Lumbard & Kellner INSIGHT

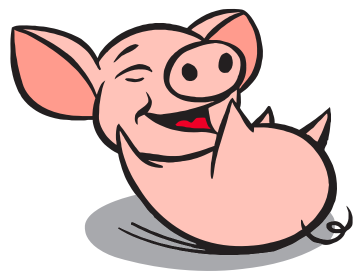
S&P 500 2,851 * Dow Jones Industrials 25,648 * 30 year U.S. Treasury Bond 2.82%

LOWER INFLATION, FASTER GROWTH

In the first quarter of 2019, productivity leapt 3.6%! Over 12 months "output per hour" grew 2.4%, improving so much that the cost of labor went up less than 1%; despite a 3.2% increase in hourly wages. Inflation is low, and there is very little pressure on corporate profits.

- The Fed has stopped raising interest rates.
- The economic cycle will run farther and faster.
- The stock market can continue to rise.

Last year there were lots of forecasts of imminent recession *and* accelerating inflation. We started pushing back a year ago with a cover page article predicting that the tight labor market would force employers to employ labor-saving devices that would push productivity higher. On the first page of our Autumn issue we suggested: "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." In recent months wages and productivity both grew



2019 is the Year of the Pig!

faster than 3%, and corporate profits are solid despite a sharp rise in the dollar.

In January we said: "You have to make a choice. You can worry that robots are going to take your job, or you can worry that productivity is going to continue to stumble along at 1%. ***You can't have it both ways.***

There's a pall of gloom across this land, and it doesn't make any sense. The unemployment rate hasn't been this low since 1969. Job offers are being extended to inner-city teenagers, the handicapped, ex-cons, and others who were never considered for jobs just two or three years ago. American war deaths and global war deaths are a fraction of the bloody totals of prior decades. World GDP growth has slowed a bit recently, but standards of living are at all-time highs, and still advancing. Huge numbers of people are being lifted out of poverty. **This is an era of unprecedented peace and prosperity.**

Note to journalists, economists, snollygoster politicians, and grumbletonians: There's nothing noble about spreading anger and gloom. If you work to lift spirits and spread happiness, your own lives will be enriched. Really. ■

Interviewer, seeking truth and happiness:

"There are a lot of questions today, people trying to figure out what the secret to life is, to a long and happy life, and I just wonder —"

Charlie Munger, 95, of Berkshire Hathaway interrupts "—That is easy. It's so simple! You don't have a lot of envy, you don't have a lot of resentment, you don't overspend your income, you stay charitable in spite of your troubles, you deal with reliable people, you do what you're supposed to do. All these simple rules work so well to make your life better."

INVESTING IN WEED

Why do you think they call it weed?

Anybody can grow it, anywhere; trying to corner the market in marijuana is like trying to corner the market in crabgrass. Back in the 80s the Hunt Brothers failed, spectacularly, in an effort to corner the silver market; and silver is actually somewhat rare.

In the future the biggest component in the price of marijuana should be taxes. The cost of distribution and marketing should come next—the cigarette companies have an edge here—and the smallest piece will be the cost of growing and drying the stuff. Meanwhile, investors are excited about the stocks of companies that grow weed indoors! Can you imagine trying to make money by growing soybeans or feed corn indoors? ■

