

Stillwater Capital - This Week in the Markets

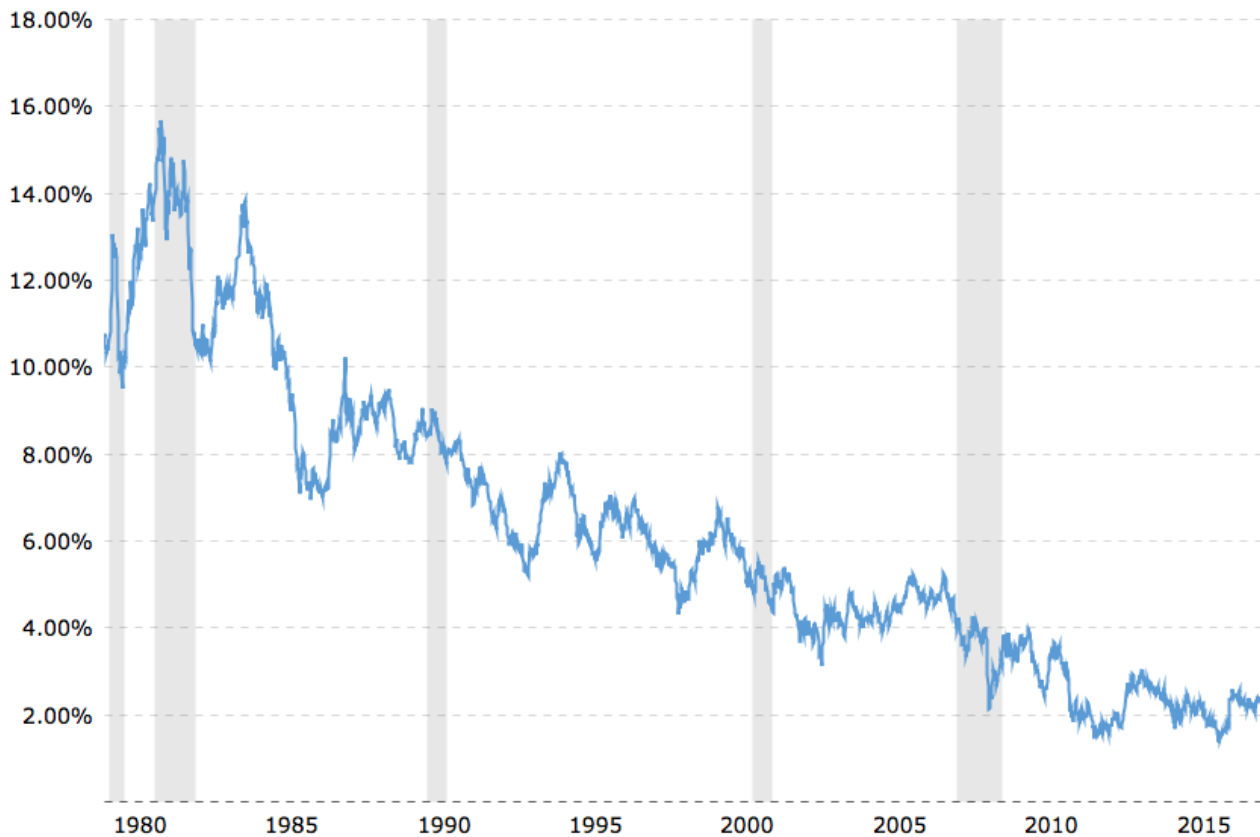


The Top- Down

Rates continue to grab the headlines, each increase creating real headwinds within the equity markets. Floor veteran Art Cashin, is not alone in his prediction that 3% is the near-term line in the sand where ‘all hell could break lose’.

Long-time market technician Louise Yamada joined the ‘rates are headed higher’ chorus when she shared her view that the 36 year old bond bull market is officially over.

10-Year Treasury Yield



Source: Macrotrends

Stillwater View: The markets love a round number, and 3.0% is the obvious choice. Next stop, 3.5%, and then finally 4%, where 'all hell' really could break loose.

Rates are headed higher, as CPI and wage inflation are starting to show signs of inflation creeping in. But if you can fog a mirror, chances are you can see inflation developing all around us.

While this isn't the end of our bull market, it is certainly feels like the beginning of the end. Similar to a wildfire, new life will spring from the ashes of our next bear market. Just make sure you have a plan to weather it and emerge on the other side.

Bridgewater's Ray Dalio believes there is a 70% chance of a recession developing before the next presidential election. During a recent engagement hosted by Harvard's Kennedy School of Management, Dalio said, "I think we are in a pre-bubble stage that could go into a bubble stage ... The probability of a recession prior to the next presidential election would be relatively high, maybe 70 percent."

