



### **The Top-Down**

Federal Reserve Chair Janet Yellen showed a rare [hawkish side](#) this week when she commented that “It would be imprudent to keep monetary policy on hold until inflation is back to 2 percent.”, adding that the Fed “should also be wary of moving too gradually”. On the news, rates spiked to 2.30% on the ten-year Treasury. Once again, financials performed well and yield havens sold off. Former Morgan Stanley global strategist and current Yale professor Stephen Roach thinks [rising rates](#) are the biggest risk to this ‘frothy’ market.

*Stillwater View: Well played Janet. Well played. It’s time for the Fed to start conditioning the market for higher rates, regardless of what the inflation rate is saying. Normalize now or normalize later, rates will eventually find a home at higher levels.*

### **Effective Fed Funds Rate - 1955 to Present**

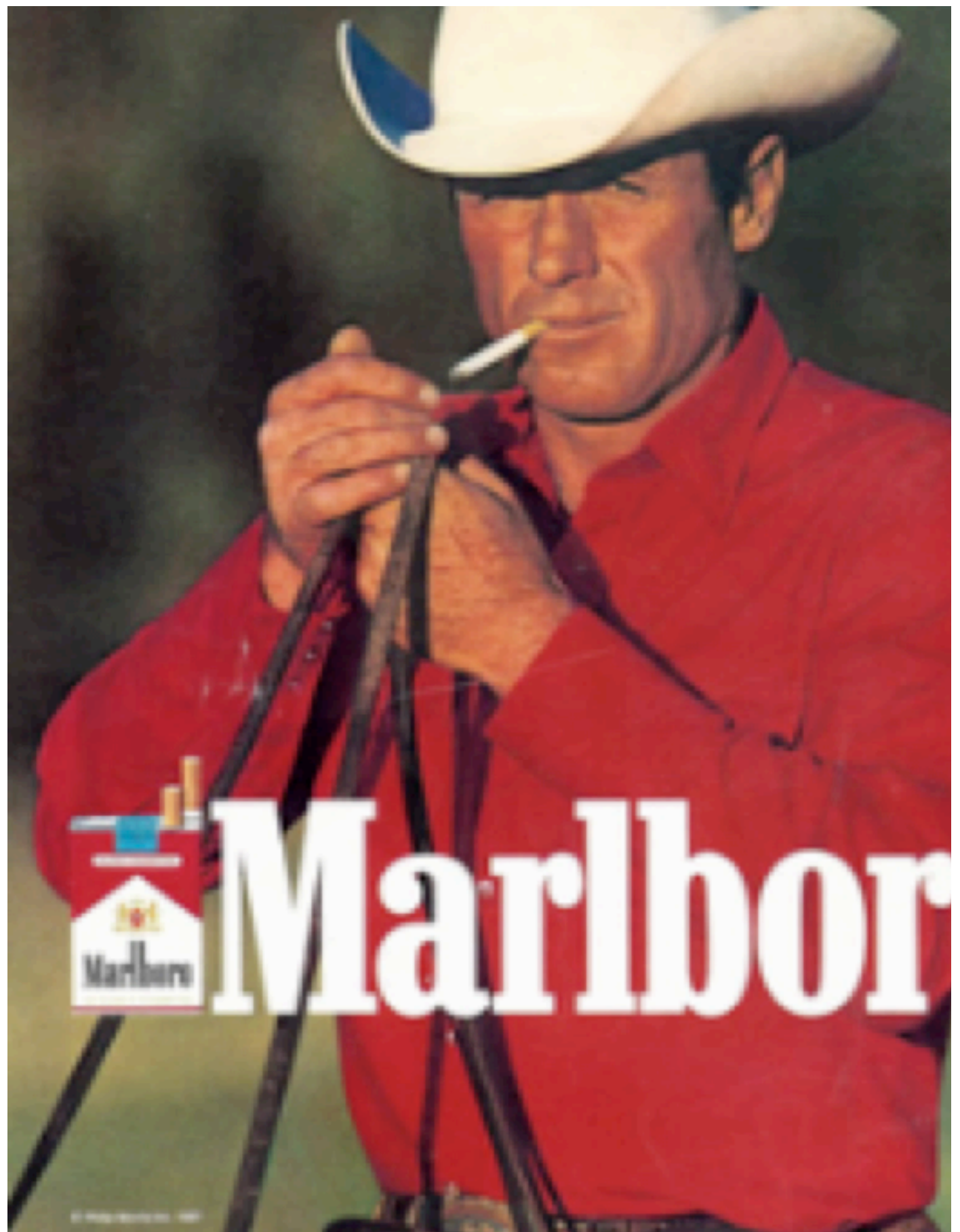


UBS joined [Wells Fargo](#) this week in advising clients to tack portfolios into a more defensive position, as “rising valuations are reducing the possibility of significant further upside.” The Swiss bank doesn’t see enough downside risk however to employ hedges. The firm’s technical team is calling September the near-term top for the S&P 500.

