

This Week in the Markets



As we wind down 2018, and look forward to next year, Stillwater Capital would like to thank you for your readership, over the past year. *This Week in the Markets* has been a huge success for us, and we look forward to continued growth, both in depth of content and breadth of readership. While it will remain free of charge next year, your endorsement by recommending it to others is always appreciated, and helps to grow our expanding footprint.

On the subject of depth, Stillwater will be rolling out a premium paid subscription service next year that includes strategic recommendations along with actionable single stock and sector calls. We are targeting this premium research for high net worth individuals, investment teams, registered investment advisors, and asset managers. The premium content will be included free of charge to current clients and strategic partners of Stillwater.

If you are interested in opening up a conversation about the premium program, structure, and pricing, please connect with us at contact@stillcap.com.

The Top- Down

The Fed's final meeting of the year came and went this week, and what we were left with is another 25 basis points worth of higher rates. The good news, the bottom of the 2.50% to 3.50% range has been successfully achieved. The bad news is, the market is chasing economic ghosts that it thinks Jerome Powell is a fool not to see.

Mohamed El-Erian made a great observation when he said the Fed is trying to break an unhealthy 'co-dependent' relationship with the market. One of our favorite managers, David Tepper, chimed in saying 'Fed put' is gone and cash 'isn't so bad' right now.

