

Lumbar  
& Kellner

INSIGHT

S&amp;P 500 7,409 \* Nasdaq: 26,225 \* 30 year U.S. Treasury Bond 5.13%

## TRANSFORMATION

The Storm Before the Calm: America's Discord, the Coming Crisis of the 2020s, and the Triumph Beyond identified two long cycles, social and institutional, that have oscillated through history. The institutional cycle ( $\approx$  80 years long) relates to changes in government and other institutions, while the social cycle ( $\approx$  50 years) relates to the pendulum that swings between straight-laced eras such as Victorian times, and the "anything goes" mores of the 1960s and today.

Author George Friedman believes that we have arrived at the end of both cycles simultaneously, and that *we're lucky that the discord in society has thus far been rather modest!*

**And that's not all.** Artificial intelligence is bringing us a technological revolution that might be more profound than the shocking change spawned by the Industrial Revolution.

Lately CEOs have been saying that their goal for AI is to keep the same number of employees but triple their revenues. That sounds good when one CEO says it, but it certainly can't be

true for a thousand companies. What they're *really* looking to do is reduce their costs, but few have laid off employees because they haven't been sure that this would save a lot of money and boost profits.

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**In the last 12 months S&P 500 profits grew 27.7%**

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Corporations have been tight-lipped about their AI successes, but we know that AI is reducing costs because corporate profits are rising **rapidly**. Soon competition will begin to squeeze those fatter profit margins and bring the inflation rate down.

If inflation is low the Federal Reserve will push interest rates down. Lower interest rates stimulate economic growth and also cause stocks to become more valuable, because cash and bonds seem less attractive to investors and the discount rate on future profits is lower. Yes, a higher unemployment rate will cause some offset to that stronger growth and it would cause those future profits to shrink a bit, but the Fed would lower interest rates even more.

A rising unemployment rate doesn't necessarily suggest a recession. The unemployment rate has been rising for three years! And recessions don't always occur when unemployment is high. In the summer of 2013, four years into an economic expansion, the jobless rate stood at 7.5%. There were 7 more years of growth ahead.

Our economy grows unless something stops it from growing. Recessions are not regularly repeated and normal, but rather events that occur when there are excesses in the economy or runaway inflation that need to be crushed by the Federal Reserve. You don't have to worry about that now.

Interest rates could drop to the levels we saw in the pandemic, even as the economy continues to grow. **Mortgage rates should go back to extremely low levels, boosting housing affordability and construction.** Bond prices would rise a lot, because bond prices always rise when long-term interest rates fall.

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### TRANSFORMATION ...

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Our bond investments have declined as the price of oil has gone up. But IF long-term treasuries go back to the levels they reached in the pandemic, **they could rise 60% or more.** ■

