

This Week In...

Economics

In the absence of any significant hard data on the economy, the vacuum has been filled by the ongoing Brexit saga in the UK. And subsequently, what is at stake is the orderly exit of the United Kingdom from the European Union. With growth slowing worldwide, these delays and confusion only add to the list of potential risk to the global markets.

“Anarchy in the UK!!!! “



Source: The Financial Times

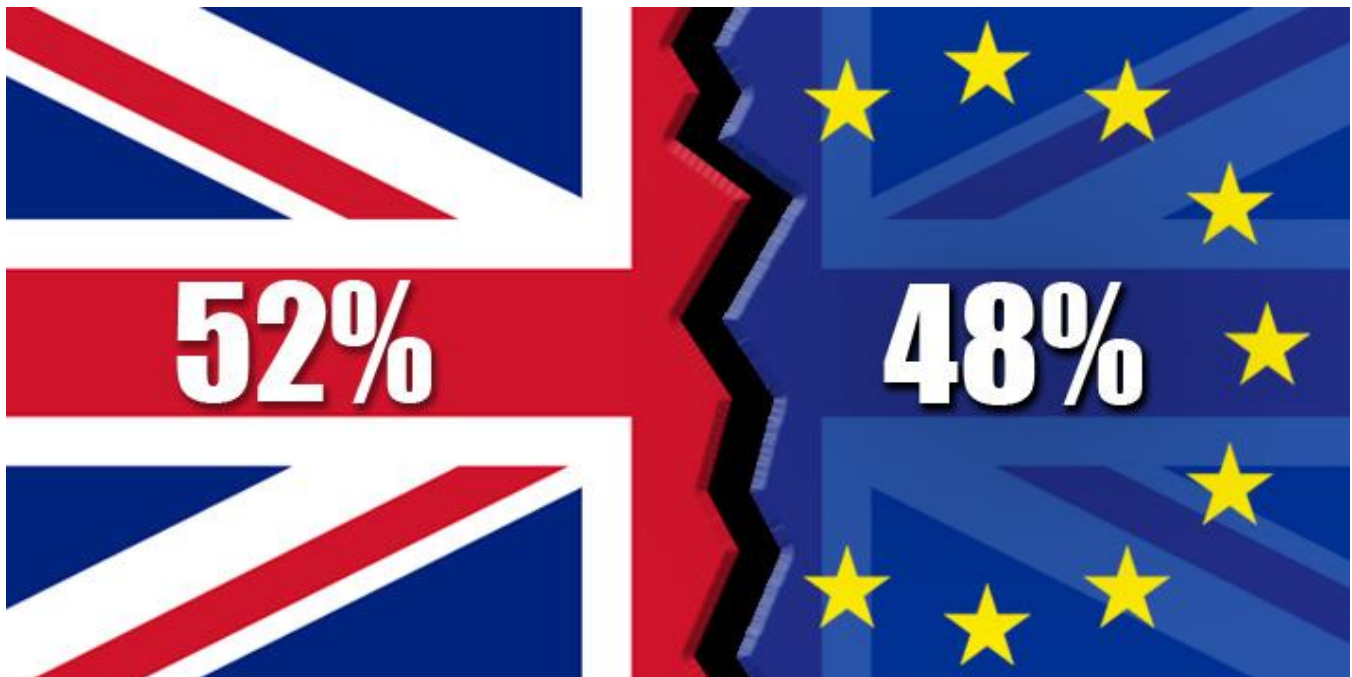
To summarize where we are today, British Prime Minister Theresa May has offered her plan for separation, the date of which is supposed to be March 29th, 2019.

Unfortunately for May, her proposal has been voted down twice, and there is concern that anti-Brexit members of parliament might conspire to derail the process. In an attempt to buy additional time, the Prime Minister, with parliaments vote of approval, is asking the 27 member countries of the EU to extend the deadline

by three months. As of today, there are no guarantees they will prevail. May did however receive a rare win on Thursday, granting some concessions on the timing of the next steps.

Keep in mind, in 2016 the people of the UK who wanted to bail out won by a narrow 4% margin. If the vote was held today, it's believed that the outcome would be different.

