

Stillwater Capital - This Week in the Markets



The Top- Down

On Tuesday, equity strategists at Morgan Stanley let loose a warning shot about the market when they wrote, “There’s less reason to behave like it’s “Morning in America than Happy Hour in America.” Jeremy Siegel agrees, as does Robert Schiller.

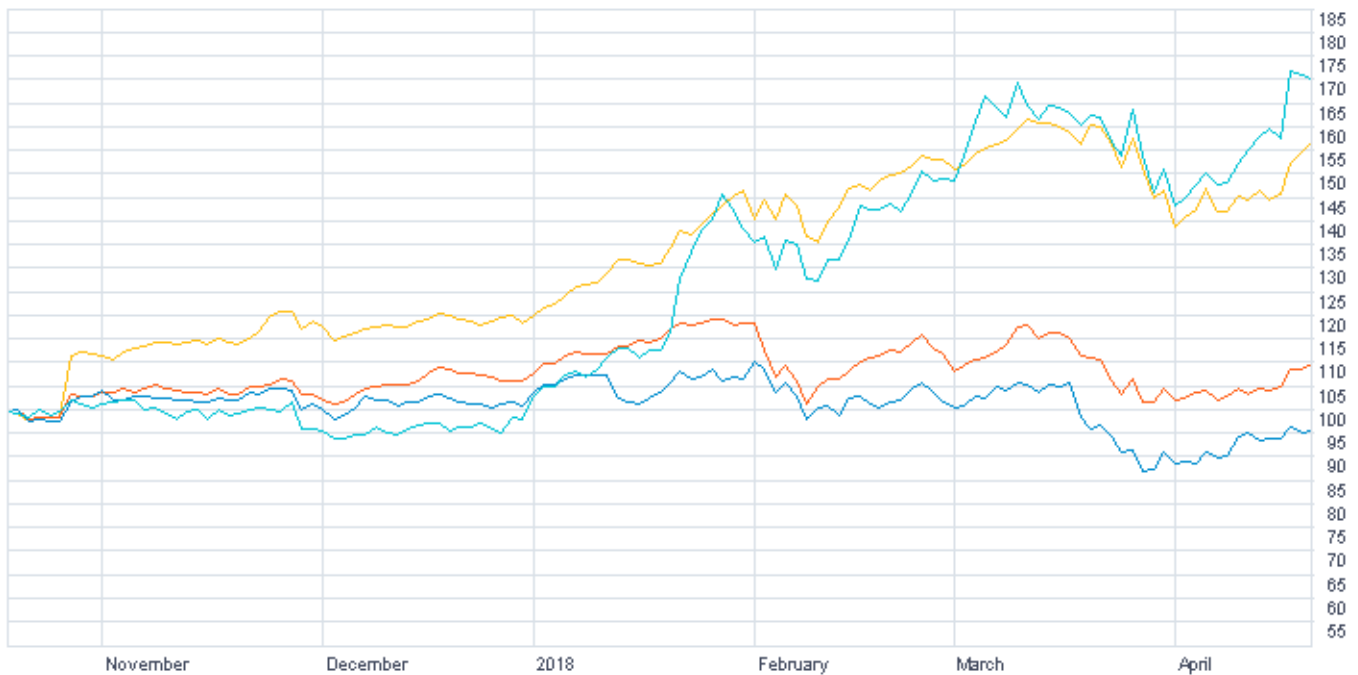
S&P 500 – GFC in Grey



Source: Macrotrends

According to Bank of America/Merrill Lynch's monthly survey of portfolio managers, a majority think equities are have topped out, or will do so later this year. Of those surveyed many are turning more cautious on technology as concerns about antitrust and privacy increase. The issue has caused divergence among the FANGs with Netflix and Amazon leading and Facebook and Google lagging.

