

Lumbar
& Kellner

INSIGHT

S&P 500 2,875 * Dow Jones Industrials 25,790 * 30 year U.S. Treasury Bond 2.98%

In the last 20 years, the proportion of the world population living in extreme poverty has ...

- A: almost doubled
- B: remained more or less the same
- C: almost halved

In 2017 Swedish physician Hans Rosling and his research staff asked this question, and 12 others, of nearly 12,000 people in 14 countries. Only 7% gave the correct answer, C. Only 5% of Americans got it right.

One of the thirteen questions was a “gimme” about climate change, but the average respondent gave incorrect answers on 10 of the other 12 questions, which covered topics such as vaccinations, average life expectancies, the

FACTFULNESS

percentage of girls finishing primary school in low-income countries, and deaths from natural disasters. Chimpanzees would be right 33% of the time.

Rosling writes, in his 2018 book **Factfulness**:

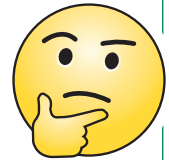
“Perhaps you would think that better-educated people would do better? ... Some of the most appalling research results came from a group of Nobel laureates and medical researchers.” Only 4% of American journalists gave a correct answer to a question about the educational attainment of women, worldwide.

“Every group of people I ask thinks the world is more frightening, more violent, and more hopeless—in short, more dramatic—than it really is.”

Using statistics from the World Bank and other well-respected sources, Rosling also points out that access to clean water is still a problem in parts of the world, but the number of people affected is shrinking by *millions* each year. In 1980, 58% of the world’s citizens derived their water from a protected source. Now it’s 88%.

On Fukushima: “1,600 people died. It was not the leaking radioactivity that killed them. Not one person has yet been reported as having died from the very thing that people were fleeing from ... It wasn’t radioactivity, but the *fear* of radioactivity that killed them.”

Continued on page 2



INNOVATION AND EFFICIENCY

In our last issue we said that this economic cycle could last for several more years if productivity—the output of each worker, each hour—increased. And we said an increase was likely, because manufacturers would respond to tight labor markets by purchasing labor-saving machines that make each employee more efficient.

It’s happening! In the most recent survey, 58% of small businesses said they’d made recent investments in machinery, computers, or other “capital”. And productivity growth just jumped to an annual rate of 2.9%, accelerating from the miserable 1% rate that has depressed wages for years.

If wages go up 3%, and output-per-hour goes up 3%, then the cost of labor won’t go up at all. Inflation will stay low, workers will get real, inflation-adjusted wage increases, and the economic cycle will last much longer.



FACTFULNESS

continued from page 1

“Our brains often jump to swift conclusions without much thinking, which used to help us to avoid immediate dangers. We are interested in gossip and dramatic stories, which used to be the only source of news and useful information. We crave sugar and fat, which used to be life-saving sources of energy when food was scarce. We have many instincts that used to be useful thousands of years ago, but we live in a very different world now. Factfulness, like a healthy diet and regular exercise, can and should become part of your daily life.” ■



We still think that the best growth story within Alphabet (GOOG-\$1,207) is YouTube. Need to learn how to fix your refrigerator, rebuild a Honda transmission, or unscrew a broken light bulb? There are *hundreds* of videos on YouTube to help you. Among the young, YouTube stars are now bigger than Hollywood stars. TV shows? “They’re too long.” Those TV shows are on YouTube anyway, along with full-length movies and music videos. How do they store all the gigabytes?

The bull market is set to become the longest in history

– MarketWatch headline, August 15, 2018, 11:02 A.M.

The Dow just registered its longest stint in correction territory in nearly 60 years

– MarketWatch headline, August 15, 2018, 8:57 P.M.

“There are three kinds of lies. Lies, Damn Lies, and Statistics.”

– True origin unknown. Quoted, to great effect, by Mark Twain.

