STRATEGIES, TRENDS AND NEWS FOR TODAY'S INVESTORS JANUARY 2018

Lumbard & Kellner INSIGHT

S&P 500 2,674 * Dow Jones Industrials 24,719 * 30 year U.S. Treasury Bond 2.74%

LET THE GOOD TIMES ROLL

Why all the long faces? Jobs are plentiful, wages are finally rising, and the economy is growing. Median household income is up, after decades of stagnation. Times are good! Tim Montgomerie of the Times of London adds, "People are living longer on every continent. They're doing less arduous, back-breaking work. Natural disasters are killing fewer people. Fewer crops are failing. Some 100,000 people are being lifted out of poverty every day, according to World Bank data."

And the stock market continues to rise steadily. Just about Every. Single. Day. It's making investors feel a bit nervous.

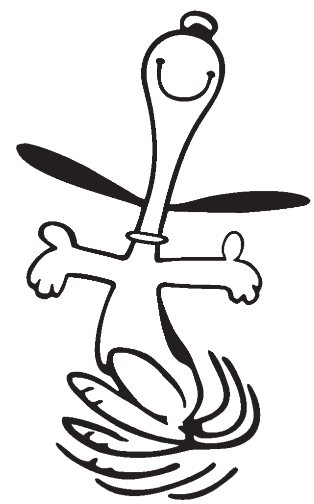
But we're not in a bubble yet! The "earnings yield" of common stocks, using 2018 estimated earnings, is a whopping 5.3%. The yield on 10-year U.S. Treasury bonds is just 2.4%. When these numbers reach parity (perhaps when bonds yield 3.33% and stocks sell at a 3.33% earnings yield, or 30 times earnings), *then* you can start talking about a bubble. A bubble that will probably extend into 2019, and maybe into 2020.

PE ratios can be confusing and unhelpful. Klazomaniacs and other pundits have been comparing today's PE with the PE ratios of yesteryear—forgetting that today's interest rates are lower than they've ever been. That 5.3% earnings yield makes this obvious.

One of the time-tested adages of Wall Street is that the stock market climbs a wall of worry. Just a few weeks ago investors were *still pulling money out of stock funds and investing it into bond funds*. With the exception of 2013 they've been doing this for a decade! When you stop worrying about the stock market, *that's* when you should pull some money out. ■

IT'S NOT RARE AT ALL.

Phys.org says that gold *seems* rare, because most of it drained into the earth's core when the planet was forming. There's enough gold down there to cover the entire surface of the planet—oceans and continents—in gold. 12 feet deep!



2018 is the year of the dog.

FREE. REALLY!

The United States spends as much *government* money on health care as do the socialized health care systems of Europe. States and our federal government now spend nearly two trillion dollars a year on health care. That's more, as a % of GDP, than Canada and the U.K. spend on single-payer government systems.

It wouldn't cost us anything to establish a "European" health care system, and we'd still have a free market system—now free of government mandates and

Continued on page 2

FREE. REALLY!

Continued from page 1

insurance, with *much* lower prices than before!

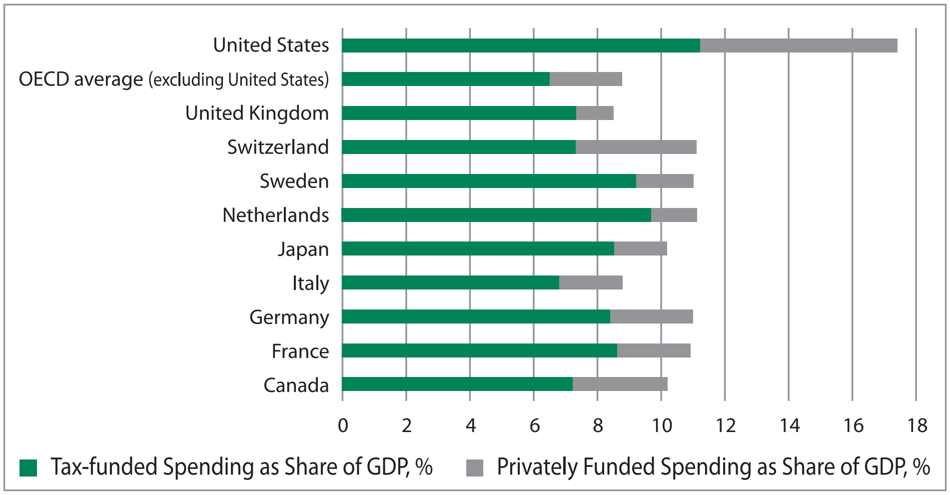
The graph at the right shows healthcare spending by country, using very comprehensive figures from the American Journal of Public Health. Note that each nation has free-market health care alongside its public system.

