The CJ Investment Newsletter
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The Crash Course

Quick Look

Market	**Next Expected Move**
?	

- We discuss the ideas and major points in Chris Martenson's The Crash Course.

First Things

This newsletter is about what I consider an almost transformational book: The Crash Course, Chris Martenson, 2011, John Wiley & Sons. (Referred to as *CC,* hereafter.) While my intention is to give an overall summary herein of the most important points in the book, I heartily recommend that you read the book yourself.

There are three main reasons I would recommend your reading this book even after reading this newsletter:

- The book covers massively important topics, especially involving the future.
- *CC* is written in easily understandable language any educated person could understand. You won't get overwhelmed by terminology or unexplained premises.
- No one will ever accuse Martenson of ***under***-researching any of the topics discussed in *CC*. Far from being grounded in theory alone, this book contains as much evidential support for its ideas and conclusions as any work I have ever read.

The only evidential "flaw" I saw in this book was because of the proliferation of fracking since 2010, when this book was finished and sent to the publisher. The widespread adoption of fracking has significantly changed worldwide levels of available and recoverable petroleum resources. While this may change the book's *timetable*, its essential truths have not changed.

Spoiler Alert: While The Crash Course is an amazing work, Part VII (the last part of the book) reveals Martenson's essential pessimism that world leaders will not realize their operative paradigms are wrong and will lead to a worldwide disaster. He also believes that, even if political leaders did start thinking with sounder understanding of economics, energy and the environment (the 3 E's), appropriate policies would still not be adopted either at all or in time to make a difference.

CC ends on a kind of survivalist note, much like Conquer the Crash, Robert Prechter, 2002, John Wiley & Sons. While something of a "downer," *I think it important not to dismiss either of these great works simply because you may not believe in an inevitable survivalist future.* I personally don't think we are in for such an apocalyptic fate, but the path we are on will need to change or certainly aspects of both of these books would seem to inevitably come to pass.

After all, actions or the lacks thereof do indeed have consequences. Effect *will* follow cause. However, books such as these provide both the evidential and theoretical understanding to warn us to change course, hopefully before the future becomes, to coin a phrase, "set in the stone age."

(Continued on page 2)

> "*Some see private enterprise as a predatory target to be shot, others as a cow to be milked, but few are those who see it as a sturdy horse pulling the wagon.*"
> \- Sir Winston Churchill

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(Continued from page 1)

In Part I, Martenson presents several short chapters describing the problems in the most general sense, along with tips on how to read and understand *CC*. In Chapter 4, and in a world where we rely on "experts" in government and the media to present us with both the facts and their opinions, Martenson tells us to trust ourselves and our own judgments, along with some good reasons why that it would be most prudent to evaluate the facts yourself, rather than believing in the "experts."

Parts II & III

From the investment, economic and political points of view, this is the "meat" of the book.

Part II lays the foundation for his Part III economic points. Chapters 5 and 6 deal with our growth mantra (mania?). Simply put, we seem to have elevated growth, and particularly *percentage* growth, to "must have" status. We have heard leaders talk about percentage growth as if it were an end in itself. Politicians and many economists (especially the ones *hired* by politicians) talk about percentage growth per annum as not simply a goal, but a necessity. Martenson takes a step back and examines the validity of this "necessity" and the consequences of our blindly seeking it for decades now on a worldwide basis.

To begin with, *percentage* growth is *exponential* growth, meaning that each year has accelerating growth. Here's an example, using 2% growth/year:

Year	Factor	Exp	Cum	Sum	Avg/Yr
1	1.02	1.02^{1}	102%	102%	102%
2	1.02	1.02^{2}	104%	206%	103%
3	1.02	1.02^{3}	106%	312%	104%
4	1.02	1.02^{4}	108%	420%	105%
5	1.02	1.02^{5}	110%	531%	106%
10	1.02	1.02^{10}	122%	1117%	112%
20	1.02	1.02^{20}	149%	2478%	124%

Notice how quickly the numbers compound. Instead of adding 40% (20 x 2%) over 20 years to your original amount, you add 2478% to it. 20 years after a 2% growth program is started, you are adding 149% per year (and increasing) to your original amount and *averaging* a *24% linear increase/year*, not 2%. As Martenson points out, we tend to think linearly, but percentage growth is not linear. It's exponential. Exponential movements have different characteristics than linear ones.