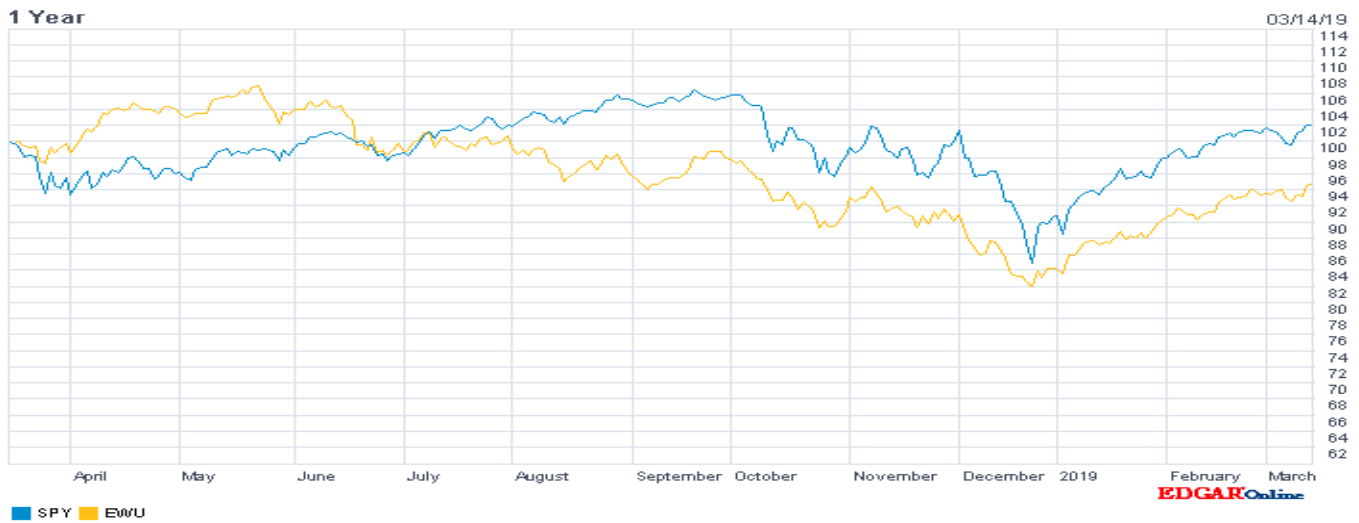
Narrow Win for Brexit



Source: BBC

If Article 50 is not extended, the next step in the process is a March 29th hard stop. Needless to say, the markets don't like hesitation and confusion, which is exactly what the breakdown of the process has done. We also see this in the United States, as CEO's are being barraged by questions as to the impact on business. In the meantime, markets remain on edge.

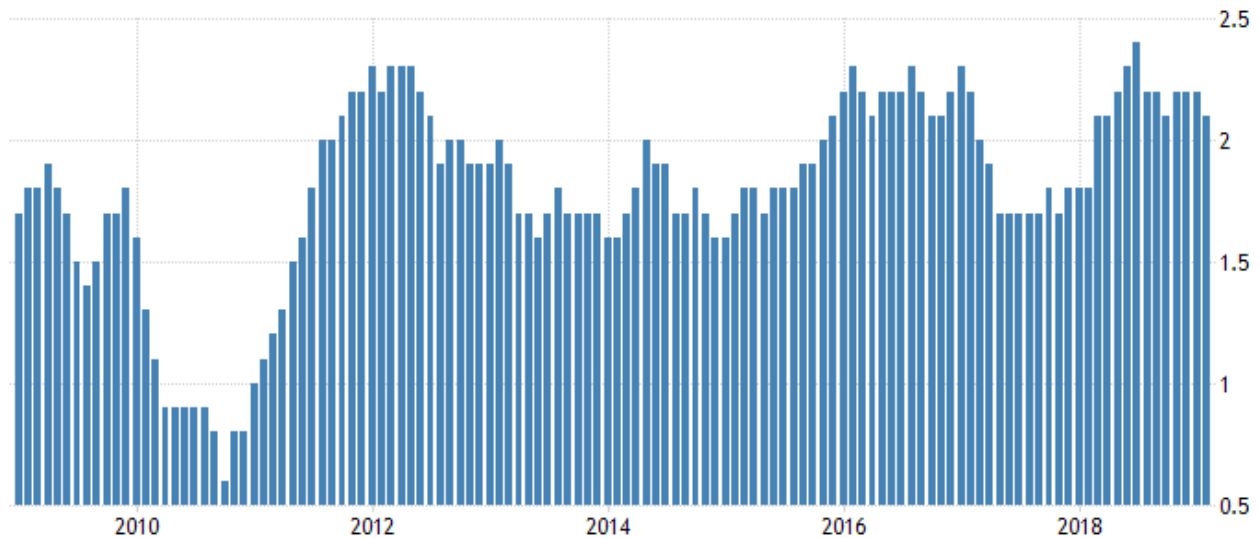
United States v. Great Britain



Source: Nasdaq

Inflation continues to stay in check, safely resting between 1.5% and 2.0% growth for the better part of the past decade, only dipping shortly in 2010 as the effects of the global financial crisis worked their way through the system. The February 2019 print of 2.1% proves once again that we are in a low(ish) inflation environment.

Consumer Price Index



SOURCE: TRADINGECONOMICS.COM | U.S. BUREAU OF LABOR STATISTICS

Source: Trading Economics

The lack of pick has confounded economists as we enter into the tenth year of expansion. It has also allowed the Fed to hold back on the rate hike regime they were on for some time.

The Ucla Anderson Forecast, released this week, projects there is a “very real risk” of a recession arriving at or before we ring the bell on 2020. The well watched forecast reads like a laundry list of the “known knowns”. Brexit, trade tensions, tax cuts, employment, etc.

In the beautiful words of former Defense Secretary Donald Rumsfeld, it’s the “unknown knowns” that we must actually worry about. We just don’t know what they are, I think?

“What da’ you know?”



