

Lumbar  
& Kellner

INSIGHT

S&amp;P 500 4058 \* Dow Jones Industrials 32,637 \* 30 year U.S. Treasury Bond 2.99%

## HUBRIS

How could this have happened? **Real wages are falling.** The inflation rate is *eight percent*; so high that wage increases haven't been able to keep up despite a significant shortage of labor in many industries. Workers are actually getting poorer. Inequality is rising, and this is the direct result of policies that were supposed to *reduce* inequality.

Hubris, according to Wikipedia, is "extreme or excessive pride or dangerous overconfidence, often in combination with (or synonymous with) arrogance."

There are times when policymakers are unlucky. This is not one of those times. All-time low interest rates, unprecedented monetary stimulus, and unprecedented fiscal stimulus would have caused objections from the children on the TV show "[Are You Smarter Than A 5th Grader?](#)" The economy was roaring; The day before the third (third!) stimulus legislation was signed into law, GDP was running at *8.4%*, as measured by GDPNow.

Policymakers say they were unlucky. They say that Europe

has inflation too. Are they talking about the Europe that had *negative* interest rates? *Our* inflation rate was *7.9%* before Russia attacked Ukraine.

To get inflation under control the Fed will have to inflict more pain, especially on the housing market and bondholders. Bonds have already been crushed, and they will be bludgeoned again and again. The pain has spread to the stock market. Everybody outside the Beltway knows that a recession is coming.

Inside the Beltway, nobody even bothers asking why politicians boast about compassion and then do things that cause pain. But the governors of the Federal Reserve System, a bit farther down Constitution Avenue, are supposed to be above all that. Perhaps they forgot that the car they're driving has no steering wheel. They pressed the gas

pedal too hard, for too long, and the only thing they can do now is jump on the brakes.

One way or another they got caught up in the magical thinking that permeates Washington these days. In the intoxicating air were new theories of How Things Work. Modern Monetary Theory, MMT, is known to wags as The Magic Money Tree because there's no need to worry about debt or inflation. And it was easy to swallow because we'd been accumulating debt rapidly for years, without any obvious immediate consequences. Inflation hadn't been a problem for decades.

### *It is now.*

During the pandemic consumers, fueled by over-the-top stimulus, had an insatiable demand for goods. So much so that corporations were able to raise prices even faster than their costs and expenses. Wages went up rapidly, but *real wages declined 2.6%* from April 2021 to April 2022.



*Continued on page 2*

## Hubris *Continued from page 1*

The Economist says that this wasn't true in Europe, because European consumers weren't flooded with government checks. Corporate profits actually **fell** in Great Britain, while they **rose** in the 'States; and these rising profits turbocharged our stock market and enriched the rich.

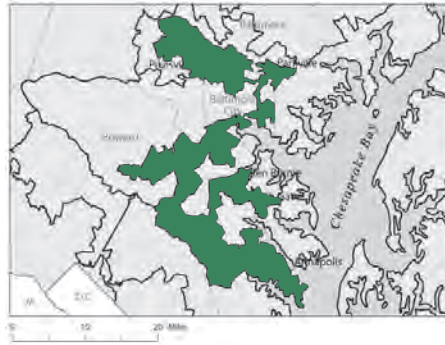
**Excessive federal spending and loose monetary policy caused inequality to increase. ■**

## DIVISIVING

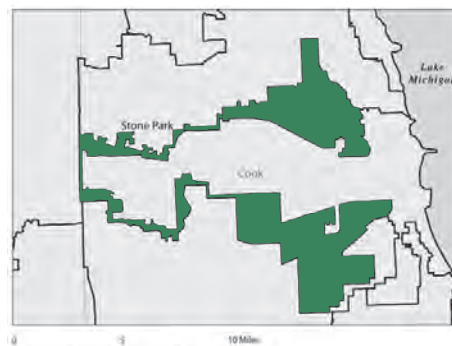
New York State's highest court just nixed a scheme that created bizarrely-shaped congressional districts to gain political advantage. Gerrymandering, first described way back in 1812, allows politicians to pick their voters—instead of waiting for the voters to pick their politicians.

