

Stillwater Capital - This Week in the Markets

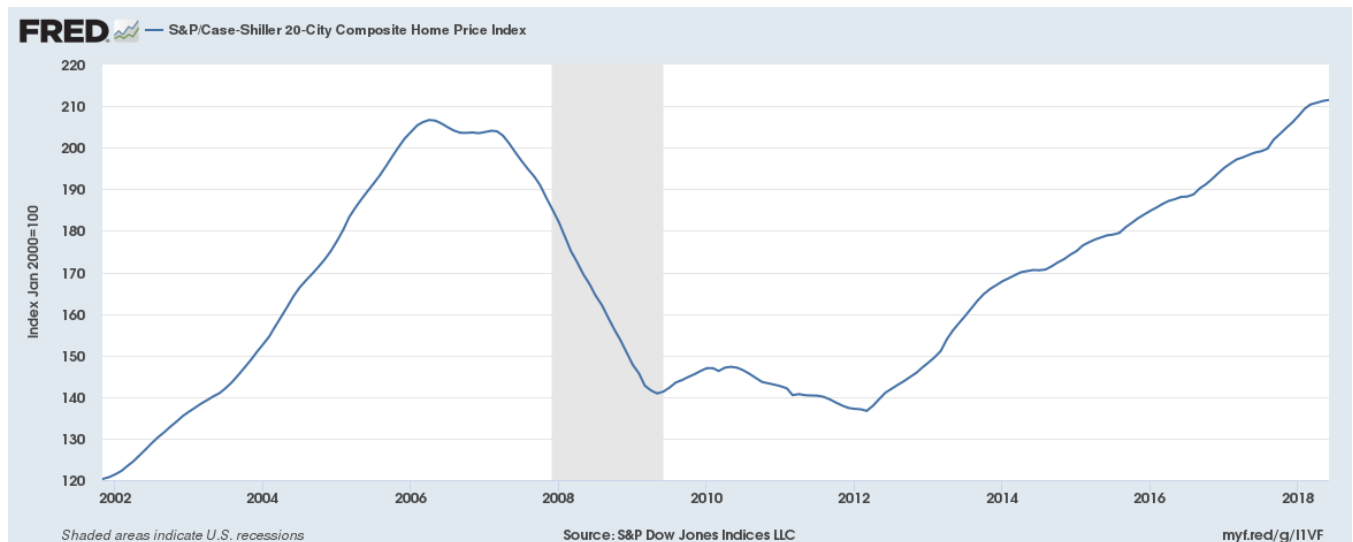


The Top- Down

The Case-Schiller 20-City home price index was released this week, showing a 6.2% gain from the previous year. A rise some have perceived as a sign that things are slowing, as homes had been gaining 7.0% and higher over the past few months prior to this report.

We still find it remarkable that it's required 11 years for prices to recover from what was lost during the global financial crisis, a full 25% correction from the top. The housing market bottomed in 2012, four years after the recession officially ended.

S&P/Case-Schiller 20-City Home Price Index



Source: St. Louis Federal Reserve

The Stillwater View: The housing market still looks and feels relatively healthy even though prices have wildly outstripped wage gains, thus causing a significant widening of the

affordability gap. The only lament heard is on the challenging conditions in the “California/New York” high end market of \$7 to \$10 million.

Every summer for the past few decades, Wall Street legend Byron Wien has held a series of casual gatherings with captains of various industries in the Hamptons. The cross section includes finance, real estate, academics, and “a few others”. While he describes all as serious investors, when he wraps up the last of them, he reports out to the world what he saw and heard. This year’s takeaway: “Talking Worried, But Being Complacent”.