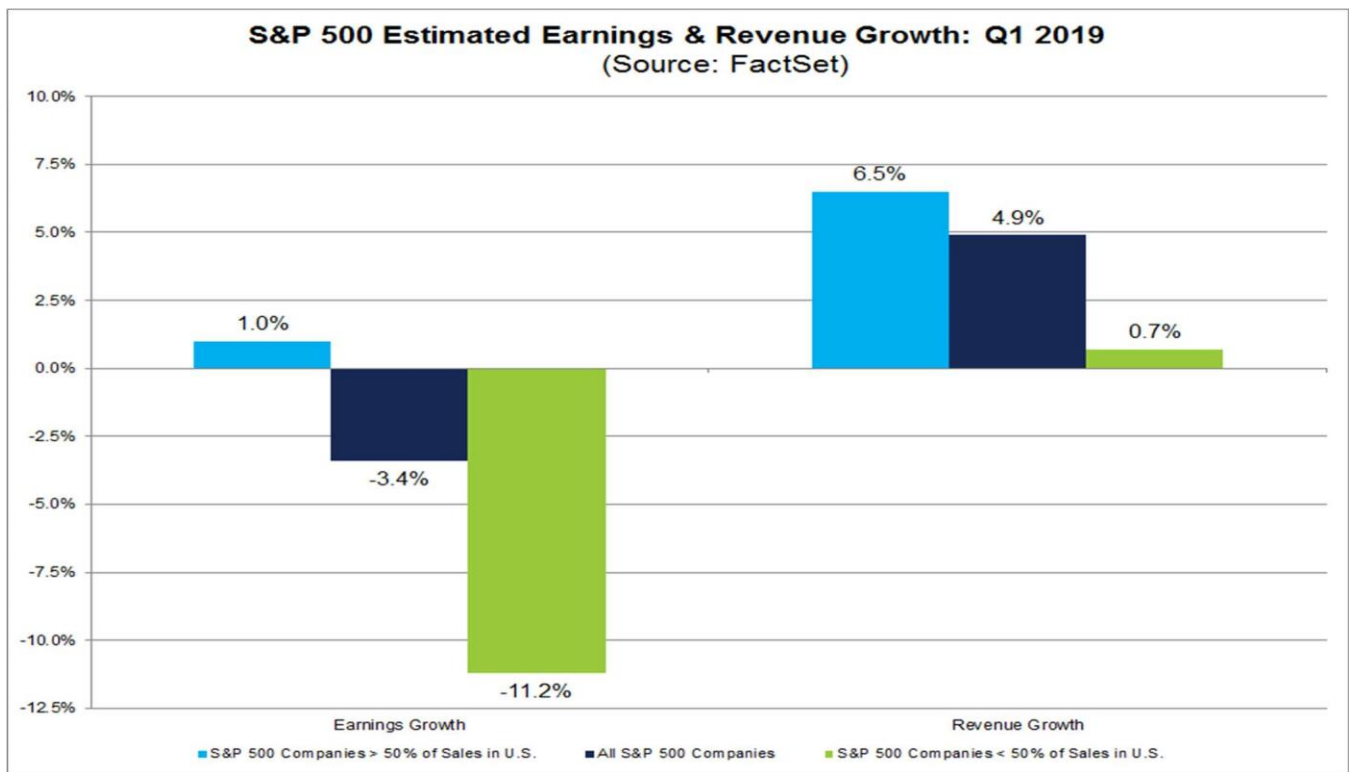
Source: Politico

Earnings

Corporate America has two weeks to pull together what should be a challenging quarter for earnings. Those with greater exposure to world trade are looking for a material decrease in revenue and EPS growth. Bloomberg reports that 40% of the

S&P 500 are facing an earnings decline. As always, FactSet does a great job of preparing the details in their weekly “Earnings Insight”.

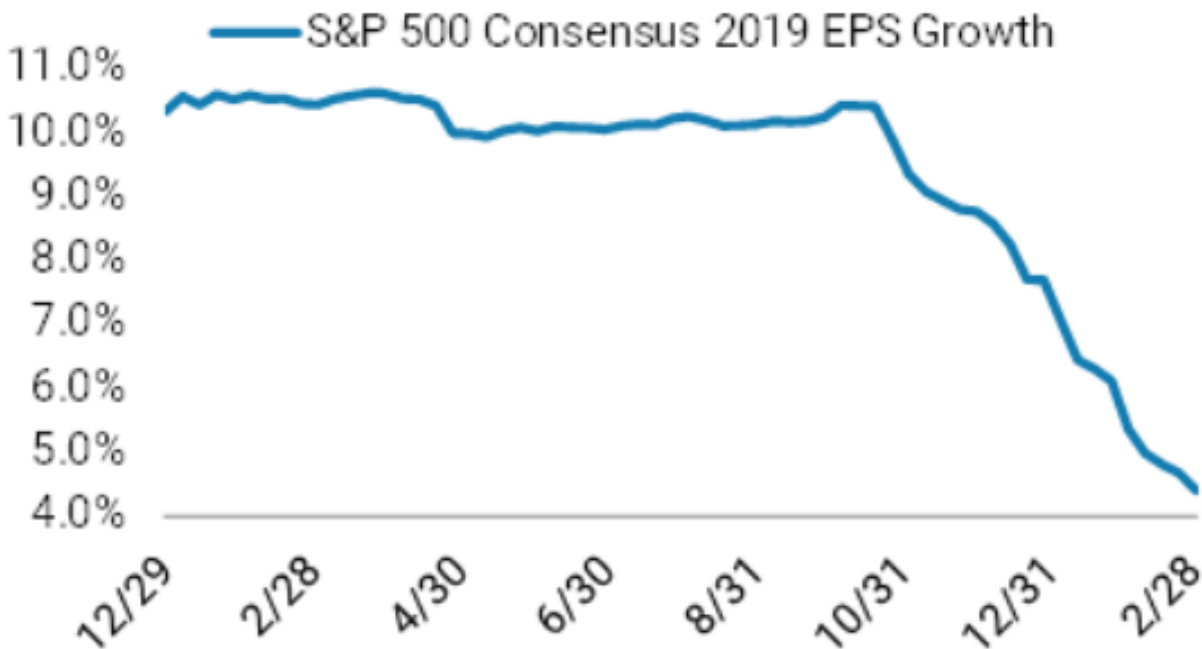
Earnings Drop into Low Gear



Source: FactSet

Last month, Morgan Stanley predicted that the earnings recession is here. The firm reiterated their position earlier this week, saying the worst wasn't over and the markets should expect a further slowdown. It's interesting to note that consensus earnings for 2019 began to come down in the fall of last year, coinciding with the worst market selloff in years. If the number keeps coming down, our bet is the market will follow it.

