SPECIAL ALERT

An optimist stays up until midnight to see the New Year in. A pessimist stays up to make sure the old year leaves.

Bill Vaughan

New Year's Day… now is the accepted time to make your regular annual good resolutions. Next week you can begin paving hell with them as usual.

Mark Twain

Good resolutions are simply checks that men draw on a bank where they have no account.

Oscar Wilde

A New Year's resolution is something that goes in one Year and out the other.

Anonymous

If you put the federal government in charge of the Sahara Desert, in five years there'd be a shortage of sand.

Milton Friedman

January 15, 2011

Garrett Jones
(925) 820-0161
E-Mail: garrett111@comcast.net

SPECIAL ALERT

A Farewell to 2010

2010 was an interesting year to say the least. I'm sure many are happy to see it go and some will miss it. On a personal level, it was a very difficult year as it was a year where loved ones were lost. On other levels, it was a year that presented many challenges in a wide range of areas – politically, socially, economically, etc. However, from a business perspective, we are grateful as 2010 was a good year for us and for our clients. We finished the year at just above +29% for our clients net after all fees and we are up over 50% from the all-time stock market high in October 2007. We are always thankful to be able to start a year with a positive thrust. We wish you a Happy, Healthy and Prosperous 2011. GJ

One of the major thrusts of my Alerts is discussing the cycle that we follow as human beings – specifically, the sequence of events in the cycle. The 'sequence of events' tell us where we are in the cycle so we know what is next to come. We want to know this so we can prepare for what is coming as opposed to being taken by surprise. Investors were caught off guard at the valuation market top in 2000 and the all-time high in 2007. The periods that followed those two tops made the past decade ***The Worst Performing Decade in US History***. My experience in sharing that with people generally brings nothing more than a glazed look. Frankly, it is information that merits significantly more in terms of a response.

The worst performing decade in US history carries a big message. Allow me to put this into perspective. The majority of the American populace has grown up in the best of times. Ever since my childhood, I learned and believed the USA was the biggest and best in everything. As a child, 'made in Japan' equated to junk. Now, 'made in China' frequently equates to junk. I noticed that equation didn't last. In the case of Japan, that "junk" miraculously turned into top quality products i.e. Toyota, Sony, etc. The quality of these products was better than what the US was producing. This resulted in an upward explosion in the purchase of Japanese products, an overwhelming balance of trade surplus, and trade leadership for Japan.

I think we can see a very similar progression with China. If you go back to the 1920s, you could see the same process unfolding in the United States. It is a very long process. In the case of the United States, the growth and innovation began in the late 1800s with the Industrial Revolution. In the 1920s the USA was the only country that could efficiently and effectively mass produce. This turned into a very favorable balance of trade, trade leadership and the Roaring Twenties. It was followed by the Great Depression and then the USA moved into a relentless position of world leadership and dominance that lasted decades. Hence, it was the reason I learned as a child that the USA was the best at virtually everything. This was the message that the Baby Boomers received as children and what we learned in school. It is the same message that we passed on to our children. So, it is not surprising the communication of THE WORST PERFORMING DECADE IN US HISTORY doesn't get the reaction it deserves. We have been brainwashed … and we have passed the message on.

Anyway, my point is that something very major has happened in the USA and it is as subtle as an undetected cancer … probably because it is an undetected cancer of sorts. Somewhere along the line, things have changed … and, due to our delusion, we have missed it. Somewhere along the line we have missed that our #1 ranking in education, for example, is currently #18 … and falling – and in the area of science, our prior top ranking has fallen to 29th … and falling. Somewhere … somehow … we are no longer #1 in everything. In fact, in many things, we have taken a tumble like we have in education. Gee, I wonder if there may be a connection?

The leadership and subsequent decline of countries is a normal and natural cyclical process. In my view, the USA peaked in 1970. That's one year after we had our last REAL budget surplus. Many years later, President Clinton claimed he had a surplus, but he's such a big kidder – he forgot to tell us that "off budge items" was a term he created to remove certain items from the budget so it would appear he had a surplus (he's clever, he was a Rhodes scholar). Anyway, in 1970, we were financially sound; General Motors was the largest corporation in the world; we had our peak production in oil; and we actually were #1 in just about everything.

