

Stillwater Capital - This Week in the Markets



The Top- Down

August slowdown? What slowdown? This week was hopping with news from the top-down.

The market got a positive boost yesterday after a strong selloff on Wednesday, when it was announced that there would be a resumption of trade talks between China and the United States. Bear Stearn's veteran head of macro strategy David Malpass will do the talking for the Treasury Department. As *Bloomberg* points out, the tariff war looks like a cold one so far.

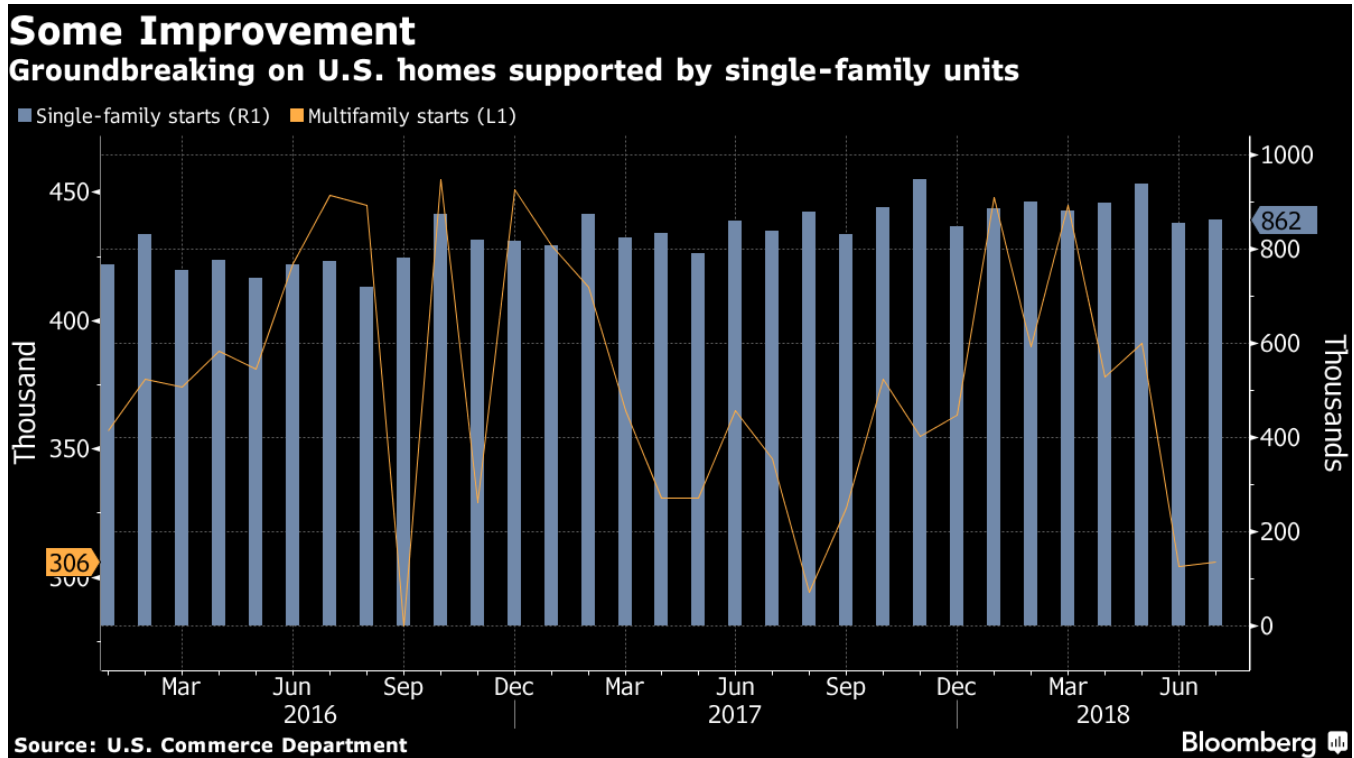
With the situation in Turkey continuing to devolve, and global growth questions percolating anew, the U.S. is once again the strongest and cleanest global investment story out there, with performance this year to prove it.

