

Stillwater Capital - This Week in the Markets

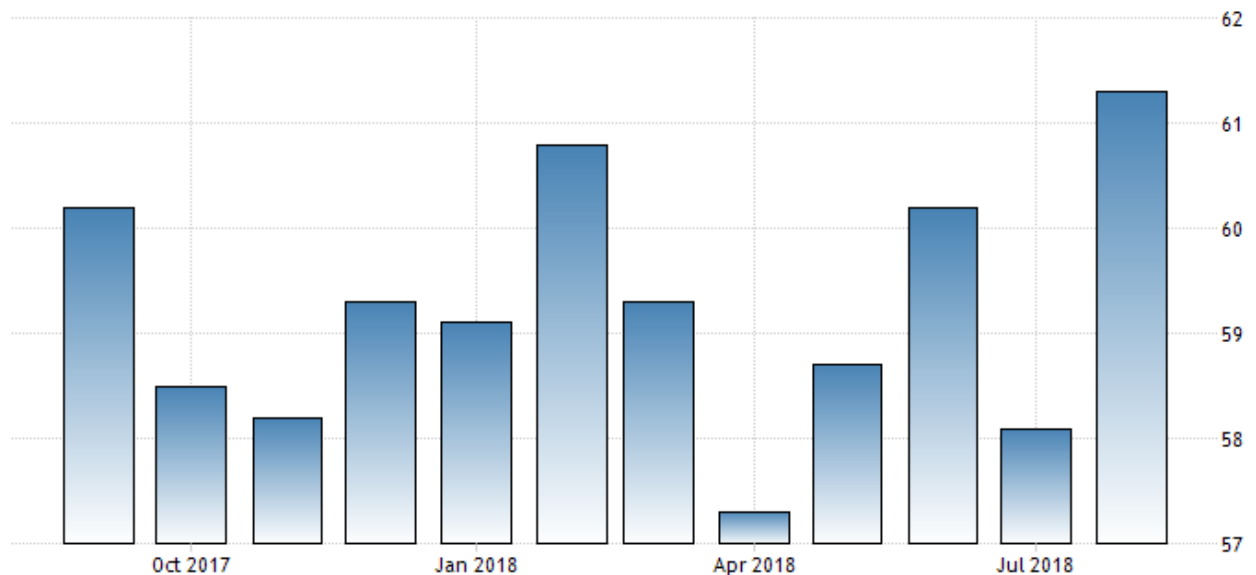


The Economic Top- Down

This morning the Labor Department released the August employment report. Over 200,000 jobs were added in August, keeping the unemployment rate at 3.9%, the lowest since 1969. Wages are on the rise as well. *Bloomberg* provides full coverage of the numbers.

The release of the Purchasing Managers Index (PMI) earlier in the week, gave us yet another marker that the domestic economy is running at a fast clip. Respondents did however note that inflation pressures are beginning to rise as the cost of materials increases.

