

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



### ***The Economic Top- Down***

President Trump did what he does best this week when he shot from the hip and called the Federal Reserve "the problem", going on to suggest that Powell & Co. should start lowering rates.

**"I'm Watching You."**



Source: Spectator UK

*Our View: As much as Trump's style and tone make everything feel bigger than it is, presidents almost always play the role of a critic when Fed policy isn't going their way. At least The Donald*

hasn't taken it to the level that LBJ did when he "physically moved" then Fed chair William Martin around the room at his Texas ranch in an attempt to bully him into lower rates.

### **Puppet Masters of the Fed?**



Source: The Milken Institute

Jim Grant, the well-respected author of *"The Interest Rate Observer"* thinks the Fed will blink. His basis for the call? Look for a "data dependent" Open Market Committee to start changing

its tune when the numbers start to roll over. Banking analyst Dick Bove agrees, writing on Wednesday that “this economy can’t handle” rising rates.

The yield curve would indicate that the Federal Reserve *does* have some room to run this tightening cycle as it has yet to go negative, and even when it does, there is usually a 12 to 18 month lag before a recession hits. This being said, the Fed should not have that be their goal.

## Yield Curve



Source: The St. Louis Federal Reserve

Speaking of rolling over, that is exactly what’s happening in the housing market, as refinance applications are down 20% from a year ago and homebuilder confidence just fell off the side of the table.

