

Stillwater Capital - This Week in the Markets



The Economic Top- Down

Well, that got interesting.

In two short weeks, we have received a spike in interest rates, watched the Chinese equity market went into freefall, real estate started showing signs of a top, huge losses mounted in the most popular technology trades. And we are bid straight up this morning.

The Fed chair now believes that economies can grow to the sky. The president who appointed him accused the Open Market Committee of “going loco”. But he’s okay with it and won’t fire anyone...yet.

All of which begs the question, is this all seriously happening?

Nervous Times



Source: Emoji Quest

Similar to February, this correction took three days to wipe out gains that had been building for months. At some point there wasn't anywhere to hide except treasuries and gold. When those two start working you know you are closer to a near-term bottom than a top.

Stairs Steps Up, Elevator Ride Down



Source: Macrotrends.com

Our View: The dislocations in equity prices over the past few days should put to rest any argument against the fact that the machines and passive ETFs have not taken over, because clearly they have. Evidenced once again by the market movements on Wednesday, Thursday, and today.

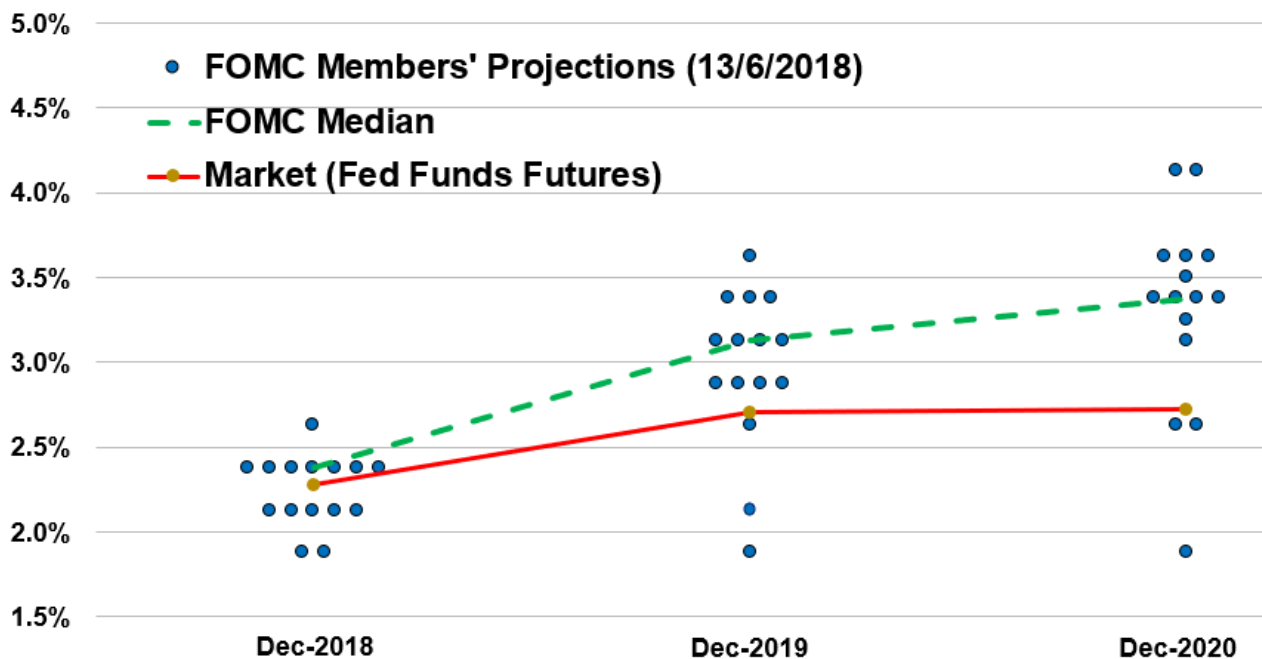
The markets continued to focus on interest rates this week as the 10-year yield rose to 3.25%. Because the market likes clean numbers many analysts concluded that this was indeed all we were going to get out of it for now and this was the place to pause.

Rick Rieder, portfolio manager for \$1.85 trillion in bond assets for BlackRock, opined that the move higher in the near term was likely overdone due to the threat of a global slowdown in 2019. He sees three more rate hikes before the Fed holsters that sidearm. The dot plot paints a different picture.