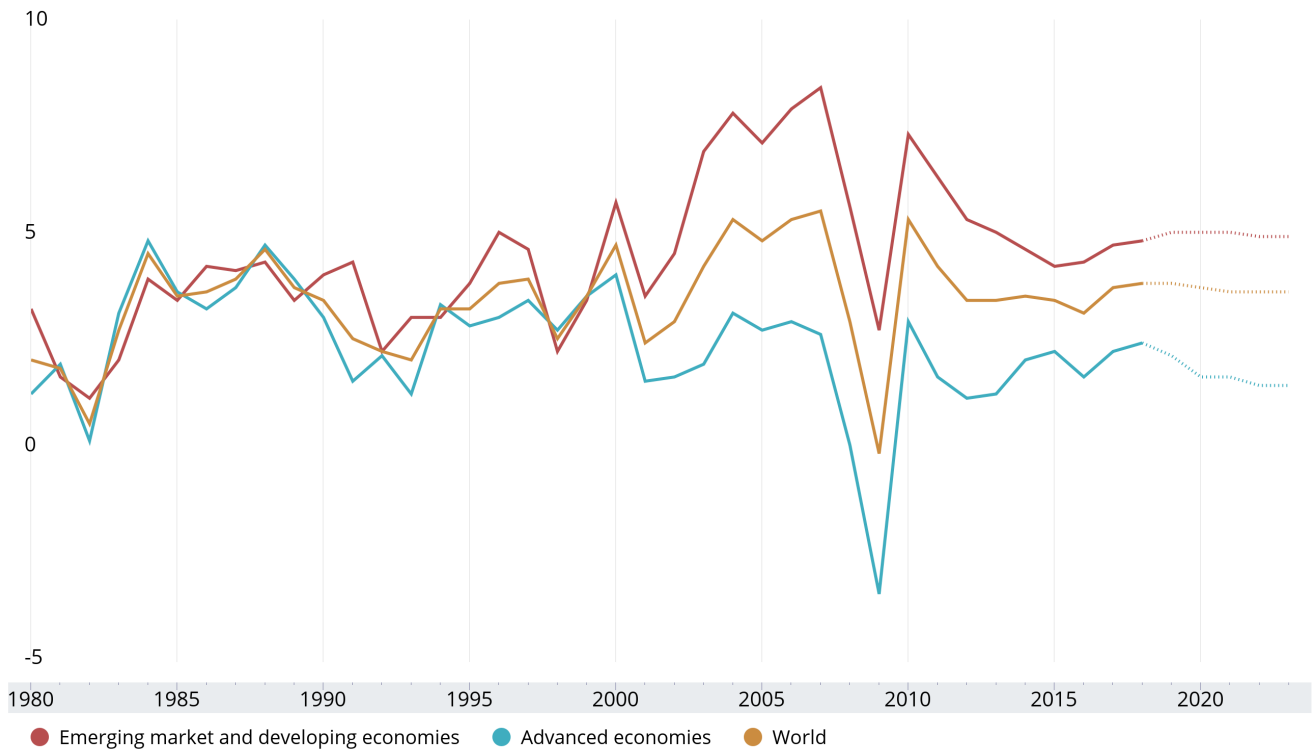
[Facebook](#), [Amazon](#), [Google](#), [Netflix](#)



Source: Nasdaq

Meanwhile, the IMF warned that global growth will peak in 2018, with the probability of posting slower growth in 2019. This view is based on rising interest rates, the unwind of central bank stimulus, and China's eventual slowdown.

IMF Global Growth Outlook



Source: IMF

The impending inversion of the yield was on Wall Street's mind this week, as the short-end and the long-end continue to converge. The financial networks were seemingly rolling out fresh economists every 30 minutes to opine on what it means for the markets.

While a complete zeroing out of the treasury curve has preceded the past five recessions, the broad equity markets have continued higher for twelve to eighteen months after it breached 0.00%. The last time it did, was in February 2006, after which the broad market rallied 25% before topping out in the fall of 2007.

Inversion Ahead



Source: Saint Louis Federal Reserve

Stillwater View: While we would like to call it a dangerous case of group think, the winds of change are indeed starting to swirl around global markets. Elevated valuations don't leave a lot of room in the form of a cushion against a unpleasant surprise.

Domestically speaking, our four big pistons driving this market continue to signal green. Albeit in a shade not quite as bright as we have grown accustomed to seeing. Earnings growth is strong, leading economic indicators continue moving higher, interest rates are fairly behaved, and the jobs market continues to tighten with wages on the rise.