It's a major force in building divisiveness. And **both parties are just as guilty as can be.**

“Politicians from gerrymandered districts live in a kind of artificial world in which they don't need to talk to people from the other party, either at home or in Congress. There's no incentive to reach across the partisan divide to compromise, or to win over the other side. In many cases, in fact, the only real danger to the job security of representatives from these districts is to offend the party activists by compromising with the other side;



*Maryland 3rd district. Source: [Slate.com](http://Slate.com)*



*Illinois 4th district Source: [Slate.com](http://Slate.com)*

which might anger their party base and produce a primary challenge from within their own party back home.”

— Gerald Seib,  
The Wall Street Journal

## GAS TAX

“The nation's biggest oil industry trade group has drafted a proposal urging Congress to adopt a carbon tax, which would put a surcharge on gasoline and other fossil fuels to discourage greenhouse-gas emissions... The American Petroleum Institute proposal suggests rebating some of the revenue collected by the carbon tax

to households, and investing the rest of the money in new technology.”

— The Wall Street Journal

Virtually every developed country has a whopping big carbon tax that hits rich and poor citizens alike. The oil industry's proposal would rebate part of the tax revenue to needy households, so it's *not* a regressive tax. Higher gasoline prices are the only good way to get drivers, and others, to make choices that conserve fuel. They're the simple cure to every fuel shortage.

If it's going to happen it has to happen now. Pass the legislation now, but delay the new taxes until energy prices decline. If we don't pass it now, it ain't gonna happen.

We'll need to pass that legislation if we're going to have “a carbon-pollution-free power sector by 2035 and net zero emissions economy by no later than 2050”. But Washington seems hell bent on pushing gas prices *down* rather than up. *Increasing* the production and consumption of fossil fuels. They're begging “dirty” foreign producers to pump more, and pumping a million barrels of crude out of the nation's Strategic Reserves. Every day. From now until November.

And “green” legislators have, *not kidding*, introduced bills in Congress that would eliminate federal gas taxes until after the November elections. ■

## JAPAN



Farmers have been switching to beans. More soybeans and less corn, even though they love corn's impressive growth and huge harvests.

Corn generally produces more profit per acre than beans, but there's a looming shortage of fertilizer, diesel fuel, and propane; and corn needs more of all of these things. Soybeans very rarely need to be dried after harvest with propane—corn does—and beans fix nitrogen in the soil. Nitrogen fertilizer is made from scarce natural gas, and corn needs a lot of it. It needs lots of diesel fuel at harvest.

The governor of Michigan is trying to shut down a propane pipeline that farmers depend upon. But Washington has just allowed the sale of gasoline with 15% ethanol. It gives you lower gas mileage, and it's made from fuel-hungry corn that will now be burned. The cost of food will rise further, and the fuel shortage will get worse. It's a two-fer!

This was supposed to curry favor with farmers. Instead, the farmers we know are laughing at Washington's ignorance and need to micromanage everything. Umm, hubris. ■



Japan will reopen shuttered nuclear plants, with the full approval of a public worried about fuel shortages and energy independence. Prime Minister Kishida said "Restarting just one existing nuclear reactor would have the same effect as supplying 1 million tons of Liquefied Natural Gas per year to the global market." LNG Shipping and Terminals says that's enough to heat 625,000 homes in North America. Every year.

Today's nuclear plants produce a HUGE amount of carbon free, almost-pollution-free electricity. For 50 years or more. What would it take to heat, year 'round, 625,000 homes for 50 years, using nothing but the renewable power sources available today? ■

Veterinary supplier Covetrus (CVET - \$20.70) has received a \$21- share buyout offer from two private equity companies. Earlier this year we received \$46.50 a share for our holdings of Kraton, a specialty-chemical company that fell to the single digits during the panic of 2020.



*Drew D. Kellner, CFA*

## NOVEMDECUPLED

Our Benchmark account, an actual fee-paying client account, started this difficult year at \$1,922,181. It's up less than 1%, to **\$1,937,499**, but it could be worse. The S&P 500 is down 14.9%, and the Nasdaq 100 average is down 24.8%. The portfolio, which holds cash and bonds as well as common stocks, is still worth more than 8 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](http://www.Lumbard.com).

David Zaslav is the new CEO of Warner Brothers Discovery (WBD - \$17.98), which owns CNN. He held a company-wide town hall meeting with Oprah Winfrey and his other new employees:

"Mr. Zaslav told Ms. Winfrey that CNN needs to be about reporting and truth and facts. 'If we get that, we can have a civilized society. And without it, if it all becomes advocacy, we don't have a civilized society.'"

