

Stillwater Capital - This Week in the Markets



The Top- Down

Markets digested their first 'Orange Swan' event of the year this Thursday, when President Trump announced the imposition of tariffs on imported steel and aluminum. Sparking concerns of a global trade war, something the president thinks are 'good and easy to win'.

Steel Smelting in Germany



Source: New York Times

While supportive of his deep blue state base, the market quickly priced in the pass through impact and the emerging threat of action against the United States.

CNBC's political reporter John Harwood provides a look at how the decision played out while the global reaction certainly wasn't pretty. The *New York Times DealBook* provides a quick and dirty analysis.

The current plan: A 25 percent tariff on steel and a 10 percent one on aluminum.

The winners: U.S. sellers of industrial metals, like AK Steel and U.S. Steel, whose stocks jumped yesterday; trade hard-liners like Wilbur Ross, the commerce secretary, Robert Lighthizer, the White House's top trade negotiator, and Peter Navarro, its trade policy guru.

The losers: Big metal consumers like Ford, G.M., Boeing and United Technologies; free-trade proponents like Gary Cohn, who has threatened to resign; many Republican lawmakers; Brazil; and Canada.

The world's response: China could retaliate with tariffs on some U.S. goods. The E.U. could, too. Japan and Korea are hoping that, as allies, they would be exempted — but they appear prepared to fight back.

The context: George W. Bush imposed tariffs on imported steel in 2002. He lifted them a year later.

Peter Eavis's take: Mr. Trump's tariffs may be quite narrow in focus and exist for a relatively short period. Investors could learn to live with those. But the U.S. economy and stock markets have some vulnerabilities that could magnify the damage from a trade war.

Stillwater View: The Street knew it could happen, just not when. Gary Cohn lost on this one, as did sensibility and the markets, at least for now. Our biggest concern isn't the tariffs themselves but a market that is still heavily levered with derivative positions.

The economic research team at Goldman Sachs put together a stress test of outcomes should a rate rise get out of hand. The results shouldn't surprise anyone. Their work concludes that a spike in yields to 4.25% would lead to a 25% correction in the S&P.