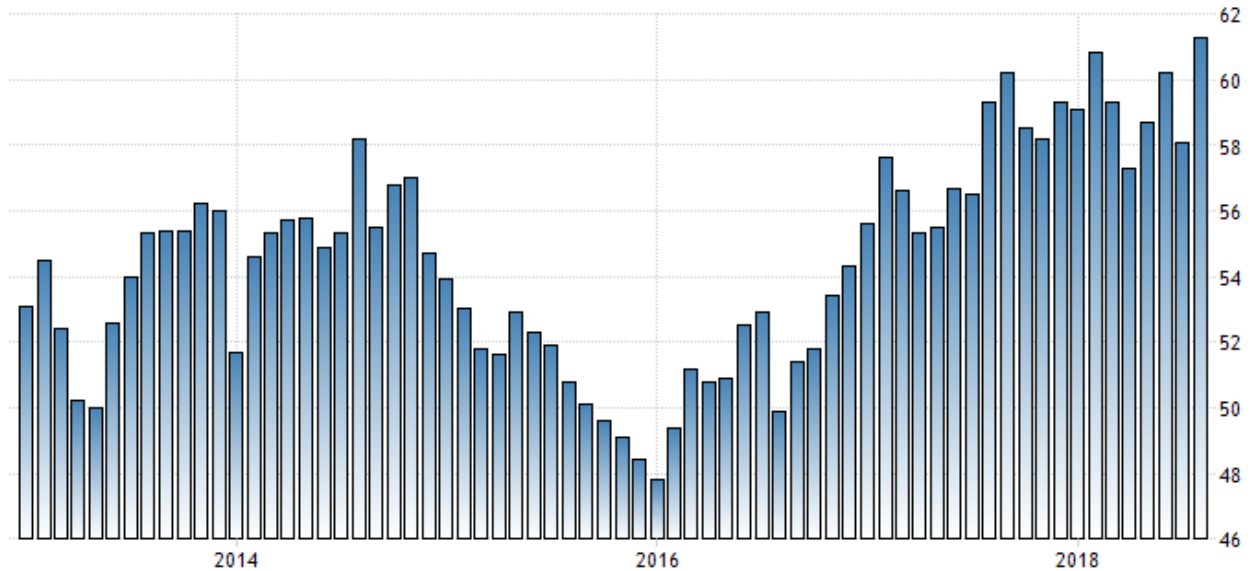
Purchasing Manager Index



Source: Trading Economics

Take this view back further and you can see parts of the economy were headed the wrong way going into the 2016 election. PMI has done nothing but head up since.

Purchasing Manager Index



The Stillwater View: While this is a secondary indicator for the overall economy, it is a primary one for the industrial sector. This kind of strength is tough to ignore, even when there is risk of it being late cycle. Politics or personal opinions aside, the election of Donald Trump and hope for his policies clearly put wind in the sails of the manufacturing economy.

Like a plague of locusts, a contagion of currency and economic problems are spreading through emerging markets. JP Morgan and BlackRock are calling it as they see it. That being said, while the situation is bad, it may not be bad enough to create a bottom. Both firms have the opinion there could be a capitulation on the horizon.

On Wednesday, Reshma Kapadia penned a piece for Barron's entitled How the Next Global Crisis Could Start. In it she laid out the laundry list of trouble spots emerging around the globe.

S&P 500, Developed Word, Emerging Markets



The Stillwater View: Rarely do these things resolve themselves with the spread narrowing from the bottom up. Buckle up buttercup, as things are about to get real.

J.P. Morgan's top quant analyst wrote about the growing risk to markets due to the explosion in exchange traded funds and quantitative trading. A decade ago there was \$1 trillion in ETF assets, today there are \$5. Going forward the risk is more structural in nature with fewer stops in place to prevent the market train from rolling off the tracks when conditions get dangerous.