Harvard Alum Wien '54, MBA '56



Source: Harvard Alumni

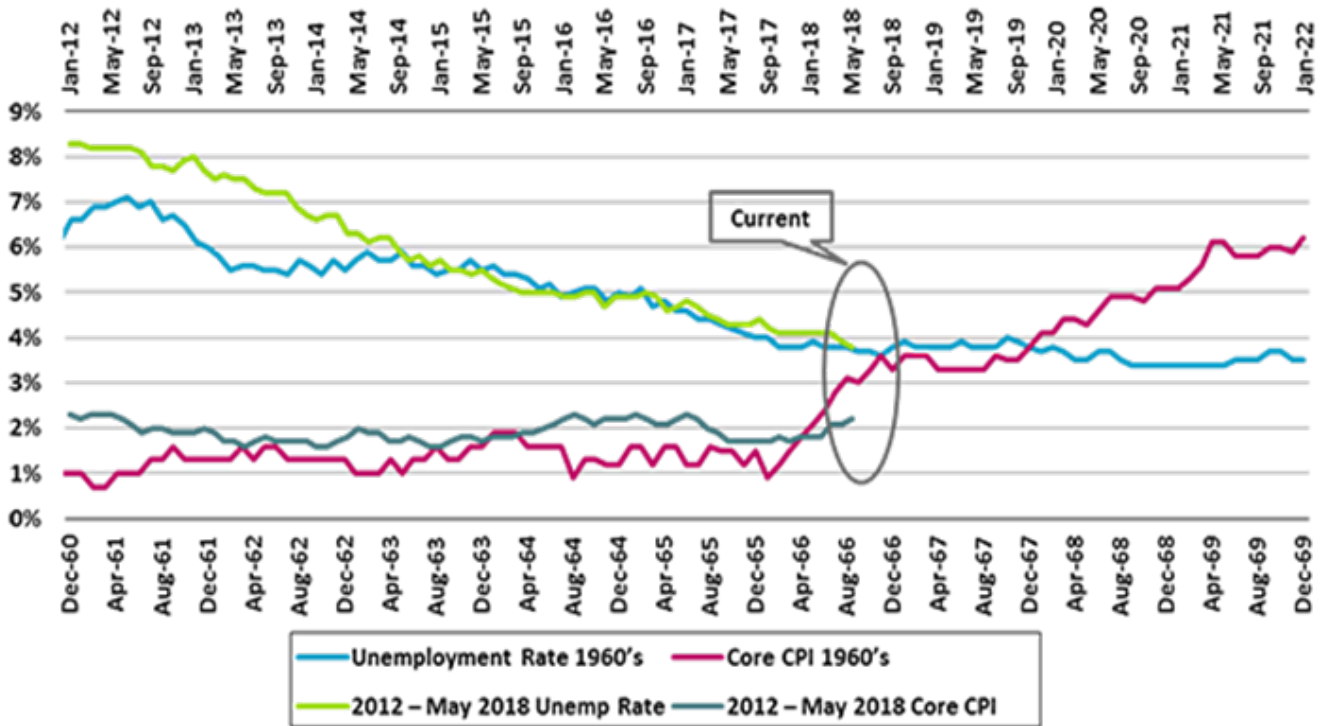
The Stillwater View: “Talking worried, but being complacent” has been the theme in the markets for the past year and a half. And aside from a downdraft in February its worked very well.

On Wien, If there ever was a scholar and a gentlemen in this business it is Bryon. His work has taught many of us how classroom theory has lived and breathed in markets.

Another of Wien’s colleagues, Blackstone investment strategist Joe Zidle, penned a piece last week titled “Lighter Fluid on a Steady Flame”. The focus of the piece was the testament that the

long simmering risk of inflation may finally be knocking on the door. If the chart below is at all accurate, we are due for a quick bump higher.

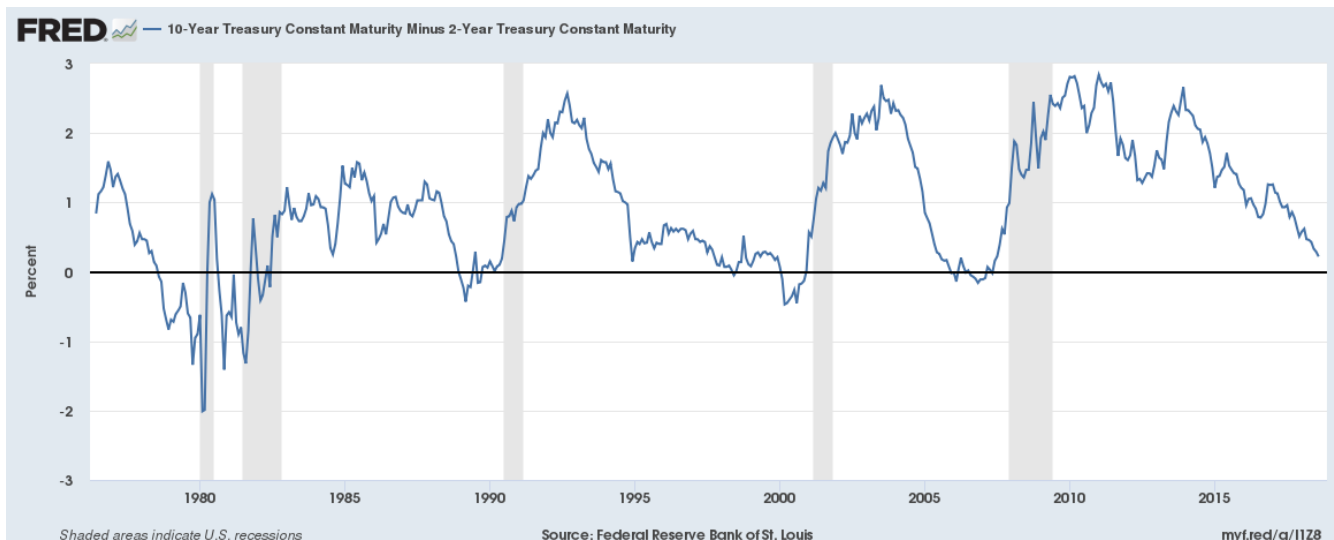
Unemployment and Inflation



Source: Bureau of Labor Statistics, Federal Reserve, Blackstone (as of Aug 6, 2018)

Stillwater is taking one last look at the overly examined yield curve, then putting it on the shelf until it actually flattens completely. But before we do we want one more shot at explaining its importance beyond that fact that every time it goes negative a recessions follows.