## Bad Sign For The Market

## Dejected Developers

U.S. homebuilders feeling less optimistic about housing market

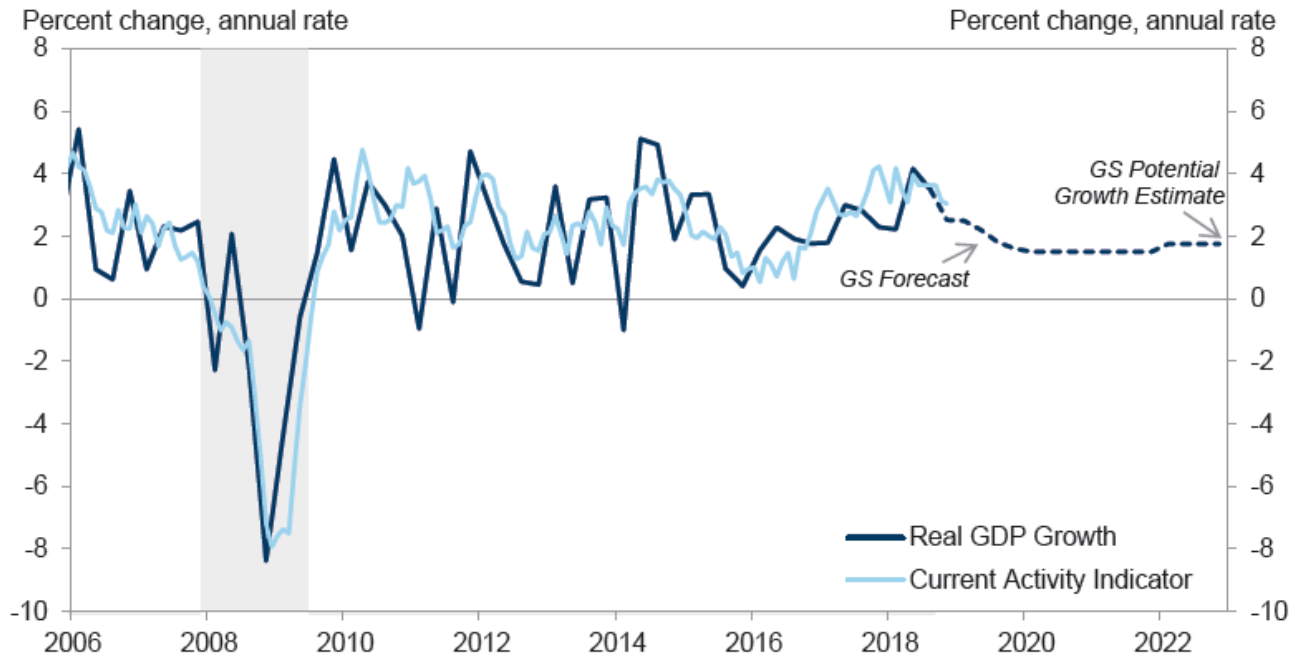


Source: Bloomberg

Goldman Sachs chief economist Jan Hatzius expects a moderating of growth next year. His reasoning, and one that has become the consensus on Wall Street, is that monetary accommodation is being removed, interest rates are headed higher, and the tax based stimulus that juiced GDP this year is going to begin to fade away. J.P Morgan's Jaime Dimon and Barclays also echoed the same opinion this week.

