



October 20th, 2017

The Top-Down

Treasury Secretary Steve Mnuchin sent a shot across the bow to Congress when he suggested that failure to pass a major tax-relief bill would tank the equity markets. “To the extent we get the tax deal done, the stock market will go up higher. But there’s no question in my mind that if we don’t get it done you’re going to see a reversal of a significant amount of these gains.” *Politico Money* has the [full interview](#) where Mnuchin guarantees that a deal will get done.

Treasury Secretary Steve Mnuchin



Source: Politico Money

Stillwater View: [“Well Surprise-Surprise-Surprise!”](#) Late Thursday the Senate passed a 2018 budget resolution 51-49, [moving forward](#) on tax reform without Democratic support. With Congress and the White House controlled by the Republicans, and little legislative achievement leading into next year, was there ever really a doubt? Stock futures are up on the news. Surprised?

The September [Leading Economic Indicators](#) reading came in soft at -0.2%, just below an [expected range](#) of 0.0% to 0.3%. This was the first decline in twelve months and the decrease was blamed partially on the recent hurricanes.

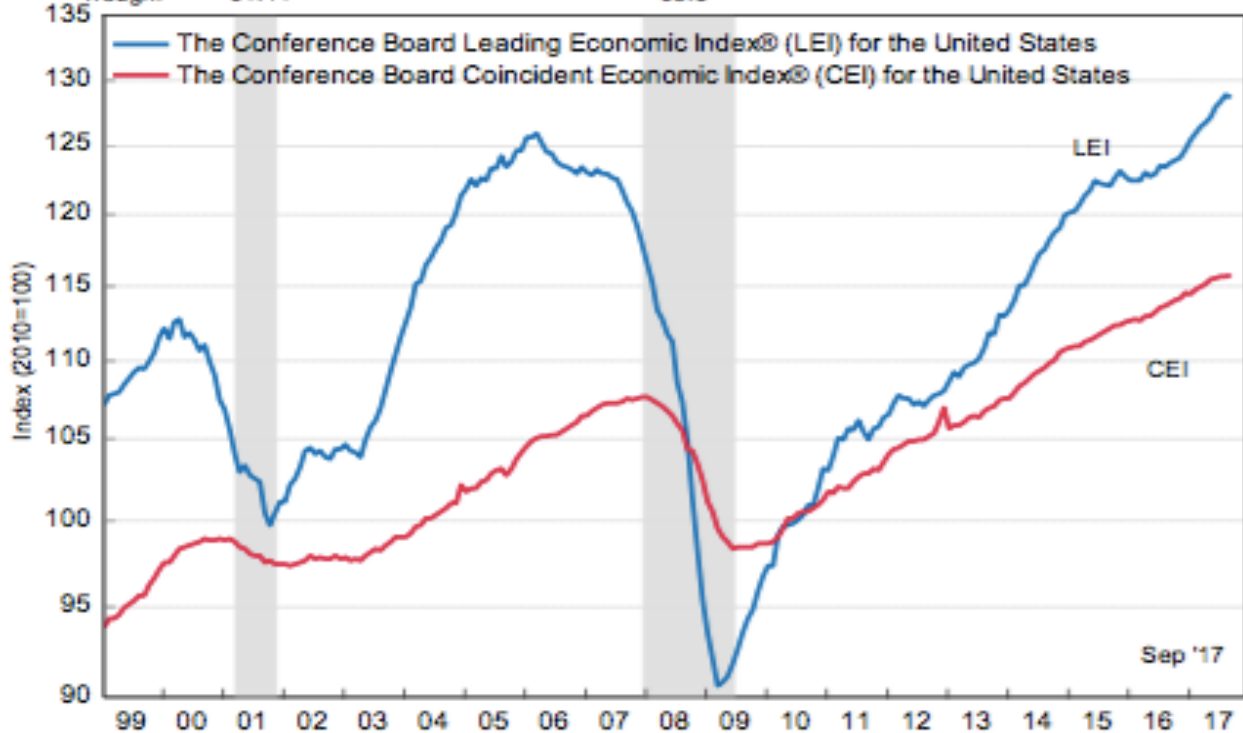
[The Conference Board](#) said “The source of weakness was concentrated in labor markets and residential construction, while the majority of the LEI components continued to contribute positively. Despite September’s decline, the trend in the US LEI remains consistent with continuing solid growth in the US economy for the second half of the year.”

