

## Loving the (Fed) Bomb

From a near death moment in March, to this uber euphoric rally to end all rallies since, this year is unlike any other, and it's not even close to an end. Traditional rules on asset pricing and what it means to have governments intervene in markets and stocks are being re-written on the fly, yet with long-term implications. For those of us skeptical bulls who hedge, and can't keep up with a market gone parabolic, this is very much a Dr. Strangelove moment, where all we can do is learn how to stop worrying and love the (Fed) bomb.

GiddyUp!



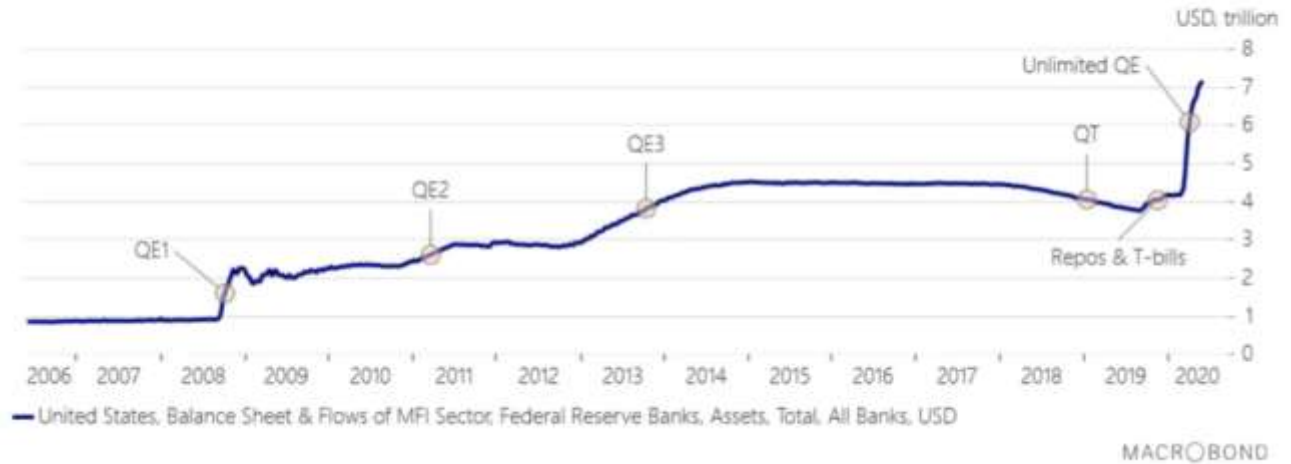
Regular readers know that we love a good movie analogy, and this is one of the best. Because those of us classically trained to believe that it's never 'different this time', now need to re-wire ourselves and believe that from here on out, when the world goes sideways, don't think twice about standing on the short side too long, because the economic bomb you are afraid of will always be defused by central bank action, at least as it relates to the thing that

matters to you most, asset prices. How the real economy survives all of this is a topic for a separate time.

## The Bomb



### Fed Balance Sheet



A big part of why we need to stop worrying and love the bomb, is that we aren't in the business of being financial theorists, or market historians. We are here to make money for clients, and to do so in a prudent manner while not looking Federal Reserve gift horses in the mouth. Because if we don't evolve, just like everyone else in the business, we are going to become one of these.