The Bottom-Up

With the market knee deep in earnings and corporate news we take a whip around with 'The Good, The Bad and The Ugly'.

"You see in this world there are two kinds of people my friend. Those with loaded guns, and those who dig."

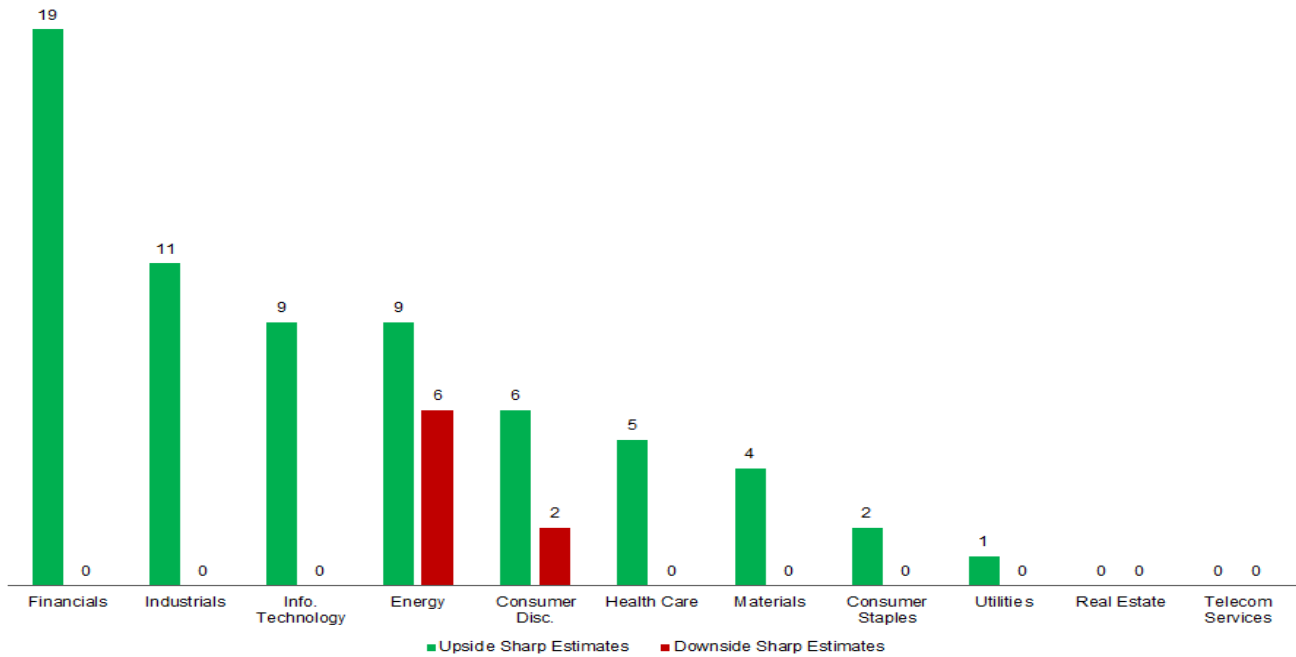


Source: IMBD

The Good

Financials outperformed this week in the wake of good earnings. Even with the headwind of a flattening yield curve. The negative impact it has on NIM (Net Interest Margin) will come home to roost as some point. Although for now, the sector is riding a wave of rising trading profits and record earnings.

