

Lumbar
& Kellner

INSIGHT

S&P 500 3,756 * Dow Jones Industrials 30,606 * 30 year U.S. Treasury Bond 1.65%

BOUNCING BACK

Most people thought 2020 was about as much fun as a dumpster fire. But it was a very good year in the stock market, and a great year for us. Our collection of ridiculously-inexpensive stocks bounced back strongly, and we did some buying at the lows of March and April.

Now we feel ... like the dog that caught the car. What are we gonna do now?

We happily chased that car in 2020, spurred on by the knowledge that the pandemic would eventually end. And with interest rates near zero, stock prices should be close to infinity!

Wall Street was nevertheless filled with fear and doubt. How could stocks rise in the face of an economic collapse that was more than twice as deep as the "Great Recession" of 2007-2009? Through the spring and summer talking heads said that the stock market was running too far, too fast; but the truth was that the recovery, and corporate profits, blew past all expectations.

By October the unemployment rate had been cut in half. ***In eight months we went from the lowest unemployment rate since 1969 (3.5%) to the highest unemployment rate since 1939 (14.7%); and then back below 7%.*** Even with massive layoffs in the hospitality and travel industries.

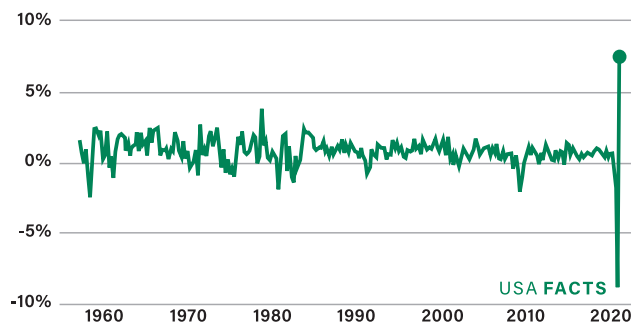


construction and renovation. That meant a boom in Made-in-the-USA carpet, light fixtures, sheet rock, lumber, appliances, roofing shingles...

This boom will continue as long as home buyers keep grabbing crazy-low mortgage rates *that you can lock in for most of your working life!* We're not about to sell our shares of D.R. Horton (DHI - \$69, up 100% from purchase), M.D.C. Holdings (MDC - \$49), or drywall supplier GMS Inc. (GMS - \$30). Earnings are still surprising to the upside.

Stocks sell at 23 times the average the S&P 500 earnings estimate for 2021. That's an Earnings Yield of 4.25%, at a time when the appropriate benchmark, the 10 year U.S. Treasury, has a yield around 1%. Inflation will probably be *more* than 1% in 2021. We're not feeling very bullish, after this big market surge, but trillions of dollars could shift from bonds to stocks in the next couple of years. ■

% Change in GDP, by Quarter (vs. preceding quarter)



How could this have happened? Federal stimulus dollars went to people, not to "shovel-ready" projects, or to corporations like Solyndra and A123. The Fed pushed interest rates to 0%. Lots of lucky people with terrific employers were able to work from home, and they had cash to spend because they weren't buying airplane tickets or hotel rooms.

They bought cars and boats and common stocks, and they created a frenzy in home

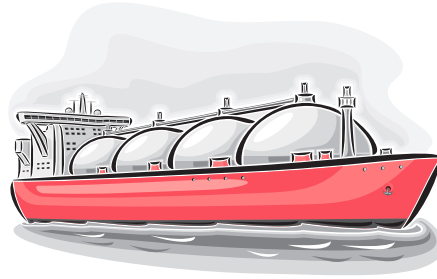
LNG

If you run a coastal nation that uses diesel fuel or coal to produce electricity, you can make a giant leap toward becoming clean and green if you shift to liquefied natural gas. Trying to produce that power with solar and wind, with giant batteries, would require huge subsidies from someone. Who?

There's natural gas bubbling naturally out of the sea floor in the oceans of Africa, the Americas, and Asia. And there are now ships which can pump it to the surface and chill it to *minus 260° Fahrenheit*. That's way colder than the *-70°* needed by the Pfizer vaccine! These ships, anchored in place, then transfer their liquefied gas to LNG tankers, which take it across the ocean.

Golar LNG has one of these liquefaction ships operating in the waters off Cameroon, and another under contract with British Petroleum, off Senegal. Golar (GLNG - \$9.64, formerly the Gotaas-Larsen Shipping Company) also has LNG transport ships, and a ship anchored off Sergipe, Brazil which warms the gas and feeds it to super-efficient combined-cycle gas turbines that provide electricity to millions of people in northeastern Brazil. And there's a similar project ramping up in Barcarena, with plans for projects in other nations, and on other continents.