"Together with the divergence on the volatility side in the VIX, and the Russell-2000 vol index, our weekly trend work turning short, plus the SPX breaking its early September trading low at 2,157, we have clear evidence that our suggested September top is in place,"

*Stillwater View: It's hard to know if there is anyone left who hasn't rung the de-risk bell yet the market moves higher. A colleague referred to this as the Marlboro Man market. Lighting up one unfiltered Red after another, unflinchingly cool in the saddle as he does it.*

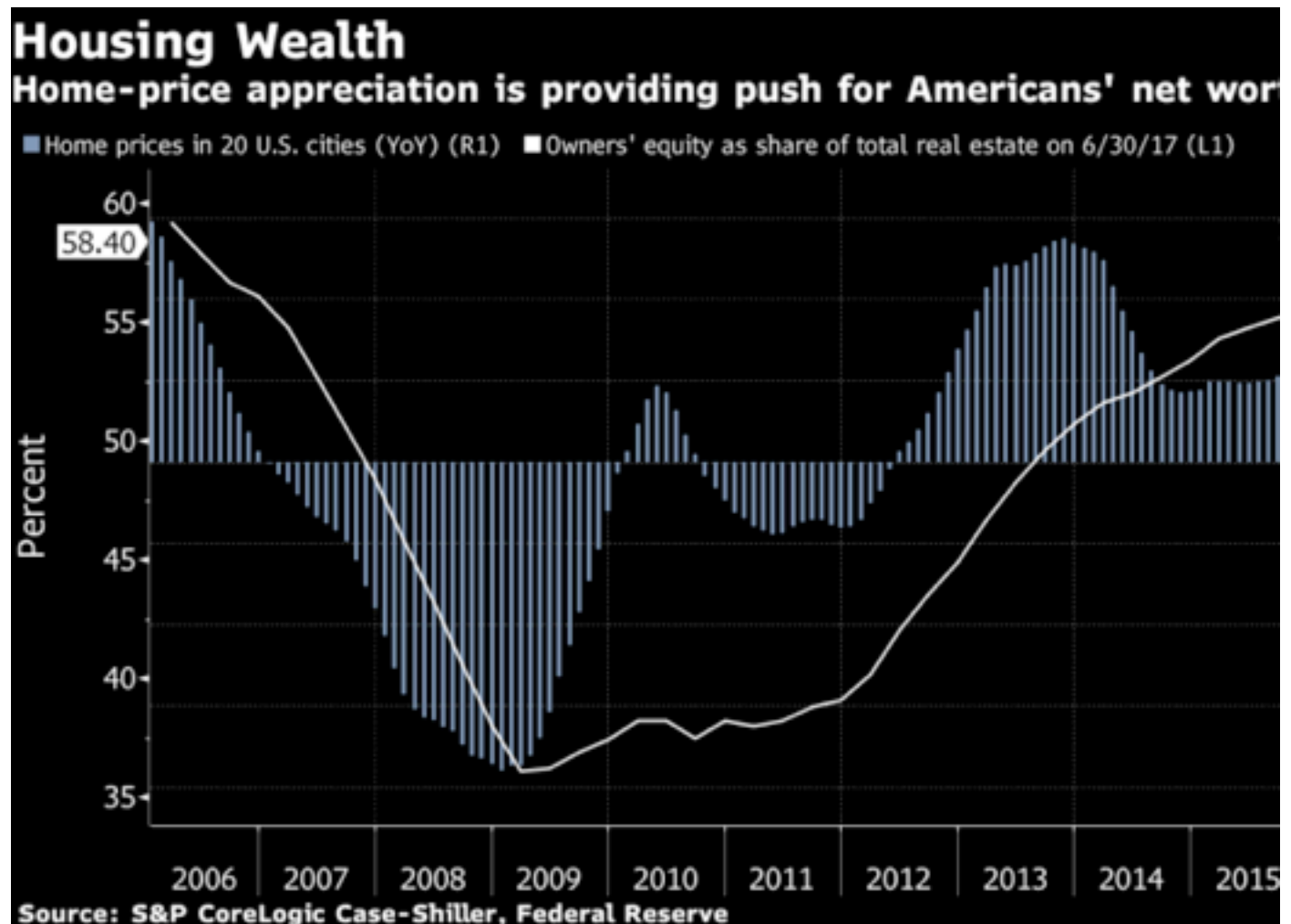
## **The Marlboro Man**



© Philip Morris Inc. 1997

Home [price appreciation](#) continued to grow at a strong pace as prices rose 6% year over year in August. This has provided a tailwind for the economy as equity levels have risen to an 11-year high. *CNBC's* real estate reporter Diana Olick points out that under the surface the situation [isn't as pretty](#), as elevated prices continue to squeeze out first time purchasers. On Wednesday, pending homes sales were reported down 2.6% further [validating her point](#).

## Home Price Appreciation and Owners Equity Share



Another week, another performance of the “Theater of the Absurd” in Washington. The GOP failed again in their eight-year mission to [repeal Obamacare](#). At the same time, the market celebrated the potential for a bi-partisan tax deal. *The Hill* providing a [history lesson](#) of the parallels to the 1986 Reagan tax reform package.

## President Ronald Reagan Signs the Tax Reform Act of 1986



September has been the month where the “[tax trade](#)” came back to the market, as the chart below shows the Goldman Sachs high-tax basket of stocks rallying once again after having round tripped the original Trump trade. They include Gap, Paychex, CVS Health, ConocoPhillips, Charles Schwab, Quest Diagnostic and Southwest Airlines.

