

Lumbar
& Kellner

INSIGHT

S&P 500 3,231 * Dow Jones Industrials 28,538 * 30 year U.S. Treasury Bond 2.39%

WE SEE A THAW

A **zwodder** is a drowsy, fuzzy state of pleasure and complacency. That's a pretty good description of Wall Street right now, because the stock market has been hitting new highs again and again. How can this possibly continue? And why would we be willing to amble along in a zwodder with The Herd?

We've reduced equities a little bit, but only a little bit. The trade wars aren't over, but a thaw is spreading. Trade conflict had caused a global chill, with icy winds from pole to pole. Investment in new ventures, robots, and artificial intelligence froze. No business wanted to invest in *anything*, because there was no way to know what the rules were.

Many tariffs are still in place, and negotiations will drag on for months or years; but the outlook is for better and not worse. Businesspeople are delighted, because they need to invest to cope with labor shortages. It takes a lot of time and effort, and a lot of money, to invest in labor-saving software and machines; and they weren't willing to take that huge leap

in a time of uncertainty about the rules of trade.

China was never going to refuse to make a deal on trade. There was no chance that they'd forswear all their unfair practices, but there also was very little chance that they would refuse to move visibly toward complying with World Trade Organization rules that they joyfully agreed to in 2001. They were lucky to be admitted, given their ongoing subsidies of government-owned companies, and they knew it. Various forms of coercion and theft came much later

There is no formal mechanism for kicking a country out of the WTO, but U.S. trade officials no longer care. They've shifted to bilateral negotiation because they believe that multilateral trade organizations are helplessly incapable of controlling a bad actor such as China.

There must be hundreds of thousands of people who sold out of the stock market because they listened to misleading reports about the trade wars. Journalists hunted for people

who were harmed, and painted a dark picture of gloom for the future. Throughout the last decade, mixed in with reports about pedophiles, lost puppies, and politician predators, they've suggested repeatedly that there were recessions lurking around every corner.

If you're feeling misled (seriously, you *should* keep an eye out for those politicians), turn off the TV and look for a better way to get your news. There's a lot more news in a newspaper! ■

Small businesses are feeling so optimistic that the NFIB index is nearing record highs. "Owners are aggressively moving forward with their business plans, proving that when they're given relief from the government they invest, hire, and increase wages," said NFIB Chief Economist William Dunkelberg. These are the men and women who are going to invest in the labor-saving devices that drive productivity to new heights in 2020.



“At my job operating a drawbridge I am expected to set performance goals relating to “core competencies”. These include building relationships, oriented outcomes, creativity and innovation. Curiously, they do not include safely operating the 900-ton piece of mechanical infrastructure entrusted to my care. At my annual review, learning agility is defined in terms of “an awareness of changing workplace trends”. That such skills are valued more highly than not crushing pedestrians says something.”

— from a Letter to the Editor written by Kristian Williams of Portland Oregon, in The Economist.

Kraton (KRA - \$25), a plastics and specialty chemical company that was spun out of Shell Oil long ago, spends a surprising \$40 million a year on research and development. In October it sold its Cariflex division for \$530 million—at a time when all of Kraton was valued for just \$730 million. Cariflex was Kraton’s best product, but it was less than 10% of revenues.

The sale caused debt to go way down, along with interest expense. Did the shares go up? Nah. Nobody noticed. They’re up a little, but still sell for less than 9 times earnings.

Wikipedia lists 80 Facebook acquisitions since 2007, and 230 Alphabet acquisitions since 2001. We’ve been getting daily updates, and it seems that a FAANG company sinks its fangs into a startup just about every week. This is obviously anticompetitive.

It’s hard to see how investors could be hurt badly by a breakup of Facebook (by splitting off Instagram or Whatsapp) and it’s also not clear that consumers would benefit. But it’s even harder to understand why legislators and regulators haven’t moved to stop the companies from acquiring competitors. Or acquiring anything at all.

It’s striking that the CEOs of three of the 5 biggest U.S. defense companies—Lockheed Martin, Northrop, and General Dynamics—are women. We own shares of Lockheed (LMT- \$389), run by Marillyn Hewson, who was named CEO of the year in 2018.

Lockheed has a backlog of \$130 billion; the F-35 is 25% of revenues. There’s a small chance that Lockheed’s famed Skunk Works will make good on its boast that it will solve the problems of nuclear fusion (and air pollution and climate change), but the stock can go up without divine intervention or alchemy.

It’s really hard to grasp the fact that everyone benefits when labor saving machinery (such as a robot) displaces workers and causes layoffs. In college economics classes they achieve this by telling an anecdote:

The famed economist Milton Friedman was in Asia, where he visited a giant construction project. Thousands of men toiled with shovels, so Friedman asked why his hosts didn’t employ earth-moving equipment. They responded "You don't understand. This is a jobs program."