Trans-Indian Railway



Source: YouTube

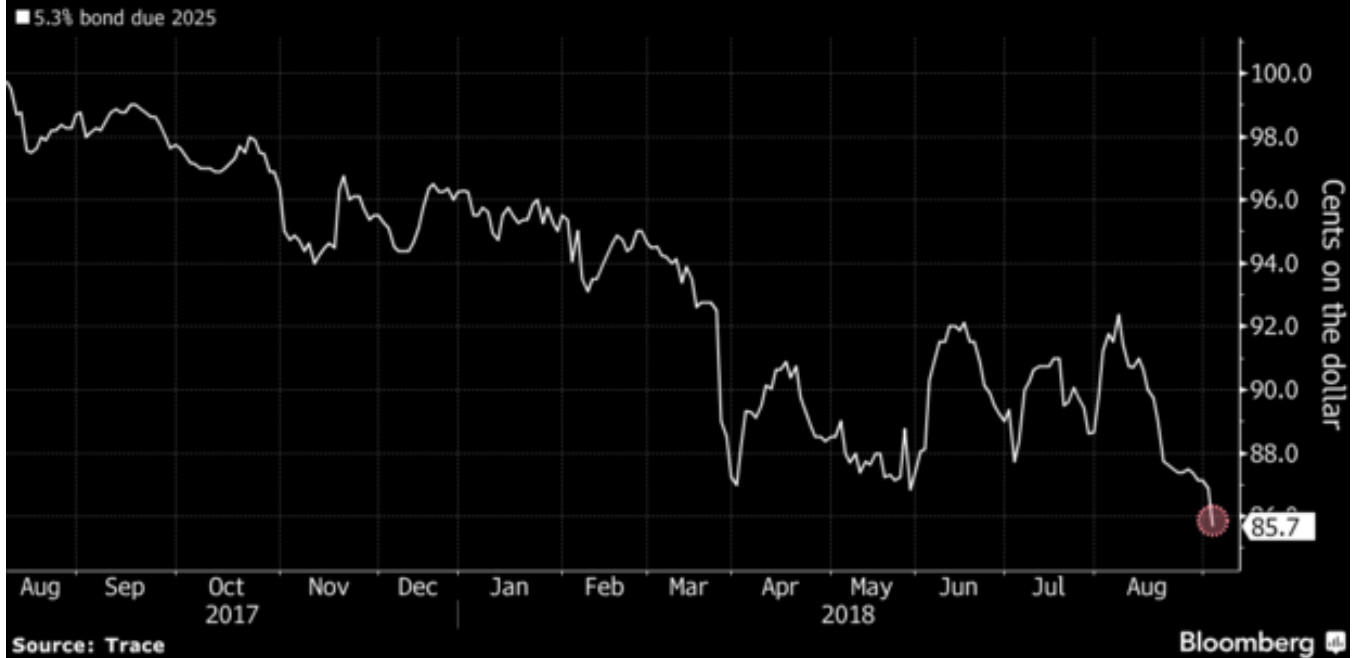
The Fundamental Bottom Up

After a healthy two month hiatus from talking about Tesla, Stillwater is back with a quick look at the bonds the company floated and how they are trading. As they say, equity can tell any tale it wants, but debt doesn't lie.

\$0.85 < \$1.00

Tanking Tesla Debt

Electric-car maker's junk bonds hit lowest price since August 2017 issuance



From the “Holy Hell” file, the carmakers Chief Accounting Officer quit this morning after 30 days on the job. Tesla and CEO Elon Musk are also being sued by short seller Andrew Left who is accusing them both of stock manipulation after the posting of this now infamous tweet. Yesterday Musk went on comedian Joe Rogan’s show and when given the chance to smoke weed, did.



Elon Musk

@elonmusk

Following

Am considering taking Tesla private at \$420.
Funding secured.

9:48 AM - 7 Aug 2018

1,594 Retweets 6,134 Likes



946 1.6K 6.1K

The Stillwater View: Who knows what Elon does in his spare time when it comes to marijuana. But it's hard not to notice that the proposed takeout price was \$420, the globally understood chemical makeup for weed and why April 20th (4/20) is a celebrated day among the faithful.

Social media stocks took a header this week when the Theater of the Absurd showed up once again on Capitol Hill. Cheryl Sandberg of Facebook and Jack Dorsey of Twitter took turns getting flogged by senators that had most likely been handed their question deck that same morning. The key topic being whether or not the companies are intentionally stifling certain viewpoints, political or otherwise, to the advantage of others.

Sandberg and Dorsey on Capitol Hill



Source: The Hill

The Stillwater View: We call hearings like these the Theater of the Absurd, frankly because they are. Every industry has their own dirty little secrets, and when the tide goes out, they get exposed. And when this happens Senators and Congressmen get their 15 minutes of allotted time to ask the most absurdly obvious questions. Most of the answers to which are already reasonably well known.

It's a time honored tradition, one that we watched in awe a decade ago when Goldman Sachs was put on the stand for the Abacus transactions. They were acting as market makers for God's sake and all the Senators knew it. "I'm shocked, shocked to find that gambling is going on in the casino." No, no you aren't Captain Renault.

