

## *Stillwater Capital - This Week in the Markets*

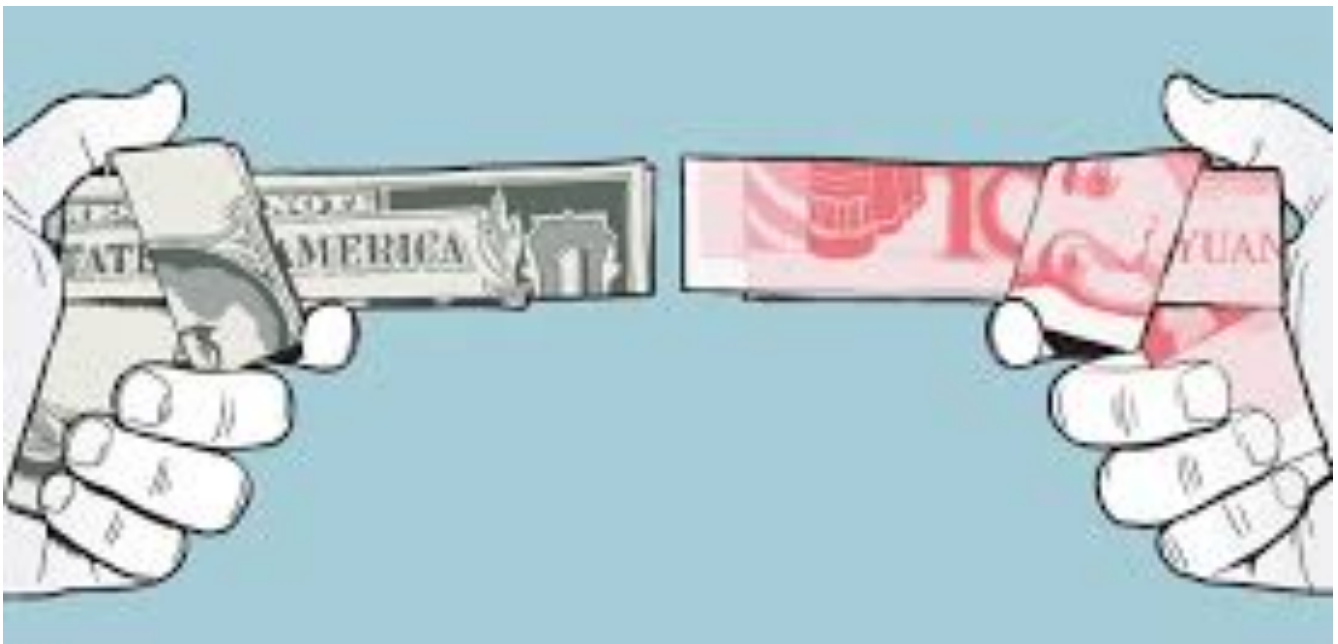


### *The Economic Top- Down*

The lukewarm Tariff war with China continued this week with more warning shots fired by both sides. Each added billions more in threatened consideration for goods crossing the Pacific. We say lukewarm because the while the bluster is headline grabbing the impact on the ground is not showing up. J.P. Morgan's Jamie Dimon called it more of a "trade skirmish" on Wednesday.

China now has imposed tariffs on \$50 billion in goods sent by us and has another \$60 billion locked in and ready to go. The United States has \$50 billion of tariffs in place on stuff they send us and has \$200 billion more lined up.

### **(Warning) Shots Fired**

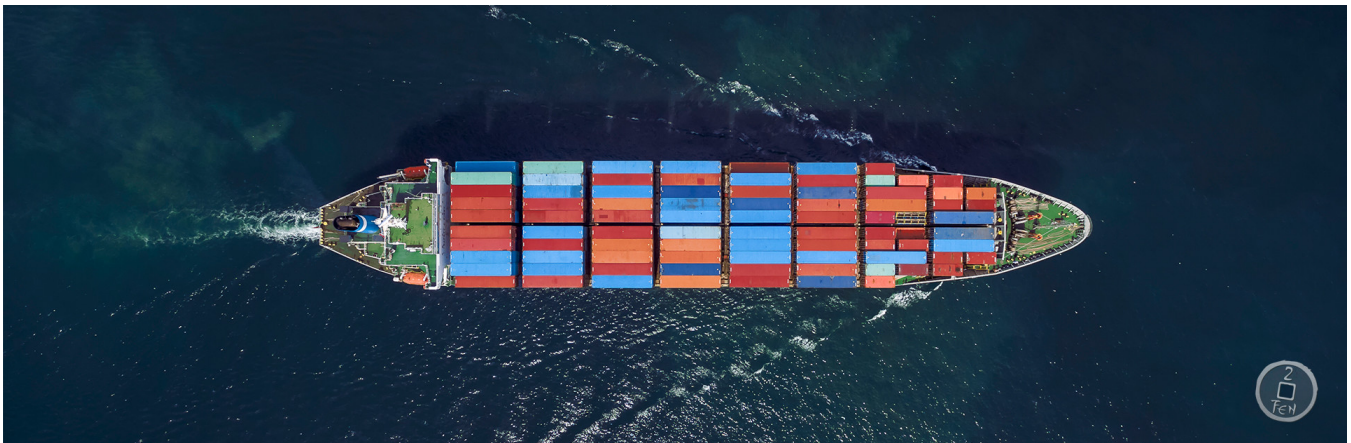


Source: WCC F-Tech

To keep things in perspective, we export a total of \$130 billion to China while they export to us \$500 billion. Point being that they have \$20 billion of dry powder left and we have \$250 billion.