United States, The World, Emerging Markets



The swirling concerns about the health of the housing market were placed on hold this week when July housing starts were reported and the news was sunny, but perhaps not 72. Higher interest rates, stretched affordability, and elevated input costs have moved up. The saving grace? Prices keep moving higher as well.

New Home Starts



CNBC's longtime real estate reporter Diana Olick has been busy painting a more cautious picture of the market in her Realty Check segment. Olick reported on Wednesday that mortgage applications have dropped as buyers are backing out. The same day she reported that homebuilder sentiment was at its lowest point in a year.

On Thursday, Diana brought home the news that the housing market was indeed shifting from a very one-sided seller's market to a more balanced one. She did so by pointing out that price reductions were beginning to pick up steam. To round things out she cast shadow over the earlier report that housing starts were holding up just fine.

As one would expect, higher input costs have sent the shares of homebuilders into a serious correction this year. Down fifteen to twenty percent in a good overall market.

S&P 500, Toll Brother, K&B Home, Lennar

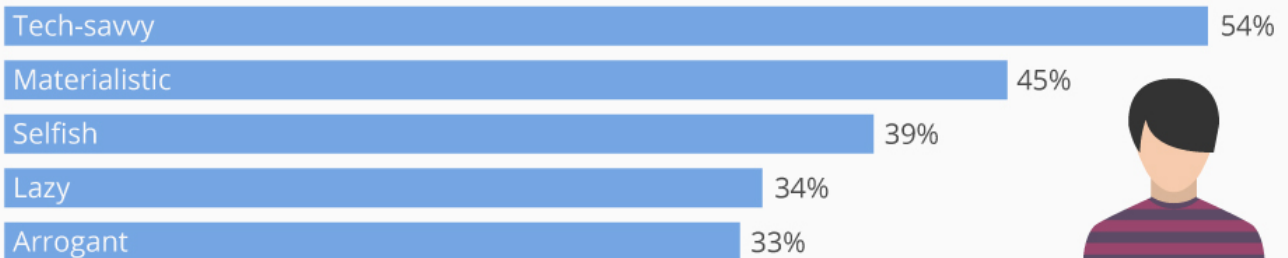


Another market veteran, [Ed Yardeni](#), appeared on *CNBC* this week articulating his thoughts that the minimalist tendencies of baby boomers and millennials will keep the economy on a smooth pace of growth that will be structurally safe from the risk of inflation.

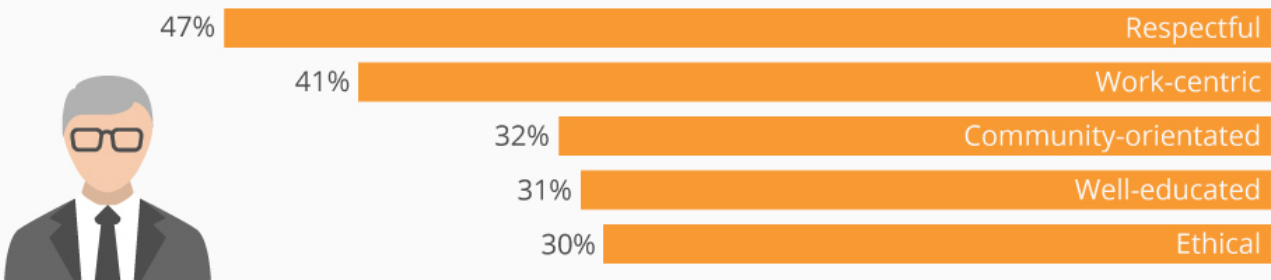
War of the Words: Millennials vs. Baby Boomers

Words most often used to describe the 'Millennial' and 'Baby Boomer' generations*

Millennials



Baby Boomers



Stillwater View: It's a pretty interesting idea, especially when you layer it over the race to zero margin for many producers of goods as intermediaries get squeezed out of the picture.

