Lumbard & Kellner INSIGHT

S&P 500 1,910 * Dow Jones Industrials 16,633 * 30 year U.S. Treasury Bond 3.3%

OPPORTUNITY

It's springtime, and investor doubts and fears are in full bloom. Unemployment is too high, profit margins are too high, the Fed is printing too much money, China's growth is slowing, Europe is never, ever going to get out of its funk, and we don't have high speed rail!

The real concern, deep down, is that we don't *deserve* another good year in the stock market. Last year we had too much fun.

Too much fun? That's news to me . . . Home construction is up, and the unemployment rate is falling. GDP has recovered from a bad case of frostbite, and should grow nicely in the second half of the year. Yes, it'll stop growing if the Fed stops printing huge amounts of money every week, but they're winding the printing presses down at a very gradual rate. Inflation is *not* raging out of control, interest rates are so low that they make stocks look cheap, and corporate earnings keep growing, steadily. If the Fed prints too much money for too long the most likely result will be . . . a bubble in the stock market.

When we say that, the first thing that goes through the minds of listeners is "the bubble is going to burst!" Whoa . . . easy there, Bucko; the bubble hasn't even inflated yet.

And then there's the fear that if you make money in the stock market people will hate you. There's been a furor about the incomes of the wealthy; maybe, instead of getting mad at the top 1%—they're only 1% of the population!—we should put that energy into improving the lives of the bottom 1%. And creating good jobs for the bottom 20%.

What's really going on here is a growing sense of failure, both in job creation and in the War on Poverty. Nobody's talking about the bottom 1%, because it's much bigger than that—and it's harder for children to break out and rise into the middle class. When they do there's still plenty of reward; if a young couple started at the bottom of the economic ladder in 1979 and worked their way up to anywhere in the middle, their incomes are 40% greater than those of their parents who did the same thing (240% greater, if you include inflation). If you think honestly about the cars, homes, food, telephones, and computers of 1979 you'll quickly realize that these statistics make sense.

The problem is that the children of today's poor have a bigger mountain to climb. The CDC says that today 40.7% of all births—*more than forty percent of all births*—are to unmarried women, up from about 16% in 1979. Harvard economist Raj Chetty says that those who grow up in single-parent households—particularly if they are part of a community of single-parent households—are much more likely to suffer from depression, anxiety, behavioral and social problems, and problems with drugs and alcohol. They are more likely to drop out of school, and less likely to go to college.

The National Poverty Center says that *31% of households headed by single women live below the poverty line.*

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Opportunity

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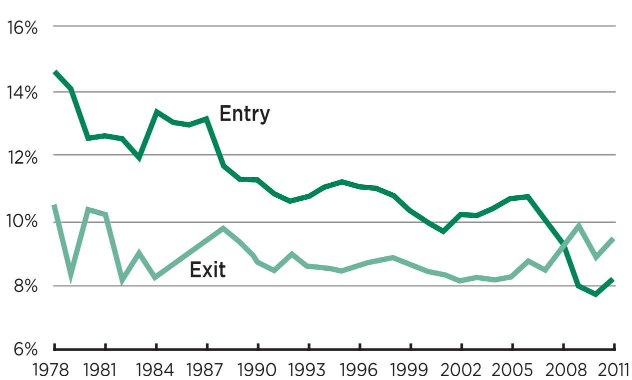
22% of all children live in poverty . . . Government has done nothing to reverse these trends, and the media (sex sells, as does promiscuity) are making them worse. Then we compound the problem with bad schools . . .

If we want to give the bottom 22% a reason to break the cycle of poverty, we need to do better for the working poor. Life is hard for those in this most-deserving segment of society—they even give more to charity, as a percentage of income, than those in the middle class—but they receive little of the torrent of government cash that flows everywhere else. And government cash can only do so much; the real answer is to persuade entrepreneurs to increase hiring.

