STRATEGIES, TRENDS AND NEWS FOR TODAY'S INVESTORS SPRING 2021

Lumbard & Kellner INSIGHT

S&P 500 4,112.50 * Dow Jones Industrials 34,021.45 * 30 year U.S. Treasury Bond 2.40%

ROCKET FUEL

In the first three months of 2021 GDP rose at a 10.7% annualized rate. Even if you adjust for inflation the economy grew at **6.4%!** That's an "Asian Tiger" growth rate, and it follows 4.3% inflation-adjusted growth in the last three months of 2020. Third quarter growth was 33.4%! The economy is booming. It's been growing rapidly since April of 2020, confounding pundits, investors, and just about anybody who spent the last year at home.

The housing industry has been especially hot. Anybody who can pound a nail can get a job in construction, and that's been true for a year. Lumber prices have tripled from pre-pandemic levels; and demand for related goods (flooring, appliances, sheet rock, cabinetry, insulation, wiring, plumbing, roofing shingles) has blown right through the roof. A sheet of plywood now costs $70!

Mortgage rates are so low that houses are as "affordable" as they were in 2018. Home buyers are still buying, and that's been a HUGE boost to American manufacturing.

Policy makers seem oblivious to the inflationary trends and the widespread shortage of workers. The day before the third stimulus legislation was signed into law, GDP Now, the instant estimate of real Growth, was 8.4%.

A sunnier view would assume that they're trying to quickly recapture the golden environment that existed in the months before the pandemic, when unusually-low unemployment rates caused wages to rise rapidly for the least-paid workers, in all demographic groups. Wages rose faster for the least-paid than for supervisors or managers; and there was hardly any inflation because productivity was rising. Workers were more efficient and productive every month.

Inflation is now a hot topic. The only good news is that productivity is still soaring; in 2020 the number of Americans working declined 7%, while GDP declined just 3.5%.

Fewer workers got more done! That's exactly how, in just 200 years, we went from a nation of dirt-poor peasants to an era which offers electric lights and cell phones to anyone who is willing to work.

THIS IS THE YEAR OF THE OX

Kinda looks like a bull, doesn't it?

But how much rocket fuel can we stand? This nation has never seen this much fiscal and monetary stimulus. The strength was already obvious when the latest stimulus bill sent $9,800 checks to families of five, even if the breadwinner was drawing a steady top-quintile salary of $150,000-a-year. We could have given *ten times as much money* to each of the people we were trying to rescue, and spent only a small fraction of 1.9 trillion dollars.

Even the elderly got $1,400 each. They won't have to deal with the debt that results. Young people got $1,400, but they each assumed $11,445 in additional federal debt. When are they going to notice?

Well over 80% of Americans got checks in the mail. It's a consumption **FRENZY**.

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Jay Conway, CFA

ROCKET FUEL

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Inflation is harder to stop than a train, because when consumers and workers begin to assume that prices will be higher next year, they take actions that *cause* prices to be higher next year. A 5% raise doesn't mean anything if your cost of living rises 5% … But there's no need to worry about that now. **It's party time!** ■

THE GREEN RUSH

In 1848, James Marshall found gold at Sutter's Mill in Colma, California and set off what became known as the Gold Rush. The Gold Rush attracted roughly 300,000 prospectors who were eager to strike it rich. For perspective on just how massive this migration was, in 1850 the entire population of the United States was just 23 million people. Only about half of the prospectors found enough gold to make a profit. The biggest fortunes were made by investors who were able to hitch a ride on the massive growth and transformation in the California economy. Selling picks, shovels and denim overalls was not only much more profitable, but much less risky!

Electric vehicles, renewable energy, and other aspects of the green revolution have hit an inflection point. They're now set to transform many parts of the US economy, but eager investors have already bid electric vehicle plays and solar stocks up to price/earnings ratios in excess of 70 times next year's earnings. That's an earnings yield of less than 1.5% on your money. At these prices, it will be hard to turn a profit on these investments unless you pick one of the long-term winners.