**Will GDP Flatline?**

### Exhibit 3: We Expect Growth to Slow from 3½%+ Recently to a Trend-Like Pace by Late 2019



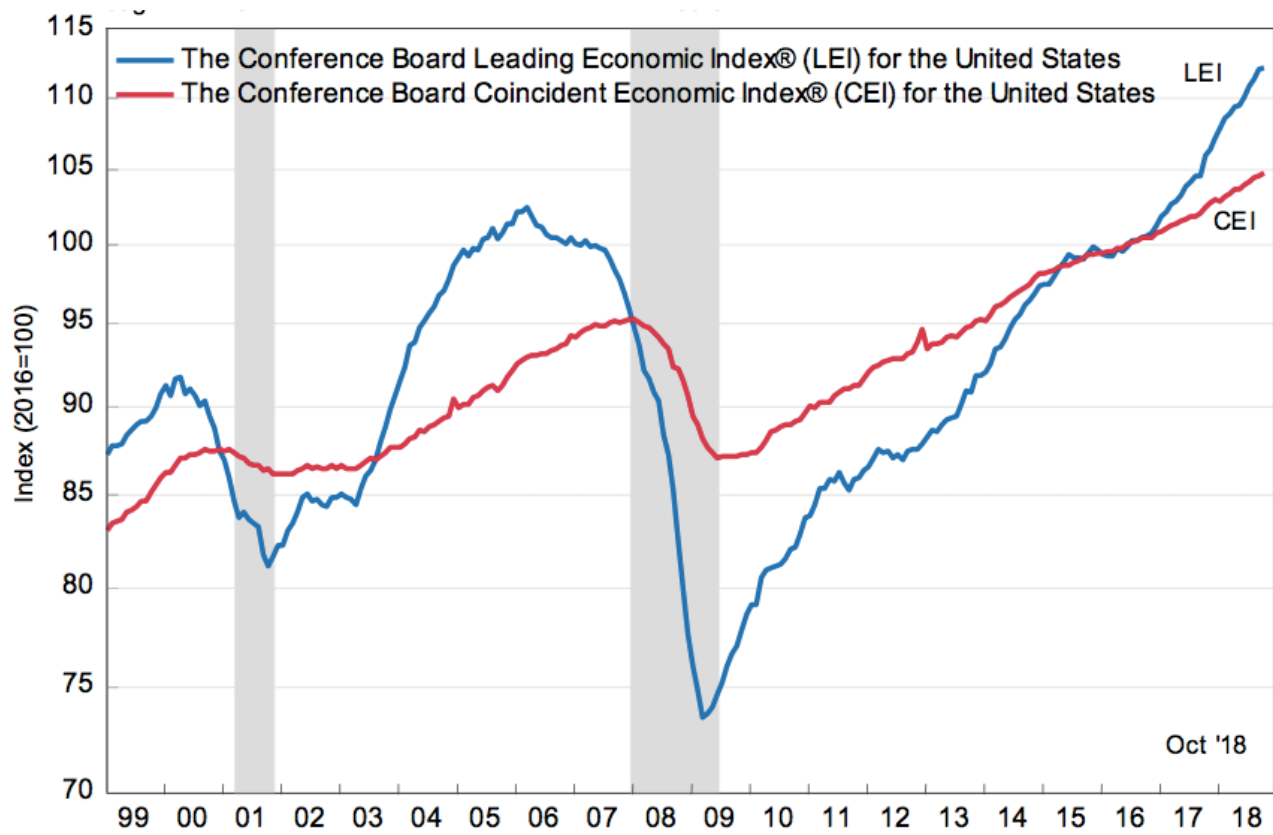
Source: Department of Commerce, Goldman Sachs Global Investment Research

Source: Goldman Sachs

Later in the week, the firm's global chief equity strategist Peter Oppenheimer, made the call that moderation of growth does not indicate a recession is on the horizon. It does however increase the chances that it will show up.