Economy Statistics > GDP in 1970 (most recent) by country

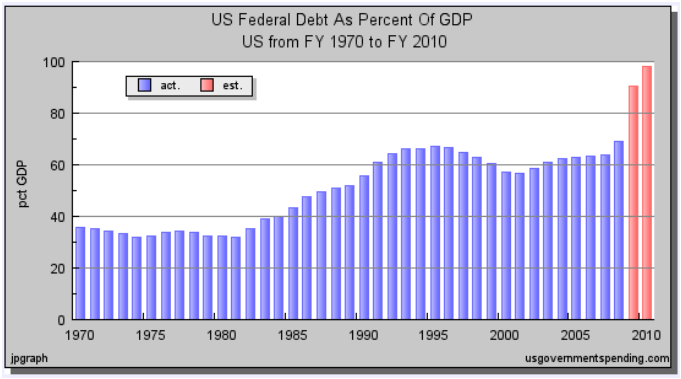
VIEW DATA: Totals | Per capita | Per $ GDP | Definition | Source | Printable version

Bar Graph | Pie Chart | Map | Correlations

Showing latest available data.

Rank	Countries	Amount
# 1	United States:	$1,025.50
# 2	Japan:	$206.80
# 3	Germany:	$203.70
# 4	France:	$147.00
# 5	United Kingdom:	$123.60
# 6	Italy:	$107.70
# 7	Canada:	$85.10
# 8	Australia:	$42.90
# 9	Mexico:	$39.60
# 10	Spain:	$39.00
# 11	Sweden:	$35.70
# 12	Netherlands:	$35.10
# 13	Belgium:	$25.60
# 14	Switzerland:	$21.90
# 15	Turkey:	$17.90
# 16	Denmark:	$16.30
# 17	Austria:	$14.90
# 18	Norway:	$12.80
# 19	Greece:	$11.30
# 20	Finland:	$11.10
# 21	Korea, South:	$8.80
# 22	Portugal:	$7.40
# 23	New Zealand:	$6.50
# 24	Ireland:	$4.20
# 25	Luxembourg:	$1.30
# 26	Iceland:	$0.50
	Total:	$2,252.20
	Weighted average:	$86.62

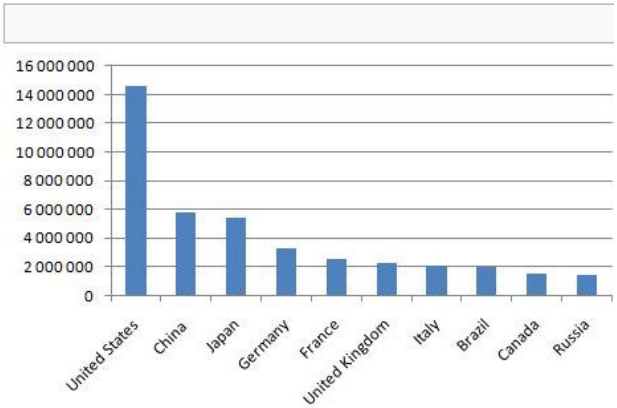
Look at the chart on the left showing the GDP of countries in 1970. Our GDP eclipsed one trillion dollars for the first time … and the combined GDP of the next 25 countries was $1.23 trillion. Notice that you don't see China or India anywhere on



that list. In the chart below you can see that our debt as a percentage of GDP was just over a third of what it currently is. So, things were way better comparatively in 1970 than they are today. But let's keep looking at the facts.

File:2010 Nominal GDP.jpg

From Wikipedia, the free encyclopedia



On the left, you can see the GDP breakdown currently. The USA, Japan, the European leaders and Canada are still in the top ten but China, Brail and Russia have replaced Australia, Mexico and Spain. Presumably, there is a message there.

The information below shows that India is right there in the picture, as well. In fact, in the information on the next page, we see that the USA is no longer #1 in two of the listings. Granted, they are referring to the European Union, but there's a message there – change is in the air. No longer does it take the next 25 countries combined GDPs to match ours.