S&P 500 – Recessions in Grey

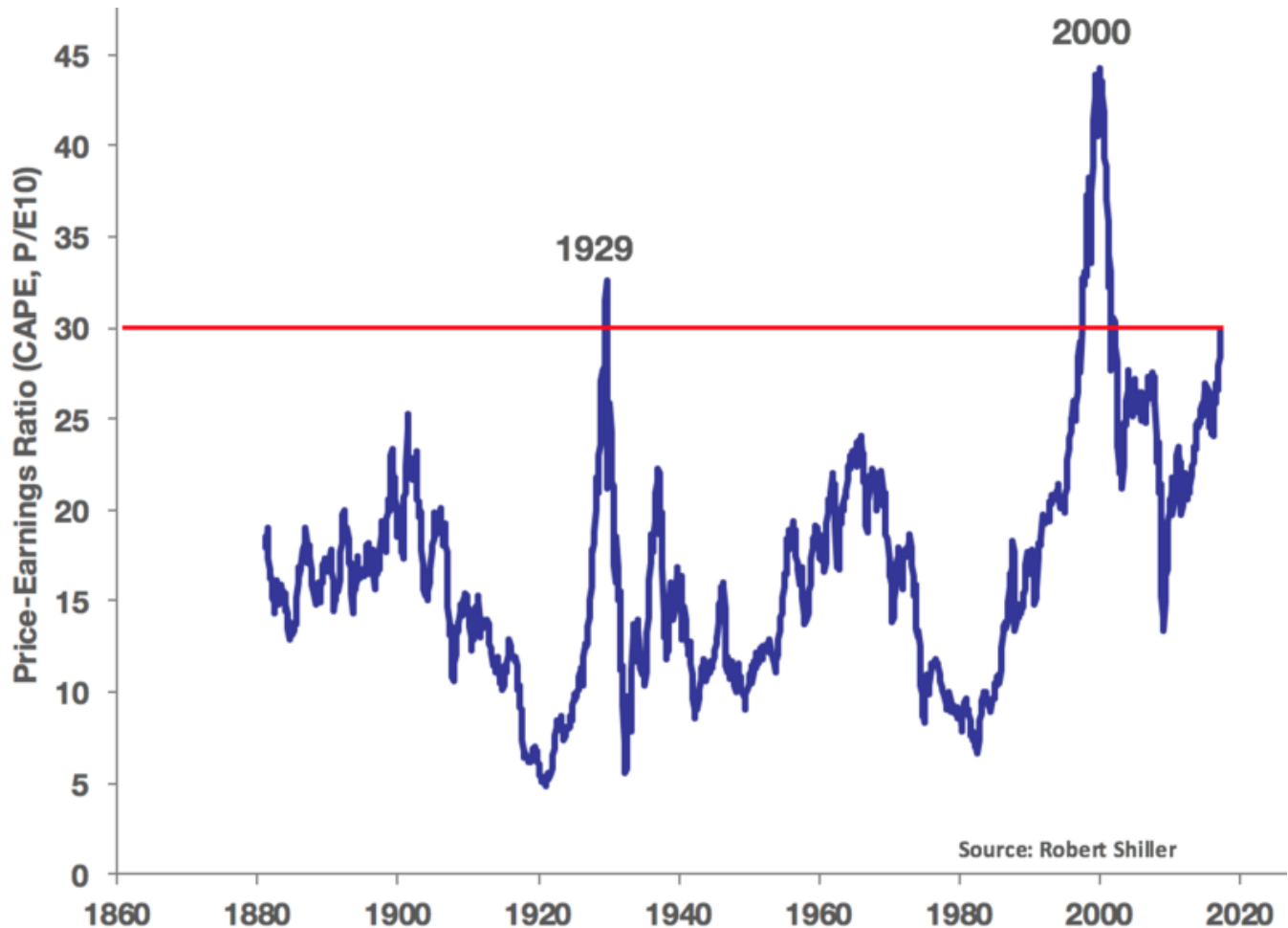


Source: Macrotrends

Stillwater View: A recession is on the way. How do we know? Because there is always one on the way. It's just a matter of time. While this expansion is getting long in the tooth and valuation reflects it, it's difficult to find evidence suggesting 2018 is the year one shows up.

Ray went on to opine that there is a propensity shown by the masses to make the wrong interpretation about markets and valuation. "The greatest mistake of the individual investor is to think that a market that did well is a good market rather than a more expensive market,"

S&P 500 Cyclically Adjusted Price-Earnings (CAPE) Ratio: 1871 – 2017



Source: Robert Shiller & Bloomberg

Stillwater View: For those of us who are skeptical bulls, present company included, valuation is indeed a challenge. Even with the tailwind of a strong economy and tax reform acting as additional stimulus, some consider current prices to still be irrational. But as Keynes once said, 'markets can stay irrational longer than you can stay solvent'.