Friedman replied, “Then why don’t you take away their shovels and give them spoons?”

At the age of 24 a friend spent time with a precocious twelve-year-old, who surprised him by asking what his ambitions in life might be. After some thought our friend responded that he would like to possess a parcel of land so large that he would own all the land he could see.

“That’s easy”, the twelve-year-old responded. “Just dig a really big hole.”



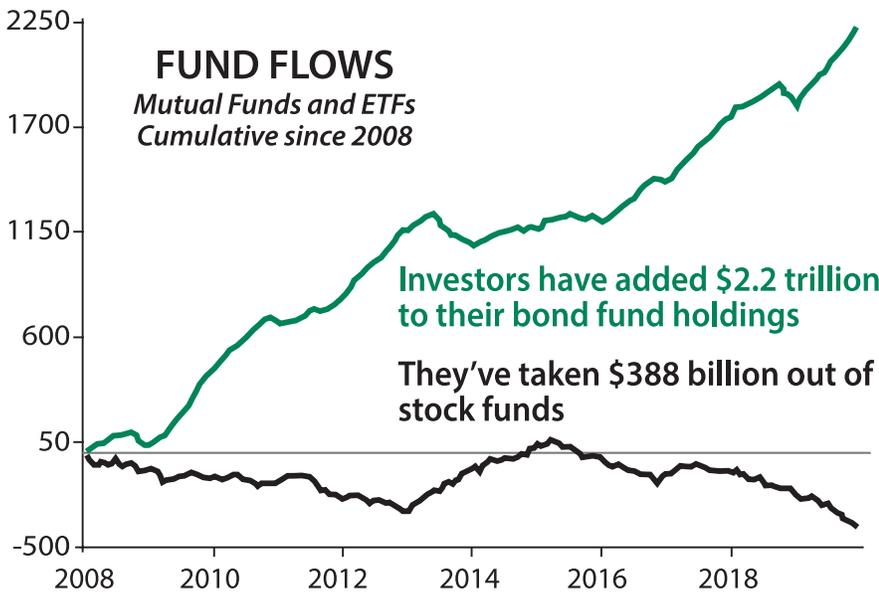
THE WAGE GAP IS NARROWING

The trade war was a heavy burden on the economy, and it pushed our manufacturing sector into a mini recession. But GDP growth continues, and there are now more people hired every month than there were during the crazed homebuilding of the real-estate boom. Job openings are at all-time highs. The Wall Street Journal reported that “Pay for the bottom 25% of wage earners rose 4.5% in November from a year earlier, according to the Federal Reserve Bank of Atlanta. Wages for the top 25% of earners rose 2.9%.”

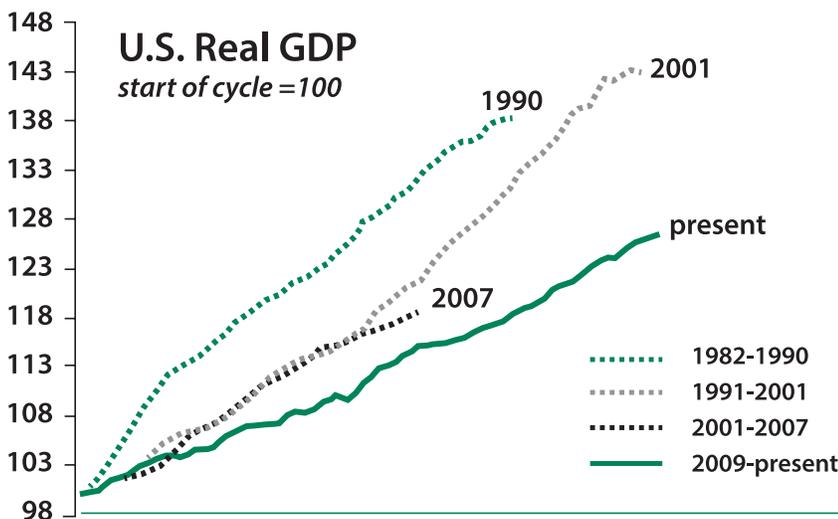
Meanwhile, investors have been pulling money out of common stocks and stuffing it into bond funds, pushing prices higher and higher. **It’s a bubble in the bond market:**



Paul K. Wright, CFA



The chart below compares the last 4 economic cycles. This one has grown so slowly that it could easily extend another 2 or more years:



Ed Hyman, Evercore ISI

2019 was a big year for stocks, but corporate earnings actually grew faster than the stock market in the last two years.

Since the 1960s there were thirteen years in which common stocks returned more than 20%. The following year was almost always, 11 out of 13 times, a good year for the stock market. Usually it was a very good year, because a strong stock market reflects confidence on the part of consumers and businesspeople. It gives investors spending power, and boosts consumer spending in the following year. The odds that we’ll see a good stock-market year in 2020 are high.

