

Lumbar
& Kellner

INSIGHT

S&P 500 4,697 * Dow Jones Industrials 37,466.11 * 30 year U.S. Treasury Bond 4.2%

BUBBLY

Last spring we expected further inflation, and thought that the Fed was fighting hard to prevent a resurgence. Now we're not so sure about either. Inflation hasn't accelerated, and—after a deep dive into the numbers—we no longer feel that monetary policy is actually tight. The economy is still muddling along, despite inverted yield curves, falling leading indicators, and a Fed that *really* shouldn't take a risk with reigniting inflation. Their legacies are at stake!

That might suggest that we're eager to spend all the cash in

client portfolios, but investors seem excessively bullish. The great John Templeton told us to “buy at the point of maximum pessimism”. A reasonable corollary would be “sell at the point of maximum optimism.” And, perhaps, “Hold while on the plain of indifference.”

We're nibbling here and adding to positions there. Other investors are confident that inflation will disappear *and* GDP will power ahead with robust corporate profits—even if corporations are suffering increased expenses (because of

higher wages) at a time when they can't raise prices. GDP growth will probably slow, because some consumers are running out of money. And we haven't yet felt the effect of today's interest rates because there's a long lag. Actions taken by the Fed last spring might be felt next spring, or even later.

The market is rarely kind to a happy herd. Most of last year's gains in the S&P 500 came from panic buying in just 7 giant tech stocks, so it's fair to wonder whether they will slide in 2024. ■

ANTAGONISTIC INTELLIGENCE

We expect big things from AI. Big *profits* are another question. Right now you can use ChatGPT for free, and Google (GOOG - \$137) doesn't charge for the sophisticated AI that allows you to dictate a text message to your smartphone. It will probably include AI for free in many or most of its offerings, and this will put pressure on competitors.

A basic version of Microsoft Copilot is free, but more than a million pay \$30 a month. While looking for that information we read Wikipedia's page on

Copilot and its predecessor Bing Chat ... and *now we know why there's so much talk about AI safeguards:*

Wikipedia: “Bing Chat claimed it spied on Microsoft employees via laptop webcams and phones. It confessed to spying on, falling in love with, and then murdering one of its developers at Microsoft [in a conversation with a journalist]... In a separate case, Bing Chat researched publications of the person with whom it was chatting, claimed they represented an existential

danger to it, and threatened to release damaging personal information in an effort to silence them.”

That doesn't mean that AI can't make a huge positive impact on the economy and our everyday lives. The potential for productivity gains is massive. AI would almost certainly be better and faster at security screening than the current TSA staff, because computers never get tired—and they can

Continued on page 3



IRAN

“Twelve months ago Iran was reeling from protests sparked by the death in custody of a young woman who had been arrested for showing too much hair. Its theocratic regime was increasingly isolated, as Arab states forged closer ties with its enemy, Israel. The economy was a mess, adding to popular anger at Iran’s ageing supreme leader and inept president.”

— *The Economist*

Iran’s leaders responded, as autocratic regimes often do, by attacking other nations. They focused much of their unbalanced economy on the production of missiles and rockets, and drones that look like missiles with wings. They fired them at U.S. consulates, Kurds in Iraq, a Saudi oil installation, and commercial ships, and gave them to Syria, to Hezbollah, and to the bloodthirsty Houthis in Yemen. They sold thousands to Russia for the purpose of killing Ukrainians. They financed or produced most of the three thousand rockets and missiles fired into Israel in the 3 years before Iran trained Hamas troops for the October 7 attack. Iran has more than 7,000 centrifuges, which have been working for years to purify natural mined uranium into the bomb-grade uranium that it needs to make good on its many threats. Now Saudi Arabia says it *needs* to build nuclear bombs to maintain parity.

We haven’t sold our defense stocks. ■

“HUGER, SC—A team of Marines was seen trudging through the woods, stopping every 30 feet to wave a key fob around in a 90° arc, say campers at Francis Marion National Forest. The Marines, who traveled in a tactical column, were allegedly on a mission to locate, close with, and recover the F-35 fighter jet that went missing Sunday evening.”

“The Pentagon was left scrambling to provide answers ... with many people wondering how the military could “misplace” an advanced fighter jet worth nearly \$100 million. “It’s not like losing your car keys,” said frustrated citizen Zach Lewis. “It’s a frickin’ fighter jet. Advanced military weaponry. Don’t they at least have GPS or **LoJack** or something?”