### **The Goldman Sachs Basket of High-Tax Stocks Rallies Once Again – Trump Trade 2.0**

## Tax Cuts in Focus Again

Stocks seen benefiting most revive leadership after post-election

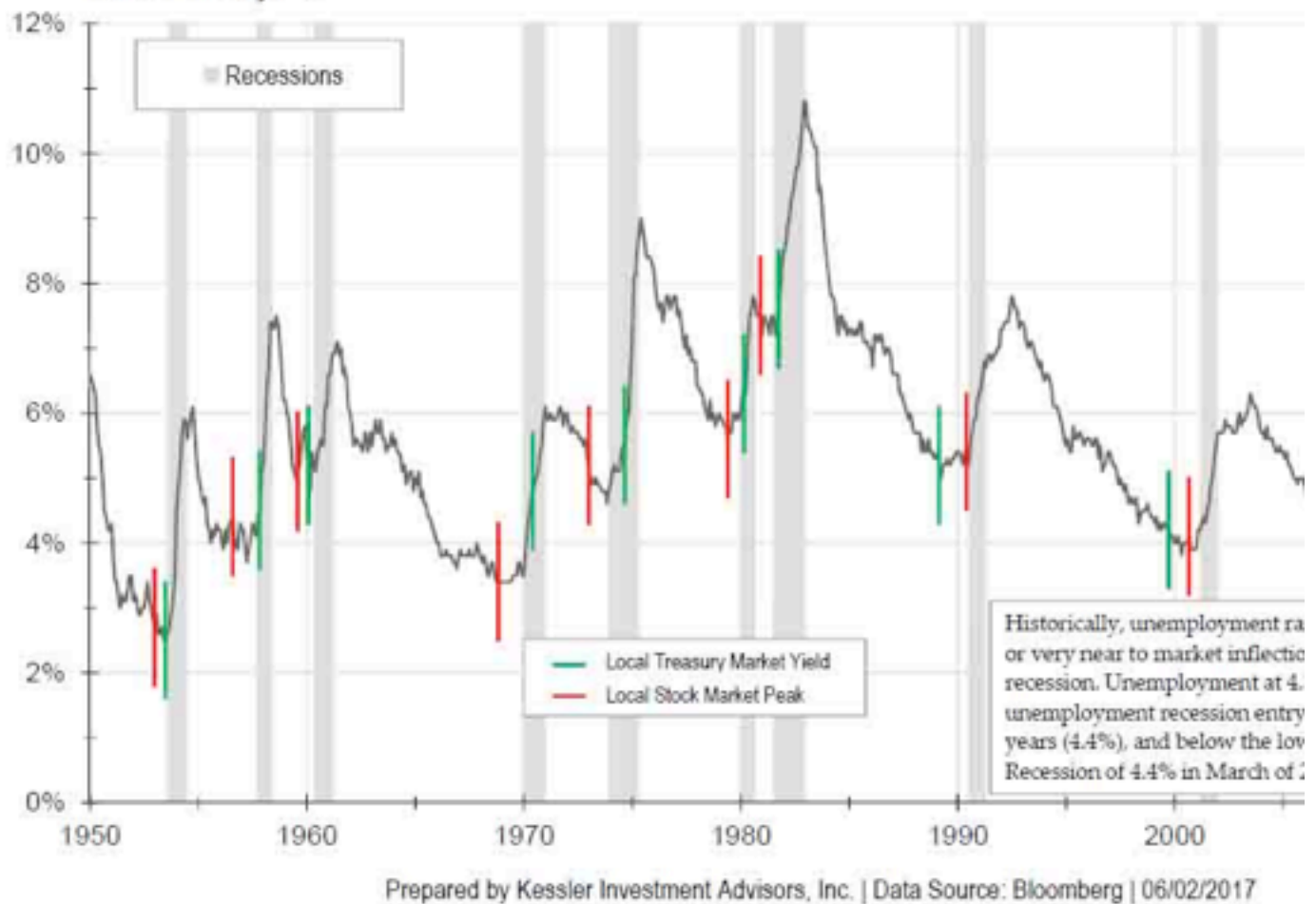


*Stillwater View: Speculating on what [version of tax reform](#) emerges from D.C. has devolved into a parlor game. That won't stop the talking heads from making the rounds pontificating on what is going to happen and how good, or bad, it will be for the economy when it does.*

*The reality is we are in the waning days of this economic expansion, and any move to cut taxes may only extend the game into extra innings. While it looks like smooth sailing for now, credit spreads and employment are the two economic indicators to be watched for changes at the margin. The economy has experienced at least one recession every decade since 1929, and the business cycle has not been repealed.*

*In April of 2009 the United States economy lost 539,000 jobs. While an awful number in isolation it was 124,000 better than the 663,000 reported in the previous month. And that positive change proved to be the bottom for both unemployment and the equity market. Inflection points don't announce themselves, but knowing your history helps find them.*

**Stock Market Tops Coincide with Employment Peaks – 70 Years of History**



### **The Bottom-Up**

Earlier this month Trian Partners, led by Nelson Peltz, released a 93-page [white paper](#) explaining why shareholder value would increase if the billionaire activist was granted a board seat and allowed to set forth his plan. Trian has an extensive [library](#) of previous white papers that included campaigns for change and seats on the board at General Electric, DuPont, Pepsi, Danone, Lazard, State Street, Heinz and Wendy's.