But what do all these green initiatives have in common? They require an absolutely massive amount of copper. A huge global build out of copper-centric infrastructure over the next two decades appears to be all but inevitable. Copper to transmit electricity from solar panels to consumers and storage facilities, and copper to build out the infrastructure to support millions of electric vehicles. The price of the red metal has already doubled in the last year. Why not buy copper mines that control some of the best copper resources in the world?

Freeport-McMoran (FCX - $42) trades at 16.5 times next year's earnings, and smaller Lundin Mining (LUNMF - $12) trades at only 13.2 times. The average stock on the S&P 500 sells at 22.7 times. These are businesses that are likely to grow steadily for a long time to come. We've already enjoyed a strong rally in these stocks, and their future still looks bright. ■

Don't fight the Fed. We tried fighting the Fed in the late '90s, and we won't try that again. Yes, when the Fed becomes concerned about higher inflation a current of fear will run through the stock market; but a client reminded us of an old saying, "three steps and a stumble", that perfectly fits these times. It's not the first interest-rate increase that hurts; it's the third. And from these incredibly-low levels it might be the fourth, fifth, or sixth.

This business cycle is very young. The news about productivity is just wonderful, because it holds down inflation and makes everybody richer. Add in the fact that the returns on cash and bonds are awful, and you simply have to stay invested in the stock market. ■

The Earned Income Tax Credit isn't a tax credit or a tax break. It's an actual payment; checks are mailed to poor families with children, in a $70 billion program that has strong bipartisan support.

SPEAK SOFTLY

If you call 911, the operator won't ask "where are you?" but instead "are you on Elm street, close to its intersection with Pine?" Those are comforting words for an American, but for a Hong Kong dissident (or Uighurs, or followers of the Dalai Lama) they wouldn't seem comforting at all. Technology is helping the government of China to bring to life George Orwell's 1984, which featured the Thought Police, thoughtcrimes, and the Two Minutes Hate. That hatred has arrived; Wikipedia offers the example of a completely-untrue 2014 report on the leading Russian TV channel, saying that Ukrainian soldiers had crucified a three-year-old child.

Russia seized part of Ukraine, and China crushed the illusion of freedom in Hong Kong. It was too easy. Now China's leaders are rapidly building their military forces, threatening Taiwan, initiating border wars with India, and moving very aggressively into the waters and islands of the South China Sea, most of which are far from their shores and claimed by other nations.

We can't prevent China and Russia from crushing other nations unless we have technological superiority. Northrop (NOC - $370) and Lockheed (LMT - $388) possess key technologies that are sought not just by the Pentagon, but by all the frightened countries on the periphery of China. Even pacifist Japan is building defensive forces and strengthening military ties with the Southeast Asian nations and Australia—as they partner with Lockheed to develop a future made-in-Japan fighter jet. ■

"In testimony to Congress … in February, Oriana Skylar Mastro, an expert on the Chinese military at Stanford University, said she had been told by Chinese military leaders that they believe they will have the capabilities to force reunification with Taiwan within a year."

— The Wall Street Journal

Bonds are declining in value, and they could be dead losers for decades. In 1981 you could buy CDs at 20%; but that would have been a bad choice. Instead you should have purchased long term U.S. Treasury bonds at 15.75%, because they paid 15.75% for THIRTY YEARS. Over the following decades yields on all bonds declined steadily—that is, bond prices rose—all the way to the middle of 2020. 39 years!!

Now bond investors are selling, and **they might keep selling for decades.** The Fed has been saying, openly, that it wants higher inflation and interest rates. And Congress is in a spending mood. Higher interest rates will be a headwind for stocks in the future, but in the near term investors are going to sell trillions of dollars' worth of bonds. Part of the proceeds should come into the stock market.