No, we're not talking about tax breaks for companies that hire workers, or "programs" of any kind. Let's just take away some of the headaches and burdens that government has created, and make the prospect of hiring an employee a little less scary. The Brookings Institution says that ***the number of businesses in America is now shrinking. Every year.***

It's hard to imagine any economic harm that would result from over-taxing movie stars, but the road to hell and high unemployment is paved with legislation that causes inventors and entrepreneurs to become just a little bit less eager. If politicians—in a belief that this can help them get re-elected—persuade Americans that the rich are bad people, fewer Americans will want to become rich. Let's not forget that it's the hunger of entrepreneurs that drives employment and better living standards. They travel a hard road of feast and famine, from big years with huge taxes to years that wipe out the retirement savings of those who are lucky enough to escape bankruptcy.

In fact, there's so much feast and famine that most of the 1% have to be considered temporary residents. During their lifetimes 12% of Americans spend at least a year in the top 1%, according to Professors Hirschl and Rank, in the NY Times. And a *majority* of Americans will have incomes that rank in the top 10% at some point in their lifetimes. ■



Births and Deaths of U.S. Businesses: Brookings

THOUGHTFUL GENEROSITY

Few of us can influence government policy, but in many small ways we can improve the lives of the people around us. In recent years you've probably increased your restaurant tips to 20%, even when that means that a waiter gets $40 for 10 minutes of work. But what about tipping the maid when you stay at a motel? Almost by definition she's a member of the working poor.

BIGOTRY

"A growing body of research has found that better-looking people tend to earn more and score higher on performance reviews—and are even perceived to be more intelligent and moral."

– R. E, Silverman,
Wall St. Journal

The bias against unattractive people, and in favor of those who are attractive and tall, is found in every workplace and in most facets of life. Most people think it's OK to discriminate against the unattractive, and can't grasp the parallels with racism.

Wage discrimination and mate selection are just two of the humiliations . . . Attractive people—Halle Berry, Demi Moore—leap from poverty to wealth. Now they're rich *and* beautiful, and we celebrate them every day. ■

"Some see private enterprise as a predatory target to be shot, others as a cow to be milked, but few are those who see it as a sturdy horse pulling the wagon."

– Winston Churchill

YOUR CHILDREN WILL BE WEALTHY

It's been 5 long years since the official end of the 2007-2009 recession, but investors still feel nervous about the sluggish pace of the recovery.

That sluggish pace has been good for investors! The simple (and perhaps uncomfortable) truth is that high unemployment has held down wage increases, and kept inflation low. Low inflation has allowed the Federal Reserve Bank to keep giving us low mortgage rates and an extraordinarily easy monetary policy that boosts the economy and pushes stocks higher.

Most people will feel more comfortable about investing in stocks when the unemployment rate finally reaches a low level (and we don't have millions of people "not looking"), but by then the bull market will be on its last legs.

At right you'll see a graph of the growth of $1,000 invested in the S&P 500 since 1950. The index has multiplied a remarkable 100 times in those 64 years, and if you add in the dividends paid by the stocks (and reinvest them) the original $1,000 investment becomes more than $800,000.

