

Lumbar
& Kellner

INSIGHT

S&P 500 2,066 * Dow Jones Industrials 17,710 * 30 year U.S. Treasury Bond 2.59%!

IT'S A BUNNY!

Jim Paulsen, market strategist at Wells Capital, says that this isn't a bull market or a bear market; it's a bunny. It hops around, but really doesn't go anywhere. We've been hitting 18,000, again and again, ever since the Internet bubble burst. Or did we really?

In January of 2000 the Dow Industrials actually peaked at 11,700, and peaked again at 14,200 in October of 2007. If you're going to pick a benchmark, how about using the peak it reached just before Black Monday in 1987? Stocks dropped 22% in one day, for no reason other than the fact that they had run up **Too High**. You can still see the spike on the long-term graph.

Here's the punch line: in 1987 "Too High" was 2,722. On the very worst day of the very worst year, 2009, the Dow was at 6,500.

The market climbs a wall of worry. If you're worried, that's a good thing! And, really, were you worried in 2007? Almost everyone we talk with, these days, seems worried.

Sure, there are legitimate issues. But they're a lot less scary than those of 2007, when people were putting down \$2,000 to buy \$200,000 houses—*100-to-1 leverage*, as they say on Wall Street—egged on by the media and mortgage brokers who were happy to lie about an applicant's income. Ratings agencies were slapping AAA ratings on bundles of this bad debt, and your government was pushing the banks to lend even more.

The thing that really upset Wall Street this past winter was a newfound sobriety and personal fiscal responsibility among American consumers. Personal Income rose faster than Personal Spending, and they refused to spend the windfall of lower gas prices. Grrr ...

Now the economy has accelerated back to "sluggish". That doesn't sound like much, but it's the rate at which it has been growing throughout this historic bull market. Here's what Warren Buffett had to say about 2% growth:

"America's population is growing about 0.8% per year. Thus 2% of overall growth produces about 1.2% of per capita growth. That may not sound impressive. But in a single generation of, say, 25 years, that rate of growth leads to a gain of 34.4% in real GDP per capita. In turn, that 34.4% gain will produce a staggering \$19,000 increase in real GDP per capita for the next generation." ■

"Scientists have declared that the first person who will live to be 150 years old has already been born. This will bring with it some interesting consequences, not the least of which is, "How long does she want to work?" If she wants to work to 65 and lives to be 150, that's going to be an interesting math equation."

—Sheryl Connelly,
manager of global
consumer trends at Ford

THE GIFT

The Always Ready Engine House, the former fire station of Hollis, NH, is a piece of history maintained by the Hollis Historical Society. From its perch on Main Street, above the town common, you can see the grand sweep of volunteerism in America. Across the common the Town Hall thrums with the voices of members of the Conservation Commission, Planning Board, Trails Committee, Energy Committee, Budget Committee ... Listen to the left and you'll hear voices coming from the Congregational Church, where Boy Scout, Girl Scout, AA meetings, and blood drives are underway. A little farther left sits the library, managed by the Library Trustees and a platoon of volunteers, and "Little Nichols Field", a ballfield well-loved by young baseball players and parents.

Just beyond the outfield lie the Historical Society, the Lucie Beebe garden, a playground—expanded in a 2014 volunteer initiative—and the—always busy—Town Volunteer Shed. The ballfield is called "Little" Nichols Field because there's a much-larger all-volunteer cluster of Nichols fields and buildings a quarter-mile away. **More than 30%** of all the land in Hollis is owned/protected by the town, or owned by the mostly-volunteer Beaver Brook Association.

When it comes to gifts of time and money, Americans rank 2nd in the world, after Myanmar. New Zealand, Canada, and Australia rounded out the top five. Japan, China, and several wealthy

European nations ranked in the bottom half of the Gallup World Survey, which asked 150,000 people in 140 nations whether they donate time or money, and whether they have recently assisted a stranger.

"Givers" says Arthur C. Brooks, in Who Really Cares, "express less negative prejudice than non-givers toward African Americans, whites, Latinos, and Asians. They are more sympathetic to Protestants, Jews, Christian fundamentalists, and Catholics... Givers are more favorably disposed to everybody than are nongivers."

