

## Stillwater Capital - This Week in the Markets

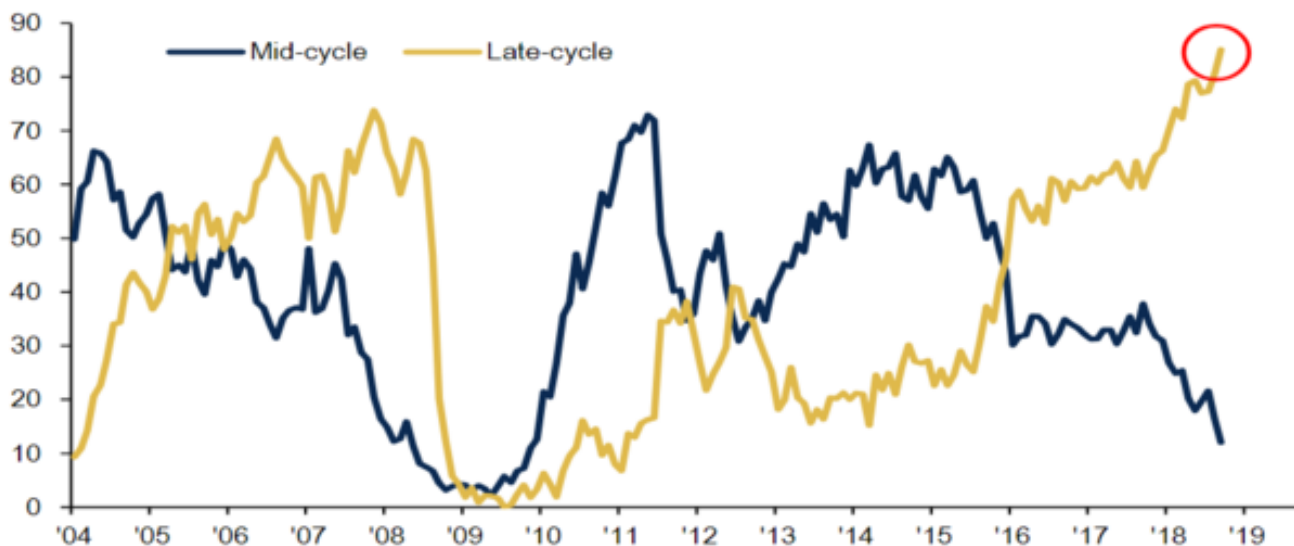


### The Economic Top- Down

While the monthly economic readings continue to signal the all clear, it hasn't stopped many from calling a top in the cycle. Merrill Lynch surveyed portfolio managers and found an astonishingly high 85% believe that we are late-cycle, with an ever decreasing 15% saying we are mid-way through the second longest economic expansion in history.

### The Delta Is Getting Wider

Exhibit 5: At this time, in which phase of the economic cycle would you say the global economy is?