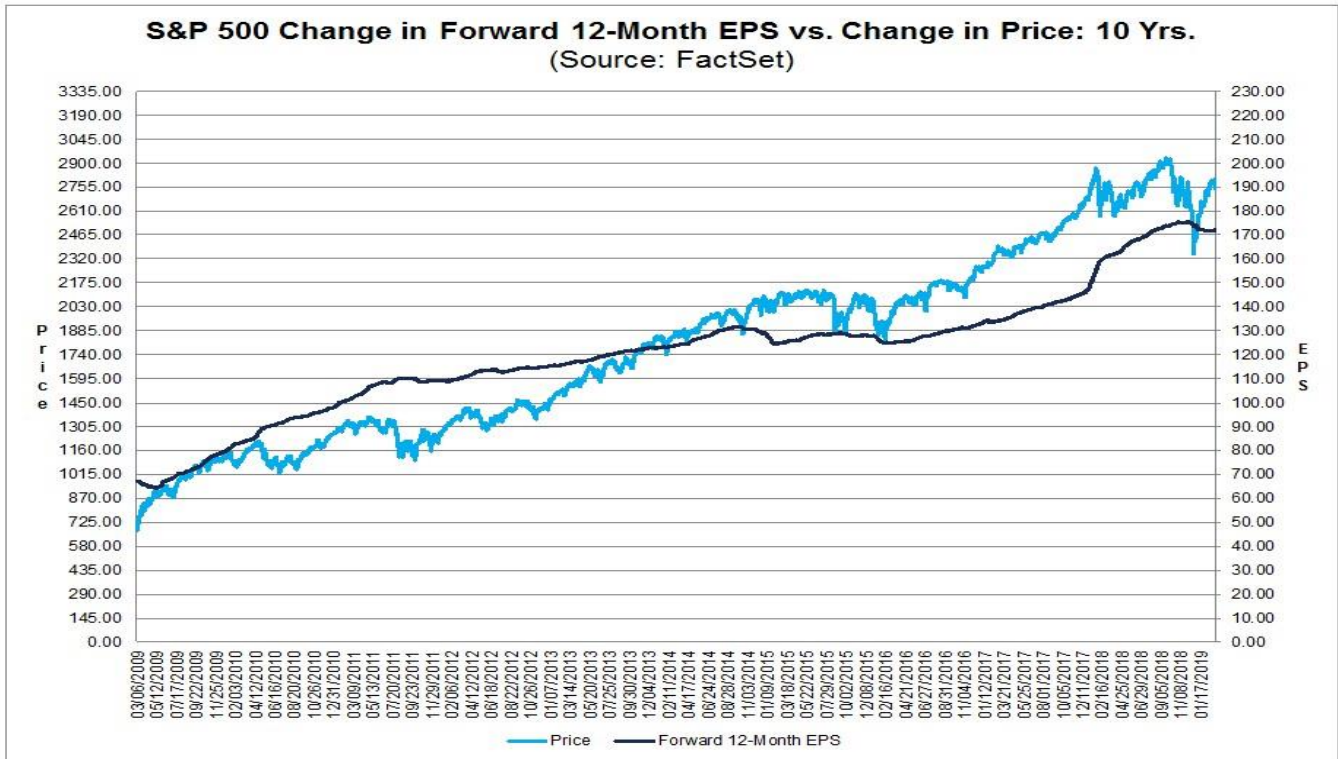
Earnings Estimates Fall Out of Bed



Source: CNBC

Big picture, the U.S is still looking good on a relative and absolute basis. That said, when earnings slow and move sideways, investors should lower their return expectations accordingly. A theme Stillwater has been talking about for a while, and for all intents and purposes, the markets appear to be supporting that theory.

S&P 500 Earnings and Price



Source: FactSet

Wall Street

In big news from the alternative investment world, Canadian real estate giant Brookfield announced the purchase of a controlling stake in Los Angeles based Oaktree Capital. The deal, announced on Thursday, will provide Brookfield instant credibility in the alternative debt market. The combination of the two will manage a grand total of \$475 billion in assets, \$3 billion more than rival Blackstone.

Forbes provides a look into what the deal means for the real estate and credit markets. Founders Howard Marks and Bruce Karash will be staying on and continue to run the business.

Standing & Sitting Pretty



Source: Phillywerise

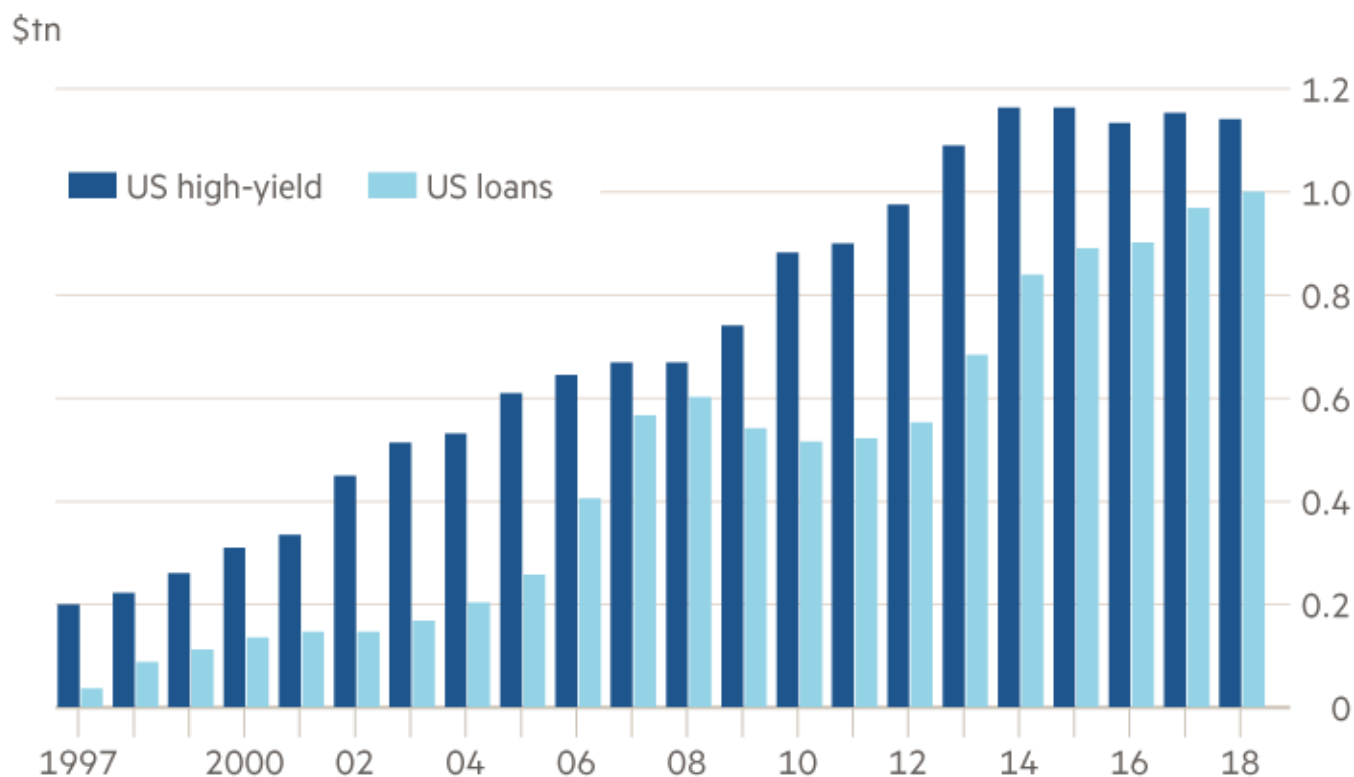
In the early 1980s, Marks was working on the Citi fixed income trading desk in New York. One day, the phone rings and a guy out on the west coast calls looking for corporate credits that are being sold in “bid wanted” fashion to get them off the books of big insurance companies. The guy on the line was Michael Milken, and he was looking for pieces of debt that would later be known as “junk bonds”.