— The Wall Street Journal





Paul K. Wright, CFA

“America’s Dept. of Agriculture predicts that by the middle of this year China will hold 69% of the world’s maize [corn] reserves, 60% of its rice and 51% of its wheat. All this to feed 18% of the world’s population.”

— [The Economist](#)

According to the Joint Committee on Taxation, the Rescue Plan Act of 2021 raised just \$9.7 billion a year in new federal revenue. The rest of the **\$1,900 billion** was borrowed from your children. No billionaire campaign donors were harmed in making this product!

When you look at the serious tax proposals in Washington—the ones that have a prayer of actually passing—you find that they’d raise just \$20 or \$30 billion a year, *less than 3% of our annual deficit*, by taxing billionaires.

## WHAT’S AHEAD

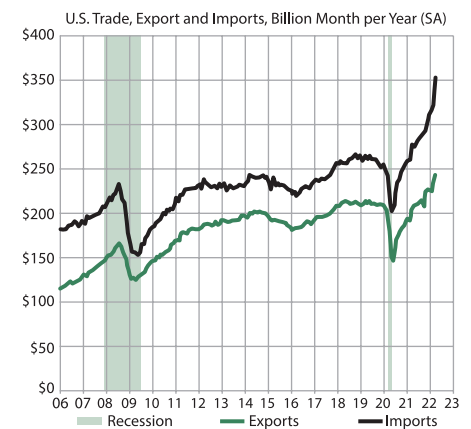
In the last 12 months energy prices rose 30%. That increase won’t be repeated next year, so it’s a reason to think that inflation will be a good bit lower than the 8.3% that was reported for the last 12 months. On the other hand, inflation in housing has been much worse than the CPI measured. In Miami, rents have increased 58% in the last two years! We believe that a better estimate of annual inflation is roughly 5%. That’s still more than twice as high as the Federal Reserve would like.

Housing usually leads the economy out of a recession and into the one that follows, with widespread impacts on all sorts of industries that will come to mind if you take a careful look at the materials, fixtures, and appliances in your home. *Home prices will need to fall 10% or more to make a meaningful dent in inflation.* Unusually low interest rates spurred panic buying in housing, and the Fed knows that it has to reverse these forces.

They’re also targeting the wealth effect created by high stock and bond prices. Bond prices have now been falling for more than two years, and stock prices have been falling since Christmas. From the Fed’s point of view Wall Street and housing are the tip of the spear. They inflated them far too much in the last two years, and now they have to bring them all the way back to earth.

If the declining markets have caused you to feel a bit more frugal, you’re not alone. When consumers do spend they’re spending more on services, such as travel and restaurants, and less on goods. The gridlock at California’s ports is subsiding, but restaurant prices and airfares are shooting higher.

In the first quarter imports grew, year over year, by \$189.3 billion or + 23.8%. No wonder the ports were backed up! Consumers were still spending the stimulus checks and supports that they received in 2021.



Short-term interest rates might reach 4.5% within a year. We think that the odds of a recession, probably early in 2023, are 85% to 90%. Stocks could bottom at the beginning of the recession. The Fed will continue to raise interest rates until a recession is underway **OR** inflation is below 3%. That 3% rate will be hard to achieve if Russia’s war on Ukraine continues, and government continues to oppose pipelines, oil drilling, and refineries. ■

## ESG

Environment, Social, and corporate Governance. Focusing on these themes in investing sounds like a painless way to do good in the world, but does it do any good? If you refuse to buy the shares of Delta, will they stop flying the gas-guzzling airplanes that take you to Europe? Would (or should) Alcoa stop making the power-hungry aluminum that airplanes are made of?

Of all the investment gimmicks in the world, this is the only one that comes with a “get out of jail free” card for the advisor or manager. “Well, you said you wanted to do good with your money. That won’t always mean better performance...”

As a nation we’ve offshored much of the dirty portion of our economy, pushing polluting industries to low-wage countries, but we haven’t stopped consuming those goods. The only way to cause change at polluters and energy guzzlers is to stop buying their products.

ESG funds have been pummeled, and now ESG principles are taking a beating as politicians call for cheaper gasoline. ESG? The G stands for Gimmick. Investing \$1,000 in an ESG fund can’t hold a candle to donating \$100 to a worthy cause. ■

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“Don’t tax you, don’t tax me, tax that fellow behind the tree!”