The Bottom-Up

The biggest news of the week from the *Bottom Up* came from Walmart and their fourth quarter earnings release on Tuesday night. Wall Street was unimpressed, as online sales slowed from 50% growth to 24% in the period. The news took the widely held stock down 10%.

Walmart v. Amazon



Source: Nasdaq

Industrial conglomerate United Technologies stock moved higher this week, on comments from CEO Greg Hayes that a breakup of the company might certainly be on the table.

UTC Business Units

UNITED TECHNOLOGIES

\$58.7B revenues; seven business units



Heating, ventilating, cooling & refrigeration systems



Clean power, cooling / heating solutions



Industrial & aerospace systems



Aircraft engines, gas turbines & space propulsion systems



Helicopters



Elevators, escalators, moving walkways, people movers & horizontal transportation systems



Security & fire protection services

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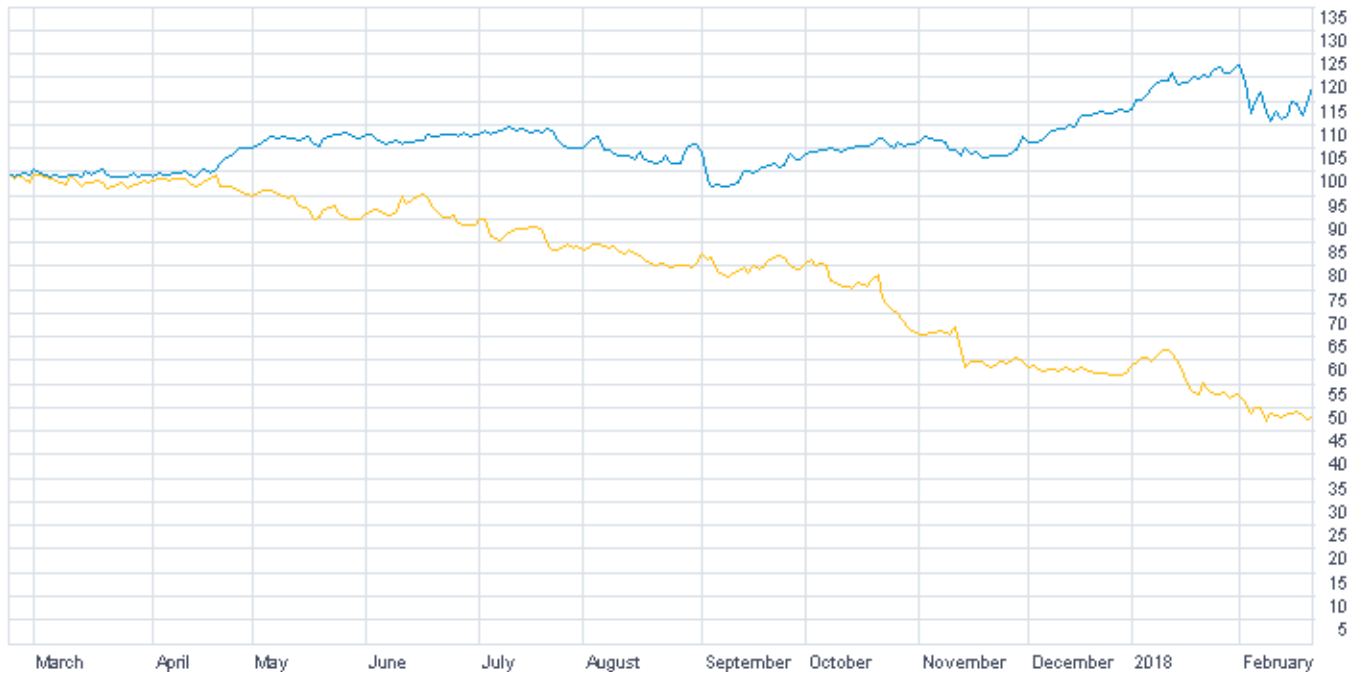
Source: United Technologies

Stillwater View: Having covered UTX as an analyst and portfolio manager, I can attest to the frustration imbedded in each business unit. Rarely were all cylinders of the company been known to fire simultaneously.

Should aircraft engines be rolling out the factory door, Sikorsky helicopters margins would be getting crushed by contracts gone bad. If Carrier air-conditions were selling out, Otis elevator would be experiencing a slowdown in recurring maintenance revenue.