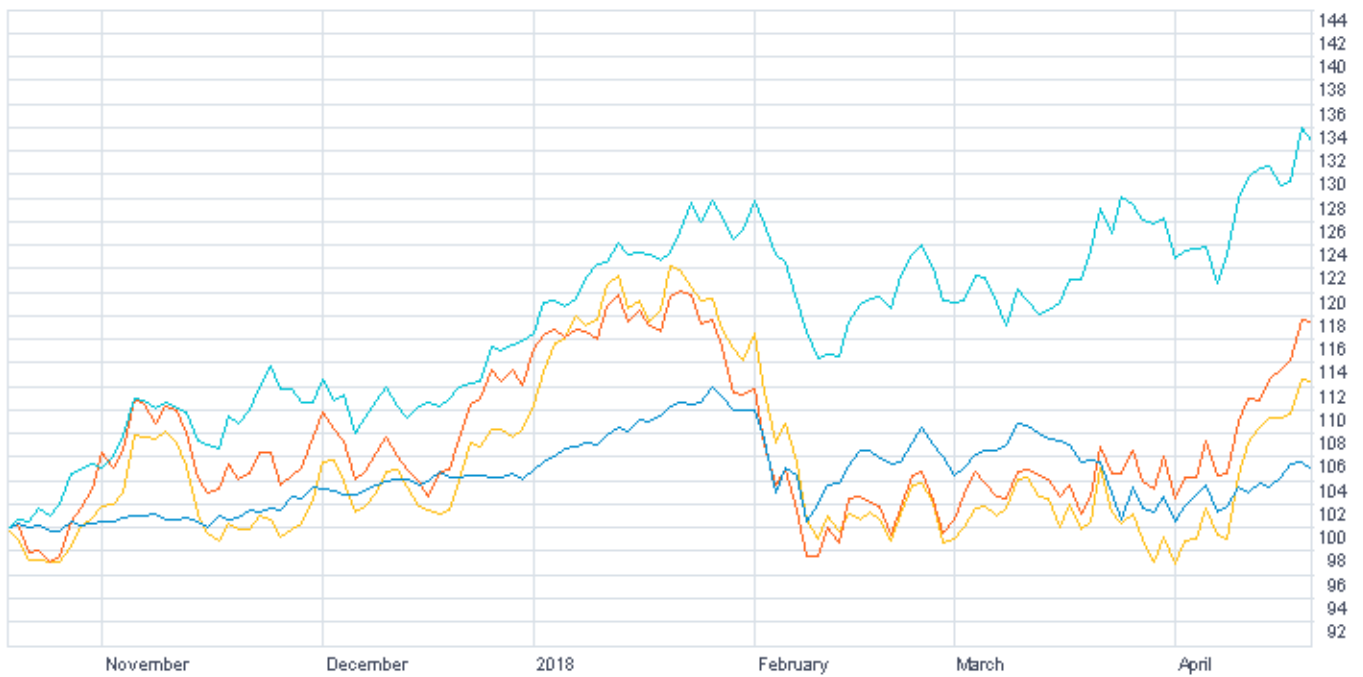
S&P Sector Surprises in Q1 2018



Source: Factset

Energy finally caught a bid, and a very strong bid at that. As companies who profit from higher crude prices played catch up with \$70 oil, supported by increased demand from a global economy firing on all cylinders.

S&P 500, Oil Service, Exploration & Production, Crude Oil



Source: Nasdaq

President Trump was out this morning, Tweeting that crude prices were too high and OPEC was manipulating the market. “Looks like OPEC is at it again,” Trump Tweeted. “Oil Prices are artificially Very High! No good and will not be accepted!”

Trump Tweets and Oil Retreats



Source: Bloomberg

Stillwater View: Energy is one of the most unloved and under owned sectors of the market. Nice to see it finally getting a little respect. Also nice to be leaning long going into it.

The Bad

Apple, and the supply chain that feeds from it, went on sale this Thursday following the news coming from Taiwan Semiconductor that demand from a certain high-end cellphone maker was weaker than anticipated. With 20% of TSMC revenue coming from Apple, you don't have to be a rocket surgeon to figure out who the guilty party was.

The semiconductor and semi equipment sector were down big on the news, as concerns about the durability of the cycle are beginning to take hold. Wall Street has started to take notice as several firms, including KeyBanc and Bernstein, warned earlier this month that sales have fallen off since December. This morning analyst Neil Campling called the iPhone 'dead' and said it would be written off next year.

The company, and second derivative suppliers, have experienced a lot of volatility with little appreciation to show for it. Maverick Capital's biggest bet in years is starting to pay off, as their belief in the smartphone market reaching a 'tipping point' is beginning to look like a reality.