These figures are from 2013. That's before the Affordable Care Act exchanges, with 12 million patients, opened; and in the years that followed another 13 million would be added to Medicaid. Free-market health care in the United States is now tiny, in comparison to our socialized medical systems.

It's often said that ordinary Europeans pay huge taxes—a 19% value-added tax, and $6 a gallon for gasoline—but that they get free health care. Our government actually ***spends more***, but the fire hose of money doesn't give us much for the dollars spent. Medical care has been the driving force behind the rapid growth of our gigantic federal debt, and it's going to get a lot worse. Government will get less tax revenue from 76 million retiring Baby Boomers, and it will spend much more on them when they join Medicare.

And really, the **biggest problem in American health care** is that Medicaid and Medicare drive up the cost of health care for everybody else by demanding deep discounts. They are parasites, sucking the life out of health care providers. When a non-profit hospital loses money on a Medicaid patient, it ***has*** to raise rates for other patients or go bankrupt. Medicaid expansion caused a big increase in the cost of health care for everybody else. And it's busting state budgets across the country.

Public and Private Health Care Spending



Nobody can afford it. Colleges hire part-time faculty so they don't have to pay for health insurance. Huge numbers of people are still looking for a "good" job—by which they often mean "a job with benefits". Health care is the key to most of the problems in our economy and our government.

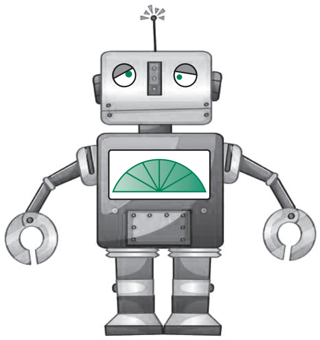
We can't have an affordable private system unless we free it from Medicare and Medicaid. The cost of health care in this country would be phenomenally low if we were to remove the burdens of Medicare, Medicaid, and the maddening paperwork demanded by insurance companies. *It already is low*, if you go to providers who don't have these burdens. The Surgical Center of Oklahoma is a "cash only" hospital that puts the prices for 250 surgical procedures, all inclusive, right on its web site.

From a cost perspective we already have the worst system in the world, so there's nowhere to go but up. ■

Here's where we go way out on a limb, and make a wild prediction. We think that in 2018 you'll see serious bi-partisan discussions about the establishment of a European-style healthcare system, using the money the federal government is **already** spending on health care—and limiting it to current spending, as a percentage of GDP. With this safety net in place, we would be able to establish an inexpensive free-market system for those willing to pay for it.

Looking back on the last 8 years of Federal Reserve policy—and 8 years of wailing and gnashing of teeth—you have to admit that ***nothing bad happened***.

AUTOMATION



We're still hearing worries that automation will wipe out all our jobs. You're going to be OK! Much of American history is about waves of innovation and layoffs. If worrying is your thing, you might instead worry about the coming retirement of 76 million Baby Boomers. We won't have enough workers to staff all the retirement communities and fix the decaying homes of those who stay at home. Automation might arrive just when we need it.

And the future isn't coming as fast as you think. If machines are so smart, why do our smartphones make utterly stupid errors when taking dictation? And how d'ya think those autonomous cars will perform in a snowstorm?

What about the day *after* a snowstorm, when the cameras and the LIDAR are covered, repeatedly, with an opaque layer of road salt? Computers are often wonderful, but in life-or-death matters "often" isn't often enough.

We love Google Maps, but lately it's been saying "right' when it means "left", and "west" when it means "east". Check the display before you make that turn! ■

Lots of people know that *Macchiato* is the high-falutin' name given to a Starbucks coffee, and that *Venti* is the 20-ounce size, so named because it's the Italian word for twenty. And people who spend too much time at Starbucks know that the company also has drinks named Ristretto and Affogato. But you can't order a galão, a Portuguese-style coffee, at Starbucks. And you shouldn't order a Masaccio, a Verocchio, or a Tintorretto, because they are dead Italian painters.

*IN*SECURITY

Don't give your phone number to Yahoo! Or Google! This is a ***really bad idea!*** Armed with your phone number, a thief can take control of your accounts. Hackers have been stealing the phone numbers of sophisticated technophiles, and using them to steal their Ƀitcoins.

"Everybody I know in the cryptocurrency space has gotten their phone number stolen," said Joby Weeks, a bitcoin entrepreneur quoted by The New York Times, which continues "Mr. Weeks lost his phone number and about a million dollars' worth of virtual currency late last year, despite having asked his mobile phone provider for additional security."

Paul K. Wright, CFA

Chainalysis estimates that 2.8 to 3.8 million bitcoins, worth about $50 billion, have simply been lost. James Howells lost 7,500 bitcoins—now $110 million!—after a hard drive containing his private key was accidentally thrown away during an office cleanup, four years ago.