In September the U.S. exported more oil than it imported, for the first time since the 1940s. We’re not as vulnerable to geopolitical events as we used to be.

OpenTheBooks.com has been running advertisements that list expenditures by the federal government, and as far as we can tell they accurately recorded entries that appeared in government reports. The National Science Foundation spent a million dollars to learn “Where It Hurts Most To Be Stung By a Bee,” and another \$1.3 million for “Testing Shrimp On Treadmills”.

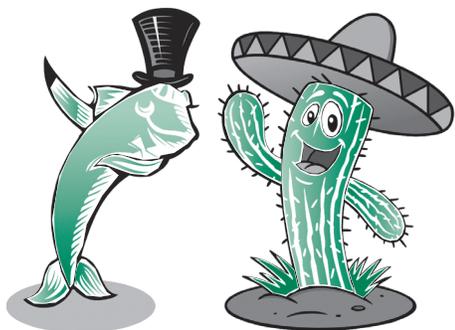


Then we come to the biggest item on the list. **\$306.6 Billion** for “Mistaken and Improper Medicaid Payments 2004-2019.” ■



An Alabama congressman got \$183,750 to develop a virtual-reality program to teach children in China how to cross the street.

There were thankfully-small expenditures by the National Foundation on the Arts for “Talking to Saguaro Cactus” and “Dancing With 15-Foot Fish”;



but NASA needed \$1.1 million for “**Preparing Religions For Discovery Of Extraterrestrial Life**”.

MIND CONTROL

“Scientists have known for decades that what we eat can change the balance of microbes in our digestive tracts. Choosing between a BLT sandwich or a yogurt parfait for lunch can increase the populations of some types of bacteria and diminish others—and as their relative numbers change, they secrete different substances, activate different genes and absorb different nutrients.”

“And those food choices are probably a two-way street. Gut microbes have also been shown to influence diet and behavior as well as anxiety, depression, hypertension and a variety of other conditions.”

— Scientific American. In other words, if you eat a lot of sugar you’ll increase the numbers of microbes that need lots of sugar to thrive. And they’ll cause you to crave sugar, sending these messages to the brain by secreting metabolites that find their way into your bloodstream. They might also cause you to become anxious or depressed.

How powerful are these microbes? *Toxoplasma gondii* is known to suppress the fear of cats that is normal to rats and mice, “often to the detriment of the rats, but to the benefit of the microbes that are ingested into their new feline host,” says the National Institutes of Health. The cat benefits the microbes because it is larger than a rat, so the microbe can multiply ... **Microbes can control your mind.**

“FedEx's growth plans largely focus on replacing 159 older jets with modern Boeing 767s and 777s that burn less fuel and have lower long-term maintenance costs. The entire MD-10 and A-310 fleet will be replaced by May 2021.”

— Brad Thomas, *Seeking Alpha*.

A Boeing 777 costs \$300 million! Replacing 159 aircraft is the right thing to do for the environment, and good for profits in the long term; but it’s been painful so far. The trade war came at a time when **FedEx** (FDX - \$151) was also digesting a European acquisition and separating its “ground” delivery from Express. Express delivery trucks have to wait for an airplane delayed by a snowstorm, while the trucks in the Ground operation need to run on a schedule, like clockwork. FedEx is nevertheless a perfect example of a company that is completely focused on the magic of productivity. ■

INSULT

We still hold a number of stocks that benefit from a rising interest-rate environment: **KeyBank** (KEY-\$20), **Huntington** (HBAN - \$15), **Prudential** (PRU - \$93), **MetLife** (MET - \$50), and **Brighthouse** (BHF - \$39), which was spun out of MetLife and took most of MetLife’s “interest rate risk” with it. Longtime clients have large gains on the first four, and it’s always been our intention to sell most of them when interest rates peaked near the end of the business cycle, as they always do.

Well, what really happened is that bond yields actually *declined*. For years! All the way to last August. To add insult to injury, these stocks always seemed to move in concert with small-company shares and anything else that might be a bad holding during a recession. Somebody on Wall Street would shout “Risk On” and this huge swath of stocks would soar; and then fears about Trade, Trumpery, Tribalism, or Trauma would cause him (*who is this guy?*) to shout “Risk Off” and make them all plummet again.

Rumor has it he’s going to spend 2020 being present and mindful, and living in a freer place. ■



TREDECUPLE

The S&P 500 roared in 2019, and it’s hitting new highs almost every day. Diversification into bonds, cash, foreign stocks, or gold was a really bad idea in 2019, and a bad idea throughout the last ten years.

