



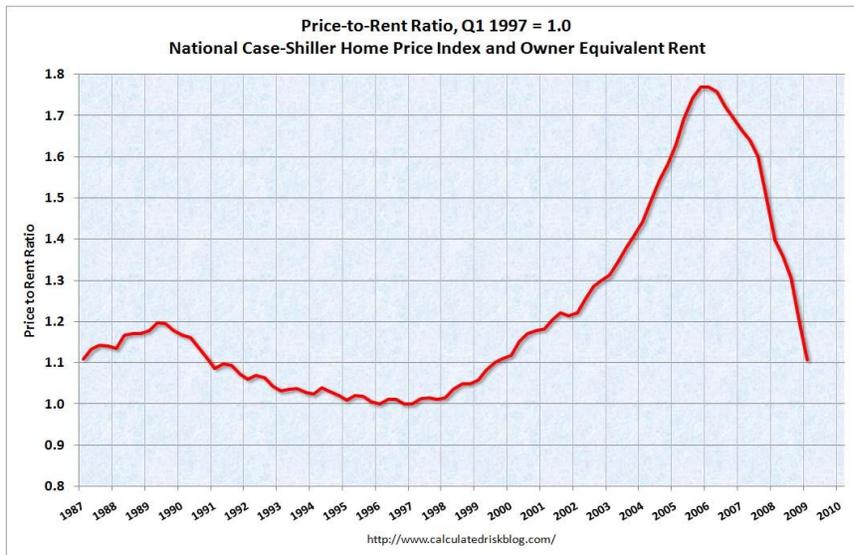
Cooked Books

This month, I attempt to show how the Bureau of Labor Statistics (BLS) data has been so manipulated that it is no longer useful. A very long (and boring) book could be written about this subject, so I will limit my writing to the two most distorted sets of data—the consumer price index and unemployment.

Let’s start with the CPI. From 2003-2008, inflation was soaring, but the good folks at the BLS were telling us that prices were hardly rising and there was nothing to worry about. Main Street was feeling a major pinch that ultimately led to the recession that started in late 2007, and the disconnect between common experience and the statistics widened ever more.

One of the biggest causes of this disconnect is that the BLS does not include house prices when calculating the CPI. They instead use something called “owner’s equivalent rent.” When home prices soared from 1998 to 2006 and rental rates stayed relatively flat, this distorted the data and artificially kept the CPI lower than the experience of most Americans. After all, 67% of the U.S. population live in homes they own.¹

As you can see below, the National Case-Shiller Home Price Index went parabolic beginning in 1998 relative to owner equivalent rent. All things being equal, lower interest rates will make house prices go up. Thanks to the loose monetary policy of “Easy” Alan Greenspan and “Helicopter Ben,”



(he did not object to lowered interest rates as Fed Governor) people were able to buy more house for lower payments. Bidding wars continued to drive up home prices while rents stayed mostly flat. How could this happen? Let’s look at the math. Let’s say I borrow \$200,000 to buy a rental home at 7% and I want to make 10% above my monthly principal and interest payment for the

Source: <http://www.calculatedriskblog.com/2009/02/house-prices-real-prices-price-to-rent.html>

¹ <http://www.census.gov/hhes/www/housing/hvs/qtr309/files/q309press.pdf>

rent I charge. My payment would be \$1,331 per month and I would charge my renter \$1,436.66, plus the property taxes, for the rent each month.

Now let's say the Federal Reserve's actions allow me to borrow that same \$200,000 at 5% per year. Here I only pay the bank \$1,073.64 per month and would need to only charge \$1,181 per month, plus the real estate taxes to my renter to get the same desired profit.

The second notable omission to the CPI calculation is employer funded health insurance. Many of my clients receive an annual statement of their total compensation that includes what the company pays for health/disability/life insurance, 401(k) matches, the employer's half of social security, and pension additions. It usually is a number that is far greater than what they consider their compensation. As an employer, I can assure you that this is how your company's owner views your compensation because these costs all come directly from their bottom line.