Americans who think that government should do more, studies show, are less charitable in their personal lives. If Peter gives money to Paul, that's a wonderful thing. If a politician promises to take money from Peter and give it to Paul, the politician benefits at the expense of Peter, who is deprived of the joy of giving, and deprived of his choice of charity. Even Paul is deprived of something, because gratitude is a characteristic of happy people.

LiveScience reported on a study by Elizabeth Dunn of the Univ. of B.C.; "Statistical analyses revealed personal spending had no link with a person's happiness, while spending on others and charity was significantly related to a boost in happiness." The same is true of gifts of time, and there's the added social benefit of participating in a community of like-minded people who are basking in the warmth of good deeds. ■



John Lumbard, CFA

78% of the USDA's budget—\$114 billion—goes to food assistance. 45 million Americans now receive food stamps ("SNAP"), and there are 14 other USDA food programs that serve 50 million people. Lumbard & Kellner nevertheless donates each year to two soup kitchens, because a lot of people fall through the cracks, or are struggling to make ends meet. Our poorest households actually receive less from government than middle-income households.

"Headcount across the firm is up 11 percent over the last four years, largely to meet regulatory compliance needs."

— An excerpt from the Goldman Sachs annual report. GS employment has grown from 32,500 to more than 36,000. That's 3,500 new employees toiling away in cubicles to fill out new government forms!

PROFIT IS NOT A DIRTY WORD

Americans have enjoyed 200 years of spectacular progress, in which every generation fared better than the one before it. Yet today only 14% of Americans think that our children will be richer, safer, and healthier than their parents, displaying one of the highest levels of gloom on the planet. 50% of Indians and 42% of Thais believe that their children will have better lives. Even Brazilians are more optimistic than we are!

The trouble is that our own children are often underemployed, carry student debt, and look forward to paying a big “youth” surcharge for health insurance. They also carry a heavy burden of federal debt, which—*hello?*—will become even heavier if the government borrows another trillion dollars so that it can pay off their student loans.

Unfortunately, many Americans are blaming unemployment and stagnation on free enterprise and free trade, which clearly were the factors that created all our wealth in the first place. Just a few generations ago, Americans had to trudge to the outhouse in the dead of winter, after a meal of musty potatoes and water.

We nevertheless frequently hear Americans grouse about the hunger for profits that motivates corporations and businesspeople. So let’s get right to the point; if profit becomes a dirty word, you will lose your job and become poor. And there won’t be any Social Security to fund your golden years.

There’s an outcry whenever a corporation shifts workers to a shorter work week, to avoid offering healthcare benefits, but it’s *non-profit* corporations, such as colleges and universities, that are some of the biggest abusers. USA Today says that most college courses are now taught by “adjunct” professors who lack benefits or decent pay. The Atlantic adds that “31% of part-time faculty are living near or below the federal poverty line.” According to the UC Berkeley Labor Center, one in four receive food stamps, Medicaid, or the welfare checks known as the Earned Income Tax Credit.

It’s today’s students who will carry the burden of the federal debt, swelled by the cost of welfare and Medicaid for their underpaid college professors. The same students who are piling up college debt, as the victims of price gouging by the “non-profits” that have been cheating their professors.

It’s the for-profit employers who create most of the employment, but they’re staggering under a rising tide of regulation and ever-more-expensive employee benefits. And living in fear of a rising tide of government lawsuits. Why would they want to take the risk of hiring, and investing in growth? ■



Paul K. Wright, CFA

Talking heads have been saying that corporate profit margins are at all-time highs, and likely to fall. What the grousers are missing is the fact that “profit margins” refers to the profit margins of the S&P 500, which means a different group of 500 companies every year. NCR, Navistar, and Dillard’s Department Stores went out, while Facebook, Netflix, GameStop, and Google—companies with much bigger profit margins—came in. On average, a company is replaced every two weeks!

DON'T GET YOUR KNICKERS IN A TWIST!

The Brexit vote is coming on June 23, and investors are sore afraid. But this is already all over the news—it’s fully reflected in stock prices. And Britain will not leave the euro. It has the £ British pound! ■

STOCK ROUNDUP

During the last few months *three* of our mid-sized companies surprised us, unpleasantly, by acquiring other firms. **Huntington** (\$10) and **Keybank** (\$12) are both financial firms; it's likely that their acquisitions will work out, but the stocks are nevertheless burdened by abnormally low interest rates. The third company, **Kraton Performance Polymers** (\$27), is a specialty-chemicals company that makes non-allergenic latex, the rubber squiggle on the handle of your toothbrush, and polymers that are mixed with asphalt to make a durable self-healing pavement.