## No Longer Relevant



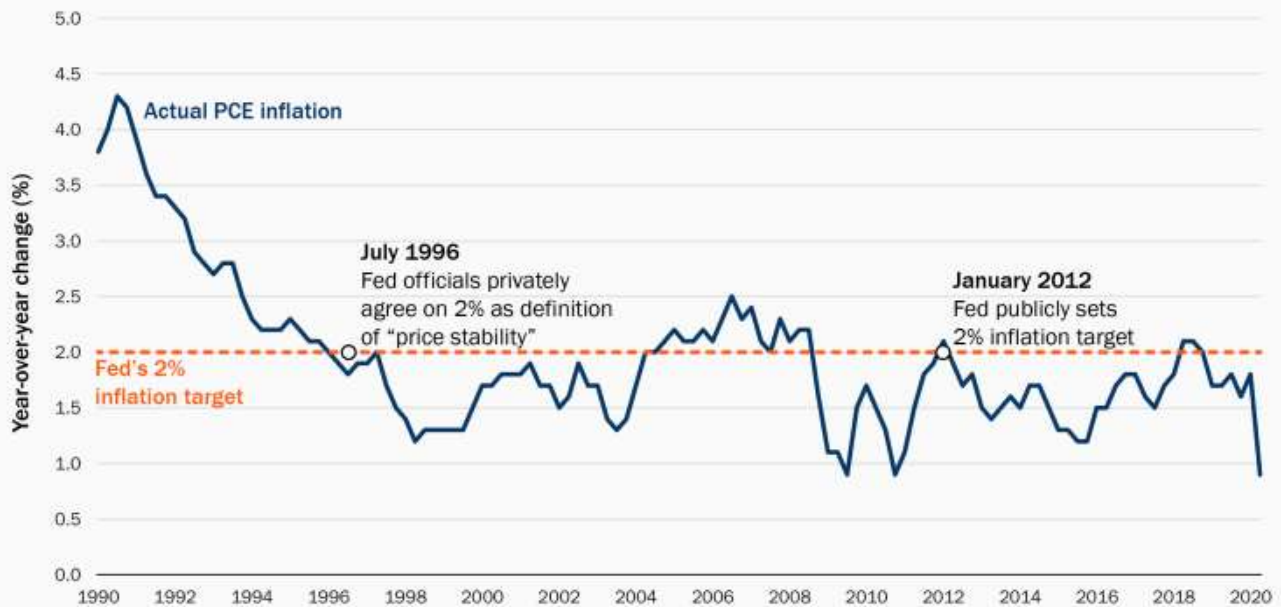
## Markets

Carlyle founder, David Rubenstein, has been making the rounds to promote his new book, “How to Lead”. This week, that landed him on CNBC’s morning Squawk Box, where he opined that while the market has come a long way, it probably still has room to run. He also has some interesting things to say about the Fed’s evolving view of inflation and how Chairman Powell declared last week that prices can, and should, run higher than the long held 2% rate it once targeted.

Well Below Target

## The Fed has failed to meet its 2% inflation objective for years

Personal Consumption Expenditures price index, excluding food & energy, year-over-year



Source: U.S Bureau of Economic Analysis, accessed via FRED.

Notes: Data is percent change from quarter one year ago, seasonally adjusted.

**B** Economic Studies  
at BROOKINGS

If you are looking for great, intellectually stimulating content during the long days of COVID, Rubenstein's Peer-to-Peer conversation program on Bloomberg is exceptionally good. Enjoy Jack Nicklaus, Ruth Bader Ginsberg, Lorne Michaels, Adam Silver, and Ray Dalio in the current season, the content of these interviews is largely what makes up his new book.

Always Out Front

**DAVID  
RUBENSTEIN**  
*HOW TO LEAD*

**TUE, SEP 8, 2 PM ET**  
**92Y ONLINE TALK**

**HOW TO  
LEAD**  
Wisdom from the World's Greatest CEOs,  
Founders, and Game Changers

DAVID M. RUBENSTEIN  
Author of *THE AMERICAN STORY*

The graphic features a central portrait of David Rubenstein, an older man with white hair and glasses, wearing a dark pinstriped suit, white shirt, and patterned tie. To the left is a red vertical banner with white text. To the right is a white book cover with a grid of nine small portraits of various business leaders. The background is a light blue gradient.

If that isn't enough to get you thinking, read this utterly inspirational/demoralizing analysis from CNBC of the mental and professional tug of war going on between the bulls and the bears, and now even the bulls and the uber bulls. Notice how many well-paid market strategists are now pulling their price targets on the S&P 500, because there is simply no way to measure how the positive impact of QE out to the horizon will effect asset prices as we have gone from cheap to very expensive in six short months.