Yardeni made a name for himself twenty years ago when he was a strategist at Deutsche Bank. He famously called for a global recession that would be caused by the Y2K, or Millennium bug. So confident in his call, Ed went on record that he would promise some pretty drastic action if he was indeed wrong.

"If I'm wrong about Y2K, I'll just check into the Betty Ford Clinic for delusional economists, publicly state that I'm on industrial-strength Prozac, and then ask for forgiveness."

In all fairness he did make the call that the bottom was in place shortly after the S&P printed a low of 666 on March 9, 2009. You win some, you lose some...and sometimes they are big ones!

And if you think Stillwater Capital likes charts, Yardeni loooovvvs charts. Some are free and others will cost you: Yardeni Research.

Why is This Man So Smug?



The Bottom-Up

This morning President Trump proposed ending the short 90-day cycle of quarterly earnings reporting.

Donald J. Trump **Verified account** @realDonaldTrump

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In speaking with some of the world's top business leaders I asked what it is that would make business (jobs) even better in the U.S. "Stop quarterly reporting & go to a six month system," said one. That would allow greater flexibility & save money. I have asked the SEC to study!

4:30 AM - 17 Aug 2018

The Stillwater View: This is a good idea for a whole lot of reasons. Number one is that it gives management a longer runway to make decisions that matter and to see their ideas work the way they were proposed, without the pressure to scramble and make a short-term earnings number.

It appears that Wal-Mart might be out Amazoning Amazon. This week the company reported the strongest sales growth in over a decade, notching a 4% gain from the prior year. This strength was attributed to success in the grocery aisle, but more importantly, a 40% gain in its online business.

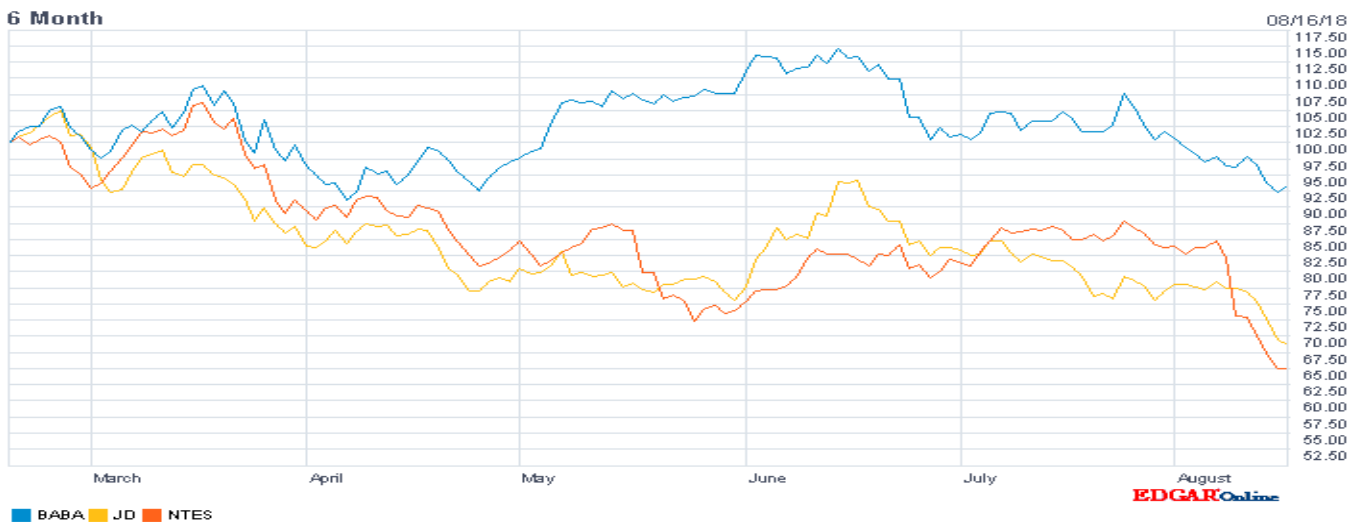
The news sent the "left for dead" grocery group higher capping, off a 7.5% gain in 15 days. And being a Walton became even more fun on Thursday as the family tacked on \$11 billion in new wealth.