— Russell B. Long

## MDC HOLDINGS

The Federal Reserve wants to crush the home-building industry to get inflation under control. So our position in MDC Holdings (MDC - \$37.50) sometimes gives us pause. MDC (aka Richmond American Homes) currently has 37,800 building lots in states that stretch from Florida to Washington state.

Funny thing: other investors have the same fear. They’ve driven the stock down so far that the dividend yield is huge. **5.5%**. The shares sell for less than book value; the PE is below 4; and the annual revenues are twice the value of the company. They don’t build spec houses, so they’re not going to be left *holding the bag*. Everything is built to order.

Millennials, born 1981-1996, are buying homes. 85% of MDC’s home sales are smaller, more-affordable single-family homes for millennials or down-sizing Baby Boomers.

It’s not likely that this this stock will “spark joy” in the months ahead. Marie Kondo would have us toss it out with the Beanie Babies and the bell bottoms. But **the right thing to do** is to grit our teeth and hold it.

Eventually interest rates will peak. These shares will rise as the economy is sliding into recession, because mortgage rates will be in a downward trend. Until then we’ll, ahh, collect a nice dividend. ■



Jay Conway, CFA

“Oil, natural gas, and coal provide 84% of all the world’s energy. That’s down just two percentage points from twenty years ago... Two decades and five trillion dollars of governments investing in green energy and we’ve barely moved the needle. Why is it so hard?”

In a word: **rocks**. To get the same amount of energy from solar and wind that we now get from fossil fuels, we’re going to have to massively increase mining. By more than 1,000%.

This isn’t speculation. This is physics. Copper, iron ore, silicon, nickel, chromium, zinc, cobalt, lithium, graphite, and rare earth metals like neodymium. We need them all.”

— Mark Mills, The Manhattan Institute

We hold:

Lundin Mining (LUNMF - \$8.60)

Hudbay Minerals (HBM - \$5.77)

Freeport-McMoran (FCX - \$38.48)

## FREE GAS!

Willie Wilson, a candidate for Mayor of Chicago, has spent \$2.2 million giving out free gasoline to voters in three events which spanned 26 gas stations. The Economist says that current mayor Lori Lightfoot responded to the threat on April 27 by persuading her city council to distribute 50,000 prepaid cards for gasoline and public transportation, at a cost of \$12.5 million. “She’s using the city’s money, he’s using his own money,” notes Derrick Orr, a school principal waiting [for gasoline] in his Range Rover.”

Milton Friedman said that there are four ways to spend money:

1. Spend your own money on yourself.
2. Spend your own money on somebody else.
3. Spend somebody else’s money on yourself.
4. Spend somebody else’s money on somebody else.

Politicians *seem* to be in category 4, but there is clear personal benefit to a pol who promises to shower constituents with gas, food, or lodging. Note that Lori Lightfoot spent six times as much money buying votes—er, gasoline cards—as Willie Wilson. The dollars are bigger when politicians spend money that isn’t their own.

## ‘FRAYED NOT

If you think that the social safety net is “fraying”, next year Congress will spend \$688 billion on food and nutrition assistance, Supplemental Security Income, the earned income and child tax credits, and other Income Security programs. If we guess that this \$688 billion will be spent on the bottom 10% of the population, 33 million adults and children, it’s \$20,848 per person.

Or you can look at the bottom 20%. The Economist, quoting the CBO, says that in 2018 the bottom 20% of Americans received means-tested transfers worth 68% of their pre-tax income. Yes, we’re spending even more on the middle class, because politicians increased that spending to buy votes. But if the social security net is fraying, it’s because very large sums of money are being spent thoughtlessly. ■

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“Venezuela holds the largest proven oil reserves in the world. A relaxing of U.S. sanctions could unleash another 400,000 bpd per day.”

— OilPrice.com

Apparently we’re willing to overlook Venezuela’s human rights infractions and trampled democracy to bring gasoline prices down. Redistribution was the trick that allowed Chavez and Maduro to reshape dreams of



fairness and equality into the horrors of dictatorship. Just ask any of your friends who grew up in countries where freedom was crushed by promises of justice that came from leaders who said that *they* would be the enforcers of equality.

It’s so easy. Redistribution buys votes, so it brings **personal benefit** to the person who gets to choose the winners and losers. It amplifies power by showering gifts on chosen voters. ■

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“Federal tax receipts through April rose an astonishing \$843 billion”

— The Wall Street Journal. Inflation is pushing all of us into higher tax brackets. Isn’t that clever?

— John Lumbard, CFA

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