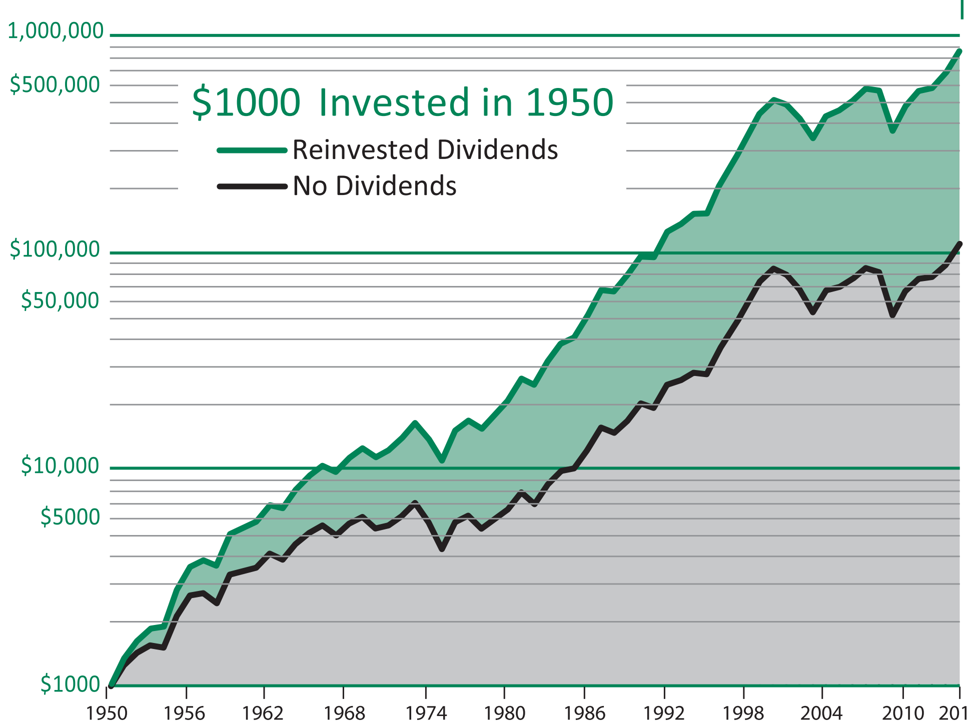
More than half of the gains occurred in the last 6 years. The first few doublings were dull as dishwater—$2,000, $4,000, $8,000—and that's always the way it is. You don't begin to feel the power until you reach the fourth doubling, and if you're starting in 2014 you might find that those doublings take 10 years. But anybody—even a minimum-wage worker who starts saving hard in an IRA at a young age—can become wealthy over the course of his or her lifetime. ■

The OECD says that our tax system is already far more progressive than that of any European nation, because we don't have a value-added tax that falls heavily on the middle and lower classes, and because our gasoline taxes are very low.

If we listen to Thomas Piketty and raise our top tax rate above 50% we're going to find that some entrepreneurs retire early. Some will move to Switzerland or Bermuda, while the young dreamers—think Steve Jobs and Bill Gates—put their energy into learning to surf. The pace of innovation will slow, and unemployment will rise.

Paul K. Wright, CFA

In looking at the chart below, the first thing you can appreciate is that longtime investors regret their failures to buy after a crash more than they regret their failures to sell before a big drop. That's the way they *should* feel, anyway . . .



www.simplestockinvesting.com; updated from 2010 to 2014 by Kevin Ciot, with data from Robert Shiller.

TRUTH IS FAIRER THAN FICTION

A 2013 Pew Research poll of 2,000 women under the age of 34 found that only 15% believed that there was wage or gender discrimination in their own workplaces. Most Millennial women polled by Pew believe that there is significant gender and pay discrimination outside their own places of work, but hardly any of them actually see it themselves.

"Young single women with no children earned more than their male counterparts in most metro U.S. areas, according to a 2010 study by New York-based Reach Advisors that analyzed U.S. Census Bureau data."

– Florida Sun Sentinel

"While the BLS reports that fulltime female workers earned 81% of full-time males, that is very different than saying that women earned 81% of what men earned for doing the same jobs, while working the same hours [women chose to work fewer hours], with the same level of risk [92% of work-related deaths in 2012 were to men] . . . and the same years of continuous, uninterrupted work experience . . . The Bureau of Labor Statistics reports that single women who have never married earned 96% of men's earnings in 2012."

– Mark J. Perry, Ph.D.,
professor of economics at
the University of Michigan.

Women who return to the workforce after ten years find that they have to settle for mediocre pay. The bigger problem is that they'll find it difficult to reach "average" pay in the years that follow. Employers always ask about an applicant's current pay, and make an offer that's just a little higher. That's hell on wheels for women and men who start their careers during recession years, or re-start at low pay.

