The CJ Investment Newsletter

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March, 2017 *231st Month, Our 20th Year*

The Trump Card

Quick Look

Market	**Next Expected Move**
?	

December 2016 Results:

	Month	**YTD**
DJI	3.33%	13.42%
COMP	1.12%	7.50%
SPX	1.82%	9.54%
Gold	**<1.64%>**	8.87%

February 2017 Results:

	Month	**YTD**
DJI	4.77%	5.31%
COMP	3.75%	8.22%
SPX	3.72%	5.57%
Gold	3.51%	8.62%

- Following President Trump's election, not only did the DJI reach the coveted 20,000 mark, it continued rising to break the 21,000 level.
- So far, this recent rally appears to be based upon the hopes of tax cuts and reduced regulation promised by the new Trump administration. The markets were already "fully valued" prior to this new rally. What happens if the government's actions fail to meet market expectations?
- Even after a terrible 4th quarter, Gold finished 2016 up 8.87%, about halfway between the returns of the COMP and the SPX.
- As of the end of February, Gold has outperformed even the best of the major indices year-to-date.

Special Comment

TCM has clients of different political persuasions. We respect and honor your right to believe what you wish about pretty much anything. That's one of the meanings of freedom. However, this letter discusses issues concerning investing and economics, often inseparable from politics. Our opinions are based upon thousands of hours of study and research, and a lifetime of experience in business finance and as an investment advisor. Our honest appraisals of what happens as a result of policy changes because of the election results in the US from November are just that – honest appraisals. We will be wrong on some of them, no doubt, but we think we will be right quite often, too.

Our point: The opinions we express here are not intended to try to change our clients' political opinions. Economic and investment opinions, perhaps, but we will back up those assertions with sound theory and data when we present them.

A Ray of Sunshine?

"Little darling, it's been a long cold lonely winter.
Little darling, it feels like years since it's been here.
Here comes the sun.
Here comes the sun, and I say
It's all right."

\- George Harrison

The election of President Trump could mean a variety of very good things, both economically and for investing. It will certainly not all be positive; that almost never happens.

(Continued on page 2)

"A government big enough to give you everything you want is big enough to take everything you have."

\- Thomas Jefferson

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(Continued from page 1)
However, if you think that taxation is oppressively high and that American business is overly hamstrung and is discouraged by overregulation, the future for American business and its citizens' personal wealth looks brighter for the first time in almost a decade – maybe in 15 years. The rub? There are several.

Campaign Promises

"So, i*f we lie to the government, it's a felony. But, if they lie to us, that's politics*."

\- Credited to Bill Murray

Despite the media's and Democrat party's fixation on many of Candidate Trump's – albeit ill advised – comments, the messages the new President was elected upon were primarily these:

- Decrease overly burdensome taxation in order to promote business and capital growth.
- Decrease vastly overly burdensome regulations that are hamstringing our businesses, overtly discouraging growth and risk taking.
- Fair trade with other countries.
- National security, especially taking action that will improve our security from internal and external threats.
- Reduce the size and intrusiveness of a national government that is actively involved in the personal lives of all citizens, even law-abiding ones. Both the expense and intrusiveness of our federal government mock the lives of the founders and brave colonists that created this country to be better than that.

Instead of playing "gotcha" politics, let's examine the core themes above to consider how they would change America, provided President Trump is a man of his word and actually able to deliver on his campaign promises. So far, it appears he fully intends to be a man of his word and he continues to fulfill those promises despite enormous opposition from the press, the Democrats and protesters.

Taxation:
The idea of lowering overly burdensome tax rates is a sound one. In general and with limits, the more taxes are lowered, the better. As discussed in past *CJ's*, while government is necessary, it's use of confiscated capital through taxation is not productive *in an economic sense*, except in perhaps some esoteric manners. Therefore, if the government collects fewer taxes, that money is left in the hands of the people *who earned it*, to be used as they see fit. Some of that money certainly will be used for consumption, but lowering taxes also enlarges the pool of private savings. Savings becomes capital available to loan to entrepreneurs and to fund business projects from established businesses trying to expand operations, explore new markets, etc. Savings are the lifeblood of economic expansion. Without them, there is no way to fund the entrepreneurial activities needed to do so.