And Ƀitcoin is Ƀad for the environment. It takes about $50 worth of computing power to verify a transaction, and far more to "mine" new coins. Digiconomist says that bitcoin already uses as much electricity as Morocco. By autumn it will use as much as France.

There's another big problem with cryptocurrencies. Any nation, or anybody with crediɃility, can create one—and flood the market with so many "coins" that their value declines. Ethereum, Litecoin, Ripple (probably backed by cases of 1976 Ripple), and Tezos are already on the market. More are on the way… Ƀ Ƀ Ƀ Ƀ Ƀ ■

Japan is buying weapons, fearful of what Kim Jong Un will do after he develops a fleet of nuclear-tipped missiles. He would probably want to reunify the Koreas under his rule, and part of the persuasion process could involve incinerating some nearby cities. Japan might be the target. ■

Corienne Pretorius of London received a big package from Amazon, which she had not ordered. But she owns an Amazon Echo, generally addressed as Alexa; and she owns an African Grey Parrot named Buddy.

"When I came home on Sunday, I could hear Buddy talking but couldn't quite make out what he was saying. Then I heard Alexa say, 'Sorry I didn't quite get that.' Buddy said 'Alexa' and some gibberish, and the machine replied, 'What is it you want to order?" ■

"About 18,000 people died as a result of the earthquake and tsunami on March 11, 2011. But no one has died, by radiation, from the meltdowns."

– The narrator of the PBS program NOVA.

"New York-based Death Wish Coffee Co. makes a strong cup of joe. The company, which says it will refund customers in full "if it's not the strongest coffee you've ever had," brands its products with a skull-and-crossbones logo. The company is now recalling its Death Wish cans of cold brew coffee.

Death Wish discovered that its brewing process could lead to the growth of the deadly toxin botulinum …"

–The Wall Street Journal.

Recently we listened to the frustrations of a Slovak friend, as he spoke of the unwillingness of Western Europeans to listen to the wisdom and experience of Central Europeans who have lived under capitalist, socialist, and communist rule. Socialism is still seducing the elite, even after the collapse of Greece—and Venezuela, where the Maduro government is accused of causing starvation in opposition neighborhoods, while feeding its supporters.

Our friend's most-painful memories didn't have anything to do with economic issues. It was the disappearance of free speech, as the thundering herd of socialists cast out wrong-thinking friends and acquaintances. The latter were accused of fascism, nationalism, racism—a litany of isms—in slander designed to suppress opposing ideas. We're seeing that drama played out on college campuses today. ■

WINNERS

Long ago we bought the stocks of heavily-taxed companies, believing that eventually U.S. corporate tax rates would have to fall to the levels of Europe.

We bought FedEx, with a 35% tax rate, which projects that the new tax rates will add a dollar a share to earnings. Early in 2016 the stock bottomed out at $127; now it's at $249. Tyson, with a tax rate of 32%, has grown from $51 to $81 since that dark winter. Walmart, taxed at 33%, has risen from $62 to $99. Online sales were up 50% last year, and you can pick up your packages in the stores!

Our financial companies were burdened with high tax rates *and* low interest rates *and* intentionally-punitive "SIFI" regulations. Since that winter of 2016, Regions Financial has climbed 133%, from $7 to $17. Key Banks has doubled. Goldman Sachs is up 70%, and Prudential has risen 88%. ■

A few years ago investors latched onto the idea that the FANG stocks, Facebook, Amazon, Netflix, and Google, were going to rise, inevitably and forever. More recently they added Apple to make it FAANG …

Our shares of Google have done well, but Boeing has been a much better holding for us. We think the company should be recognized as well. **800** orders for new aircraft in 2017, along with assorted bombs and cruise missiles. **FABANG!**

TAX REFORM

Only 17% of Americans believe that the new tax legislation will lower their taxes. The plan will add more than a trillion dollars to our $20 trillion debt. Legislators didn't get rid of the special tax rate for hedge fund managers, they didn't raise the gas tax, and they didn't simplify our monstrous tax code. So is there *anything* good about this bill?

Most Americans will now find it very easy to file their taxes. That's because Congress doubled the size of the standard deduction. You can stop saving receipts! The Tax Policy Center says that 92% of us will now take the standard deduction instead of itemizing. And the political support for our staggering array of deductions will shrink to just the wealthiest 8% of the population. *More simplification might be in our future.*

The top 5% of households have been paying 58% of all the taxes, so they've obviously been getting most of the benefit from tax deductions. Most deductions harm the economy, and every one of them is a "giveaway to the rich". Even the home mortgage deduction showered almost half of its benefits on the top 5%, and it created incentives to borrow excessively. Without it, the real estate bubble would not have grown to such a stupendous size.