PLAYING US FOR SUCKERS

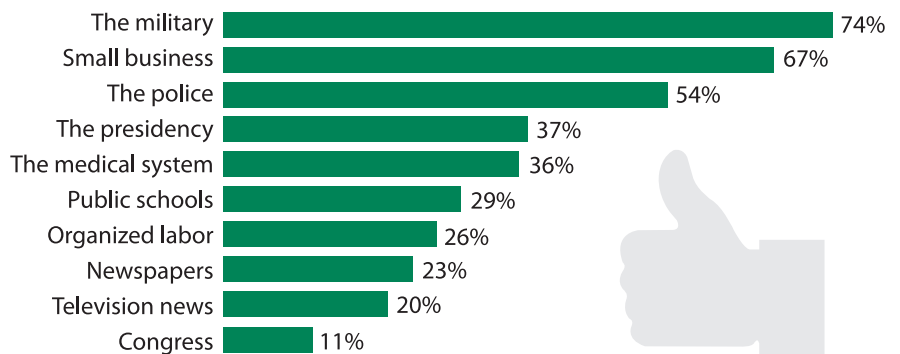
“Facebook said Tuesday that it had discovered a sophisticated coordinated disinformation operation on its platform involving 32 false pages and profiles engaging in divisive messaging ahead of the U.S. midterm elections ... The pages Facebook disclosed Tuesday promoted an event pegged as a counter-rally to a far-right march.”

– The Washington Post, August, 2018. A Russian page calling for protestors to the far-right march was called “Resisters”. Another was “Black Elevation”. Sometimes the Russians organize *both the march and the counter rally*, in an effort to widen the divisions in our society and undermine democracy. In 2016 their posts were seen by 126 million Americans.

The Russians are winning!

The Institutions Americans Trust Most and Least

Share of U.S. adults trusting the following a great deal/quite a lot (June 2018)



@StatistaCharts Source: Gallup

statista

I Write the Songs That Make the Vagrants Cry

Rite Aid has been playing Barry Manilow songs, over and over, loudly, outside its stores, to “deter loiterers and panhandlers”, according to the Wall Street Journal. “Cynthia Schick, a drug counselor who works near the Hollywood Rite-Aid, commented “It’s like a low-grade migraine”.

BOOMING

“U.S. households have been socking away a lot more money in recent years than had been earlier thought, revised government statistics released on Friday showed. The saving rate over 2016 and 2017 is now pegged at an average 6.7 percent, up from a previously reported 4.2 percent.”

– Bloomberg

The 2017 personal savings rate was first reported as just 2.4%. Consumers are in much better shape than economists thought. And the latest figures show that household net worth is nearly **\$100 trillion**.

Corporate earnings are also rising, rapidly. If analysts are correct in their estimates for next year, per-share earnings will have jumped nearly **50%** from 2016 to 2019. Earnings are skyrocketing, so any analysis based on “trailing” numbers

is going to be misleading. That’s especially true for the Cyclically Adjusted PE Ratio, CAPE, which averages the earnings for the last ten years. The last ten years include the depressed earnings of 2009!

Why are profits growing so fast, and why are profit margins bigger than we’ve ever seen? A good part of the answer is regulatory reform and tax reform, but it’s also important to note that the S&P 500 has changed a lot. It’s been overwhelmed by giant tech companies with huge profit margins and fast-growing earnings. Google’s earnings in 2013 were \$34 billion, and in 2017 they were \$65 billion. The company’s profit margins are huge. Facebook is the same way, with even faster growth.

Emotion can have a powerful impact on stock prices, but in the long term the only two things that matter are



Paul K. Wright, CFA

earnings and interest rates. Right now the forward “earnings yield” on stocks is nearly twice as high as the yield on 10 year U.S. Treasury bonds. Corporate earnings have gone up more than you realize, and interest rates have been so low for so long that many investors have forgotten that they’re low. ■

“MADE” IN CHINA

Early this year a Beijing-based wind turbine company, Sinovel, was found guilty of stealing vital software from American Superconductor of Massachusetts. Sinovel had suddenly rejected all shipments of American Superconductor’s electronic components, causing a loss of 700 jobs and hundreds of millions of US dollars. All it took was a \$21,000 bribe to an employee based in Europe. Here’s what CBS News had to say, in **January of 2016**:

“The Justice Department says that the scale of China’s corporate

espionage is so vast it constitutes a national security emergency, with China targeting virtually every sector of the U.S. economy, and costing American companies hundreds of billions of dollars in losses – and more than two million jobs.”

The U.S. trade representative says that “Chinese theft of American intellectual property currently costs between \$225 billion and \$600 billion annually.” Here’s a photo of our new F35 jet, with China’s pirated version, the J-31, superimposed:

F-35 vs J-31



MIL.QQ.COM

If we all boycott China, it will eliminate the need for a trade war. What, exactly, do you *have to have* this year, that you can’t buy from Japan, Korea, or Vietnam? Or the USA?? ■

F-35

The production of the F-35 is now in full swing, after years of delays and software issues. Lockheed (LMT-\$319) is making money hand over fist. And Chinese military expansion is going to drive our defense spending upward.

