

Lumbar
& Kellner

INSIGHT

S&P 500 2,412 * Dow Jones Industrials 21,009 * 30 year U.S. Treasury Bond 2.86%

THE BUBBLE OF 2018

Bubble in the stock market? It still hasn't arrived! We've been saying this for years, and it's not complicated; stocks are cheap, because interest rates are low. The average dividend yield for the S&P 500, nearly 2%, is *twice* the yield on that CD your local bank wants you to buy.

If companies wanted to give *all* their earnings to their shareholders in the form of dividends, they could pay 5.6%. So the "real" yield on common stocks—the "earnings yield"—

is 5.6%. That's huge. For most of the past 35 years the yield on 10-year U.S. Treasury bonds has been higher than the earnings yield on stocks; but today those bubbly bonds yield just 2 ¼%. *The yield on stocks is way more than twice as high!*

Next year we're gonna have a bubble. Investors suffered through a 15% market correction in 2010, and a Panic—nearly a 20% drop—in 2011; only to see prices rise. There were waves of fear in the fall of 2015

and the winter of 2016. There were pre-election jitters, and post-election jitters ... but share prices always went to new highs. *Honey Badger Don't Care.*

Investors have had enough. Those who purchased common stocks in the 50s, the 60s, the 70s, or 80s, and just held the shares—no selling, ever!—got rich. Even if they finally sold on the worst day of 2009! Panic selling is becoming tiresome. We're not going to let CNBC scare us any longer! ■

INSURANCE IS THE PROBLEM

"A 2015 Blue Cross Blue Shield study found that one hospital in Dallas billed \$16,772 for a knee replacement while another in the same area charged \$61,585."

— *Time* magazine, which stated that insurance companies pay \$54,000 for the average hysterectomy, while a good free-market hospital in the same zip code will perform the surgery for just \$11,000, **as long as you pay cash and don't demand any insurance paperwork of any kind.**

Similarly, insurance companies pay **5 times** as much for the average (\$253,000!) coronary bypass.

Clearly, the high cost of health care is the result of our obsession with "I can have anything I want" insurance. *Time* magazine continues: "With Direct Pay, the idea is that health insurance would begin to look more like auto insurance. Insurers estimate the cost of a procedure and send a check to the patient, who

compares prices and chooses a provider."

Read that again. Wouldn't you love to have car insurance that pays for *everything*? All repairs, a new engine, and new upholstery every 10 years. You can go to any repair shop that you want!

Of course, you'd call the shop that picks up your car and leaves you a luxury-car loaner (and a steaming latte).

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INSURANCE

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The cost of this policy would be completely unreasonable, because nobody would care about prices, or waste and abuse. That's how our health care system works. ***Your favorite hospital is ridiculously expensive because you refuse to go anywhere else.***

This is busting family budgets, and causing federal health spending to skyrocket. It's up almost 100% since 2006. That means more debt, and cuts in *everything else* in the federal budget.

There are two ways to reduce costs. Either we have a single-payer system, micromanaging every aspect of the industry, or we insist that Americans shop for their care the way they shop for computers, chain saws, and 500-horsepower pickup trucks.

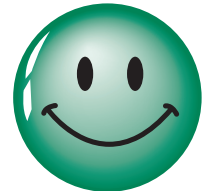
We already have a single-payer system. The *American* single-payer system is called the Veterans Administration, and yes, we could put everybody, from birth to age 110, into the VA. It would work OK, but it certainly wouldn't be Swiss health care.

The alternative is to force most Americans to shop for their care. The insurance company would write you a check for the *estimated* cost of your hip operation, and you would go out and buy it. There's nothing complicated about that. ■

AND NOW FOR THE WORLD AND NATIONAL NEWS:

“Everything is fine. You're going to be OK. Have a great day!”

Markets tremble when the Federal Reserve raises an eyebrow. Politics? Not so much. If there's no impact on corporate earnings or interest rates, the stock market yawns. Government policy can push debt up to unbearable levels; and it can create unemployment, push down wages, or crush the will to work. But these things usually take decades. The things that matter to stock prices in the near term are low (*ridiculously* low) interest rates, and the fact that corporate earnings are rising.



AMAZON

Morgan Stanley says that there were 2,087 store closures in the first 3 months of 2017! Amazon hasn't yet been painted as a destroyer of jobs and small retailers, because it hasn't been the subject of the kind of expensive public-relations attack campaign that tarred and feathered WalMart. But the lights are going out on Main Street and in the malls of America. Amazon is willing to suffer big losses for years and years to destroy rivals, and it has the deep pockets to succeed.