Having said all of this, United Tech is still one of the most well run industrial conglomerates out there. This year it's the envy of every General Electric shareholder.

United Technologies v. General Electric



Source: Nasdaq

Bloomberg credits [Kylie Jenner](#) with wiping out \$1.3 billion from Snap Inc's market value this week when she told her followers that she was over the app, causing shares of SNAP fall. Jenner Tweeted 'sooo does anyone else not open Snapchat anymore? Or is it just me... ugh this is so sad' on Monday.

The Modern 'Influencer' Family



Source: eOnline

Stillwater View: While this author may be in the very small minority, he still don't understand the KardashaJenners. And he's at peace with that.

Up & Down Wall Street

CalPERS, the Golden State's public employee retirement plan, lost a cool \$15 billion in the mid-February market correction. The good news for contributors and beneficiaries is the 4.6% drawdown was roughly half of the overall equity market decline.

The other positive news for state employees is that regardless of performance, the plan is backstopped by taxpayers to make up for performance shortfalls. Daniel Bornstein wrote about the issue in a sobering commentary that ran late last year in the *San Jose Mercury News*

California's Top Employee Beneficiaries

TOP 10 MOST HIGHLY COMPENSATED CALPERS RETIREE PENSIONS



| PAYEE NAME | AGENCY AT RETIREMENT | YEAR RETIRED | ANNUAL PENSION | YEARS OF SERVICE |
|------------------|--|--------------|----------------|------------------|
| MICHAEL JOHNSON | COUNTY OF SOLANO | 2011 | \$390,485 | 42.9 |
| STEPHEN MAGUIN | LOS ANGELES COUNTY SANITATION DISTRICT NO. 2 | 2012 | \$345,408 | 41 |
| JOAQUIN FUSTER | UNIVERSITY OF CALIFORNIA AT LOS ANGELES | 2002 | \$340,632 | 45.2 |
| DONALD GERTH | CALIFORNIA STATE UNIVERSITY AT SACRAMENTO | 2003 | \$319,404 | 47.3 |
| WILLIAM GARRETT | CITY OF EL CAJON | 2004 | \$313,404 | 38.5 |
| JAMES STAHL | LOS ANGELES COUNTY SANITATION DISTRICT NO. 2 | 2007 | \$303,420 | 37.7 |
| GLENN SOUTHARD | CITY OF INDIO | 2010 | \$293,640 | 38.7 |
| JOHN SCHLAG | UNIVERSITY OF CALIFORNIA AT LOS ANGELES | 2005 | \$293,604 | 45 |
| RANDY ADAMS | CITY OF BELL | 2010 | \$293,868 | 38.5 |
| JULIUS SCHACHTER | UNIVERSITY OF CALIFORNIA AT SAN FRANCISCO | 2008 | \$279,720 | 47.5 |



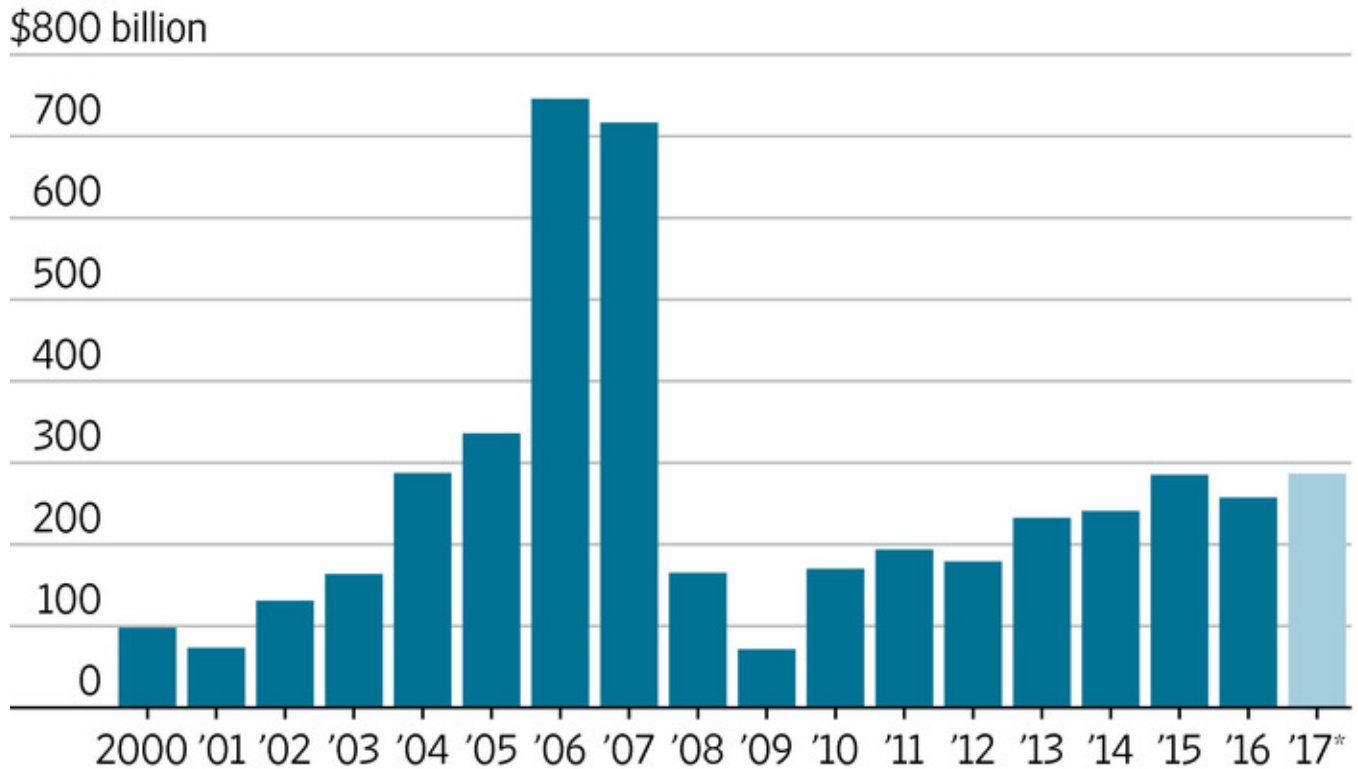
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Source: Forbes