Jeffery Gundlach, founder of DoubleLine, thinks otherwise and sees 3.6% as a possibility on the 10-year. Notice his comments in the piece that there is a government debt tsunami headed our way. He also thinks Trump is "crazy like a fox".

The Fed is Pulling Away the Punch Bowl

Fed Projections vs. Market Expectations

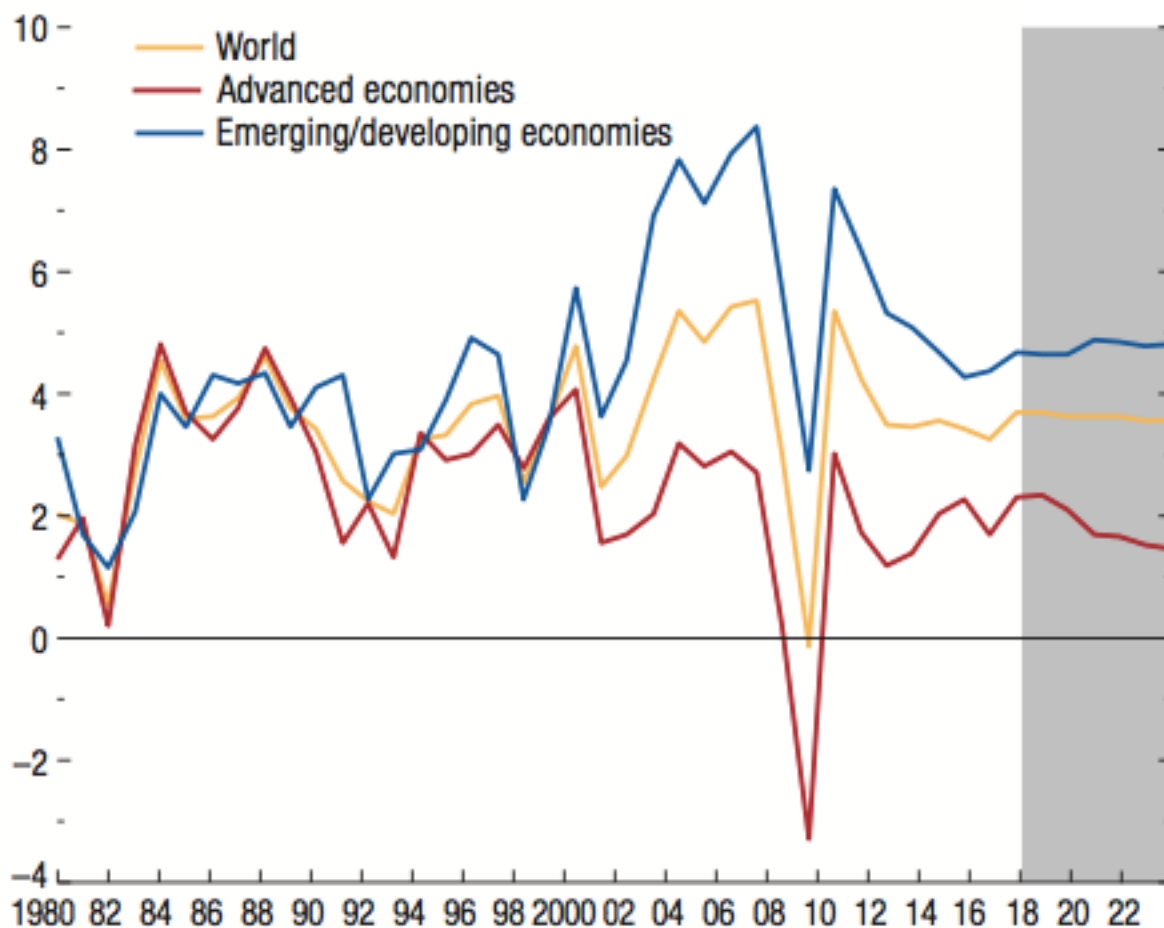


Source: Franklin Templeton

Our View: Rick is a very smart man with a work ethic that should be admired by anyone ever looking to call Wall Street their home. Having said this, there is still a good chance of an overshoot in interest rates that could eventually compound the slowdown thesis.