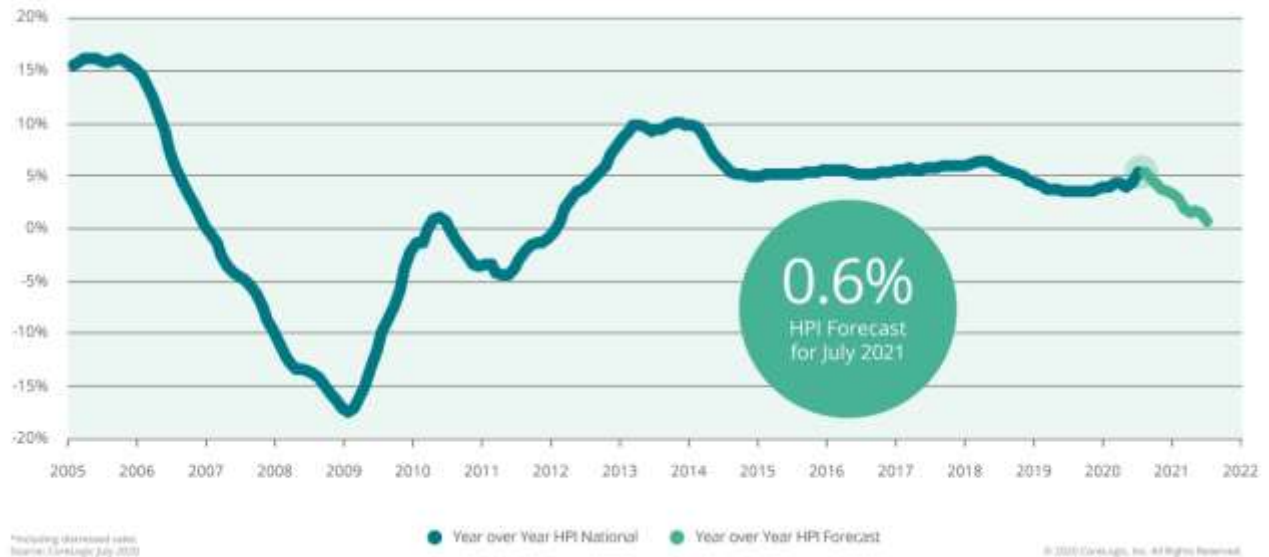
Party Likes it's 1999



It's not just the equity market that is on fire, real estate investors continue to reap the benefits of almost free money. We were reminded of that this week, when CoreLogic reported the biggest price gain in existing homes in two years. The only thing odd in the report is that expectations for the next twelve months aren't nearly as rosy as what the current price environment is showing. Is it really possible that this is the last hurrah for the next twelve, and price gains are going to slow materially? Anyone up for dart throwing?

Peaked Out?