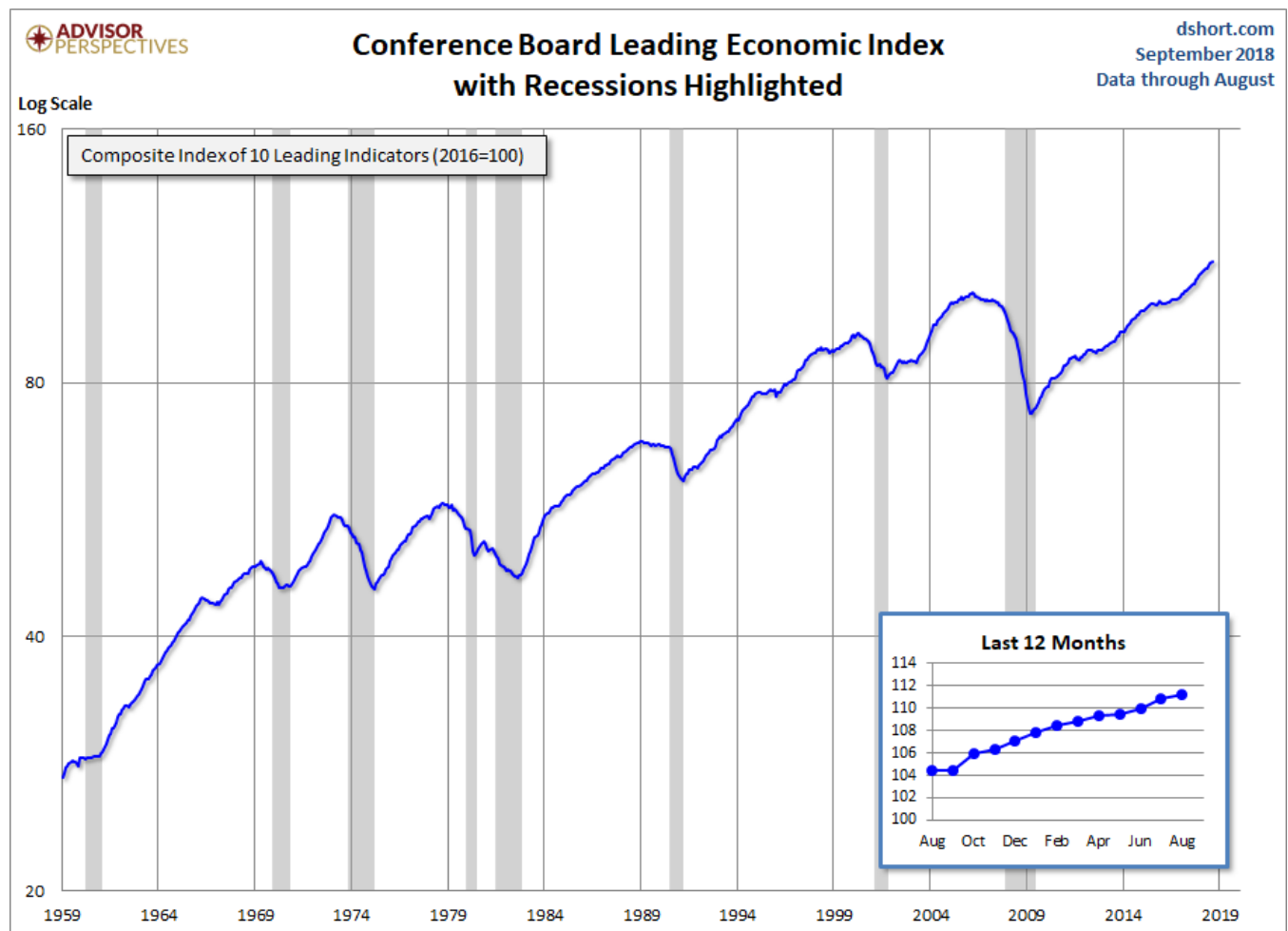


Source: Merrill Lynch

J.P. Morgan was also out with a note, placing the odds of a recession in one year at 30%, in two years at 60%, and in three years at 80%. This is far more bearish than the New York Fed's view that there is a 15% chance of a recession within the next year. Goldman Sachs is also on the other side of J.P. Morgan's trade, saying there is a longer runway than most people think.

*Our View: Unless the indicators with the best track record at calling an end to the cycle start flashing yellow, the correct call is that we probably have some more room to run before this expansion ends. Case in point, the very predictable LEI has rolled over before every recession since 1960 and hasn't softened yet.*