As prelude to their annual meeting in Indonesia, on Monday, The International Monetary Fund released their 200 page "World Economic Outlook 2018" and the forecast was not "Sunny and 72". The laundry list of reasons included the consensus concerns of the negative effect of trade wars, increasingly weak emerging market economies, the draining of central bank monetary liquidity, and higher oil prices.

Global Growth Set to Flatline



Source: The IMF

Our View: The IMF is about 0 for lifetime when it comes to nailing a slowdown. This time may be no different as their laundry list of reasons is about as consensus as it gets for those who think that there are storm clouds on the horizon. Needless to say there is a good chance that globalist Christibe Lagarde and nationalist Donald Trump don't see eye to eye on this one.

Lagarde & Trump



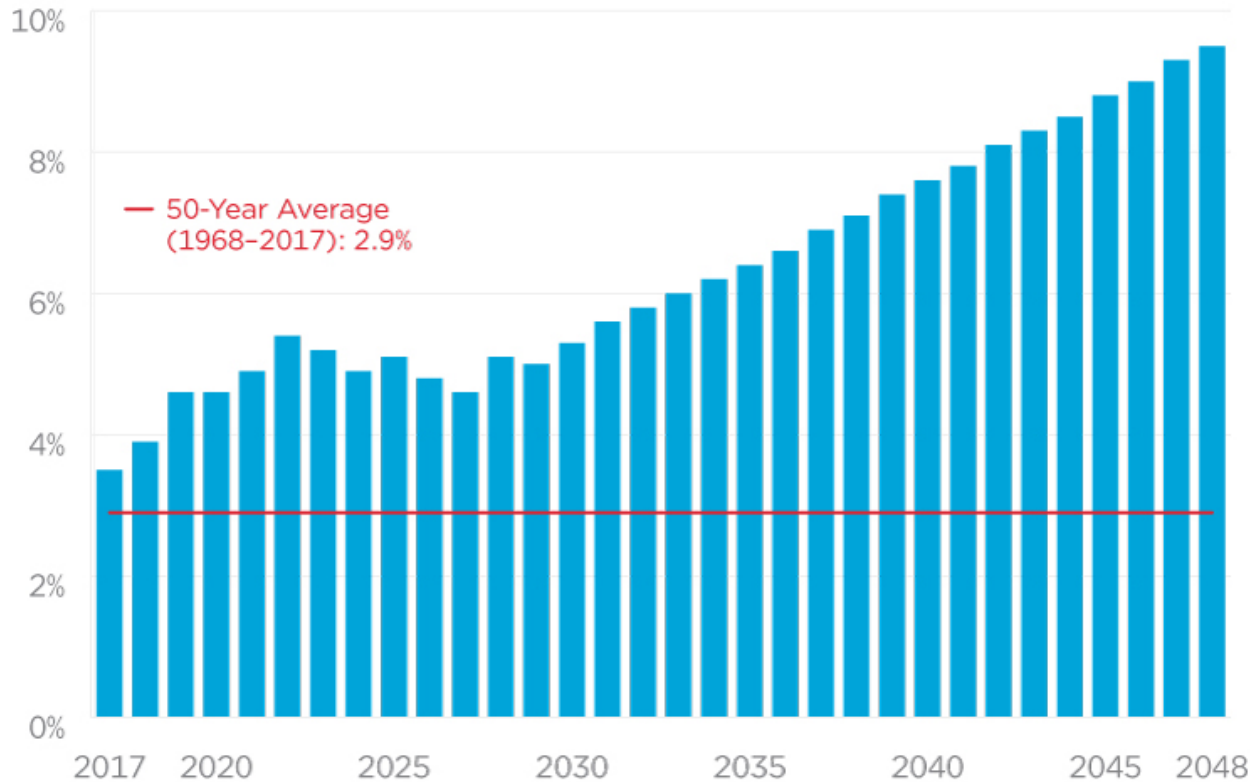
Source: Time

With rates on the rise and deficit hawks as rare as the Dodo bird, there is an increasing concern that the interest expense line on the U.S. government's P&L is about to get a lot bigger.

