



**The Top- Down**

Appaloosa Management’s David Tepper provided fodder for the bulls this week when he chimed in on CNBC that with the tax cuts in place, the equity markets are only as expensive as they were when we kicked off 2017.

Tepper said, "Explain to me where this market is rich? It's not rich with the tax thing that just changed earnings projections. With earnings forecasts going up and interest rates where they are, how is this market expensive?" He would go on to say, "I don't see the overvaluation. World growth is higher."

*Stillwater View: Tepper has been far more right than wrong during long portions of the equity market rally, so his counsel is well worth listening to. He is also genuinely entertaining and gives great interviews on the rare occasions when he does appear live.*

With calendar year 2017 in the books and 2018 now open for business, it’s time once again for Jeff Gundlach’s annual ‘Just Markets’ presentation, to be held next Tuesday, January 9<sup>th</sup> after the markets close. Unique to this call is that it’s free from the discussion of DoubleLine strategies, giving Mr. Gundlach the advantage of a wide berth to make his market views public.

**DoubleLine Just Markets**



Source: DoubleLine

*Stillwater View: 'Just Markets' has become an attendance required event for investors, as Mr. Gundlach's thoughts are often provocative, able to move markets, and have proven to be very profitable. His firm has over \$100 billion in assets to validate that point. Register and listen as the market master takes you on a macro tour around the globe.*

*In case you're wondering, the chart heavy nature of 'This Week in the Markets' was inspired in part by Gundlach's work. Over under on how many references are made to his hometown Buffalo Bills: three.*

### **Those 'Krazy', Long Suffering, Bills Fans**



Source: New York Magazine

Blackstone's Byron Wien released his annual ten surprises for the coming year. A 'surprise' is an occurrence where the market is only ascribing a 30% chance of something happening, whereas Byron predicts a greater than 50% chance of it coming to fruition.

*Stillwater View: Now in its 33<sup>rd</sup> year, a reading of Wien's surprises is a ritual for many on Wall Street. 'Surprises' four through seven appear more likely to occur than the 50/50 chance given, at least in Stillwater's humble opinion.*

4. The U.S. economy has a better year than 2017, but speculation reaches an extreme and ultimately the S&P 500 has a 10% correction. The index drops toward 2300, partly because of higher interest rates, but ends the year above 3000 since earnings continue to expand and economic growth heads toward 4%.
5. The price of West Texas Intermediate Crude moves above \$80. The price rises because of continued world growth and unexpected demand from developing markets, together with disappointing hydraulic fracking production, diminished inventories, OPEC discipline and only modest production increases from Russia, Nigeria, Venezuela, Iraq and Iran.
6. Inflation becomes an issue of concern. Continued world GDP growth puts pressure on commodity prices. Tight labor markets in the industrialized countries create wage increases. In the United States, average hourly earnings gains approach 4% and the Consumer Price Index pushes above 3%.
7. With higher inflation, interest rates begin to rise. The Federal Reserve increases short-term rates four times in 2018 and the 10-year U.S. Treasury yield moves toward 4%, but the Fed shrinks its balance sheet only modestly because of the potential impact on the financial markets. High yield spreads widen, causing concern in the equity market.

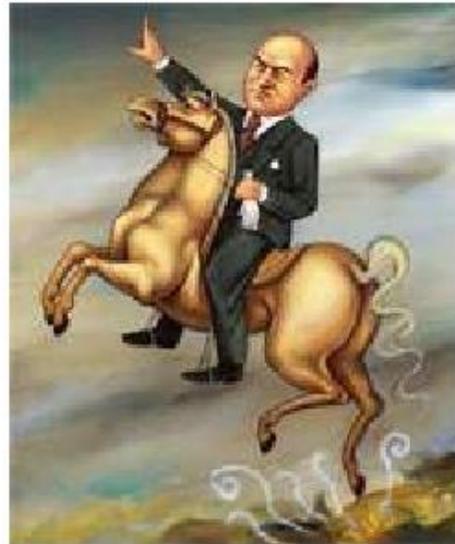
#### Best 'Also Ran'

15. The regulatory authorities in Europe and the United States finally get concerned about the creative destruction of Internet-related businesses. As a result of pressure from retailers and traditional media companies, they begin an investigation of anti-competitive practices at Amazon, Facebook and Google. The public begins to think these companies have too much power.