2010 List by the International Monetary Fund[1]

Rank	Country	GDP (millions of USD)
—	*World*	**61,963,429**[4]
—	*European Union*	16,106,896[4]
1	United States	14,624,184
2	People's Republic of China	5,545,133[2]
3	Japan	5,390,897
4	Germany	3,305,898
5	France	2,555,439
6	United Kingdom	2,258,565
7	Italy	2,036,687
8	Brazil	1,610,528
9	Canada	1,463,664
10	India	1,430,020

2009 List by the World Bank[2]

Rank	Country	GDP (millions of USD)
—	*World*	**58,133,309**
1	United States	14,119,000
—	*Eurozone*	12,455,979[3]
2	Japan	5,068,996
3	People's Republic of China	4,985,461[2]
4	Germany	3,330,032
5	France	2,649,390[4]
6	United Kingdom	2,174,530
7	Italy	2,112,780
8	Brazil	1,573,409
9	Spain	1,460,250
10	Canada	1,336,068

2009 List by the CIA World Factbook[3]

Rank	Country	GDP (millions of USD)
—	*World*	**58,090,000**
—	*European Union*	16,210,000
1	United States	14,120,000
2	Japan	5,069,000
3	People's Republic of China	4,985,000[2]
4	Germany	3,339,000
5	France	2,656,000
6	United Kingdom	2,179,000
7	Italy	2,118,000
8	Brazil	1,574,000
9	Spain	1,468,000
10	Canada	1,336,000

Again, this is a natural process, but it does have ramifications. Why have we fallen like this? That part is easy to answer – it simple psychology – it's all about ATTITUDE. In the late 1890s we were a scrappy underdog country. Like a young boxer, we had a goal and we were hungry. After we won the championship and held it for years, we became fat, happy, lazy and complacent. Simple. As I said before, it is similar to an undetected cancer – it slowly kills the patient and if he isn't paying attention, he doesn't even see it.

So, let's wake up and be aware of reality. This all factors into why we just completed the worst decade in US history. Does that phrase have a bit more relevance now? I hope so. We can't change this, but if we recognize it, we can use it to our advantage as opposed to being victimized by it. The fact that people respond with a 'deer in the headlights' mentality is simply confirmation of where we are in the cycle … and, it is that attitude that perpetuates the cycle.

Now, let's take a look at some of the more recent events in the sequence of events in the cycle and see if we can determine where we are:

- Stock Market Crash (PARTICULARLY IN THE AREA OF THE NEW TECHNOLOGY) THERE IS AN INITIAL CRASH IN THE FAVORED MARKET SECTOR FOLLOWED BY A RECOVERY IN STOCK PRICES. LATER THE SECOND DECLINE BEGINS WHERE THE REAL SHARE DEVASTATION OCCURS
- Disinflation becomes Deflation (PRICES OF ASSETS FALL)
- Bankruptcies and Liquidation (DUE TO DEFLATION, UNEMPLOYMENT & HIGH DEBT LEVEL)
- Debt Default (INDIVIDUALS AND CORPORATIONS BELLY UP ON DEBT)
- Stock Market Bottom (TOTAL CAPITULATION) AT THIS POINT PEOPLE LITERALLY HATE STOCKS AS THEY HAVE FALLEN TO AN EXTREME LEVEL OF UNDERVALUATION
- Economic Bottom (BANK CLOSINGS; DEBT RESTRUCTURING; REMONETIZATION; NEW CURRENCY)