Leading Economic Indicators

The Conference Board Leading Economic Index® (LEI) for the U.S. Declined in September

Peak: 01:3 07:12

Trough: 01:11 09:6



Latest LEI Trough March 2009, Latest CEI Trough June 2009

Shaded areas represent recessions as determined by the NBER Business Cycle Dating Committee.

Source: The Conference Board

Source: The Conference Board

Stillwater View: While barely noticeable on a long-term chart, any decrease in LEI is worth paying some attention to. Combine this with the September employment report going negative, and we now have the possible beginnings of a different economic picture. The market isn't having much of a reaction to this news. Leading Economic Indicators are important for those looking toward the horizon for signs of the next recession, as LEI was in contraction leading up to the last two.

In another sign that this market might be [nearing a top](#), well-known Wall Street technical analyst Ralph Acampora has literally run out of room on the side of his Minnesota barn to paint the move any higher.

Dow 23,000 Hit Ralph's Barn Roof

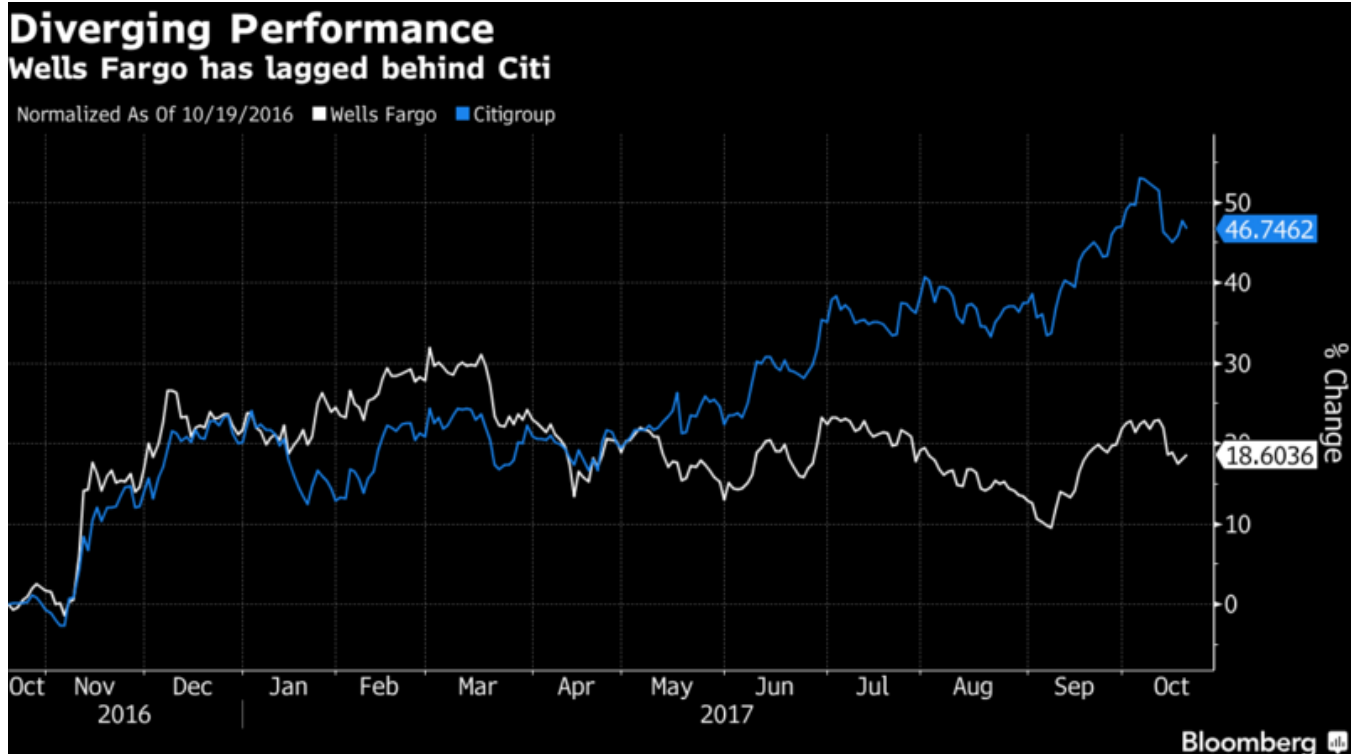


Source: The Wall Street Journal

The Bottom-Up

Neuberger-Berman fund manager Steve Eisman discussed his long Citigroup short Wells Fargo [pair trade](#). While he believes tailwinds are in place that will benefit the banking sector long-term, Wells is less likely to participate as “it’s going to take years to unwind that culture”. *Bloomberg* provides the snapshot of what a proper pair trade looks like.