*Macro Polo* has a great piece walking through how different scenarios might play out. While a few industries are in the cross hairs, the market doesn't seem to be showing much concern. Let the brinkmanship continue until something goes bump in the night...or the day.

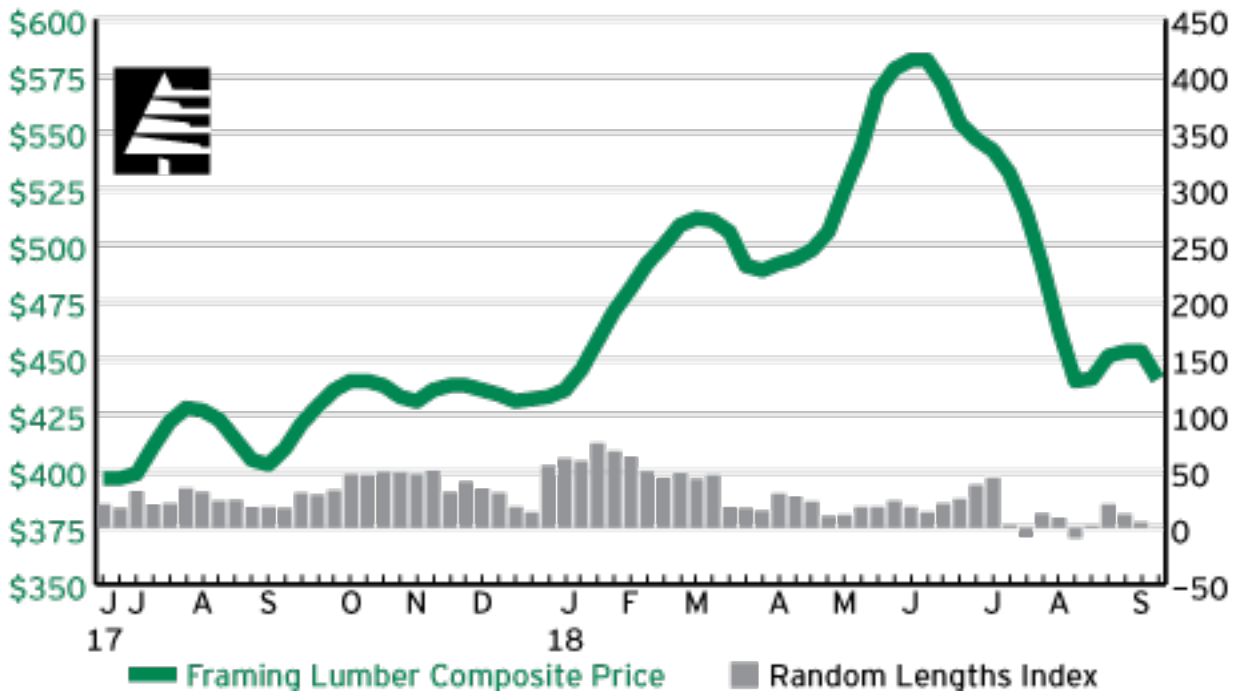
### **Rocky Shores Ahead?**



Source: Macro Polo

In other tariff related news, lumber prices have come back down to earth after spiking in the summer. The rise was largely the result of fears surrounding the impact of tariffs on Canadian imports. Since then, concern has entered the market that new home sales have plateaued and housing appears to be taking a breather.

### **Framing Lumber Prices**



Source: Random Lengths

Well, well, well. Look what happened to rates this week. The ten-year crossed over 3%...and actually stayed there. Goldman calls the situation in real rates like 'a boiling of the frog' as it puts risk assets in the crosshairs. The markets don't see it that way as both rates and equities rose this week.

**Bonds & Equities Both Up**

## Correlation Intact

Bond yields and stocks moving in unison



Source: Bloomberg

*The Stillwater View: For now the market is acting like an spoiled child that doesn't seem to care. Which is a far different scenario from February of this year when a rate spike spooked the equity market. Another really smart guy sees the divergence as being too big to ignore as well.*



**Jeffrey Gundlach** ✓

@TruthGundlach

Following

Yields: On the march! 10's above 3% again, this time without financial media concern. Watch 3.25% on 30's. Two closes above = game changer.