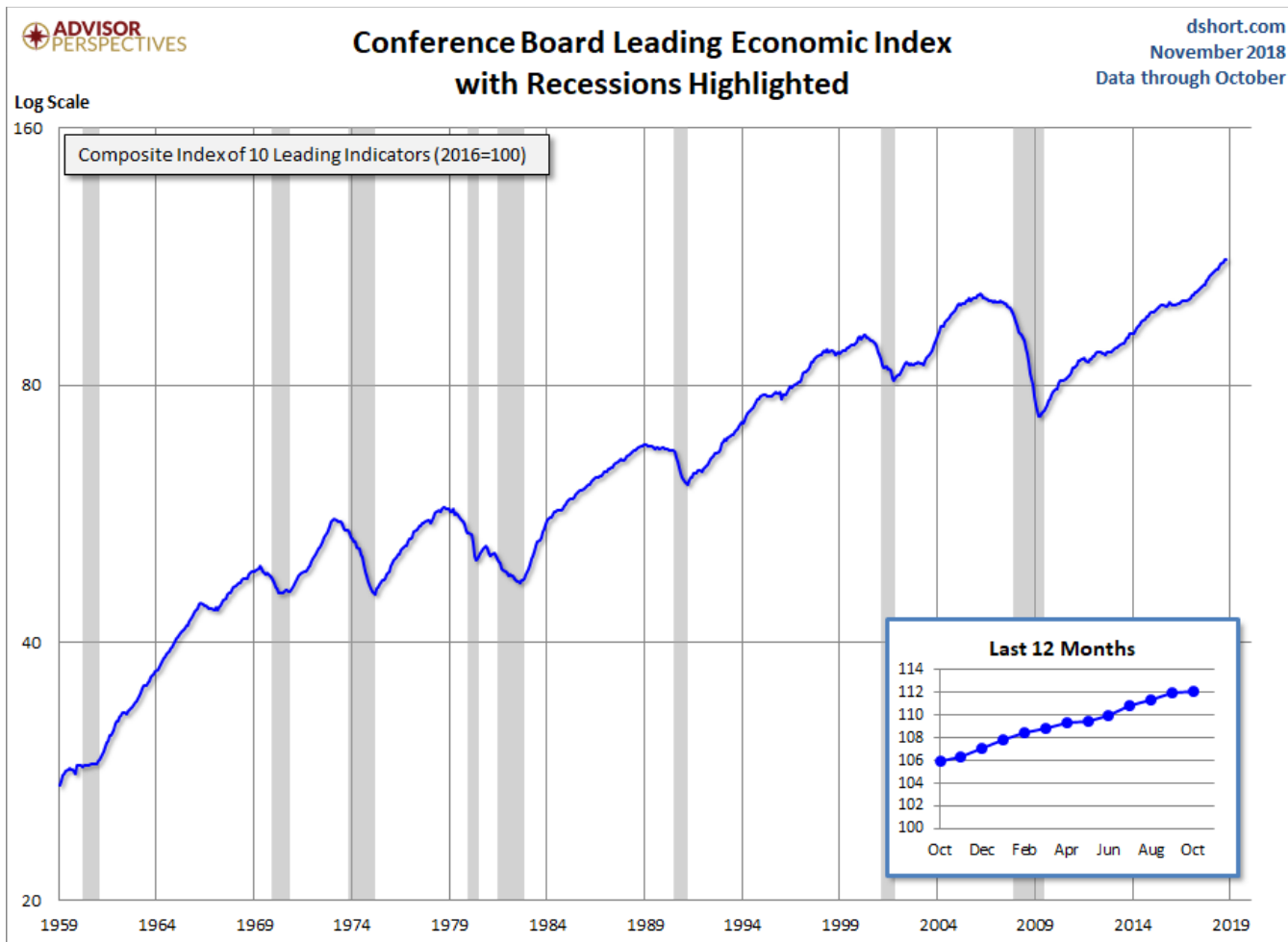
Boogie Boogie



Source: Grunge

If you are feeling dazed and confused, you are not alone. Four months ago consensus had us late in the cycle, with at least 12 to 18 months to go before the economic shit *really* hits the fan. Case in point, we have never entered into recession with leading indicators in expansion mode.

Leading Economic Indicators



Source: Advisor Perspective

Fast forward to today, and the narrative has changed dramatically. If you believe the markets and enjoy a good baseball metaphor, we are now down a bunch of runs and in the bottom of the ninth with our 7, 8, and 9 hitters due up. Basically, we have no chance whatsoever of going into extra innings.

Game (Almost) Over



Source: Boston

If you want to try and put some reason into this, listen to the words of FedEx CEO Fred Smith. During the company's earnings call on Tuesday, the man with special purview of the economy had this to say.

"I'll just conclude by saying most of the issues that we're dealing with today are induced by bad political choices," Smith said. "I mean, making a bad decision about a new tax, creating a tremendously difficult situation with Brexit, the immigration crisis in Germany, the mercantilism and state-owned enterprise initiatives in China, the tariffs that the United States put in unilaterally. So you just go down the list, and they're all things that have created macroeconomic slowdowns."

And that, dear readers, is the best summary of what is ailing us right now. This was similar to what we saw in 1984, 2008, and 2011 as external events swamped bottom up fundamentals and it became nearly impossible for portfolio managers to turn a profit. As of this writing, the only place anyone has made any money this year is in certificates of deposit. Yes, that's right, good old fashioned CDs are the top performing asset class.