Misleading news on gender equity contributes to unhappiness and anxiety in America—as do the suggestions that "one-percenters" such as Oprah, Nancy Pelosi, and Meg Whitman are somehow taking money from the 99%. It's an election year . . . But there are light-hearted moments. When the President fibbed that women make "77%" as much as men, the press corps pointed out that there is a clear pattern of wage discrimination in his White House. ■

If CBS announced that 60% of college degrees are awarded to men—and only 40% to women—anger would rain down from coast to coast. The truth is the reverse, but many women seem to think that's OK. It's boys who are suffering most of the failings of our schools; and the result will be more unemployment and poverty for both sexes, and a higher crime rate.

MORE GOOD NEWS

Remember Hubbert's Peak? The graph showed that US oil production had been declining since 1970. Just 3 or 4 years ago the Energy Information Administration was telling us that the long slide would continue; now they're saying that we're close to our highest production ever, and that the U.S. just became The Largest Producer In The World. The fleets of oil tankers crossing the Atlantic are shrinking, and our trade deficit is improving.

Canadian oil production is also rising, and Iraq just hit a new record of 3.6 million barrels a day—on its way to at least 8 million barrels a day in 2035. These numbers might make you wonder about our investment in Seadrill (SDRL - $37), but there's plenty of oil demand out there.

Deep sea drilling—Macondo spill notwithstanding—is the most-attractive frontier for international oil companies, which have been bloodied by their dealings with governments across the globe. They've also been bloodied by cost overruns on big projects in Australia, the Arctic, and the Caspian Sea. By comparison, drilling with the state-of-the-art rigs owned by Seadrill looks safe and predictable. We'll collect a 10% dividend as we wait for the story to unfold. ■

THIS WEEK'S CURRENCY TRADING TIPS:

Sell the Ukrainian Hryvnia, and buy Venezuelan lima bean contracts denominated in Bolivars—if the trade goes sour you'll always have beans to eat. Close out the short leg in your bearish straddle on bitcoins; wait for a collapse in paper money and gold, and a powerful 10% move to the upside overnight!

Things we learned during the government shutdown:

"More than 40 government agencies, including the EPA, the Department of Agriculture, and the Department of Commerce, are involved in trade shipments, said Ms. Rowden. Fourteen agencies have "release and hold" authority that trumps clearance from U.S. Customs and Border Patrol."

—The Wall Street Journal

Forty agencies? Good grief . . .

Our benchmark account, which opened in 1990 at a value of $100,000, now stands at $931,931—up from $461,826 at the end of 2007. We do not accept bitcoins in payment for our services. If you'd like further information, please call us at 800-Lumbard, or visit our website www.Lumbard.com.

SOCIAL RESPONSIBILITY

We recently purchased shares of Walmart (WMT - $76), shrugging off the accusation that the big retailer drove "mom and pop" stores out of business. They did, but low-income shoppers suffered greatly from the inefficiency and high prices of those mom-and pop stores. They were a *cause* of poverty. And let's point out that all the big-box stores beloved by yuppies and media (Tarjé, anyone?) were part of the same trend.

Target is popular among wealthier consumers because it has a better-looking clientele. Poor people don't shop there! Target's stores are a brightly-lit and pleasant place to lose your credit-card information and your identity, but their prices are far higher than Walmart's—even though Target's employees are also not unionized.

In fact, the source of most of the venom about Walmart is the United Food and Commercial Workers Union, which sponsors *two* anti-Walmart websites that feed data to the media (and your e-mail inbox) about how awful it is that 70-year-old grandmothers work as greeters at the front door. Walmart is taking market share from unionized grocery stores by offering better prices—again, an effective wage increase for the working class—and the UFCW will fight them by fair means or foul.

Drew D. Kellner, CFA

This year online sales will grow from $10 billion to $13 billion. Yes, we think that many of the stores need to be brightened up, but that's an opportunity to bring in more traffic. And nowhere else can you buy designer eyeglasses, a Sony TV, Mobil One, Valium, and Texas Ruby Red Grapefruit at bargain prices in a fast hour of shopping.

If you can reduce a worker's cost of living by 20%, it's more impactful than giving him a raise of 20%. But Walmart didn't oppose the minimum-wage increase, because it doesn't have any workers who are paid the federal minimum wage. 75% of its store managers started as hourly associates, and every year it promotes 170,000 people to jobs with more responsibility and higher pay.