7:26 PM - 18 Sep 2018

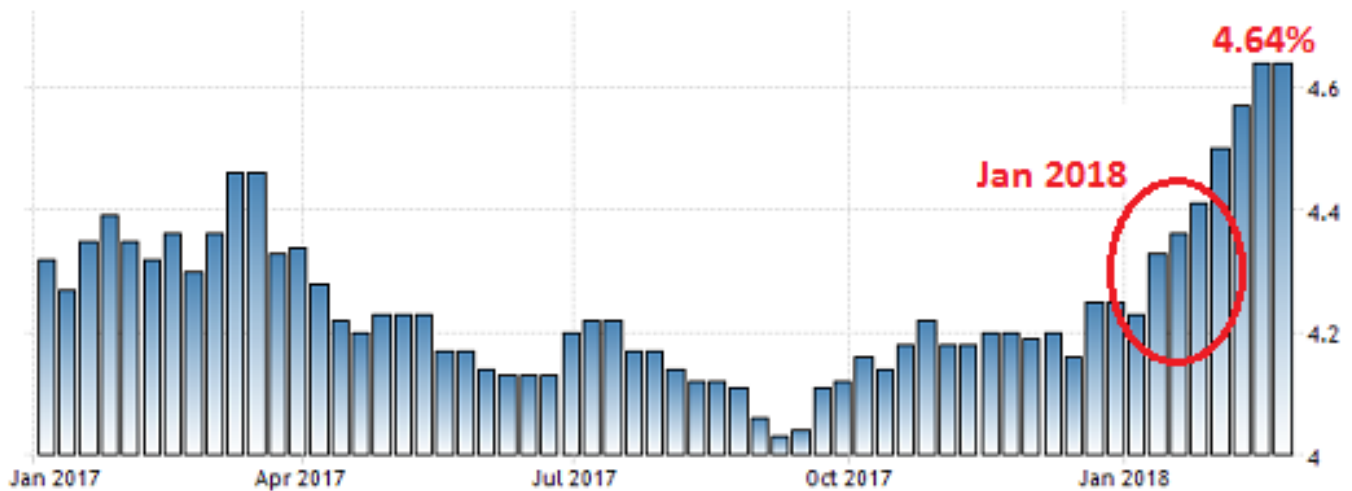
The move higher in rates sent a solid bid into banks as they benefit the widening spread on loans. You remember, borrow short and lend long?

Financials have lagged the broad market this year out of concern with the flattening of the yield curve and what it means to profitable lending and credit growth. Bankrate gives you 7 reasons why higher rates are a good thing, and then tries to sell you a savings account. Better lock in that mortgage now, things are looking up. Just as inventories of homes are as well while prices are coming down.