After several calls from the desk out west, Marks’ boss asked who the guy was. Howard didn’t know, but was willing to jump on a plane and head to Los Angeles

to find out. That serendipitous moment would be the start of a long and very prosperous career in the business. For those with the intellectual curiosity, watch the hour and a half interview with Milken entitled “Mastering the Market Cycle”.

High Yield and Levered Loans

Loan market catching up to bonds



Sources: BofA Merrill Lynch Global Research; LCD

© FT

Source: *The Financial Times*

While Oaktree’s partners and employees have done well, shareholders of the publicly traded OAK have lagged the financial sector by a handsome sum for the past five years. Another example of private equity, hedge funds, and alternative asset managers being better served in the private markets, not the public. At least for buyers of OAK, OZM, APO, BX and MC.

XLF, **OAK**, **BX**



Source: Nasdaq

For those of us in business who remember the days when sales traders and analysts roamed the halls of many an asset manager, and also yearn for yesteryear, you are going to want to pop a Xanax before you read the next piece.

ZeroHedge contributor Tyler Durden penned a piece this week highlighting the demise of the qualitative side of our business in favor of the ever-growing quant world. The sobering headline read, “Goldman had 600 cash traders in 2000, now it has 2”. To further illustrate the point, Durden included a before and after picture of the once sprawling trading floor at UBS.

UBS circa 2000



Source: ZeroHedge

UBS circa 2018

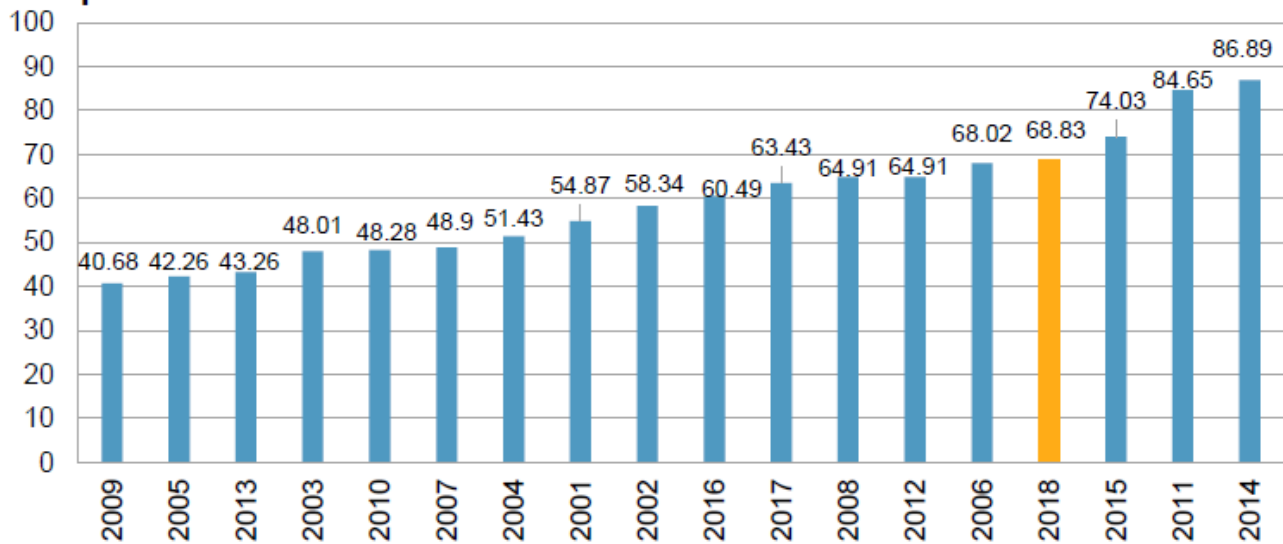


Source: ZeroHedge

One reason for the death of cash trading is the flood of assets into ETFs and away from active managers, and the continual underperformance of the latter. *CNBC's* Bob Pisani reported the sober news on Friday that for the 9th straight year, passive beat active. This time with an alarming percentage of those that did. Is 89% even a big number? Um, yes, it is.

Yeouch!

Exhibit 1: Percentage of Domestic Equity Funds Underperforming the S&P Composite 1500



Source: S&P Dow Jones Indices LLC. Data as of Dec. 31, 2018. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Source: CNBC

If that's not enough tough news for one week, we have one last nasty tasting cherry to put on the top of the turd sundae we just served up. While most of the headlines springing from the college admission scandal are attached to those living west of the 405 and north of Wilshire, there were some casualties on Wall Street as well. None being bigger than Bill McGlashan, who ran TPG's social-impact funds.