Both consumption and savings would actually expand the economy, although the second much more so than the first. The demand being satisfied from consumption does stimulate the economy through profits. However, the stimulation derived from private savings is vastly greater in its ability to fund entrepreneurial activity and economic growth.

One can make the argument that both government and private consumption are still consumption, meaning that no new capital or wealth is created (except profits) and that savings are consumed, not invested. However, the percentage of waste in government consumption is vastly higher than that in private consumption for a variety of reasons, both good and bad. Parts of that differential historically have been saved and those parts have entered the capital pools from private consumers' savings when that money is left in the private sector.

Regulatory Burden:
Just in case you don't believe how burdensome federal regulations have become, here is an excerpt from the 2/13/2017 *Investor's Business Daily*, "To Get America Going Again, a Very Different Green Agenda."

"*A 2014 study from the National Association of Manufacturers estimated the total cost of federal regulation at over $2 trillion. Another study, from the American Action Forum, estimated that the total cost of selected 2016 regulatory measures would exceed $164 billion and cost over 10,000 jobs. More broadly, the Mercatus Center at George Mason University reports that doubling regulation in a given industry results in a 9% decrease in new startups and a 5% decrease in new hires.*"

That is just a sample of measured and estimated effects from federal regulations on the American economy. Over 80,000 regulations. Winston Churchill once famously said, "If you have 10,000 regulations, you'll destroy all respect for the law."

If new regulations are passed regarding banking, then if you are a mega-bank, you just hire another lawyer or two; no big deal. If you are a small or regional bank, that may be completely unaffordable. This incredibly
(Continued on page 3)

(Continued from page 2)
burdensome regime hurts and hampers small business, as the costs of regulatory compliance are relatively much more expensive to them. This causes a real problem because small business is the greatest engine of job growth and product innovation any economy has. As government and compliance costs are imposed on ever-greater portions of our businesses and private lives, we should not be surprised that we all become relatively poorer and jobs become scarcer.

This doesn't even deal with the problem that regulations are NOT laws. They are essentially powers given to regulatory agencies by Congress that have the force of law behind them. Regulations are written, interpreted, enforced and changed selectively by members of a regulatory agency all the way down to the auditor/agent level. Agents, supervisors and top-level leaders can create their own agendas, and some clearly do – even sometimes violating the spirit of the law itself.

As new administrations re-interpret the law and pass new regulations (often leaving the old ones on the books), companies and residents are forced to deal with changes at a much faster pace than when actual laws are passed. It's been said that the power to legislate is the power to destroy. We are of the opinion that the power to regulate is the power to destroy faster and more completely.

President Trump has publicly stated that his administration would require the abolition of two old regulations for every new one implemented. It should be very interesting to watch how much better American businesses (and jobs) grow as the size of government shrinks and this burden is reduced.

Fair Trade:
It's too bad the people proclaiming "free trade" are only proclaiming it concerning America's *imports*. Free trade is indeed a righteous ideal. According to Webster's dictionary, the definition of free trade is "*trade based upon the unrestricted international exchange of goods with tariffs used only as a source of revenue*."

However, how can there be "free trade" in a world where American goods are laden with import tariffs by foreign countries? Where currency manipulation is intentionally done to provide a competitive advantage to a foreign country's exports? The clear answer is that there can't be ***one-sided*** "free trade." The consequence is that American producers are put at a competitive disadvantage in their ***own*** country, not to mention some or all of the countries to which they export. As long as other countries impose competitive import tariffs and manipulate their currencies, there will never be "free" trade; but we can at least take steps to make it *fair*.

This is what President Trump is trying to do. To save American jobs and businesses by levelling the playing field through using techniques others already use on us. Yes, at least initially, it would mean that the costs of imported products would increase. But, as part of that process, competing American firms would find more buyers, at least here in the US creating more profits and the benefits of profits – a general expansion of the economy. Some businesses may find they could re-enter and compete with foreign companies by producing here, creating (recovering) jobs at home, also expanding the economy.