This is a bold company. All the shares of Golar are worth just \$1 billion, but the conversion of just one of its LNG tankers to a floating liquefaction "FLNG" ship cost



\$1.3 billion. One just went into a yard in Croatia for conversion by a company called LNG Hrvatska. You can't help but be impressed: *Three consonants in a row, in two separate places in one word!*

Meanwhile, Golar can make money from conventional LNG ships. The "Risks" section of their SEC filings says:

"We operate the majority of our vessels, through the Cool Pool, in the spot/short-term charter market, which is subject to volatility. Failure by the Cool Pool to find profitable employment for these vessels could adversely affect our operations."

We want to be in the Cool Pool.

Doesn't everybody? Don't you? ■

DON'T SELL SHORT

It's dangerous to sell short when stocks are rising. If a stock moves against you your short position will get bigger, not smaller, and you'll have to add money, painfully, to your margin account. It was John Maynard Keynes who said: *"The stock market can stay irrational longer than you can stay solvent."*

THANKS

During the shutdown many businesses took extraordinary measures to keep people working or get them back to work. Corporations get more criticism than praise, so let's take this opportunity to recognize that many reached deep into their own pockets. Some took risks to expand, and hire extra people when the economy began to turn. They worked to lift spirits and lift the economy.

"Corporations", after all, are **employers**. And there are few things more noble than providing jobs to people who need them. ■

"The Australian newspaper has obtained the leaked database of almost two million CCP [Chinese Communist Party] members – including their party position, birthdate, national ID number and ethnicity – and 79,000 branches, many of them inside companies, universities and even government agencies. Among the companies identified as having CCP members in their employ are manufacturers like Boeing and Volkswagen, drug giants Pfizer and AstraZeneca, and financial institutions including ANZ and HSBC." — news.com.au

In recent weeks the stock of Alibaba, a giant Chinese financial-technology company, dropped a *quarter of a trillion dollars*. The CEO had given a speech criticizing Xi Jinping's program of financial reform, and suddenly the authorities cracked down. Investors beware!

EXPERIENCES

Several decades ago, consumers used their income to buy “things” such as houses, cars, and lawn tractors. It was a special treat to go out to dinner. More recently they sought to buy “experiences”, and built towering industries of restaurants, hotels, and air travel. And dropped them like a hot potato when the virus struck.

There’s been serious pain for workers in these industries. But extra cash has been piling up in the checking accounts of workers with steady jobs, because they aren’t spending on restaurants, hotels, or air travel. They mailed some of that cash to China, via Amazon, but they also spent it on American boats, cars, RVs, new homes, and home renovation. Factories are humming, and factory workers have dollars to spend.

The Organisation for Economic Co-operation and Development (OECD) says the middle class in America has the third highest income among OECD nations, in terms of median disposable (that is, after tax) income adjusted for purchasing power parity. The median is the income of the person in the middle, so there is no distortion from the huge incomes of George Soros and Mike Bloomberg.

If in 2019 someone told you that our middle class was struggling, you could have replied that the median disposable income in the United States, \$34,514, was almost 20% higher than the median incomes of Denmark, the Netherlands, and

Belgium. 25% higher than the \$27,569 median income in Germany.

Our GDP will probably decline in the first quarter of 2021, even with the recently-passed stimulus deal, and a stock-market correction is likely. But by summertime consumer spending on “experiences” will explode upward. Rising earnings will justify higher stock prices, as long as interest rates do not rise significantly. That’s an important risk, but we don’t believe it will pose a problem in 2021, or even in 2022. This is the beginning of a new economic cycle. ■



The world is unusually peaceful right now. Yes, there are troubles, but in relative terms war has receded. In fact, peace is quietly spreading in the Middle East. The Saudis and Qatar have settled a feud. The United Arab Emirates, Bahrain, Sudan, and Morocco (and Bhutan!) have established diplomatic relations with Israel.

Ten years ago we were told that new cars and light trucks would get 56 miles a gallon by 2025. Instead the size of the average vehicle has jumped sharply, and **there are now more trucks sold than cars.** The Wall Street Journal says that the average pickup truck gained **1,142 pounds** between 1990 and 2019.



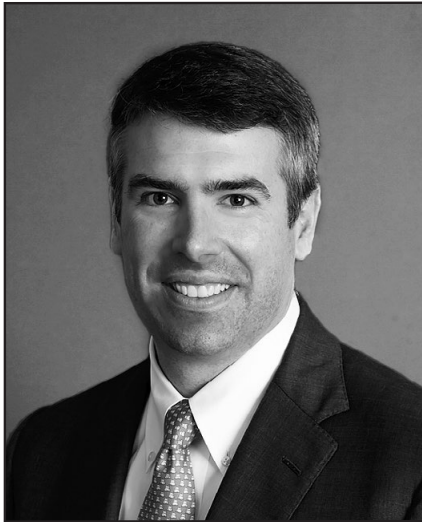
Paul K. Wright, CFA

The first task for the new president should be to tackle the nation’s huge debt problem. The river of red ink that accompanied the pandemic is bad enough, but we have no plan, whatsoever, to deal with the rapid and continuing growth of Medicare, Medicaid, Social Security, and other social spending.