*Stillwater View: The extensive detail that Trian puts into their work is worthwhile reading for anyone with an interest in activist investing. Stillwater has an unwritten policy of getting out of the way when Mr. Peltz shows up on the other side.*

### **Trian's Nelson Peltz**



In an interview with *Bloomberg* Royal Dutch Shell CEO Ben van Beurden he stated that crude oil should be priced around [\\$60 per barrel](#) by the end of the decade, and the market would be well served to build resilience for a “lower forever” environment. The company’s shares have benefitted from the rally in the energy sector that began on September 1<sup>st</sup>, gaining 10% in a short 30-days. While most likely not over, some might call this move extended.

### **Royal Dutch Shell ADR Price History**



A look at the price history of natural gas is a good way of understanding what ‘lower forever’ looks like. Ten-years ago, conventional thought was that we had about a decade’s worth of natural gas in the ground. When turning the bit allowed for horizontal drilling, the market discovered that there was likely a century of the commodity in place. This overhead supply will continue to keep a top on price as production ramps up with every move upward move. [Horizontal Drilling 101](#) from natural gas producer Chesapeake Energy.

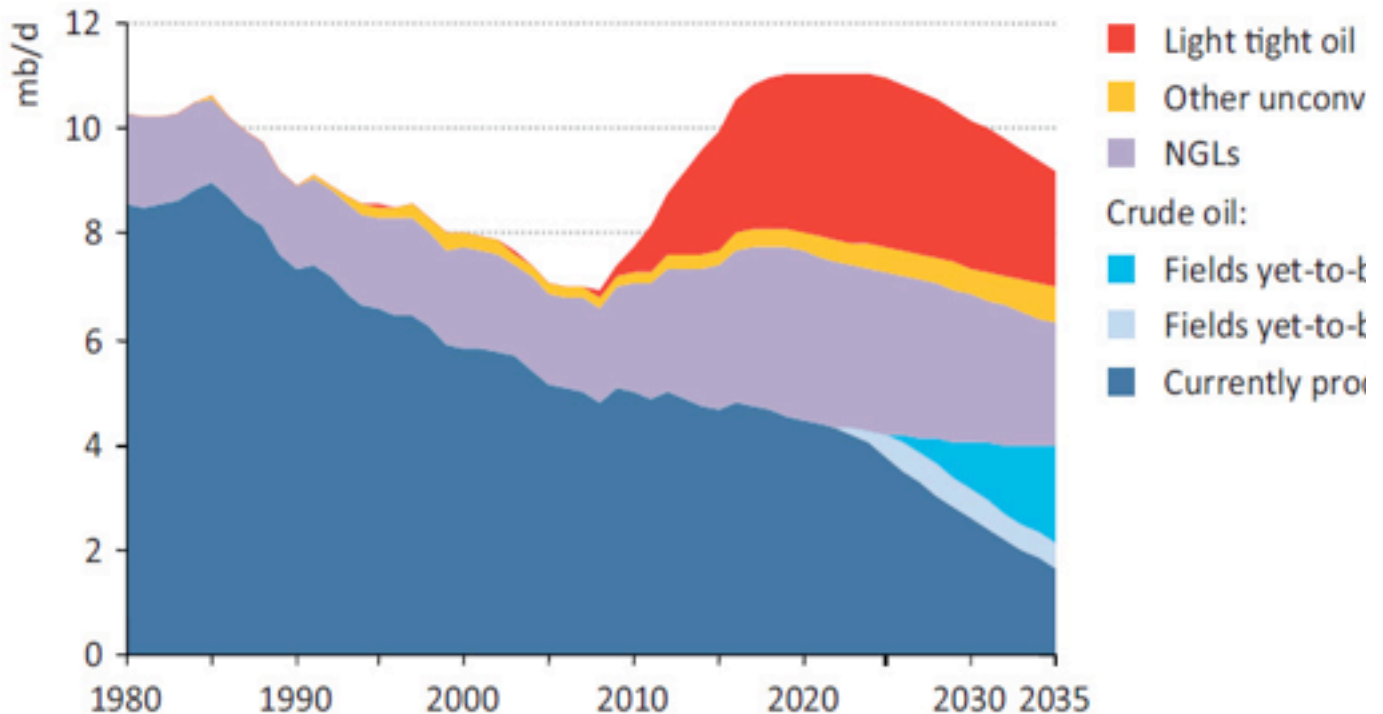
### Ten-year Price of Natural Gas



Source: [Macrotrends](#)

Like natural gas, crude oil now has much higher overhead supply than was previously thought. The increase is illustrated below where the ‘light tight oil’ is represented in red. It’s referred to as ‘tight oil’ because the crude is trapped in rock that requires fracking to loosen it and allow it to flow. This supply will continue to come online as prices rise.

### **Domestic Oil Production by Type**



Note: The World Energy Model supply model starts producing yet-to-find oil after it has developed fields into production. In reality, some yet-to-find fields would start production earlier in the figure.

