August 4th, 2017

The Top-Down

The July jobs report came in strong this morning with an increase of 209,000 in payrolls as the labor market continues to tighten. Bloomberg reports on where the employment is strongest.

Alan Greenspan voiced his opinion that while the equity market was on stable footing, there was a bubble in the bond market. DoubleLine founder Jeff Gundlach is getting long volatility as owning five month puts on the S&P 500 is like "free money".

The Dow Jones Industrial Average crossed 22,000 this week on the back of a strong earnings report from Apple. Unfortunately, half of the country continues to have zero ownership of equities. Bulls like Ed Yardeni are raising their market forecasts. Jim Paulson, formerly of Wells Capital and now at the Leuthold Group, thinks "the bull market can go on forever". The side story to all of this has been the weakening of the dollar and the tailwind it has created for U.S. based multinationals.

Goldman Sachs CEO Lloyd Blankfein shared his view that the economy is firing despite what's happening in Washington, not because of it. Joe Zidle of Richard Bernstein Advisors also counseled investors to ignore the sideshow in D.C. and focus on the fundamentals. CNBC's Ron Insana says to give the economy credit, not the man residing in "the dump" at 1600 Pennsylvania Avenue, for the run to 22,000.

Stillwater View: If all the side currents and back stories in the market are making your head spin, you are not alone. The fear of being left behind is driving many to rationalize what is increasingly becoming a low return environment for equity investors.

The Bottom-Up

Strength in the broad indexes continues to mask sector rotation under the surface. This is a recurring theme of late. One that is creating opportunities and frustration for active managers who are looking for value or sitting on large gains in technology as the sector stalls out.

Goldman Sachs was out this week with a research piece that identified free cash flow yield as the *only* metric showing stocks as being cheap.

S&P 500 aggregate index and median stock both highly valued on most metrics
as of August 1, 2017

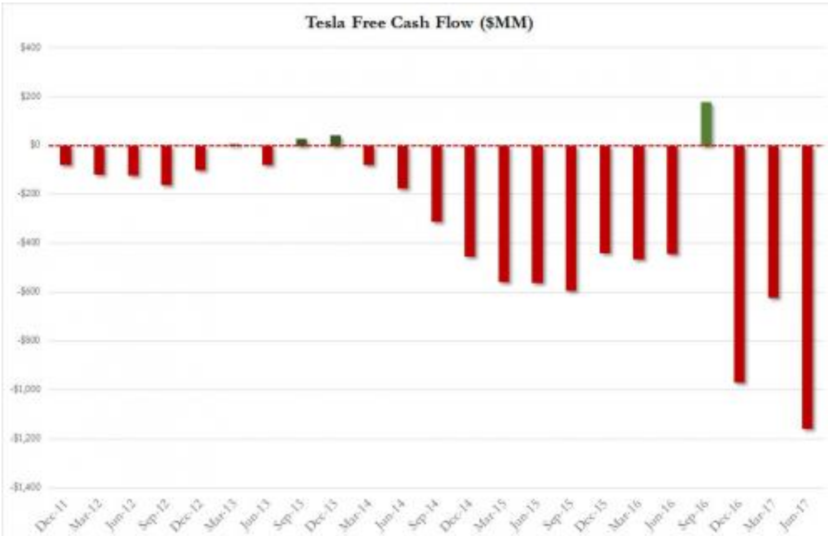
	Aggregate Index			Median Stock		
Metric (Aggregate index)	**Current**	**Long-term average**	**Historical %ile**	**Current**	**Long-term average**	**Historical %ile**
EV / Sales	2.3 x	1.3 x	**95 %**	2.8 x	1.4 x	**99 %**
EV / EBITDA	11.6 x	8.2 x	**88**	12.0 x	8.1 x	**99**
Forward P/E	18.0 x	12.8 x	**89**	18.1 x	13.1 x	**96**
Cyclically adjusted P/E (CAPE)	26.0 x	18.7 x	**87**	NA	NA	**NA**
P/E to growth (PEG)	1.4 x	1.1 x	**89**	1.9 x	1.2 x	**100**
Cash flow yield (CFO)	7.4 %	9.4 %	**87**	7.2 %	9.0 %	**96**
Price / Book	3.2 x	2.5 x	**85**	3.4 x	2.2 x	**99**
Free cash flow yield (FCF)	**4.2 %**	**4.0 %**	**52**	**4.3 %**	**4.1 %**	**47**
Median			**88 %**			**99 %**

Note: Data since 1990 for CFO and FCF, 1981 for PEG, and 1976 for all others.
Cash flow from operations yield and free cash flow yield exclude Financials and Real Estate.