**Mortgage Rates on the Move**

# Interest Rate for 30-Year Fixed-Rate Mortgages

## Mortgage Bankers Association



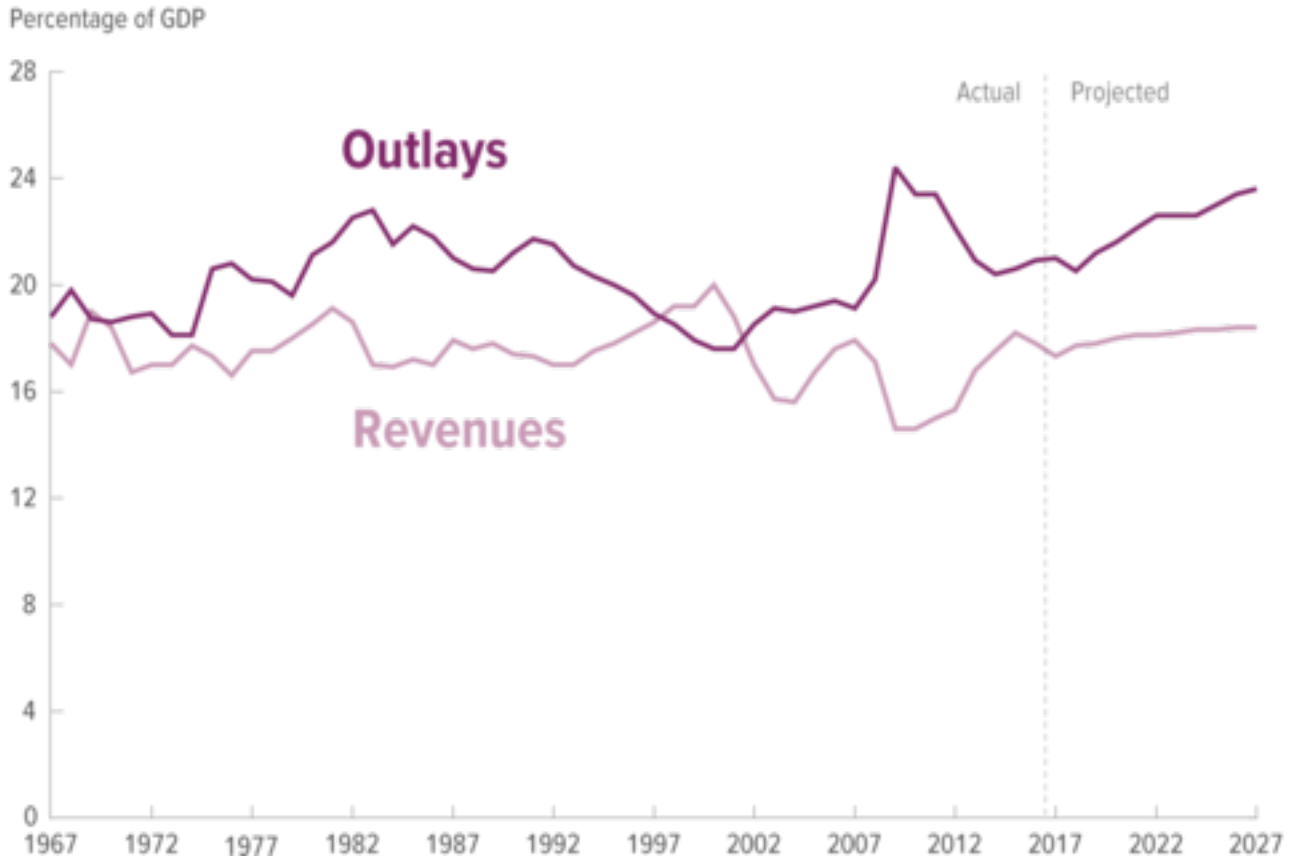
SOURCE: TRADINGECONOMICS.COM | MORTGAGE BANKERS ASSOCIATION OF AMERICA

Source: Mortgage Bankers Association

An emerging risk, that very few in Washington D.C. seem to care about, is the rising federal deficit and the eventual need to pay for it in a rising rate environment. Something that hasn't happened since Jimmy Carter was president.

The pivot point is if United States can get into a long-term economic growth to stay above trend growth. More growth, more revenue, more revenue, less deficit. All of which leads to a narrower spread between outlays and revenues.

**Just Grow, Baby!**



Source: CBO

*The Stillwater View: This is the time of milk and honey in the economy. The trillion dollar question remains, are we in a new era or has the economic cycle been revoked?*

*The former would mean that "it's different this time" while the latter would follow an economic tradition going back a century. The jury is out for now, but the party is on and the host is pouring 100 proof into the punch bowl.*

**Drink Up While the Drinking is Good!**



Source: The Washington Post

### *The Fundamental Bottom Up*

Jeff Bezos made an appearance on the *David Rubenstein Show* this week. He and Rubenstein discussing everything from Amazon prime being a buffet for “big eaters” to why he set the companies roots in Seattle. In the conversation he credits the “art of wandering” for his ultimate success. Bezos owns 16% of the \$1 trillion company. And *Business Insider* explains how this week’s announcement shows just how much he plans on owning the home.

### **Amazon Goes Parabolic**



Source: macrotrends

*The Stillwater View: Twenty years ago during the Dot.com bust AMZN went from \$130 to \$6. Turns out that was a pretty good buying opportunity as its now trading at \$2,000.*

*Dear Mr. Bezos, I apologize for ever shorting your stock. That was a really poor idea and I want to make amends. For a whole host of good reasons Stillwater currently holds a decently sized position in the shares.*

As was mentioned in the *Top Down*, higher rates this week put a bid under the banking sector. As the chart below shows, this has indeed been a mediocre year for financials as the overhang of a flattening curve, and what that does for credit creation, has been a headwind.

### **Banks Flatline in 2018**



Wells Fargo has been its own special underperforming snowflake for the past two years as boiler-room sales tactics at the bank has put a serious tarnish on the brand. The shares got a lift this week as speculation rose that Gary Cohn might be lined up to be the next CEO if Tim Sloan can't get the Wells Fargo wagon back on the tracks. Yesterday, the company announced that it would cut 5% to 10% of its workforce over the next three years.

### Wells Fargo Re-Commits



Source: YouTube

Market watchers went wild this week when Tilray, a Canadian cannabis producer went up 50%...in a day! The move was sparked when CEO Brenden Kennedy appeared on Jim Cramer's *Mad Money* and talked about the pot industry being a great hedge against tobacco and alcohol.

*CNBC* nearly lost its mind, covering the parabolic move in the pot stocks from every angle possible. Including the opinion of one analyst who thinks that "this is just stupid time." Even if this is simply a case of stupid is as stupid does, the stock has gone up ten-fold in two months.

**That's Dope!**



Source: CNBC & Getty Images

*The Stillwater View: To our fellow short sellers Andrew Left and Michael Novogratz, good luck with your “manageable” position against Tilray and other cannabis stocks. Given the current market fever we would need to put on an adult diaper to stay in that trade.*

**It All Depends**



Source: PM Caregivers

Vivek Ranadive, founder of TIBCO Software, and current owner of the Sacramento Kings, made an appearance at AltsSV, an alternative investment conference we attended in Silicon Valley earlier this week.

**Vlade Divac, Vivek Ranadivé, and Shaq**



Source: Sacramento Bee

During his time on stage Vivek wandered through his early life in India, arriving at MIT with \$50 in his pocket, and how the city of Sacramento pulled off coup by keeping the Kings out of Steve Balmer's hands. He also joked about the first time he coached his daughters basketball team and that his complete lack of knowledge of the sport forced him to have the girls spend their entire practice running laps around the court.

When it came to innovation and growth from the bottom up, he said to forget perks like dogs in the office, foosball tables, and company chefs. These wont draw out of you the thinking you need to hatch ideas that can truly change an industry or the world.

**Millennials Can be So Very Demanding!**



Source: Made in Silicon Valley

Instead, he said, lock the company talent in a room with no food, water, lights, or electricity and see if anything comes out of it. If there are “green shoots” emerging under the door then maybe you have something. It will show that there was a real fire and a desire to think like an entrepreneur, searching desperately for a solution, and come out with an idea of how to change the world.