Stillwater View: If you are at all queasy or nervous about the future unfunded liabilities at public pension plans, you may want to take the 'cover your eyes' approach on this one.. The reality is that the ship has left the harbor and is cruising towards a future rendezvous with a very rocky shore. With a heavy pro-public employee legislature in place, the likelihood of any meaningful pension reform coming out of Sacramento is slim to very none.

The Wall Street Journal reported that Goldman Sachs raised \$2.5 billion for a 'permanent capital' fund that will be used to buy stakes in private equity firms. Permanent capital funds, or evergreen funds as they are also known, do not have exit dates for holdings, and provide pensions, endowments, and the ultra-wealthy with a form of direct investment into the buyout world.

Total Value of Leveraged Buyouts



Source: Dealogic and the Wall Street Journal

J.P Morgan is planning on tearing down it's Park Avenue headquarters with plans to build something more modern at the same location. The building was acquired in 2008 when Jaime Dimon went shopping for real estate and got Bear Stearns thrown in for free.

J.P, Morgan Headquarters on Park Avenue



Source: Quartz

Diversions

The United States women's hockey team ended a twenty year drought on Wednesday when they beat Canada for the gold in an overtime shootout.

U.S.A Women Bring it Home



Source: The Wall Street Journal

Not to be one upped, the men's curling team took out our heavily favored friends to the north in the semi-final round of 'bocce on ice'. Sports Illustrated calls this band of misfits the 'Cinderella story' of these games.

The United States Curling Team



Source: Seattle King Five News

CNBC provides you with six Winter Olympic venues where you can participate in winter sports right along with where the athletes did.

Lake Placid, New York



Source: The New York Times

From the theater of the absurd, a new product called Petcube recently debuted. Similar to a nanny cam, it allows owners to keep tabs on their furry loved ones from afar. The product [demo video](#) is brilliant. Fair warning, this is not a *Saturday Night Live* skit! As much as it may resemble one.

As one might expect, venture capitalists and Wall Street bankers are enamored with the ‘Connected Pet’ space. The intersection of connected home and...pets.

‘Chuck’ the Lab Waits for His Treat



Source: Petcube

Stillwater View: Thank you, Silicon Valley! Thank you!!! The innovation you bring to the table continues to push the envelope.

Michael Dell got out his oversized wallet and wrote a \$100 million check for a 10,000 square foot condominium on Manhattan's billionaires row. The sale price is the richest ever paid in the city.

Dell's Manhattan Residence Looking up the Hudson



Source: The Wall Street Journal

Stillwater View: Born out of a dorm room at the University of Texas, the direct to consumer PC maker founded by Dell changed the way we purchased computers. 'Tell us what you want, give us cash, and we will make sure it arrives on time'. No more obsolete hardware on the shelves.

'Easy to buy, easy to own, easy to Dell' worked, and worked well. While we were all 'getting a Dell', Michael was living the dream and getting rich doing so. Really, really, rich. Hook Em' Horns.

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