#### **Joseph Schumpeter on Creative Destruction**

## Joseph Schumpeter

*In capitalism, innovative entry by entrepreneurs was the force that sustained long-term economic growth, even as it destroyed the value of established companies that enjoyed some degree of monopoly power.*



8 February 1883 – 8 January 1950

Source: The Economist

With equity markets continuing their fearless tear early in 2018, it's smart to put the macro setup in perspective. To help frame the conversation, let's compare the economic and market cycles to flight from Los Angeles to New York.

You have a long takeoff, ascension to cruising altitude, bumps over the Rockies, a nice long stretch over the plains, and finally a touchdown on the edge of the Atlantic. While our current location can't be pinpointed on the map, most think we are somewhere east of the Mississippi. With some even calling for final approach into JFK.

The craft taking us along for the ride has engines. Four big fancy engines that have been running very smooth as of late. Pulling in rare air, firing it with fuel and blasting it out the back. Propelling the markets to new heights every day.

### **Climbing Through Rare Air**



Source: Boeing

While we could pick any number of indicators to give us a read on how well the engines of the economy are performing, we choose to use the employment condition, earnings growth, the treasury yield curve, and the leading economic indicators (LEI) as our proxies.

We will explore each indicator this January, with this week dedicated to the employment engine. A timely subject given that the Labor Department released the December reading this morning and the positive momentum continues, albeit it at a slower pace as the economy added 148,000 jobs last month against expectations of 190,000. The unemployment rate held steady at 4.1%. This was the 87<sup>th</sup> consecutive month of job growth in the United States.

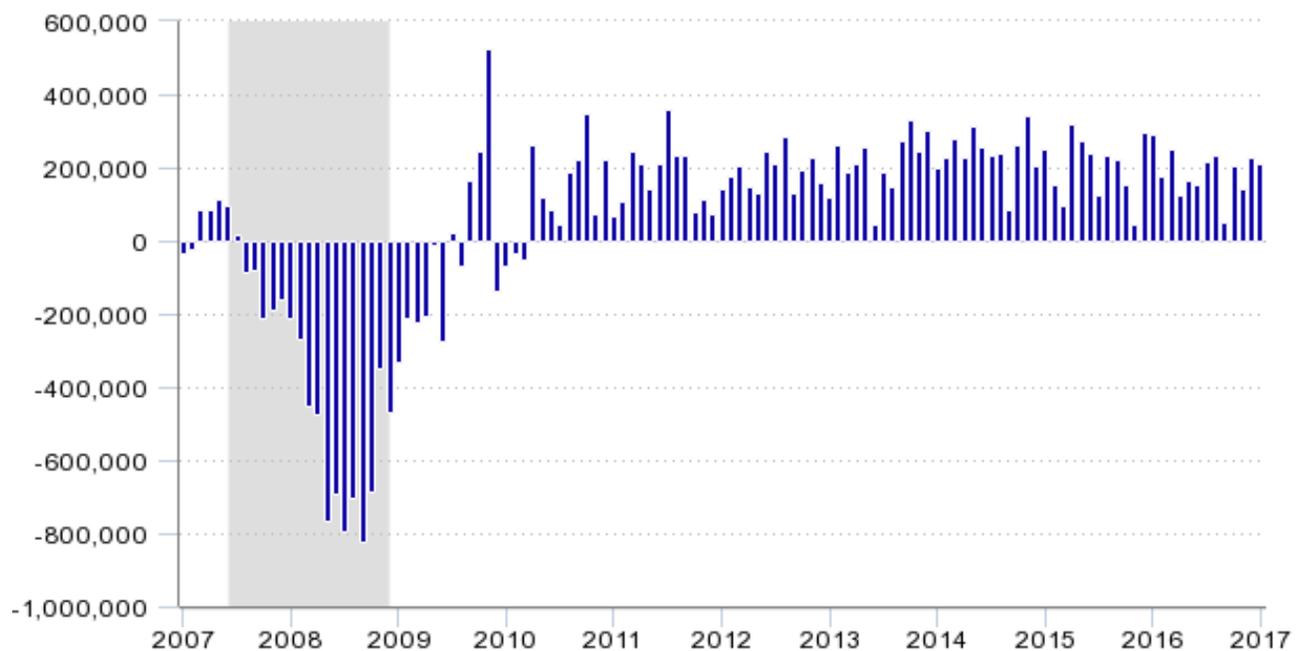
### Domestic Unemployment Rate 1950 – 2017 with Recessions in Grey



*Stillwater View: With 70% of GDP being driven by consumer spending, employment is clearly a measure that heavily influences markets. Looking back to the spring of 2009, the economy looked flat on its back with the referee not only giving it a ten count, but also last rights.*