If we get 4% GDP growth as far as the eye can see this chart doesn't matter. On the flip side, more modest growth or a recession creates a mountain of problems in Washington and the current cast of characters will be long gone when it does.

Yikes!

DEFICITS AS PERCENTAGE OF GDP



Our View: Just because politics has turned into a 24 hour/365 day MMA cage match doesn't mean that policy needs to follow suit. Nothing has come out of Washington D.C. with more than a two year time horizon for as long as we can recall.

Elections Have (Painful) Consequence



Source: The Independent

The Fundamental Bottom Up

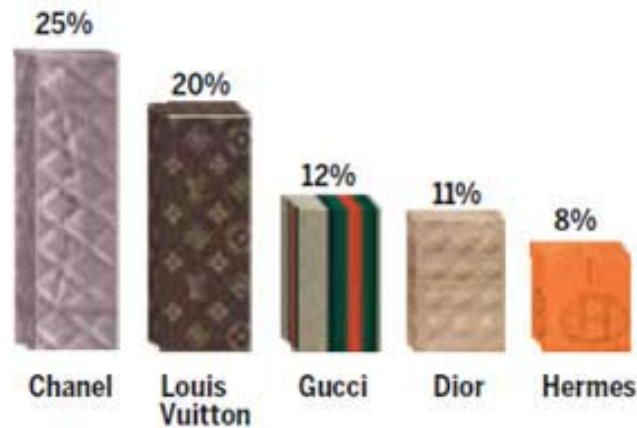
China authorities continue to engage in rolling crackdowns on different sectors of life and economies. Earlier this year, it was internet gaming and now its luxury goods. Rumors started last week that there would be a crackdowns on un-declared goods that were making their way into the country. The CEO of LVMH confirmed the tightening this week and Morgan Stanley threw additional fuel on the fire with a downgrade of the European luxury goods sector.

理想的品牌

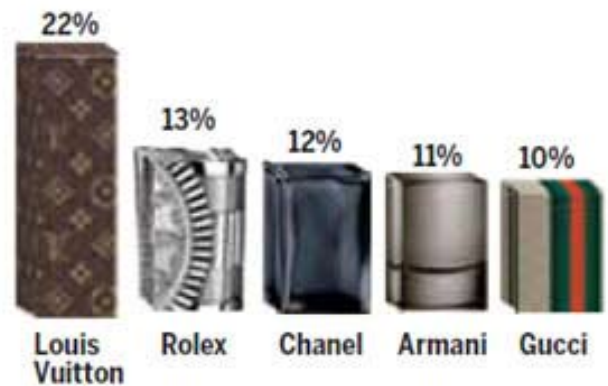
MOST DESIRED LUXURY BRANDS IN CHINA

Percentage mentioned

WOMEN



MEN



Source: China Daily

Our View: Stillwater holds long positions in Ralph Lauren and Ferrari and short positions in Ford and General Motors. The latter have been working well for most of the year while the former got summarily whacked this week in the selloff.

National Beverage, the parent company of the La Croix brand of sparkling water, was hit earlier this month with a class action lawsuit claiming that the use of linalool disqualified it from claiming 100% natural ingredients in its spritzers. It doesn't help that linalool is also found in cockroach spray. Monster Beverage was also sued for a similar claim about its Hansen's brand earlier this year and settled out of court.

Bubbly Water Gets Crowded



Source: brands.com

Our View: Class action suits are going to follow any consumer products company, beverages no different ever since the “mouse in a bottle” incident at Elsinore brewery. The firm has been short the shares on National Beverage, the maker of La Croix, on the view that the flood of new entrants into the market is going to be strong headwind going forward. We have also been short the shares of Monster over concerns about the health effects it has and the risk of market saturation.

S&P 500, LaCroix, Monster



Source: Nasdaq

The beleaguered Papa John's rallied this week on news that Trian might be interested in buying the company. To be clear, this is not the first time an activist has shown up at the doorstep and asked to come in and help clean things up. Company founder John Schnatter was forced to bow out earlier after dropping a racial slur.

Schnatter was also forced to step down from the board of the University of Louisville, his alma matter, after the incident. The university summarily removed Papa John's from the football stadium.

Papa John's No Mas



Source: CNBC

Our View: While there may be the occasional bad actors in the pizza business, there is still no such thing as bad pizza.