By Friday of this week, McGlashan had either quit or been fired depending on who you ask. The news had real financial impact on TPG, as redemption gates that had been in place were removed, and clients were allowed to take money out of a previously locked up fund. Bill is in good company, as the former CEO of bond giant PIMCO was also implicated in the scheme.

Smile for the Camera



Source: WSJ

The View from Canyon Partners

On Tuesday, we had the opportunity to attend Canyon Partners Investor Day in Los Angeles. For those who don't know the firm, it was founded 29 years ago by Josh Friedman and Mitch Julis. The two were roommates at Harvard, and the partnership was cemented early. Even though by their own admission, they strongly resembled Oscar and Felix.

Josh Friedman & Mitch Julis



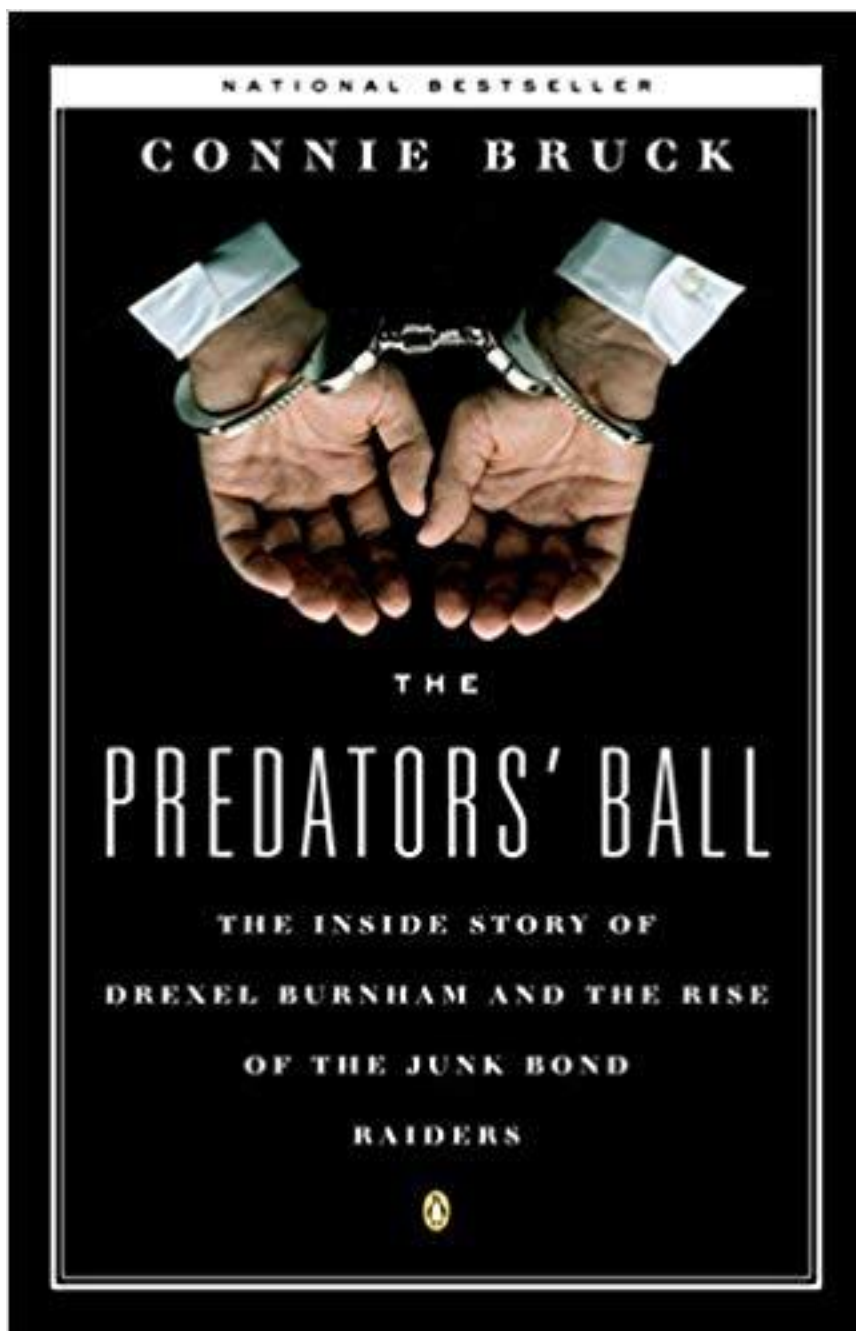
Source: Institutional Investor

While the firm doesn't run the \$100 billion that Oaktree and DoubleLine manage, the \$25 billion they do maintain has provided nice returns for investors and partners of the firm.

Their style comes from the distressed investing family tree that Michael Milken planted and grew almost 40 years ago at Drexel Burnham. From that same tree came Wall Street legends such as Ken Moelis, Jess Ravich, and Mark Attanasio, to name only a few. All of which had distressed or value investing in their DNA, including Josh and Mitch.

For anyone interested in reliving the story of the Milken and junk bond barons of the 1980s, read Connie Bruck's, *"The Predators Ball."* A seminal book about a time when life changing amounts of money were made.

