The CJ Investment Newsletter

Callom B. Jones, V Investment Adviser Representative

Chart Review

Quick Look

Market	**Next Expected Move**
?	

	Month	**YTD**
DJI	0.75%	0.03%
COMP	-2.01%	-1.49%
SPX	0.62%	1.93%
Gold	0.94%	7.81%

- We look at charts for short- to intermediate-term market guidance.
- Estate Tax Issues

You can blame me mostly for the delay in getting out this month's newsletter, but Microsoft will have to take the hit for one day of the delay. Trust me, unless you're really ***good*** with MS Office, trying to import a jpeg or pdf file into a Word document is a real exercise in frustration and patience.

Reporting or Opining?

First, notice how inconsistent the month and YTD results for the indices and gold are in the table above. Year-to-date, the DJI is basically flat, the COMP is down 1.5%, the SPX is up almost 2%. Finally, gold is up 7.8%.

If you listen to CNBC or some other news outlets, you would think YTD stock results would be considerably better.

Gold, which has outperformed all three averages by a lot YTD, is rarely discussed. When it is, it is generally portrayed in a negative light – at least in my observations.

When an analyst does portray gold in a positive fashion, he/she is almost always labelled as a "gold bug," *i.e.* someone who is unreasonably positive on gold, regardless of whether it is a good time to buy/own gold or not. When analysts are consistently optimistic about securities prospects, he/she is rarely labelled a "permanent bull," yet analysts that are currently bearish are often labelled permanent *bears*.

The point? There are clearly parties that have vested interests in stocks and bonds appreciating. Governments and advertisers come to mind immediately. Because of these vested interests, perhaps the reporting is less even handed than it should be. Like much other "journalistic reporting," the viewer needs to be aware that what they see, hear and read may not be an accurate portrayal of reality, either because of the innate optimism of the reporter or, perhaps, for darker and more vested reasons.

How can someone get past the opinions to historical facts and form his/her OWN opinion?

Charts: Factual, Historical Information

Charts begin with very basic historical information: date, time, prices (open, high, low, close) and volume. All chart analysis I know of is mathematically derived from this base historical information.

I believe charting (aka Technical Analysis or TA) can provide valuable insights into what could happen to a security or an index, notwithstanding direct manipulation by a powerful party or serendipity itself.

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Trend Capital Management, LLC

9717 W 121 Terrace ▪ Overland Park, KS 66213 ▪ O (913) 897-7576 ▪ C (913) 568-9916

e ▪ www.trendcapitalmgmt.com

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I probably have the greatest confidence in *my* charts in what I call the *speculative* time frame – from 6 to 24 months out. More on this later.

I perform fundamental analysis in order to help assure that an individual security, industry or index is healthy and profitable or if there are underlying signs of trouble evident. Perhaps the best way to sum up how I approach things is that I use fundamental analysis to determine *what* I'm interested in at a point in time. I use TA to determine the *timing* of entry and exit points; that is, to attempt to minimize risk and maximize return through entering in less risky periods and selling when it appears a substantial profitable move is near an end.

Please look at page 3 for simplified, but actual, charts that I constructed and use to attempt to determine the future direction of securities movements.

My charts were designed to allow someone using them to see the presence of risk or opportunity without the reader needing to understand the theory and math underlying the chart itself. When well constructed, the chart will "take your eyes" to areas of risk and opportunity, as well as providing some guidance as to which of those two is more prevalent now.

It's important to understand that the *historic price movements reflect the actions of a quasi-finite group of investors* in the security or index being analyzed. The group is quasi-finite in that there are essentially two subsets of investors:

- Investors who will own the security long-term, i.e. for longer than two years.
- Investors who move in and out of the stock, sometimes once, sometimes repeatedly.

The first group rarely impacts shorter-term movements, that is trading (<6 months) and speculation (6 months to 2 years). The second group impacts shorter movements, but rarely affects movements in the investing (>2 years) time frame.

Also implicit in my charting is the concept that these investors act in a *periodic* fashion. There are rhythms to all earthly life, including human behavior, both individually and in groups. *Especially* in groups. My understanding is that group behavior in people is considerably easier to observe, measure and predict than individual behavior.