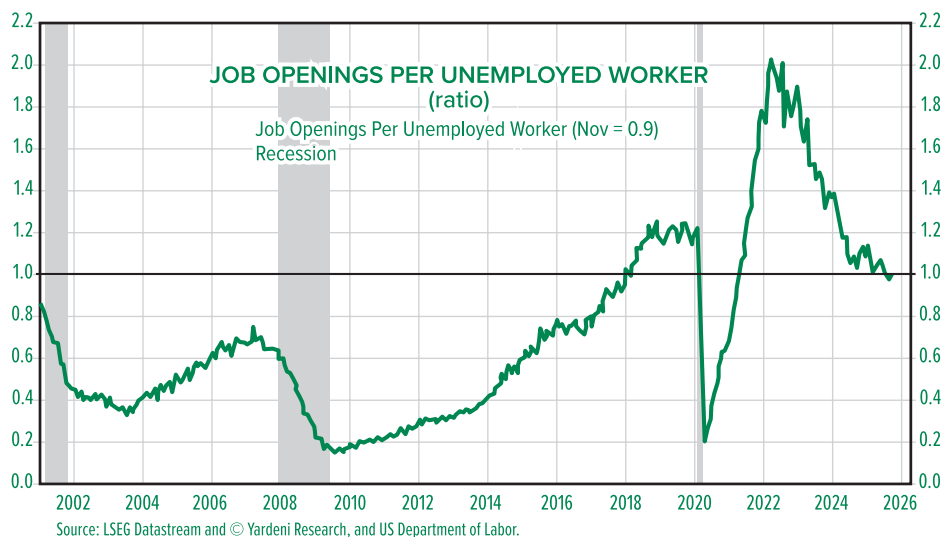


“I saw a note once, pinned to the door of a meeting room in the ITT building in Brussels, that said “The only person who got all their work done by Friday was Robinson Crusoe.””

— Excerpted from a letter to *The Economist* by Danae Penn of Lannes, France

### Job Openings Per Unemployed Worker

2022 was a *terrific* time to look for a job. 2025 seemed much worse by comparison, but it was better than any of the job markets from 2001 to 2017.



### JOBS

The Industrial Revolution caused massive job losses among farmers, weavers, spinners, and artisans who made shoes, cookware, and other items by hand. However, the cost of clothing, tools, and household goods declined, bringing luxury items to the masses and lighting the dark nights. Before the revolution you needed to own land to be wealthy. The new world rewarded those who were smart and industrious, and goods cost less for everyone.

AI will bring medical care to new heights, and there will be much more wealth. Spending on travel, restaurant meals, and Door Dash will continue to rise. There will be more leisure, and many new jobs in Leisure. **This is a good time** to be a musician, a landscape artist, a boatbuilder, a sculptor, or a timber-frame builder. Or an aesthetic surgeon who repairs dueling scars and the slowly-deflating puffy lips of aging Hollywood starlets. ■

“Meta Platforms looks like a money-printing machine. So why has it been loading up on billions of dollars in debt to pay for its new data centers?”

It turns out that the abundant free cash flow that Meta reports to investors is something of an optical illusion. Yes, it generated billions in cash last year, but that was largely devoured by the all-too-real cash costs that come with paying stock-based compensation to employees.”

— *The Wall Street Journal*



“Headlights are becoming alarmingly expensive. To the point that a BMW owner recently got a bill for \$8,510.38 to have a single headlamp replaced on a 2023 BMW M4 Competition.”

— *MSN.com*

The “5 Ws of Journalism” (*Who What When Where Why*) insisted that we interview an expert. So we made the long drive to Hollis Auto, where a customer needed a headlight for her Land Rover. The shop had determined that a (sealed, impenetrable) headlight assembly would cost **\$4,700!** Their assessment: “*Land Rover should be ashamed of themselves.*” ■



## DENALI

Denali Therapeutics (DNLI - \$18.62) had its first drug, Avlayah, approved in March. The drug is for Hunter syndrome, a rare genetic disorder in baby boys that can affect breathing and brain function. It's the first drug to use Denali's TransportVehicle™, which has a nearly-unique ability to get neurological drugs across the blood-brain barrier. This fierce barrier has stymied many efforts to cure Alzheimer's and Parkinson's disease.

Denali has partnered with Takeda and Biogen to develop drugs for Alzheimer's and Parkinson's. Other big drug companies need this capability, so it's not unreasonable to hope that Denali will eventually be acquired. ■

"There are 19,000 private equity funds in the US. There are 14,000 McDonald's in the US. How are there more private equity funds than McDonald's? That's actually crazy, right?"

— *Alisa Wood, a partner in KKR & Co.*

## VOLUNTARY EXTINCTION

According to CIA.gov, America has a total fertility rate, or births per woman, of 1.84, far below the 2.1 rate that's needed to keep the population from shrinking. You might be surprised to learn that Mexico is shrinking faster; its fertility rate is just 1.79.