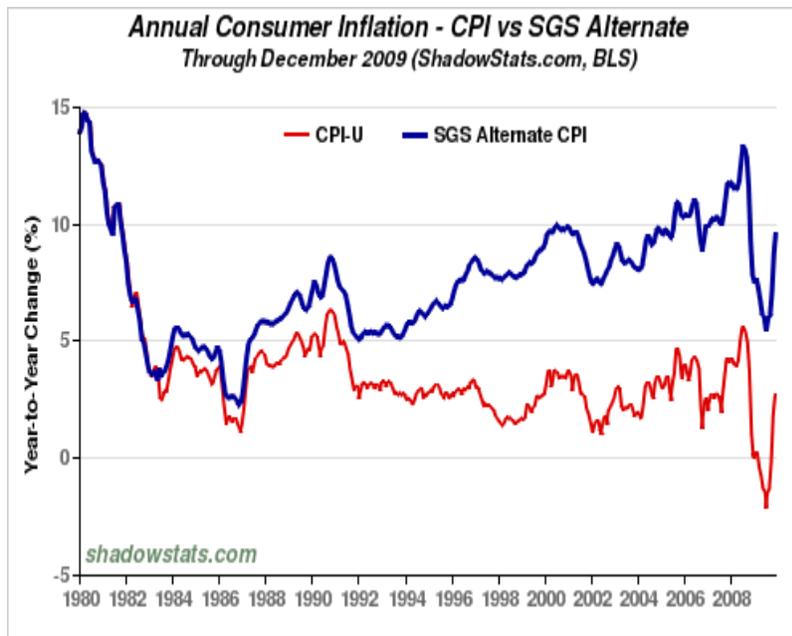
I have seen massive increases in my health insurance over the last few years despite the fact that I am perfectly healthy and have only been to the doctor twice in five years. If your employer didn't pay or subsidize your health insurance, they could afford to pay you more. This is one of the many reasons that jobs continue to be outsourced to countries that have lower employment taxes,

regulations, and overall costs of

doing business. Many prices may not be lower than they were in mid 2008, but I do not know of a single instance where health insurance premiums have been coming dropping.

To the left is economist and Shadowstats.com author, John Williams', estimate of what the year over year change in CPI-U (for all urban consumers) should be if we were actually trying to calculate inflation.

Now that we have covered two major omissions in the CPI calculation, let's turn our



Courtesy of Shadowstats.com

attention to the sorcery of the Boskin Commission. I relied heavily in this section from examples used in Chris Martenson's excellent "Crash Course" video available for free on his website. The commission was appointed in 1995 to investigate an assumption from the government that the BLS was over stating CPI. They published a report titled "Toward a More Accurate Measure of the Cost of Living" on December 4, 1996 and some of their recommendations were implemented in 1999.²

² <http://www.ssa.gov/history/reports/boskinrpt.html>

The creative Boskin Commission invented three adjustments to the CPI calculation that helped the government get its wish of “lower inflation.”

Their first act of sorcery was to add “substitution” to the calculation. The Bureau of Labor Statistics now assumes that if the price of fresh salmon goes up too much, you will now replace your salmon purchase with fish sticks. This conveniently hides the actual inflation of the price of salmon. How could this be an improvement to the prior calculation method? If you truly were trying to measure inflation, would you allow this to happen?

The Boskin Commission also gave the government license to use “geometric weighting.” The BLS lowers the weighting in the CPI basket for goods or services that rise the fastest in price under the assumption that people will use less of them as they become more expensive. Healthcare is approximately 17% of our GDP, but it is only 6% of the CPI calculation.³

The last manipulation brought to you by Boskin and Co. came in the form of “hedonic adjustments.” These are adjustments made to the price of a good or service when new features are added to make the product “better.” According to Chris Martenson, 46% of the CPI is hedonically adjusted.

In 2004 the BLS noted that a 27 inch television was selling for \$329.99, the exact price it was selling for in 2003. Because the 2004 television had a better screen than the 2003 model, the BLS adjusted the price of the 2004 television to \$195.⁴ You read that correctly—even though this manufacturer stopped making TVs with the old screen and the cheapest 27 inch television that they sell now costs \$329.99, the government manipulators tell us that TV prices went down \$135 from 2003 to 2004. “There is nothing to see here—get back to your American Idol and sports watching, worker drones!”

Steve Leuthold once calculated that the price of a new car in the U.S. had risen from \$6,847 in 1979 to \$27,940 in 2004. Using hedonic adjustments, the government calculated the price of a new car had risen from \$6,847 in 1979 to \$11,708 in 2004.⁵

According to John Williams, “When gasoline rises 10 cents per gallon because of a federally mandated gasoline additive, the increased gasoline cost does not contribute to inflation. Instead, the 10 cents is eliminated from the CPI because of the offsetting hedonic thrills the consumer gets from breathing cleaner air.”⁶

“In reality, the Boskin Commission was formed to lower the reported inflation rate as a backdoor method of reducing the cost of living adjustment (COLA) paid by Social Security and many other government programs, including benefits for veterans and their dependents. These payments are linked to CPI inflation” says Barry Ritholtz in *Bailout Nation*.⁷

This makes me sick. Our all-knowing rulers don’t have the courage to tell us the truth. They have taken the path of lying and printing paper to try and deal with the biggest Ponzi scheme in