Bull Market in Eggs and Bread



Chinese online gaming and retailers are suffering from a major slump in investor confidence, as the group that at one time could do no wrong has gone cold. Very cold! The culprit is slowing user growth, and in the case of Tencent, negative growth. Online gaming has become an overwhelming large business in China, so much so that regulators have begun to get concerned and started to ban certain titles, adding to the risk.

[Alibaba](#), [JD.com](#), [NetEase](#)



The Stillwater View: We've been all over the map on this group, but not necessarily the good side of the map. This was a great opportunity to make some real money on the short side, and while our initial

instinct was right, we just got chewed up in the execution. In the words of one very successful macro investor, "It's easier to call them than to trade them."

Good news for all of you out there with sub-700 credit scores, you have just been moved up the borrowing ladder. A recently implemented rule forbids the three credit rating agencies from including large items like civil judgement and some smaller items like parking tickets, gym memberships, and even late fees on library books into the calculation. The change increased scores by 10 points on average and 30 for those in the lower echelon.

The Magic Credit Score Formula



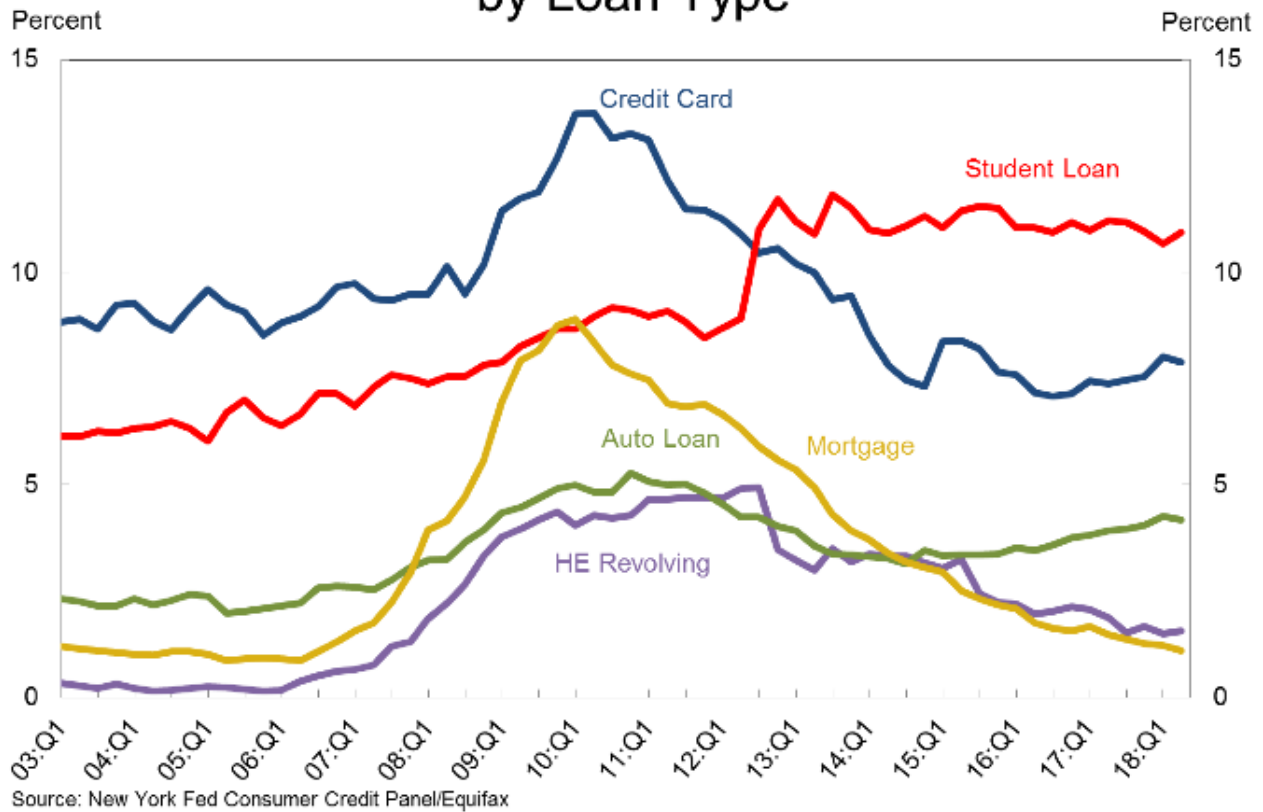
Source: The Lenders Network

For credit geeks out there who love to pore through data and immerse yourself in charts, the New York Fed released their second quarter 2018 report on the state of Household Debt and Credit in this country.

You could pick out about twenty charts that would paint a reasonably healthy picture. We chose the one that shows the 90-day delinquent trends.

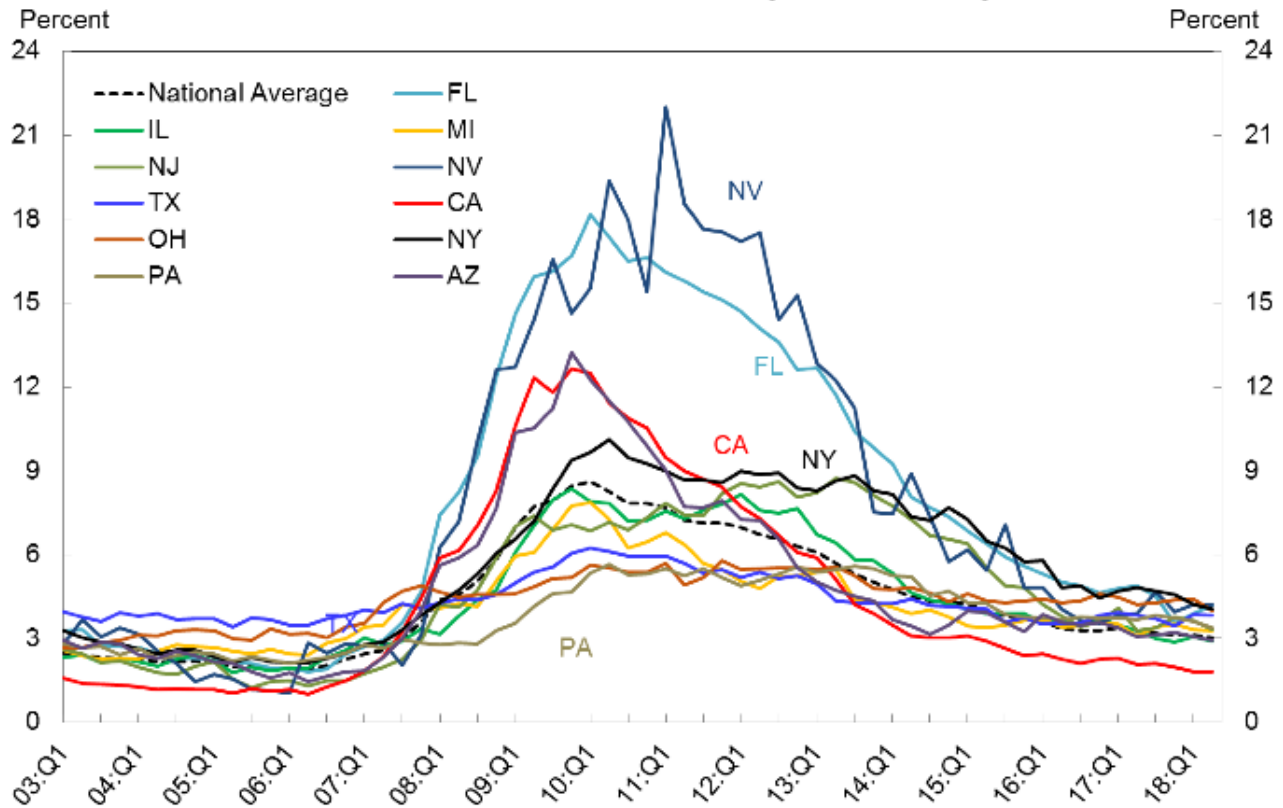
Mortgage debt and revolving credit are both still headed down, while credit card, auto, and student loans have flatlined for about three years. Something to watch as once a trend begins it tends to last a few years and provides a great read into the overall health of the consumer.