Walmart is staying in the game. Last year the big retailer bought Jet.com, run by Marc Lore—who has hated Amazon ever since CEO Jeff Bezos forced him to sell Diapers.com, after a huge price war. In March Bezos spitefully shut down Diapers.com, and laid off 263 employees. ■

“I've seen no evidence that America was less divided in the past. Off the top of my head, the Civil War comes to mind.”

— Patrick Cox, Tech Digest

CHINA

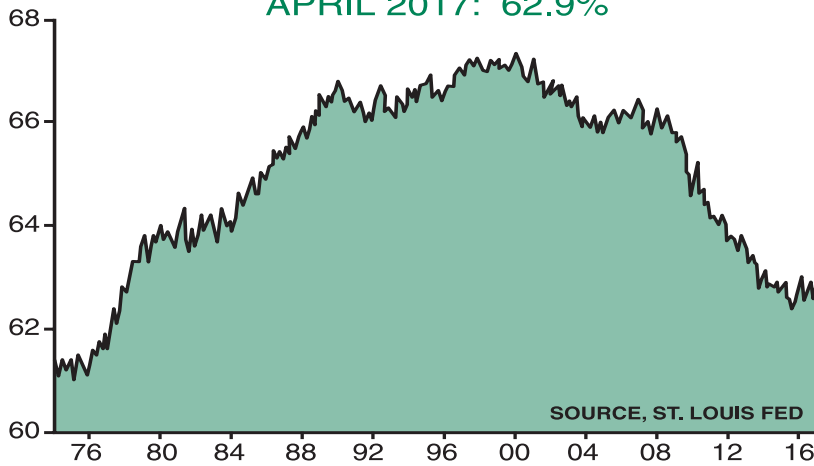
Xi Jinping is willing to try to force North Korea to give up its nuclear missiles. In return he wants the Spratly Islands, Taiwan, and open access to American markets. And we have to quit bugging him about the 25% tariff that China slaps on our automobiles. China is sitting pretty.

If Xi is unsuccessful we're going to have to decide between doing nothing, and attempting a flawless bombing of North Korea's missile and bomb programs. By flawless we mean that no North Korean missiles escape to Japan or South Korea (we'll need to fill the air with thousands of expensive anti-ballistic missiles), and that Seoul isn't destroyed by the North Korean artillery that's just 35 miles away. *That* could require tactical nuclear missiles.

On the other hand, doing nothing could be painful. The soul-less Kim Jong Un would continue his father's practice of demanding ransom. “Give me Seoul!” “I want Japan. And Hawaii ...” ■

U.S. LABOR FORCE PARTICIPATION RATE

APRIL 2017: 62.9%



Our labor participation rate (the number of adults, 16 and older, who are working) rose relentlessly at the end of the last century, as women entered the work force alongside a larger-than-usual number of Baby-Boomer men. It's been declining ever since.

The unemployment rate is now only 4.4%, but that doesn't include people who say they are not looking for work. "Discouraged" workers are slowly trickling back into the work force, holding down wage increases and thus keeping inflation in check.

Wages have accelerated somewhat, to about 2.7% a year, and workers are also working more efficiently. Productivity has been improving at a 0.7% rate, so the cost of labor is effectively increasing at just 2%. Productivity is the fountain of wealth that lifted our nation out

of poverty, and when it rises at a good clip the Fed doesn't worry as much about rising inflation.

By the end of this year wage increases should be above 3%, and inflation might be in the vicinity of 2.3% or 2.5%. That's not high enough to cause the members of the Fed to panic, but they would continue to push interest rates higher.

The IRS says that *there's been a steady decline in the number of people paying FICA* for their nannies and housekeepers. It's probably true that there are more and more Americans of all occupations working under the table and not paying taxes, so we might not see the labor-participation rate rise much. 64% might be a good target for the end of this economic cycle.

That might be 2 or 3 years away.



Paul K. Wright, CFA

There are few signs of frenzy in the construction of homes or factories, or other excesses that would give you reason to worry; and consumers are enjoying their best credit scores ever. It's still onward and, slowly, upward. ■

In 2016 the United States dropped **26,172 bombs** overseas. That's 72 every day! Special Forces deployed to 138 nations.

The White House Budget Office says that in 2016 defense spending was just 15% of the federal budget, down from 18% in 2013, three years before—and down from 49% when JFK was president.

"Batteries should not be charged to their full 100% capacity, as this puts strain on the battery. The sweet spot is generally within the range of 40% to 80% charge. Batteries should be plugged in when they approach the 40% mark, and disconnected once they have reached an 80% charge."

– Battery University/ Cadex.

From The Scallion:

**Rex Tillerson Returns Alaska, For \$7.2 Million
Putin: "No Receipt Required"**

Sarah Palin Says She Can See Russia From Her Bearskin Rug

INNOVATION

The Third World has enjoyed a spectacular improvement in living standards by following our free-enterprise example. We should all feel proud.