Figure 1: HPI and HPI Forecast Percentage Change Year over Year



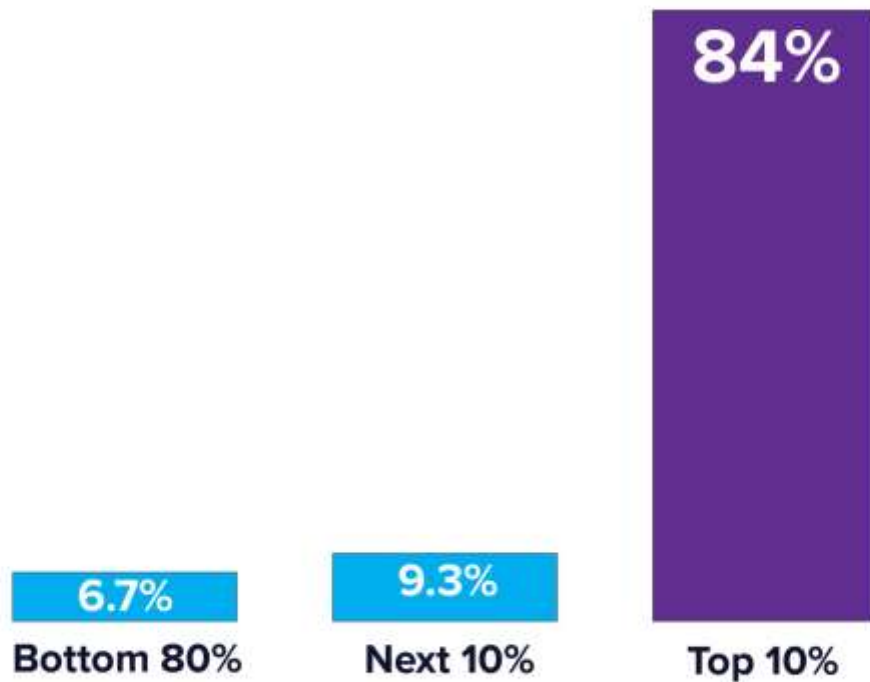
## Indexes & Asset Classes

The market is not the economy, is a very common refrain these days, and in May the Economist flogged the idea that the delta between Main Street and Wall Street is getting stretched so far that the long-term impact of participation and wealth inequality is going to be more severe, as the rich are getting much richer, and the proletariat is getting left behind. As we have said consistently, if the Fed reflate assets and you don't own any, you aren't going to participate. It's that simple.