A Forgettable Year

The Asset Class Quilt of Total Returns

Chart 14: The Asset Quilt of Total Returns

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018*
US Treasuries 14.0%	MSCI EM 79.0%	Gold 29.2%	US Treasuries 9.8%	REITS 23.8%	S&P 500 32.4%	S&P 500 13.7%	S&P 500 1.4%	Global HY 14.8%	MSCI EM 37.8%	Cash 1.8%
Gold 4.3%	Global HY 62.0%	MSCI EM 19.2%	Gold 8.9%	Global HY 19.3%	MSCI EAFE 23.3%	REITS 11.7%	US Treasuries 0.8%	S&P 500 12.0%	MSCI EAFE 25.9%	US Treasuries 0.3%
Cash 2.1%	MSCI EAFE 32.5%	Commodities 16.8%	Global IG 4.5%	MSCI EM 18.6%	Global HY 8.0%	US Treasuries 6.0%	Cash 0.1%	Commodities 11.8%	S&P 500 22.0%	REITS -1.1%
Global IG -8.3%	REITS 31.7%	REITS 15.9%	Global HY 2.6%	MSCI EAFE 17.9%	REITS 0.7%	Global IG 3.2%	MSCI EAFE -0.8%	MSCI EM 11.2%	Gold 12.9%	Global HY -2.6%
Global HY -27.9%	S&P 500 26.5%	S&P 500 15.1%	S&P 500 2.1%	S&P 500 16.0%	Global IG 0.1%	Gold 0.1%	REITS -3.4%	Gold 8.6%	REITS 11.5%	Global IG -3.4%
Commodities -35.6%	Gold 25.0%	Global HY 13.9%	Cash 0.1%	Global IG 11.1%	Cash 0.1%	Cash 0.0%	Global IG -3.8%	Global IG 4.3%	Global HY 10.2%	Gold -3.7%
S&P 500 -37.0%	Global IG 19.2%	MSCI EAFE 8.2%	REITS -9.4%	Gold 8.3%	MSCI EM -2.3%	Global HY -0.1%	Global HY -4.2%	REITS 1.3%	Global IG 9.3%	S&P 500 -6.1%
MSCI EAFE -43.1%	Commodities 18.9%	Global IG 6.0%	MSCI EAFE -11.7%	US Treasuries 2.2%	US Treasuries -3.3%	MSCI EM -1.8%	Gold -10.4%	US Treasuries 1.1%	Commodities 7.6%	Commodities -11.6%
REITS -50.2%	Cash 0.2%	US Treasuries 5.9%	Commodities -13.3%	Cash 0.1%	Commodities -9.5%	MSCI EAFE -4.5%	MSCI EM -14.9%	MSCI EAFE 1.0%	US Treasuries 2.4%	MSCI EAFE -12.6%
MSCI EM -53.2%	US Treasuries -3.7%	Cash 0.1%	MSCI EM -18.2%	Commodities -1.1%	Gold -27.3%	Commodities -17.0%	Commodities -24.7%	Cash 0.3%	Cash 0.8%	MSCI EM -14.7%