Silver Cufflinks



Source: Amazon

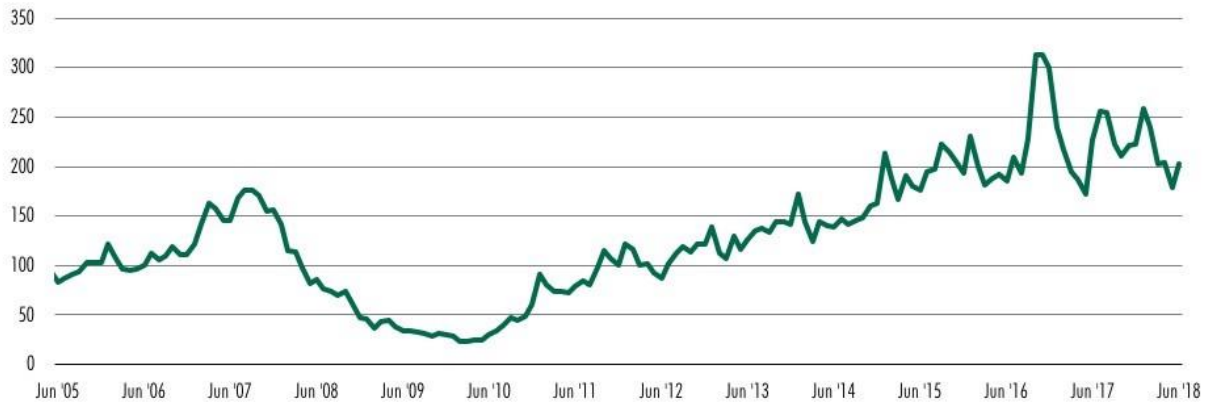
During a lunch held at the Beverly Hilton, the two Canyon founders provided their view that this was a late cycle environment for investing, and holding some dry powder for distressed opportunities in the future would be a good plan. They followed along with the logic of many others, that QE has run its course, and while tax cuts juiced growth over the past two years, eventually this will wear off. Of particular concern to Canyon was the debt market for commercial real estate.

It has more than recovered from the 2009 lows, and credit quality has decreased along with a slipping of lending standards. Just what you would expect as we get closer to putting a bow on this expansion.

Commercial Loan Closings

CBRE Lending Momentum Index

Seasonally Adjusted, 2005 average = 100



Source: CBRE Capital Markets and CBRE Research, Q2 2018.

CBRE

Source: *CBRE*

During another part of the day's presentation, the portfolio management team dove into how the firm was reducing down long equity positions and increasing cash levels in preparation for what they anticipate is a changing environment going forward. From our perspective, this was a tacking of the boat, and not a full-scale pounding of the rudder. Regardless of the size of the move, they too see the seas getting choppy.

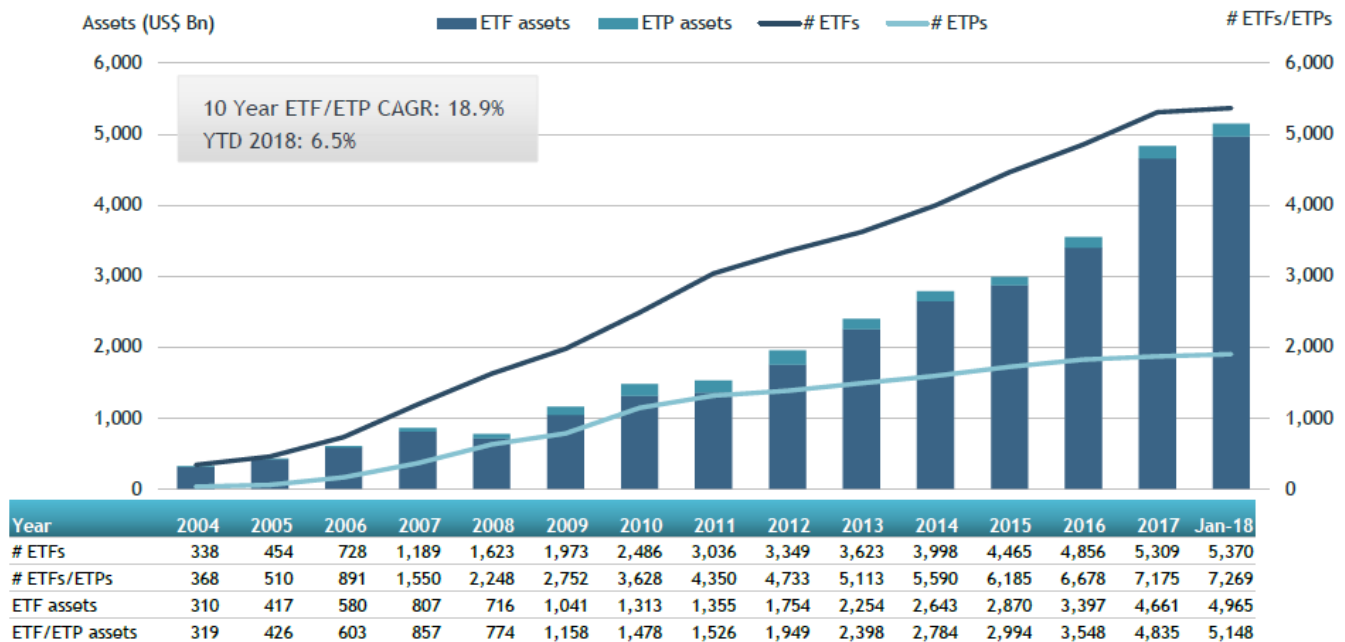
Tack to Port



Source: St. John The Evangelist

The last piece to mention from Josh and Mitch involves the rise of ETFs across stock and bond strategies. While they didn't go so far as to call the tectonic shift "un-Democratic", they did lament the distortion and auto pilot nature of the products and how when a button gets pressed, and as a result, a basket of securities get purchased, regardless of a change in any one single member's underlying fundamentals. A trend that makes it harder for them to find price dislocations that make for good investment opportunities.

ETFs Owned Globally



Source: ETFGI data sourced from ETF/ETP sponsors, exchanges, regulatory filings, Thomson Reuters/Lipper, Bloomberg, publicly available sources and data generated in-house. Note: "ETFs" are typically open-end index funds that provide daily portfolio transparency, are listed and traded on exchanges like stocks on a secondary basis as well as utilizing a unique creation and redemption process for primary transactions. "ETPs" refers to other products that have similarities to ETFs in the way they trade and settle but they do not use a mutual fund structure. The use of other structures including grantor trusts, partnerships, notes and depositary receipts by ETPs can create different tax and regulatory implications for investors when compared to ETFs which are funds.

