The Healthcare Blues

By John Mauldin | February 27, 2013

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It has been some time since we peeked into my worry closet. A few questions this weekend prompted me to think about things I am paying attention to but have not written about, and one thing that I am not worried about at all, despite the apparent media hysteria.

But first, a quick note. My tenth annual Strategic Investment Conference (May 1-3 in Carlsbad, California) seems to be filling up nicely. The speaker lineup is exceptional: Kyle Bass; Ian Bremmer; Mohamed El-Erian; Niall Ferguson and his wife, Ayaan Hirsi Ali; Lacy Hunt; Charles and Louis Gave; Jeff Gundlach; Anatole Kaletsky; David Rosenberg; Nouriel Roubini; and Gary Shilling.

Seriously, where else can you find a roster like that? And the attendee list has a "who's who" feel to it, as well. Those who come regularly know that the real value is in meeting the other attendees. David Rosenberg noted last year that this is the top investment conference he has ever addressed. The speakers all seem to bring their "A" game. The attendees agree, and this year we will have more interaction than ever.

The conference always sells out, and we offer an early-bird registration, which is about to run out. Because of security regulations, we do have to limit attendance to accredited investors and those in the securities/investment business. You can start the process by going to the Strategic Investment Conference page.

But before we go any further, did you know that you can now absorb *Thoughts from the Frontline* through your ears, if your eyes are otherwise occupied? That's right – our new audio service delivers my weekly letter to your cellphone, iPod, MP3 player, or computer, whenever and wherever you choose. You can check it out *right here*.

And now, let's peek into my worry closet.

On Being a Professional Worrier

I should note that I am a professional worrier. I get paid to think about what can affect our economy, finances, and investments. Over the years I have become quite good at it. But the sheer volume of things to worry about has grown so much that there is not enough time to worry about everything, so I have had to prioritize.

For instance, there was a time in my life when I worried about what the markets did on any given day. But serious study showed me that worrying about the day-to-day movements of markets was pointless (at least for me, and probably for most of you), so now I let the media and traders do that for me. Instead, I try to think about what could move markets longer term. And yes, I "worry" (as in ponder) what could make the markets go up as well as what could make them go down. It is enough to try to get the direction of the movement right, let alone the day-to-day gyrations.

Further, I do not worry (at least in terms of economics and investments, the beat of this letter) about things that I can either avoid or at least hedge against. I may pay close attention, but I do not spend time worrying.

I try to devote my actual professional worry time to things for which I don't have a solution, and to ponder the likelihood of their happening and what we might do about them.

This prioritization helps my worry closet remain a closet and not expand into the living room. I must confess that my living room is crowded enough with worries about how my kids are doing that I simply have to close the worry closet door every now and then, as they remind me of the here-and-now problems of life. However, problems that they deal with do often find their way into my worry closet. Problems like, where will the jobs come from? (Which is the subject of a book I hope to have off my desk in a few months.) Another such problem is the subject of my central worry in this letter: health care.

For new readers, I have seven kids, so I have lots of opportunity to worry. Five are adopted, so we've been tossed into a random lottery of past family health issues. Some we know about, and some we don't. Henry, my oldest son, is from the Virgin Islands. He played serious high school football (6'1" and 290 pounds, all Dallas-Fort Worth area tackle) and slimmed down a few years after to a ripped 230 pounds. Solid muscle. He is now 31 but still in good shape.

He was diagnosed a few years ago with type 2 diabetes. It is under control most of the time, but something seems to take him to the emergency room about every four months. This past month it was a liver and gall bladder issue. He has a good job with good insurance, except that his employer has cut back the hours he works. He has a union job, and the new employees make about half what he does, so they get the hours. Henry has a young son, and that makes it tough. And with diabetes, he can't afford to quit and take a new job without solid health benefits, yet because of his problem it seems he can't get a job with insurance. So part-time jobs are the order of the day, and they pay less.

Daughter Melissa was diagnosed with thyroid cancer last year, and her thyroid was removed. They were pretty confident they got it all, but recent scans showed some spots on the lymph nodes in her chest area. We are waiting for results from a recent and more detailed scan, which seem to be taking forever. She did not have insurance for the first operation, so I became intimately aware of the costs of medical care. The quality of the hospital and doctors was superb (Baylor in Dallas). In terms of costs, I was pleasantly surprised, as I was expecting a horror story. I thought that all in all it was reasonable. We now have insurance for her, but given her history there are limits to it.