Drew D. Kellner, CFA

$300 MILLION

2020 and 2021 have been very good years. Our assets under management now exceed $300 million dollars by a comfortable margin, and our Benchmark account has octodecupled to **$1,861,644**. It's an actual fee-paying client account whose performance is not distorted by additions or withdrawals. The portfolio holds cash and bonds as well as common stocks, but it has nevertheless appreciated nicely from $1,590,597 at the beginning of the year.

The account is worth more than 8 times its $217,974 valuation on December 31, 1999, at the peak of the great millennial tech-stock bubble. For further information please see our website, www.Lumbard.com.

There's a labor shortage. Let's launch a program to create jobs!

FAIRNESS

When people talk about the injustice of our tax system they're generally thinking about corporations that pay no tax, or wealthy individuals whose tax rate is lower than that of a middle class taxpayer. They call for higher rates; but higher rates are not going to fix the problems they have in mind.

The real causes are tax deductions, and the complexity that they've introduced into our tax system. Complexity is an invitation to tax lawyers to devise creative ways to cut a client's tax bill, and of course it's the wealthy who can afford to pay the large legal bills that result.

Total federal tax deductions, as calculated by the OMB, are worth more than a trillion dollars a year to a government that only received $3.5 trillion in taxes in 2019. IRS Commissioner Chuck Rettig says that *another* trillion could be harvested if we got all taxpayers to simply pay what they owe, under the current CRAZY rules.

Wealthy people who ***do*** pay what they owe and ***don't*** maneuver for tax deductions are leaving New York and California, where their total tax brackets can exceed 50%, and moving to Florida, Texas, and other low-tax states. The wealthiest can move all the way to New Zealand (a 33% top tax rate) or the Cayman Islands (0%. Nada. Nothing!).

The same is true for corporations. Before the 2017 tax reform we were losing corporations to Ireland (where the corporate tax rate is 12.5%) and Switzerland (as low as 11.9%, depending on canton). They'll stay if they think they're being treated fairly.

Congressmen like to protect the beloved tax breaks of their campaign donors. But charging higher tax rates to compliant taxpayers, while letting the schemers get off tax free, isn't just stupid; it's mean. John McCain liked to say that the tax code is the foundation for the corruption of American politics. ■

We got MET (MET - $65). **It paid!**

INNOVATION

Why hasn't Europe created big new employers like Amazon, Microsoft, Apple, Google, or Facebook? Why haven't these 38 nations produced a Steve Jobs or an Elon Musk? Europeans are smart and well-educated. There's an important message here, if we can find it.

Resentment against the rich has run strong in Europe for many decades, and European regulation can be crippling. Some Americans now say that "every billionaire is a policy mistake". But our billionaires, who include some spectacularly-generous people, have created huge numbers of jobs. It's employers who create employment.

That seems obvious, but you could watch American TV for a year and never get a hint.

Employers go bankrupt all the time, so it's critically important that new companies rise up out of the ashes of the old ones. And the creation of those new companies depends on a small number of inventors, entrepreneurs, and risk-taking investors. If they retire, or we drive them to other countries by applying heavy-handed regulation and taxation, we'll be in deep trouble.

Public policy should be tightly focused on the working class and especially the working poor, *who choose to work instead of accepting government support*. That means focusing on employers, and the investors and innovators who help employers to thrive. Successful policies *reduce* the number of non-working poor. They increase the wages of the working poor, and all workers, in real, inflation-adjusted terms.

This is not the same thing as reducing inequality. The distinction is incredibly important. ■

In 1996 Alan Greenspan said that there was "irrational exuberance" in the stock market, but he didn't tighten monetary policy. In fact, he loosened it, and the Internet Bubble peaked ***four years later***. Back then interest rates were around 5%; sky high compared to today. If interest rates had been this low in 1999, stock prices would have gone twice as high.

MAÑANA

Inflation is a concern, but much of what you see in the newspapers is temporary. Workers will return to ease the labor shortage when enhanced unemployment ends and the stimulus checks are spent. Spending those checks will also cause the huge demand for goods that is driving up commodity prices to dwindle. And the end of the pandemic will siphon dollars away from goods and toward restaurant meals and other services.