*Stillwater View: As energy companies share different degrees of commodity price risk, on top of business risk, the volatility of the sector is higher than most. Therein lies the opportunity, as it's well suited for long/short investing. Integrated majors, refiners, oil service, exploration and production; they all have a distinct place in the energy supply chain.*

*Stillwater is seeking investors to seed the firm's third hedged equity strategy with a pure energy focus. It will be offered as a separately managed account with no lockup restrictions or performance carry and a flat management fee. Contact the firm at [contact@stillcap.com](mailto:contact@stillcap.com) to hear more about the [Stillwater Trinity](#) hedged equity strategies and [Stillwater Trinity Energy](#).*

### **Up and Down Wall Street**

Closing the [carried interest loophole](#) is on the table as part of the Trump administration's proposed tax overhaul. Much to the chagrin of private equity, venture capital and hedge fund managers. The loophole allows for investment company profit participation to be taxed as long-term capital gains, not ordinary income, as [CNBC](#) explains.

Whitney Tilson, a man who never met a television camera he didn't like, is [shutting down](#) his

hedge fund, Kase Capital Management.

To his investors he wrote, “If I were managing only my own money, the fund's recent results wouldn't bother me quite so much. But investing and running a money management business are two very different things, and reporting sustained underperformance to you was making me miserable.” His fund was down 8% on the year.

*Stillwater View: One can understand how 'reporting sustained underperformance' would indeed make someone miserable.*

### **Whitney Tilson Appears on CNBC**

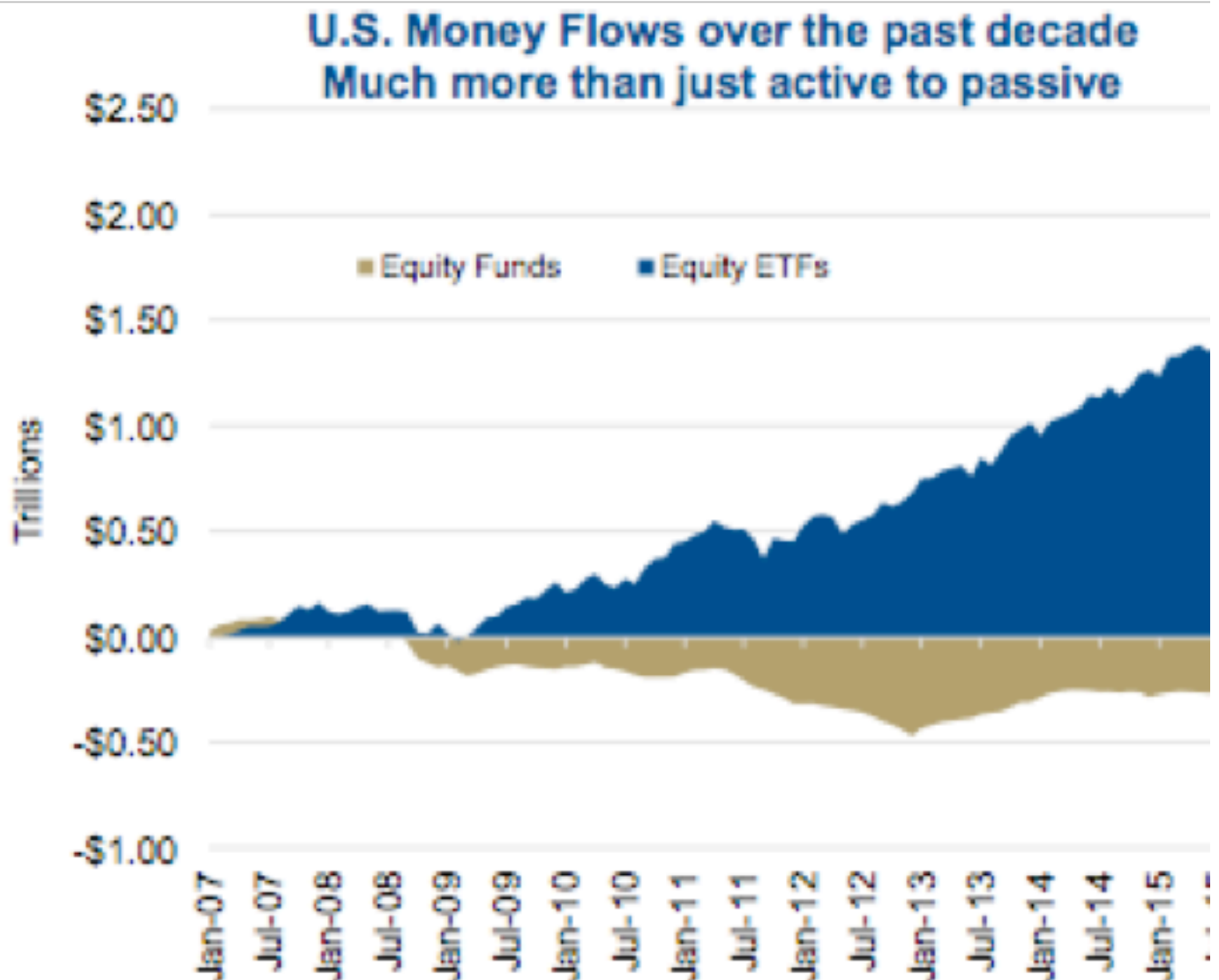


News that Invesco was buying [Guggenheim's](#) \$37 billion ETF business hit the markets this week. This will add 79 ETFs to the firms existing \$125 billion platform. While there is [growing evidence](#) that there is an ETF bubble, *Bloomberg* columnist [Ben Carlson](#) took the other side.