METHUSELAH IN A BOX

Genetic techniques for lengthening life spans are coming. Pay \$100,000, and you can live to 130! But this country is struggling to provide a comfortable retirement for people who work for 40 years and retire for 20. If folks are going to fiddle with their DNA, they should give up their Social Security and Medicare. And we’d better get that rule established soon, before the centenarians get organized politically.



Jay Conway, CFA

TOO POPULAR!

As the green investment boom has gone mainstream over the past few years it has taken on a cartoonish character. Solar-energy-themed businesses now trade at nearly 100 times earnings, and electric vehicle companies with no earnings and hardly any revenue have risen astronomically. These stocks offer huge risks, and little hope for reward.

But wait. It gets worse. Recycle PV Solar says that only 10% of solar panels, which often contain cadmium and lead, are properly recycled. It costs \$12 to \$25 to recycle a panel, and less than \$1 to dump it in a landfill. The International Renewable Energy Agency projects that 78 million tons of solar panels will have reached the end of their useful life by 2050. Wind turbine blades, now 155 feet long and 27,000 pounds, last just 20 years; and then rest in giant landfills for 20,000.

Private equity firms and people with high incomes receive most

of the subsidies that drive these industries. Solar and wind also consume farmland and forests, and this impact will grow tremendously because wind towers currently supply only 2.7% of energy needs (7.4% of electric generation) according to the Energy Information Agency. Solar supplies just 1% .

They also require back-up power. When the sun isn't shining and the wind isn't blowing, efficient gas turbines fire up to keep your lights on, and that's a good thing. Coal is not a good thing. The US still has 241 coal-fired power plants, generating 23% of the country's electricity. Converting these coal plants to natural gas will reduce carbon emissions by 50-60%, with virtually no negative side effects. Europe knows this, and is building huge new pipelines to bring in more gas from Russia, Azerbaijan, and Israel, to replace coal.



Some of our gas is renewable! Gas from livestock operations, landfills, and other sources is still small, but wsj.com says "Analysts and utilities believe renewable natural gas could reach 10% to 30% of total natural-gas supply by 2040". That's VERY optimistic, but recapturing methane is a worthy goal; it's 80x more potent than CO2 when it comes to trapping heat in the atmosphere. Of course, cattle and hog operations will need pipelines to move that gas...

The shares of Kinder Morgan (KMI - \$13.67), the largest natural gas pipeline operator in the U.S., yield 7.7%. Should regulators prevent new pipeline projects, this will likely just increase the value of KMI's existing network. While we wait for the stock market to come around to our way of thinking we can enjoy the huge dividend, which is easily covered by long-term contracts. ■

"If I ask what the most important development was in 2001, most people would say it was 9/11. With the benefit of hindsight, it was China joining the World Trade Organization, which changed the world for the following 20 years. If I ask about 2007, you'd say it was the start of the subprime crisis. With the benefit of hindsight, it was the launch of the smartphone."

Louis-Vincent Gave, Gavekal, in Barron's.

What about 2020? Perhaps "Western governments discovered and embraced unrestrained deficit spending."

"The [emergency stimulus] bill also includes funding for two new Smithsonian museums, one focusing on Latino-Americans and one on women"

— The New York Times. Maybe we could focus this part of the emergency rescue package on actually rescuing Latino-Americans and women who need help in the pandemic?

In our Spring issue we compared the stock of MetLife, then at \$33, to that of Netflix at \$453. MetLife had made real money over the years, paying big dividends, paying down debt, and buying back stock. Netflix was spending all it earned, and billions more that it borrowed, on new videos. MET is now at \$47, and NFLX at \$541.

Even at this higher price MetLife pays a 4% dividend. Competitor Prudential (PRU - \$78) pays 5.7%. Brighthouse (BHF) pays no dividend, but the earnings yield on expected 2021 earnings is almost 33%. Book value on this \$36 stock is \$200.

The oldest millennials are turning 40! They're middle aged! In 2019 the millennials (Generation Y) became the largest; at 72 million they outstripped the Baby Boomers for the first time.

Generation Z runs from ages 9 through 24, and behind it is "post-Gen Z". The generation behind that is called "extremely young people".

According to the Energy Information Administration, U.S. production of CO₂ declined from 2007 to 2019, despite economic growth; from 6 billion metric tons in 2007 to 5.1 billion tons in 2019. More than any other country. On a per capita basis our emissions are lower than they were in 1955!

"Even if it is true there have been some attacks over many months and the Americans managed to do nothing about them, possibly it is wrong to groundlessly blame the Russians right away."