Apple, Semi Sector ETF, Taiwan Semi, Applied Materials



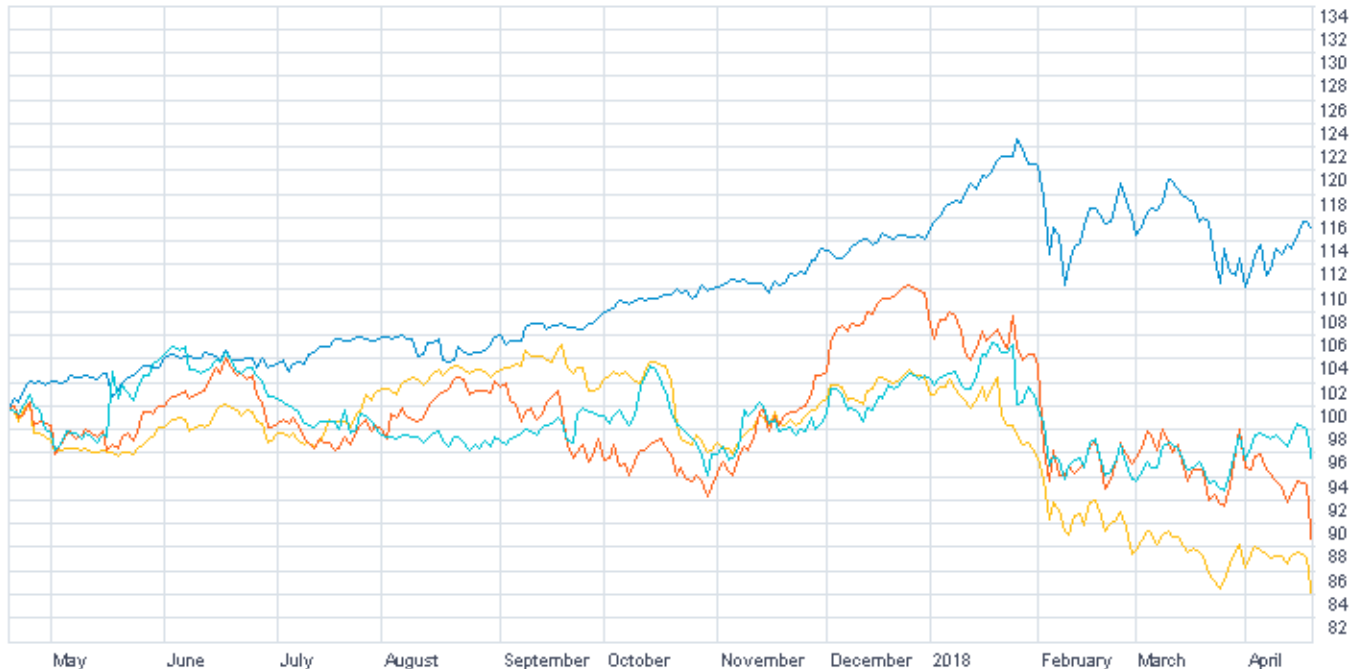
Source: Nasdaq

Stillwater View: With Apple being such a large component of the indexes, and overweight in most actively managed portfolios, it's no wonder that Wall Street is concerned. If the market loses the leadership of Apple and the semiconductor sector, it would be hard pressed to pick it all back up with strength in energy and financials.

Consumer staples continue to suffer from a lack of top-line growth and weaker margins. A trend that has been in place for the past two quarters. On Thursday, Proctor & Gamble sold off on news that Gillette was losing market share and suffering pricing pressure. Chalk one up for the little guys, as Harry's and Dollar Shave Club continue to 'Amazon' the company.

In other consumer product news, Clorox was downgraded by Morgan Stanley on concerns that consumers were shifting their buying preferences to smaller brands and other private label options. All in all, a very clouded outlook for the once safe place to hide and clip a solid dividend.

S&P 500, Proctor & Gamble, Clorox, Colgate-Palmolive



Source: Nasdaq

Stillwater View: We have been 'long and wrong' on staples in the Stillwater Trinity Equity Income strategy so far this year. While they have the lower beta and dividend income welcomed by the three pronged mandate of 1) stable equity exposure 2) income via dividends and 3) downside protection through hedges, the sector has been disappointing.