Percent of Balance 90+ Days Delinquent by Loan Type



Geographically, Nevada and Florida tend to lead the nation in borrowers who can't make good on their payments, which should come as a surprise to absolutely nobody.

Percent of Balance 90+ Days Late by State



Source: New York Fed Consumer Credit Panel/Equifax

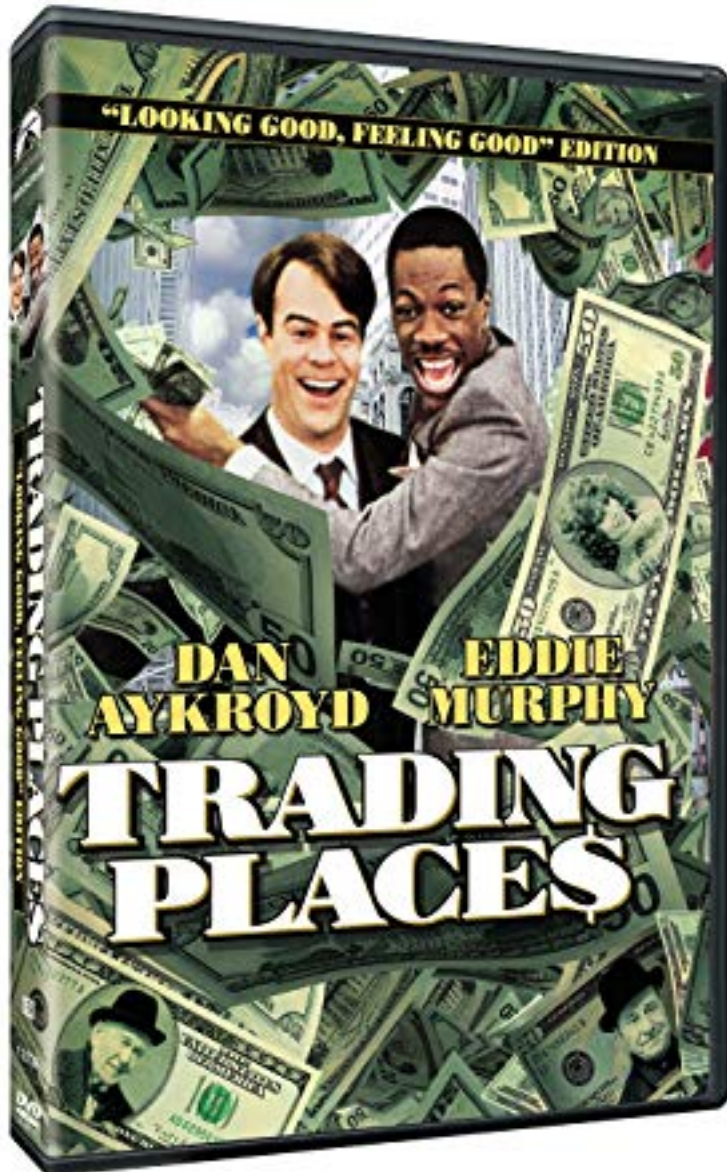
The Stillwater View: As a smart man once said, beware of shady people living in sunny places.