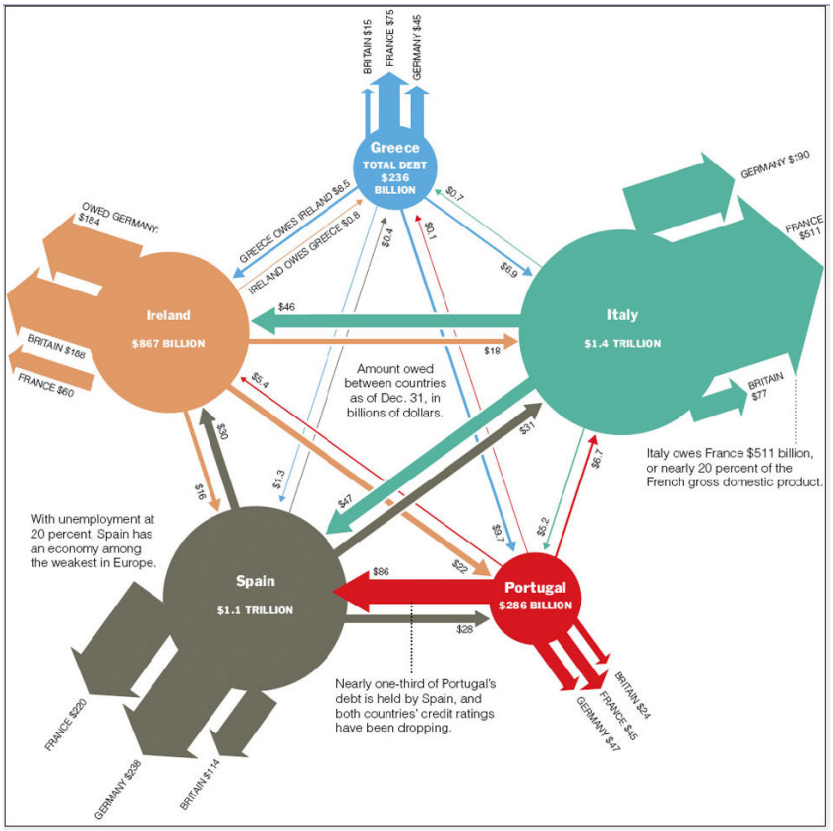
The above sequenced events are from my The Sequence of Events in the Cycle, Part I *article*. There are a total of 16 events that comprise a full cycle – we are looking at the last six. The first listing above is the stock market crash – this would pertain to the 83.5% correction in the NASDAQ 100 that followed the "real" valuation top in 2000. One could also argue that it may be the crash that followed the all-time high in 2007 which resulted in the largest decline in the S&P 500 in 77 years – that's OK, too. Both occurred in periods of disinflation. Deflation followed and can most easily be seen in the prices of real estate across the country. It is

clear by the valuations that accompany stock market bottoms that we don't have a real bottom yet and, since the economy always follows the stock market, we clearly haven't had the economic bottom yet. That's the process you use to determine where we are in the cycle. We know what has occurred and we know what has not yet occurred. By the process of elimination, we know where we are. We are left with Bankruptcies and Liquidation and Debt Default. Clearly, both are (and have been) occurring. However, we can fine tune this just a bit more. The Debt Default event refers to a massive default which hasn't yet happened. So, we are in the Bankruptcies and Liquidation phase. Bankruptcies are happening at all levels and liquidations are obvious in the real estate market, but occurring in other markets, as well.

I have pointed out how people don't learn from history. We have just had two major examples in the past decade – investors were not deterred by the most overvalued market in history in 2000 and, apparently, they completely forgot about 2000 at the all-time high in 2007. It is this type of human programming that perpetuates the cycle. If we are somehow going to reach yet another high this year (it could happen) will investors get devastated again? My bet is that they will.

What's the risk? The risk is BIG. Really big. We are at the wrong end of that 40 year cycle where every other 40 years or so something REALLY BAD happens. Simply falling to normal valuations for a primary cycle bottom is bad enough i.e. this would equate to a price/earnings ratio of 6 or 7; a dividend yield of over 6% and the market selling at or below book value. That's bad enough, but consider a total breakdown of our financial system and/or a complete destruction of our currency. If you don't think both are possible, if not probable, then you just aren't paying attention. We are ten years into a massive secular bear market defined by the worst performing decade in US history. Please let this sink in … it's reality.

If it makes you feel any better, we are not alone. Europe is in terrible shape, too, but I find that seeking to find someone or something worse off is the perpetuation of the attitude that got you in trouble in the first place. Our attention needs to be on someone (or some country) that is doing things right. The idea is to find a successful player and imitate or adopt what they are doing right. Clearly, it is NOT to focus on someone or something that is doing worse – presumably, so we can feel better about our situation by comparison. That is a loser mentality and certainly not what we should be thinking – so avoid that type of thinking at all costs!