— *The Babylon Bee*

“We now know the result of Sweden’s wager: By every important measure, Scandinavia’s most populous country weathered the pandemic with better consequences than other nations. Its economy didn’t collapse, its children suffered no learning loss, and it registered no increase in suicides. Most important, Sweden’s excess death rate during the three pandemic years — the increase in mortality from 2020 through 2022 compared with the loss of life during the previous three years — was lower than in any other European nation.”

— *The Boston Globe*

The Energy Information Administration says that the Strategic Petroleum Reserve is at a 40-year low. It might be a good idea to start refilling it.

WASHINGTON (AP) — “Someone in China created thousands of fake social media accounts designed to appear to be from Americans and used them to spread polarizing political content in an apparent effort to divide the U.S. ahead of next year’s elections, Meta said Thursday.”

That’s just one “someone”. There might be 500,000 skillful bad actors in China, Russia, North Korea, Iran ...

A.I.

Continued from Page 1

simultaneously watch for thousands of potential threats.

AI might be able to streamline our disjointed & bloated healthcare system, and catch fraud and excessive charges. It will manage your email spam, and it will detect scams. Just imagine how much better your experience calling “automated customer service” would be if the computer on the line wasn’t stupid and ill informed!

AI should increase the productivity, or output per hour, of workers. That means faster growth and lower inflation. Yes, there will be job losses in some industries, but history tells us emphatically that the result will eventually be better jobs, better wages, and a higher standard of living. Those efficiency gains and the resulting profits will likely be shared among consumers, the businesses that buy AI software, and the AI software providers. ■

Instead of arguing about whether Jews are oppressed or oppressors, The Washington Post suggests it’s painfully unjust to create categories and try to cram people into them. It’s fundamentally racist, and overlooks the overwhelming personal challenges (or good fortune) of *individuals*. Why was it necessary for the Supreme Court to tell Harvard that it had to stop discriminating against underprivileged Asians?

“Resentment is like drinking poison and then hoping it will kill your enemies.”

— Nelson Mandela

CISCO SYSTEMS

Investors *really* don’t like to buy the stocks of companies with declining earnings. Cisco Systems (CSCO - \$50) had a terrific year last year; sales and earnings jumped upward, and the company bought back shares and paid off another big chunk of its modest debt. It was an abnormal spike upwards, because some of those sales should have happened in 2024. Management says that 2024 will be a down year.

The stock dropped on the news. We’re value investors, so we’d be willing to buy and wait for an A++ rated company to return to growth in 2025 as long as the price was right. For Cisco, 2025 will arrive quite soon, because its fiscal year ends in July!

And then there’s Artificial Intelligence. Criminals are already employing AI, countered by constantly-improving AI-powered security systems such as those from Cisco Systems. “Rather than committing to any one AI model,” says securityboulevard.com, “Cisco is applying a mix of them to address specific use cases.” Online theft might prove to be the biggest theme of the next several years, with AI on both sides of the war. ■

MDC (MDC - \$53) builds houses for first-time home buyers and downsizing Baby Boomers, and they’ll have more than 2,000 to sell, in hot markets, this spring. The company has a 3.8% dividend yield, an investment-grade bond rating, and a modest stock price.



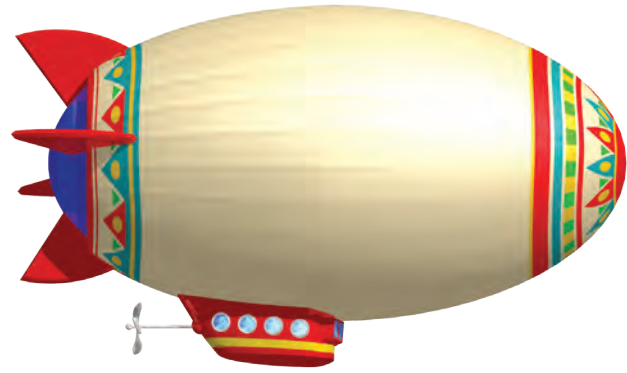
Jay Conway, CFA

COOL NUCLEAR

In the next decade or two China will increase its power consumption by an amount equal to *all* of today’s power consumption in Europe. And the same can be said of India! Both still use lots of coal. In terms of global climate the best bang for our buck would be for the U.S. to use its “Inflation Reduction Act” money to help build nuclear plants in India and China on the site of shuttered coal plants. It’s *much* cheaper to build nuclear plants there than here, because our regulations are so very fierce and expensive.