Stillwater View: Free cash flow is measured by taking operating income and deducting capital expenditures. A strong free cash flow yield is an indicator of a healthy company operating within their means and is one of the primary metrics we look for when investing in stable growing companies. The fact that it's the only measure showing value in the current market is a concern.

AMC Entertainment collapsed 25% following the reporting of weak box office sales. The sell-side didn't do itself any favors by acting "shocked, shocked I tell you" over the results. Bottom line, going out to the theater simply isn't as appealing as streaming content to the comfort of your device. Wherever that may be. This is another setback AMC owner the Dalian Wanda Group which in July made the decision to cut and run instead of continuing to attempt to challenge Disney in theme parks.

Elon Musk had a good week, adding $5 billion to his fortune and once again frustrating the Tesla bears with an earnings report that sent the stock up 7%. Even while the company continues to burn through billions in cash and faces significant competition from the established car makers. The path to bankruptcy was articulated by researchers at Auburn University in September of last year.



Sapporo Holdings purchased San Francisco's legendary Anchor Brewing on Wednesday even as beer is losing out to wine as millennials tastes have shifted. The very trendy rosé has seen a huge increase in demand. Wall Street has taken notice as Goldman Sachs downgraded Constellation Brands and Boston Beer last week.

Up and Down Wall Street

Speculation continues to mount that Gary Cohn will be the next Fed Chair. At this point in the game the former number two at Goldman would happily accept the appointment.

BlackRock's ultra-cheap $1.6 billion hedge fund continues to see large inflows this year while liquid alternative funds are attracting assets as well. Wilshire Associates reported inflows of $20.7 billion this year bringing the category total to $310 billion. Northern Trust released the results from an alternative investor survey highlighting the increasing demands placed on transparency.

On the flipside, troubles continue for the biggest names in the hedge fund business as Paul Tudor Jones has seen assets under management cut in half in the past twelve months. His global macro fund is down 1.9% this year. "Oil God" Andy Hall is shutting down his main $2 billion energy fund after finding himself down 30% year to date. Dan Loeb admitted that it's better to be "lucky than right". As Leon Cooperman puts it, money flows to where it's treated best.

Stillwater View: Hedge funds, private equity, and alternatives in general continue to evolve at pace never seen before. Managers that came into the market in the gilded age of hedge fund investing circa 1995 are facing the same reality that active equity managers have been facing for a decade. While the likes of Elliot's Paul Singer continue to rail against the passive trend. Structure and pricing are evolving and the investor is the beneficiary.

Diversions

The Princeton Review released their annual rankings of the best colleges in the nation. Instead of the traditional top-50 it now slices and dices the rankings into every category imaginable. West Point provides the best classroom experience. Vanderbilt has the happiest students. Tulane is the place to party. Rice University has the best quality of life. Best school of tree hugging, Birkenstock wearing, clove smoking, intellectuals? Sarah Lawrence College in Bronxville, New York.

Burning Man is fast approaching. The 2017 version takes place from August 27th to September 3rd. Just last month Black Rock Desert was a giant mud puddle. This annual confluence of art and entertainment is showing its middle-age as it evolves into a more mature kid friendly event. Photo book "Dusty Playground" proves the point. For those seeking a more gentrified experience there is the Pebble Beach Concourse d'Elegance coming up on Sunday, August 20th. Both BMW and Mercedes-Benz plan new concept car introductions during the annual Monterey Car Week that leads up to the Concourse.

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