## LEI Batting 1,000

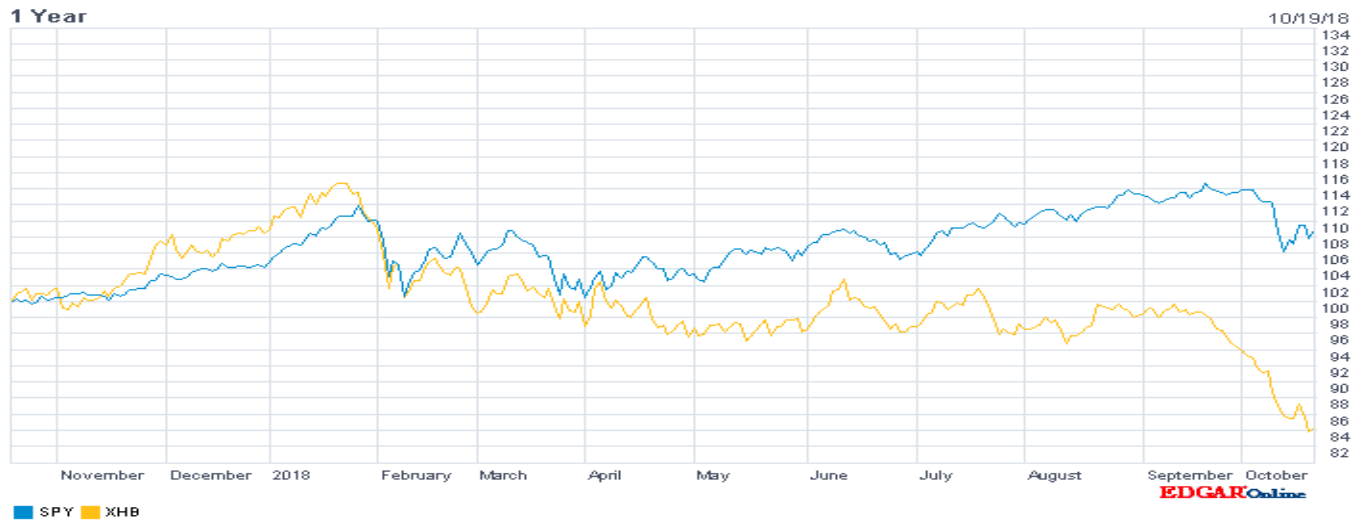


Source: The Conference Board

The one area where evidence is mounting that a secular slowdown is happening, is residential real estate. This week, mortgage applications for new purchases and re-financing fell off the table, as the former fell 7% and the latter 9% week-over-week, with refinance applications down 30% from one year ago.

Stocks in the housing group largely reflect that a shift has occurred. The homebuilder ETF and companies tied to the housing trade, such as Lowe's and Untied Rentals, have been pummeled this month to the tune of a 20% selloff in their shares.

## S&P 500 vs. Homebuilders



Source: Nasdaq

Wall Street is now piling on in a predictable “late to the party” way. Yesterday, Bank of America Merrill Lynch downgraded several homebuilders and Credit Suisse did the same to home improvement companies.

The Economic Cycle Research Institute is raising a red flag that leading indicators of home price appreciation are already showing signs of rolling over. The ECRI touts itself as “the world’s leading authority on economic cycles” and provides a history of their calls to validate the work.

## Inventory Loading Up



Source: Realtor.com

*Our View: Real estate isn't just a home you live in, it's a levered asset class. Loose money and zero interest rates reflat all asset classes, therefore, it should come as no surprise with the draining of liquidity, that there would be a downward adjustment in asset prices as well.*

While I believe we have decent writing here at Stillwater, I also recognize when someone else produces a true gem. The following came to us from Ian Lyngen and Jon Hill, US Rate Strategists at BMO Capital Markets. It's set to the Gilligan's Island theme song, pull up a rum drink and enjoy!