The 10 - 2 Treasury Spread



Source: St. Louis Federal Reserve

One of our readers, Leigh Crawford of Crawford Capital, rightfully pointed out to me last week, that the curve really isn't a *predictor* of recessions, but a *cause* of them. His short but thoughtful description of why is certainly worth repeating.

"All flavors of banking are essentially an asset liability duration mismatch. It's a commodity product -- money -- and you earn a spread on longer duration assets funded by shorter duration liabilities. When the yield curve is inverted the banking system has negative carry and is dysfunctional. When the banking system can't grow its balance sheet neither can businesses = credit contraction = recession. Even a flat yield curve is toxic because that spread has to cover expenses too."

Another reader, a global-macro strategist with more years of experience than most, pointed out that there is too much focus on the curve, and not enough on the high yield spread barometer. His most recent observation is that 3.75% is the level to watch out for. We have remained contained below it for all of 2017, and most of 2018.

High Yield spread to 10-Year Treasuries



Source: Bloomberg

He also points out that a similar pattern existed for the four years leading up to the market-top in 2007, averaging 3.0% until spiking higher in a move that presaged the pending global meltdown.

High Yield spread to 10-Year Treasuries



Source: Bloomberg

The Stillwater View: If you were to give us one, and only one, reading on the market, it would be the high yield to treasury spread. It's the most reliable EKG of the health of the market that we know of, and right now its showing a nice healthy beat.

Thump-thump, Thump-thump...



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Investing

State Street Global Advisors has teamed up with Elizabeth Banks to help sell the mid-cap 400 ETF, under the banner “Crazy Enough to Work”. The theme of the campaign is that smaller companies face small company hurdles in the early years, and therefore need to adopt a sometimes crazy dice rolling mentality in order to survive.

In the campaign, Banks visits executives and the companies they run to explain to the world what a mid-cap sized company looks like. Stick around to hear the “Happiness Professor’s” opinion of whether life is better with things or experiences.

The Mighty Mid-Cap



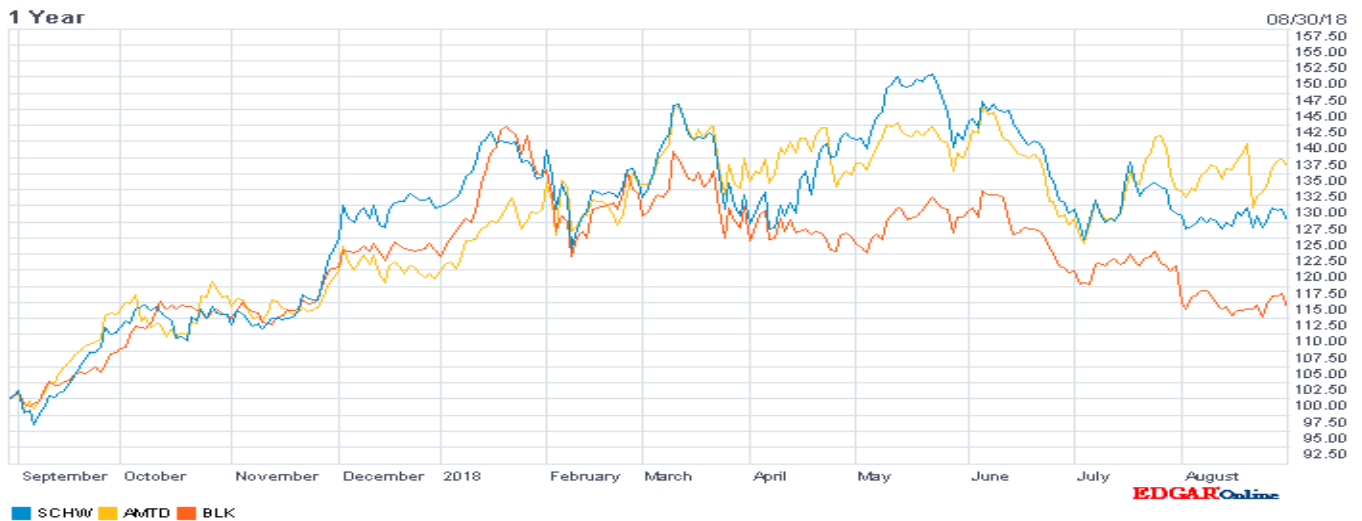
Source: State Street

The Stillwater View: In a world of pedestrian campaigns to get your money, this one certainly isn't one of them. Sadly, very few investors really ever know what they own.

