The CJ Investment Newsletter

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The Value of Money

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
?	**?**

- Two categories of economics
- Limits on economic "theories"
- How economic categories affect the government we have
- Some of Jefferson's thoughts

Two Categories of Economics

We will start with one of the few truly funny jokes about economics I've ever read. I have put it in the *CJ Newsletter* before, but it's been a while. Moreover, a good joke bears repeating, just not too often.

> A student named Michelle was taking a class taught by Milton Friedman at the University of Chicago. After a late night studying, she fell asleep in class.
>
> This sent Friedman into a little tizzy and he came over and pounded on her desk, demanding an answer to a question he just posed to the class. Michelle, now awake, said, "I'm sorry, Professor. I missed the question, but the answer is to increase the money supply."

(No matter the economic question, the answer is always the same? Huh.)

Actually, to keep this from being too boring, I'll pepper the "meat" of this article with

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other jokes from On the One Hand… The Economist's Joke Book, Jeff Thredgold, Thredgold Economic Associates, 2001. It was given to me by an old friend who thought I would appreciate the humor. Hmmmm

Much of processing information to make it useful involves classification based upon differences. Recently, I mentally began dividing economic schools and economists into two very broad categories:

- *Intrinsic*: These are economists and schools who believe that money is NOT just a medium of exchange. This thinking necessitates that money has intrinsic value; it either is *composed* of something of recognized value (basically *specie*) or, if paper, is *backed by and redeemable for* physical commodities that have tangible value, most generally gold and silver.
- *Medium*: To these economists, money is ONLY a means of exchange, having no intrinsic value, not backed by anything of tangible value. Its value is derived from the military, political and economic power of the issuing government. It is also usually *fiat* money, *i.e.* money issued by a government and *required to be the only medium of exchange* in the issuing government's economy.

In both cases, economic theorists attempt to understand and define the "rules" of human economic behavior, both individually and in groups, and to use those rules to predict likely future events and outcomes in the "real world."

Given the number of jokes about economists, you can decide for yourself what level of success they've had. In fact:

Q: Why do economists provide estimates of inflation to the nearest tenth of a percent?

A: To prove they have a sense of humor.

The difference pointed out above is actually striking. Since much of the answers derived from asking a question *depend upon the method in which the question is stated*, it seems clear that the Medium economists are looking at a much different world than the more traditional Intrinsic economists. Their world is thoroughly modern. At least in western societies, the first widespread issue of fiat money I know of was described in last month's *CJ Newsletter*: the story of John Law and France in the early 1700's. Certainly, for most of history, the predominant form of currency or money was specie.

Given what most of us understand as "human nature," which is, after all, what economists attempt to discover and use predictively, is it not likely that such differing points of view would result in different, if not violently different, laws of human behavior and predictive results? Further, what if the Medium economists do not compensate for those people who were taught the Intrinsic way of thinking, *i.e.* that money has value in and of itself and that it is not solely a medium of exchange? If large groups of people act as if a "dollar is a dollar," rather than understanding that the dollar itself is both valueless and a moving target with regards to the goods it can buy, does that not make any observations, theories and predictions *highly* suspect?

Time for another one:

Two economists were walking down the street when they noticed two men yelling across the street from their apartment windows. "Of course, they will never come to an agreement," stated the first economist.

"And why is that?" inquired her companion, continuing with, "Why, of course! Because they are arguing from different premises."

So many jokes. So much truth.

In fact, I'm not sure I've ever read where any economic school dealt with the potential dual or multiple approaches groups of people may have towards money. It seems to make looking for reliable laws of behavior from groups almost *prima facie* ludicrous.

It seems the leap to behavioral theories and laws outreaches the evidence presented in economics. Like psychology, as much as economists would like to consider their discipline science, it simply can't be considered such until we can understand human behavior in a much more scientific and predictive way.

That said, there is important work in the economics field. It took thousands of years for us to accumulate the level of knowledge we have in physics, chemistry and biology. Economics is a MUCH younger discipline. If economists can avoid the hubris of making sweeping conclusions that are unwarranted in the actual "real world," the foundational evidence can be accumulated until it can be dealt with in a truly scientific way. Until that time, we could refer to guidelines or trends instead of laws and theories.

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The Value of Money

The other big problem with both categories of economics, but especially the Medium category, is that it treats human beings as if they were Pavlov's dogs. "If we lower the interest rate, it will stimulate economic activity. If we increase government spending, it will increase economic activity." I see. NONE of us are smart enough to understand what is being done for what reason and understand that it may or may not be to our benefit to act in the expected fashion. Are we really just stimulus/response beings?

I'll never forget President Obama's remarks about his Stimulus program in early 2009. He said, (I'm paraphrasing) "People are criticizing it for being a spending program. That's what a stimulus program is." Pavlov's dogs again. Structure doesn't matter at all? What a misinformed and hubris-laden comment that is! As many with better understandings of how economics work predicted, his stimulus plan stimulated very little and ran up the debt almost another *trillion* US$. See the 2/2009 *CJ Newsletter* for a critique of the then ***proposed*** Stimulus plan and see whether the critique was correct or not. You can find a copy of it in the Newsletter Archive on www.trendcapitalmgmt.com.

That was a good letter. It talked about how government steals from us through inflation and why the structure of the Stimulus (it really WAS just a spending plan) wouldn't stimulate anything, but would accomplish other, less desirable things. Without teasing you any more, here are the last two paragraphs of that letter:

"To have 75% of the bill not be stimulative certainly stretches credulity in the government that says we "desperately need" to pass a stimulus bill. As discussed in previous *CJ's*, they desperately need to fix the economy they, themselves, are responsible for screwing up. Republican, Democrat, Clinton, Bush, Rubin, Paulson, Greenspan and Bernanke. This is truly bipartisan; a major bipartisan screw-up.