The end is near for the iconic Sears chain of department stores. Taken over by former hedge fund manager Eddie Lampert in 2005, the retailer has entered its final days as negotiations for the planned liquidation continue and continued payments have stopped following to vendors. The company has a big debt payment due on Monday.

Good news for you tool heads, the Craftsman brand was sold to Black and Decker a few years ago and as of April of this year is available at Lowe's.

Lowe's Picks Up Craftsman



Source: Lowes

Our View: This has been a tough one to watch as Sears demise has been akin to watching the old family dog atrophy away for years before finally heading off to the big kennel in the sky.

On a recent visit to our local Sears, the floor manager was overheard saying to his two person sales staff, "If there is downtime I want you fluffing Christmas trees as they aren't going to fluff themselves." In prison they call this a "dead man walking".

Will Christmas Ever Survive?



Check out Sears exclusive Christmas tree collections

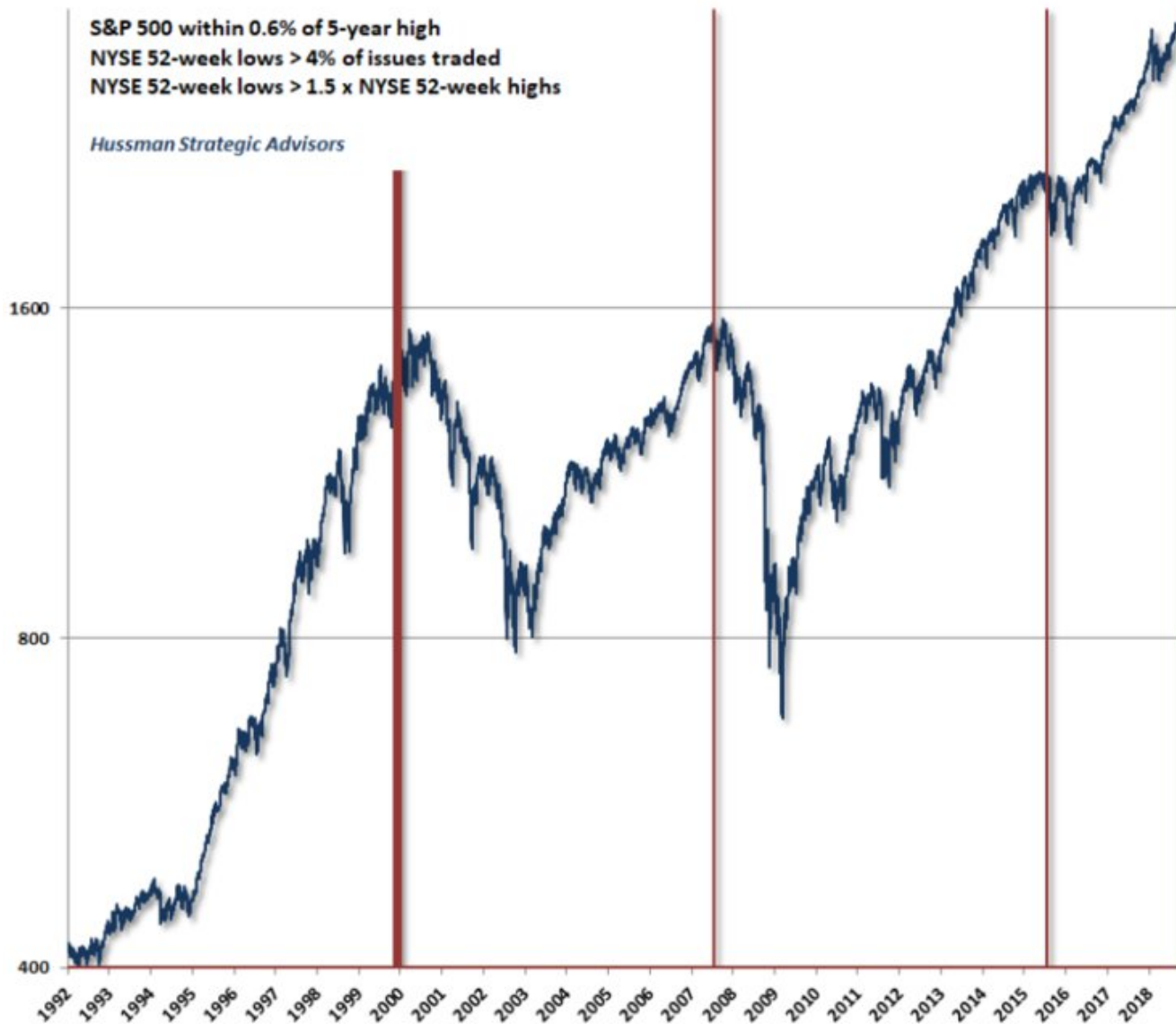
Source: Sears

Markets

Perma-bear John Hussman got out in front of this move in the market, which brings his average up to about .200 lifetime. Having said that, he most certainly swings for power. As *Business Insider* points out, he did call the 2000-2002 tech bust, right down to the number. How it's possible that he came up with 83% and the Nasdaq lost that exact amount will forever be in the ether.

He also predicted in 2000 that the S&P 500 would see negative total returns over the following decade, which proved to be right again. Seven years later he said the broad market could lose 40%. Tip to tail it would eventually lose 55%.

Two Big Up Moves & One Lost Decade



Source: Hussman Funds

Our View: You have to hand it to him, anyone that can be right about once every five years, lose you 50% of your money over a decade, and still manage \$300 million is (maybe) worth listening to. The aforementioned performance comes to you courtesy of the Hussman Strategic Growth Fund.

Hedge Funds

A team of researchers at the University of Alabama recently released a study where they concluded that the type of car a hedge fund manager drives says a lot about their style. Their work found that "hedge fund managers who purchase performance cars take on more investment

risk than do fund managers who eschew performance cars.” It took them 48 pages to write this one up? Holy hell.