Not enough however to derail an otherwise good year as the average investor in the strategy has a 2.00% total return year-to-date with lower volatility than the overall market. The dividend yield on the strategy is just shy of 2.50%.

With growth being rewarded elsewhere, staples have fallen into a no-man's land devoid of demand. The companies are too weak on the top and bottom line for the growth crowd, and too expensive for the value cohort. And perhaps not yet interesting enough for those looking to hide out during a bear market. Which takes you to a tough spot with little sponsorship.

The Ugly

Remember when your mother told you not to smoke? Looks like someone is actually listening now as sales at Philip Morris are faltering. So much so that sellers took the stock of 'Philly Mo' down 18% on Thursday. The largest one day loss for the company in a decade. Even their new vape product, the iQos, is struggling.

Stillwater View: Kids, don't vape. It's bad for you!

Up & Down Wall Street

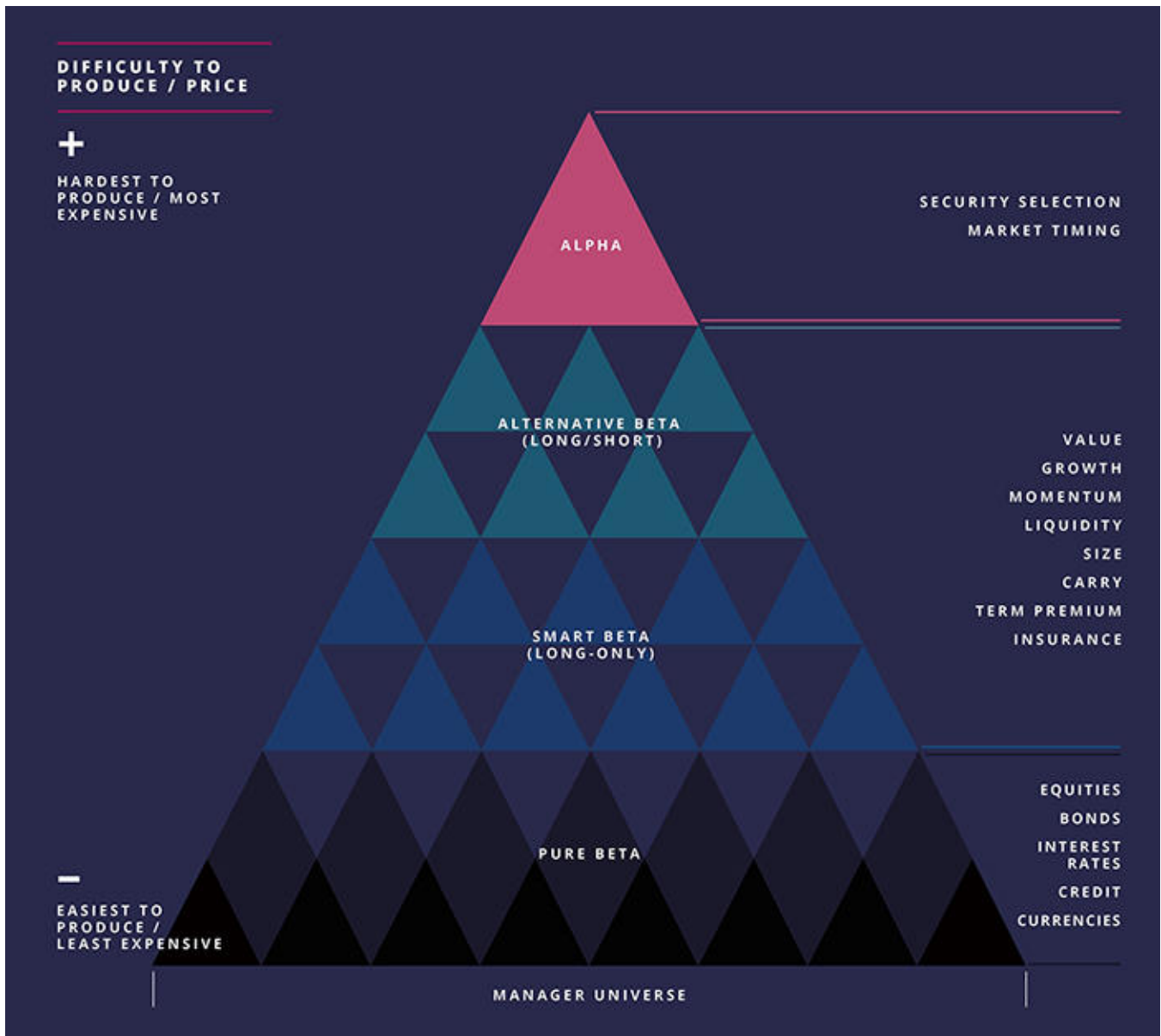
Maverick Capital founder Lee Ainslie and Hayman Capital's Kyle Bass came out in defense of hedge funds this week in a whitepaper released by Alternative Investment Management Association.