Such changes in the economy would tend to create new jobs and, as labor markets became tighter, increase wages. More people working, making more money. A general increase in American prosperity, as we had in the 1980's.

Yes there are complications and possible issues with adopting such a stance, but, do they justify continuing our existing policies? No. The definition of insanity is to do repeatedly the same things, expecting different results.

A word of caution: The BAT (border adjustment tax) as we understand it appears to create an enormously long period of adjustment before reaching an equilibrium. We also believe the BAT violates a whole host of essential accounting principles. Our understanding of the BAT is this:

- For tax purposes, the cost of importing goods, including transport to the US, are not deductible for tax purposes.
- Conversely, revenues derived from exports to other countries are not includable in income for tax purposes.

As Rip Torn said in Men in Black, "*You're everything we've come to expect from years of government training*." To deny for tax purposes the expensing of completely legitimate costs of goods sold expenses makes a mockery of good accounting principles, beginning first and foremost with the matching principle. The waiving of the reporting of revenues derived from exports is much less egregious because of tax nexus issues involving taxes assessed by the country in which the products are actually sold.

(Continued on Page 4)

(Continued from Page 3)

Imagine what such a law would do to the cost structures of companies that import the goods they sell or materials used in their manufacturing and assembly processes. For example, a dealer sells imported cars. Assume the cost of acquisition to the US was $45,000 for a car the dealer would sell for $55,000. Add in commissions, transportation to the dealer, prep and overhead at a rate of $5.000, so the total cost of selling the car would be $50,000. Profit to the dealership would be $5,000 or about 9%. Net profit after taxes in our example at the corporate rate of 35% is $1,750, leaving a net profit of $3,250 or about 6%.

Net profit before tax using BAT would be $50,000 instead of $5000 since the cost of acquiring the car is $45,000 and is not deductible. Even at the proposed lowered corporate tax rate of 20%, income tax under the BAT would be $10,000 – twice the total profit the dealer made on the car! To make the same $3,250 after tax profit, the car would have to be sold for over $65,300. But, how many sales would they lose for over $10,000 (18%) more per car? The challenges of staying in business would be extreme.

We can't support the BAT as we currently understand it as a means to this end, even an end that we wholeheartedly agree with. We much prefer simpler import tariffs corresponding to the tariffs levied on US products by the countries exporting to the US on a country-by-country basis to be collected by the government, not offloaded to the accounting systems of the purchasing companies. They already file plenty of government reports. We have heard reports on business news channels that the BAT may have been changed to a set percentage at 20%, presumably billed to the purchaser at the time of importation. But, we don't know that for a fact at this point.

National Security:

The economic impact of President Trump's commitment to increased national security involves additional monies designated to improve the power of and to modernize our weaponry and add soldiers. In other words to improve our readiness and make certain our enemies understand the US stands ready. Considering we already have the strongest military in the world, the deterrent effect of our needed buildup is obvious. Much of our technology is seriously out-of-date, however, including our nuclear arsenal.

These additional monies, when spent, will create considerable revenues, profits and jobs for our military suppliers and their entire supply chains. As government expenditures go, these tend to expand the economy much more than other types of government expenditures. Amounts spent on infrastructure improvements would have similar positive impacts upon our economy. Eventually, our crumbling infrastructure would have a deleterious effect on the economy. In fact, it probably is now.

Shrinking the Government:

If you believe in the idea of minimalist government (as did the founding fathers' and as President Trump does) and that government is involved in areas in which it shouldn't be, many government costs would be saved if we shrink the size and involvement of the government in our lives. An important consequence would be increased freedom from our government, the ideal that our founding fathers risked life, liberty and personal fortunes to achieve.

Less costs from taxes and regulations. More freedom. Sounds like a great way to fire up the engines of the American economy and make us all more prosperous.

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.