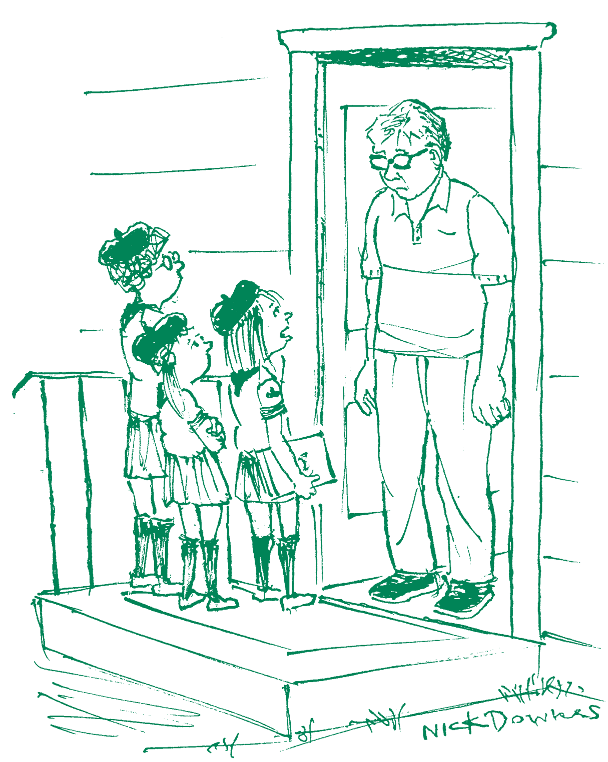
Three years ago there were still lots of people looking for work. Businessmen created jobs, hiring workers instead of looking for ways to make their workers more efficient. Today it's much harder to find good workers, so they're finding ways to forge ahead with fewer workers. That's *exactly* the process that transformed America from a nation of dirt-poor farmers to the wealthy and charitable nation that it is today.

WATER-RICH

It takes 518 gallons of water to make a pound of chicken, and it takes 1,847 gallons to produce a pound of beef. These are reasons to buy **Tyson** (TSN -$82).

Apart from the arid Southwest, the United States is a water-rich country. We can't export water at a reasonable cost, but we *can* export valuable products that are made with the use of large quantities of water. Rising incomes in formerly-poor parts of the world are causing meat consumption to rise, but water is scarce in many of these nations.

Tyson owned a piece of Beyond Meat, but sold its shares before the IPO because it will soon introduce its own meatless meat. We just doubled our position in Tyson, because it seems likely that this product will be a big success. The company owns shares in three other meatless meat companies, and has the distribution and marketing muscle to make a big impact on a market that is growing quickly. Huge numbers of Americans are cutting back on their meat consumption; not becoming vegetarians, but eating veggie burgers and other meatless entrées from time to time. ■



"THE WAY IT WORKS NOW, SIR, IS, WE'VE PLANTED COOKIES IN YOUR COMPUTER, AND YOU PAY US TO REMOVE THEM."

"The unemployment rate fell to its lowest level in half a century last month, capping the longest streak of job creation in modern times and dispelling recession fears that haunted Wall Street at the start of the year."

– The New York Times

In April the unemployment rate was just 3.6%. It's important to take a moment to remember those widespread fears of a springtime recession, and it's even more important to understand that employment is a big deal. Low unemployment rates cause wages to rise. They cause welfare spending to decline. And they cause labor productivity to rise, thus causing faster GDP growth without inflation.

"Growth" is frowned upon in some circles, because it raises fears of overdevelopment and pollution. But in the last 50 years air quality and water quality have improved as the economy has grown 1,700%. And it's *always* true that lower growth rates cause lower wages, increased social spending, bigger deficits, a larger federal debt, and human misery. Faster growth causes rising wages and human happiness.

In the last 12 months the wages of production workers (in retail, mining, hospitality, etc) rose 3.4%; faster than the wages of supervisors and employees in finance. Inequality narrowed, but let's admit that wage increases are far better than narrowing inequality. If the wages of supervisors had *declined* over the course of the 12-month period, would the report have been better, or worse? In the real world "inequality" is a way to describe *stagnant wages* and the hopelessness that results.

Tight labor markets are causing corporations to retrain and "upskill" their workers, providing growth and career opportunities for the working class. AT&T pays tuition for workers who want to study on their own time, and offers its employees an online system that shows which jobs are in high or low demand. The Wall Street Journal quotes John Donovan, CEO of AT&T's telecom business: "We show the projected annual salary and its projected growth rate, so you can pick a future and get a sense of what would that do to change your economics".