(Adapted from *CC*, p29-30) For example, assume you double the drop rate from an eyedropper every minute. One drop. After a minute, 2 drops. Another minute, 4 drops. And so on. The drops are happening in Arrowhead Stadium beginning at Noon and you are handcuffed to your chair on the top row of the stadium. How long before you'd better be out of those cuffs to avoid drowning? Do a quick estimate of the time before reading the answer below. At 12:50 PM, just 50 minutes later, you would drown if not out of the cuffs and Arrowhead.

Another question that lends perspective to this process: At what time would the stadium still be 97% empty space? Answer: 12:45 PM, 5 minutes earlier than when you would drown if not out of those cuffs. Essentially, by the time you noticed there was any water in the stadium and that it might represent a danger to you, you were 5 minutes from drowning! Exponential moves do NOT behave like linear ones.

Chapter 6 deals with exponential growth as applied to an economy. Early in the Chapter 6 is a quote (*CC*, p35): *"Anybody who believes exponential growth can go on forever in a finite world is either a madman or an economist."* – Kenneth Boulding (1910-1993) Yet, it's almost an accepted truism that the answer to all economic (and political) problems is growth.

In what I think is one of Martenson's more brilliant observations, he writes, "Unless we are careful, we might accidentally pursue growth when what we are really after is prosperity." (*CC*, p35) As seen above, exponential growth simply can't go on indefinitely. The limitations of the container (Earth) alone make this undeniably true. Huge as it is, the Earth is still finite. Yet, in America and other developed countries, the concept of percentage growth is widely accepted as necessary to maintain modern life.

(Continued on page 3)

Recommended Reading

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Bubbles, Bubbles Everywhere by John Mauldin was his 11/2/2013 weekly column with the continuing title of *Thoughts from the Frontline*. This latest article borrows heavily from Chapter 9 of his new book, Code Red. In the article, he and co-author Jonathan Tepper discuss the root causes, anatomy, Marshallian K theory, and other aspects of financial market bubbles to see if we are, in fact, in a bubble. If we are, where in the bubble cycle we are, and what appropriate actions might be.

(Continued from page 2)
But, are we really seeking growth? Or, are we seeking *prosperity*? It would seem obvious that our real desire is the latter. Prosperity is dependent not on growth, but upon creating a surplus. Effectively, surplus in this sense is partly excess production (saving) and partly profits. If large enough, the surplus can be used to create *both* growth and prosperity. But, what if it's not large enough? Then, growth *or* prosperity becomes the choice. Of course, if there is no surplus or the economy incurs a "loss," neither will happen.

From Martenson: "If growth in structures and population could bring prosperity, then Quito, Ecuador and Calcutta, India, would be among the most prosperous places on Earth. But they're not. If growth in a nation's money supply brought prosperity, then Zimbabwe would have been the wealthiest country on the planet in 2010. But clearly it wasn't. Growth alone does not bring prosperity, and, worse, growth can steal from prosperity if there aren't enough resources to support both." (*CC*, p38)

Chapters 7, 8 and 9 deal with our monetary systems and how they relate to economies, including economic growth and prosperity.

Chapter 7 reviews money in general and, eventually, US money and the Fed. We have discussed what constitutes money before in the *CJ*, but it never hurts to review such vital concepts. Early in the chapter, Martenson makes this assertion, which I found to be a BFO (Blinding Flash of the Obvious). However, it still needs to be included here because of its importance. "Money is essential, especially to complex societies. Without money, the rich tapestry of job specializations enjoyed today would not exist, because barter is too cumbersome and constraining to support a lot of complexity." (*CC*, p41)

He then goes to lay out the essential characteristics of any kind of money:

- Money must be a store of value
- Money must be an accepted medium of exchange
- Money needs to be a unit of account; any unit of money must be of the same value of any other comparable unit.

According to Martenson, once money meets these criteria, it can then be truly defined as a *claim on wealth*.

As many of you know, I believe that the *best* money is incorruptible and therefore would be *specie*. Therefore, I believe that money best fulfills its "store of value" criterion by *having its own intrinsic value*. In a world where most transactions are digital and cash is less needed for the transportability it provides, the portability problems originally solved by paper money are much less daunting. Martenson's definition is probably more accurate in the way money interacts with the economy, especially since paper (fiat) money became widely accepted worldwide.