**Wozniak & Jobs Circa 1976**



*The Stillwater View: HHS, ohhh you are the very best! Good luck tonight against Los Gatos. Go Mustangs!*

### *Markets*

Mohamad El-Erian joined the party this week saying that global divergence in markets is the biggest risk right now. Jeff Gundlach said something similar the week before. And the aspirational Stillwater Capital said the same thing a week earlier. Great minds....

The U.S., The World, Emerging Market

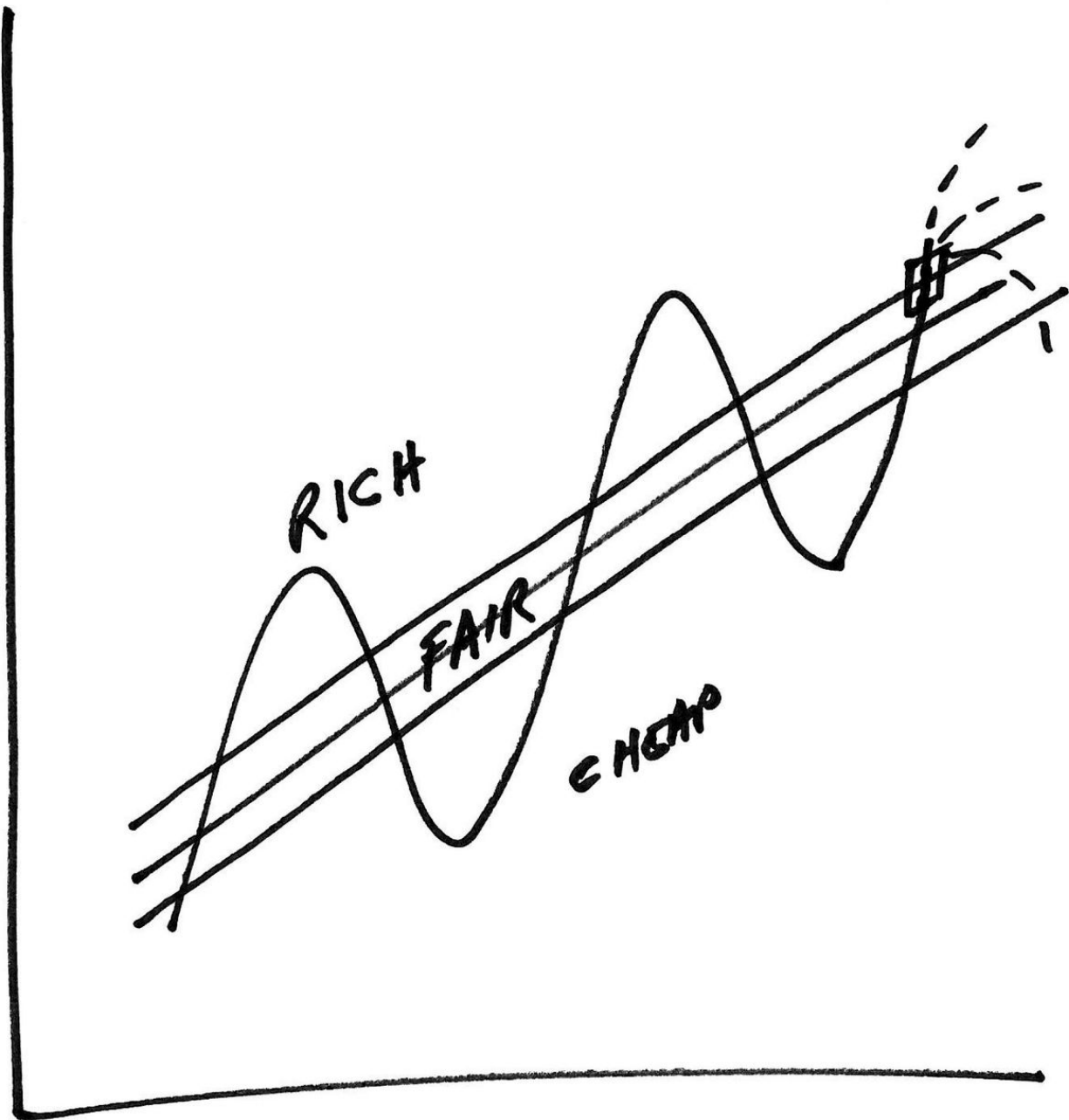


*The Stillwater View: The fact remains, the divergence in these markets will narrow at some point. Which side gives in is the money making question.*

Billionaire investor and founder of Oak Tree Capital, Howard Marks has been making the rounds to promote his new book "Mastering the Market Cycle". But it's not necessary what you might think. Mr. Marks makes the point that the more you try to guess every inflection point, the more likely you will get whipsawed that you will never get it right. Similar to the adage, "you can't see the forest for the trees."

The more you understanding the economic cycle, the more likely you will be able channel it into a clarity that can help you avoid being overcome by emotions. He writes, "Everything about our human makeup conspires to make us do the wrong thing. Most people get excited at the highs and depressed at the lows instead of being able to buy low and sell high. That's the human failing."