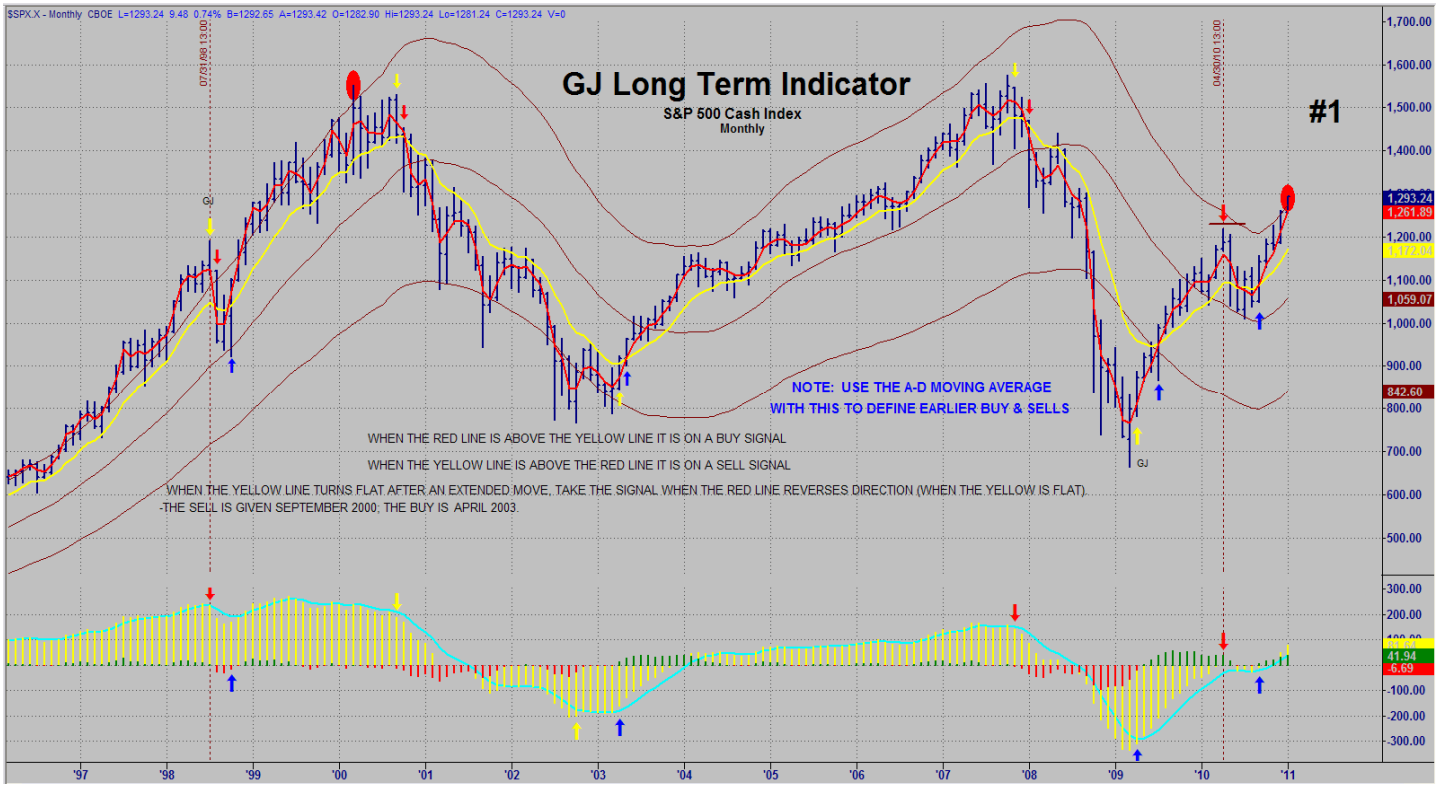
It is estimated that the amount of derivatives may now be as much as one quadrillion dollars. Frankly, I have trouble grasping the idea of one trillion dollars because I have an idea of just how much <u>one trillion</u> dollars represents. It is all the goods and services produced by the USA in 1970 when we were far and away #1 in the world … and that's only ONE trillion dollars. We are talking about 1000 times that in derivatives. Are you beginning to understand the basis for my concern? This is complete insanity. Look at the graphic of Europe (at the left) – it is the classic "robbing Peter to pay Paul" idiom. If you think that is complicated, I'll bet that Goldman Sachs can show you some financing schemes that make that look like a straight line between two points.