But, Martenson's definition of money, while accurate, allows politicians and leaders to manipulate the quantity, and therefore, the value per unit, of their issued fiat money. As I have discussed at length over the years in the *CJ* and as Martenson discusses exhaustively in *CC*, numerous problems go along with the manipulation of the value of fiat money. In fact, Martenson says, "It is therefore vitally important that a nation's money supply be well-managed (particularly if it is fiat money), because if it's not carefully administered, the monetary unit can be rapidly destroyed by inflation." (*CC*, p43)

Martenson devotes space to fiat money creation, including how the US Fed creates money. He also explains why the method used by the Fed creates its own form of exponential growth in debt, which further reduces the stability of the system as this process proceeds through time. This process can be exacerbated by government deficit spending enabled by the Fed even at lower levels, let alone the 30%+/year of deficit spending used in recent years!

Additionally, politicians are notoriously "near sighted." Rarely can they see beyond their own agendas and certainly not beyond the next election. As a side note, we seem to be particularly rich in such politicians these days, those who are more than willing to trade government-paid benefits for votes. It's been generally attributed to Alexis de Tocqueville for saying, "*A democracy will last only until the voters discover they can vote themselves largess from the public treasury*."

Chapter 8 deals with the difference between problems and predicaments. From CC, p53: "…Problems have solutions; predicaments have outcomes. A solution to a problem fixes it… A predicament, by contrast, has no solution. Faced with a predicament, people can develop responses, but not solutions."

Chapter 9 discusses what wealth actually is. There are three levels of wealth:

- *Primary wealth* is comes from the Earth itself. Examples include rich soil, ores, oil, fresh water and edible wild animals.

(Continued on Page 4)

(Continued from Page 3)

- *Secondary wealth* is the end product of production operating on primary wealth. Farm crops, metals, gasoline, and processed meats are examples.
- *Tertiary wealth* is financial abstractions applied to the first two forms of wealth. Tertiary wealth is a *claim* on sources of wealth, not a source of the wealth itself.

In Part III, Martenson builds on the concepts described in Part II, and describes how manipulations of money, debt and the rest of the financial system as constructed have led us to where we are today.

Chapter 10 deals with debt and the problems we have created with it. He also distinguishes between debt and liabilities, an important distinction:

- Debt is a legally binding contract to repay a specific amount along with interest incurred for the borrowing period.
- Liabilities are future obligations, but are often currently immeasurable and, therefore, not legally binding because of this uncertainty.

The primary troubles we have created deal with the exponentially created debt load, which does have to be paid or defaulted upon. He, like many others, does not believe the nominal existing US debt can be paid off without massive inflation making the "repayment" considerably less valuable than the value of the original debt incurred.

Chapters 11 and 12 deal with the creation of the US credit bubble, along with why our government continues to use monetary expansion to deal with its debt and liabilities. Chapter 13 was dealt with at length in last month's *CJ*, documenting and demonstrating how government statistics have been manipulated. Chapter 14 ties Parts II and III together before proceeding to the remainder of the book.

Parts IV, V and VI

Part IV deals with energy and the economy, and especially the use of oil as an energy resource with a perspective which I have never seen before. Martenson's premise is well developed, supported and may be dead right. Without my going into why here, Martenson attributes the enormous energy stored in petroleum as being the driving force allowing the exponential growth of virtually everything human since the industrial revolution, including population. Generally, we expend much less energy acquiring oil resources that the energy provided, even now. Due to peak oil and no viable energy replacements, he sees this coming to an end very soon. (See the paragraph on p1 regarding his not considering fracking in this.)

Part V deals with human activity stripping the Earth of precious resources such as minerals, soil, water and fish. As we continue to use these resources up, it will put a clear damper on future society. The case is frighteningly real and a clear result of our overpopulating the Earth with people.

In Part VI, he ties the 3 E's (above, p1) nicely, showing the interplay and interdependence of the individual E's. In Chapter 25, he even lays out three different scenarios as to how the convergence of the concepts presented could play out. All seem reasonable, but none fails to exact a high cost for our lack of understanding, concern and planning for the final end to consuming finite resources at exponential rates. I hope science comes up with the miracles necessary to prevent his scenarios from playing out. Given what I've seen of global and US politicians, I really doubt our "leaders" act like adults and actually deal with any of these problems. Now, THAT would be a miracle, indeed!

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.