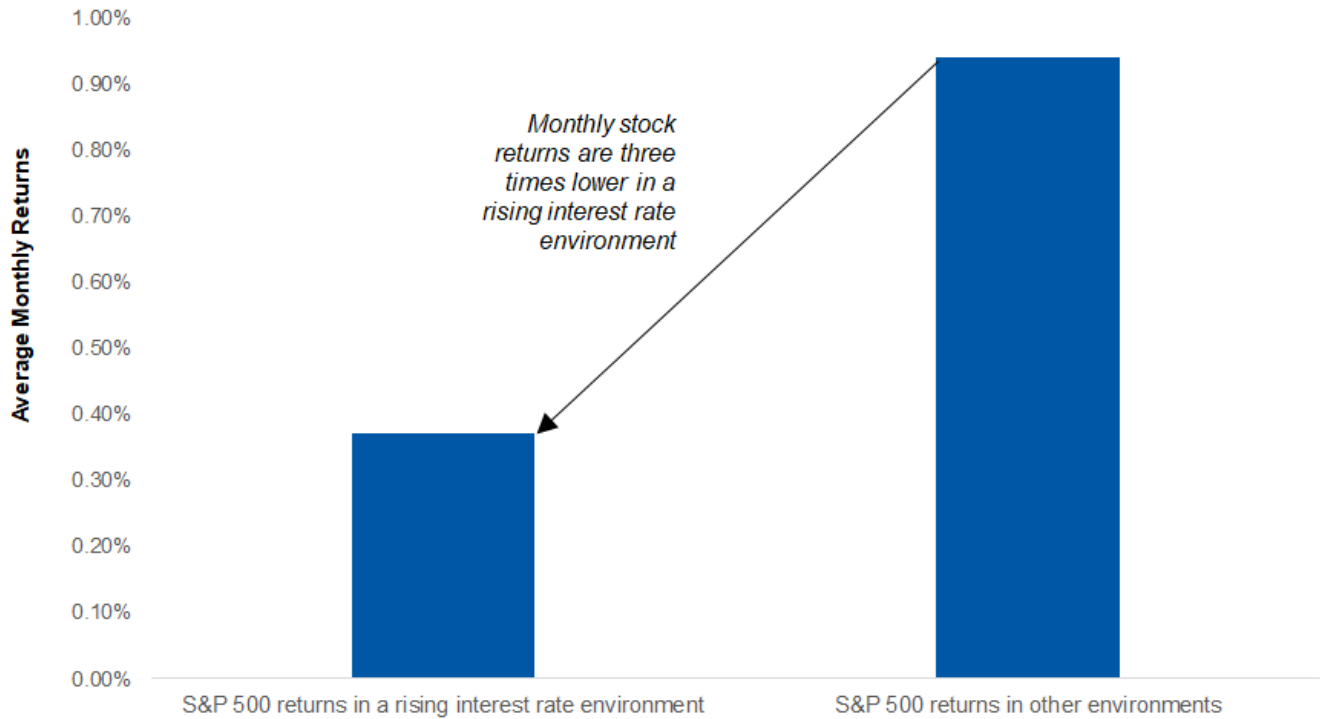
S&P 500 v. **10-Year Yield**



Source: Goldman Sachs & Bloomberg

Stillwater View: Best quote we heard all week was 'If you are afraid that stocks are going down, and that it's going to be caused by higher rate, sell some stocks!'. Rates are headed higher. And when they do, equity returns will face a headwind.

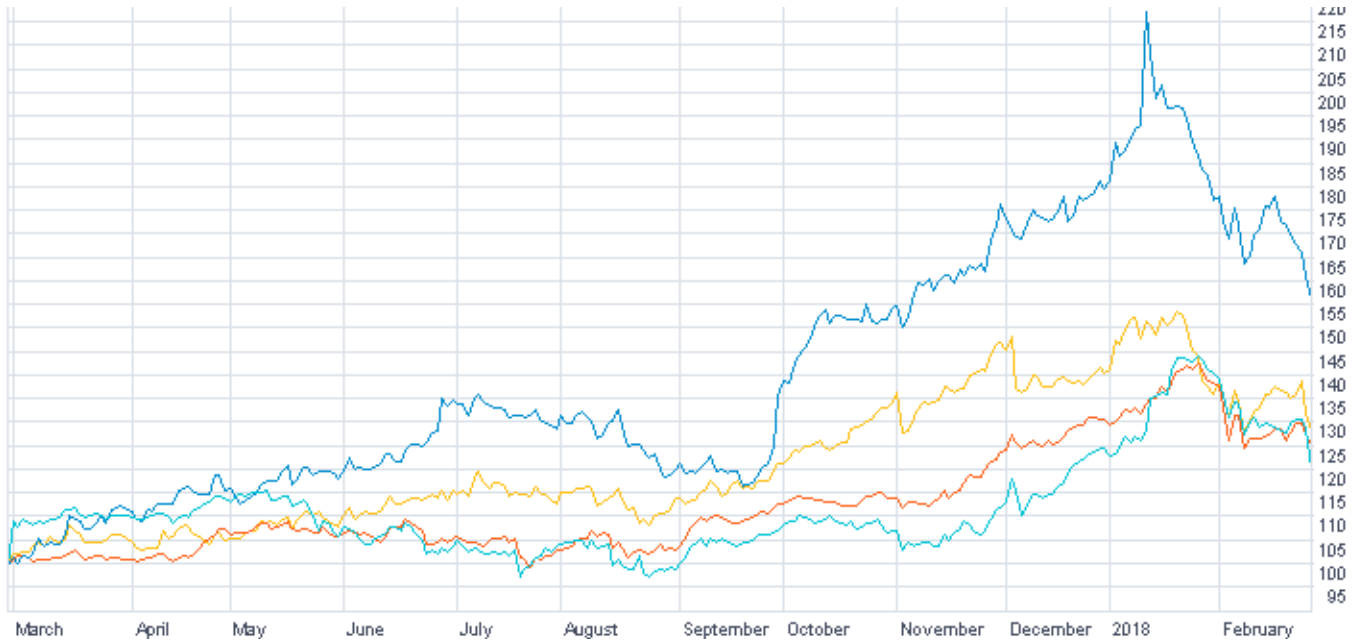
Diminished Returns as Rates Rise



Source: Value Walk

After a significant rally in January, the housing sector has taken it on the chin as rates increased. And the headlines responded with a roar. “Higher Mortgage Rates Crushing Housing” from *Seeking Alpha*, “Rising Mortgage Rates Hit New Home Sales Hard” at *CNBC*, and this kiddie pool shallow one from *Fox Business News...* “Higher Interest Rates Can Tip the Housing Market, Yale’s Shiller Warns.”