One of the key markers for the health of the economy is the leading indicators. The economy has never entered a recession without the LEI contracting. The October release from the Conference Board this week gives no reason to believe that there is one on the horizon.

### Leading Economic Indicators



Source: The Conference Board

## ***Markets***

It was another tough, and volatile, week for the markets. Every strategist on the Street was out with their prognostications about the causes of this correction and what could come next.

## **The Bear Is On The Prowl**



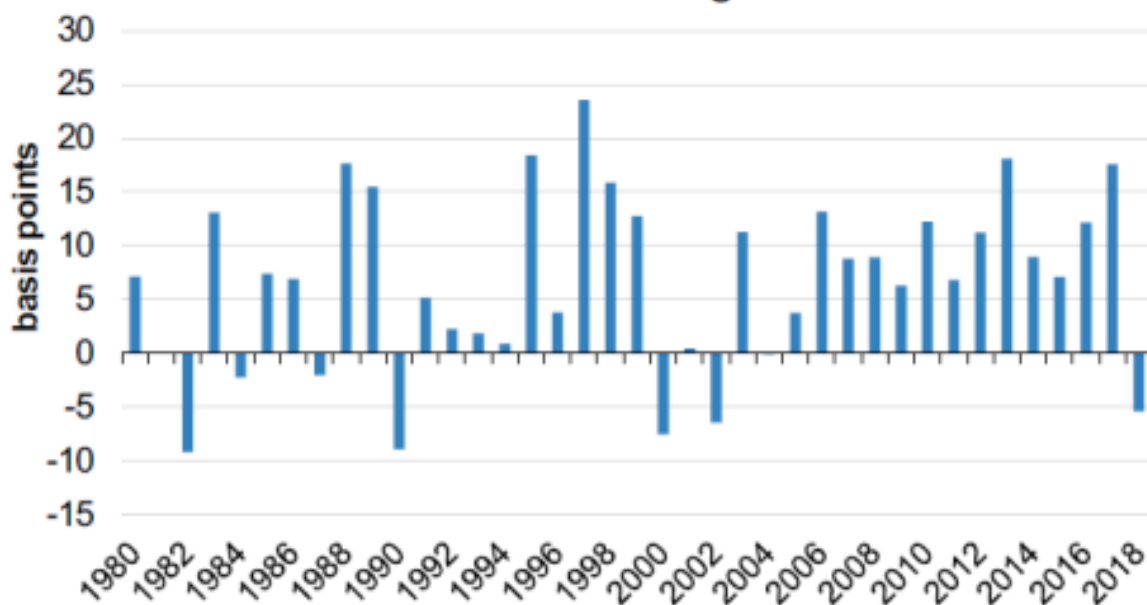
Source: Money Crashers

Morgan Stanley produced a research piece that highlighted how rare it is for the market to react as poorly as it has. Since 2002, buying the dip in equities has proven to be the right thing to do. Not this time though, as market weakness hasn't been followed by renewed strength, happening only seven times since this occurred in 1980.

### **Dip Buyers on Strike**

1980 1982 1984 1986 1988 1990 1992 1994 1996 1998 2000 2002 2004 2006 2008 2010 2012 2014 2016 2018

### Average Daily SPX Return if Previous Week Return was Negative



Source: Morgan Stanley

Aside from the damage inflicted upon the investor psyche, there has also been a great deal of technical damage done to the markets. As a quick primer, technical analysis means evaluating the market charts and learning what they want to tell us.