Source: BofA Merrill Lynch Global Investment Strategy, Bloomberg. *YTD annualized returns

Source: CNBC

The Bottom Up

While it never feels good to lose money in the market, it comes with the territory if you want to stay in the game. While trying to time every move is a fool's errand, picking spots when certain companies and sectors get cheap enough can make for a very profitable portfolio. As Warren Buffet likes to point out, "It's far better to

buy a wonderful company at a fair price than a fair company at a wonderful price." That being said, a great number of wonderful technology companies just got a lot fairer in price.

Tech's '20%-off' Sale



Source: Bloomberg

This week, vice became nice, as the makers of the Juul were validated by an equity investments from Altria. On Wednesday, the maker of Marlboro cigarettes handed over \$12.8 billion for a 35% stake in the world's largest maker of "the alternative for adult smokers". The 1,500 employees of the company just got a nice early Christmas present. But they still can't vape at their desks.

The Juul Vaping 'System'



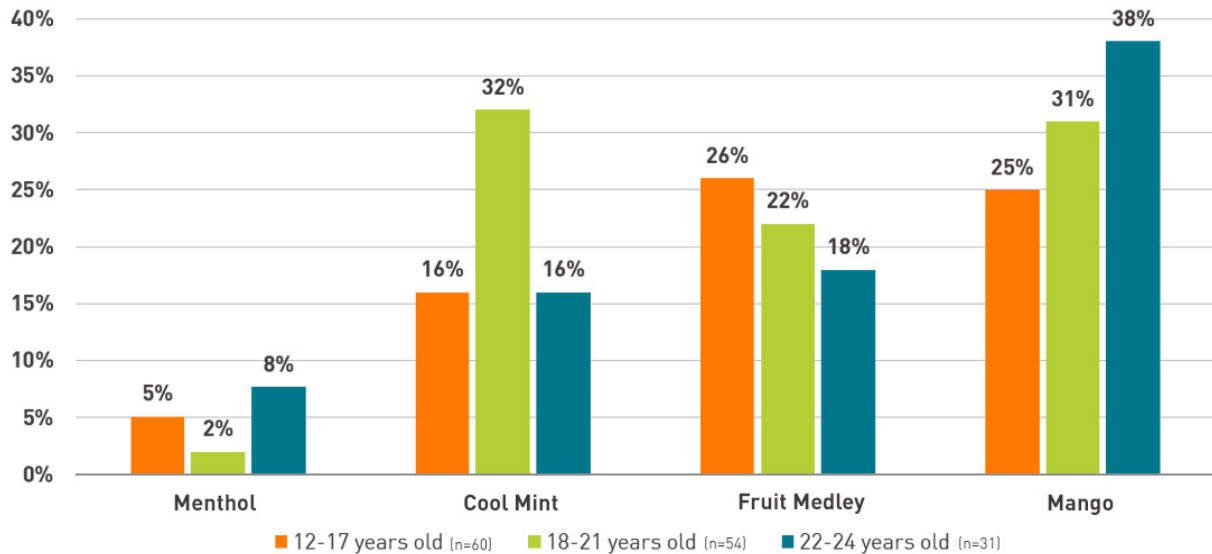
Source: CNBC

On one side of the ledger, the deal is all fine and good, getting existing smokers off the combustible lung charring kind of smokes is something that should be cheered. The only problem, kids think it's cool too. With flavors like 'fruit medley' and 'mango', what's not to like? Out of curiosity, the author recently tried the Juul and all I wanted after was the last two minutes of my life back.

No Cantaloupe?

Popularity of JUUL flavors

Most recent flavor used by JUUL users who used the device in the past 30 days



Source: Truth Initiative survey of 1,541 12- to 24-year-olds conducted between April 3-9, 2018

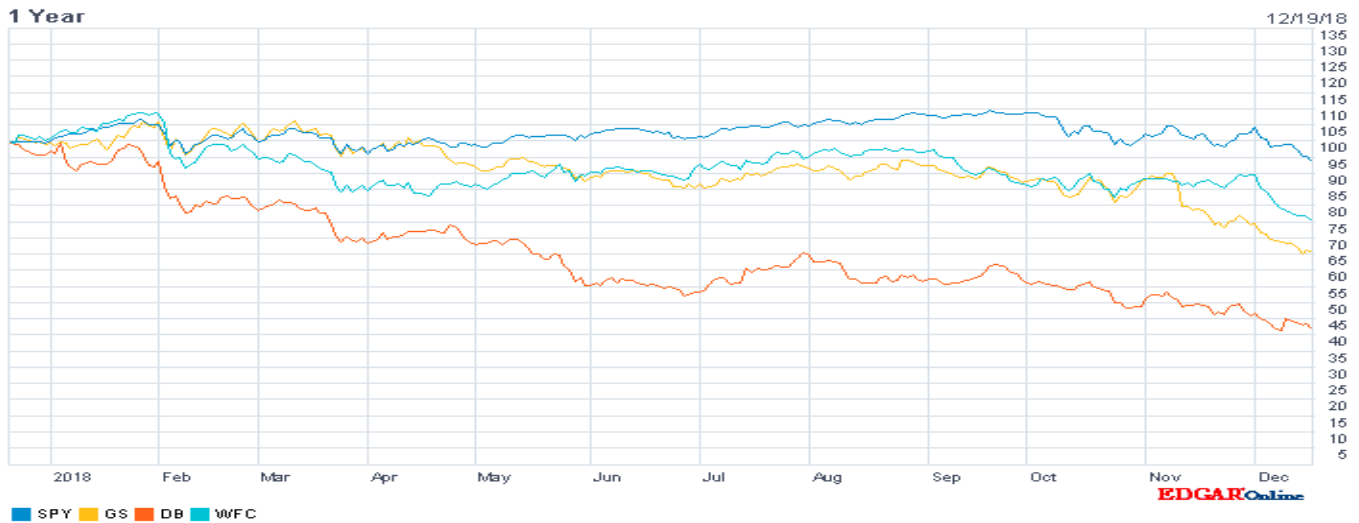
Source: The Truth Initiative

Up & Down Wall Street

We call it 'Up and Down', but this year it's been nothing but 'Down' for Wall Street. Wells Fargo can't shake the taint of running sales tactics much akin to Stratton Oakmont. Germany's Deutsche Bank is on life support and may not make it, research is nothing but dead in Europe, and most certainly dying here. In addition, Goldman Sachs is now suffering its worst stock performance year ever, as the 1MDB scandal is reported to have made it to the C-suite.

Bottom line, it's a dog eat dog world out there, and those employed on Wall Street right now are wearing Milk Bone underwear....albeit still making a lot of money doing so.

S&P 500, Goldman, Deutsche, Wells



Source: Nasdaq

Markets

As a way of helping to understand market conditions, while still using the basic and understandable principles, we borrowed from the military and built our own version of DEFCON (Defense Condition) for the markets, aptly named MARCON (Market Condition). The former was to let the troops know what level of readiness we are in, that latter what condition the markets are in.