Please look at the DJI chart. Notice that there are a series of nested bands surrounding the price action. The bands are color matched to a set of arcs (cycles), which match the length of the moving averages that create the bands. The principle is fairly simple:

Recommended Reading

- The Law, Frederic Bastiat
- That Which is Seen and That Which is Not Seen, Frederic Bastiat (Part of The Bastiat Collection)

Bastiat was a French Economist and Pamphleteer who lived from 1801 until his untimely death in 1850. None of his works is exceptionally long, but that doesn't diminish their importance.

I am unaware of any *major* new theoretical contributions Bastiat made to economic or political theory. His contribution consisted of something perhaps even more important: he was able to make economic theory not only understandable, but also convincing, to non-economists. As Mark Thornton wrote in his introduction to The Bastiat Collection, "This collection represents some of the best economics ever written. He was the first, and one of the very few, to be able to convincingly communicate the basic propositions of economics." Writers are hard-pressed to communicate ideas they don't thoroughly understand to those who know little to nothing about them. Of the economics writers I'm aware of, only Henry Hazlitt, an Austrian economist was able to express economic ideas so clearly to those of us not ourselves professional economists.

Bastiat himself predates both Keynesian and Austrian economics. Austrian economics arose with Carl Menger in the late 1800's. Keynes's established his place in history forever with The General Theory….., published first in 1936.

If you want to understand economics on a basic, but practical level, there is no better place I know of than to read these two books. Both are included in The Bastiat Collection, but are also available individually. Best of all, the copyrights on these books expired long ago. So, with a little patience, you can download them to your PC or Tablet for ***NO COST***. You simply need to be patient until you can find the free version of Bastiat's works. It might be best to begin at www.Mises.org, but you can find them with some patience through the app stores for tablets and phones.

If a band contains substantially all of the price action and the moving average (cycle) is the correct length, the cycles should match up with the price action ***within*** *the band, allowing for predictable bottoms and tops*. If the cycles don't substantially match the price action within its band, the relationship is invalid and
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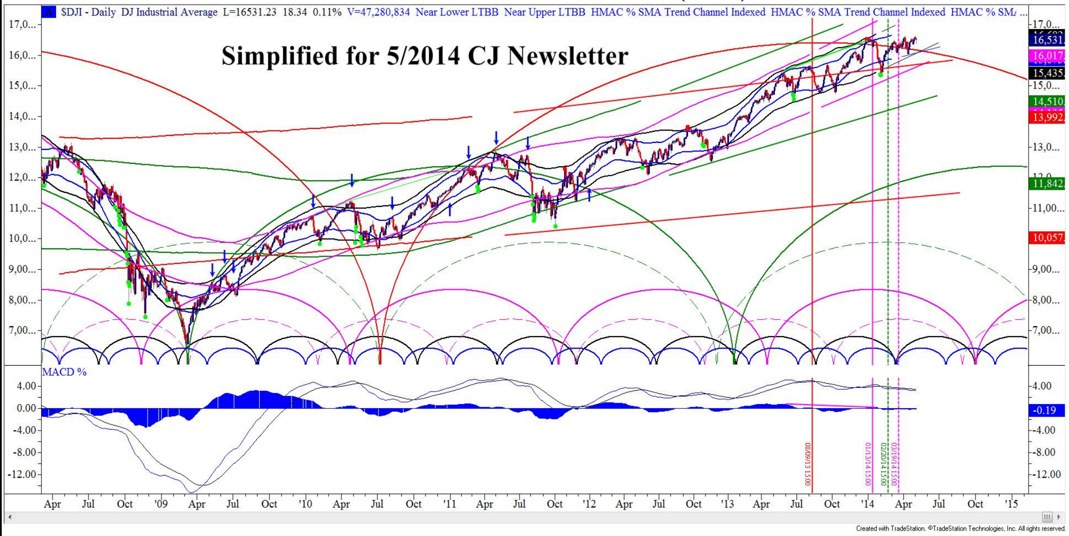
Dow Jones Industrials (DJI)



Nasdaq Composite (COMP)

with smaller deviations (thinner bands) from the moving average. While I haven't tried to *prove* these assumptions, time and much analysis have not provided any contradictory evidence that these assumptions and postulations are inaccurate. Please note that stock and index cyclic movements do not factor in large, unrepeated events such as a sudden major disaster or war.