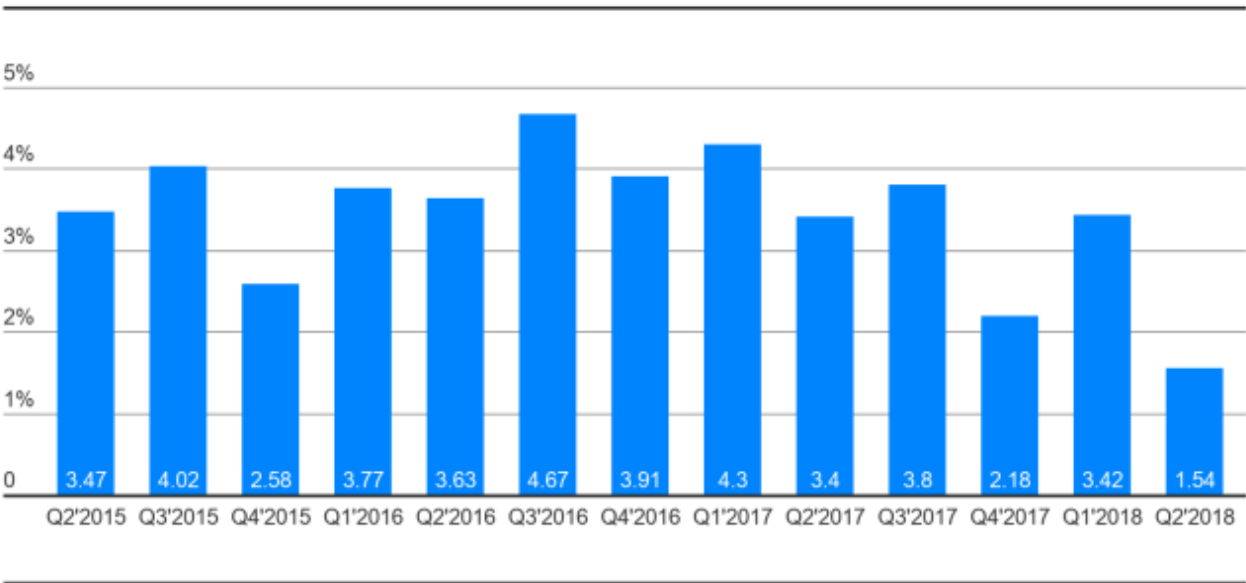
Rick and Captain Renault



Source: IMG

In related news, Facebook was downgraded at research firm MoffettNathanson this week. The reason? Combined slowing in user growth and increased regulatory risk are a “toxic combination” for the shares.

Facebook Growth Q2'2015 - Q2'2018



Source: CNARENA

The Stillwater View: The firm continues to hold a short position in the shares of Facebook on the same thesis that MoffettNathanson articulated in their report.

And finally, in news that was not at all surprising, Theranos announced it would dissolve itself. Investors were told in a letter that debt would wipe out any chance of them seeing a return of capital. "Because the Company's cash is not nearly sufficient to pay all of its creditors in full, there will be no distributions to shareholders."

CEO Holmes on the Cover of Fortune



Source: Fortune

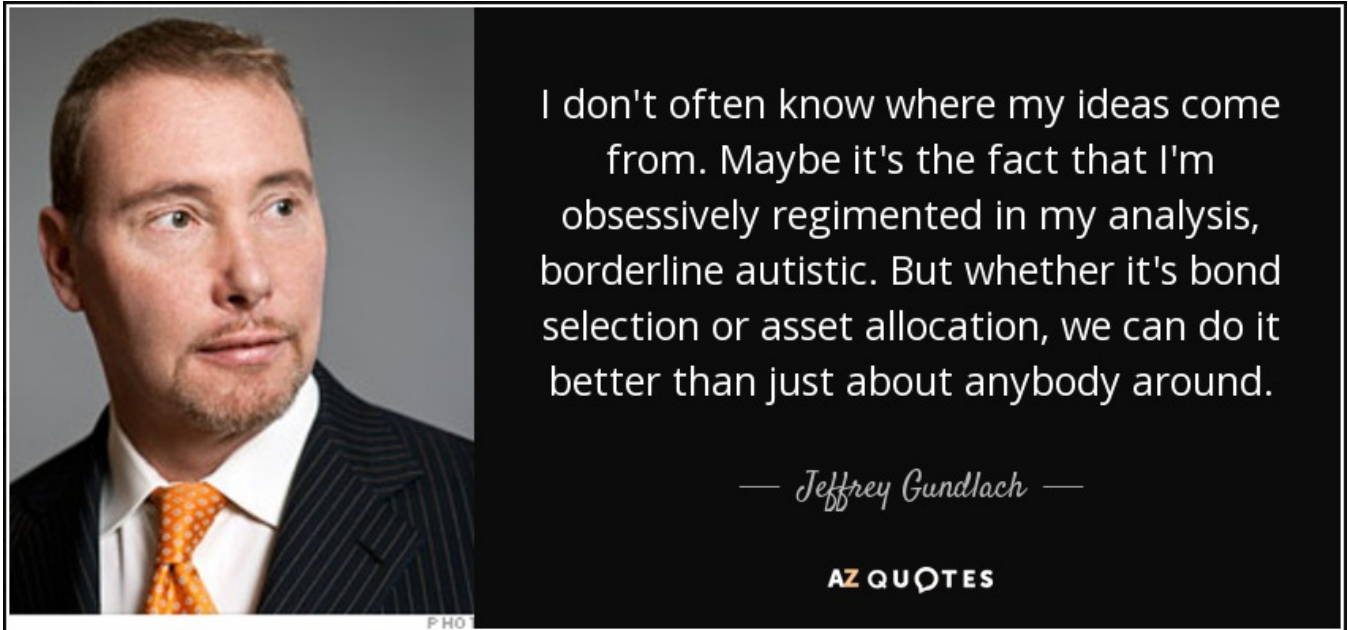
The Stillwater View: While disappointing for many, it is a small victory for those of us who cast a wary eye on the cult of celebrity CEOs, of which Ms. Holmes was a card carrying member. In the words of entertainment icon Jerry Perenchio, "Stay out of the spotlight - it fades your suit."