## Bull Market for Who?

# MOST AMERICANS DON'T OWN STOCKS

## DISTRIBUTION OF STOCK OWNERSHIP BY WEALTH PERCENTILE

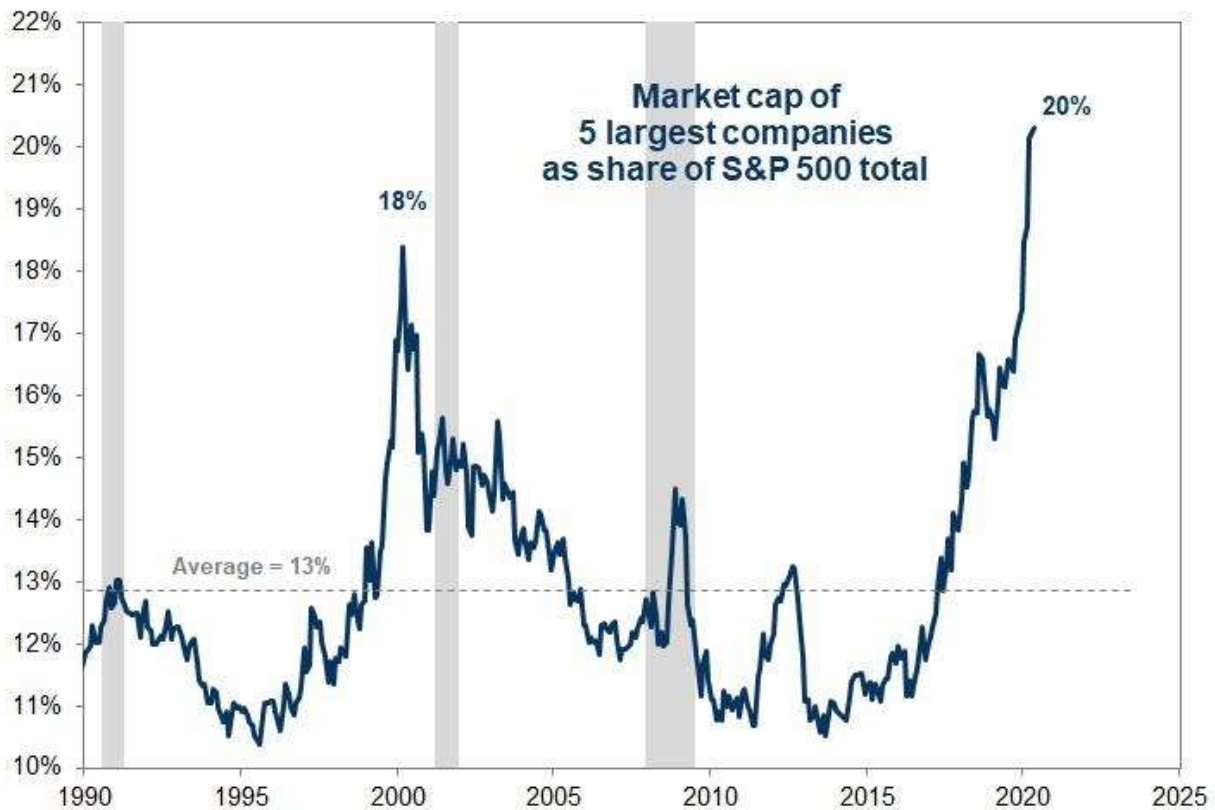


**ROKHANNA**  
DEMOCRAT FOR CONGRESS

Just as the stock market isn't the real economy, indexes aren't the stock market either. This has never been more truer. Actually, literally never. The last time this level of concentration in a few names became this large was in, you guessed it, 1999. And at that time, the top-heavy nature of the S&P 500 topped out at 18%. Right now, we are at 20% and rising...fast! To call this a broad measure of the economy simply doesn't hold water.

The Nifty Five

**Exhibit 4: Record concentration of market cap in 5 largest stocks: AAPL, AMZN, FB, GOOGL, MSFT**  
as of May 27, 2020



Source: FactSet, Goldman Sachs Global Investment Research

Which takes us to our main point for the week, and that is how far other asset classes such as value and small capitalization have been left behind. The list below was compiled by 361 Capital and distributed via their very well read [weekly commentary](#), curated by Blaine Rollins. It shows that not only have the aforementioned value and small have lagged, they are all actually negative in a year that has produced robust gains elsewhere. If you are an institution and own these, you are okay with the underperformance, as that is what you would expect. On the flip side, if you are a Merrill/Morgan/Goldman/UBS client and you own these, you probably aren't that happy with your year right now.