"Given the relative efficiency of capital use between the private versus the public sectors, perhaps executing the 21% that might work and suspending taxes assessed for the remaining $650 billion would actually be "change we can believe in" instead of just another leg of the inexorable march to socialism for the USSA – the United Socialist States of America. Elections have consequences. If this bill passes, we have only ourselves, collectively, to blame."

Why did I go through all that – besides the fact that it's all true? Because elections have consequences. If we keep voting the same way, we should expect what's being described here to become the American standard. Change starts with information, new thinking and a few committed individuals.

While we must recognize that our understanding of economics is limited and primitive, there are some principles that are just plain "common sense." The trouble is, many of us have turned our backs on our own common sense because we've been told those beliefs are wrong; that most economic academics (who live off those actually generating profits) know better.

If they know so much better, why are we so much worse off now than just a few years ago? Bernanke has been singing the same song Greenspan did since he got in office. ("Increase the Money Supply.") So, if it's so right and money is NOTHING but a medium of exchange, why isn't everything fixed? Bernanke essentially has unchecked power; the President has proved he doesn't understand economics (see above), so he defers to Bernanke, who is definitely a classic Medium economist.

Time for another joke:

> The First Law of Economics:
> For every economist, there exists an equal and opposite economist.
>
> The Second Law of Economics:
> They're both wrong.

The American Way

This country and the worldwide capitalism that made the modern world possible were built on the foundation of Intrinsic economics – hard money, sound money, real money. It may or may not be any more "right" than Medium economics, but it does have a few advantages Medium economics does not. Since money is tied (and redeemable in) tangible, measurable wealth:

a) the government has to collect honest taxes in order to spend, meaning they can be held accountable for taxes and spending in the next election.
b) because of a), deficit spending would be severely limited, if not eliminated altogether.
c) because of b). the government cannot steal the wealth of its citizens through inflation.
d) because of b) & c), government itself is limited.

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That last group of assertions sounds a lot like the America that became the envy of the world in the 1800's, despite still being run by flawed human beings. Medium economics gives the government too much power. Intrinsic economics limits government power. You make that choice every election.

Perhaps, because he's really famous and had an estimated IQ of around 200, give or take a few points, we should avail ourselves of some wisdom from one of America's greatest, Thomas Jefferson:

- When the people fear their government, there is tyranny; when the government fears the people, there is liberty. (Less government power = More liberty CBJV)
- I am not a friend to a very energetic government. It is always oppressive.
- The policy of the American government is to leave their citizens free, neither restraining nor aiding them in their pursuits. (Guess that one has changed. CBJV)
- In matters of style, swim with the current; In matters of principle, stand like a rock.
- Were we directed from Washington when to sow and when to reap, we should soon want bread.
- The democracy will cease to exist when you take away from those who are willing to work and give to those who would not.
- He who knows nothing is closer to the truth than he whose mind is filled with falsehoods and errors. (Did they have economists back then? CBJV)

Last joke:

If an economist and an IRS agent were both drowning and you could only save one of them…would you go to lunch or read the paper?

Action Plan Update/Market Assessment

We did take some action last month, purchasing a long position. Since my clients paid for TCM's management in making that purchase, I will withhold the nature of the purchase for a month or two. There are other long candidates that might be purchased, should the market continue as it has recently.

To the surprise of many, including me, the general markets continue rising, although the down days are somewhat stark and seem to want to lead to a larger decline. Still, the downward momentum seems to abate and the market has recovered every time so far, moving to all-time high territory, and staying near, but not at, that level. Until it breaks into new highs and retreats a little again. Odd behavior, at least to me.

The US$ is still the best house on a bad block, propping up both our economy and the US stock markets. Japan, in particular, has been printing money at an enormous rate in order to lower the yen's exchange rate compared to other major world currencies *and* to introduce inflation into their economy. Wow. Great idea and so original! Pavlov, did you hear a dog bark?

The stock markets, particularly in the US, continue to be bolstered by driving investors to "risk assets," creating a Marshallian "Super K" effect. These are described in the 2/2013 *CJ Newsletter*. As investors reach for yield not available in the bond markets due to the Fed's and other world central banks' interest rate policies, these effects continue to occur.

Still, after the amazing runs in the major indices this year, it would be reasonable to expect a correction with additional moves to the upside following it. Although many fine analysts keep predicting a correction, it hasn't seemed to materialize, yet. When it does, that always poses the question and fear of whether the correction is only a correction, and not the appearance of a new bear market.

Some specifics:

- ***DJI*** After its big decline the w/e 4/19/2013, the DJI has rallied to within striking distance of its all-time high. It nears an upper long-term band, which may put a "lid" on the move, although the cycles are neutral here.
- ***SPX*** The SPX is a bit more constructive, having broken into new high territory this week. It is knocking on the same upper long-term band the DJI is. Long-term cycles are neutral, with mid-term cycles somewhat negative.
- ***COMP*** Upper bands appear to be meeting at a point around the 3500 level, but that type of convergence is usually negative in the mid-term. Longest cycles are neutral, but mid-term cycles are somewhat negative.
- ***TRAN*** The trannies are weaker than their other major index brethren are recently, but they are not weak. They do have converging upper bands like the COMP, but not as severely. Cycles appear pretty neutral right now. One issue is that the trannies have NOT confirmed the DJI's move since mid-March.
- ***Gold*** After bottoming on 4/16/2013 at \$1321.50/oz., gold the metal has rallied to \$1466.10 at the close 5/2/2013. Gold is encountering resistance at the old 38.2% retracement level of around \$1485. Cycles look positive, so it could move up for a while.