Amanda (adopted from Korea) has a baby due in six weeks and is doing fine. Tiffani has given us a scare or two (the lump in the breast thing). Chad has been in a few serious accidents. Abigail (Amanda's twin) and Trey have nothing out of the ordinary.

I have written extensively in this letter about the unsustainability of the entitlement programs, especially Medicare and Medicaid. They are growing at a much faster rate than the economy. We simply cannot afford as a nation to maintain our current system without reform.

It is one thing to say in the abstract that we have to get the entitlement programs under control and another thing to see the unintended consequences of a healthcare system that works for most of us but can devastate more than a few of us at the wrong time. Melissa was given the best of care because she had a Dad who was fortunately able to help. What about the millions of Melissas who don't?

It's all so very complicated, and it can become very emotionally trying. I get the economic issues of insurance companies having to deal with pre-existing conditions. But I also see what can happen to young people when they have those pre-existing conditions. I deal firsthand with my kids and insurance and healthcare costs. It is very real to me and not at all abstract.

I have been told that in a few weeks or months I am going to be one of the first to receive a new type of genetic analysis. Rather cutting-edge, it will tell me a great deal about my genetic predispositions and tie them into the latest research. I am not sure of the cost (it will not be cheap), but in a few years it will be standard procedure for those who want it and reasonably affordable, as it is one of those things that can be computerized.

In a few months, I will know of a lot of my potential pre-existing conditions. What if my insurer also eventually knows them? Do we work together to prevent a problem before it happens, or will they dump me or limit coverage? I worry about such things. The day is not too far off when such genetic insight will be cheap and easily available to everyone. Should health insurance costs be based on the gene-pool lottery? (Let's not even go into life insurance!)

The Healthcare Blues

For this week's issue of *Time* magazine, the cover story is ***Bitter Pill: Why Medical Bills Are Killing Us*****,** by Steven Brill. I had to have something to read while the plane was taking off, and that turned out to be it. (Since I got my iPad I no longer carry books, so I make sure I have something to peruse while waiting to be able to use my electronics in the air.) I have read work by Steve Brill in the past and like his style, so even though I don't usually read *Time*, I picked up this issue on health care.

I wish I could get every voter in America to read that article and then go to the Internet, Google the piece, and read the comments. I don't agree with all he wrote, but he does a marvelous job of giving us the picture on just how broken the American healthcare system is in terms of costs. He goes into detail about how hospitals create those staggering bills. If you have private insurance or a government plan, you don't have to pay those prices, but what if you don't? The billing system is out of control: $1.50 for a 1.5-cent acetaminophen pill (Tylenol). A simple niacin tablet marked up 240 times. Routine products like gauze marked up 10 times. Billing for a lamp shade? Are you serious? Double and triple billing for routine items that no insurance company or government agency will pay for, but that you will be billed for if you are on your own. You have read the stories or heard them from friends, but Brill makes it real.

We spend almost 20% of our gross domestic product on health care in the US, and that figure continues to climb. I could quote at length from the article, but let me just excerpt six paragraphs:

> Taken as a whole, these powerful institutions and the bills they churn out dominate the nation's economy and put demands on taxpayers to a degree unequaled anywhere else on earth. In the U.S., people spend almost 20% of the gross domestic product on health care, compared with about half that in most developed countries. Yet in every measurable way, the results our health care system produces are no better and often worse than the outcomes in those countries.
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> According to one of a series of exhaustive studies done by the McKinsey & Co. consulting firm, we spend more on health care than the next 10 biggest spenders combined: Japan, Germany, France, China, the U.K., Italy, Canada, Brazil, Spain and Australia. We may be shocked at the $60 billion price tag for cleaning up after Hurricane Sandy. We spent almost that much last week on health care. We spend more every year on artificial knees and hips than what Hollywood collects at the box office. We spend two or three times that much on durable medical devices like canes and wheelchairs, in part because a heavily lobbied Congress forces Medicare to pay 25% to 75% more for this equipment than it would cost at Walmart.
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> The Bureau of Labor Statistics projects that 10 of the 20 occupations that will grow the fastest in the U.S. by 2020 are related to health care. America's largest city may be commonly thought of as the world's financial-services capital, but of New York's 18 largest private employers, eight are hospitals and four are banks. Employing all those people in the cause of curing the sick is, of course, not anything to be ashamed of. But the drag on our overall economy that comes with taxpayers, employers and consumers spending so much more than is spent in any other country for the same product is unsustainable. Health care is eating away at our economy and our treasury.
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> The health care industry seems to have the will and the means to keep it that way. According to the Center for Responsive Politics, the pharmaceutical and health-care-product industries, combined with organizations representing doctors, hospitals, nursing homes, health services and HMOs, have spent $5.36 billion since 1998 on lobbying in Washington. That dwarfs the $1.53 billion spent by the defense and aerospace industries and the $1.3 billion spent by oil and gas interests over the same period. That's right: the