Has Walmart has done more for the poor than any charity? ■

BUY IN JUNE. WHISTLE A HAPPY . . .

We didn't "sell in May and go away" this year, because too many other investors were doing the same thing. In the first four months of the year the market went nowhere, while earnings rose despite the frigid weather.

Along with Walmart and Toyota (which should benefit from further declines in the yen; TM - $110), our recent purchases included Regions Financial (RF - $10) and Huntington Bancshares (HBAN - $9), two regional banks that sit above great swathes of the nation's oil shales. Royalties are pouring into the checking accounts of farmers and ranchers, providing low-cost funding. Meanwhile loan demand is growing, because these are the fastest-growing parts of the country.

We continue to like Metlife, Prudential, and IBM; as a group all these stocks sell for far less than the S&P 500, but analysts expect average earnings growth of almost 8%. ■

COMPETITIVE SCHOOLS

"If you care about those at the bottom then you are wasting your time and everyone else's time unless you focus on one and only one phenomenon: the inequality of educational opportunity . . . There is almost nothing we could do that would be more impactful in reducing inequality of educational opportunity and inequality overall than to do what Sweden has done: give every child a voucher and let them select a school of choice."

– John Goodman, on Townhall.com

Good news! The era of uncompetitive, monopolistic schools is slowly drawing to a close.

In the most-recent school year 69,000 students entered lotteries to win 18,600 open seats in NYC charter schools, which have a total population of 70,000 students. Their parents truly see this in terms of winning the lottery . . . These students are overwhelmingly from poor, minority families, yet they have higher average test scores than students in traditional NYC public schools, especially in math.

John Lumbard, CFA

Teachers' unions have recruited politicians and the Justice Department to crush the rebellion. The new mayor of New York is working to choke the growth of the charter schools championed by his predecessor, Mike Bloomberg; and there are battles underway in Illinois, Massachusetts, and Tennessee. In Louisiana the Justice Dept. tried to claim racial discrimination in an effort to shut down charter schools, even though most of the beneficiaries of the schools are minorities.

As in any business or any aspect of life, it's competition that creates the pressures needed to make tough decisions—without which excellence is impossible. Competition also allows experimentation and new ideas; some succeed, and others fail and are forgotten. In a monopoly the bad ideas live on and on; as do burned-out teachers and incompetent principals.

– John Lumbard , CFA

"Restoring earmarks in today's Congress would be like opening a bar tab for a bunch of recovering alcoholics."

–Senator Tom Coburn arguing against the return of earmarks or "pork". Until 2011 legislators were allowed to cram amendments for unrelated spending into legislation; and now some members of Congress are lobbying to get it back!

Performance Results:

The performance results presented below are for our "Benchmark Account", using January 1, 1998 as the date of inception. The performance results for the Benchmark Account are calculated by Lumbard & Kellner, LLC's current custodian, U.S. Bank (prior to 2004 State Street was the custodian). The account pays fees based on our firm's fee schedule from the 1990s (top rate of 1%), and the percentages shown are net of fees and expenses—that is, the returns shown would have been higher if fees had not been deducted. The performance results for the Benchmark Account include the reinvestment of dividends and other earnings, but there have not been any other additions or withdrawals since inception. The comparative indexes shown are the S&P 500 Composite Index, Dow Jones Industrial Average, NASDAQ Composite, Barclays U.S. Aggregate Bond Index, and the Citigroup 3 Mo T-Bill Index.

Actual returns for individual client portfolios managed by Lumbard & Kellner, LLC may vary and will not necessarily coincide exactly with the returns for the "Benchmark Account." Past performance of the "Benchmark Account" does not guarantee future results. No assurances or guarantees can be given or implied concerning future investment results for Lumbard & Kellner, LLC or any investment index. Future returns may differ significantly from the past due to materially different economic and market conditions and other factors. Investments within portfolios, and therefore, portfolios, involve risk and the possibility of loss, including a permanent loss of principal.

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