The CJ Investment Newsletter

Callom B. Jones, V Investment Adviser Representative

September, 2016 225th Month, Our 19th Year

Wrongheadedness

Quick Look

Market	**Next Expected Move**
?	

August 2016 Results:

	Month	**YTD**
DJI	**<0.17%>**	5.60%
COMP	0.99%	4.11%
SPX	**<0.12%>**	6.21%
Gold	**<3.40%>**	23.65%

- The major averages were relatively flat for the August. By 9/14/2016, the indices were down from 0.7%-2.1% after an initial jump to new highs.
- YTD gains for gold and silver still far outstrip the major averages.
- Recent market volatility reflects the uncertainty related to the US election and other world concerns.

Election Year Note

Please note that the uses of "she" or "her" in this letter are not direct references to Ms. Clinton, Democrat candidate for the US presidency. Since the universal pronoun "he" is no longer politically correct, we often adopt the more palatable "she" or "her." Perhaps the PC police should work on creating a sexless pronoun that can indicate a human being, or lobby to make "it" a pronoun acceptable to designate a person. Actions have consequences. This awkward grammatical hole is one.

Dr. Stiglitz

Sometime around the beginning of September, CNBC had an article and video seeking the opinion of the famous economist Joseph Stiglitz, professor of economics at Columbia University. Stiglitz has won a Nobel prize in economics, as well as serving on President Clinton's council of economic advisors. He has many other honors as well. The man definitely "has his chops," at least in the world of economics. Based upon Wikipedia's biography, though, we can conclude he is primarily, if not completely, an academic.

Before going any further, this article may be more meaningful if you can open up this short video: http://video.cnbc.com/gallery/?video=3000547715. Here, Stiglitz is commenting upon the recent tax controversy regarding Apple and the EU.

Frankly, what Professor Stiglitz said was stunning and, to us, surprisingly simple minded, as well as just plain wrong in some aspects. His most egregious comment was this: "The first element of corporate responsibility is the responsibility to pay their taxes." Seriously? The ***first*** element of corporate responsibility? We will expand on this below. The professor's communication skills and his thinking are flawed in other areas, too.

Avoidance or Evasion?

You may notice in the video that the Professor uses the terms tax avoidance and tax evasion virtually interchangeably. This does not enhance his credibility at all, since these terms definitely do NOT have the same meaning.

Tax *avoidance* is the *legal* use of aspects of the relevant tax code to minimize the tax burden to the

(Continued on page 2)

Your vote matters. You can make your life better or worse with it. Use it wisely. An uninformed vote can be worse than no vote at all.

Trend Capital Management, LLC

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

e ▪ www.trendcapitalmgmt.com

(Continued from page 1)
company. This is not only good stewardship by the accountants at the company; it's an *obligation* to protect and preserve company assets, as they belong to the company, and therefore, its shareholders.

Tax *evasion* is a *crime* for which relevant parties can be fined, penalized and, if egregious enough, imprisoned. Essentially, tax evasion is simply not paying the taxes that should be assessed upon the taxpayer under the relevant law. The evasion is NOT based upon any aspect of the law itself; the taxpayer simply falsifies information reported to the taxing authority in order to lower the tax payment to that authority *illegally*.

Professor Stiglitz's use of these terms interchangeably would certainly seem to highlight that, in fact, *he does not know* the difference between two commonly used and familiar terms. In fact, at one point in the interview, he says, "… an attempt at tax evasion, tax avoidance, whatever you want to call it…" No, Professor. *Most definitely not.* Maybe, just maybe, the professor's knowledge of global tax law is not the equal of his knowledge of New Keynesian economics.

Therefore, a perhaps impertinent question presents itself: If the Professor doesn't know something as common as the difference between tax evasion and tax avoidance, why is he opining on an issue as complex as tax nexus for a global company like Apple that operates in multiple global tax jurisdictions?

The Tax Inversion Problem

As we have discussed in the past, if you use the power of the purse to pursue political power by promising benefits to those who vote for you, your government will need to collect more taxes in order to pay for them. This increases the burden upon those who *do* pay taxes beyond the benefits they receive from their government, an unpopular and arguably unfair burden.