For as long as we can remember, the 200-day moving average has proven to be the support line for the markets. While the quick selloff in February did not cross over it, this one most certainly has.

### S&P 500 with The 200 Day



Source: Nasdaq

*Our View: Once the trendline is broken, there is no doubt that a psychological impact is left on those who actively watch and trade the markets. Keep in mind, it took seven months to reach new highs after February's selloff, and there was no breach of support available this time.*

### ***The Corporate Bottom Up***

Retailers took center stage on Tuesday with a bevy of earnings reports, most of which the market didn't favor. Strong consumer demand wasn't enough to offset higher costs at Target, which traded down 10% after reporting. Kohls traded down the same percentage on what amounted to an "all clear" from the company. Rounding out the trio was Ross Stores, which raised earnings guidance but commented that it was in a fierce retail environment. All of which have given up a year's worth of gains in the last two weeks.

**Target, Ross, Kohls**



Source: SF Gate

Fast forward to today, and the headlines would have you think the nuclear winter is upon us. Turns out, we are just back to 2016 valuations without a huge change in fundamentals aside from Facebook.

### Tech Gets a 20% Valuation Haircut

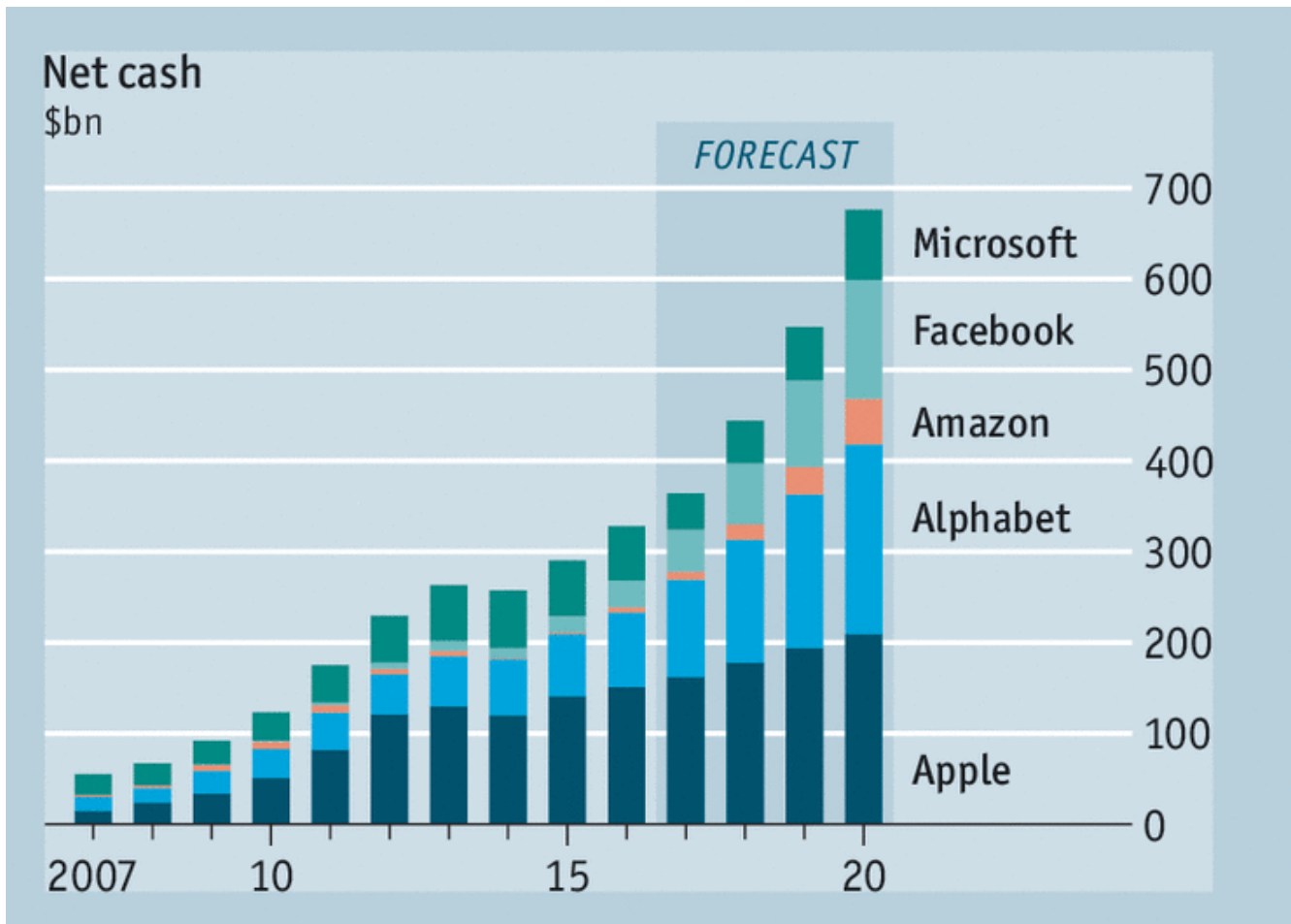


Source: Bloomberg

*Our View: The technology sector has changed so much over the past twenty years. Back in the day there was an income statement focused on growth, and a lack thereof, that led to the reputation of it being a volatile sector. That can still be found, albeit to a lesser extent, in the smaller emerging areas of tech.*

*What can't be denied, is that those that have survived and evolved over that period are now respected for the cash flow statement and balance sheet. The lesson being, the sector is far removed from being a cyclical monolith. Pay the right multiple for free cash flow, and over time you will make out just fine.*

### Follow The Free Cash Flow



Source: The Wall Street Journal

*Silicon Valley was where this author called home for the first 18 years of his life. It was a great place to grow up, as there was an early energy and excitement there that could not be denied. The name itself comes from the old silicon wafers that microchips were produced on, and although today you are far more likely to find that production in a fabrication plant in Asia, the name lives on. As does the classic version of the quirky board game we played as kids.*

### **The Original “In The Chips”**



Source: Vintage Pharoh

### ***Hedge Funds & Asset Managers***

Time to check in on our favorite EKGs of the hedge fund world, performance of the Goldman Sachs Hedge Fund VIP (Very Important Position ETF) versus the broad market. Turns out, the 2 and 20 crowds favorite names are highly correlated to an index you can buy for 5 basis points, and offering little in the way of downside protection. Are there any hedge funds left that actually hedge?