At the end of the year Kraton bought Arizona Chemical, a slightly-smaller specialty chemical company, and—during a bond-market panic—issued “high yield” bonds to pay for it.

The stock bottomed in late January, down 50% from its 2014 high, and then doubled. First-quarter earnings were strong, and then a hedge-fund manager predicted on TV that the stock will rise from today's \$27 to \$65. Or maybe \$97.

And, oh yes, **Fedex** (\$160) has finally received approval for its acquisition of Netherlands-based TNT. In the shipping business size is a good thing. ■



WORKING-CLASS BLUES

The primary results are in. The working poor—some of our most-admirable citizens—are furious at the Establishment. Politicians subjected them to a flood of brutal competition that slashed their wages and put them out of work. Journalists sneer at “older uneducated whites”, but if you look closely at that crowd you'll see young, old, black, white, and Hispanic. Workers feel that journalists, politicians, and their Baby-Boomer Establishment supporters—many of whom claim to be champions of the working class—are arrogant, selfish, and dim-witted.

There's always a sweet deal for unions, but politicians have left most workers vulnerable to withering competition from unskilled illegal and legal immigrant workers. Only 12 million of our 41 million immigrants have college degrees. Are journalists really unable to grasp the obvious truth that the addition of tens of millions of unskilled laborers depressed the wages of American workers?

Politicians lavish attention on the non-working poor, but they aren't helping. Since the beginning of the “War on Poverty” 50 years ago, the poverty rate has increased, despite an expenditure of trillions of dollars. Hardly any inner-city children now have two parents in the household. Religion has been replaced by drugs and alcohol. Fatherless boys go to jail, or die of drug overdoses.

Our working classes know all these things, and they are seething. ■

BOYS WITHOUT FATHERS

“Children who grow up without a father are five times more likely to live in poverty and commit crime; nine times more likely to drop out of schools and twenty times more likely to end up in prison. They are more likely to have behavioral problems, or run away from home, or become teenage parents themselves. And the foundations of our community are weaker because of it.”

– President Barack Obama

According to CDC.gov, 40.6% of all American births (53% of all Hispanic births, and 71% of all African-American births) are to unmarried mothers. ■

NEGATIVE INTEREST RATES? REALLY?

“Negative or very low yields have made life very difficult for many Japanese living on a fixed income. The FT reports a wave of larceny by elderly Japanese desperate to get into prison for 3 square meals a day and free healthcare. The surge in older inmates has caused a demographic budget crisis for the penal system, the paper says.”

Christopher Low, Chief Economist, FTN Financial

ISLAND DREAMS

In early May, Puerto Rico defaulted on some of its debt, which is held in lots of tax-free mutual funds because it's exempt from all state and federal tax. Puerto Rico will now balance its budgets, because it won't be able to borrow.

In return for any bailout our Congress should demand a balanced-budget amendment to the Puerto Rican constitution. We The People should demand the same for the U.S. Constitution. In 1995 a balanced-budget amendment passed the House of Representatives with a 2/3 majority, but then failed by a single vote to pass the Senate.

Some conservatives oppose a balanced-budget amendment because it might lead to higher taxes. OMG! Most proposals include a limitation on spending as a % of GDP. And do you really think that the giant deficits of the last couple of decades have restrained spending?

In 1995 the public debt was only \$3 trillion. It reached \$5 trillion by the start of the 2007-2009 recession. It's now \$13.5 trillion, and it's still growing.

The figure you usually hear, \$19 trillion, includes the bonds held in the somewhat-fictional Social Security Trust Fund. All those totals are calculated using shoddy accounting practices; David Walker, the former U.S. Comptroller General, says that

proper GAAP accounting would put the debt at \$65 trillion or more.

Still, *this isn't an insurmountable problem*. It gets harder every year, and hardly anybody in Washington has the courage to take action. But if we were to hold the debt at \$19 trillion while GDP grew, in a couple of decades it would look fairly small. Faster growth in GDP would help a great deal.

When a government runs deficits, it taxes too little or gives too much to its citizens, or both. The citizens of yesterday and today get a free ride at the expense of the citizens of tomorrow. Every day 10,000 Baby Boomers retire, and start collecting Social Security and Medicare.