There's lots of innovation underway. On air, land, and sea, you can expect that soldiers, sailors, and airmen will be surrounded by swarms of small drones, along with larger unmanned aircraft, submarines, or vehicles. Drone motherships will follow behind.

Intense efforts by Russia and China to steal our defense secrets prevent our Defense Dept from venturing far beyond the largest military contractors. It has to heavily favor those who have the best security, and trustworthy longtime employees who are willing to endure constant surveillance. Lockheed is prime. ■

Ad Hominem Attacks are the choice of bloviators and snoutbands who are losing an argument. If your facts are weak, your mind is weak, or you're just feeling grumpy, attack your opponent! It's a good way to bond in fellowship with other haters.

This nation needs to heal its divisions and wounds. Let's set aside insults, arrogance, class warfare, and suspicions of pervasive racism that are gleefully fed to us by Russian agents. External threats are supposed to bring us together. Not tear us apart.



In the twelve months that ended on June 30, Instagram added 300 million users. Facebook added 228 million, despite Russian chicanery, and Whatsapp added 200 million. All three of these companies are owned by Facebook (FB-\$174). Over the course of the last five years, earnings grew 57% per year! Analysts think that they'll grow 22% in the next five years. If Facebook grows at half that rate its shares are ridiculously cheap.

“Fed economists do not believe productivity can possibly grow as fast as it did in 1995-1999, but there's a terrific example of productivity growth on the front page of today's WSJ. Oil output in the US has topped 11 million barrels a day (just a month ago the IEA optimistically predicted 10m bpd), 20% above the 2014 peak 9m bpd. And it was achieved with 23% fewer workers.

– Christopher Low, FTN Financial

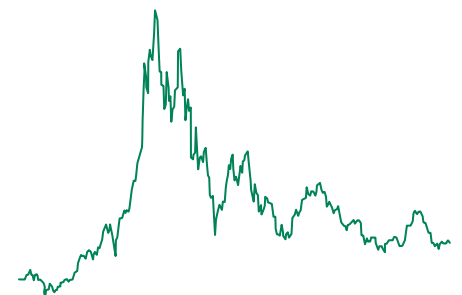
Disney (DIS-\$112) is buying 21st Century Fox. The merger proposal that they mailed to shareholders was **519 pages long**. Regulation and cover-your-a** legalese aren't growing as fast as before, but they're still growing. Everyone loses, except financial printers and investment bankers. Our clients own shares of Goldman Sachs (GS-\$240).

The Roth IRA is a loophole for millionaires. It's even more nefarious than it sounds, because it *creates* millionaires. If your child or grandchild earned \$3,000 this past summer, you can contribute up to \$3,000 to a Roth IRA in his or her name. Way better than “leaving money to your heirs”.

“Roughly one million households in the top 1% will pay for 43% of income tax [in 2018], up from 38% in 2017 ... Estimates for 2017 and 2018 come from the Tax Policy Center, a nonpartisan research group.”

– The Wall Street Journal. Our tax system has become more progressive, largely because the deduction for state taxes was eliminated. Like other deductions, it was mostly a gift to the wealthy. The political support for these deductions is shriveling, because more than 90% of Americans will now use the standard deduction. And less political support could mean more tax simplification in the future!

The price of Bitcoin has dropped from \$19,343 to \$6,371. If you can't explain, in a simple sentence, why an investment is worth \$6,000 and not \$600, don't buy it.



CHINA RISING

If you're interested in what's happening in the world you should pay attention to China. Nearly half of the 1.1 billion people who have been lifted out of poverty since 1990 were Chinese. China's economy grew from \$300 billion in 1980 to **43 times more**—\$13 trillion—last year. Biggest economy? The IMF says that if you use “purchasing power parity” as a yardstick, China

has the largest GDP, at more than \$23 trillion. World's largest army? China has 2.2 million soldiers and sailors, 83% more than we do. It's the world's biggest polluter. The largest exporter. If you're worried about unfair trade practices and theft of intellectual property, China is at the top of the list; but they were also #2 in international patent applications in 2017. ■



Drew D. Kellner, CFA

Figure 1. ASIA'S GLOBAL RELEVANCE

There are more people living inside the circle than outside of it



Source: Matthews Asia, using United Nations data

“Even today, less than 4% of births in China are out of wedlock, and the same is true in India, Japan, and Korea. For the vast majority of young adults in Asia, the path to success clearly runs through education, work, and marriage—in that order.”