Italy and Spain, at 1.3, are sliding quickly toward oblivion. Soon there won't be anyone left but the tourists! *And parenting has become odd and intimidating* in Taiwan (1.11), South Korea (1.12), and Singapore (0.87!) because there are no babies to be seen. ■

*"Resentment is like drinking poison and then hoping it will kill your enemies."*

— *Nelson Mandela*

## ELIXIR

"If generic semaglutide [the active ingredient in Wegovy and Ozempic] were made available to everyone with obesity and diabetes globally, it could save 2.1m - 3.1m lives a year, according to one model. Moreover, glp-1 medications are known to reduce cardiovascular events, improve sleep apnea, protect the kidneys and liver, and even show promise for reducing addictive behaviours. Early data have even hinted at reduced risks of cancer and Alzheimer's."

— *The Economist*



*Drew D. Kellner, CFA*

"TO GRASP THE stakes of economic growth, start with the arithmetic of compounding. Over two generations an economy growing at about 1% a year will not even double in size; one growing at 7% will expand roughly 30-fold. South Korea and Ghana show what such differences can mean. In 1960 the two had similar incomes. Today South Koreans browse Gangnam's luxury boutiques and sip lattes in Garosu-gil's trendy cafés, while the typical Ghanaian still lives on less than \$4 a day.

Even a few percentage points make an enormous difference over time: fewer children die, people live longer, education spreads and daily life becomes more comfortable. Little wonder that Robert Lucas, a Nobel-prizewinning economist, remarked that once you start thinking about economic growth it is hard to think about anything else."

— *The Economist*



## BANKING PROFITS

Can you remember the awe with which people spoke of Bell Labs? **Today’s “Bell Labs” is Google,** aka Alphabet Inc. (GOOG - \$393).

Google’s Demis Hassabis and Deep Mind gave to science and humanity the predicted structures for nearly all 200 million known proteins—way back in 2022. Next will be drug design, revolutionary diagnostic capabilities, and systems that can identify and repair genetic problems.

Other Google engineers created the “Transformer”, the key piece of technology that enabled ChatGPT; Google felt it wasn’t safe enough to put on the market. Last year saw 800% growth in revenue from AI agents specialized to cybersecurity, financial services, medicine, software development, drug discovery, customer service, and fusion power. ■

“Core” inflation, not counting food and energy, is up just 2.8% in the past year despite continued GDP growth, war, shortages, tariffs, \$100 oil, and all sorts of other craziness in trade. *Some of the cost savings of AI must be flowing through to consumers.* Inflation should keep sliding to very low levels, and short-term interest rates should continue sliding as well.

Banks tend to borrow at short-term interest rates and lend at long term rates, so they benefit when long rates are higher, *as they are now.* Banks have also been relieved of some of the vastly increased post-2008 regulatory load. And banking is one of the very best places to apply artificial intelligence.

We hold shares of three exchange-traded funds that are focused on big banks (XLF - \$51), small banks (QABA - 60) and middle-sized regional banks (KRE - \$67). So far the small and mid-sized banks have been leading the way. ■