Three years from now, as the recession of 2019 (or thereabouts) gets under way, most of the developed nations of the world—especially Japan, Greece, Italy, Portugal, France, Belgium, and the United States—will look back in wonder, struggling to understand how we failed to get our financial houses in order. By then we will have squandered ten years of economic recovery. ■

The May 17 value of an account we often reference in our newsletter was \$913,513. If you'd like further information or context please go to www.Lumbard.com, and click on the "Performance" tab.



Drew D. Kellner, CFA

RATES RISING

Health insurance premiums are heading for another big jump in 2017. Insurers are beginning to file, state by state, for Affordable Care Act increases. From the AP: "In Virginia, a state that reports early, nine insurers returning to the HealthCare.gov marketplace are seeking average premium increases that range from 9.4 percent to 37.1 percent."

They'll probably win approval, because 12 of the 23 non-profit ACA insurers have folded. Last year non-profit insurers went bankrupt in New York, Nevada, Iowa, Kentucky, Louisiana, and Nebraska. The biggest for-profit insurer, UnitedHealthcare, is throwing in the towel in all but a few states, after suffering huge losses.

Most Americans think the rates are already too high. 10 million have signed up (and are paying premiums), while 36 million Americans are still not insured. ■

THE FUTURE OF ENERGY

On peak summer days, Germany now produces 50% of its electric power from solar panels. But over the course of a year solar produces just 7.5% of Germany's power, despite a massively-expensive effort to reduce CO₂ production by shifting to renewable energy. Power in Germany now costs more than twice as much as power in France, where 77% of it comes from CO₂-free nuclear plants.

The problem is that it takes 31 square miles of solar panels, plus huge backup natural-gas (from fracking!) plants, to equal one large nuclear plant. Germany has been shutting down all its nukes, so it has not succeeded in lowering its CO₂ output at all. Coal now produces 45% of the nation's power—six times as large as solar!—and most of that is dirty, deadly, brown coal.

In 2004 ABT Associates estimated that power-plant emissions of fine particulates—mostly coal—were causing 24,000 deaths a year in the United States. 1970s-era protests in the U.S. caused a big shift from nuclear to coal, and the deaths of *hundreds of thousands* of people.

Nuclear plants haven't killed *anybody* in the United States, in 60 years. There weren't any radiation-poisoning deaths at Fukushima, and—in 22 years of searching—UN

scientists have only been able to find 64 Chernobyl deaths.

The really good news is that there are new nuclear designs available that are inherently safe, and *can even burn nuclear waste*. Unlike the ubiquitous “pressurized water” design they don't require massive concrete-and-steel containment structures, and they extract nearly all the energy in their fuel. Today's nukes generally extract only 3% or 4% of the energy available in their fuel rods, which have to be removed and replaced about every five years.

Bill Gates has invested many millions in Terra Power, which has a new nuclear design that we hope will succeed. But we (with the guidance of a local nuclear physicist) are going to tell you about a different new design that was extensively tested in the 1960s at the Oak Ridge National Laboratory. At the time it couldn't get any traction because the pressurized-water design was considered too safe and too successful.

In this old/new/better design, the fuel is dissolved in a liquid—hot, molten salt—that can be left in the reactor for decades until nearly all of the energy has been extracted. Transatomic Power, an effort that emerged from MIT, believes that it will be able to extract 96% of the

energy. From nuclear waste!

The key to any reactor is space. When there is space around a pound of fuel, it's going to stay cool. Push a lot of fuel together in a pile, and it heats up. Two billion years ago this happened naturally in Gabon, West Africa, causing several uranium deposits to “burn” quietly for hundreds of thousands of years.

When uranium is dissolved in molten salt it stays relatively cool, as long as it's stretched out long and thin in a pipe. Pump it up into pipes that are bunched closely together, and it will heat up. Let it drain back down at night, and it will cool down.

The low pressure of Molten Salt Reactors eliminates the need for massive concrete domes, so they will cost much less. They will cool down automatically unless the liquid fuel is continually pushed up into the power-producing core.

Now for the bad news. China is leaping ahead of us in this race, with a better-funded molten-salt effort that expects to produce a functioning reactor in just 8 years. The U.S. effort will spend those years filling out the required paperwork.

– John Lumbard, CFA

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