Blue = All good, clean air for economic expansion, earnings are in growth mode, tame interest rates, a low probability of external negative shocks. Exuberance is high and trees can grow to the sky.

Green = Earnings still supportive, economic indicators positive, upward bias for interest rates, and an elevated level of external event risk. The investing public is still feeling good and a positive outlook remains the name of the game.

Yellow = Peak earnings, the economic tea leaves begin to look a little unsettling, rates flatten due to emerging uncertainty, forces outside the market begin to take over the narrative. Investors start to head for the exits.

Red = Earnings begin to decelerate, key economic measures start to roll over, interest rates fall, and events outside the economy's and markets control begin to kick in. Fear arrives in the form of scary headlines and tough client calls.

Black = Earnings fall through the floor, companies can no longer adjust to decreased demand, economic signals enter a downtrend, the spread between safe and marginal debt blows out. “Bid wanted” investor panic takes over.

In 2018, we’ve almost run the full MARCON gamut, including one melt-up, two volatile sideways moves, six months of relative tranquility, and a mini-crash that we are currently in the midst of.

- January = Blue
- February & March = Yellow
- April, May, June, July = Green
- July, August, September = Blue
- October, November = Yellow
- December = Red



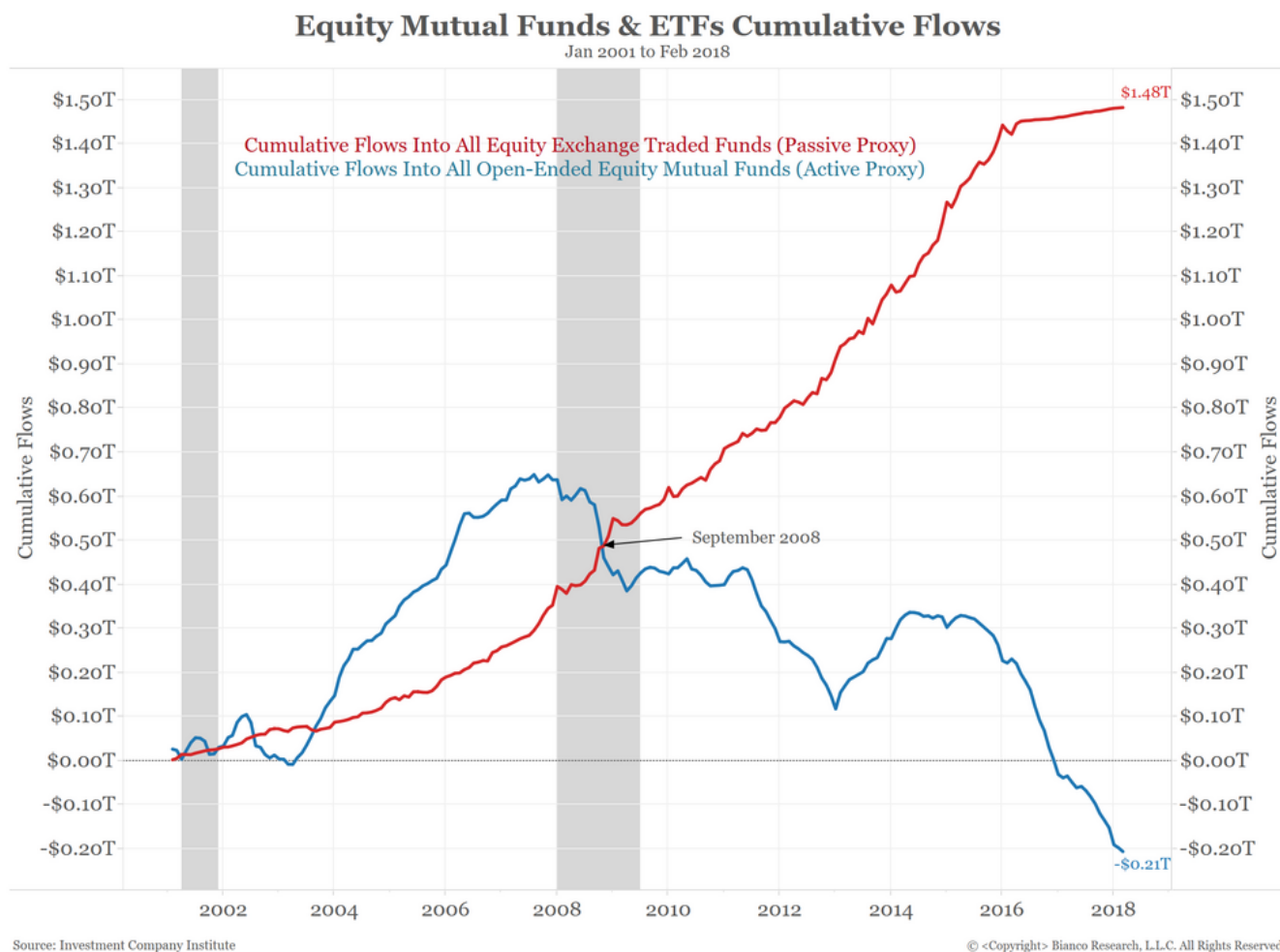
Source: Nasdaq

Like other notable Angelinos, Jeff Gundlach is getting to be as ubiquitous as the Kardashians these days. This week he shared his views about the markets from DoubleLine’s Los Angeles headquarters, with *CNBC’s Halftime Report* host Scott ‘the Judge’ Wapner, and they aren’t particularly good views.

The one bit of positive news for those of us who ply our craft in the active management world, he thinks the ETF bubble might be over. “I wouldn’t advise

anyone to be a passive investor,” Gundlach said. “My strongest advice is to not invest in passive U.S. equity funds.”

The Active/Passive ‘Pain Trade’



Source: Bloomberg

Hedge Funds

Even a legend of the Golden Age of hedge funds, who four months ago called this move, is having trouble understanding the reasons behind it. Stan Drukenmiller is the legend, and he still doesn't like financials and thinks we have a debt bubble ready to pop.