As we have also shown in the past, *any* taxation of companies becomes product costs passed through to consumers, raising the costs of goods they purchase. This is a regressive tax that hurts poorer citizens more than wealthier ones. In other words, the government is taxing us in secret. If consumers knew how much of their costs were passed-through taxes, they would be shocked, then angry. As they should be.

One law of economics is: *Capital flows to where it provides the best return*. We're sure that Professor Stiglitz and other Keynesian based thinkers would deny that this assertion is true, along with Say's Law and many other non-Keynesian economic laws. Nevertheless, denial doesn't disprove. Common sense and actual behavior would demonstrate that people invest their money in the places they believe they can get their best risk adjusted returns.

As discussed above, it is an obligation of company officers to protect and preserve company assets, including income. Income is not an asset *per se*, but the profits collected from earned income become assets, and would therefore be subject to the obligation to be protected and preserved. Net income, therefore, should also be protected, including minimizing *all* the tax burdens paid by the company.

We realize the seeming contradiction between declaring that business taxes are product costs that are passed through to consumers and the obligation of company personnel to minimize tax burden to a company. (Revenue + taxes) – (costs + same taxes) = revenue – costs = net income, right? So, what difference would it make? The answer is that it does make a big difference to many groups for many reasons, not the least of which are competitive pricing and market position for the company, the general price burden on consumers, and ratio analysis for investors attempting to find superior returns. Doesn't that bring us back to the law that ***capital flows to its best return***?

At this point, the concept of tax ***nexus*** needs to be introduced. Simply stated, a nexus is a point of attachment to a particular jurisdiction that allows the government of that jurisdiction to legally tax assets or income within that jurisdiction. As you may imagine, this is an incredibly complex maze of laws, as not all jurisdictions define nexus in the same way. The stakes involved are generally large enough for governments to fight companies over the ability to tax assets or income within their jurisdictions.

Perhaps the classic example of this involves the application of nexus to sales and use taxes, particularly with the emergence of the internet as a widespread forum from which consumers purchase goods and have them shipped directly to them. Is the nexus at the consumer's location? The shipping location? The company's home office?

This has been an issue between states in the US for decades, as taxes in some states are decidedly higher than in others. If other conditions were met, companies would sometimes relocate across state lines or even across the country. High tax states would find their tax bases reduced or depleted by companies
(Continued on page 3)

(Continued from page 2)
exiting their states for lower tax states. People, especially retirees, will sometimes move to other states in order to avoid things like state income taxes, provided other important considerations are met.

That is tax inversion, although the term itself is more recent than the phenomenon. It has become such a large issue recently because US business income taxation is among the highest and most burdensome in the world. Additionally, the US also has a ridiculous policy that income made (and taxed) in other countries is subject to *additional* income taxation once assets attached to that income become repatriated within the US! Is it any wonder that companies would consider all kinds of machinations to avoid having to pay such incredibly burdensome taxation? It's ridiculous when government personnel talk about "fair share."

Put these principles together and the reason for the tax inversion "problem" becomes clear. Companies look for ways to minimize their tax burden in order to enhance their results and keep taxes from hurting their competitive position in the marketplace. Since taxes are not applied equally to all companies in all locations, it can be beneficial to companies, shareholders and consumers for a company to change some or all of its locations in order to minimize its tax burdens.

Companies found themselves in the position that moving to other countries and/or establishing their "home" residence there would drastically reduce their income tax burden and perhaps other tax burdens as well. If the costs of moving to another country and other company critical conditions are met, why would a company NOT move to another country and establish "residence" there? Haven't we established it is their *obligation* to their shareholders and customers?

This issue is not at all simple, though. In some cases, a company will establish a home office in a country and the remainder of its operations would be unchanged. That calls into question the legitimacy of whether the company has actually made a real change of location or if its new address and "home" country is a sham.

What is the US response to this problem? Certainly *NOT* to make competitive and fair changes to US tax law. No, instead we *demonize the companies* publicly for following their obligations to shareholders and consumers, before ever getting a determination from a lawful court. Guess the government realizes they gave away far too many benefits to secure those votes. Now, they are attempting desperately and unethically to hold on to a taxpayer base to pay for those obligations they undertook.