Investing

The market moving founder of DoubleLine, Jeff Gundlach, will be hosting a conference call next Tuesday to highlight the firms total return bond strategies. The call will also cover

markets and the theme this time...."Miracle Grow". Register in advance at the [DoubleLine website](#).

Market Master Jeff Gundlach



Source: AZ Quotes

The Stillwater View: If you are at all interested in insightful commentary and discussions of today's markets, be a regular observer of Mr. Gundlach's work. He's just that good.

Last week we previewed the idea of walking through the investment life of Billy Ray Valentine with his advisor and lifelong friend Louis Winthrop III.

Louis and Billy Ray



Source: Amazon.com

For our example we stripped away any of the confusion heaped on asset classes and investment products and changed the names of stocks to “awesome”. Bonds are now “amazing”. And alternatives are “awesome & amazing just different”. Stay with us and don’t roll your eyes too much. This Week in the Markets has a broad spectrum of readers. What we are attempting to do here is to demystify things and focus on what asset classes do and not what they are called or how they are marketed.

Let’s start with a little background. Billy Ray founded a GI Joe manufacturing business that produced niche action figures with a Kung Fu grip. He got the business off the ground and was making decent money when Louis introduced him to the idea of saving and investing. The first conversation went something like this...

Louis: We need to get you taking some of that extra hard earned cash and invest it for your future and retirement.

Billy Ray: I’m cool with that. What are we going to invest in?

Louis: We have three buckets to think about. One is awesome, another is amazing, and the last is amazing and awesome just different.

Billy Ray: Interesting.

Louis: Each have different characteristics. Because you are young you want to maximize growth at this point in your life, so I would recommend you own mostly awesome. We can talk about amazing and amazing and awesome just different when they are more appropriate for your portfolio.

Billy Ray: What is awesome going to do for me?

Louis: It grows your money by about 10% a year on average, and if we keep you owning awesome you should do pretty well. With compounding the “Rule of 72” says you should double your money in a little over 7 years. One thing to keep in mind is that inflation runs at about 2% so if you do nothing with your cash your buying power gets eaten up.

Billy Ray: Do I want to own the US Awesome 500?

Louis: You could, but the market for awesome is really much bigger than that. There is US awesome, international awesome, and emerging market awesome to consider as well. Blend them together and you get a very diversified ownership of awesome.

Billy Ray: How much does global awesome cost?

Louis: It used to cost about 1.00% but that has been whittled down to 0.10%.

Billy Way: Seriously? It's one tenth the cost it used to be?

Louis: Yep, in terms of price almost everything has been going the investors way.