Up & Down Wall Street

It was a quiet week on Wall Street. Anybody pulling a real paycheck is getting close to following that long standing tradition of putting it on auto-pilot until Labor Day.

When everyone gets back in gear this September, we plan on offering up an entertaining look at the world of investing and the evolution of things you may have once had in your portfolio, have now, or may want in the future.

To keep it real we will be using Billy Ray Valentine and Louis Winthorpe III as lead characters in our financial melodrama.



This week we give you one more look at a couple of struggling hedge funds, which we must admit, is becoming a bit of an oxymoron. We cover these more than one probably should, but since it's been our beat professionally for the last twenty years, we are drawn to it like a moth to flame.

Cerrano, a well pedigreed and financed hedge fund, has closed its doors after 11 short months in operation. The fund was started by Michael Weinberger, the former head of equities at York Capital. The \$230 million fund posted a 5% gain last year and a 1 ½% loss so far in 2018. It had received backing from York founder Jaime Dinan as well as Dan Loeb of Third Point. The reason given for the quick hook? Weinberger didn't like the time that was necessary to market the fund.

The investment philosophy marketed by the firm...

“Cerrano Capital manages a concentrated, opportunistic long/short fund. While the firm is equity focused it has the ability to invest across the capital structure. The fund seeks to generate alpha and attractive absolute returns by identifying, analyzing, and profiting from dislocations, mispricing and asymmetry around surrounding corporate and industry change. Cerrano uses an opportunistic and nimble investment approach, while leveraging its investment professionals’, proven acumen and commitment to process when identifying investment opportunities.”

The Stillwater View: Well said, well spoken. They did a great job describing how they do what they do, including many of the proper buzzwords and fancy phrases like opportunistic, across the capital structure, generate alpha, dislocation, mispricing, asymmetry, acumen, and process. We give it a strong 7, maybe even an 8.

Wouldn't it be nice to just say “We buy a bunch of stocks and bonds we think are going to go up and short a bunch of stocks and bonds we think are going to go down. Our goal is to do it before everyone else figures it out. While it doesn't always work, we've been doing it for a long time with a reasonable amount of success.”

In a big setback for a guy who rarely sees big setbacks, Pierre Andurand lost 15% last month on wrong way bets in oil industry. We say rare because Andurand has made money every year since opening his eponymous shop in 2013. His main fund was down 5% through the first 7 months of the year. Pierre is on record saying \$300 per barrel is “not impossible”.

West Texas Intermediary – WTI



The Stillwater View: Funds focused on the energy industry that can bet both ways tend to be some of the most successful performers in the business. Not only do you have the business fundamentals of the underlying companies, you get the commodity risk...and reward as well.

Stillwater Capital is looking for investors to fund a new alternative energy strategy designed to make money regardless of the condition of the oil market. This will be our first singularly focused sector fund. Contact us if this would be something you would like to explore.

Diversions

In the market for something a little older, look no further than this 700 year old manor house in the English countryside. To keep that in perspective, it was built 200 years *before* Columbus sailed the ocean blue en route to America. The asking price is \$4.9 million.

Lymm Hall



Source: Mansion Global

The Queen of Soul slipped off into the big Apollo Theater in the sky this week at the age of 76. Poignant reminders of her life and music are everywhere. Our favorite performance by her was from the movie The Blues Brothers where she told her husband, Matt “Guitar” Murphy, that he better “Think” before he walked out that door to join Jake and Elwood.

John Belushi, Aretha Franklin, Dan Ackroyd



Source: Esquire

The Stillwater View: Godspeed Aretha, we hope that James Brown was there waiting for you at the gates.

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