Instead, we feel as though we're slipping as they advance. We're hoping that the decline of our manufacturing sector will be offset by growth in the services that we sell to other nations. Hopefully not just X-rated movies, but also engineering and product development.

If this is going to work we'd darn well better lead the world in patents and inventions; but our patent system is slow and expensive. So slow that *it doesn't make sense for an individual inventor (or even a small company) to file patents in China*, or in most of the world.

Leading the world in technology won't mean much if the rest of the world can take our ideas and use them for free. And lots of our best ideas come from small entities; even fusion research is now conducted by startups! But our patent system takes years—we know an engineer who has been waiting for *five years*—and it's impossible to sell an idea until the patent has issued. Potential buyers are terrified by

the threat of future litigation.

It would cost very little to triple the number of U.S. patent examiners, so that each patent examination would start and finish before any foreign filings are required. Those foreign filings cost hundreds of thousands of dollars—the initial filing in Japan costs \$6,000—so today an individual inventor *can't protect an idea in a way that serves the best interests of our country*.

We should also simplify the patent bureaucracy, which seems to befuddle its own people. And let's join with the other English-speaking nations and the EU to create a joint patent office that will register your idea in 30 nations at once. If we slide to also-ran status it will harm employment and wages, worsen inequality, and create a large and permanent underclass. ■

Princeton University economists Anne Case and Angus Deaton have found that, after decades of decline, the death rate for white, middle-aged Americans has been rising. "These deaths of despair have been accompanied by reduced labor force participation, reduced marriage rates, increases in reports of poor health and poor mental health."

MEXICO

Last year we exported \$262 billion in goods and services to Mexico, and imported \$318 billion. On a global basis Mexico ran a trade deficit, so this is not a country that's trying to "win" in trade. By comparison our trade deficit with China was \$310 billion. Since 2005 it has totaled about 3.3 *trillion* dollars.

Someday we'll look back and realize that we traded long-lived, income-producing assets to China to get manufactured goods that only lasted for a few years. But that's not at all true of Mexico, whose manufacturing is integrated with ours in ways that make us more efficient and effective. Mexico is the least-expensive place in the entire world to build an automobile.

Helping Mexico build its economy would boost our exports and jobs, reduce illegal immigration, and help us deal with our drug problem. And among all the nations to whom we extend a helping hand, there should be a special place for our closest neighbors. Mexico should be our *most* most-favored nation. ■

If you go out looking for America, you'll see some pretty good names for hair salons. There's grit and determination in **Hair We Are** and **Hair To Stay**, and a laudable commitment to service in **Hair To Please**.

But would you feel relaxed getting your hair done at **Blood, Sweat, and Shears**? Smosh.com has some of the wackiest names—the **Chain Saw Massacre Salon**, **Big Texas Hair**, **The Best Little Hair House**—and they have the photos to prove it.



POPULISM

“In Venezuela the food lines are only the most visible evidence of a nation in free fall ... In a country that sits atop **the world’s largest known petroleum reserves**, hungry citizens wait on their assigned day for whatever the stores might stock ... Domestic production has plummeted as farms and factories that Chávez expropriated are all but idle ... Medicines often can’t be found at any price.”

– *Time* magazine, on the misery spawned by populism and socialism. The IMF believes that this year inflation will average 720% percent a month.

Hugo Chavez promised equality as he seized corporations and farms in Venezuela. Lenin and Marx promised equality, and the result was poverty for (almost) everybody. Fidel impoverished Cuba. Socialism drove Greece into bankruptcy (it’s sliding back into recession right now), and if you study the relatively-recent histories of Zimbabwe, Argentina (several times!), or Tanzania, you’ll start to wonder whether efforts to create *fairness* cause poverty and misery.

Certainly we can say that politicians who promised gifts of food, health care, or cash used those gifts to purchase good will. They purchased *votes* with dollars that did not belong to them—dollars that often had to be repaid by children too young to understand that they had been swindled. ■

BARGAINS

Since 2010 Goldman Sachs has repurchased more than 100 million of its shares, causing earnings to rise 34% despite huge costs related to new regulation. Goldman’s shares are cheap because the firm is burdened with the designation *Systemically Important Financial Institution* (SIFI), which means that it has to get permission from the Fed before it can buy back shares or pay a dividend. There are lots of other rules.

Prudential and MetLife are also SIFIs. If they could get permission from the government they’d be able to buy back more than 10% of their shares every year. Keycorp, Huntington, and Regions Financial, which also bear the “SIFI” regulatory burden, are a bit more expensive; but there’s hope that their earnings will rise as some of their other regulatory burdens are lifted. And rising interest rates should give their earnings a further lift.