KB Home, Toll Brother, Home Depot, Lowes



Source: Nasdaq

The cost of capital is on the rise for those looking to buy a home or refinance. And that can't be good for business given the elevated valuation.

30-Year Mortgage Rates



Source: CoreLogic

Stillwater View: If you are afraid higher rates are going to depress home prices, sell a home!. While not as easy as an equity that trades T+2, houses are an asset where the cost of capital matters. Thank the Fed for the nice ten-year tailwind they provided.

The Bottom-Up

The Berkshire-Hathaway annual letter to shareholders got heavy attention after its release last Saturday. *CNBC* went all in with a three hour interview engaging Warren Buffett.

It covered everything from the markets, companies where they are invested, Charlie Munger, and the three things that can make you go broke: 'ladies, liquor and leverage'.

In the letter Buffett indicated that they are indeed on the hunt to make a large acquisition. But doing a 'huge deal' is more difficult than it seems given that cheap rates have pushed up equity valuations.

Berkshire Hathaway Top Holdings

Company	Market value of position (\$ millions) ▲
Wells Fargo (WFC)	\$29,276
Apple (AAPL)	\$28,213
Bank of America (BAC)	\$20,664
Coca-Cola (KO)	\$18,352
American Express (AXP)	\$15,056
Phillips 66 (PSX)	\$7,545
U.S. Bancorp (USB)	\$5,565
Moody's (MCO)	\$3,642
Southwest Airlines (LUV)	\$3,119
Delta Air Lines (DAL)	\$2,974
Goldman Sachs (GS)	\$2,902
Bank of New York Mellon (BK)	\$2,871
Charter Communications (CHTR)	\$2,281
BYD Company (foreign)	\$1,961
General Motors (GM)	\$1,825

Source: Berkshire's 2017 Annual Letter

Stillwater View: Open your mind and play along with the Stillwater narrative of where Berkshire invests their billions...

“Charlie and his pal Warren hopped on a Southwest Air flight in San Antonio to see a property they wanted to buy in Dallas with a mortgage pre-approved by Bank of America. The lender used Moody's to score their credit and they put the airfare on a American Express card.

To get to the property they drove in a Chevy with gas from the Phillips 66 station. When they arrived, Warren checked his iPhone to see what price Goldman Sachs had hit that day. When he and Charlie realized it was at a new all-time high, they had a Coke and a smile to celebrate.”

That short soliloquy covered roughly 75% of Berkshires top holdings. We hope you enjoyed it.

Up & Down Wall Street

The Wall Street Journal reports that Fidelity Investments may be abandoning the star manager system that led to the ascension of stock picking legends like Peter Lynch and Will Danoff. The former led Fidelity Magellan in its prime and the latter currently runs a cool \$100 billion in the firms Contrafund.

A 'Young' Peter Lynch



Source: The New York Times

Stillwater View: As they say in the business, 'live by the star, die by the star', And Wall Street has been doing that for a long time. It's not their fault, it's simply the nature of the beast. But don't shed a tear, there was plenty of money to be made back in the day.

On the subject of star managers, two of Wall Street's hedge fund finest are licking their wounds as David Einhorn and Bill Ackman are facing down a tough reality this year.

It has been reported that Einhorn's Greenlight Capital is down 12% this year through the end of February and is probably off to another rough start in March.

Meanwhile, Bill Ackman has thrown in the towel on a his short position in Herbalife, allowing Carl Icahn to take a billion dollar victory lap. Ackman went out of body on this trade, tearfully claiming that it was a crusade.