**Rich, Fair, Cheap**



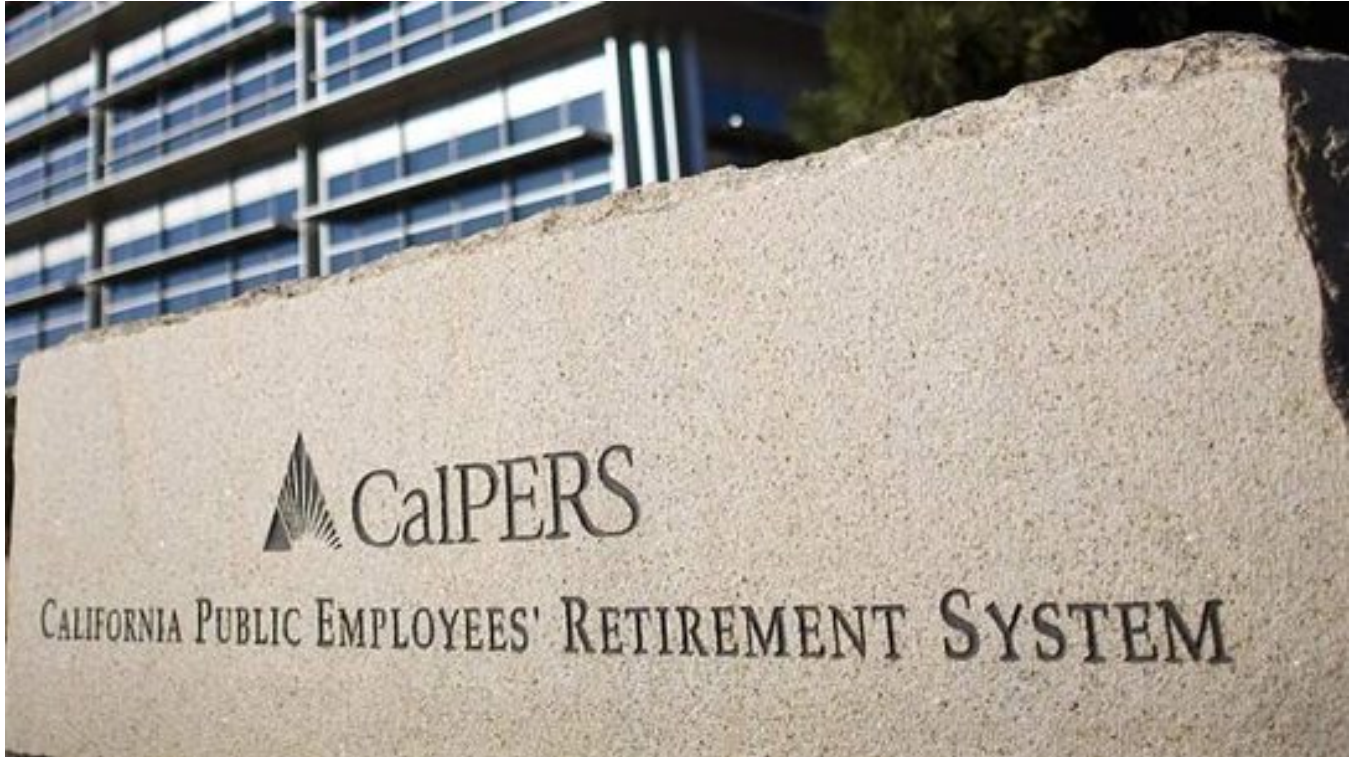
Source: Howard Marks and The Wall Street Journal

### *Investing*

As mentioned earlier, we spent the early part of the week at Alts Silicon Valley. A gathering of investors, practitioners, vendors, and financial institutions. One of the morning sessions had three pension fund managers providing their insights into where the world was headed. Their views were synchronized, as each said their plans were reducing risk and bringing down

expected returns for the next few years. The three collectively managed over \$400 billion in assets.