*Subsequently, in April something changed at the margin. While still an awful print at a loss of 687,000 jobs, it was an improvement from the 823,000 jobs lost in the month prior. One month later that number would shrink to 349,000 jobs lost. This would help put the bottom in for the equity markets and summons those brave enough to conjure their animal spirits and join the 'risk on' trade.*

### **Month Over Month Change in Payrolls – 2007 to Present**



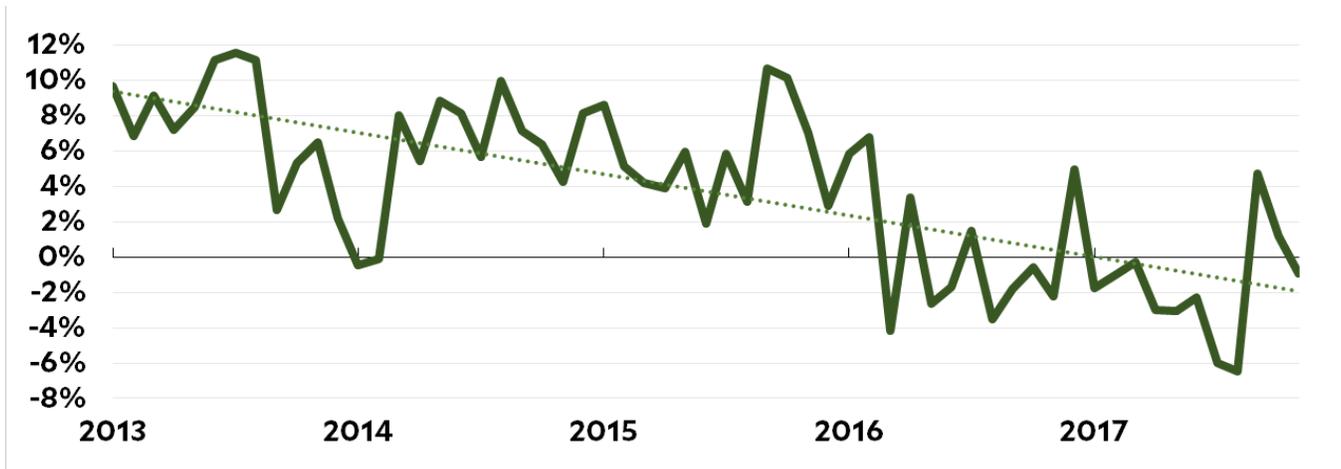
Source: The Bureau of Labor Statistics

### **The Bottom-Up**

Wall Street spent much of the week focused on the top-down, as earnings won't start to be reported in earnest until later this month. Or in news media parlance, it was a slow one.

It was tough news for the automobile sector once again as the *Wall Street Journal* reported that while profitability might still be on the upswing, volume trends continue to deteriorate.

### **Monthly Auto and Light Truck Sales**



Source: Bureau of Economic Analysis

Meanwhile, Tesla's near-term woes continue as the Model 3 production ramp got pushed out once again. *Wired* and the *New York Post* both covered the story of how plans for a 5,000 per month build rate have been pared back to 1,000.