Source: *ETFGI*

Diversions

The 2019 Players Championship kicked off on Thursday, and by Friday the news flow coming out of TPC Sawgrass was both intriguing and sublime. The intriguing part being a tight leaderboard at the top. The sublime was the fact that angry journeymen Pat Perez blew out his Achilles before the tournament even started and was replaced by Wyndham Clark.

In news that high handicappers would appreciate, Tiger Woods carded a quadruple bogey on the iconic par three 17th. The guys at the PGA clearly have a sense of humor, as they tweeted "Golf is Hard" with a video of Woods hitting two in the water. The PGA tour website has good coverage, as does CBS' live streaming, and The Peacock Network is producing the show this weekend.

Thanks Pete Dye

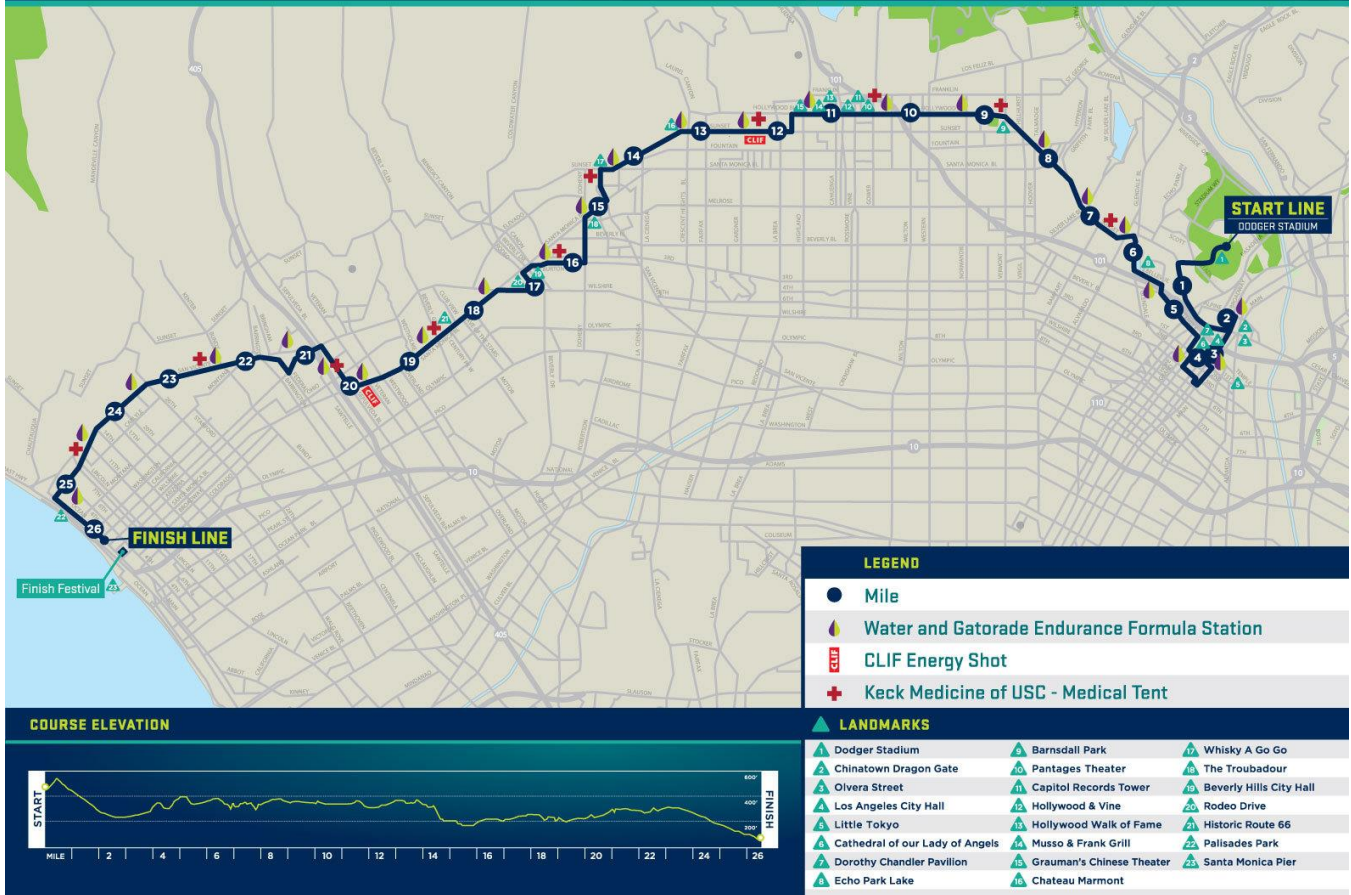


Source: PGA Tour

The Los Angeles Marathon is this Sunday, and the Times provides a preview of the race that includes 24,000 runners, 300 medical volunteers, and 13 first-aid stations. The race used to follow a fairly random course through downtown and Griffith Park. About a decade ago the route was changed, and the marathon now ends in Santa Monica. In a blessing to the runners, the last leg is downhill.

Good Luck, Runners

COURSE MAP



Source: LA Marathon

Fifteen years after the blessing of New York Cities upper management to rezone an old rail yard into the Hudson Yards Special District, the long-awaited Hudson Yards opens this weekend. *Curbed New York* provides a great look at what those experiencing the development should expect. Along those lines, *Eater New York* gives readers a look at what the culinary experience is like. To complete the journalistic triumvirate, Related Companies CEO Jeff Blau provided *Bloomberg* with a behind the scenes look before the big open.

Hudson Yards



Source: Facebook