### **One of the Members**

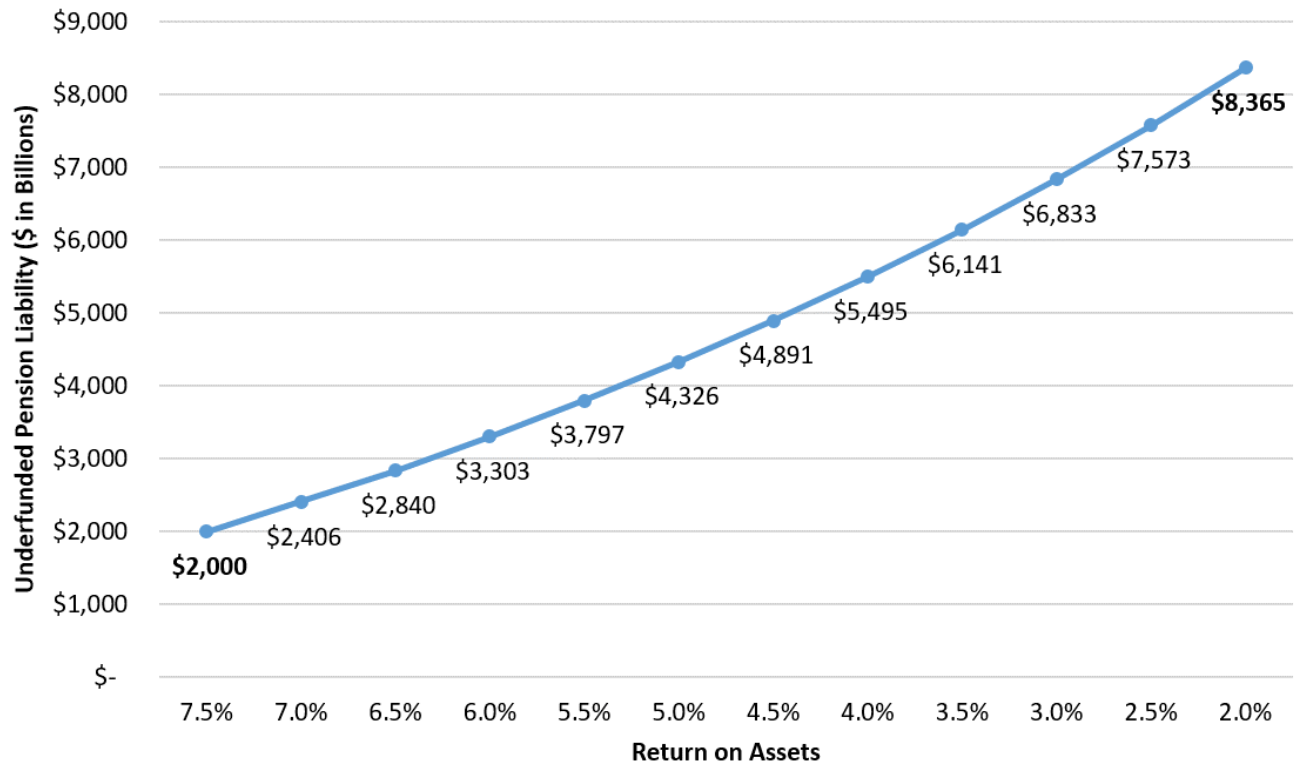


Source: Snopes

If you get scared by big numbers that are probably going the wrong way, skip the next chart. It shows how underfunding balloons when investment returns drop from the magic 7.5% that most plans need to keep the wheels spinning. This is compounded by the fact that there are far fewer paying in to today pension plans than are getting paid out. Twenty years ago California had four workers paying in for every one worker being paid out. Today that ratio down to two payors for every one payee.

### **Hope Is Not a Strategy**

## Federal/State/Local Underfunded Public Pension Liability



Source: ZeroHedge

This is a perfect segue to setup for the conclusion of our three part Billy Ray and Louis saga. Our man Billy Ray Valentine sold his G.I. Joe with the Kung Fu grip company to Mattel, netting him a cool \$10 million. His financial advisor Louis, told him to spread that money between awesome (bonds) and amazing (stocks). As part of the deal with Mattel he got a nice piece of equity.

### Louis & Billy Ray Celebrating



Source: Mental Floss

Fast forward ten years and Amazon comes along decides it desperately want in on the G.I. Joe franchise and buys Mattel for \$10 billion. When the deal closed Billy Ray now had a liquid net worth of \$100 million. His next stop was to pay his advisor Louis Winthrop III a visit and ask what he should do with the money. The conversation went something like this.

Bill Ray: Well, well, well. Looks like I rounded the bases again. Never in a million years did I think...

Louis: Stop right there. You had a vision, worked hard, and made your own luck. Never lose sight of that.

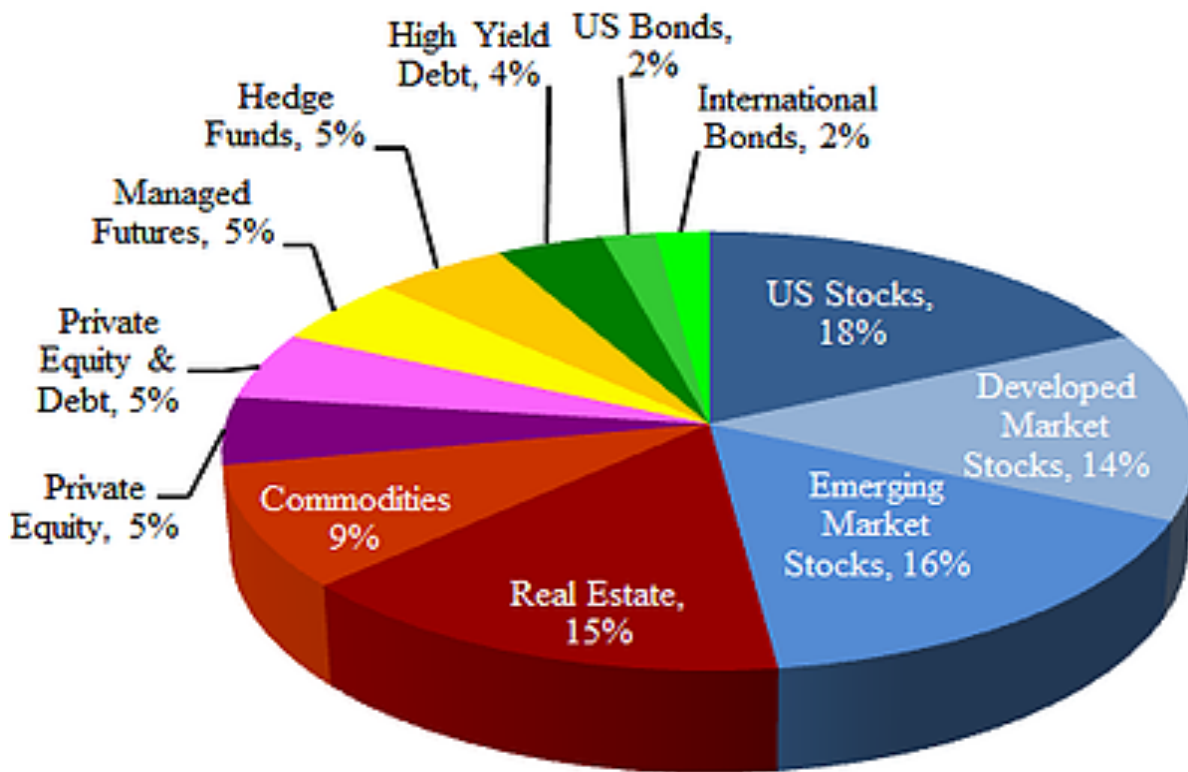
Billy Ray: You are indeed correct. Now get over your manly crush on me and lets figure out what we are doing next. My goal with much of this money is to create an endowment to fund my charity, Kids with Problems. How do we invest the money to do that?