> health-care-industrial complex spends more than three times what the military-industrial complex spends in Washington.
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> When you crunch data compiled by McKinsey and other researchers, the big picture looks like this: We're likely to spend $2.8 trillion this year on health care. That $2.8 trillion is likely to be $750 billion, or 27%, more than we would spend if we spent the same per capita as other developed countries, even after adjusting for the relatively high per capita income in the U.S. vs. those other countries. Of the total $2.8 trillion that will be spent on health care, about $800 billion will be paid by the federal government through the Medicare insurance program for the disabled and those 65 and older and the Medicaid program, which provides care for the poor.
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> That $800 billion, which keeps rising far faster than inflation and the gross domestic product, is what's driving the federal deficit. The other $2 trillion will be paid mostly by private health-insurance companies and individuals who have no insurance or who will pay some portion of the bills covered by their insurance. This is what's increasingly burdening businesses that pay for their employees' health insurance and forcing individuals to pay so much in out-of-pocket expenses.

I know about those business healthcare burdens. At my very small business, the fastest-rising cost is health care. I have my staff get bids on health care every few years and try to hold down costs. I should note that after reading the Brill article I am actually going to go back and check a few items to make sure we have proper coverage. You think you do until…

Let's be clear: the US has the best medical care on the planet. Expensive, yes, but our best is truly the best. As I get older and as my kids have issues, having access to good health care seems a very good idea. I want to live a very, very long time. Which is why I worry. I don't want to see our healthcare system get sidetracked.

Now, we are getting ready to dramatically change how we pay for 20% of our economy. I fear Obamacare is going to be a bureaucratic nightmare. Before you consign me to some Neanderthal Republican hell, let me quickly state that **any** necessary reform is going to be disruptive and expensive. Even if we adopted Paul Ryan's plan, it would be very disruptive. You simply can't change the incentives and payment structures of 20% of the economy without creating macroeconomic problems. There are more unintended consequences than we can imagine lying hidden in the grass of healthcare reform, like hungry lions.

Having to cover pre-existing conditions is going to raise the costs of private insurers. In my business, we are getting reports that our cost will go up by as much as 50%. Individual rates may rise even more.

Under Obamacare, businesses may have sufficient incentive to drop insurance coverage and pay a $2,000-per-employee penalty. I am not certain where they came up with that number, but $2,000 is cheap insurance. Insurance companies are going to lose business customers as they raise prices. If your employees can get government health care (mine can't, I hasten to add!), then from a financial perspective you are better off paying the penalty. When insurance costs rise, the pressure to drop coverage will rise as well, which will mean those still covered have to pay more. It will be an ugly trap until things get sorted out.

By the numbers, Medicare looks like a government program run amok. After President Lyndon B. Johnson signed Medicare into law in 1965, the House Ways and Means Committee predicted that the program would cost $12 billion in 1990. Its actual cost by then was $110 billion. It is likely to be nearly $600 billion this year. That's due to the US's aging population and the popular program's expansion to cover more services, as well as the skyrocketing costs of medical services generally. *(Time)*

I fear that the Medicare budget will rise even further unless we get aggressive on holding down costs. But that will not be easy. The systemic and political incentives to effect change are just not there until there is a real crisis. And while Brill talks about the excess profit in the system, when you take that away, things will change. Some think they will change for the better, but I am afraid we are all indulging in wishful thinking.