Well Paired - Long Citi & Short Wells Fargo



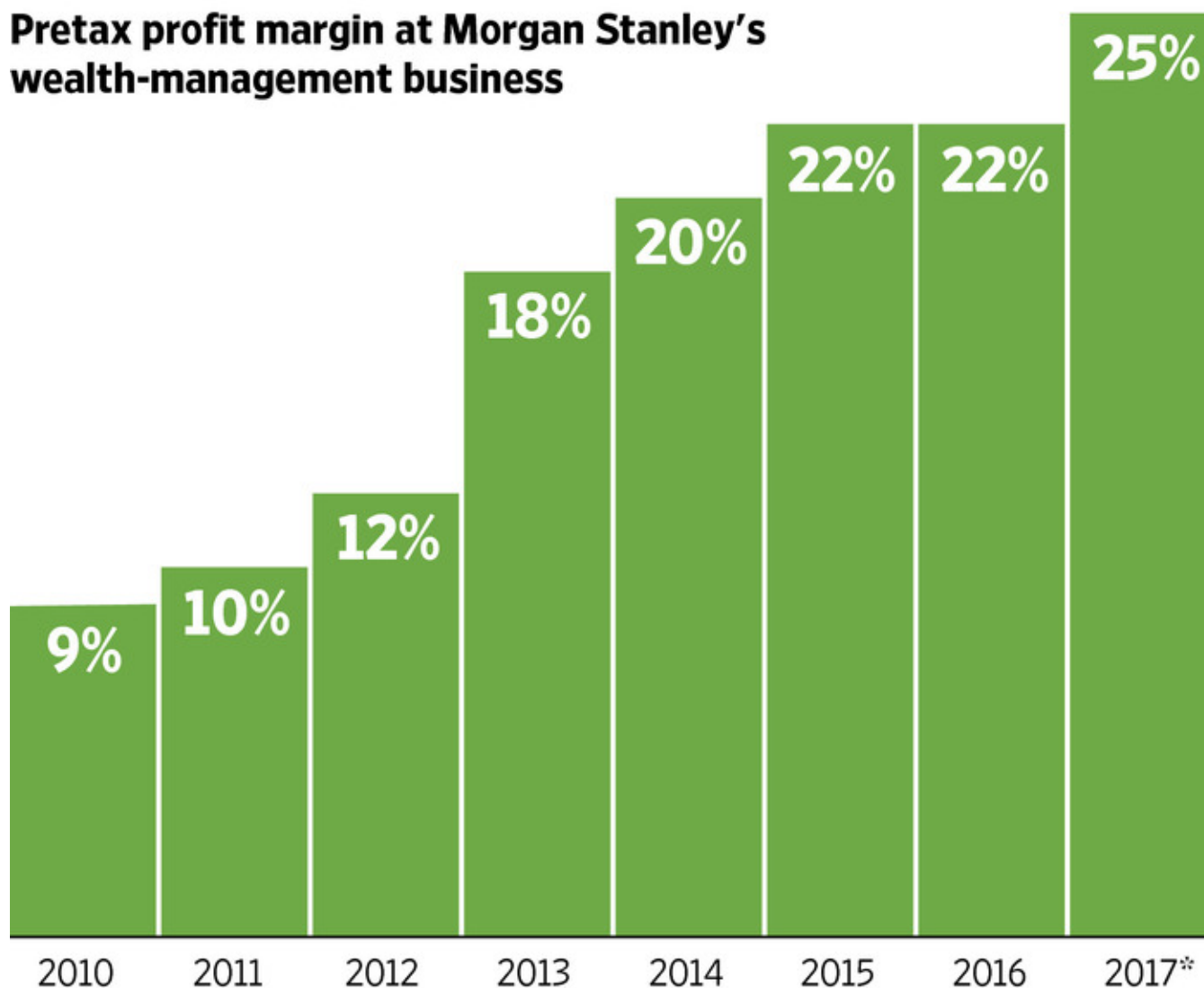
Source: Bloomberg

Stillwater View: Stillwater shares Steve's view, and position, on the short side of the trade. The firm is looking to add Morgan Stanley on the long side at a lower price. Their success in de-risking and growing a larger, more profitable, wealth management unit is part of the appeal.