## Have and Have Nots

## Asset Class Performance

ETF	Description	Week	MTD	YTD
SPY	S&P 500	3.27	7.37	10.07
DIA	Dow 30	2.66	8.70	2.06
QQQ	Nasdaq 100	3.78	10.06	38.12
IJH	S&P Midcap 400	1.95	4.66	-4.56
IJR	S&P Smallcap 600	2.00	5.43	-9.73
IWB	Russell 1000	3.26	7.36	10.43
IWM	Russell 2000	1.64	6.64	-4.47
IWV	Russell 3000	3.22	7.39	9.42
IVW	S&P 500 Growth	3.77	9.33	26.19
IJK	Midcap 400 Growth	1.27	4.01	4.41
IJT	Smallcap 600 Growth	1.38	4.17	-2.94
IVE	S&P 500 Value	2.41	4.31	-8.67
IJJ	Midcap 400 Value	2.75	5.30	-14.60
IJS	Smallcap 600 Value	2.54	6.92	-17.09
DVY	DJ Dividend	2.65	3.08	-17.06
RSP	S&P 500 Equalweight	2.83	5.15	-1.53
XLY	Cons Disc	2.98	9.88	20.88
XLP	Cons Stap	2.29	4.90	5.87
XLE	Energy	1.19	1.19	-37.02
XLF	Financials	4.32	5.53	-16.33
XLV	Health Care	1.10	2.34	7.02
XLI	Industrials	3.06	9.84	-2.07
XLB	Materials	3.36	5.98	5.46
XLK	Technology	4.43	11.53	35.43
XLC	Comm Services	4.63	9.34	19.09
XLU	Utilities	-0.59	-2.89	-6.86

Back to the subject of wealth inequality. This week, we heard an idea that we have personally championed in the past that falls in-line with financial literacy, and it came from an unlikely source, Bill Ackman. In his quarterly letter to investors for Pershing Square holdings, Ackman extolled the virtue and benefits of a mandatory investment account for every child in the United States. Do the math, and a \$8,000 wad of cash at birth, compounded at 8%, would yield more than a million at the time of retirement.