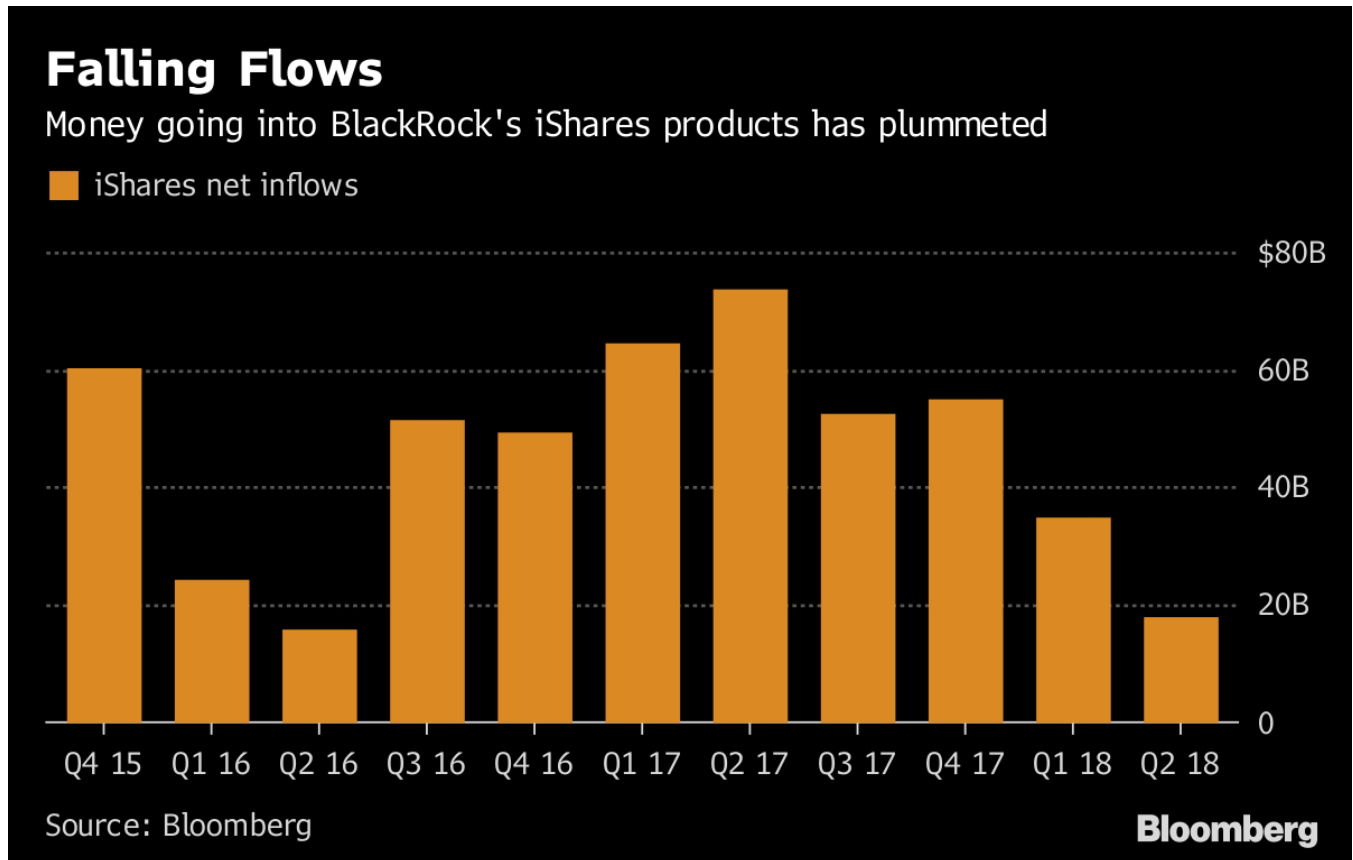
### **S&P 500 vs. Goldman's Hedge Fund VIPs**



Source: Nasdaq

Asset managers are getting hit hard at the wrong time as the bonus pencil is getting sharpened and hope springs eternal for an “upside surprise”. Those prospects are looking more and more dim in a year where only one in three saw net inflows. Even ETF powerhouses like BlackRock are suffering from money going out the door and the race to zero as freemegeddon sets in.

