

Lumbar  
& Kellner

# INSIGHT

S&P 500 2,239 \* Dow Jones Industrials 19,763 \* 30 year U.S. Treasury Bond 3.06%

## ANIMAL SPIRITS

Stocks are rising, and the economy is accelerating. Consumer confidence is at its highest level since 2001. Businesses are laying plans for hiring and investing. Retail analysts believe that Christmas sales were up almost 5% since last year—the strongest gain since 2005. It’s a far cry from the fear and gloom of last winter!

The new optimism is especially evident in the financial sector. Three of our bank and insurance stocks have climbed more than 80% since the fearful low of mid-February! Financial firms are looking forward to less regulation, and fewer lawsuits filed by the federal government.

For years, the markets have been worrying that the Fed would—yikes!—raise interest by a quarter of a percent. In mid-December the Fed did just that, and the stock market “plunged” 0.8% ... the next day it resumed climbing toward Dow 20,000.

Economist John Maynard Keynes called it Animal Spirits. Consumers and businesses suddenly become more confident, and economic growth is lifted

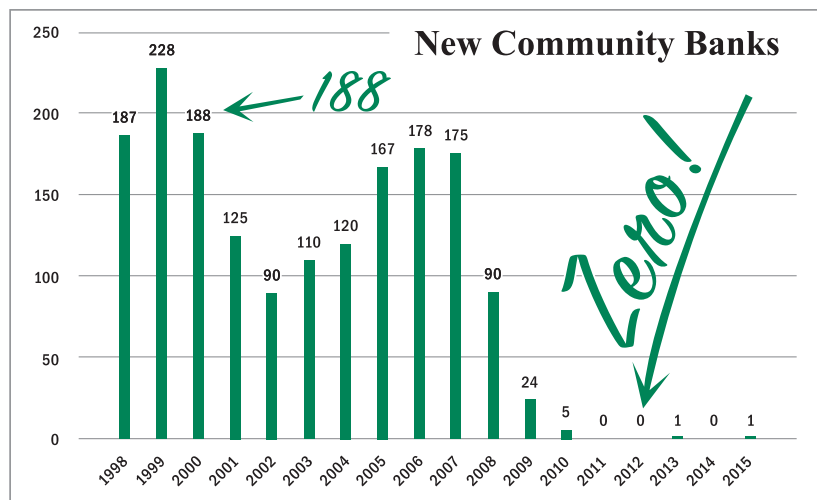
without any change in monetary policy or government spending. Faster economic growth causes wages to rise, and the merry goes ‘round.

Investors have learned, again and again in the last 7 years, that it pays to be optimistic. They won’t be shaken as easily now.

There’s still a lot of money on the sidelines, sitting in “cash”. If you’re earning 1% in CDs,

and inflation is at 2%, you’re slowly getting poorer. And starting to think that it might be worth taking some risk to get a higher return.

Meanwhile, even more cash is heading for the sidelines as bond investors—appalled by recent losses of 10% or more—sell out of their supposedly-safe bond-fund holdings and put some of the proceeds into stocks. It’s a bull market! ■



If you want to know why the bank stocks have been soaring, you need look no further than this graph, drawn from FDIC data. Small-town businessmen used to open more than 100 new banks every year, but only two have opened since 2010! The regulatory burden is now so heavy that nobody wants to invest or hire. Investors are thrilled by the prospect that this burden, and its heavy costs, will be reduced.

# INFRASTRUCTURE

You know those paddles that doctors use to shoot electric current into the chest of a heart-attack victim, hoping to revive him? That’s a good analogy for the zero and negative interest rates that central banks have engineered in all the developed countries. They’re trying to juice their half-dead economies to life.

The same can be said about the big budget deficits of these nations. Politicians borrow money for “stimulus” or “infrastructure”, and spend it in a way that creates jobs buys votes. Then the project ends, the workers are laid off, the economy deflates, and we have to pay interest on the resulting debt for the rest of our lives.