Emerging-market stocks have gone nowhere in the last nine years. Gold hasn’t moved much, unless you bought it at a market bottom, and bitcoin is down more than 60% from its 2017 high. Marijuana stocks have cratered since we pointed out that anybody can grow weed, almost anywhere. Barclay’s bond index shows returns of just 2.5% a year over the last five years, and yields are so low that they promise more of the same. Or worse, because bond prices are extremely high. Cash has been killing you since March of 2009.

You can’t learn much from hindsight, so we’ll stay diversified. The good news is that our “Benchmark” account, a fee-paying client account that is managed just like our other portfolios, has finally crossed the thirteen-fold mark to **\$1,308,411, up from \$217,974 on December 31, 1999**, near the top of the tech-stock bubble. For further information, see www.Lumbard.com. ■

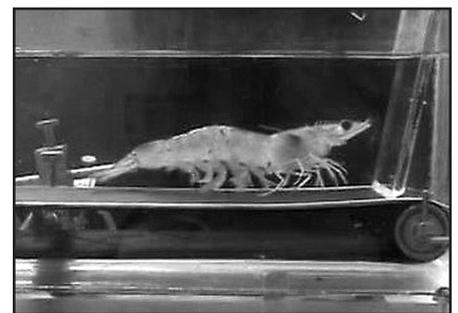
A California congresswoman secured \$1,000,000 for a “Mobile App For Sex Diary”.



Drew D. Kellner, CFA

A student from China told us that his mother is a lending officer at a Chinese bank. We’d read that most of the loans made by banks are to companies owned or controlled by the government, but he said that his mother primarily lends to private entities.

Loan losses have been rising sharply. “Her job was very easy. She would go to lunch with a borrower, he would ask for money, and she would say yes.” ■



Actual photo of a shrimp on a National Science Foundation treadmill. Think it’s easy? YOU try running on a treadmill in water.

THE PROLETARIAT

It was the French economist Thomas Piketty who sounded the alarm about inequality, and called for the working classes, in Europe and in the U.S., to revolt against the rich and sharply reduce their wealth.

They didn't. They rebelled against people like him. In America the working classes seized power from the conservative and progressive elites who had failed them during the financial crisis and the years of wage stagnation that followed. Obviously their leaders, from all political parties, were self-serving and incompetent. None of the CEOs of America's collapsing banks were put in jail, and one of them was even appointed Secretary of the Treasury!

And elites, on both sides of the Atlantic, were strangely eager to open their borders to huge numbers of unskilled or lightly skilled immigrant workers who drove down wages by competing for jobs with the working classes. Workers pounded the pavement looking for jobs while academics, politicians, and pundits sat securely in their ivory towers making up rules for everybody else.

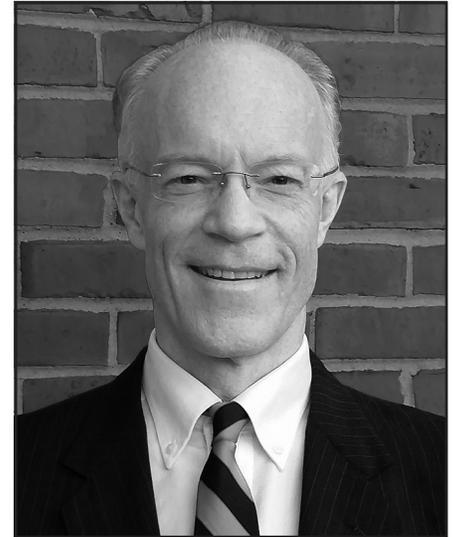
Let's talk about those rules. Cleaning up the air in Europe

triggered the loss of millions of jobs, mostly because of bankruptcies in industries that couldn't handle the added costs. Really clean air put more out of work; and really, really clean air caused the loss of millions more. And then Germany dirtied up the air again by burning coal, because it had shut all its nuclear plants down.

Clearly, jobs and livelihoods were no longer a priority. Here in America the media referred to the working classes as "whites with no more than a high school education". That's a far cry from the admiration they received from the same Baby Boomers in the 1960s and 1970s.

If you drive down Silver Lake Road in Hollis you'll see a "Don't Tread On Me" flag flying over a house by the lake. It's not populism and it's not nationalism, but rather a clear message to bossypants elites. Across the pond the election of Boris Johnson, followed by a huge re-affirmation in the December snap elections, shows that this great wave is still rolling. ■

Interest rates are *extremely* low. So stock prices should be *extremely* high.



Shares of **Tyson** (TSN - \$91) hit \$82 near the end of 2017, fell all the way to \$53 at the end of 2018 on fears about trade wars, and then roared back. Wall Street finally recognized that China wasn't going to forbid imports of pork and chicken forever.

The people of China don't trust their own food supply, after a long series of scandals, and African Swine Fever has nearly halted Chinese pork production. American farmers have a big advantage, because they have access to huge quantities of clean water at very low cost. It takes 576 gallons of water to produce a pound of pork.

– John Lumbard, CFA

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