The earnings yield for the entire Polish stock market is 7%. Not bad, considering that their economy is growing faster than ours (and their currency is *not* tied to the euro). Last year Polish shares were even cheaper, as a result of fears that the nation’s banks would be forced to bail out homeowners who had signed up for **Low**-interest-rate mortgages that were denominated in Swiss Francs. The Swiss Franc soared, and the ‘moaners were shocked to discover that they’d have to pay the loans back in ... Swiss Francs.

If it seems too good to be true, it probably is. ■



Drew D. Kellner, CFA

The current market value (as of June 1, 2017) of an account we often reference in our newsletter is \$1,093,738. If you would like further information or context please go to <http://www.lumbard.com/html/performance.html>

MetLife

During the next few months MetLife will spin off its retail operations under the name Brighthouse Financial. Morgan Stanley believes that the new company will be far more sensitive to interest rates than the parent, so it should perform well as interest rates rise.

The parent will become *less* sensitive to interest rates, so it will become *more* resistant to the effects of a recession. It’s hard to find reasonably-valued stocks that will hold up well in the next recession, so we’re happy to have MetLife in our portfolios. Best of all, we have big gains in the stock. Those are gains that we *won’t* have to take as the next recession approaches. ■

THE GOOD LIFE

Commencement speakers always tell you to “*follow your passions*”, and “*make a difference in the world!*” What really happens is that you stumble out into the sunshine and start looking for a job, probably in a cubicle, that will allow you to live in a small apartment that you share with 3 other struggling grads.

The first few years after college can be painful. A lot of grads respond by spending their big new salaries to put a little fun back in their lives. Now it becomes *really hard* to go back to school, or step down to a better job—one with a real future—that doesn’t pay as well.

Savings are power. By saving your money you’ll build a war chest that allows you to switch careers or start a business, and you’ll retire happy. If you opt for a nicer apartment, a sexy car, and dinner out, you’ll trap yourself in a job that you’ve come to loathe—and retire poor.

Over the course of a lifetime, even a little bit of saving each year can compound to a million dollars. If you wait until your 50s, you’ll have to save **8 times** as much. So eat dinner at home. Make your own coffee! An evening out, with cab fare home, can cost \$50 (and did you know that alcohol causes cancer?). A tax-free Roth IRA is a

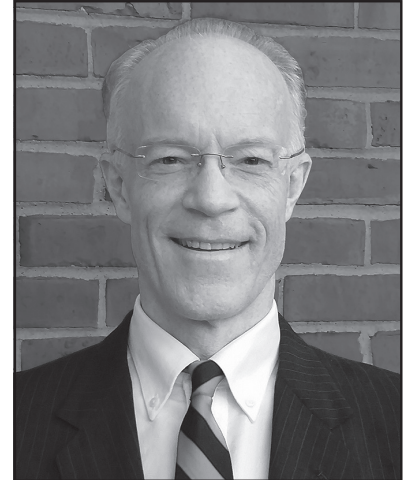
better place for your paycheck than the veterinarian’s office. Would you rather have a million tax-free dollars, or a cute puppy?

It’s never too early to build a network of friends and former employers who can help you with your career. People who trust and respect you, and who can help you find the best employers—and more important, the best bosses.

If you are burning with passion for something, by all means pursue it. For the rest of us a better question is “What are your aptitudes?” If you have no idea, you can get them measured by the Johnson O’Connor institute—which tells its clients that failing to utilize their aptitudes will doom them to lives of frustration. Using them in hobbies is OK too ...

Conventional wisdom can hurt you. It was Common Knowledge that drove us to inflate two giant bubbles in real estate in just 20 years, along with “Peak Oil” and bubbles in technology stocks, and—right now—bonds. The fact that “everybody” is jumping off a cliff, as your mother warned, is not a reason to believe that it’s OK.

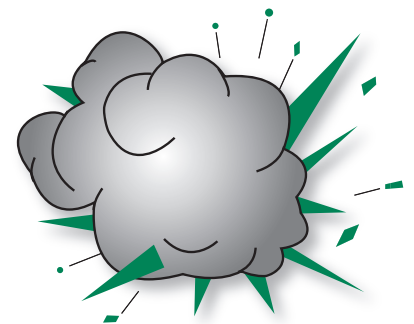
As you age your health and athleticism will slowly deteriorate, but you can get satisfaction from



John Lumbard, CFA

increasing wealth and comfort, a community of dependable friends, the respect that accrues to those who are trustworthy, and the power that results from having money. Don’t put yourself in a position of powerlessness and poverty! ■

– John Lumbard, CFA



“I was literally just sitting and reading when my Fitbit exploded.”
– Dina Mitchell, as related by ABC News. “It was either defective or really mad I was sitting still so long.”

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