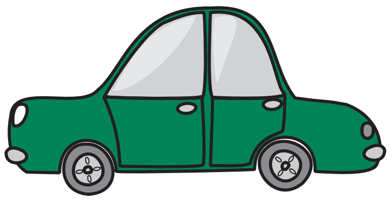
JP Morgan is rolling out a program called Skills Passport, Walmart has the Walmart Academies, and even Amazon is planning to offer training that will allow warehouse workers to get jobs in its data centers at twice the pay.

Some of the recent reductions in regulation have reduced environmental protections, but they've contributed to the jobs boom. It's not often that we're treated to such a clear example of the damage that regulation does to the working classes and the poor. In the last year unemployment among African Americans, Hispanics, disabled Americans, and women has been at or near all-time lows. Wages are rising, hope is blossoming, and companies are being forced to train their lowest-paid employees for better, more-complex, more-highly-compensated jobs. ■

Paul K. Wright, CFA

Stock prices are roughly at fair value. That might not sound exciting, but next year's "fair value" will be higher still. The U. S. consumer is in fabulous shape with both income and balance sheet strengths that are robust. Recent earnings releases have been robust, notwithstanding tough currency headwinds. Economic activity is picking up in the U.S., and may be turning up around the world.

Often in these newsletters we print the value of our "Benchmark" account, a fee-paying client account that buys and sells in block trades along with our other accounts, and our personal portfolios. There is no favoritism here! On April 30th the account stood at $1,249,395, up nearly sixfold from the peak of the Internet Bubble on December 31, 1999, when it stood at just $216,635. For more-detailed performance information please visit www.Lumbard.com.



UBERPRICEY

"Two City Council members are working on a bailout plan for taxi-medallion owners … who sank their life savings into buying medallions whose value has plummeted from a high of about $1.2 million in 2011 to $250,000 now ... Several taxi and livery drivers have committed suicide in the past year and a half as a result of the industry's financial crisis. "

– The New York Post

A medallion is a license for all eternity. If medallion prices drop, taxicab companies should become terrific investments, no? Uhhh, no. Nobody wants to invest in boring old taxicabs, even if they can pick up more rides in a New York minute than any Uber.

Uber is valued at ***$70 billion***. It reported a $3 billion loss last year, and says that 2019 losses could be larger still. There are now too many cars for hire on the streets of our cities. Why would you want to invest in a turkey like that?

"What matters a lot more than a big income is how people spend it. For instance, giving money away makes people a lot happier than lavishing it on themselves. And when they do spend money on themselves, people are a lot happier when they use it for experiences like travel than for material goods."

– The Wall Street Journal

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Yale has proudly announced that tuition for the coming school year will cost $55,500, and if you want room and board you'll have to cough up a total of **$72,100**.

The price of education has soared to ridiculous levels because colleges can attract more students by *raising* their prices, and using the money to enhance prestige. Or maybe they just add another hundred administrators … Parents, like Felicity Huffman, want to be able to tell their friends that their children go to the most-expensive schools.

There are proposals on the table which pretend to help the disadvantaged by canceling only the debts of those earning less than $100,000 a year. Of course, that's a huge incentive for a recent graduate to become a ski bum with a low income for a few years, until his debt goes away. Colleges will raise their fees (this has happened twice, in response to expansion of federal tuition and lending programs), and students will be even more eager to attend the most-expensive schools.

Still, you have to admire the chutzpah of trying to buy votes from young people with their own money. These generations are the ones that will be responsible for the federal debt that results from debt forgiveness. It's like using your credit card to pay off your mortgage. The debt doesn't actually go away! ■

"Google Maps – effectively a utility with a billion+ users – remains the most under-monetized asset we cover."

– Brian Nowak, CFA, of Morgan Stanley, pointing out that Alphabet's Google Maps has a lot of room to increase advertising and otherwise generate revenue.

We've steered our clients through boom and bust by differentiating between the things that matter and the things that don't.