Last week, the playing field got tipped even more in favor of the individual investor when J.P. Morgan announced they were introducing free trading when done through the companies mobile app. Vlad Tenev, co-CEO of Robinhood, talked to CNBC about how they were expanding their free trading options as well.

All of this dovetails with Fidelity's recent offering of global ETFs at no cost to their investors. The catch is they will want you to use other Fido services to make up for the loss leader. All of this has put a lid on the stock of Charles Schwab, TD Ameritrade and BlackRock as this is what happens when the innovator gets out innovated in the race to zero profit margin.

Schwab, Ameritrade, BlackRock



Source: Nasdaq

A couple of weeks ago we told you we were taking you through the lifecycle of a successful investor. From the early days of grinding it out to eventually running the family foundation. To do so we are using the semi-fictional Billy Ray Valentine who figured out that there was money to be made in selling the niche G.I. Joe with the Kung-Fu Grip to a hungry public.

Billy Ray Valentine



Source: Trading Places

His financial advisor, who will follow and advise him through a very spectacular life and career, is Louis Winthrop III whose family owns the main-line Philadelphia investment house, Winthrop Brothers.

Louis Winthrop III



Source: Trading Places

Important to our story isn't the characters, though we do like the reunion of Louis and Billy Ray, it is that we are going to strip away the traditional names given to asset classes. Or at least the three we use the most.

Stocks will no longer be stocks, they will be "awesome". Bonds are going to be re-named "amazing" and alternatives are going to be "awesome and amazing...just different".

It all starts in next week's edition of "*This Week in the Markets*". Let's have some fun and see if we can send the Duke brothers to the poor house...again!

Randolph and Mortimer Duke



Source: Trading Places

The Stillwater View: "Margin call, gentlemen."

Special College Football Preview

Like the Swallows to Capistrano, the late summer return of college football is upon us as the "Boys of Fall" are back. And with it Stillwater Capital's fast and loose look at the games to watch this weekend.

Game On!



Source: SB Nation

The Lane Train and Florida Atlantic visit Norman, Oklahoma while Michigan takes on Notre Dame in a rivalry game that should never be cancelled again.

There will be a great top-ten matchup between Washington and Auburn at AT&T Stadium in Atlanta. On Monday the Florida State Seminoles and new head coach Willie Taggart take on the Virginia Tech Hokies.

Seriously, What's a Hokie?



Source: 24/7 Sports

The Stillwater View: Straight up winners are the Sooners, Michigan, Washington, and the Noles.

ESPN's provides an amazing look at every single change made to uniforms and team logos from last year. The more minute, the more fascinating. The TCU Horned Frogs are going to be ready, although for what we aren't exactly sure.

Football or Combat? You Decide.



Source: Auburn Uniforms

Diversions

Last week's Pebble Beach Concourse once again brought together the world's finest cars with the world's finest car auctions. Of the \$370 million in automobiles participating, a 1937 Alfa Romeo 8C took home Best in Show.

The Grand Champion



©2008 Richard Owen - Supercars.net

Source: Supercar.net

On Saturday, the gavel fell on the most expensive automobile in history when a 1962 Ferrari 250 GTO sold for \$48.4 million at R.M. Sotheby's annual car collector sale in nearby Monterey.

The New King



PATRICK ERNZEN @E018 COURTESY

Source: CNN Money

Stillwater searched high and low for great Labor Day barbecue recipes and the best one we found was from *The Spruce Eats* which provides readers with [15 Cookout Recipes](#). Each one looked great with the Steak Burger with Port Wine Reduction coming out on top. Enjoy.

Seriously Good



Source: The Spruce Eats

We are hitting our full stride in Flushing, Queens as the [US Open](#) rolls on. Extreme heat on Tuesday caused several matches to be [called early](#) as players hit the ice baths.

On the women's side [Simona Halep](#) made tennis history, albeit an unfortunate history, as she became the first number one seed to lose in the first round of a major.

Meanwhile defending champ Sloane Stephens had some [choice words](#) for the newly constructed \$150 million [Louis Armstrong Stadium](#).

New Digs in Flushing



Source: The Architects Newspaper

Even the rich are having to cut prices to get properties to move these days. Super-sized case in point, last week Warren Buffett dropped the \$11 million asking price for the Laguna Beach hideaway where he wrote his annual letters by 27%. The new \$8 million price tag will hopefully bring some action from a buyer who wants to get richer by osmosis.

Buffett, ever the value investor, bought the home for \$150,000 in the early 1970s. He purchased it in part to make the visit to Disneyland easier. He was an early and large shareholder of the House of Mouse.

Buffett by the Beach



Source: The Wall Street Journal

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