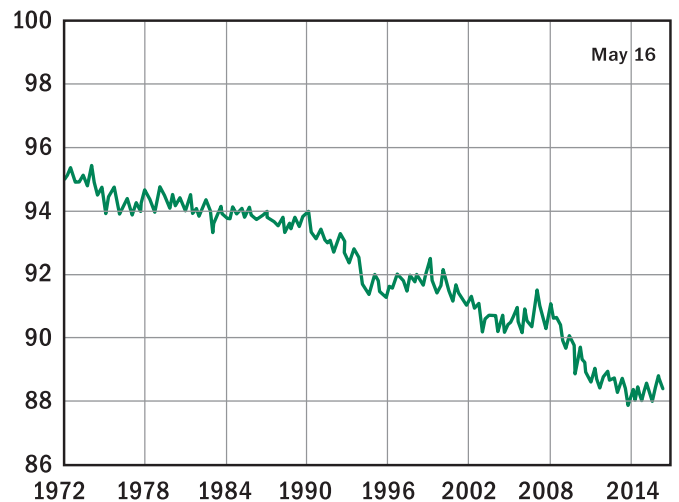
Of course, *infrastructure doesn’t have to involve deficit spending*, and it doesn’t have to shovel money to boondoggles such as Solyndra, or high-speed rail for rich people. How about “smart” electric meters, that allow utilities to charge lower prices at night? They would reduce pollution and fuel consumption, and lower the cost of energy. A few years down the road we’d all be a little bit healthier and wealthier.

The same would be true if we were to build a dozen research ships, each powered by a next-generation, super-safe power plant that burns nuclear waste, and drive them around until we can pick a winner. Then we build ships by the hundreds, and sell them to seacoast cities around the world—where they can produce both power and fresh, clean water.

Exports! Skilled jobs! Technological leadership! Clean power that’s not “intermittent”, and which doesn’t kill endangered species, industrialize mountaintops, or pave wheat fields with glass. If we don’t do this, China will—and we’ll continue sliding toward second-rate status. You’ll find a description of molten salt nuclear plants in our Summer 2016 newsletter. ■

In the last five years the amount of oil produced from a well in Texas has doubled, and it’s still rising. Technology is lowering the cost of producing oil and gas in the United States, and the economic impacts are far greater than anything happening in “high” technology, medicine, or any other field.

Percent of Men aged 25 to 54 who are employed.



U.S. Bureau of Labor Statistics, [www.TradingEconomics.com](http://www.TradingEconomics.com)

“America is now home to a vast army of jobless men no longer even looking for work—more than 7 million between the ages of 25 and 54 ... Government disability programs figure prominently in the calculus of support for unworking men—ever more prominently over time. According to Census Bureau data, nearly three-fifths (57%) of prime-male unworkers in 2013 were obtaining benefits from at least one disability program.”

– Time Magazine

As a greenhouse gas, methane is 30 times as potent as carbon dioxide. And it can be burned as fuel! If only ....



## DE-REGULATION

Investors seem to expect big changes in Washington in the next 100 days. New legislation will almost certainly impact inflation, growth, interest rates, profits, and the dollar. The dollar has already moved higher, benefitting consumers and holding down inflation, but harming the profits of multinationals (because their foreign profits now look smaller in dollar terms). The rising dollar also makes it harder for our manufacturers to export

and compete, and harder for them to keep jobs in the United States.

President Trump will have to compromise substantially, with Mitch McConnell, Paul Ryan, and the House Freedom Caucus, to move his agenda forward. If these parties agree they will be able to reform the tax system, pass spending bills, and change or repeal Dodd-Frank and the Affordable Care Act without fear of a filibuster. ■



*Paul K. Wright, CFA*

## SHARE THE WEALTH

The three richest counties in the United States are in the Washington metro area—as are 11 of the 20 richest counties. Our founding fathers never intended to concentrate wealth and power in Washington, sucking resources from the rest of the nation like the monarchies that they so deeply loathed.

Washington is now so large that its citizens live in a bubble, unable to understand attitudes in the rest of the country. Alec MacGillis of the Washington Post suggested, way back in 2010, that federal agencies should be moved to other parts of the nation, where their employees could

mingle with real Americans. It's a terrific idea—we could spread some of eastern Virginia's concentrated wealth to West Virginia—and the proposal is now reverberating from CNN to the Wall Street Journal.

Detroit would be happy to take in a government agency, along with its wealthy lobbyists, suppliers, and hangers-on. How about El Paso or Louisville? Anywhere in Louisiana or Mississippi .... People who spend their lives writing regulations would rub elbows, on the sidelines of playing fields, with people whose livelihoods are affected by the rules. ■

## THE GREEN MONSTER

“More than 3,500 birds died during the 377-megawatt Ivanpah solar project's first year of operation, a new report estimates.”

— [The Desert Sun](#)

“Wind turbines kill an estimated 140,000 to 328,000 birds each year in North America.” – Audubon.org

“Over time, there have been hundreds of eagles killed. Probably about 2,000.”

– Ornithologist Shawn Smallwood, who studies the effect of wind turbines on raptors.

