we can discuss it. For now, suffice it to say that if the money supply grows faster than the actual value created by the economy, the value of the currency will decline and vice versa.

Therefore, the blue lines represent the nominal value of the indices restated to the approximate value of the US$ beginning on 12/27/1999. In other words, the index values restated to compensate for the effect of M2 growth. Admittedly, this does not compensate for *net* currency growth *in excess* of actual economic growth, but if you read the 10/2013 *CJ*, you know that the reported numbers from the government regarding GDP are so manipulated that any semblance they have to reality is purely coincidental. Any attempt I would have made to calculate the net excess currency growth would probably not be any more accurate in real terms that the numbers charted herein.

What is important to remember is that while the blue numbers are probably not perfectly accurate, the principle is, and ***the message shown by these charts is clear WAY beyond any margin of error***.

Looking at the DJI, from the reference point of 12/27/1999, the difference between the nominal and restated values has become shockingly large. For example:

- The 2007 nominal peak of 14093 restates to 8808, or roughly 62% of that nominal peak and 75% of the 1/14/2000 peak of 11723 – *a loss of 25% in those 8 years*.
- The nominal value of 16086 on 11/29/2013 restates to 6816, or 42% of the current peak and 58% of the 2000 nominal peak – *a 42% loss over the last 14 years*.
- The nominal increase in the DJI since the 3/6/2009 low of 6627 is 143%. The increase in the restated index is 84%, meaning that 59% of the nominal increase can probably be directly tied to the increase in M2 since that time, even if the remaining 84% is less directly attributable solely to the increase in M2.

Looking at the SPX, we find:

- The 2007 nominal peak of 1562 restates to 976, or roughly 62% of that peak and 64% of the 3/24/2000 nominal peak of 1528 – *a loss of 36% in those 8 years*.
- The nominal value of 1805 on 11/22/2013 restates to 765, or 42% of the current peak and 50% of the 2000 nominal peak – *a loss of 50% over the last 14 years*.
- The nominal increase from 2009 to 2013 is 124%, while the restated value increased 100%. As described above, the additional 24% nominal increase is clearly attributable to M2 growth alone.

While these numbers are sobering, simply looking at the charts again should show you the value destruction in the US$, helping you understand that while stocks are priced higher, as a general rule, they are NOT worth more (at least collectively) than the value of the previous peaks occurring in both 2000 and in 2007. ***If you've been a "buy & hold" stock investor since 2000, in general, you will have incurred significant real losses masquerading as nominal gains.***

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DJI Weekly Adjusted for M2 Growth

SPX Weekly Adjusted for M2 Growth

Now What?

We've discussed the meaning of all of this before, but for the benefit of new readers and as a reminder to the rest of us, who do you think benefits from the wealth that is being stolen through inflation? Your federal government. Because they live largely in the M0 and M1 world, they get to use the money, fully realizing its value at those levels before the money circulates and inflates at the M2 level. This is because money is not absorbed evenly into the economy all at once. Money is absorbed through the banking system, meaning that those who get to use it first can get the full value of the money, before it is multiplied and diluted at higher levels – AND before the vendors selling to the government realize the money will be inflated soon and lose value through the inflation process. Thus, vendors are cheated, too. Better hope their gross margins are high!

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And it's still not enough. Even using inflation as a "hidden" tax, the federal government is still running a deficit of between $500B and $1T *per year*! And, they still look us straight in the eyes on TV and tell us how "fiscally responsible" they are and how the deficit has been "cut in half." Really? "Cut in half" from currency-collapsing stupid to simply dangerously outrageous? They have no respect for our intelligence at all. Given that we keep electing them, perhaps they shouldn't, at least not as a group.

Back to "So what?" for a bit. It is still true that more money is better than less. No sane person would deny that. Nevertheless, not all investments have the same level of *risk*. Given what we've just discussed, what do you think that the risk level of most or all securities, but especially stocks, is given:

- The real value of the price of the stocks has declined due to value lost in the currency since at least 2000 (demonstrated above)?
- Stocks have been bid to extreme valuations due to both Marshallian K theory, Super K theory (2/2013 *CJ*) and bond market interest rates providing a net-negative *real* return (interest paid less inflation)?

While I agree that most *companies* will continue to exist unless a true depression-type disaster strikes, potentially signaling the end of the US$ as the world reserve currency or perhaps even its end as the currency of the US, being replaced with a new currency. It may even be called a dollar, but it won't be the *same* dollar. If that happens, the US$ will have gone the way of all the fiat currencies in the history of mankind, short of those still in existence. Of those still in existence, the US$ is currently the oldest.

Regardless, while the *companies* will continue to exist, their *stock prices* will decline greatly as the forces that bid even slow growth, large-cap, dividend-paying companies to P/E levels above 20? 25? 30+? Do a bit of mental math: What happens to the stock price of a company whose P/E is 40 when their growth rate supports a P/E of 20 and the joy ride in this current market is over? The subsequent decline is a *real loss*; one that may not be recovered for years or decades.

Even though I've discussed it maybe too much recently, the distortions in the markets are destroying most, if not all technical analysis and (despite the fact that fundamental investors don't know it) fundamental analysis. (See the 8/2013 & 9/2013 *CJ's* for more discussion on this.) Given that, who is confident that they will know when to "get out" of the market before what is likely to be a frighteningly large and quick market decline?

Bonds, while generally less risky than stocks, aren't truly safe anymore. As interest rates back up, discount to maturity will drive bond valuations way down. Among other market forces, as losses mount from defaults, creditors will cause market interest rates to rise (to compensate for the higher risk), adding *capital losses* to often net-negative real returns on bonds. The economic implications of higher borrowing rates for businesses aren't pretty, either.

So, what? So, there you have it. The oldest *CJ* on TCM's website is from 2003, entitled "Even Keynes Wouldn't Approve." It seems there is simply NEVER a good time for the Fed to take back some of that money pumped into the money supply for the last emergency – or for the ones before that. Or to allow interest rates to rise to *market determined* levels. Keynes, among other failings, failed to factor in the *real* behavior of politicians wanting to be re-elected.

Purpose

The *CJ* Investment Newsletter deals with most of the spectrum of securities investing, including cash (money market funds), bonds, equities and derivatives. It will evaluate the overall investing environment and, from time to time, discuss the relative allocations (including avoidance) of these asset types, as well as strategies to implement them (individual stocks or bonds, CEF's, ETF's, open-end mutual funds, and derivatives). Essentially, it reflects what I'm actually doing with my clients.

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 consider important when investing may help you. I'd also love to hear any questions or comments you may have about my letter.

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 analyze the markets and economy, as well as 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 contact me for more information.