[Morgan Stanley](#) and [Goldman Sachs](#) reported earnings this week and it was the tale of two money center banks. Post-crisis, Goldman remained focused on traditional trading and investment banking, while Morgan Stanley looked to tack the ship towards the more stable wealth advisory business. This move paid off handsomely for the latter.

Wealth management now makes up 46% of Morgan's revenue with profit's rising 24% year-over-year to \$698 million. Pre-tax margins are now 27%, up from 23% a year ago and single digits following the global financial crisis.

Pretax profit margin at Morgan Stanley's wealth-management business



Source: Morgan Stanley & The Wall Street Journal

[Client lending](#) is a factor that continues to strengthen relationships for Morgan Stanley. CEO James Gorman pointed out on the earnings call that he recently talked to a “multi-hundred-million dollar” client who had no intention of letting his assets follow an advisor who had recently left the firm. Gorman said, “The lending side provides a lot of stickiness with relationships.”

Over at Merrill Lynch, the directive from the head of Wealth Management, Andy Sieg, is to open more accounts, with five per advisor being the goal. Sounds intuitive, right? But the reality inside the walls of Merrill is that the average advisor has opened [less than one](#) new household account over the past year. The five-account target was referred to as a ‘directional prod’ and not a quota.

Merrill Lynch Advertisement Circa 2012



Source: Merrill Lynch

The Nordstrom family is officially [putting off](#) trying to take the company private until next year. The only dance partner the company could find was asking for an interest rate that they felt was too high. The family owns 30% of the shares outstanding.

Moody's top economist, Mark Zandi analyzes what metrics Amazon should be considering as it [narrows down the search](#) for a second headquarters. Austin, Texas has long been considered the favorite, even more so after the purchase of Whole Foods. Final bids were due yesterday with the announcement expected next year. NBC profiled the contenders and why having Amazon choose them ["may ruin your city."](#)

Mark Zandi's Quantitative Score of Where Amazon's Next Headquarters Lands

Top Ten Metro Areas for Amazon's HQ2

Highest ranked metro areas, excluding Seattle

Metro area	Business Environment	Human Capital	Cost	Quality of Life	Transportation	Geography	Avg Score	Rank
Austin-Round Rock TX	4.62	3.27	1.87	3.46	2.21	2.17	3.08	1
Atlanta-Sandy Springs-Roswell GA	3.63	4.32	3.28	2.50	1.67	2.67	3.08	2
Philadelphia PA	3.10	4.05	3.10	2.23	2.87	4.33	3.07	3
Rochester NY	1.75	3.33	4.18	3.13	2.64	3.04	3.01	4
Pittsburgh PA	2.92	3.72	3.49	2.06	2.76	3.98	2.99	5
New York-Jersey City-White Plains NY-NJ	3.26	4.46	0.62	3.83	2.68	3.67	2.97	6
Miami-Miami Beach-Kendall FL	3.64	3.21	2.41	3.24	2.18	2.96	2.94	7
Portland-Vancouver-Hillsboro OR-WA	3.74	2.23	2.05	3.62	2.89	0.98	2.91	8
Boston MA	3.92	4.18	0.79	2.90	2.69	3.48	2.90	9
Salt Lake City UT	4.01	1.85	3.23	2.62	2.73	1.25	2.89	10

Source: Moody's Analytics

Source: Moody's

Stillwater View: Expat Californians in Austin will be pulling hard for the city. An influx of outsiders from the Pacific Northwest and other locales will likely take the heat off as long-time residents can start accusing someone else for failing to "Keep Austin Weird". Book your tickets now for 'Weird-Fest' 2018.

Meanwhile back in Seattle, Amazon took down another 170,000 square feet of downtown office space this week when it leased 300 Pine Street. The building was formerly Macy's anchor property in the Emerald city. In an ironic twist, the retailer will still operate a brick-and-mortar operation from the first floor.