Bloomberg hosted a full hour interview with a man who should be listened to. Mr. Drukenmiller also shared some insight into why it's so hard to trade these

markets. Quick hint, it's the rise of algos. And no, you aren't paranoid Stan, it's very real.

To add insult to the hedge equity performance injury, short positions became too hot to handle this year at the absolute wrong time. While we were able to stay in some, it is never enough when a correction of this size comes along.

Cover Your Shorts



Source: Bloomberg

Diversions

One of the biggest swells in recent memory rolled through the California coast this week, and the images were striking. Enjoy this one from the Coast Guard's big wave training off San Francisco's Ocean Beach.

'I Hope This Works'



Photo: Dave Rogers/SF Gate

Down the coast in frigid Half Moon Bay, the Mavericks Big Wave competition was postponed because, you guessed it, the waves were too big. This video doesn't quite do justice to what is considered to be one of the heaviest waves on the coast. Local PBS station KQED has a cool old school look at how Mavericks works. Alex Haro provides the brief history of Mavs and how it got its name.

'I Hope This Works 2.0'



Source: Adventure Sports Network

While it may be too late to get delivery on the last few things on your list, it's not too late to plan your Christmas Eve play list. And with that, Stillwater gives you the five best Christmas songs ever to be recorded on video, homemade or otherwise.

Jose Feliciano, accompanied by Daryl Hall, in his celebration of Merry Christmas and a Happy New Year. "[*Feliz Navidad, próspero año y felicidad*](#)"

José Feliciano



Source: Amazon

Find us a song more classic than this, and Stillwater buys the Egg Nog, [“Christmas Time is Here”](#) by Vince Guaraldi



Source: Biography.com

While unknown to some, to others it's a trumpet inspired, can't live without holiday classic, The Waitresses ["Christmas Wrapping"](#)



It wouldn't be a top-five song list without Band Aid's 1984 *“Do They Know It's Christmas?”*



And to round things out, Stillwater Capital's all-time favorite Christmas medley, *“Little Drummer Boy (Peace on Earth)”* with Bing Crosby and David Bowie.

DAVID BOWIE & BING CROSBY

Peace on Earth / Little Drummer Boy



Merry Christmas, everyone.

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