The crux of their argument was that after a decade of QE and artificial stimulus the one way Beta trade is largely over and Alpha is going to be achievable once again.

Bass opined that "History will end up repeating itself and we'll have some geopolitical risk really enter investment portfolios again accompanied by increased volatility," he added "With the introduction of those two ingredients, our business should thrive, because the passive long-only investors will not do well in that environment in my opinion, and hedge funds will do very well in that environment, on a relative basis."

Stillwater View: We agree with Kyle's view and respect his opinion. We also wish him well and hope he can recoup the negative 19% his fund saw last year. Largely on a short wager against China.

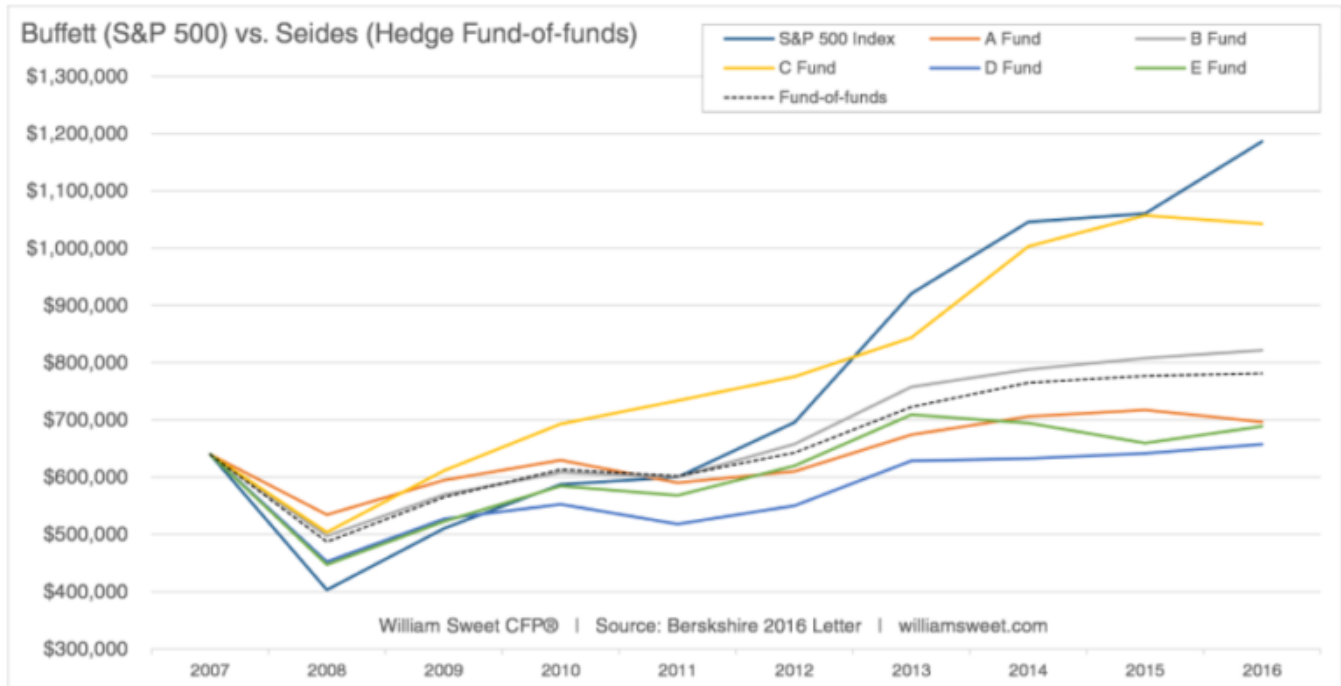
The Beta vs. Alpha Taxonomy



Source: AIMA

The hedge fund industry better hope that there is a return of Alpha, as there has indeed been a lack of it over the past ten years. Warren Buffet's famous bet with Ted Seides of Protégé Partners, that the indexes would beat hedge funds, has paid off in spades. At least for Girls Inc. of Omaha. Seides explains why he lost to Buffett in a [Bloomberg](#) post.

Buffett Wins...In a Landslide



Source: Ritholtz

Stillwater View: As Siedes points out, don't compare apples to oranges, even if you have a \$1 million side bet on the line.

Indexes and hedge funds aren't supposed to act the same. That's why the former is called an equity index and the latter alternative equity. It doesn't absolve hedge funds from dismal performance, it simply puts it in context.

Stillwater is bullish on alternative equity. For one, that's what we do. But also because the market is ripe for a change in demeanor after the long one way march that has brought the markets to these levels. Our most favored approach is long biased with a flexible mandate to exposure.

And if you thought your tax bill was high this year, take a look at what big name managers Paulson, Einhorn, and Cohen and having to hand over as a ten year old rules change obligation regarding offshore funds comes due.

Larry Fink and BlackRock have been 'absolutely killing it' as the hip kids say. The world's largest asset manager reported blowout earnings with AUM tipping just north of \$6.3 trillion. And yes, that's 'trillion' with a big old fat 't'.

BlackRock's success recently made Larry Fink a billionaire through his 0.7% interest in the firm. Not a bad outcome for a company that started as 'two guys in a room with an idea and no revenue.'

Fink Receiving the UCLA Medal from Alma Mater