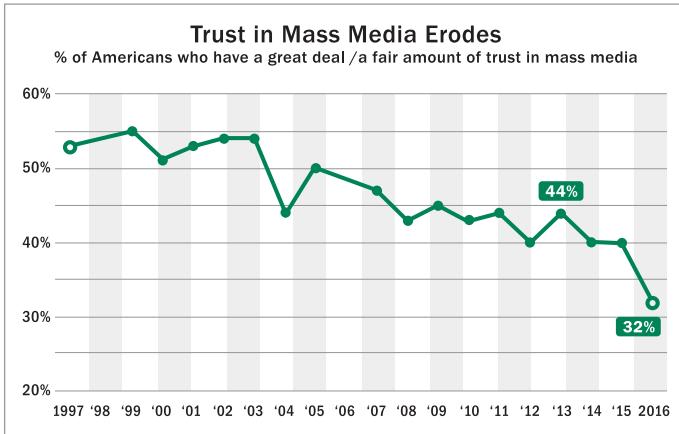
The real estate market has improved a great deal. But a Q3 2016 analysis by ATTOM found that in 17 of the nation's zip codes—including the inner cities of Chicago, St. Louis, and Detroit—*more than 66% of the mortgages were “Seriously Underwater”*, meaning that the mortgage is 25% larger than the value of the home.

“The federal government's affordable housing goals ... required Fannie Mae and Freddie Mac to meet annual quotas for mortgages made to borrowers at or below the median income.”

– Peter Wallison, author of [Hidden In Plain Sight: What Caused the World's Worst Financial Crisis and Why It Could Happen Again](#).

“It was a great mistake to push lower-income people into housing they couldn't afford.”

– Mea Culpa by Congressman Barney Frank, as related by [The Atlantic](#).



Source: Statista.com, using data provided by Gallup

## OUT OF TOUCH

“Historically, the *Los Angeles Times*, where I worked twice, for instance, was a reporter-driven, bottom-up newspaper. Most editors wanted to know, every day, before the first morning meeting: “What are you hearing? What have you got?”

It was a shock on arriving at the *New York Times* in 2004, as the paper’s movie editor, to realize that its editorial dynamic was essentially the reverse. By and large, talented reporters scrambled to match stories with what internally was often called “the narrative.” We were occasionally asked to map a narrative for our various beats a year in advance, square the plan with editors, then generate stories that fit the pre-designated line.

Once, in the Los Angeles bureau, I listened to a visiting National staff reporter tell a contact, more or less: “My editor needs someone to say such-and-such, could you say that?” The bigger shock came on being told, at least twice, by *Times* editors who were describing the paper’s daily Page One meeting: “We set the agenda for the country in that room.”

– Michael Cieply, a 12-year veteran reporter for the *NY Times*, writing in *Deadline.com*. On the eve of the 2008 election the *New York Times* accused John McCain, who has an adopted daughter of color, of racism. ■

In 2005 Randi Weingarten and her United Federation of Teachers opened a charter school in Brooklyn, declaring that its success would “finally dispel the misguided and simplistic notion that the union contract is an impediment to success.” The school’s student test scores and other metrics were so poor that it closed in March.

“In Illinois, the Natural Resources Defense Council, along with the Sierra Club and the Environmental Defense Fund, are among the advocacy groups working with Exelon and state lawmakers on a legislative deal that would reverse a decision the company made in early June to close two nuclear reactors in the next two years.”

“After reactors closed in Southern California and New England in 2013 and 2014, respectively, emissions in those regions rose after having declined for some time, according to data from nonprofit electricity transmission organizations. Regulators replaced those reactors with natural gas, which is often the cheapest option but emits carbon dioxide.”

– The Wall Street Journal

**L**ong ago Elon Musk envisioned that Americans, disgusted with environmental degradation, would prefer to live on Mars. Of course, that was before the film “The Martian” came out. Now we know that you can achieve the same quality of life by plopping a mobile home in a barren and dead part of Nevada (the outskirts of Las Vegas would do nicely) and NEVER EVER coming out.





## THE AMERICAN PEACE

“*Pax Americana* is a term applied to the concept of relative peace in the Western Hemisphere, and later the world, as a result of the preponderance of power enjoyed by the United States beginning around the middle of the 20th century and continuing to this day.”

– Wikipedia. The years before Pax Americana featured World Wars I and II, and seven other major wars and genocides that took 73 million lives in just a few decades. It’s called The American Peace for a reason.

The White House Budget Office says that in 2016 defense spending was just 15% of the federal budget, down from 18% in 2013—and down from 49% when JFK was president.

There is plenty of potential trouble in the world, and it’s not all in the Middle East:

“North Korea is on track to have a nuclear-capable missile with the range to reach the continental United States by early next decade. Kim Jong Un ... boasts of his ability to ‘burn Manhattan down to ashes’”.