300 Spring Street, Downtown Seattle



Source: Seattle Times

The company currently leases 8 million square feet of office space in the area and a full 20% of all prime downtown Seattle real estate. Last month, Amazon [signed on](#) for more than 700,000 square feet of the [Rainer Square Tower](#), which is currently under construction. When done, it will be the second tallest building in the Pacific Northwest.

The Rainer Square Tower, Completion Date 2020



Source: Seattle Times

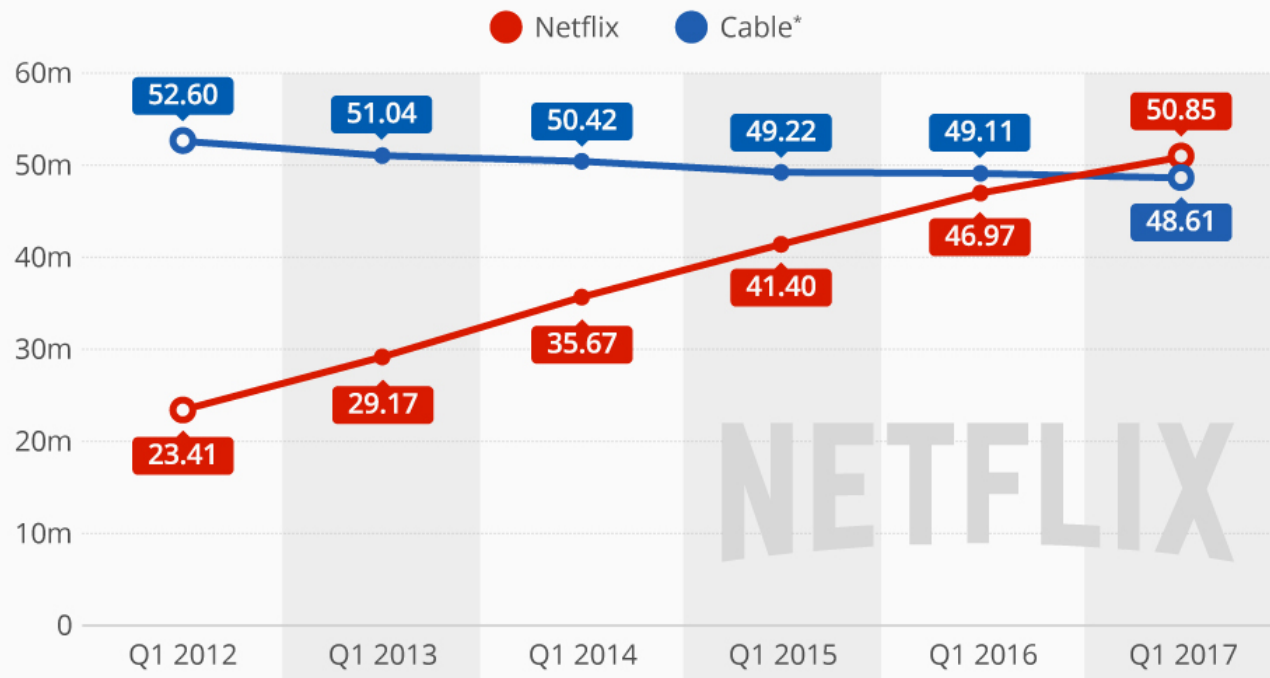
Turns out Nelson Peltz was right when he claimed his proxy fight with Procter & Gamble was [‘too close to call’](#). On Monday, the company announced that Mr. Peltz lost out in his quest for a board seat by 6.2 million votes, a 0.2% margin. Mr. Peltz’s firm, Triun Partners, continues to assert that it’s still in a dead heat and will concede only after an independent arbitrator certifies the results.

Netflix reported another solid quarter of net subscriber additions as Wall Street was expecting 4.5 million and the company gave it 5.3 million. The stock had a subdued reaction, as maybe, *just*

maybe, an ever-expanding [content spending binge](#) is beginning to take some shine off of the shares. Long-term debt has risen 45% since the beginning of the year to \$4.9 billion. The company is forecasting an add of 6.3 million new subscribers in the fourth quarter of this year, down from 7.1 million last year.

Netflix Surpasses Major Cable Providers in the U.S.