— *Neener Neener. We got you good. And you can't prove anything!* Russian Presidential spokesman Dmitry Peskov, in response to questions about the massive SolarWinds/ FireEye cyber intrusions.

"... All nations engage in espionage, but they are morally obligated to do so. Every government is responsible for national security. It is perhaps its highest obligation... Moscow's intelligence operations – now known as hacking – are thus a moral obligation of the Russian state. Moscow must know our intent and capabilities."

— George Friedman
of Geopolitical Futures

This is an interesting twist! If the Russians harvested vast amounts of information from hacking Solar Winds, and used it only to increase their understanding of American intent and capabilities, then we shouldn't become outraged. But we *should* feel outraged if they use some of that information (such as trade secrets and technology) to bludgeon our employers and put Americans out of work. That's what the Chinese have been doing.



Drew D. Kellner, CFA

QUINDECUPLE

On December 31 our "Benchmark" account, an actual fee-paying client account whose performance is not distorted by additions or withdrawals, finished the year at **\$1,590,597**. The account holds cash and bonds as well as common stocks, but it nevertheless appreciated nicely from \$1,308,411 at the beginning of the year.

The account is worth more than 7 times its \$217,974 valuation on December 31, 1999, just before the great millennial tech-stock bubble burst. For further information please see our website, www.Lumbard.com.

We are neither bullish nor bearish. If a client's account has too little in stocks we buy, and if it has too much we sell.

"Too little" is too risky. "Too much" is risky too.

EXPRESS

In December FedEx (FDX - \$253) reported phenomenal earnings and revenue growth, but the stock declined because investors worried that these results would be tough to beat. *This isn't just an online shopping story.* FedEx Express is the largest division, and nobody uses it to buy paper towels. There might have been a few express-mail rolls of toilet paper ... FedEx Ground trucks now carry Express packages, for the first time, enhancing efficiency within an organization that's laser-focused on productivity.

Talking heads predicted that Amazon would eat FedEx's lunch. Nonsense. FedEx dumped Amazon as a customer, and now 200,000 FedEx trucks and 680 aircraft are filled to capacity. Amazon's big innovation? It saves money by dropping packages on your front steps. Festival of the porch pirates!

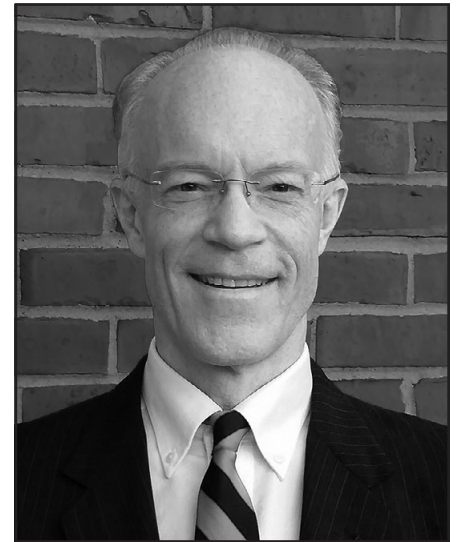
The key point about FedEx is that it benefits hugely from route density. On a per-package basis it's cheaper to deliver 1,000 packages to one zip code than it is to deliver 500. And the business is growing. ■

THE CITY LIVES.

Remember Y2K? It was going to plunge the world into darkness. And Brexit was supposed to be the death of Great Britain. The EU was determined to inflict pain on the Brits; enough pain that no other EU member would consider following them out the door. Paris, Frankfurt, and Luxembourg were hoping to seize a large part of London's massive transaction volume. Not going to happen. ■

"A recent working paper by Gerald Auten and David Splinter, economists at the Treasury and Congress's Joint Committee on Taxation, respectively, reaches a striking new conclusion. It finds that, *after adjusting for taxes and transfer payments*, the income share of America's top 1% has barely changed since the 1960s".

— The Economist. In the 1960s we had Howard Hughes, J. Paul Getty, and the Hunt Brothers. And recently the tax rate for the working class declined from 15% to 12%. Middle class tax rates were cut from 25% to 22%; yet federal revenue did not decline. It went up from \$3.27 trillion in 2016 to \$3.46 trillion in 2019. ■



VACCINES!

The NY Times says that *twenty* vaccines are in large-scale, phase 3 trials. *Seven* are in limited, early use. And *three* are approved for full use.

You can forget about the glacial vaccination timetables you've seen; the federal government has already paid for *nearly a billion doses* of vaccine from Pfizer, Moderna, AstraZeneca, JNJ, Glaxo, and Novavax, if you read the Operation Warp Speed web site carefully. The Economist says that continental Europe is lagging far behind us because they tried to be frugal. We've also spent at least \$825 million to fund research and buy doses of monoclonal antibody treatments from Regeneron and Eli Lilly. ■

— John Lumbard, CFA

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