The nation's productivity has clearly leaped higher. Off the charts! Productivity is harder to measure than many think, but GDP was at an all-time record level in the first quarter, despite the fact that 8.5 million fewer people were employed than at the prior peak, early in 2020. **The economy should boom for another 4 to 8 quarters.** Producing more goods with the same amount of effort will hold prices down.

We're still in the early stages of this business cycle. Corporate earnings are exploding, with S&P 500 earnings up from $138 in 2020 (and $162 in 2019) to $200 this year! Analysts are projecting $220 for next year, even if the corporate tax rate goes up to 25%.

Inflation will probably reassert itself farther down the road, especially if Washington enacts a good part of the spending proposals currently under consideration. GDP could be lifted to an artificially-high level from which it would be hard to grow, and inflation could be high enough to cause some anxiety at the Fed. But it shouldn't cause much in the way of pain for equities for a year or more.

When do we have to worry about this? **Mañana.**

These are the salad days.

Paul K. Wright, CFA

Most people are enthusiastically in favor of freedom, especially for themselves. And it's freedom, and free markets, that have ended poverty for most of the world's people. Even in America, just a few generations ago huge numbers of people lacked indoor plumbing, lighting, safe water supplies, and nutritious food in the winter.

So freedom has been good for everybody, but some do better than others. Those who work hardest and are more talented (or who make the best use of their specific talents) will tend to gain wealth and power. Luck does play an important role.

If you change the word "freedom" to "equal opportunity" you'll have the same result. Inequality. The hard thing is that anything you do to create more-equal outcomes is going to reduce freedom, reduce opportunities for some citizens, create surprising disincentives, and restrain the improvement of living standards that has been underway for centuries.

JARGOGLED

"The Biden administration said Wednesday that it will support a proposal at the World Trade Organization to temporarily waive intellectual property protections on Covid-19 vaccines … The biopharma industry is fiercely opposed to the move."

— Endpoints News

Biotech companies are arguing that poor countries won't actually be able to produce effective and safe vaccines in time, but their real objection is that this proposal would crush the biotech industry. Nobody on Wall Street is stupid enough to put money into a biotech company that develops a cancer cure, but doesn't really own it.

Right now you, and many of the people you know, would be willing to pay almost anything to cure cancer. That fact is highly motivating, so for decades biotech and drug companies having been hurling billions of dollars a year at the problem. Most of those billions have been a dead loss, but the winner of this contest will be able to charge "almost anything" (remember, that's the price you named) and make a fortune on the successful cure.

If the US government wants to give away the patents for the precious vaccines, fine; ***the government should buy them***. Be honest; pay for the drug! If the government simply *takes* the drug it makes a statement to employers and to the world that property rights don't matter. Don't buy a house, because if your land is needed for a highway they might take it—and save a bundle by not compensating homeowners.

If patents can be ignored, then innovation is worthless. We've been trying to get the Chinese to stop stealing intellectual property for decades. Now ***our*** government is going to steal patents?

Few things are more frightening than a loss of confidence among investors and employers. March of 2020 was just a small taste. If employers sense diminished respect for property rights and the free market, they won't invest, and they won't hire. No jobs program could possibly overcome the economic damage that would result. ■

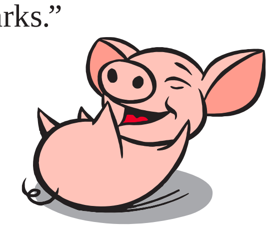
"We learn from history", wrote George Bernard Shaw, "that men never learn anything from history."

PORK IS BACK

"The House Committee on Appropriations and Committee on Transportation and Infrastructure have separately announced that individual Members may request funding for specific transportation projects. This ends an effective ban on earmarks that has been in force in the House since 2011."

— The Congressional Research Service, April 8. On May 6 Forbes commented:

"This week, the U.S. House posted online 3,309 earmarks."



– John Lumbard, CFA