*Stillwater View: Wall Street loves to build and sell shiny objects. ETFs, with their liquidity and low fees have been some of the shiniest. More than [100 firms](#) are building new(ish) ideas*

to get out the factory door. But ask yourself, does the world really need 60 [emerging market ETFs](#), when 47 of those have less than \$1 billion in AUM?

### Money Flows into ETFs Over the Last Decade – From Redwood Asset Management’s [“The Great ETF Bubble?”](#)



One of the last swashbuckling macro managers, Mike “Novo” Novgratz, is opening a [crypto currency hedge fund](#) to take advantage of “the biggest bubble” of our lifetime. Before this he was the high-profile manager of Fortresses’ \$3 billion [global macro strategy](#) that lost money in 2014 and 2015, eventually leading to the liquidation of the fund. He was early in his “Brazil is so [fugly](#) it must be bought” trade.

*Stillwater View: When Mike left Fortress, he was most certainly guaranteed to get back in the game. Guys with Novo’s reputation develop a cult like following and half a billion in*

*AUM will travel with them wherever they go. Determining which asset allocation box cryptocurrencies fall into remains a mystery.*

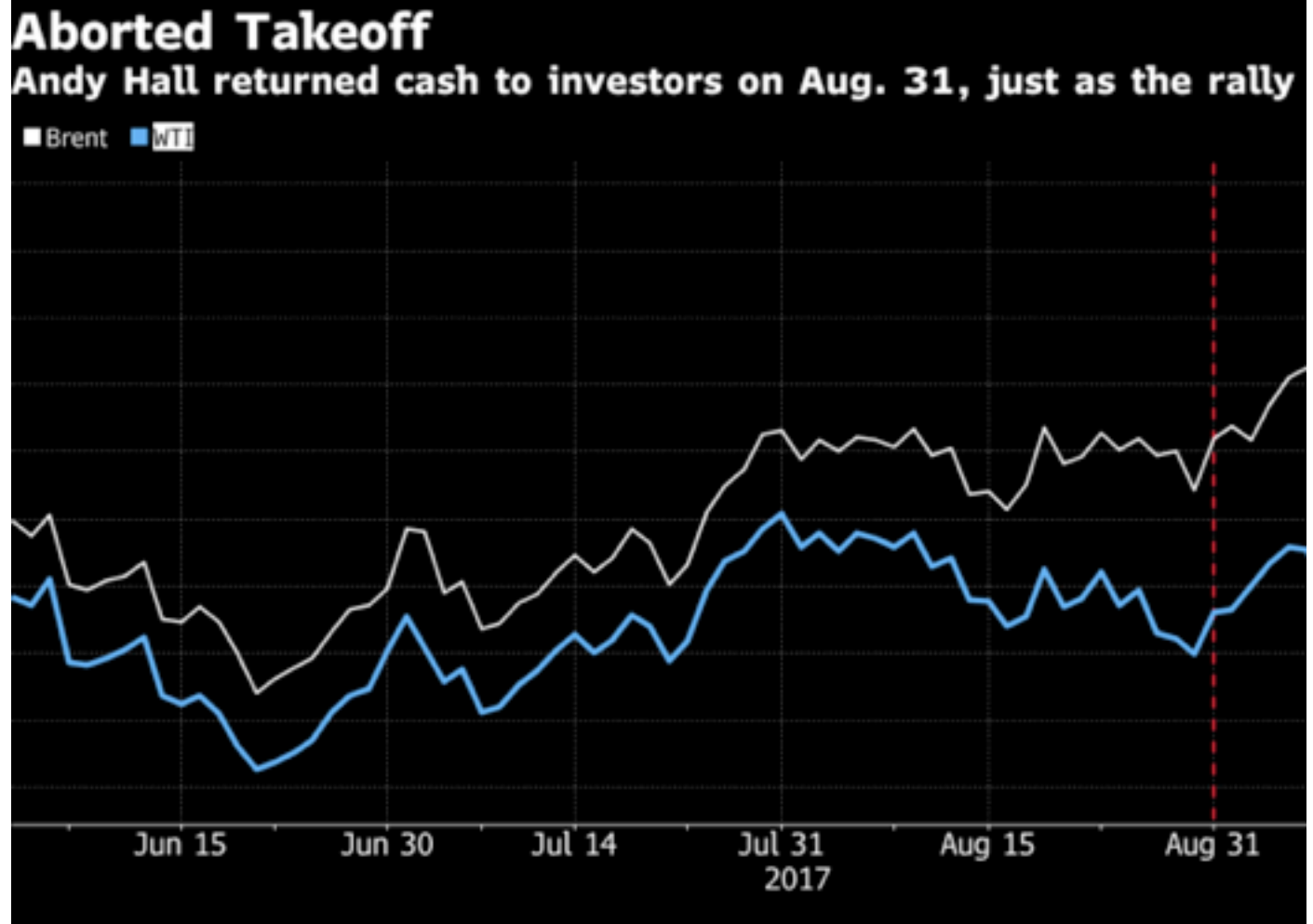
### **Bitcoin in a Bubble**



In an painful [twist of fate](#), a strong rally in the energy sector started quite literally the day after ‘Oil God’ Andy Hall sent back the last dollar to investors after shuttering his energy hedge fund. Since September 1<sup>st</sup>, the group has seen sizable gains to the tune of 10% for the integrated majors like Chevron and Conoco, and 20% for the more speculative E&P companies like Continental and Pioneer Resources.