Billy Ray: Well then let's get us as much awesome as we can get our hands on. Within reason of course.

Louis: I like the plan.

US Awesome



Source: St. Louis Federal Reserve

The Stillwater View: A \$10,000 investment in US Awesome at the bottom in March of 2009 would be worth roughly \$45,000 today. That is a whole bunch of really great awesome had you not tried to call the bottom, stayed invested, and let time in the market take care of the rest. Simple but true.

Alternatives & Hedge Funds

Blackstone recently released a “black paper” on the subject of alternatives, titled “Understanding and Allocating to Alternatives”. In it they describe how volatility has been on the rise and the diversifying characteristics of alts can and has helped smooth the ride.

The Roller Coast or Merry Go Round



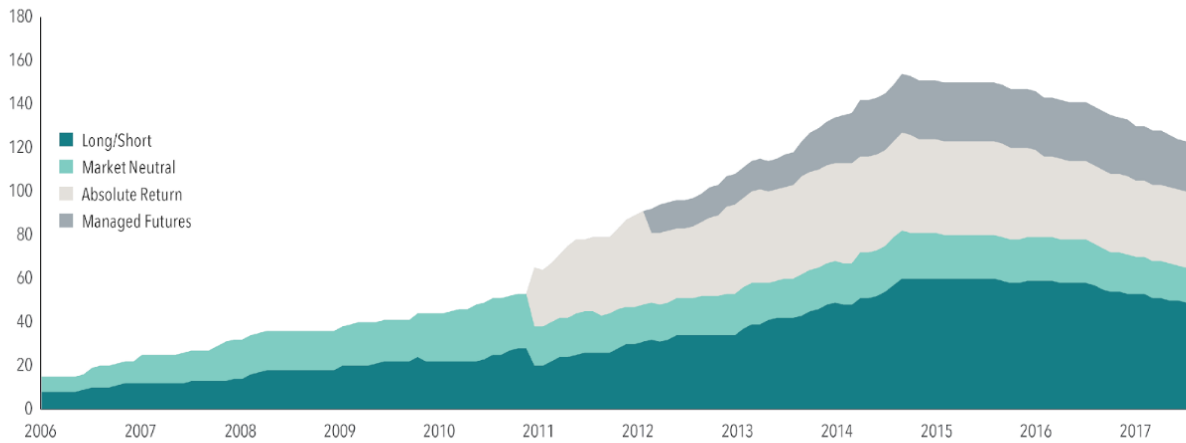
Source: Pngtree

Morningstar has taken a different view of the alts market, specifically those offered in liquid form. In the last 60 days, the mutual fund rating firm released not one, not two, but three separate pieces skewering the strategies that are most often offered as mutual funds. The titles should tell you where the company stands.

- Death is a way of life in liquid alternatives.
- Liquid alternatives have yet to show they belong in your portfolio.
- Liquid alternatives haven't lived up to the hype (yet).

Growth in Alternative Mutual Funds

Number of Liquid Alternative Mutual Funds in the US, June 2006–December 2017



Sample includes absolute return, long/short equity, managed futures, and market neutral equity mutual funds from the CRSP Mutual Fund Database after they have reached \$50 million in AUM and have at least 36 months of return history. Multiple share classes are aggregated to the fund level.

Source: Morningstar

Earlier this year CNBC ran a piece highlighting the challenges facing the alternatives market. The investment professionals at the Denver based liquid alts provider 361 Capital, a group that includes former Janus managers, responded with a good counterpunch.



From the office of redundancy office, hedge funds are back to having a tough year after some standout moments in February, *Bloomberg* reports.

Another Mixed Year

Left Out

Hedge fund returns dwindle despite record-setting equity rally



The Stillwater View: As practitioners of the art of alternative investing, we too can report that the year has played out pretty much the way the chart shows. Any hedged product should have done well in February, but the grind higher since hasn't given managers who kept hedging much of a chance to shine.

Looks like the University of Colorado picked the right alternative managers as the schools endowment gained 11% in the last fiscal year. This put them well ahead of the endowment benchmark as private equity, real estate, and hedge funds all did well.

Go Buffs!



Source: University of Colorado

Diversions

The US Open continues into the weekend where the women will battle it out for the championship on Saturday and the men wrap things up on Sunday.