The Atlantic says that only 17% of Americans believe that they will get a tax cut, but that 80% will actually receive one. The marginal tax rate paid by average folks—married couples with incomes below $77,000—will drop from 15% to 12%. That's a big drop, in a big bracket that includes many of the working poor and many from the middle class. The median household income is $59,039.

Researchers at the Wharton School say that a married couple with two children, living in California and earning $68,000, will see their federal tax drop from $2,810 to $900. A Florida couple with two children and a $50,000 income will *receive* a check for $1,600 in the mail, up from last year's $230, because of the Earned Income Tax Credit.

Corporate Tax Reform

In recent years there's been a huge drain of tax revenue to low-tax countries such as Ireland, where the corporate tax rate is just 12.5%. Medtronic, Seagate, and Allergan are among the companies that moved to Ireland to get a big tax break, and it's not just Ireland. Corporations in Switzerland and other European countries, which lowered their tax rates a lot in recent years, have been buying up U.S. companies and boosting their profits by applying low tax rates. Our corporate taxes were lowered to stanch the bleeding.

And the tax-revenue drain has been even bigger. A smartphone that was engineered and designed in California, and then built in China for $250, can be sold for $750. The $500 profit was created in America. But if the smartphone company transfers the design to its Irish subsidiary, Ireland will claim all the sales as Irish exports, and collect the income taxes that result.

Europe would have sucked up even more of our tax revenue in 2018. ■

Drew D. Kellner, CFA

DUODECUPLED

On December 31, 2017, the value of our "benchmark" account reached $1,238,216; up from $1,027,111 in January and $241,129 on the first day of 1999. It's a fee-paying client account that we've been tracking in this newsletter since 1990. If you would like further information or context please visit the "Performance" page on our website. Most firms don't even *have* a "Performance" page …

If you own the stock of Aetna, Anthem, United Healthcare, or other health insurers, you might want to consider selling. This model isn't working for society, so it seems risky to bet that it will continue.

YOU'VE GOT MAIL!

From the KGB.

"When Facebook finally admitted that there were ads bought by Russian agents in 2016, it said they mainly focused on "divisive social and political messages" … The ads targeted both sides: the goal was not conversion so much as conflict as an end in itself. 126 million Americans may have been exposed to Russian content on Facebook, including ads that were paid for in rubles."

– Nancy Gibbs, Time Inc.

The Russians are playing us for suckers! Facebook, Twitter, and forwarded e-mails from friends have been feeding you half-truths designed to create anger and divisiveness. Facebook was the perfect vehicle, because its business model involves telling you things that you want to hear.

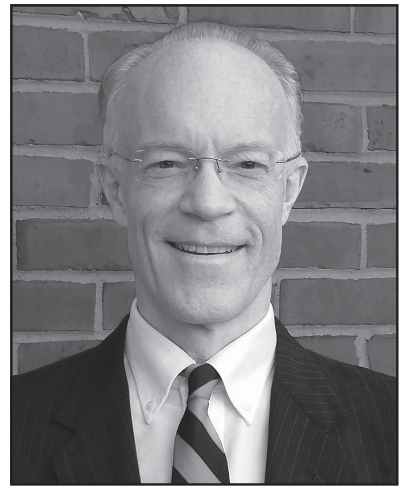
And divisiveness comes easily in an environment in which median household income—despite good recent gains—has barely risen since 1980. The media keep looking for story lines which describe resentment felt by the working classes against the wealthy, but the proletariat decided to revolt against the establishment instead.

Most members of our working classes have friends or family members whose wages were cut in half in the last decade, as factories closed and a tidal wave of unskilled workers arrived from other countries. Job losses and falling wages wiped out savings accounts, and caused families to lose their homes.

If we were to bring in a million professionals each year, the wages of professionals would plummet. Voters who think of themselves as compassionate have trampled on the lives and livelihoods of our working poor, who wondered why the non-working classes got all the love. Then the compassionate voters accused the "uneducated, white, aging" workers of racism.

BlackMattersUS, a Russian-linked group, managed to turn out "5,000 to 10,000" people for an anti-Trump rally in New York, according to The Hill. Russian agents were even able to pit protesters against counter-protesters! High fives in the Kremlin! ■

– John Lumbard, CFA



John Lumbard, CFA

GEEEE

When Jeff Immelt was the CEO of General Electric he often used TWO corporate jets at once. How do you use two? You have the second one follow as a backup, just in case the toilet in the first jet overflows. Shares of the iconic manufacturer have plunged 45% since the beginning of 2017, and 70% since Jack Welch was the CEO.

But let's not forget that Welch was praised, by zounderkites and fopdoodles, for "managing" earnings to present a picture of steady growth. Call it "fudging"… Tell us again, please, why this company was on a pedestal for so many years. ■

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