*Stillwater View: Let’s do the math. \$3 billion fund, assumed 15% one month gain, \$450,000,000 profit, 20% performance carry, \$90,000,000 in performance fees never to be collected. Painful indeed! Normalizing it takes some of the sting away as the energy sector had been largely left for dead this year and few portfolio managers were overweight.*

**Andy Hall Returned His Last Investor Dollar the Day Before the September Crude Oil Rally**



### Diversions

[The Austin City Limits Music Festival](#) kicks off next week with an eclectic list of headliners including Jay-Z, Ryan Adams, Red Hot Chili Peppers, Ice Cube and The Killers.

*Stillwater View: While visiting Austin, one of America's finest cities, take the one hour drive through Hill Country to the [Salt Lick](#) in Driftwood. While wildly commercialized, it is indeed a bucket list stop for any barbecue aficionado.*

### **The Salt Lick's Iconic Circular Barbecue Pit**



*The Wall Street Journal* released their [annual rankings](#) of colleges. Harvard took number one overall and UCLA was deemed the best public institution.

*Stillwater View: Bruins will take any number one ranking we can find these days. Seeing that it isn't going to happen on the gridiron or hardwood anytime soon.*

***The Wall Street Journal's Top-10 Private and Public Universities***



## **THE TOP 10**

These schools achieved the highest overall scores in the Wall Street Journal/Times Higher Education College Rankings

1. Harvard University
2. Columbia University
3. Massachusetts Institute of Technology
- Stanford University
5. Duke University
6. Yale University
7. California Institute of Technology
8. University of Pennsylvania
9. Princeton University
10. Cornell University

Source: Wall Street Journal/Times Higher Education College Rankings

**THE WALL STREET JOURNAL.**



## **THE TOP PUBLIC SCHOOLS**

The state schools that achieved  
the highest overall ranking

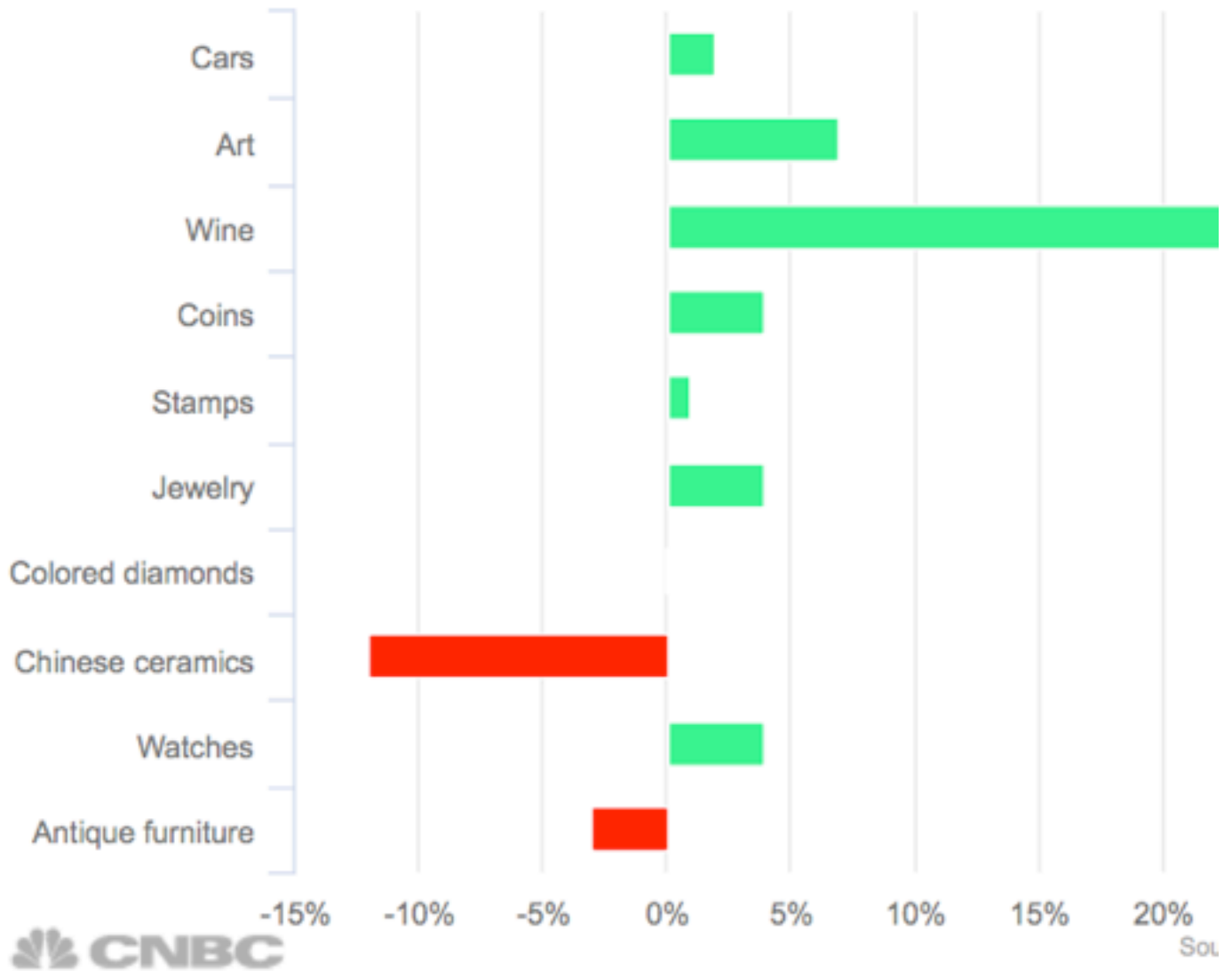
1. University of California,  
Los Angeles
2. University of Michigan,  
Ann Arbor
3. University of North Carolina,  
Chapel Hill
4. University of California,  
Berkeley
5. Purdue University,  
West Lafayette
6. University of California, Davis
7. University of California,  
San Diego
8. University of Illinois,  
Urbana-Champaign
9. Georgia Institute of  
Technology
10. University of Texas, Austin  
University of Virginia