Louis: Okay, so far you followed the script well. Owning both awesome and amazing in a good ratio of each. Now that you have made a big payday it's time to diversify with some awesome and amazing but different (alternatives).

Billy Ray: Awesome and amazing but different? Help me out here.

Louis: Once you get to this point our investment plan really changes. Because you have made so much money, and the funding needs aren't astronomical, we can diversify into things like high-yield awesome, and alternative amazing. Not to mention owning amazing and awesome bridges and tunnels. This is what called the endowment model and it's been working for places like Yale for a long time.

### Diversified Awesome & Amazing



Source: Wildermuth Advisory

Billy Ray: So if I'm getting this right, we slice up our pie into more pieces that each taste a little different?

Louis: Exactly. And if we stick to a plan to move the money around when the opportunity arises, your endowment will thrive and you will have successfully completed a long journey.

Billy Ray: You're a good man, Louis. Even if those mean old Duke brothers tried to take you out.

Louis: You to are a good man. Taking a big chuck of your money to make kids' lives better is a good and noble cause. I do have one question though. Where did you come up with the name Kids With Problems?

Billy Ray: I'm glad you asked. You tell a kid he's "underprivileged", it leaves a mark. Call them "at risk" and it leaves a stain. Call them "Kids With Problems" and you take that mark and that stain away. Because at the end of the day, we all got problems. You, me, everyone. And you can overcome any problem if you put your mind to. It just takes time and effort.

### **Good Times, Good Times**



Source: Etsy

*The Stillwater View: And with that our story ends. We just took you through Billy Ray as a young investor, as a business owner who cashes in, and as a large equity owner who cashes in again.*

*We demystified the world of investing by stripping away the names stocks, bonds and alternatives and just called them what they are; amazing, awesome, and amazing and awesome but different. We hope you enjoyed it and wish you the best as you travel this path yourself.*

### ***Diversions***

While we tend to be light on the call to action requests, this one is close to our heart and very much worth it. As you read this, 30 boats with over 200 paddlers are crossing the Santa Barbara Channel headed to Santa Cruz Island. Saturday morning they will enter the water early and cross the 25 mile wide channel on paddle boards. They are doing so to raise money and support for Cameron Benson who is suffering from a rare strain of cancer.

### **Ella, Cameron, Lisa, and Josh**



Source: The Friendship Paddle

This will be the 15<sup>th</sup> year that this group of like-minded waterman and women will make the crossing. Each year paddling for a different beneficiary. It's a truly special group of people who deserve every accolade given and every dollar they can raise. Please do what you can to help their cause. The Friendship Paddle.

## Paddlers Setting Out



Source: The Frienship Paddle

Looks like Anthony “Mooch” Scaramucci doesn’t have much staying power in real estate either as he is trying to flip out of the Hamptons house he purchased just nine months ago. This is the same guy who lasted a whole 10 days as White House communication director. In his mind those nine months were special. So special that the \$7.49 million he paid is now worth \$9.00 million. Anthony is leaving to find a place “closer to the water.”

**30 Lawrence Court, Water Mill**



Source: Town & Country

You have exactly one month to get your tickets to the final night of the 2018 Outlaw Music Festival featuring Willie Nelson at the Hollywood Bowl. The Red Headed Stranger will be joined by Margo Price, Sturgill Simpson, and the Grateful Dead's Phil Lesh. The tour has included stops with Neil Young, Van Morrison, The Avett Brothers, and Old Crow Medicine Show.

## **Willie and Lukas Nelson**



*The Stillwater View: While Willie might be “Still Not Dead” don’t blame us when he is and you missed his last tour. It’s not like this one is going to creep up on anyone. We call dibs on Triggerer.*

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