*'Just sit right back and you'll hear a tale, a tale of a momentum shift, that started in the equity market, perhaps a sinking ship.*

*The Chairman was a former legal man, the President a polarizing dude; Treasury yields set sail on Fed day for three-handle 2s, for three-handle 2s.*

*The data started getting rough, inflation forecasts were tossed; if not for the dogma of the current Fed, the outlook would be lost, the outlook would be lost.*



*10-year yields ran aground on the shore on this chartable technical isle, with the Powell-man, the Chinese too, billions in bonds and trade strife, the dollar star, a recession and low-flation... here on Treasury Isle!*

*So this is a tale of consolidation, with range-bound yields for a long, long time. Investors will have to make the best of things, term-premium's in decline. Draghi and the BoJ will do their very best, to make global rates comparable, but expect a bullish mess.'*

Source: BMO Capital Markets

Gilligan...The Skipper Too



Source: IMDB

*The Fundamental Bottom Up*

Will it be earnings to the rescue once again? The bulls certainly hope so, while it's getting harder and harder to deny that perhaps they have peaked.

Is The Party Over?



Source: Bloomberg

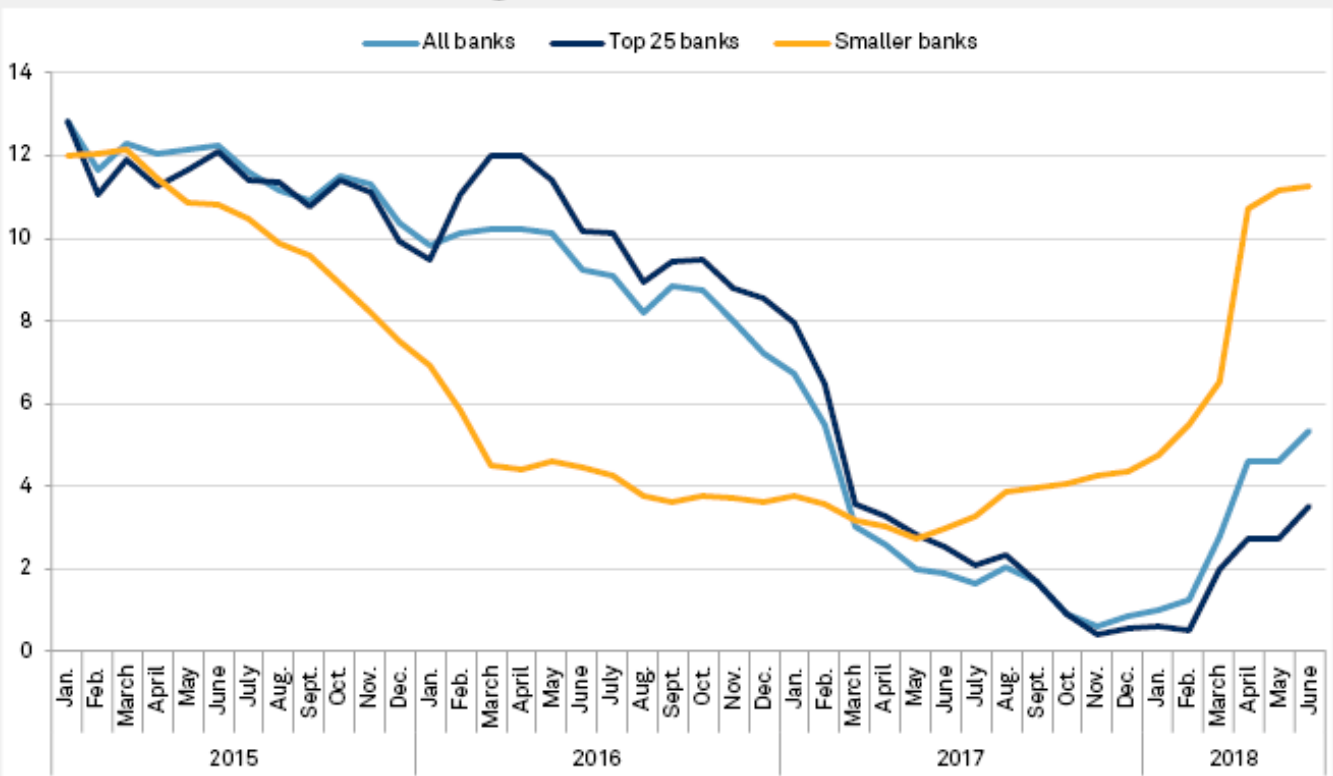
Here is a sampling of the Good, The Bad, And the Ugly so far.