The piece went on...”Specifically, sports car drivers exhibit annualized return standard deviations that are 1.80 percentage points, or 16.61%, higher than those of non-sports car drivers. Similarly, funds managed by drivers of high horsepower and high torque automobiles deliver more volatile returns.

Conversely, we find that managers who acquire practical but unexciting cars take on less investment risk relative to managers who shun these cars. Minivan owners, for example, generate annualized return standard deviations that are 1.28 percentage points, or 11.74%, lower than do other owners. Moreover, managers who purchase cars with high passenger volumes and excellent safety ratings also produce more stable returns.”

Sporty but Safe



Source: The Drive

Bill Ackman announced that he was investing nearly \$900 million worth of client money into Starbucks, saying he thinks it’s a double in three years. As was reported, his 43 page thesis was devoid of any controversial activist edge to it. He actually just likes the company and simply thinks its undervalued.

The First Starbucks



Source: 1921 Pike Place

The Stillwater View: It's tough to fade a billionaire activists, but let's face it, across the fundamental hedge fund universe the tide has gone out and a lot of managers are swimming naked. Bill Ackman is no different. When you can average ten plus percent for a decade with a broadly diversified portfolio of longs who needs 2/20 locked up.

Having said that, those that survive this storm could very well look like Forrest Gump when his boat, the Jenny, survived a hurricane that took out the rest of the shrimping fleet in Bayou La Batre, handing him a small fortune when his was the last boat floating. He took that windfall and bought shares in a little "fruit company". Nicely parlayed, as they say.

A Different Variety of Apple



Source: icollector.com

Investing & Financial Planning

Disciples of Wall Street visionary John Bogle, or Bogleheads as they like to be called, gathered once again in Valley Forge, Pennsylvania to celebrate the 89-year old icon and how he forever changed the definition of investing. Bogle founded Vanguard in 1974 and a year later introduced the first inexpensive stock index fund.

In bringing market access to the masses, Vanguard allowed the common man the chance to participate in one of the greatest wealth creating machines the world has ever known, doing so at a fraction of what that access previously cost. The epitome of his gospel being that investors should control what they can – fees and taxes – and let go of what they can't, namely volatility.