At this stage of the cycle, nothing seems to make much sense and people are “dumbed down”. It is merely a natural, yet unpleasant, stage of the cycle. To some degree, there is a romancing of stupidity. We listen to people intently that we wouldn’t have given two minutes of our time to in the past. As stated earlier, we are in the process of turning our thinking 180 degrees the opposite of the things that made our nation great. We sorely lack leadership in all areas – not just politics. Corruption is at a high and seems to be respected and even encouraged in some sectors. I am not going to name names, but if you have been paying attention, you can come up with as many areas as I can. We supposedly have a government of checks and balances that is a government ‘of the people, by the people and for the people’. Neither could be further from the truth – it’s truly sad, and both parties can share the blame. Think of the words ‘honor, integrity and leadership’ and see how many people come to mind who you would feel comfortable with as President. I don’t know about you, but I would have a difficult time counting them on one hand – and I’m not favoring either party.

The taxpayer is being used and abused to a level that is beyond the imagination. Why is this happening? Because that is where we are in the cycle and there is no one to stop it. The foxes are guarding the hen house. They started by voting to increase their salaries. That worked and they created an incredible health insurance program for themselves (not for the people who pay their salaries). Then they created a retirement plan that required serving only one term. There was nothing standing in their way i.e. no checks and balances – as we are taught in grade school … and certainly nothing about ‘of, by or for’ the people. We, as taxpayers, are deeply upset but what can we do about it? Who do we turn to?

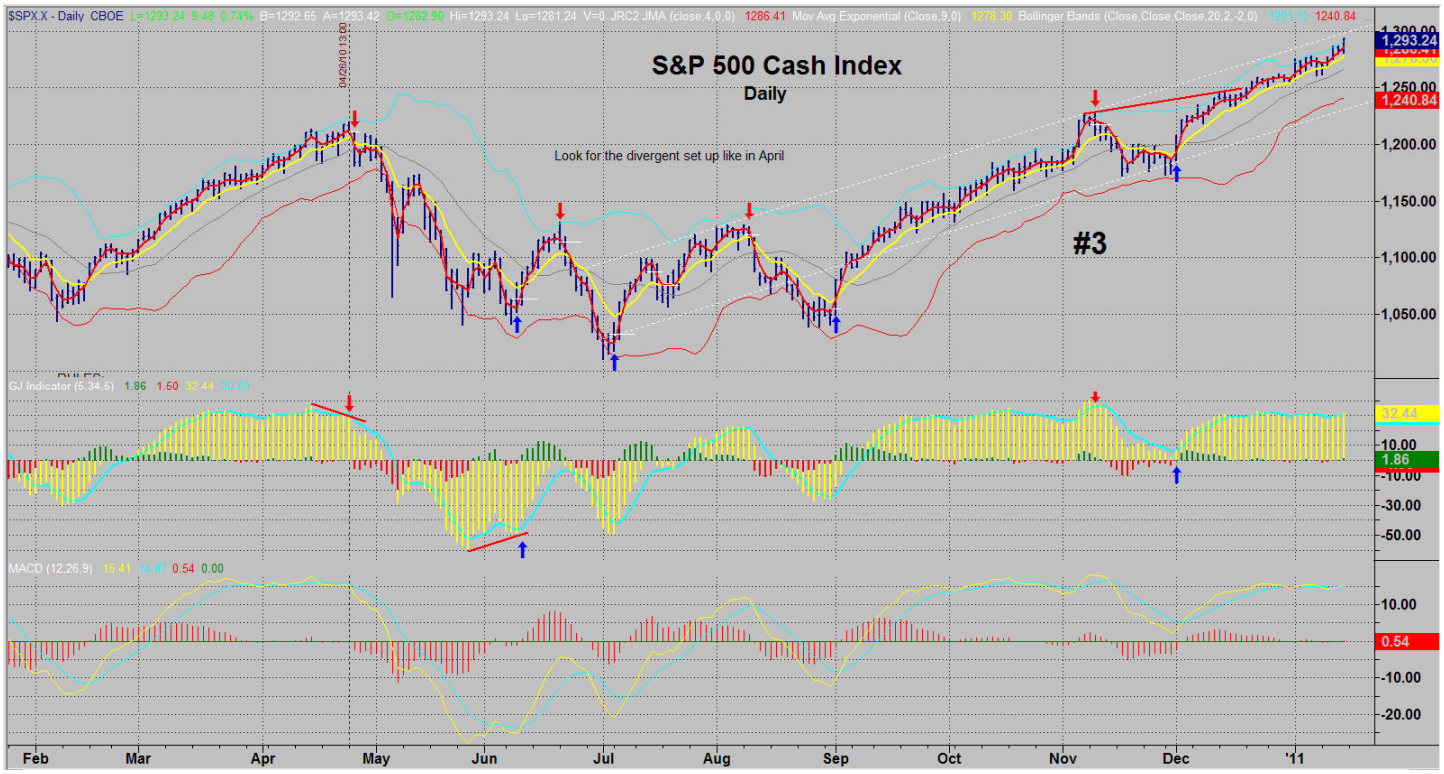
Please take just a few minutes to view this video http://www.youtube.com/user/fiercefreeleancer - it is an outstanding coverage of the rampant corruption we face. I also suggest that you view the following video http://dailybail.com/home/there-are-no-words-to-describe-the-following-part-ii.html immediately afterwards. Total viewing time is only ten minutes and I believe this to be extremely important to understand the gravity of the situation. These two videos are just a very small part of what is going on.