#### The Good...

**Morgan Stanley:** Terrific performance on every metric. Revenues, earnings, and return on equity all showed why this is one of our favorite money center banks. The Morgan Stanley CEO is "bewildered" by the stock's performance. The market continues to toss current fundamentals aside, and has turned the whole story into the flattening of the yield curve, not a loan growth tale.

#### C&I Loan Growth Rebounds

## Commercial and industrial loan growth, YOY (%)



Data compiled July 17, 2018.

Data shows year-over-year change in loans held by all U.S. banks on a monthly basis. Data is nonseasonally adjusted.

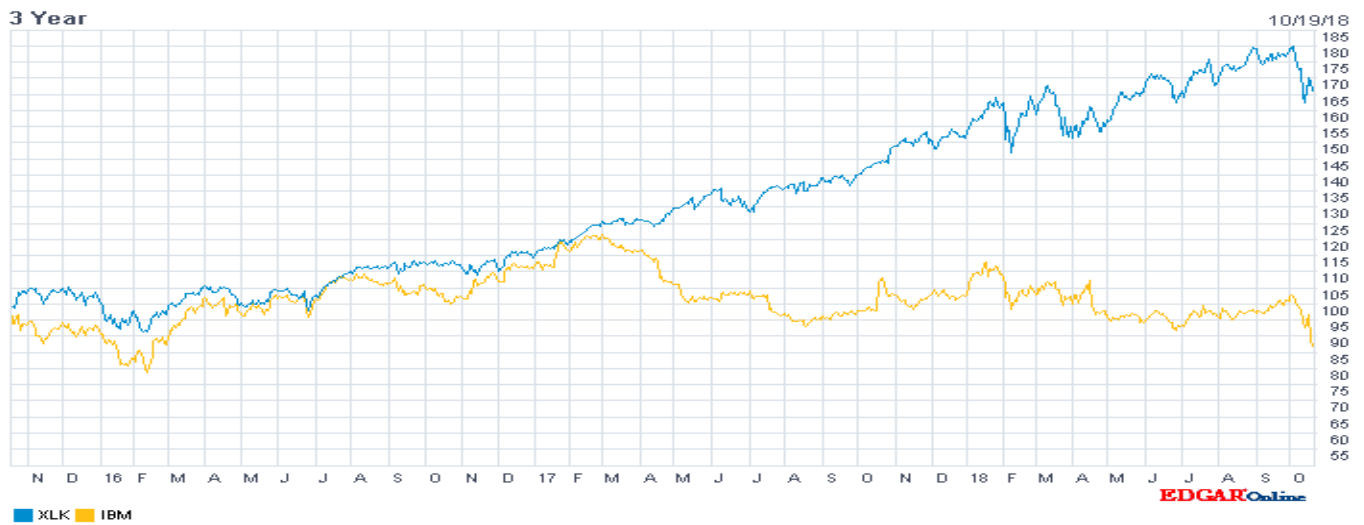
Source: Federal Reserve

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### The Bad...

Warren Buffett is looking smarter and smarter for punting his ill-fated investment in IBM earlier this year. Big Blue is back to negative topline growth and the market is none too pleased. The company's CFO blamed a high U.S. dollar and a transition in the business mix. For shareholders, IBM has been the anti-tech for the better part of three years.

Technology Spyder vs. IBM



## The Ugly...

**United Rentals & Snap-On:** Both are tied in similar ways to construction and newly problematic tariff headwinds. This week, a bad cocktail of the two sent the shares of URI and SNA reeling, the latter is down 15% on the month, while the former is off 30%.