Obamacare may have brought forward the crisis that we all knew was coming. Rather than runaway entitlement spending being a problem for the latter part of this decade, it may soon be a topic for your child's "show and tell" time at school. We either get a handle on the problem this year or things could quickly spiral out of control. Medicare and Medicaid costs could quickly rise by 5-10%, which would blow a hole a mile deep in our national budget. Yes, that would mean that costs that had been absorbed by emergency rooms and picked up by charities would now be paid for by the government, but while they might amount to the same total (unlikely), they would not be part of cost and budget projections.

Maybe the government does a better job at estimating future costs than it did in 1965, but I worry that it won't. And the consequences of being wrong could be very disruptive to a healthcare system that is as vital as food and energy. Honestly, I do not get a good feeling when I think of Washington DC and crisis management. Call me silly, but I worry about that.

I don't have an answer, or at least not an easy one. Should we treat health care as a utility? That is anathema to my free-market sensibilities. Should people be without basic health care? That is also not acceptable. Can we afford universal health care? Not as costs are currently structured. Can we change? Sure, we will have to. But I expect a bumpy ride. I read and think a lot about health care because I am worried it is going to impact our economy in ways we simply don't yet understand.

China, Japan, and a Few Rocks

I also read a lot of material written by other professional worriers – as opposed to amateurs who worry about everything simultaneously, or even worse, the tin-hat crowd that feels compelled to conjure problems and conspiracies that don't exist in order to assign blame to some imagined cabal of bad guys.

(OK, let me generate a lot of negative comments with an example. I find the belief that there is a "Plunge Protection Team" simply bizarre. You know, the guys who are supposed to control the stock market? The "Working Group on Financial Markets"? If there is one somewhere, deep in the bowels of government, they are the most incompetent conspirators ever assembled. And no one has come forth and spilled the beans in a memoir after 25 years? Puh-leeze!)

But when I start to pick up similar themes from people I know and respect who don't know each other, I start to pay attention. And one of those themes has been coming to me from people, including some at very high levels, who have deep knowledge and experience of Japan and China.

They are getting concerned that the level of rhetoric surrounding the Diaoyu/Senkaku Islands dispute is starting to get out of control. The real estate in question is a very small chain of five uninhabited islets and three rocks in the middle of the East China Sea. They are located roughly due east of mainland China, northeast of Taiwan, and west of Okinawa Island (the largest of the Ryukyu Islands), as shown in the map below.

China and Japan have had an on-again, off-again relationship for centuries. At times, it has not been very pretty. China suffered a great deal at Japanese hands during WWII. Just when you thought the old wounds were finally healing, the off-again phase has come back in full force. Japan nationalized what were to them the Senkaku Islands last September. (Technically, Japan bought them from the Kurihara family for 2 billion yen.)

The earliest historical records we have indicate that the Chinese discovered the islands in the 15th century. The Japanese nationalized them in 1895. After WWII, the US administered them but gave control back to Japan in 1971. Returning control to Japan angered both China and Taiwan, as both countries considered the islands as their own. China and Taiwan then began to officially declare ownership of the islands.

The rub is that these rocks may be perched in the middle of a rather large oil and gas field. The UN identified the petroleum potential in 1969, but no drilling has taken place.

The leaders of both China and Japan have made strong statements, and their citizens have expressed even stronger emotions. The Chinese are boycotting certain Japanese companies, and Japanese exports to China have dropped 14.5% (as of latest data). Recent meetings between the two countries have not been helpful. Recently, in what was supposed to be a speech to smooth things over, a top Japanese foreign policy advisor basically lectured the Chinese on their behavior in Hong Kong. Not the stuff of great diplomatic gestures.

And as I get ready to finish this letter, this timely note has come in from Stratfor:

> Japanese Prime Minister Shinzo Abe has warned Beijing that Tokyo is losing patience with China's assertive maritime behavior in the East and South China seas, suggesting China consider the economic and military consequences of its actions.
>
> In an interview *The Washington Post* published just prior to Abe's meeting with U.S. President Barack Obama in Washington, Abe said China's actions around the disputed Senkaku/Diaoyu islands and its overall increasing military assertiveness have already resulted in a major increase in funding for the Japan Self-Defense Forces and coast guard. He also reiterated the centrality of the Japan-U.S. alliance for Asian security and warned that China could lose Japanese and other foreign investment if it continued to use "coercion or intimidation" toward its neighbors along the East and South China seas.