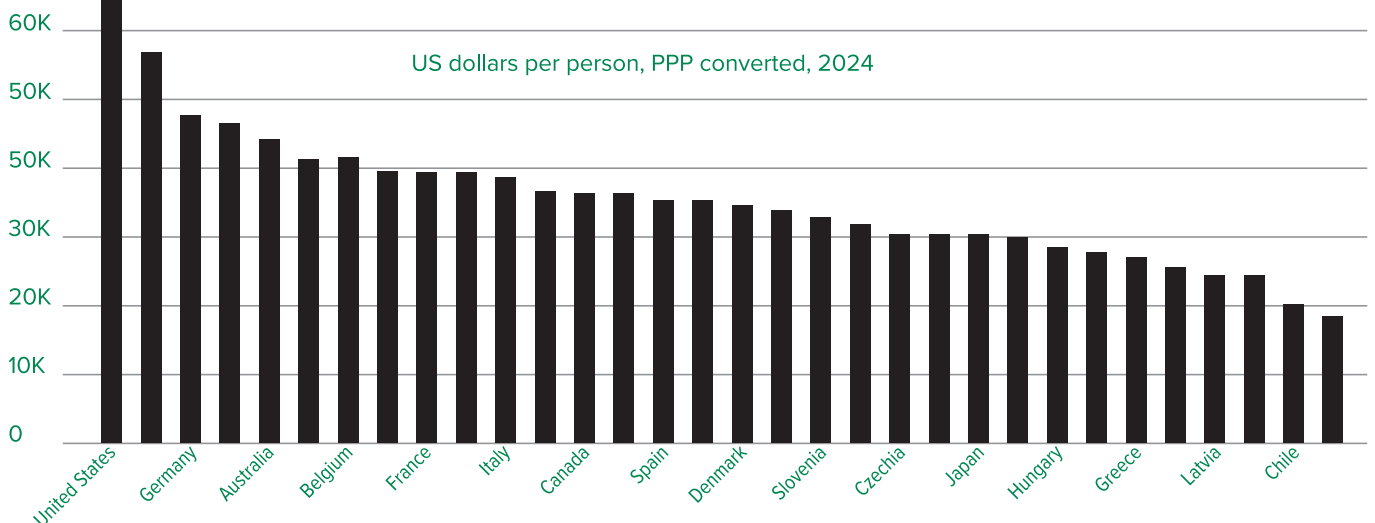
“After seeing a decline in Amazon (AMZN - \$186), a seemingly unstoppable juggernaut whose stock has always been expensive, we took a position in the shares. Then we purchased shares of Primoris, (PRIM - \$66), a firm that strings high-voltage lines and builds data centers; Enersys (ENS - \$90), a manufacturer that’s opening a big lithium-battery plant in South Carolina; and Jabil (JBL - \$150), which designs and manufactures electronic circuit boards and should derive significant benefit from reshoring.”

— *This newsletter, one year ago.*

Jabil now stands at \$340, Enersys is at \$237, and the shares of Amazon trade at \$264. Primoris rocketed to \$205, and then dropped **50% in one day** because of a somewhat-lousy earnings report.

Individual stocks are *much* more volatile now. This is an advantage for price-conscious investors who buy *stocks* instead of index funds.

### Household Disposable Income including welfare, Medicare, and other transfer payments:



## SBC MEDICAL



More than a million reconstructive surgery procedures—for injury, accident, or surgical scars—are performed each year in the United States. 1.5 million other patients seek cosmetic surgery for cleft lips, misshapen noses, Ozempic face, or anything that they were teased about by the mean girls in high school. They want the world to see them as they really are, inside. And cosmetic procedures, non-invasive or invasive, enjoy a much greater level of social acceptance today than ever before.

Do attractive people have an advantage? Socially, romantically, and in higher earning potential? *Of course* they do. Numerous studies have shown that they earn 15% more, on average. Improving a patient's appearance can be life-changing.

SBC Medical (SBC - \$2.97) owns surgical and non-surgical aesthetic treatment clinics in Japan, Singapore, and Vietnam, and provides management services to 237 other clinics in Japan. It recently purchased a stake in a California chain of 24 clinics that provide non-surgical treatments and skin care, and has entered the “longevity” market with

preventative, AI-powered, data-driven health management.

Our population is aging, as are the populations of Japan and Singapore. Sensible, frugal citizens retire with the greatest wealth of their lifetimes, and this AI-fueled stock market has turbocharged these wealth gains. Many will spend their newfound wealth on ways to have a longer, happier, healthier, more confident life.

Grandview Research says that the Japanese aesthetic market is expected to grow at a *15.1% annual rate*. The price of a share of SBC is low compared to earnings, book value, or revenues per share, and cheaper than a cup of coffee! SBC expects to expand further in the United States and Asia.

**American patients can save money by seeking treatment in Japan, even when the cost of airfare is factored in. ■**

*“Look for the good in everyone.”*

— Jason Mraz

“Five years ago, about 30 incoming freshmen at UC San Diego arrived with math skills below high-school level. Now that number is 900—and most of those students don't fully meet *middle-school* math standards... Almost all of them had taken advanced math courses in high school.”