³ <http://www.chrismartenson.com/crashcourse/chapter-16-fuzzy-numbers>

⁴ <http://www.chrismartenson.com/crashcourse/chapter-16-fuzzy-numbers>

⁵ http://aucontrarian.blogspot.com/2010_01_01_archive.html

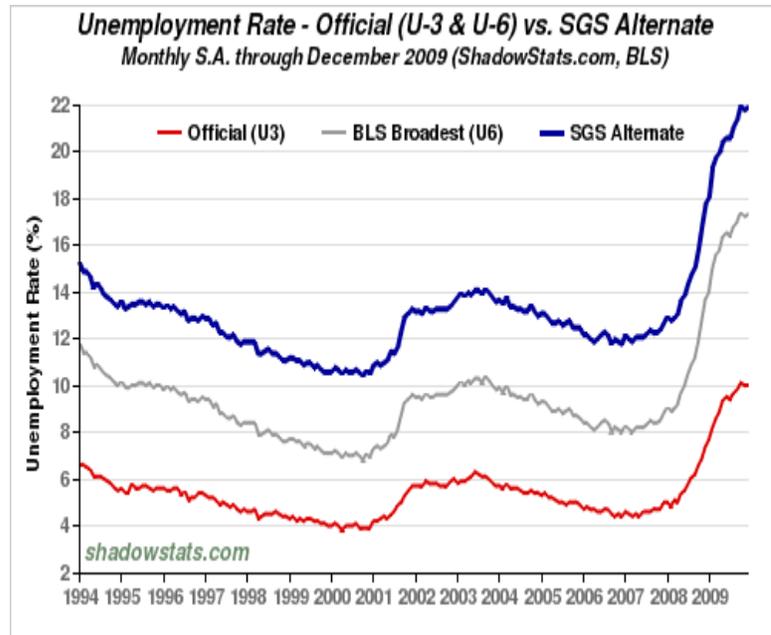
⁶ http://www.shadowstats.com/article/consumer_price_index

⁷ Barry Ritholtz, *Bailout Nation* (Hoboken, NJ: John Wiley and Sons, 2009), 152.

history—Social Security. Eventually, Social Security will be forced through a major overhaul that is sure to have benefit ages extended and means testing added. Until that day, rest assured that your veteran neighbor and your widowed grandma will continue to be robbed each year by the spin-doctors in the BLS pretending inflation doesn't exist.

Unemployment

Let's start with some definitions. The "official" unemployment number reported by the BLS is U-3. Nationally, this number is 10%. It is the number that you hear reported all over the news when non-farm payroll numbers are released on the first Friday of each month. Within the same report is a broader unemployment statistic called U-6. This includes U-3, plus discouraged workers, marginally attached workers, and workers who are working part-time but would like to find full-time work. As you can see on the graph to the right, there is almost a 7% difference between the "official" unemployment number and the broadest (U-6) measure of unemployment.



Courtesy of Shadowstats.com

The SGS Alternate unemployment number is John William's attempt to calculate unemployment the way the BLS used to report U-6 before 1994. Shadowstats.com explains that the complete overhaul of the surveys make it impractical to compare post 1994 unemployment numbers to pre-1994 data because:

Up until the Clinton administration, a discouraged worker was one who was willing, able and ready to work but had given up looking because there were no jobs to be had. The Clinton administration dismissed to the non-reporting netherworld about five million discouraged workers who had been so categorized for more than a year.⁸

Williams estimates that real non-farm unemployment is now a staggering 22%.

So what happened in 1994 for the BLS to change the way they estimate unemployment? NAFTA. The North America Free Trade Agreement became effective January 1, 1994. I am all for competition and free trade. I am not for deception. I believe the government knew that signing this deal with Mexico would permanently remove jobs from the United States. After all, lower taxes, lower environmental legislation, and lower wages are attractive to manufacturers.

⁸ <http://www.shadowstats.com/article/employment>

Should we be surprised that our central planners manipulate data to make us feel like the economy is better than it is? Who can forget Bill Clinton’s famous attempt to avoid perjury in front of the grand jury in 1998:

It depends on what the meaning of the word “is” is.⁹

If a Rhodes Scholar can’t come up with the standard definition of the word “is,” then you can bet a group of bureaucrat statisticians can redefine “inflation” and “unemployment.”

In 1994 Clinton knew that we were going to permanently lose thousands of jobs to Mexico and decided to dramatically change the way they calculate unemployment. By June of 2000, it was clear that the NASDAQ bubble had burst and the BLS needed to create a new weapon of mass distortion—the BLS Net Birth/Death Adjustment model.