Source: UCLA Anderson School

Stillwater View: To all those of you out there with an idea and no revenue, we salute you. Keep hope alive!

Wells Fargo announced that headcount in its wealth advisory business fell again in Q1. This continues the trend of attrition to six straight quarters as the brand continues to suffer the fallout from the sales practice scandal. Even with advisors fleeing the firm Wells managed to increase profitability in the division. It is being widely reported this morning that the company is looking down the barrel of \$1 billion fine from the government.

[Morgan Stanley](#) & [SVB Financial](#) vs. [Wells Fargo](#)



Source: Nasdaq

Stillwater View: The firm has held a short position in Wells against long positions in Morgan Stanley and SVB Financial (Silicon Valley Bank). We have done so based on the headwinds faced by the former's brand against the tailwinds pushing profitability at the latter two.

Diversions

On Monday, Patriots Day, an American woman won the Boston Marathon for the first time in 33 years, as Desiree Linden from Chula Vista, California crossed the finish line ahead of an international field. A race that *Outside* magazine's Martin Huber called the 'most enjoyable to watch ever.'

At 85, Katherine Beiers was the oldest to compete. While three time cancer survivor Mary Shertenlieb successfully finished the race after midnight.

Desiree Linden



Source: CBS Boston

Stillwater View: Winners, every single one of them.

While this is family publication, we would be remiss if we didn't send a mellow 'Happy 4/20' to anyone out there celebrating marijuana's high holiday this year. We do live in California after all.

PennLive has the story on how five 'stoner kids' from San Rafael started the tradition 50 years ago. Good luck out there, especially to residents who live in the epicenter of the legalize pot movement in Denver, Colorado.

“Happy 4/20”



Source: Denver Post

It was a sad week in America as former first lady Barbara Bush passed away at the age of 92. The woman who the secret service code named ‘Tranquility’, slipped through the bonds of this earth with the her husband, George H.W. Bush, by her side.

Her son, and 43rd president, George W. Bush, retold the story of when she asked a doctor if he knew why “W” was the way he was. When the surprised doc didn’t respond she said “Because I smoked and I drank when I was pregnant with him”.

First Lady Barbara Bush



Source: CBS News

Stillwater View: Our heartfelt condolences to the Bush family. Godspeed, Barbara.

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