— *The Atlantic*



Jay Conway, CFA

## OIL

In our January 2023 issue we offered praise for ARC Resources (AETUF - \$23) at \$13 a share, and Petrobras (PBR - \$20) at \$10.60 per share. For a long time the attraction to Petrobras was the yield; in one crazy year it was equal to 50% of our initial investment!

ARC will be acquired by Shell Oil in the second half of the year at a price a bit higher than the current quote. Yes, it's going to be another capital gain, but *it's not our fault*.

The cheapest and quickest way to generate power is the kind of solar power that utilities buy for themselves. It's *still* the cheapest even if they add batteries big enough to last 4 hours, which covers the supertime surge of demand. There's no shortage of power at 3 AM!

First Solar (FSLR - \$233) sells unique, American made, inexpensive “thin film” panels to utilities and data centers. Even in the cold northern states.

## THE BEGINNING OF THE END

“Vladimir Vladimirovich,” Ms [Victoria] Bonya says, “the people are afraid of you, bloggers are afraid of you, artists are afraid, governors are afraid. But you are the president of our country, and people should not be afraid. I am not afraid.”

“Though formally banned, Instagram is widely used by Russians, and within hours her video had clocked 10m views.”

— The Economist

“FOR DECADES, surveys have suggested that middle age is the low point of life. While young and old generally reported high levels of life satisfaction, those in mid-life endured a slump... [But] A study published on August 27th ... finds that young people across the world are now reporting the highest levels of misery of any age group.”

“[An] oft-cited culprit of teenage angst is smartphone and social-media use, which has risen in lockstep with youth mental-health problems since the early 2010s. There is some support for a causal link, but the most rigorous studies, which track teenagers’ mood and social-media use over long periods

of time, do not find a strong relationship between such app use and subsequent mental ill-health.”

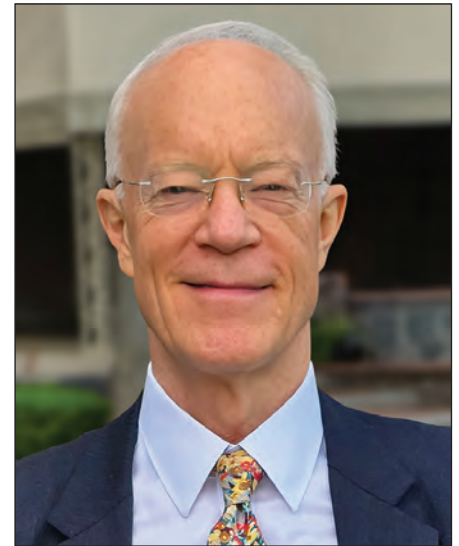
— The Economist

“Since at least the turn of the century our young people have been told, endlessly—in school, in media—that they will never have a nice life. The rising seas will drown them, a racist, misogynistic culture will abuse them, the economy can no longer make a place for them. If it is relentlessly drilled into you that you’ll never have a satisfying and constructive life, and you are 22 years old and your brain isn’t even fully developed yet, you just might think it wholly legitimate that you indulge your fury and strike at those who have thwarted you.”

— Peggy Noonan,  
*The Wall Street Journal*

“We live in the richest time and place in human history. Yet today’s young people are the first generation since we’ve had polling that has thought the future is going to be worse than the past. They also believe they’ve lived through more economic hardship than any of the previous three generations.”

— Ben Sasse,  
*the Wall Street Journal*



**Kratos** (KTOS - \$52) received a \$447 million contract from the US Space Force to lead a team to build and operate the space operations center, which among other things will detect and track missiles. It won a \$1.45 billion contract to manage the testing of hypersonic missiles, and it will build solid fuel rocket motors in conjunction with Rafael, the primary force behind the Iron Dome system. ■

“More than two-thirds of U.S. households have inflation-adjusted incomes today that would have put them in the top one-fifth of households in 1967.”

— Phil Gramm and John Early

— John Lumbard, CFA

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