Herbalife Products



Source: Herbalife

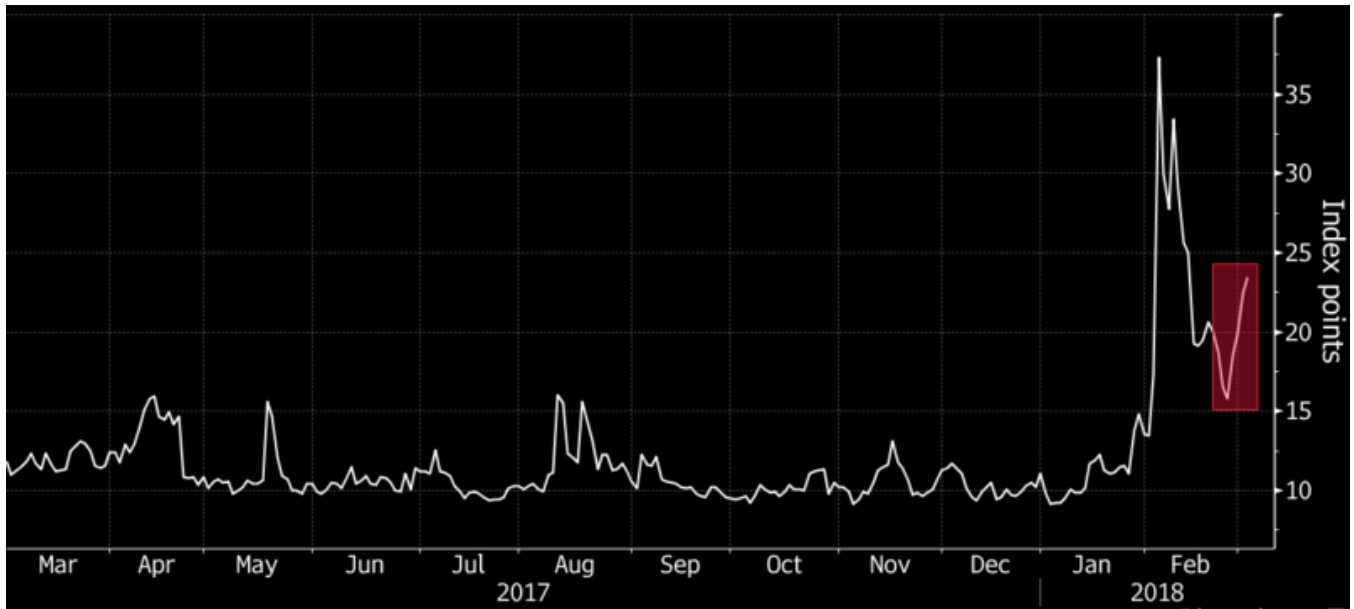
Stillwater View: Stillwater has taken a negative position in Herbalife and other multi-level marketing companies like Nu Skin. While we have only mixed results to show for it, we also don't have tire tracks on our back. This experience has been one where we prove we can live to fight another day.

In other hedge fund news, Paul Tudor Jones gave Goldman Sachs clients a look into his world view with a wide ranging interview on where he saw it headed. Turn out, it wasn't good.

"We're in the third-longest economic expansion in history. Yet we've somehow managed to pass a tax cut and a spending bill, which together will give us a budget deficit of 5% of GDP—unprecedented in peace time outside of recessions ... I think the recent tax cuts and spending increases are something we will all look back on and regret."

Stillwater View: Tudor Jones is on the increasingly crowded 'rates are headed higher' trade. Though the move remains somewhat contained...for now.

Market Volatility on the Rise



Source: Bloomberg

Diversions

The three weeks of bull riding and barbecue kicked off yesterday at Rodeo Houston. Patrons will be packing NRG Stadium to catch everything from Mutton Busting....



To Garth Brooks...



Stillwater View: Giddyup!

Hollywood gets together on Sunday night to celebrate just how amazing their efforts are at the 90th gathering of the Academy Awards, better known to you and I as the ‘Oscars’. *The Wall Street Journal* film critic Joe Morgenstern provides his view of who will take home a golden statue.

The Class of 2018 Nominees



Source: [Oscar.org](https://www.oscar.org)

A beach house on Santa Monica's '[Gold Coast](#)' has gone on the market for the first time in 38 years. The 5,000 square foot 4 bedroom home was once owned by Howard Hughes and Cary Grant. The asking price is \$12 million. Adjacent parking lots not included.

1038 Palisades Beach Road



Source: Zillow

A few hundred yards north sits the former residence of Peter Lawford, a member of the original Rat Pack, Lawford was also John F. Kennedy's brother-in-law.

It was from the patio of the legendary 625 Palisades Beach Road that President Kennedy bounded into the surf for an impromptu 'Pacific Dip'.

The event was memorialized by the iconic picture of Kennedy smiling bright at bikini clad local Eva Ban.

President Kennedy's 'Pacific Dip'



Stillwater View: John, you old presidential bird dogger, you!

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