– The Economist

If you want to feel depressed, look up the history of our anti-nuclear treaties with North Korea. We’re following the same script with Iran:

“Iran will retain about 5,000 centrifuges capable of separating the uranium-235 isotope from uranium ore, “ says Bloomberg News, “The technology gives

Iran the ability to pursue nuclear weapons should it choose to break its commitments.”

China has a new aircraft carrier, *seventy* submarines, and a new stealthy fighter jet with technology stolen from the F-35. It continues to build on the Spratly Islands, defying a ruling from the International Court of Justice. Relations with Taiwan, South Korea, and the ASEAN nations have soured. Vietnam has moved rocket launchers to the Spratlys, purchased 6 missile frigates, and acquired 6 submarines. ■

## INNUMERACY

Politicians tell us regularly that they’re going to take care of the poor, the elderly, the young, the middle class, families .... Total it up, and it’s more than 85% of the population. We can afford to “take care of” 20% or maybe even 25% of the population, but we can’t “take care of” *most* Americans.

“If we can but prevent the government from wasting the labours of the people, under the pretence of taking care of them, they must become happy.”

– Thomas Jefferson, 1802

“The principle of spending money to be paid by posterity, under the name of funding, is but swindling futurity on a large scale.”

– Thomas Jefferson, 1816



Drew D. Kellner, CFA

## SERENITY

Stock-market investors are nearly always—eventually—rewarded for patience and serenity. You can’t know *when* share prices will improve, but someday they will—at the most-surprising moment. Our “benchmark” account reached \$970,000 in the middle of 2015, and then took a horrifying drop below \$800,000 on a single day in February, as recession fears and panic swept Wall Street. Ten months later—with nearly the same list of stocks—it was at a new high. The only harm was felt by investors who sold equities during those months of gloom and despair.

The latest figure, from December 31, 2016, is \$1,027,111; up from \$241,129 on the first day of 1999 (we wish we were allowed to tell you the 1990 value, but we’re missing a handful of statements from the mid 90s). If you would like further information or context please go to [www.lumbard.com](http://www.lumbard.com)

## ENRON-ESQUE ACCOUNTING

“In the fiscal year ending September 30, 2016, the U.S. budget deficit jumped to \$590 billion ... However, over the same time period the change in total gross federal debt surged upward by \$1.4 trillion.”

– Dr. Lacy Hunt and Van Hoisington

Government accounting is *awful*. That’s an \$800 billion deception! The federal government insists on the use of Generally Accepted Accounting Principles for everybody except itself. No corporation would be allowed to operate like this!

Part of the \$800 billion in “secret” borrowing reflected the fact that Social Security and Medicare spent more last year than we raised in FICA taxes. These programs can only stay solvent if the Baby Boomers keep working, and pay

lots of FICA and other tax. We really can’t afford to have them retire and *start drawing benefits*, and we’ve known this for a very long time. The Medicare trustees say that they’ll run out of money in 12 years!

As we write these words the federal debt is about to hit \$20 trillion. It’s a massive transfer from young to old, and if young people don’t protest now they’ll protest later, when the interest on the debt rises above a trillion dollars a year. They might simply refuse to pay for Medicare.

In 2016 we collected about \$3.3 trillion in taxes, and that was an all-time record. ■



John Lumbard, CFA

“Approximately 20,000 cancer cases per year could be prevented by increasing fruit and vegetable consumption.”

– From a study cited by Michael Greger, MD, of Nutritionfacts.org, as he expressed concern that the high prices of organic fruits and vegetables are causing organic consumers to eat less of them—and thus *raise* their cancer risk. If you’re going organic, go big. *Cutting back on veggies of any kind, including GMO crops sprayed with pesticide, is dangerous to your health.*

**Dow to Drop 80% in 2016.**

— a *January 1, 2017* ad on NFL.com.

**The OLD Toblerone Bar:**



**The NEW Toblerr ... ahhh...  
Tooths-R-Gone Bar**



Each decade, tuition at private, non-profit colleges goes up another 50%. The NY Federal Reserve studied three big increases in federal student loan programs, and found that every time Congress increased its loans to students, colleges raised their fees. They took 63% of the money, in the form of higher tuition.

Young people should be marching in the streets!

**GENERAL DISCLOSURES:** Statements in this communication are the opinions of Lumbard & Kellner, LLC and are not to be construed as guarantees, warranties or predictions of future events, portfolio allocations, portfolio results, investment returns, or other outcomes. None of this material is intended as a solicitation or offer to purchase or sell a specific investment. Readers should not assume that all recommendations will be profitable or that future investment and/or portfolio performance will be profitable or favorable.