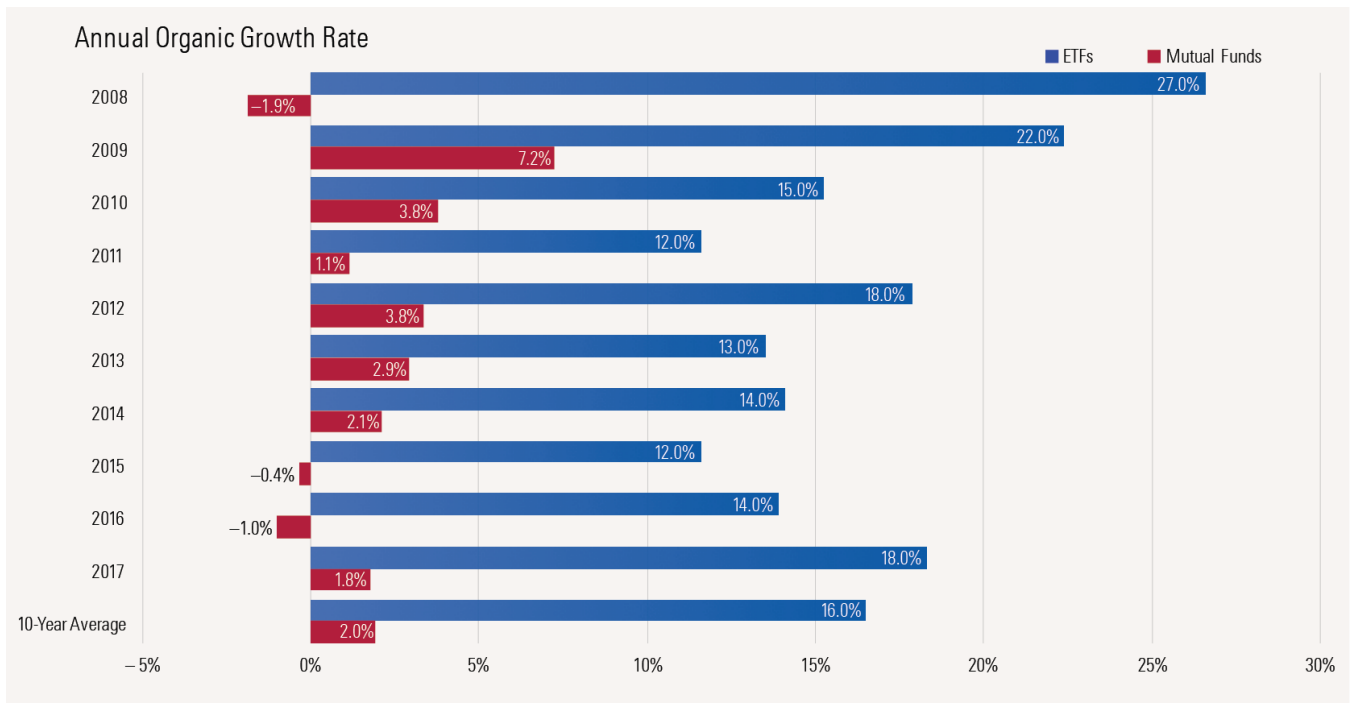
“Et tu, Brute?”



Source: Bloomberg

*Our View: You know it's bad when the ETF hunter becomes the hunted. And this time by its own kind. Turns out, fee compression on top of declining assets flows is a headwind no asset manager is immune to. We managed to mess this up by believing the long passive, short active trade would persist. Turns out the right one was to sell short the whole group as the basket of BlackRock, T. Rowe, Franklin, and Invesco is down 25% this year.*