Number of Netflix subscribers vs. cable pay-TV subscribers in the U.S. (in millions)



* includes major cable providers accounting for roughly 95% of cable subscribers and slightly less than half of all multichannel pay-TV subscribers



@StatistaCharts

Sources: Netflix, Leichtman Research Group



Source: Netflix & Leichtman Research

Up and Down Wall Street

Next week's edition of *Up and Down Wall Street* will set aside hedge funds and alternative investments and focus solely on factor based investing and the impact it has had on asset allocation. It will chronicle the rise of Dimensional Funds, the proliferation of 'smart beta' ETFs and how all of this has helped spur the growth of the Registered Investment Advisor industry.

[Blockchain Capital](#) has announced the formation of two new funds to target crypto and blockchain opportunities. The firm has already raised \$85 million of its \$150 million target. Capital raised will be invested in companies building on top of the blockchain ledger. Over in the Netherlands, the Taihuttu family is going as ['all in'](#) as you can on crypto and Bitcoin. Selling everything down to

their shoes to get maximum long exposure. While Denmark isn't quite Holland, the ['Tulip Bubble'](#) irony is thick.

Twelve Month Performance of Bitcoin



Source: [CoinDesk](#)

Bloomberg reported that [Glen Point](#), a global macro fund backed by George Soros, was having a banner year. It is up 23% through the end of September on the back of successful wagers on emerging market debt. This is a rebound from 2016 when the fund was down 4.6%

These results are in stark contrast to an otherwise mediocre year for global macro funds, where the average return is 2.5%. Some well-known managers are in the red. The article points out that Brevan Howard's flagship fund is down 4.6%, and Chris Rokos is off 1.2% through September.

Private equity and hedge funds continue to go 'down market' in search of assets. *The Wall Street Journal* reports that Blackstone is targeting the ['millionaire next door'](#) by offering access to the [Blackstone Real Estate Investment Trust](#) with a \$2,500 minimum investment and monthly liquidity. It is managed by the same team that runs the firm's other private real estate pools. The fund charges a 1.25% management fee and collects an additional 12.5% once a 5% profit hurdle is met.

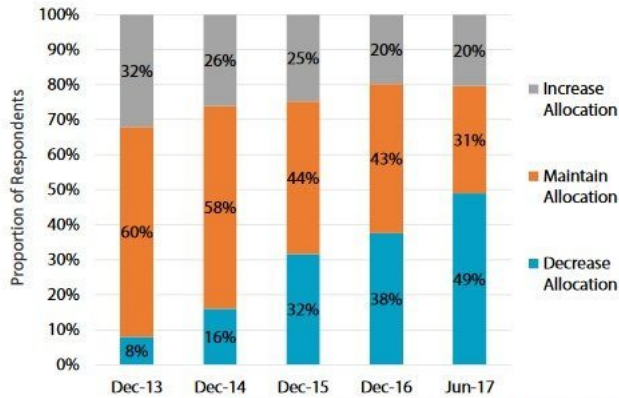
Not to be one-upped, Bridgewater is also talking with partners to offer [low minimum](#) access for smaller institutions and endowments. The *New York Times* reports that institutional consultant, Cambridge Associates, is working on creating a feeder fund to gain access to the otherwise more exclusive offerings from the firm.

Bridgewater's Pure Alpha is down 2% this year and All Weather is up more than 8% through September. Last month, *Business Insider* reported the [not-so stellar](#) returns for some of the larger hedge funds.

The *Wall Street Journal* reports that Lee Ainslie’s Maverick Capital will offer a [0% performance fee](#) option for existing clients who want to add capital. His flagship fund lost 10% last year and is down another 2% in 2017. Maverick has a 1.75% management fee and 17.5% carry for most new money.