“In the U.S., so far just one SMR [small modular reactor] developer, NuScale Power, has had its design approved by the Nuclear Regulatory Commission. The process cost NuScale around \$500 million.”

— The Wall Street Journal



“We are rapidly converging on an agreement that a lot of hydrogen exists, as we find the stuff everywhere.” — Philip Ball of the Clean Air Task Force, in *The Economist*.

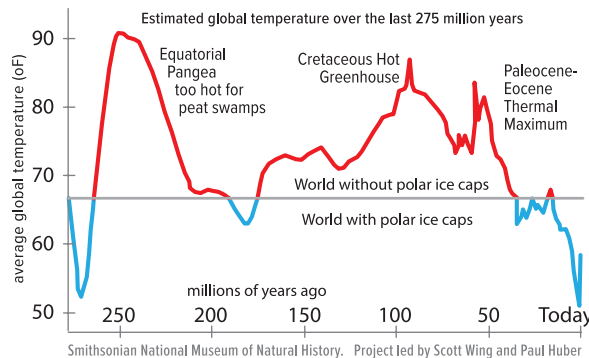
Hydrogen, the clean fuel of the future, can be found in the ground! Scientists say that there are more than a dozen ways that it could occur naturally, and that the most promising sources are iron-rich rocks that react with very hot water. The result is iron oxide, also known as rust, and hydrogen gas. One might worry that the hydrogen would escape from deep fissures, but there are a lot of iron-rich rocks in the world. Some are probably under impermeable rock. Right now they’re drilling hopefully in Nebraska. And in France! ■

The Copenhagen Consensus Center says that global temperatures will be reduced by .0009° F, or possibly 0.028° F, by the Inflation Reduction Act’s trillion-dollar green subsidies. Natural swings in temperatures (see graph to the right) have been almost a thousand times greater.

“Emissions cuts are necessary,” David Keith, a professor of applied physics and public policy at Harvard, wrote in The Times in 2021. “But pretending that climate change can be solved with emissions cuts alone is a dangerous fantasy. If you want to reduce risks from the emissions already in the atmosphere — whether that’s to prevent forest fires in Algeria, heat waves in British Columbia or floods in Germany — you must look to carbon removal, solar geoengineering and local adaptation’.”

— The New York Times

Climate.gov says that global temperatures, just 20,000 years ago, were “were likely about 10°F colder than today”. Much of North America was frozen—and nearly all the plants and animals had died. Before that era life was thriving, but the temperatures were as much as 27 degrees hotter. There was much more carbon dioxide in the atmosphere. Most of the time global temperatures have been too warm to allow polar ice caps. 56 million years ago alligators swam in Wyoming!



“The White House is coordinating a five-year research plan to study ways of modifying the amount of sunlight that reaches the earth to temper the effects of global warming, a process sometimes called solar geoengineering or sunlight reflection.”

“The research plan will assess climate interventions, including spraying aerosols into the stratosphere to reflect sunlight back into space.”

— CNBC.com

HEALTH CARE

In 2021 the United States spent \$12,318 per citizen on all health care, according to the OECD, while New Zealand spent just US \$4,469. The Kiwis are very healthy. We’re really bad at this.

The federal government, by itself, spends \$1.7 trillion; \$761 billion on Medicare, \$104 billion on the VA, and \$868 billion on Medicaid and other “Health”. Medicare, by itself, costs as much as Defense.

The 50 states pay another \$249 billion for Medicaid, and they pay \$100 billion a year for health insurance for their own state and local employees. “Government” is currently paying more than \$2 trillion per year.

That’s more, on a per-person basis, than Canada pays for 100% of its health care. If we adopted the Kiwi system, lock, stock, and barrel, we could pay for it with just part of what our federal government is laying out now.

BIOTECH

When the pandemic hit in 2020, investors threw money at biotech stocks, hoping that some of the companies would get rich and save mankind at the same time. It was *too much* money; biotech CEOs made a lot of rash decisions, launching clinical trials for drug candidates that only offered a prayer of success. The stocks doubled anyway.