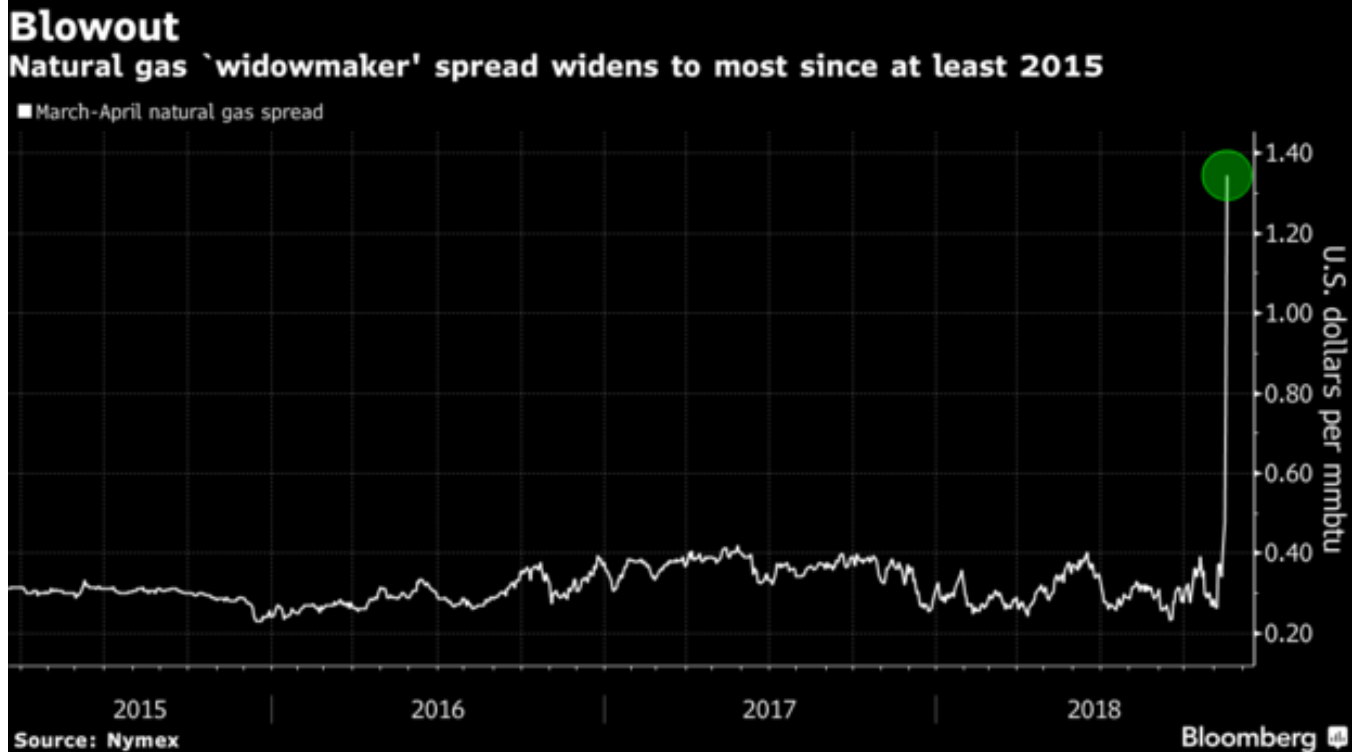
### Organic Growth Slowing



Source: Morningstar

Rarely does the world offer the chance to look into the soul of a man as he confesses to losing all his clients' money, and for all intents and purposes his career, than there was this week. Natural gas trader Jim Cordier spent 10 minutes on YouTube painfully explaining to his investors what had happened after a "tsunami" hit his trading strategy.

### Game Over for OptionsSellers



Source: Bloomberg

*Our View: What Mr. Cordier experienced is the ultimate nightmare for anyone who tries to master their craft in a world where one anomalous event can take you out. The decision to traffic in naked options was his, and he knew the risks. We wish him well and hope he resurrects his career, however that looks.*

### ***Diversions***

God willing, everyone has successfully emerged from their Thanksgiving induced food comas and are ready for the culinary mastery of what's left over. For some, self-included, this is even better than the first round. Look no further than the Food Network to provide you with the best ways to make the meal come back to life. Frittatas, chili, salads, stews, Bolognese, pot pie, pho...

### **Round Two**



Source: Food Network

Saturday is rivalry day in college football. Across the country teams will play in “The Game”, “The Holy War”, “The Iron Bowl”, “Apple Cup”, “Civil War”, and for the “The Battle for the Jeweled Shillelagh” when USC and Notre Dame meet at the Coliseum. ESPN provides readers with the “*Haters Guide to Rivalry Week.*” Enjoy.

**For the 86<sup>th</sup> Time**



Source: Sports Illustrated

*Our View: Fight On!*

For the same price as a reasonably well appointed home in Aspen or Vail, you too can purchase your very own ski destination. The Blacktail Mountain Ski Resort in Western Montana was listed on Craigslist for \$3.5 million earlier this week. For that price you get three lifts, a lodge, one ski shop, access to 1,000 acres of Flathead National Forest, and a great view of the lake. If that price is too steep, you can look into the Marshall Mountain Ski Resort near Missoula. Asking price, \$2.25 million.

**Blacktail Mountain, Montana**



Source: Billings Gazette

The Rolling Stones announced a thirteen city tour next year, playing mostly the big venues you would expect. The “*No Filter*” tour kicks off in Miami April 20<sup>th</sup>, and will swing through the western states during the month of May. They wrap up in Chicago on June 21<sup>st</sup>.

It’s hard to believe that all the members of the band are now in their 70s, with Mick checking in at 75, Charlie Watts is 77, Keith Richards is clocking in at 74, and Ronnie Wood as the youngster with 71.

**It’s Only Rock n’ Roll...But I Like It!**



Source: Consequence of Sound

*Our View: Consider us booked for the May 11<sup>th</sup> show at the Rose Bowl.*

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