## A Future Have



## Politics

If angst about the winners and losers in the stock market is a ten, the uber angst about the 2020 election is a twenty. Investment houses are taking a closer look, and the hedging of bets has begun. What looks like a big lead for Biden on a national level, is beginning to look like a street fight, literally, where it matters most. This week, J.P. Morgan opined that nascent momentum for Trump could likely swell into November, and the market isn't positioned for four more years. Michael 'Loving the Left' Moore agrees, and says that the enthusiasm from

the two bases is far different, and there isn't enough Valium in the world to soothe an almost unfathomable outcome for the Democratic side of the ledger.

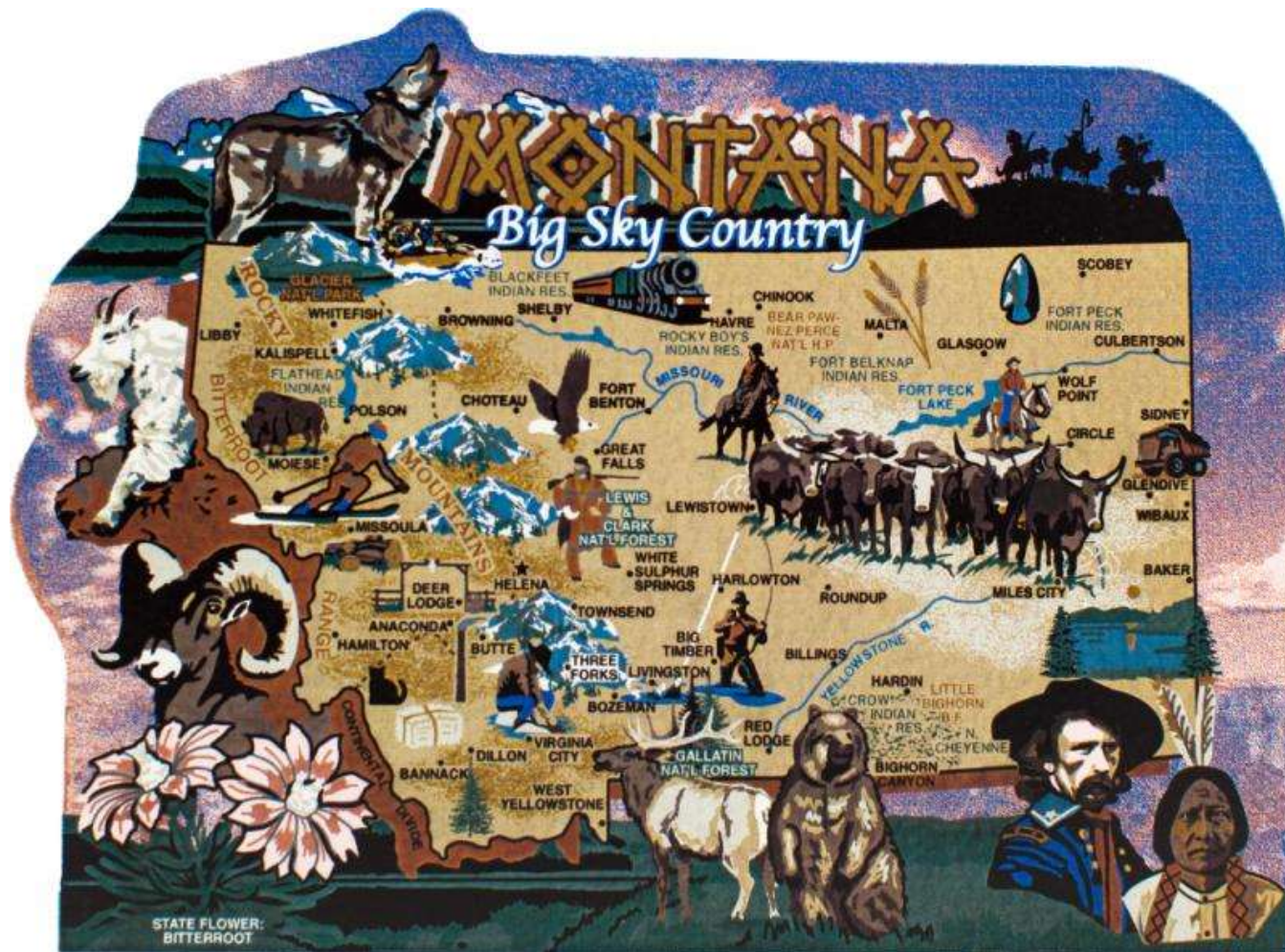
## The Right's Messiah



While the top of the ticket is the subject line most everyone is looking at, the Senate is still very much a wild card. If flipped, it would reduce the sting of a Trump win for those not in

his camp. Bloomberg highlighted this week that a lesser known race between the ‘two Steve’s’ in Montana could be the deciding factor. For those with the time and interest, read the article in full, as it’s a great look inside the libertarian tilt of the deep purple Treasure State, whose residents like low taxes, a small government, their guns, and the right to bear them. They also aren’t big on carpet baggers, as they somehow keep showing up.

## A Treasured Senate Seat



The New York times published a great piece last week on the uncomfortable position Treasury Secretary Steve Mnuchin has been in since he signed on to take the job when Donald Trump was first elected. So much so, that the headline read “Steve Mnuchin tried to save the economy. Not even his family is happy.” The article deep dives on the challenge it can be working for the 45<sup>th</sup> President and the dossier he needs to take up to Capitol Hill with him when he sits down with the Speaker of the House, Nancy Pelosi. If you think your job is tough, you won’t when you are done reading it.