The Stock Market



YOU CAN EXPAND THIS CHART FOR BETTER VIEWING BY INCREASING THE PERCENTAGE NUMBER ON YOUR TOOLBAR

The chart on the prior page is my monthly chart and is the chart I use for the "big picture". It is bullish and gave its most recent buy signal back in September 2010. It is important to note that prices have now climbed above the top of the trading bands – which last occurred in March of 2000. The weekly chart is also on a buy signal as is the daily chart. Prices are extended in all of the three charts, but there are no sell signals yet. Clearly, this is a time to be on alert for a change in direction, but it is important to wait for a reason to sell. So far, we don't have one. In the daily chart below, I will be looking for the red line to pierce the yellow line and my indicator to confirm. I will look for a prior low to be broken and may take a position if the upper channel line is touched. Otherwise, getting in the way doesn't make much sense to me.



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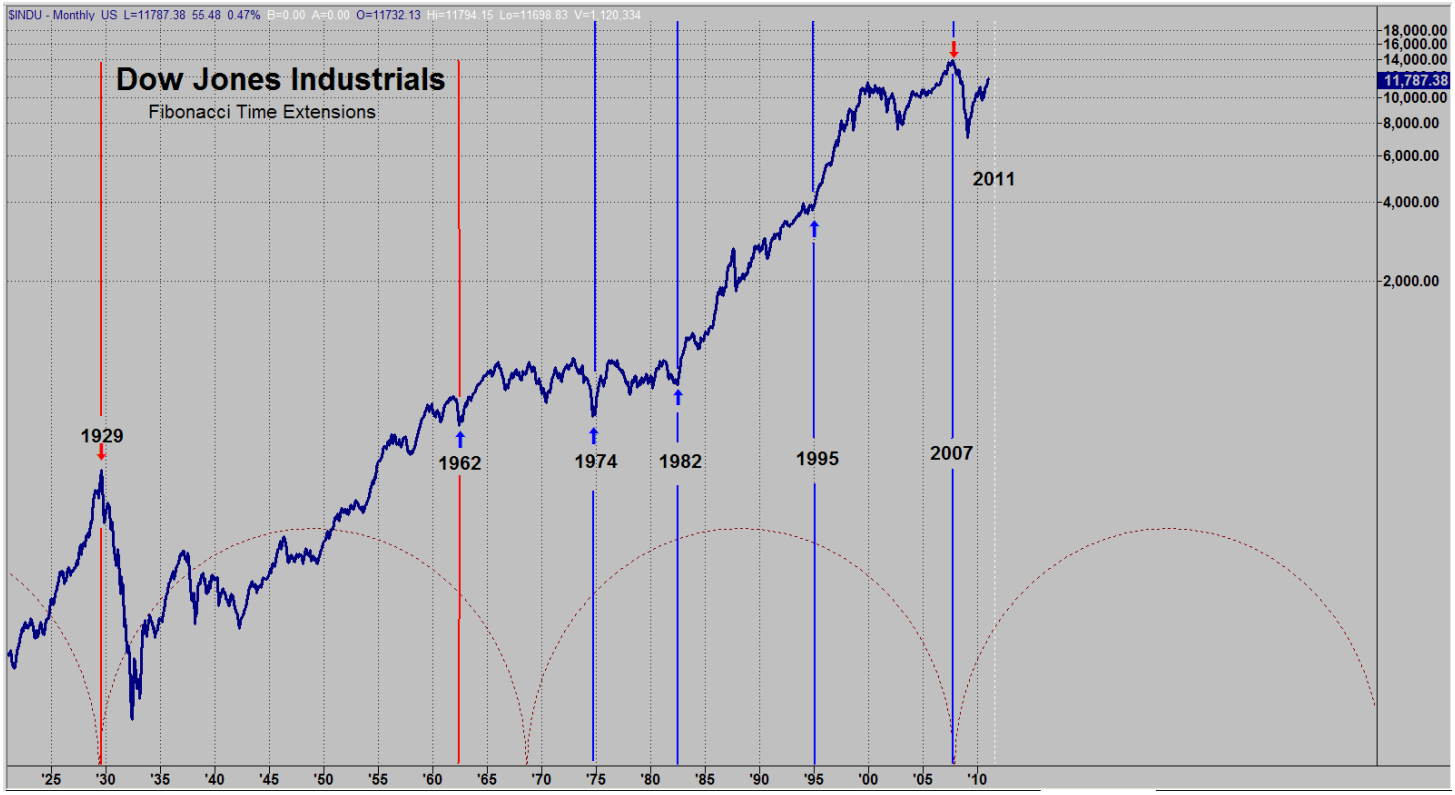
In the monthly chart, I am concerned that we are above the band and that hasn't occurred since March of 2000 – the initial top of the secular bear market. However, note that the market came back to test those levels in September before it collapsed. It is important to be aware that this is the third year of the Presidential cycle. The third year of a president cycle is the pre-election year. The track record for pre-election years is pretty remarkable. The last 17 pre-election years have been up for the Dow Jones Industrials. Another interesting statistic pertains to the first five trading days of the year. They have registered a gain 49 times since 1933 – in 40 of those periods, the Dow was higher at the end of the year. That's 82% of the time. Jay Kaeppel of Optionetic.com did an interesting study using years where these two statistics were in play. He looked at years when the first five trading days of the year were up and when that occurred in pre-election years. It happened 14 times