Bogle-Palooza 2018

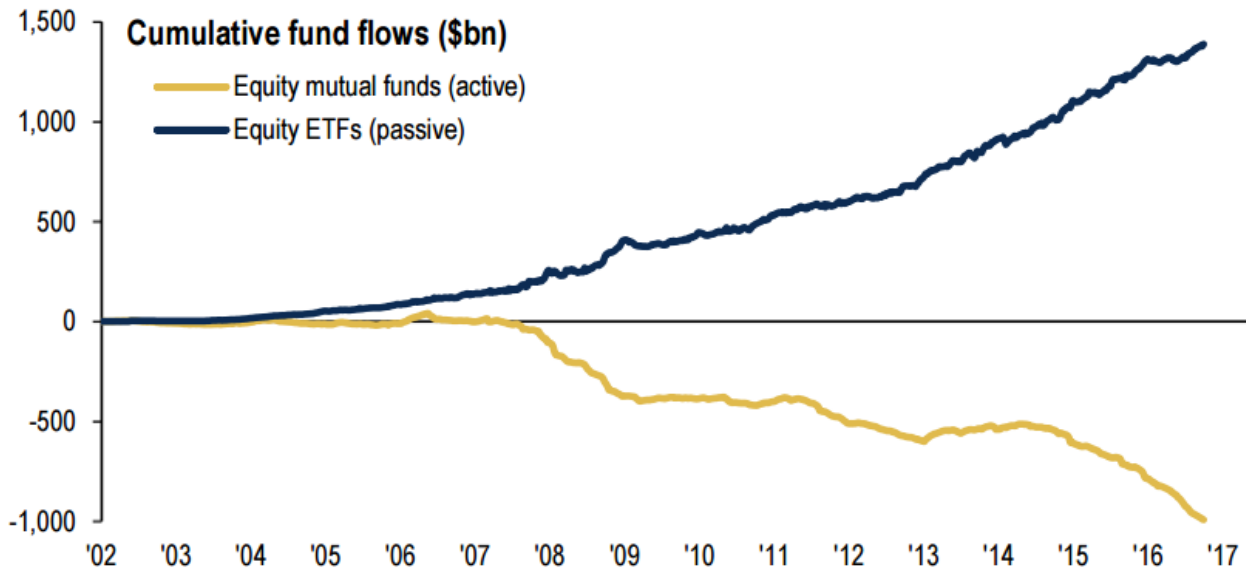


Source: The Wall Street Journal

Our View: Bogle truly changed the way the world accessed markets. Because of this we are forever grateful. He also let a genie out of the bottle that could never be put back. Forcing many an active stock picker and actively managed fund company to re-evaluate careers and the long-term viability of an aging business model.