## Who you calling a hoe?



Source: United Rentals Houston

*Our View: There is no real way to sugar coat this, the industrial sector got ugly in a hurry. The combination of slowing global growth, rising tariff related costs, and a market that shoots first and ask questions later, have led to the group being hit by live fire.*

**“Ask Yourself One Question...”**



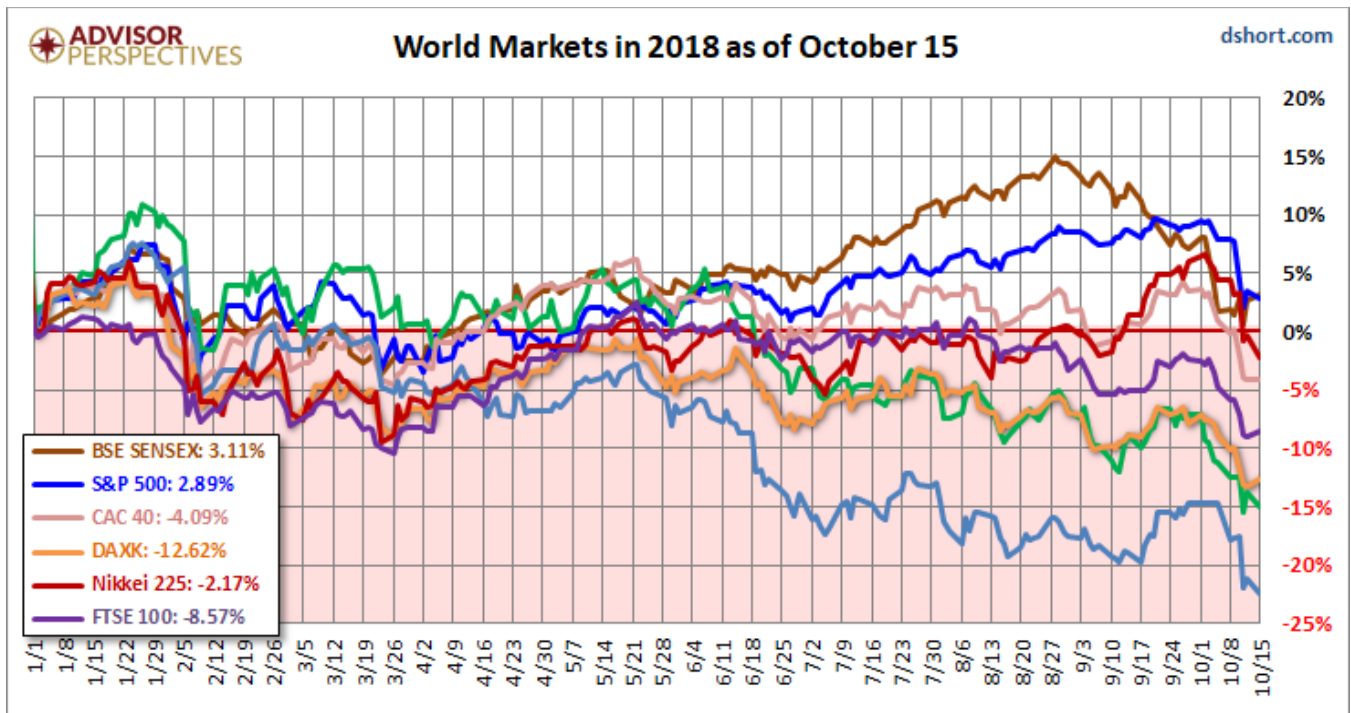


Source: Cineplex

### *Markets*

Another volatile week in the markets came and went, and the U.S. remains the “cleanest of the clean” shirts, as our markets clearly reflect. The phrase is an adaptation of how Mohamad El-Erian’s the “cleanest of the dirty shirts” reference was coined when the world was crawling out of the global financial crisis and we were on top.