It is hard for the world to understand the national emotion surrounding a few barren rocks. But stranger things have happened. Remember the Falklands (although they were at least populated)? I bring this issue to your attention not as something to worry about, perhaps, but as something to which you might want to pay closer attention. Let's hope cooler heads prevail; this is not something the world wants to choose sides over.

Stupid Sequestrations

The media and much of the political chattering class seem to think that the upcoming sequestration of certain government spending is going to bring down the republic. The actual reality is that we are talking about some $45 billion this year. In a $16 trillion economy, that is a rounding error. And with a $1 trillion+ deficit, it is not enough cutting.

Yes, across-the-board cuts are stupid. The Defense Department and, yes, even the other government departments should be given leeway to decide where to make the cuts, with proper Congressional oversight. But we need those cuts and more. We should be cutting the deficit by $100-150 billion a year every year until the budget is balanced (by which time we hopefully see some growth). If we simply held spending where it is, the problem would get solved with no cuts. Or if we cut the growth of spending in half, we could get close with some other adjustments.

I worry about a lot of things. But this sequestration is just simply not on the list.

Whiteboard Fun

I want to call to your attention a new whiteboard animation series by my partners at Altegris.

Every single one of these videos is fun to watch. I love a good story, and great whiteboard animation is all about storytelling. Through these videos, Altegris has tackled some fairly complex and important alternative investments topics and made them easier to understand in a very engaging way. Take a look at the "edutaining" first video, called *Common Myths About Alternatives*. This video addresses ongoing myths circulating about alternative investments. I encourage you to watch and then go check out the Altegris premiere lineup of hedge fund managers, normally difficult to access otherwise. (In this regard, I am president and a registered representative of Millennium Wave Securities, LLC, member FINRA.)

Argentina, Cambodia, Singapore, Humiliation, and Homeless

I am back home for a few days. Tomorrow Jon Sundt and Dick Pfister, my partners at Altegris Investments, are coming to town for a planning and strategy session (which must of course include a Mavericks game). The next day we drive out to see Kyle Bass and his team at his Barefoot Ranch in East Texas for more in-depth work, some thinking about Japan and global macro investing, and possibly a little skeet shooting.

I leave for Cafayate, Argentina, Thursday after next, for two weeks. I'll spend time with friends and try to relax a little, but mostly I'll work on finishing my part of the book Bill Dunkelberg (chief economist of the National Federation of Independent Businesses) and I are writing on the future of employment. As it turns out, healthcare costs might be partially responsible for the significant drop in new business formation. Go figure.

When I get back from Argentina, I will be living in a hotel until the new place (hopefully) closes. Homeless, sort of.

Last time I was in Cafayate for a few days, I played nine holes of golf with my friends and partners David Galland and Olivier Garret. I had not played any golf for about four years and had a very loose 29 handicap when I did play. I was not expecting much. After a very bad, cold start on the first hole, I slowed my swing way down and found myself hitting the ball where I could find it. I ended up shooting about 51 for the nine holes and was quite happy with that score.

So this past weekend I decided to play in a scramble format with my friends Victor Adair and Michael Campbell of Canadian business radio fame, whom I had never met except by phone during interviews. Victor knows I am good friends with Greg Weldon and arranged for him to be on our team. They were marvelous gentlemen, it was a beautiful day on a magnificent course, and I thoroughly enjoyed the outing.

Except. Golf can be so humiliating. I stepped up to the tee carrying the confidence from my Argentina outing... and sent the ball screaming right into some nasty brush. Oh well, there's always the next hole. And then I proceeded to lose exactly one ball per hole for nine straight holes. I got back in the cart with Victor and muttered something along the lines of, "That may have been the ugliest exhibition of golf you've ever seen." The silence and slight smile from Victor said it all. He was just too polite to agree out loud. Things did get better, though: I only lost three balls on the back nine. (On the plus side, I did make our five birdie putts for the team.)

In the middle of April, I will be speaking in Singapore and will take the opportunity to go see Angkor Wat in Cambodia. It has long been on my bucket list.

Ironically, since I've been writing about health care, I seem to have picked up a slight head cold in Palm Springs, so I think I will just call it an evening. I don't want to jinx myself, but I've been feeling amazingly good lately, so even losing 12 balls hasn't affected my mood tonight.

Have a great week. Don't sweat the small stuff. And remember: it's mostly small stuff.

Your having too much fun to worry too much analyst,

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