### Tesla Model 3



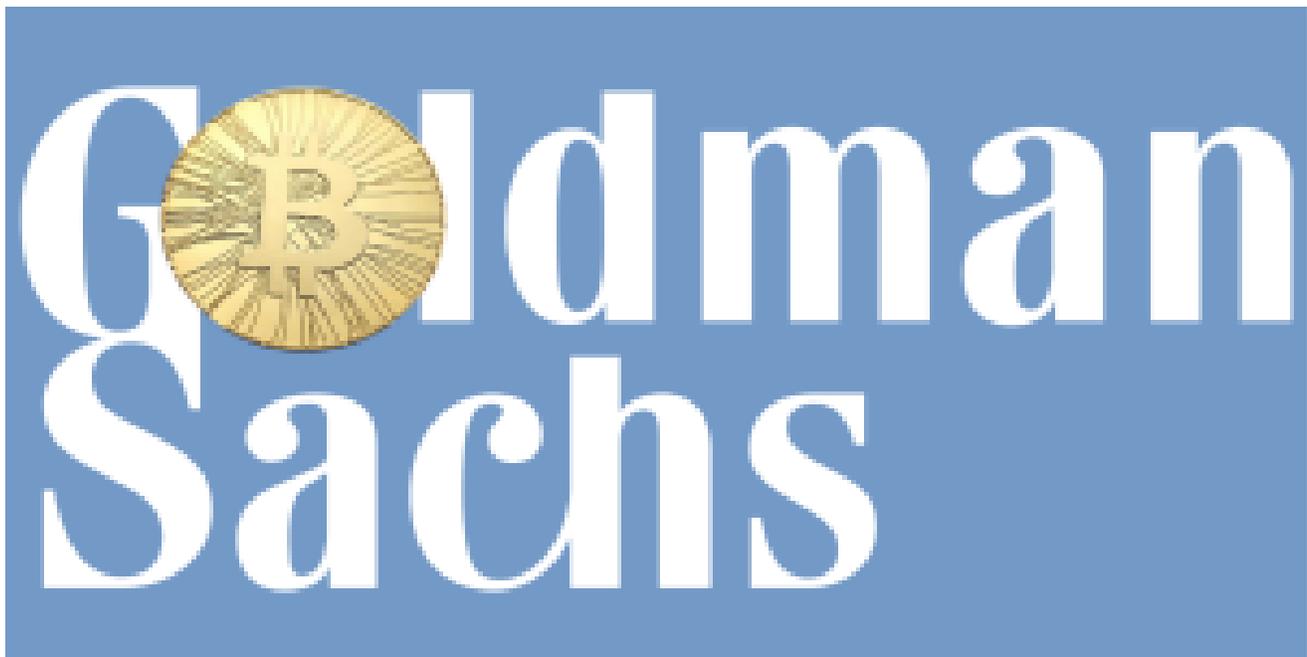
Source: Wired

*Stillwater View: In an ongoing effort to find profitable short opportunities, Stillwater has maintained a negative position in Ford, General Motors and Tesla in part for the issues mentioned above. The positions are flat, with limited gains to show for the effort. In this environment, where images of 4% to 5% GDP growth dance in the mind of the market, sadly that's a win. Given the relentlessness of this rally, flat is now the new up when it comes to shorting.*

### **Up & Down Wall street**

Citing suitability risk, Merrill Lynch banned the trading of Bitcoin related investments this week. Including the Greyscale Investment Trust, a popular cryptocurrency derivative product. In related news, a crypto parody named Dogecoin now has a \$1 billion valuation. And Dealbreaker lays out the new math for cryptocurrency hedge funds. Work at Goldman + Start a Crypto Fund = Profit.

### **Goldman + Bitcoin**



Source: Dealbreaker

*Stillwater View: Enjoy this Theater of the Absurd while it lasts. Stillwater holds no position on one side or the other but is having a great time watching it all play out.*

CNBC provides a great view inside what an old school mutual fund machine looks like when it profiled Ron Baron and his mutual fund company, Baron Capital. Against a tidal wave of outflows into ETFs and struggling performance, the growth fund company still holds roughly \$24 billion of high fee paying assets.

*Stillwater View: The mutual fund industry, and its requisite fund boards, have long been the fodder for 'buyer beware' exposes. This article touched only the tip of the trillion-dollar iceberg. One that has existed for a very long time. No wonder assets are flowing to ETFs. As hedge fund legend Leon Cooperman once said, capital goes to where it is treated best.*

### **Fund Manager Ron Baron with Elon Musk in 2015**



Source: Baron Capital

### **Diversions**

The long and winding college football road ends on Monday night, when the Georgia Bulldogs take on the Alabama Crimson Tide in an all SEC title game. *The Wall Street Journal* points out that the 'We Want Bama' mantra the Bulldogs have adopted hasn't really been working out all that well...for anyone.

### **Georgia Squares Off Against Alabama**



*Stillwater View: While most of the country's heart, including ours, is pulling for a Georgia win, the head says otherwise as this is just what Alabama does. Stays in it long enough while everyone around them exhausts themselves, and then steps in to deliver on the promise of being the perennial best in the land. And with Georgia pulling off the double overtime win against Oklahoma last week, it looks as though it's going to happen again. Roll Tide!*

The stories and images of the arctic blast hitting our country were nothing shy of surreal. The magnitude of the Northeast portion of the storm is shown here from space.

### **The 'Bomb Cyclone'**



Source: The New York Times

A Singapore Airlines A380 was diverted from JFK to tiny Stewart International when the storm shut down New York.

**An A380 on the Tarmac at Stewart ‘International’**



Source: SWFairport

Meanwhile down in the Sunshine State, semi-frozen iguanas are falling out of palm trees as the temperature is dipping below 40 degrees.

### **A Stunned Iguana Warms Up Poolside in Boca Raton, Florida**



Source: The New York Times

*Stillwater View: Stay Safe. Stay Warm. And watch out for ice cold flying reptiles.*

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