Source: Wall Street Journal/Times Higher  
Education College Rankings

**THE WALL STREET JOURNAL.**

CNBC reports that [fine wine](#) is now the preferred collectable of the rich. Surging 25 percent in value over the last 12 months.

### Luxury Asset Price Growth



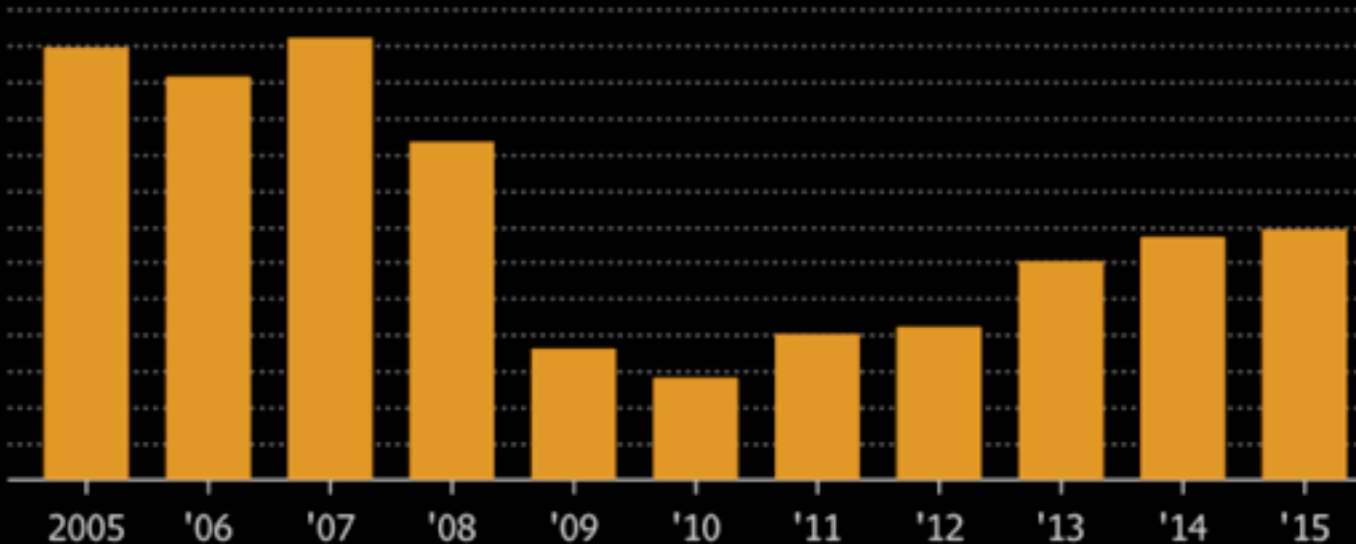
*Stillwater View: A bottle of Chateau Margaux for anyone that can show proof of being long fine wine and short Chinese ceramics with a [thoroughbred steepener](#).*

### Number of Horses Sold for \$500,000 or More at Keeneland

## Half-Million Dollar Yearlings

Horses sold at the Keeneland September auction for \$500,000 or more

■ Number of horses



Source: Keeneland Association Inc.

The entertainment world [lost a legend](#) this week with the passing of Hugh Hefner. Hefner parlayed \$600 and a dream into the [Playboy empire](#) and multi-million-dollar personal fortune.

In 1971, his then girlfriend Barbi Benton came across an aging gothic stone mansion in the Holmby Hills section of Los Angeles. Available with an asking price of [one million dollars](#), Hef wound up buying the place and the iconic [Playboy Mansion](#) was born. The [residence was sold](#) in 2016 to neighbor Daren Metropoulos for \$100 million, half of the original \$200 million asking price.

*“Life is too short to be living someone else’s dream.” – Hugh Hefner*

**Hugh Hefner Outside the Playboy Mansion in 1972**



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