Enlisting the help of enablers like Professor Stiglitz to demonize companies performing their rightful job of tax *avoidance* will not improve people's lives, except perhaps the Professor and some misinformed and/or corrupt socialist government officials. Recall your Orwell: *Everyone is equal, but some are more equal than others*.

Wrongheadedness

Let's revisit Professor Stiglitz's incredible remark regarding the taxation of businesses. Paying their taxes is the ***first*** element of corporate responsibility? We sure hope not. Before you try to suggest that it was a slip of the tongue, a gaffe, remember that you were listening to a Nobel Laureate, indicating a man of high intellect, accomplishment and ideas. No. *He believes what he says*, and we will at least touch on what that means shortly.

Let's examine what his statement means just on the face of it. Effectively, *it means the payment of taxes is the single highest priority of a company*. While we don't deny that a company should pay taxes to pay for the support provided by the various governments in which jurisdictions they reside, paying their taxes are anything ***but*** their highest priority.

Such comments betray Professor Stiglitz as a socialist and a believer in government micromanagement of an economy. Clearly, he is not a believer in laissez-faire economy. However, going all the way back to Adam Smith, a company participating in a competitive, free market economy would have to do the following to survive, thrive and grow:

- Provide a product or service that *meets an unmet need*, or if the need is being met, meet that need better than their competition. In this case, better would mean more effectively and/or cheaper.
- The provider would need to meet the need and still make a *profit*. If a business cannot make a profit, it cannot survive to continue to meet its need or grow to meet the same needs of more consumers.

The US was founded to allow for freedom by individuals to pursue their own version of life, liberty and the pursuit of happiness (originally property). Clearly, top-down micromanagement of an economy does not allow for the original vision of America to exist. There is a cost for this change.

(Continued on Page 4)

(Continued from Page 3)
Further, in a capitalistic economy, there are three major players:

- **Savers** (capitalists) are people who consume less than they earn and save the difference that provide the capital.
- **Entrepreneurs** (and existing companies) who provide the goods and services that meet consumer needs at a profit.
- **Bankers,** which loan the capital needed by the entrepreneurs at a cost (interest) which has in turn been entrusted to them by the savers for which the savers earn interest.

Did you notice the *absence* of government in the list? Perhaps that's because they are *not* primary players. The proper role of government concerning business in a capitalistic economy is to protect the property of businesses from unlawful theft and damage, to allow for free, uncoerced economic transactions and, to some degree, to protect the public from harmful or worthless products. In other words, *governments should function as referees, not players.*

The relatively unfettered business environment that existed in America's past allowed individuals with ideas to create new products, new technologies and the most vibrant economy in the history of the world. Even the poorest people in modern America eat better, are healthier and have access to things unimagined by royalty as little as 70-80 years ago. Still, the politics of the last 60-70 years seems to be set upon taking control of the business world. Governmental control of the means of production has a name: *socialism*.

The freedom of individuals to act personally to improve their economic conditions provides a massive, real life laboratory for experimentation to find the best available means of meeting individual and societal needs. Top-down control of economies has repeatedly failed to create what the American economic system has. The next time socialism works will be the *first* time.

As we've discussed in previous *CJ Newsletters,* the US government immediately glommed onto the permission to intervene in the economy given by Lord Keynes's *General Theory* in 1937. They insured they would be able to keep that permission by "adopting" Keynesianism and making sure it was taught almost exclusively in any colleges, schools or school districts receiving federal education funds. Nowadays, Keynesianism IS "economics" to even educated people, as they have not been exposed to other economic schools in their "education." What has happened as a result of this?

Professor Stiglitz's responses on CNBC are egregious examples of why our economy has not really recovered from the crash of 2007-9. The massive overregulation of all aspects of American business since early 2009, coupled with the Fed's ZIRP, has crippled our economy's ability to heal and grow. This has been discussed for years in prior *CJ's*.

The wrongheadedness of our march towards socialism, our crippling of American businesses and economy, our removal of incentives to save and therefore provide future growth capital are all "coming home to roost." More of the same - miseducation, propaganda and increased governmental control - will not make things better. Our governments are *supposed* to report to us. We can find keys to a better future in *some* of the policies of the past. However, will we, as a society, recognize our wrongheadedness and exercise our rightful control over government to restore the conditions that will allow us to improve the future?

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.