Allocations to Hedge Funds Continue to Decrease

Fig. 4.8: Investors’ Intentions for Their Hedge Fund Allocations in the Next 12 Months, 2013 - 2017



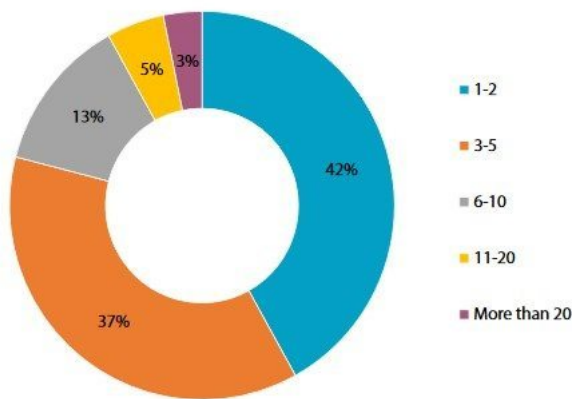
Source: Prequin Investor Interviews, December 2013 - June 2017

Fig. 4.9: Amount of Fresh Capital Investors Plan to Invest in Hedge Funds over the Next 12 Months



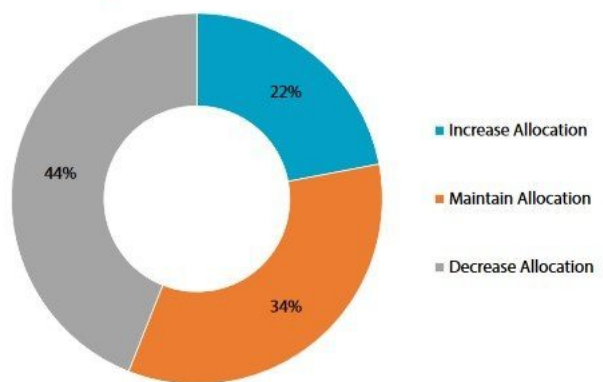
Source: Prequin Hedge Fund Online

Fig. 4.10: Number of Hedge Funds Investors Expect to Add to Their Portfolios over the Next 12 Months



Source: Prequin Hedge Fund Online

Fig. 4.11: Investors’ Intentions for Their Hedge Fund Allocations over the Longer Term



Source: Prequin Investor Interviews, June 2017

Source: Prequin

Diversions

The Los Angeles Dodgers punched their ticket to the World Series for the first time in 29 years with a [big win](#) over the Chicago Cubs last night. Kike Hernandez had a major league tying [three home run](#) game. Fox Sports quickly dubbed Puerto Rico’s Hernandez as Senior Octubre in deference to the original Mr. October, Reggie Jackson.

[The Yankees](#) can close-out the Houston Astros with a win later today. Expect the people at Fox, and every other media outlet on earth, to be pulling for the boys in pinstripes. The Yankees and Dodgers have met eleven times in World Series. The last was in 1981.

The Only Thing Kike Hernandez Missed Last Night Was Yasiel Puig's High Five



Source: Sports Illustrated

Things are tough all over in the restaurant world as New York's [Le Cirque](#) is set to serve its last meal on December 31st after having filed for bankruptcy earlier this year. This week, Romano's Macaroni Grill joined them, going BK themselves. Macaroni Grill was no surprise as the market for grilled macaroni is finite. While the two sit at opposite ends of the dining spectrum, it's a telling sign that tastes are changing.

Meanwhile, Danny Meyer continues to run two laps ahead of the pack with the "fine casual" experience he provides at [Shake Shack](#). In his [60 Minutes](#) interview with Anderson Cooper Meyer said, "we are sometimes as mystified as everyone else by the success". Here is the math behind the concept: 80% of the quality of fine dining, 80% less money you are going to spend, while saving you 60% of the time.

The Original Shake Shack in Madison Square Park



Source: *New York Times*

Stillwater View: Being an ardent fan of the In-N-Out [Double-Double](#), it was tough to give the Shack Burger and Danny Meyer the credit they deserve. While this author still has his favorite, the one born in Southern California, kudos to the man for mastering the craft of his chosen profession. Buy the burger, not the stock (NYSE:SHAK).

Augusta National Golf Club has a new chairman, effective this week, as [Fred Ridley](#) took over for Billy Payne. Ridley won the 1975 U.S. Amateur and is the first member to have both played in the tournament ('76, '77 and '78), and [ascend to the chairmanship](#). He was matched with Jack Nicklaus in the first round of the 1976 Masters.

Billy Payne with Fred Ridley at the 2016 Masters



Source: Golf

The Natural History Museum in London released the winners of their 2017 [Wildlife Photographer of the Year](#) awards. The competition was broken up into [adult awards](#), [young awards](#) and a [grand title](#) winner for both groups.

Sperm Whales Gathering off the Coast of Sri Lanka – Tony Wu, Photographer



Source: Natural History Museum of London & Business Insider

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