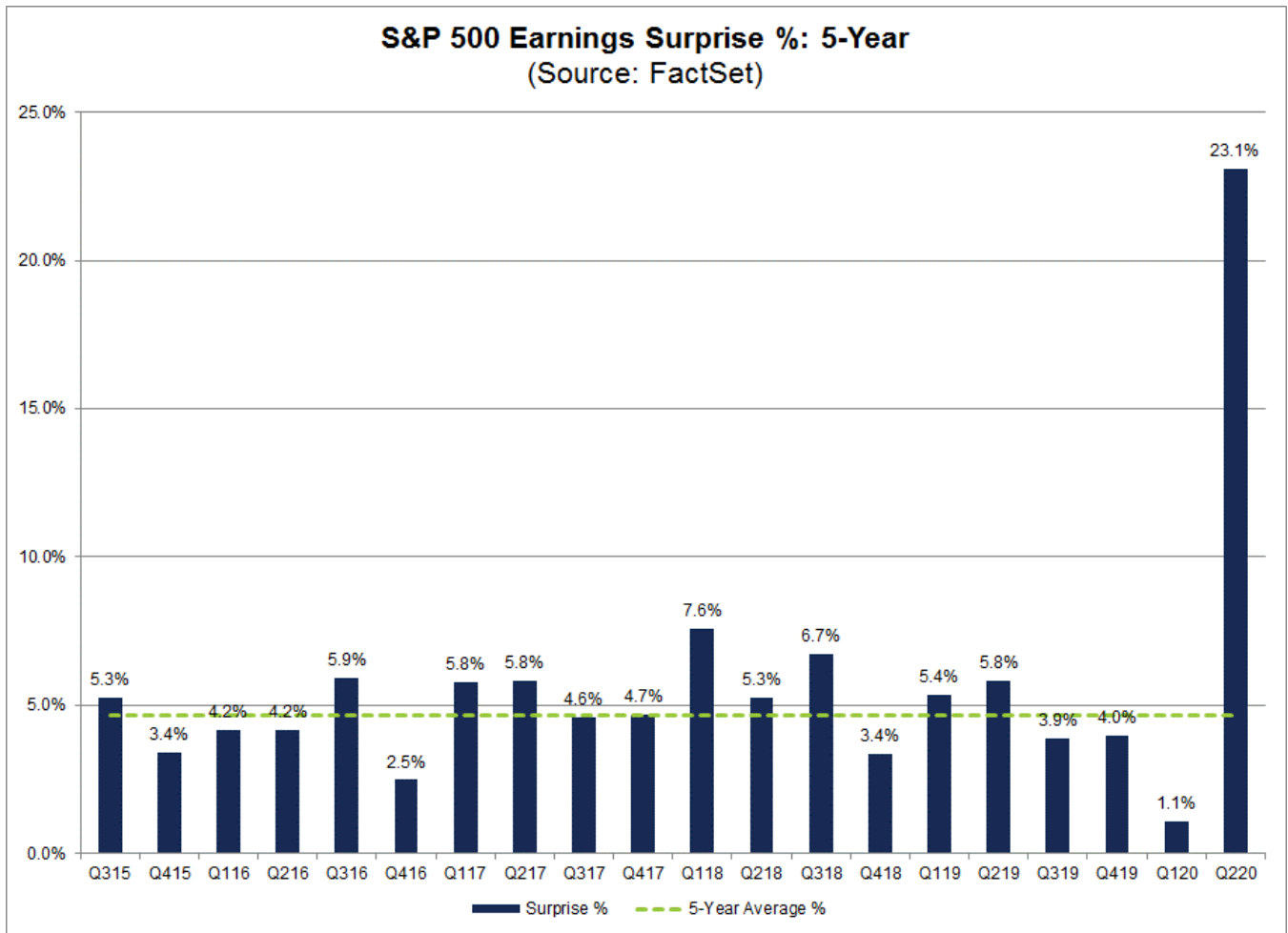
## Next Question



## Earnings

As was highlighted earlier, there are some really expensive segments of the market right now, and some downright cheap ones as well. Moments like this are reminiscent of 2009, when the rally in equities was theoretically not supported by near-term fundamentals and stocks kept rallying. They did so in part because the news was bad, but no longer getting worse, and we saw some of that in second quarter earnings. With companies and analysts flying blind, estimates had a daisy cutter dropped on them. When the actual results came in, the percentage that were 'better than expected' was the highest ever, and that is great fuel for a momentum driven market.

'Surprise, Surprise, Surprise'



## Hedge Funds

From the ‘fact is greater than fiction’ file, news has made its way out that the implosion of Dan Kamensky’s Marble Ridge Capital was more sinister than it first appeared. Turns out, a former Navy SEAL channeled his inner Bud Fox, and took down the firm by pushing back on the idea to go along with a bid rigging plan Kamensky tried to execute for a distressed debt position from failed retailer Neiman Marcus. John Femina is the hero in this sag, and is also the head of distressed trading at Jefferies Group. Turns out, Kamensky asked the wrong sailor to ‘STAND DOWN’.

## Femina’s Current Post



It's no secret that 'traditional' hedge funds are struggling this year, as the downside they promised to protect didn't happen in the first quarter. And unless they went 'balls to the walls', the chances of keeping up with the torrid pace of recovery is very low. Which brings us to another round of news that David Einhorn's value focused Green Light Capital is struggling, as it's down 17% after a .50% rebound in August, if that's what you consider a rebound. Down from a peak of \$12 billion, the now \$2.7 billion dollars Greenlight has hasn't done too well with the long gold/short Tesla paired position.

## Tough Trade



## Happy Birthday, Warren

The greatest practitioner of value investing, Warren Buffett, clocked 90 this week. Ironically at a time when the genre is on its proverbial ass. Among the many well-wishers was Microsoft founder, and longtime friend, Bill Gates. In a very lighthearted video, a wordless Gates bakes the Oracle an Oreo encrusted cake worthy of the man who was once the worlds richest.

Just a Couple of Regular Guys



## Diversion from Diversions

While we do not consider ourselves ones who run out of material very often, the world has gone very binary, and it's tough to keep finding things to write about that you can't very well do. We will get back at it soon enough, but for now let the world toggle back and forth between politics and the stock market, with a little sport thrown in for good measure. Keep the faith, stay balanced, and we will see you back here in two weeks time.

Fire & Water



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