since 1933 and the market was up in 13 of those 14 instances. That kicks the win percentage up to 92.9%. The only year that experienced a loss under those circumstances was 1987, but it is interesting to note that the market had rallied 36% that year before producing a loss of 3.2%. Here are some other statistics for those 14 periods: Average gain = 15.7%; median gain = 14.7%; largest gain = 36.1%; largest loss = 3.2%. The average drawdown was 4.7% with the largest drawdown being 13.2%.

I have one more chart that I want to share with you. It is a Fibonacci time extension chart where I started with the 1929 top and the 1962 low. Four of the most meaningful years since that time are the result of the time extensions: 1974 and 1982 (major bottoms), 1995 (launch point of a powerful advance), and 2007 (the all-time



YOU CAN EXPAND THIS CHART FOR BETTER VIEWING BY INCREASING THE PERCENTAGE NUMBER ON YOUR TOOLBAR

high for the market. Now, 2011 is indicated in this remarkable series of dates. Should this date be as auspicious as the others, I would suggest that it may be a top due to the sequence of events in the cycle discussed earlier.

Final Comments

The Dow Jones Industrials are at the top of their channel and the New York Stock Exchange advance/decline line is approaching a trend line. Both will either break out or fail. The market has had a strong advance from the lower channel in the S&P to its upper channel. Finally, we are approaching a logical place to sell or take a short position, but one still has to be very careful as there is no sell signal. In my view, this is a time for extreme discipline. Have your parameters set and know when and at what price you will exit. I have mentioned some of the things I will be looking for to step aside. In the meantime, the market seems to easily find support and is capable of moving higher without a great deal of effort. That has to be respected.

I hope you enjoyed the holidays and I wish you health, happiness and prosperity in 2011. By the way, here's a photo you may enjoy.

All the best,

Garrett Jones