### **Don't Drag Me Down**



Source: Advisor Perspective

*Our View: Its starts to get a little scary when Brazil, Israel, Norway, India, and New Zealand are the only world markets in positive territory this year.*

In an interview on CNBC, Goldman Sachs CEO David Solomon repeated what we said last week, the recent selloff in equities was compounded by the machines and algorithmic trading.

**Diddy with D.J. D-Sol**

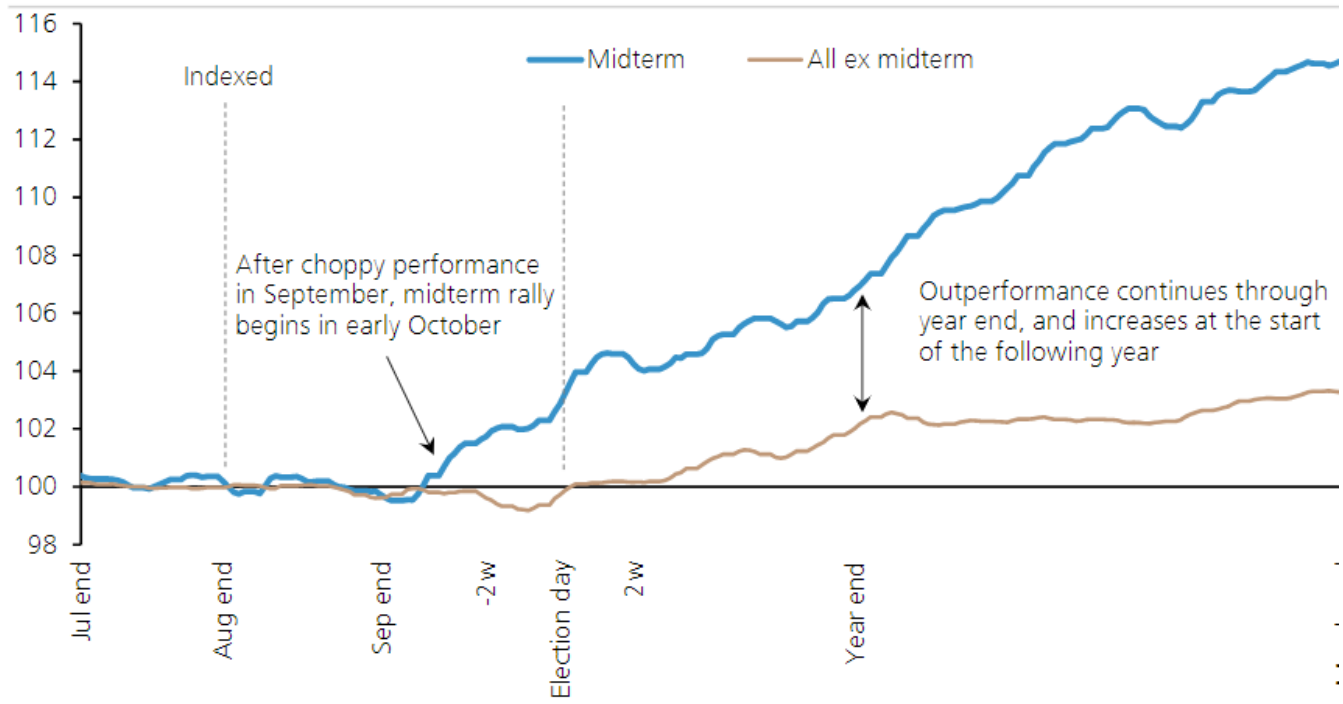


Source: CNBC

While the major news networks have entered into a duel focused solely on the midterm elections, markets for the most part don't seem to care, as the average price return 12 months after the vote is settled is 16.7%.