The model is supposed to make up for the lag between when a firm forms and when it gets counted by the BLS. The “births” are new businesses that are created and the “deaths” are firms going out of business. Below is a table showing the most recent adjustments made to the employment numbers for 2008. What controlled substance was this model on when it created 100,000 construction jobs and 300,000 leisure and hospitality jobs in 2008? Wasn’t 2008 the year that Bear Stearns, Lehman Brothers, Merrill Lynch, Wachovia, Washington Mutual, Fannie Mae, Freddie Mac, and the entire construction market imploded? Someone please ask Winston Smith at the Ministry of Truth how 904,000 jobs were added (or should I say padded) to the non-farm payroll numbers of 2008.

Net Birth/Death Adjustments (in thousands)													
January 2008 – December 2008													
Preliminary Estimates	Jan 08	Feb 08	Mar 08	Apr 08	May 08	Jun 08	Jul 08	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08	Total
Mining & Logging⁽¹⁾	-2	1	1	1	2	2	1	2	2	1	0	1	12
Construction	-74	9	28	45	42	29	1	16	12	7	-7	-8	100
Manufacturing	-36	4	7	-10	9	7	-14	4	3	-6	3	3	-26
Trade, Transportation, & Utilities	-64	11	22	24	31	20	-12	21	20	23	17	20	133
Information	-20	5	2	3	5	1	-5	4	1	1	3	3	3
Financial Activities	-37	10	6	8	9	8	-4	9	8	13	5	18	53
Professional & Business Services	-100	39	23	72	23	22	-2	23	10	43	11	10	174
Education & Health Services	-11	17	2	31	11	-5	3	16	18	30	10	10	132
Leisure & Hospitality	-20	35	44	83	77	86	44	26	-35	-40	-12	12	300
Other Services	-14	4	7	10	8	7	-8	4	3	-1	0	3	23
Total	-378	135	142	267	217	177	4	125	42	71	30	72	904

<http://www.bls.gov/ces/cesbdhst.htm>

⁹ http://news.bbc.co.uk/onthisday/hi/dates/stories/september/21/newsid_2525000/2525339.stm

Markets



Chart Courtesy of StockCharts.com

gap or the September gap of 1020. If we break too far below 1020 on the S&P 500, it is possible that January 19th was the peak of this cycle. I believe the clowns in Washington have stimulus package B, C, and D ready to go if the markets fall apart and I think Bernanke will continue his purchasing of government bonds through his wonderful electronic printing press. His program of quantitative easing is supposed to be over in March, but I think he and Mervin King are ready and waiting to continue their programs of quantitative easing in their quest to destroy the purchasing power of the dollar and the pound.¹⁰

I am also concerned about the bullish sentiment out there. As the January issue of "The Elliott Wave Financial Forecast" reports "The percentage of bearish advisors in the Investors Intelligence survey recently fell to 15.6%, its lowest level in 22 years, since April 1987, less than five months before the market collapsed 40%."¹¹

It should be another interesting year.

Ben Shalom Bernanke

Gold Bugs celebrated on January 28, 2010, when the Senate voted 70-30 to reappoint Benito Bernanke as Chairman of the Federal Reserve.¹² Unfortunately for Americans, he now has 4 more years to prove that he can be a bigger bubble-blower than "Easy Al." When he first took office on February 1, 2006, gold was trading for \$570 per ounce. As I write, gold is trading for \$1,081 per ounce. In my estimation, he has been a total failure as Fed Head.

¹⁰ <http://business.timesonline.co.uk/tol/business/economics/article5556024.ece>

¹¹ www.elliottwave.com

¹² <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aFJH6lFpTFYs>

The S&P 500 recently broke its 50 day moving average and trend line. The technical analysts at Marketfield Asset Management note, that once a correction begins, "gaps" tend to be filled.

I have circled the three gaps to the left. As you can see, the gap on November 9, has already been filled. A logical stopping place for this correction would be the October

We recently found out that Bernanke had contact with 24 senators between August 4 and November 30, 2009. Most of these meetings were at congressional office buildings. Ken Thomas, a lecturer in finance at the Wharton School of Business, makes an excellent point:

In all my years of doing this, and I have been doing this since 1996, I have never seen a Fed chairman put a full court press on Congress, especially on the Senate Banking Committee. This is unprecedented political contact for a Fed chairman in such a short period, especially considering Bernanke's vow before his first Senate confirmation hearing that "I will be strictly independent of all political influences."¹³

What back-room deals were made in these meetings? What influence do these Senators now have over Bernanke for reappointing him? When will we get the first real audit of the Federal Reserve? The following two video clips say it all.

Ben Bernanke was WRONG

<http://www.youtube.com/watch?v=9QpD64GUoXw>

Senator Jim Bunning's comprehensive burial of what was left of Ben Bernanke's reputation

<http://www.youtube.com/watch?v=rka9VbPPMys>



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¹³ <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aS5NjPlew.DI>

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