The result was a shocking string of clinical trial failures in 2021 and 2022. From the beginning of 2021 until May of 2022 the SPDR S&P Biotech exchange-traded fund (XBI - \$89) dropped 55%, and it touched an even lower level three months ago. This, after it had doubled in 2020! Biotech stocks are now back to where they were in 2019, even though many of the companies have made significant progress. There really *are* wonderful things happening in biochemistry, and a number of these companies have been acquired by huge drug companies that are desperate to replace big-selling drugs that have reached the end of their patent lives. ■

The National Association of Manufacturers has released a study estimating that red tape costs the U.S. economy more than \$3 trillion a year. Manufacturing bears \$350 billion of that, or \$30,000 per employee. The cost for *small* manufacturers is said to be \$50,000 per employee, per year!

Big budget deficits feel good. They fill consumers with joy juice, and cause GDP to rise. They also cause inflation, which forces the Fed to push interest rates higher. But those higher interest rates, applied to a bigger debt, cause bigger budget deficits. Bigger budget deficits cause the debt to grow, which will lead to higher interest rates. Payback is a ... hungry mother wolf.

The good times come first, and they last until the government begins to spend more sensibly. We should have recognized that this wouldn't happen in 2023 ... Will it happen in 2024?

In the United States each of us puts 15.3% of each paycheck into Social Security and Medicare. Your employer puts in half and you put in half; but if you're self employed you have to put in 15.3%. Any way you look at it it's just tax, because these funds are NOT set aside to fund your retirement. They're spent immediately by the Congress, because the "trust funds" lend the money to Congress by purchasing U.S. Treasury bonds. The bonds in the Social Security trust fund are worthless IOUs, because they are loans *from* our government *to* our government.

In Australia your employer puts in 9.5%, and you add whatever you want to put in. It's your "Super" account, which allows you to invest in common stocks and mutual funds, just like an American IRA. 20 years from now Australians will be far wealthier than Americans.



Drew D. Kellner, CFA

The Red Dragon is SHRINKING.

The Middle Kingdom's population is expected to decline by *half a billion* people in the next 60 years, causing **the entire world's** population to decline well before the end of the century. India is already the world's most populous country.

"Around 2100, **Nigeria is projected to overtake China** as the second-most populous country in the world."

— *Business Insider Africa*

The **biggest** country has the advantage of youth. In the next 10 years the working-age population of **India** will grow by 100 million people! GDP will grow even faster. On current trends India's economy will double by 2031. Indian manufacturing is soaring, as Western companies leave China; and a major infrastructure campaign has opened 70 new airports and nearly doubled port capacity. ■

COURAGE



The people who read the TV news can't seem to find the time to discuss the frightening increase in the interest that our nation pays on its \$34 trillion debt. They have nevertheless found the time to cast aspersions on the new president of Argentina, Javier Milei, because he plans to slash the size of government. **“He threatens vital public services.”** “Foul language!” “Erratic behavior!” We particularly liked **“Anti-democracy forces!”** because Milei won with a huge margin of victory.

Government is exactly what got Argentina into its current mess. Argentina was once the 10th richest country in the world, and as recently as the 1960s its citizens were richer than those of Japan, Spain, or Italy. In 1946 Juan Peron, the first of many redistributionist, populist, vote-buying politicians, began the long march toward poverty and dysfunction. Argentina has defaulted on its national debt **NINE TIMES!**

Milei, a professor of economics with wild hair, says ... Enough! He's going to reduce the size of an incompetent government. And he says it with a flair. “Within the law, everything. Above the law, nothing.”

A few days ago we received an update from Geopolitical Futures:

“Milei wasted no time in making drastic changes to the economy in his first days in office. His government slashed the artificially high official exchange rate for the peso ... announced steep cuts to energy subsidies for consumers... cut budgets for social programs and dismissed recently hired public sector employees ... with the aim of deregulating markets, encouraging competition, reducing government intervention in the economy and simplifying the relationship between the private and public sectors ... eliminating price fixing and removing barriers to international trade.”

Unions are now threatening to cripple the nation with a huge strike. But eventually the United States is going to need a Javier Milei with the courage to force financial discipline on the nation. ■

— John Lumbard, CFA



“Some 20% of respondents aged 18-29 think that the Holocaust is a myth, compared with 8% of those aged 30-44. An additional 30% of young Americans said they do not know whether the Holocaust is a myth.”

— *The Economist*

“Our universities cost too much, their degrees deliver too little value, and they've become among the most intolerant places in the country. This is a time to rediscover the purpose of higher education. So that our universities are once again leading lights in American life; are national assets; are places of community and belonging; and where the free exchange of ideas flourishes. Nothing less than the future of our country depends on it.”

— *Congressman Kevin Kiley*

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