“Brookings scholars Ron Haskins and Isabel Sawhill call it the “success sequence”: getting at least a high school diploma, working, and then marrying before having children—again, in that order.”

“Among young [American] adults who grew up in low-income families, those who followed all three steps had a poverty rate of only 6%, compared with 35% for their peers who missed one or more steps. Eighty percent of those with lower-income backgrounds made it into middle- or upper-income brackets when they followed all three steps, versus only 44% for those who missed one or more steps.”

— Wendy Wang, in the Wall Street Journal

FARPOTSHKET

Farpotshket is a Yiddish word that means “All forked up **because** you tried to fix it.” That’s a perfect description of our health care system.

We can have low cost, excellent, competitive free market health care, but it would have to be completely independent of the heavy burdens of Medicaid, Medicare, and other government programs and regulations. It would even have to be independent of our private health insurance system, a Rube Goldberg contraption which drives up costs and drags down the nation’s productivity. The answer is to put all the government spending, state and federal, into one single-payer system—we’d save *trillions* of dollars—and open it to everyone. Then let patients spend their own money to go outside of it. That’s what they do in Europe, where private-pay health care is much bigger than we have imagined. ■

“We spend a trillion dollars a year. Even poor people don’t believe that they’re effective. No one, actually, in this country, believes that they’re effective. And yet government spending on poverty programs, broadly defined, has gone up every year, through Democrat and Republican administrations alike, every year since the Great Society in the 1960s.”

– Ken Stern, former CEO of National Public Radio, speaking on [The Rubin Report](#)

ADMIRABLE

If you’ve been wanting to do something meaningful about unemployment, poverty, and happiness in America, learn about EforAll. We did, and we’re impressed. It’s a non-profit organization, well-established and growing in low-income communities in Lowell, Lawrence, and other small cities, which trains entrepreneurs among the working poor. They’re the most important citizens in our society, because *they choose to work rather than seek public assistance*. That’s both admirable and essential.

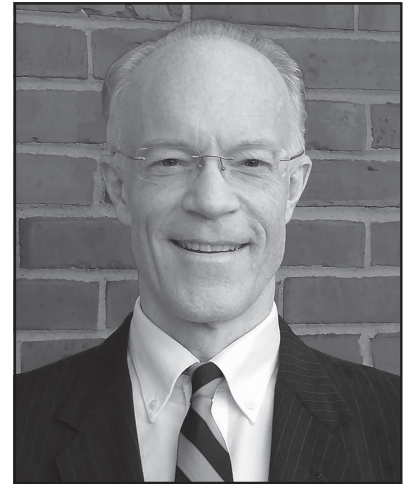
When EforAll comes to a low-income neighborhood it hires two staffers who go out into the community and spread the word. The Word comes in two parts. Entrepreneurs can win modest cash prizes in Pitch Contests that are characterized as “Shark

Tank without the teeth”. And they can apply for a 12-week training program for entrepreneurs. There are two of these training sessions each year, and many of the spots are awarded to those who enter the pitch contests.

The pitch contests are exciting. The smell of nervous perspiration is in the air, and contestants pitch their ideas one-on-one, at card tables, and then in front of the whole audience. The educational attainment of the contestants ranges from PhD to “not much”, and the businesses range from mundane-but-already-profitable to ingenious dreams of what might be.

There’s also excitement and tension in the first class of a training program, in which 15 trainees get to know each other—and learn about an upcoming speed-dating night in which they each choose three of *forty-five* mentors. In the months that follow some of these entrepreneurs will discard their business plans and go on to success with something more sensible, guided not just by the mentors but also by the bursting-with-newfound-pride entrepreneurs who surround them in classes twice a week.

EforAll already lists hundreds of successes on its website, often created by entrepreneurs who were previously unemployed and destitute, or miserably unhappy in demeaning jobs.



John Lumbard, CFA

Government’s efforts in this arena stagger under heavy handicaps. A client who mentored for one found that applicants are rarely poor; and that they arrive without gratitude or a sense of personal responsibility. If the mentors want a budget, the mentors should do the work ... By contrast, EforAll’s entrepreneurs feel deeply thankful for, and somewhat incredulous at, the volunteer efforts of their mentors. They’re thrilled by their good fortune to be selected for the program. The relationships often last for years.

We’re trying to bring this dynamism to New Hampshire. If you’d like to help, put “for NH” in the memo line of your check, and send it to:

EforAll
175 Cabot Street, Suite 100
Lowell, MA 01854

– John Lumbard, CFA

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