Continuing with our review of the DJI, note that the top of the widest (red) band is substantially below the actual index values, and has been so since about the middle of 2013.

I placed color matched vertical lines to mark the points where 4 of the longest arcs/bands looked to have topped. Notice that 4 of the 5 longest cycles have topped and are declining, indicating activity from *these cycles* would make prices decline.

the cycle and/or bandwidth (deviation from the moving average) should be altered until they *do* match up. This can be seen visually, and is why my charts are "part science, part art." If you look at the charts, they should look "clean" and aesthetic to your eye. If the chart is not put together properly, it will appear almost as if the "pieces don't fit."

There are a series of nested bands in the charts for a couple of reasons:

- There are many rhythmic periods/cycles at play simultaneously in human behavior.
- The expressions of these simultaneous rhythms interact mathematically to create the complex price movements of the security or index being studied.

Additionally, I postulated that shorter cycles would have less impact upon the prices over time than longer cycles – expressed as shorter arcs being matched

Experience with this system has shown that, when narrower bands have progressively increasing slopes that "break through" longer bands, a top is generally forming.

Turning to the COMP, notice that the beginnings of a massive top appear to have already begun. Three of the 4 longest cycles have already peaked and should be declining within their bands for quite some time to come. Combined with the DJI chart, I think this indicates a significant decline will be expressed soon.

Perhaps more importantly, what do these charts "say" to you? Do seeing cycles expressed through boundaries (bands) change the way you see the prospects for these indices? The natural tendency when seeing "unguided" charts is to simply extrapolate the direction of the previous movement. But, life and

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investing don't act that way, no matter how optimistic you are.

I believe well-constructed charts can and should provide an unbiased and accurate view of what may happen to traded securities and indices without all the hype and agenda present in journalistic presentations. I can't imagine trying to invest without using them.

Estate Issues

Prior to my father passing away, like many people, he tried to make the wrapping up of his affairs as simple and tax efficient as possible. Unfortunately for him and his heirs, he got some VERY bad advice from his lawyer. I hope to save you the headaches inherent with structuring things as this lawyer did.

When a person (participant) dies with an IRA, the named beneficiaries can effect transfers of all or part of the original IRA trust corpus into new, Inherited IRA's for which they are the participants. These transfers do not trigger taxable events, although there are some special distribution requirements in future years for Inherited IRA's.

If a person also has a living trust, and that trust is the designated beneficiary of the IRA upon his/her death, the trust becomes the participant of the new, Inherited IRA. *There is now no legal path to transfer further the new IRA assets to Inherited IRA's for the intended beneficiaries without creating taxable distributions from the trust's Inherited IRA*. Still, this strategy may be useful given certain objectives.

The laws and regs are clear regarding what happens when a posthumous trust is made the new Inherited IRA participant. One of two things must happen:

- If the entire corpus of the trust's Inherited IRA is passed to the inheritors currently, the entire transaction is considered a *disbursement* and the entire transaction becomes taxable in the current tax year. In the case of a large IRA corpus, this means tax is assessed at the marginal rate applied after each inheritor's IRA disbursement is added to each inheritor's AGI for that year. Depending on the circumstances, that could tax all or part of the IRA proceeds as high as 39.6%. In other words, 40% of the IRA would be eaten up by taxes.
- The other option is to allow the trust to take annual IRA distributions based upon the life expectancy of the oldest inheritor, which are then passed on and taxed to the inheritors. This means the trust will continue to exist long after it was intended to terminate by the deceased. Further, the inheritors may or may not have control over how what is essentially their money will be invested. That is the responsibility of the trustee of the trust.

There was a PLR (private letter ruling) from the IRS back in the early 2000's that permitted a tax-free transfer to inherited IRA's of the heirs from a qualified company retirement plan trust through a decedent's living trust. The catch? *A PLR is only a safe haven for the people for whom the PLR was written*. It does not create new regulations or law. The law is still as described above. The IRS is under no obligation to treat other parties in the manner decided in the PLR under similar or even identical circumstances.

If your intent is to fund beneficiaries' inherited IRA's without triggering taxable distributions, make sure your tax deferred investment vehicles like company plans, IRA's, etc. have ***people*** listed as beneficiaries and keep your beneficiary lists current.

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.