In 2016 the U.S. spent $3.3 trillion, or 17.9 % of GDP, on health care. $329 billion was spent on prescription drugs.

The prices of new drugs are breathtaking, but drugs are less than 10% of healthcare spending. The reason is that patents don't last long. Can you remember the outcry over the high cost of statins? They're all off patent now.

EUROSKEPTICISM

Our only widely-held investment in Europe is an exchange-traded fund that invests in **Poland**, where GDP reached an incredible 5.4% in 2018. Poland is part of the EU but its currency is NOT the doomed euro, and the nation's relationship with Brussels is often contentious. These are good things.

TAXES

Wealthy Brits are buying homes on the island of Guernsey, says The Economist, so they can easily move there if Jeremy Corbyn is elected. Corbyn wants to apply the 45% tax rate to those making just $105,000, and establish a new 50% rate. **And** create a wealth tax, **and** raise the tax rates on inheritance and capital gains. **And** extend the 20% value-added tax to private-school tuition **and** put a tax on all financial transactions.

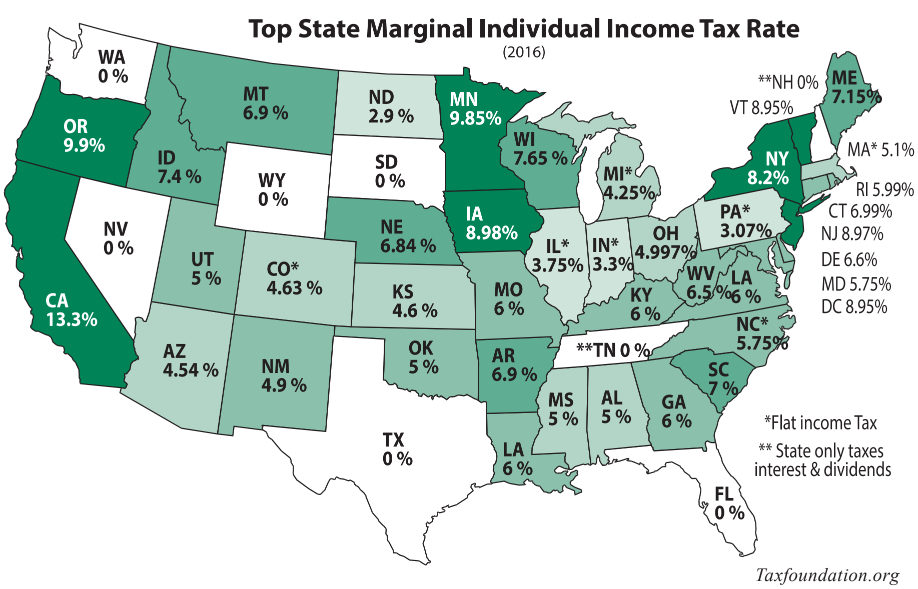
Guernsey's income-tax rate is a flat 20%, and there are **no** capital-gains taxes or inheritance taxes. Income-tax rates are even lower for residents of the Bahamas, the Cayman Islands, Bosnia, Guatemala, Hong Kong, Hungary, Macau, Monaco, and Montenegro. The point is that wealthy people can easily escape increased taxation. If taxes are raised to levels they feel are unfair, they will move to a more-friendly jurisdiction.

In most of the 1950s the top income tax rate in this country was 91%, but we didn't collect much in tax revenue. A chart provided by the St. Louis Fed shows that federal tax collections in those years averaged about 16.5% of GDP. In the late eighties and early nineties the top U.S. tax rate was 28% and 31%, but revenues were ***higher***. In those years we collected about **17.2%** of GDP.

State taxes are the same way. Most Americans pay less than $10,000 in state and local income tax, so they're not troubled by the new limit on deductions; but wealthy people in high-tax states find it very painful. They're discovering that they can save real money by living 183 days of the year in a second home in Florida or Nevada. Expect annual budget shortfalls in New York, Vermont, and Oregon; and a crisis in California.