### **Post Mid-Term Performance**

**Figure 1: S&P 500 performance around midterms vs all other years (average)**



Source: Haver, S&P, UBS

Source: Haver, S&P, UBS

### *Hedge Funds*

Lee Cooperman made an appearance this week on CNBC's *Fast Money*, providing his opinion on AMC Entertainment, the oil trade, IBM, Dow/DuPont, Largo Resources, and his PA position in the marijuana trade.

### **High Times Indeed**



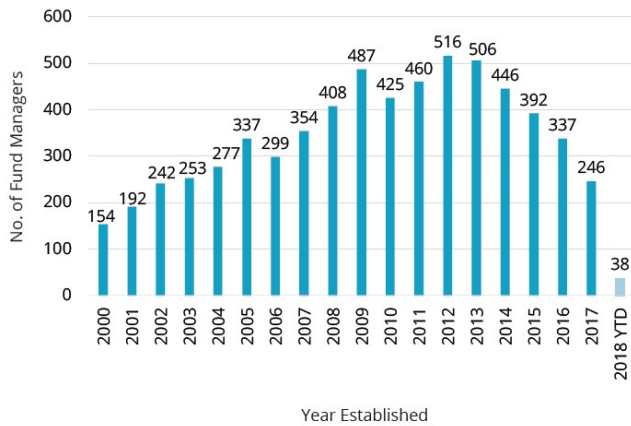


Source: DealBreaker

Not a single hedge fund of any size or relevance announced they were shutting down this week. That constitutes a win these days for an industry under enormous pressure.

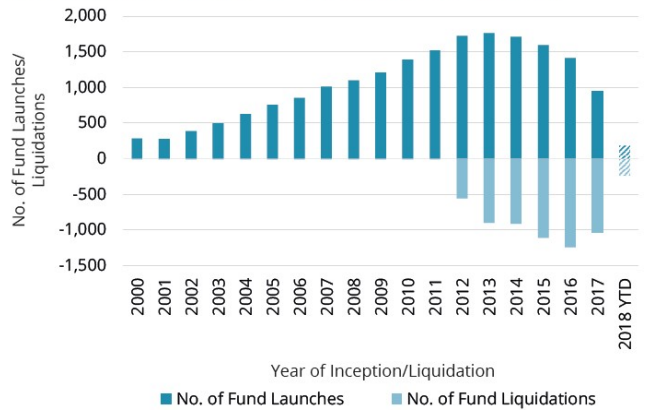
**Headwinds Increase**

Fig. 1: Hedge Fund Managers by Year Established, 2000 - 2018 YTD (As at June 2018)



Source: Preqin

Fig. 2: Hedge Fund Launches and Liquidations by Year of Inception/Liquidation, 2000 - 2018 YTD (As at June 2018)



Source: Preqin

Source: Preqin

### *Diversions*

Last night the Boston Red Socks played their way into the World Series with a 4-1 win over defending champion Houston. They will face the winner of the Dodgers v. Brewers series where LA holds a 3 - 2 lead. Game five is tonight at 8:39.

### **A True Dodger Dog**



Source: The Los Angeles Times

*Our View: Please, please, please God...make this a Dodger vs. Red Sox world series. They last met 102 years ago, when the Dodgers were known as the Brooklyn Robins.*

It's Lotto fever across the country, as this week's jackpot reached \$970 million, making it the second biggest in history. The sum has been rolling higher since July 27<sup>th</sup> when it started at \$40 million.

Tired of high taxes? The winner of the mega millions will be as well. H&R Block estimates that a New York or California winner who opts for the lump sum, will take home about \$275 million after the government takes their piece. Como se dice...Ouch!!!

**Big Money, No Whammies**





Source: New York Times

According to *Vox*, fall foliage will be peaking today. The publication has an [interactive map](#) showing conditions across the country. Readers Digest provides the [20 Best Places to be in America](#) to view the changing of the leaves.

### **Adirondack Mountains**



Source: Andrew Cuomo

*Our View: There is only one Fall of 2018, get out there and enjoy it while you can.*

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