Friday, May 5th, 2017

The Top-Down

The view from the top continues to be dominated by Washington. Last week it was news of sweeping changes to the corporate and personal tax structure. This was preceded earlier in April by news that going forward, these institutions are going to need to figure out what they want to be, lenders or investment banks. With Gary Cohen's endorsement and the support of the likes of Ken Griffin, the possibility of breaking up the big banks is looking more like a reality.

This new movement comes at a time of health in the banking industry and will likely lead to a more constructive outcome. Far better to overhaul how banks conduct business from a position of strength. Morgan Stanley got out in front beginning in 2011. And this week the WSJ highlighted how Goldman Sachs is increasing the firms more pedestrian lending business.

Weekend reading from the Atlantic in 2015 on how difficult it is to change the hardwiring of bankers and their appetite for risk. Final thought on the new pro-business atmosphere in D.C. from former Sun Microsystems CEO Scott McNealy.

Today's April employment report put the growth train back on the tracks with an addition of 211,000 in payrolls following a soft 79,000 in March. On Monday, the April ISM index came in light for the first time in seven months. This is on the heels of a Q1 GDP print that showed an anemic 0.7% growth rate. Weak consumer spending, especially on autos, is becoming an increasingly strong headwind. While only the first read, there are signs that the consumer is taking a step back. Warren Buffett interviewed this morning on CNBC providing his opinion that Q1 was an anomaly and he expects GDP to be revised upward. He likes his position in Apple and is envious of their balance sheet.

Even with some signs of softening over the past few months, the Federal Reserve signaled this week that it isn't flinching and a rate increase in June is almost a lock. Stripping away the noise, wage inflation remains and the single most important indicator the Fed is watching. For a full account of all economic data use The Economic Calendar - Bloomberg

The View from Stillwater

After eight years, the global economy appears to be finally reaching escape velocity. But we are still only ascending, and the clean air of 3% economic expansion sits at a higher altitude. Earnings growth, profitability, strong balance sheets and supportive policies will help with the current state of extended equity valuation in the United States. A modest allocation shift out of the US and into international markets continues to hold water based on the price to earnings differential.

The Bottom-Up

Earnings reports for the first quarter continued in earnest with Apple doing what it does best, proving once again why it's the world's largest company and nothing shy of the greatest cash generator in history, as explained by Aswath Damodaran.

Challenging news this week for auto makers as April sales confirmed a disappointed trend. Auto sales fell 4.7% with a strong slowdown felt by Ford and General Motors. This while banks are tightening the reigns on auto lending and the subprime portion of the auto finance market is showing signs of stress.

The oil and gas sectors continues to experience a downright awful first half of the year. Crude has been hitting a ceiling in the mid-$50s due to overhead supply, even with OPEC trying to engineer higher prices. And while the commodity is off 15% from its peak price this year, many E&P and oil service companies are down twice that amount.

For four years (2010 – 2014) crude traded in a $20 range, averaging $100 the entire time. This was in large part because Saudi Arabia wanted $100 crude. At that price, the entire production chain profited as did the Saudi balance sheet. In 2015 OPEC turned its production guns on US shale producers. And as we have entered fracking 2.0, it's about finding more profitable ways to operate at lower price levels. And companies like EOG continue to push that envelope.

The View from Stillwater

Favorable on Apple, unfavorable on IBM. Unfavorable view of autos, auto retailers, and auto parts retail. The energy sector remains better suited for traders than investors, to be bought with crude in the mid-$40s and sold with it in the mid-$50s. Favorable on EOG.

Up and Down Wall Street

The Milken Institute held it's 2017 gathering in Beverly Hills earlier in the week, and once again the participants and content didn't disappoint. The Institute does a great job of posting volumes of material from the event. Use the link above to access this year's presentations.

John Bogle paints a utopian picture of his Vanguard empire while providing an ominous outlook for the future of active managers. "We have to get back to building products and services that are good for investors and good for the community. That is your long-term survival." Well said. And this profile of Rob Arnott, "The Godfather of Smart Beta". highlights the tectonic shift in assets towards intelligent index funds and ETF. This shift caused a purge at the top of the asset management division of AllianceBernstein on Monday.

The View from Stillwater

Focus on the outcome you are looking to achieve. Find the best solution to get you there. And avoid the fee trap. Pay as little as necessary for broad market (Beta) exposure. Reserve your dry powder for specialized active managers and alternatives (Alpha) that support your investment goal. And if one has the means, attend next year's Milken Conference in person and sign up for their quarterly review.