Drew D. Kellner, CFA

The average taxes paid by Californians aren't very high, but the rich pay at rates that top out at 13.3%. "The top one percent income earners in California pay 48 percent of the state's income tax" says Tom Campbell, a professor at Chapman University. If a third of those one-percenters leave, it's going to put a gigantic hole in the state budget. ■

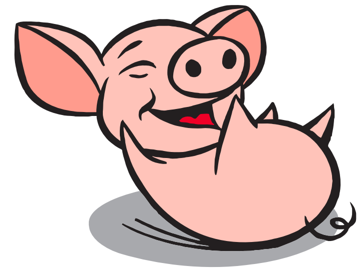


Taxfoundation.org

"By one count, the lowest-earning quartile of college grads earn roughly the same as the top quartile of high-school-only workers, but with more student debt to show for it."

– Joseph Sternberg, a 37-year-old Wall Street Journal columnist, and author of The Theft of a Decade: How the Baby Boomers Stole the Millennials' Economic Future

BIPARTISANSHIP BLOOMS!



The President, the Speaker of the House, and the Senate Minority leader shared a celebration of goodwill and harmony recently, in agreeing to spend ***TWO TRILLION DOLLARS*** on infrastructure. Yes! Let's pick a gigantic round number first, and then come up with a list of ways to get the biggest political impact! So far they've come up with nine items, starting with the notion that it's essential to "create jobs immediately". Four days later the Labor Department announced that the unemployment rate was at the lowest level since December of 1969.

The new jobs are to pay "the prevailing wage", which is code for "hang the expense, we're giving all the jobs to our union donors." And only a very select group of contractors ("women, veteran and minority-owned businesses") will be allowed to bid, so you can add another few zeroes to the cost of each project. There will be projects in "every congressional district", so this was never really about the danger of collapsing bridges.

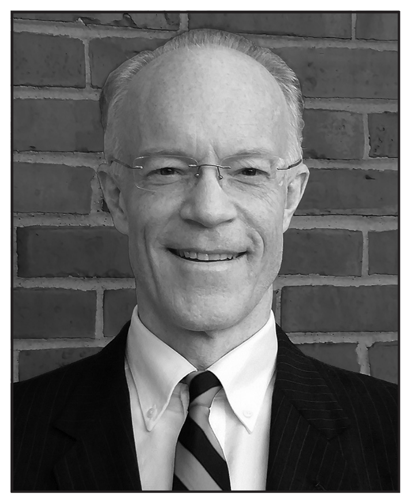
Collapsing bridges sound a lot less exciting when the Department of Transportation describes the risk: "The percentage of structurally deficient bridges declined from 12% in 2010 to 9.1% in 2016". If the nation's bridges are rotting, why don't they bother to keep them painted? And maybe use a little less road salt?

The President said "We will build gleaming new roads, bridges, highways, railways, and waterways across our land." Clearly he's not talking about boring stuff like improving the electric power grid. He must be planning to help California build high speed rail! *The train for rich people* ticks off all the boxes, with "women and minorities" bidding on giant "prevailing wage" contracts in "several congressional districts", and "bolstering commerce" in the sparsely-populated Central Valley by spending amazing amounts of money. If they run some wires alongside the tracks they might be able to tick off "expanding broadband to underserved areas", and they can surely claim item #6, "being for the future", because it could take 30 years to get this boondoggle built.

This is the Year of the Pig, so it's wonderful to learn that they've found a way to bring pork back to Washington, where the word "infrastructure" (*don't it just roll along your tongue like honey*) is a euphemism for "I get to buy votes**!**". Politicians have been mourning the loss of earmarks ever since they were banned in 2011, and recently made noises about bringing them back. Eager grunting noises ...

Spending on infrastructure is every bit as good. Two trillion dollars works out to $14,500 per American voter! It's no wonder that incumbents win so many elections. ■

– John Lumbard, CFA



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