The \$2.5 Trillion Pair Trade

Chart 1: Investors shun active for passive



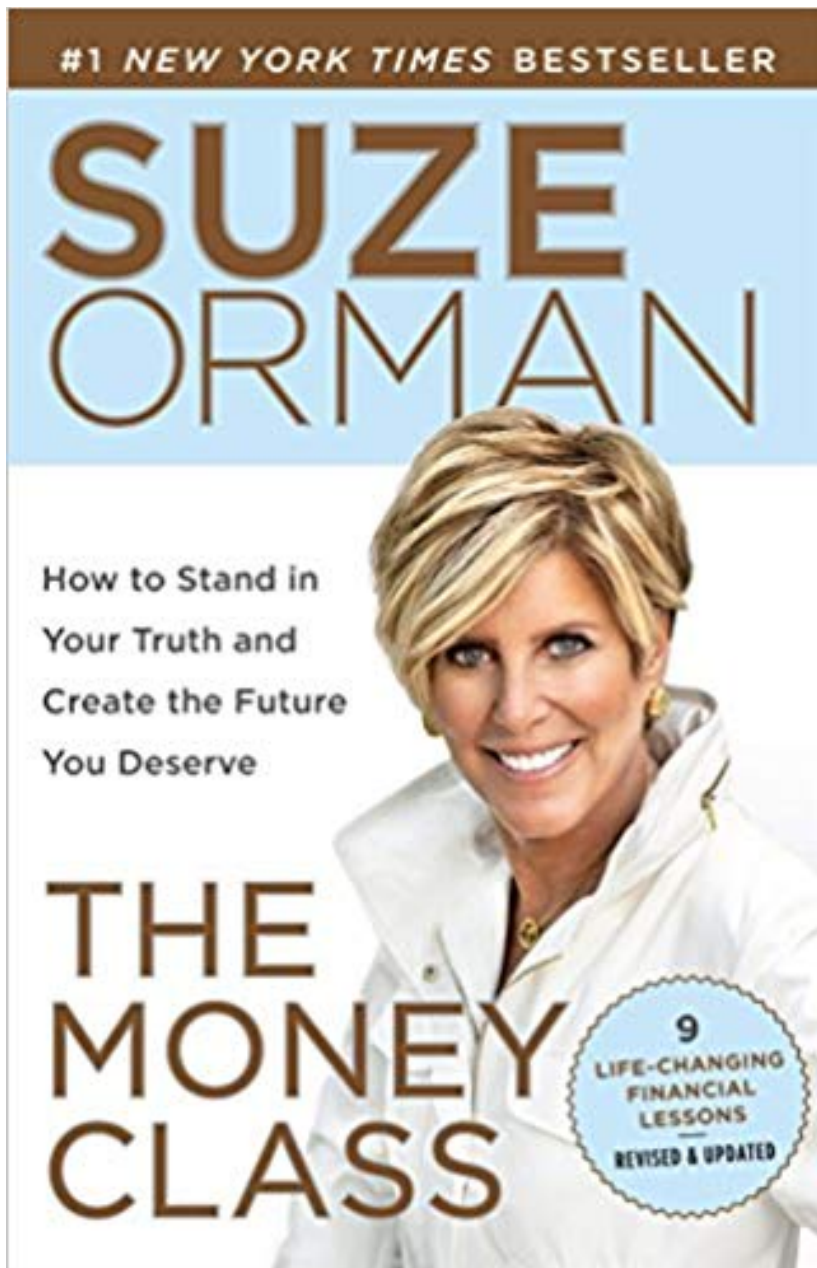
Source: BofAML Global Investment Strategy, EPFR Global

Source: Merrill Lynch

If you find yourself making the mistake of looking at the chart of massive winners like Apple, Google, and Amazon and hating yourself for not dropping every spare nickel into each, you are not alone.

Personal finance guru Suze Orman disclosed recently the biggest mistake she ever made in investing was selling her \$5,000 investment in Amazon after it quadrupled in the late '90s. Had she held the shares, they would be worth approximately \$6 million today. Not a bad twenty-year return. One that Suze says “makes her sick to even tabulate.”

The Ubiquitous Suze Orman



Source: Amazon

Our View: Orman is truly one of the greats, empowering those who want to take control of their finances through planning and investing. Even though you will likely feel like you missed the boat when you read her work, it is never too late to find financial planning religion. It very well could set you free.

As has been reasonably well chronicled in these pages, the author grew up in Silicon Valley and went to Homestead High School in Cupertino, the same as Steve Jobs and Steve Wozniak. Had I

taken every dollar of lunch money bestowed to me and bought Apple stock with it, I would be sitting on a mountain of Benjamins too. But then what would I have had for lunch?

Go Mustangs!



Source: Trip Advisor

Diversions – Space Special

Two astronauts, American Nick Hauge and his Russian counterpart, had to pull the rip cord when a booster rocket failed to lift them into orbit on the way to the International Space Station. The result was an unexpected fall from 300 miles up and a g-force 7 descent times that of gravity. Makes your Thursday morning commute look kind of pedestrian. Doesn't it?

The Soyuz 7 Rocket



Source: Rianovosti

In movie news, Ryan Gosling has been getting great reviews for his portrayal of Neil Armstrong in "First Man". While Neil had his reservations, Ryan said no thanks, I'm totally fine down here on earth. Which is understandable.

Gosling & Armstrong



Source: Geek Tyrant

At dusk on Sunday, most of Southern California was treated to a light show that they will not soon forget when SpaceX launched a Falcon 9 rocket from Vandenberg Air Force base. The atmospheric conditions were just right and the rocket burned orange, blue, yellow, and grey across the sky.

The main body kept going after separation in route to deliver an Argentinean communication satellite. The first stage headed back to earth and made a successful landing back at the base. This was the first launch and landing in California.

Yes, that's right, we now regularly launch and land rockets like it's no big deal. Make Space Great Again!

The View of the Falcon 9 from Disneyland



Source: ABC News

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