Last night Serena Williams easily punched her ticket and will face upstart Naomi Osaka for the title. Osaka is the first woman from Japan to reach a Grand Slam final and has dreamed her whole life of the moment she could face Williams on the court.

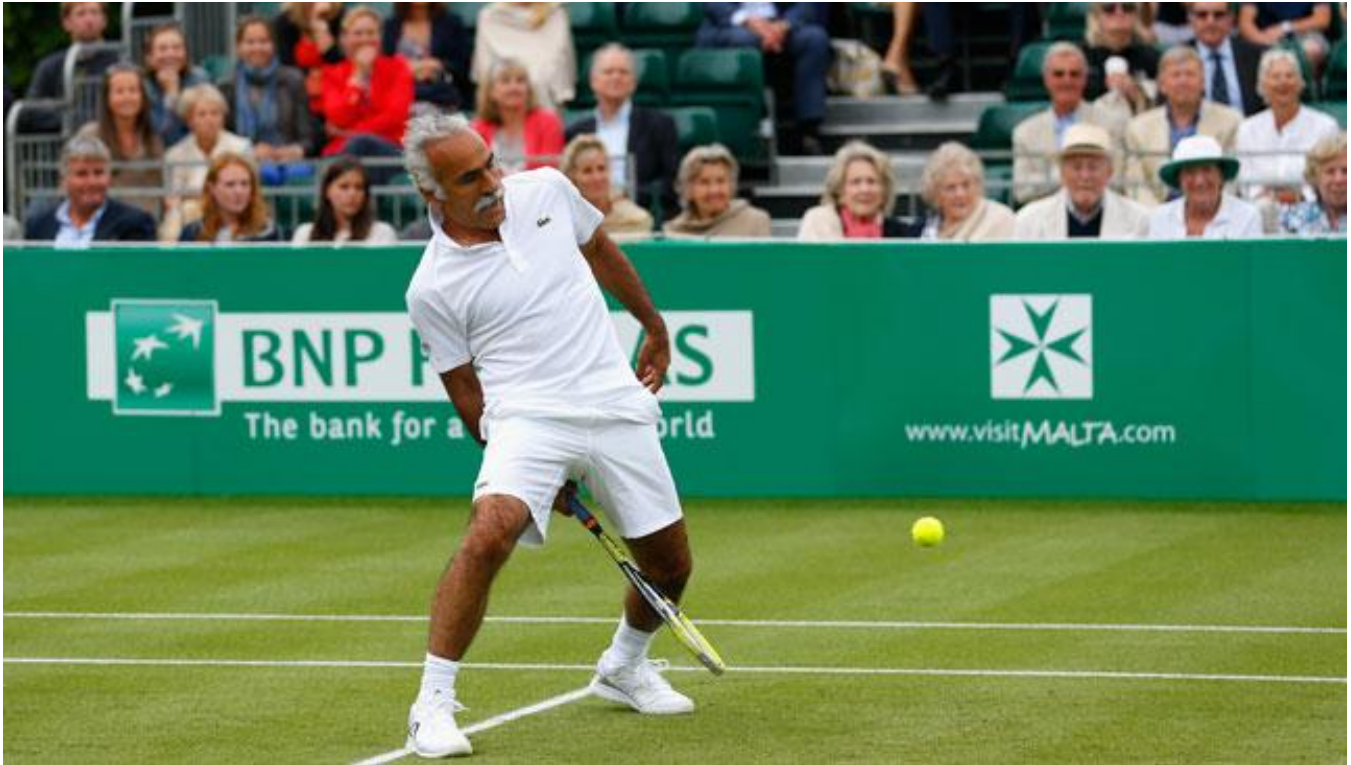
Naomi Osaka



Source: Tennis.com

HBO's Real Sports with Bryant Gumbel recently ran a piece on the accomplishments of Mansour Bahrami, the Court Jester of tennis. The Iranian born Bahrami has entertained crowds from Melbourne to the All England Club. This crowd pleasing match took place during the Australian Open and pitted he and his partner against the McEnroe brothers.

The Bahrami Dropper



Source: Sports 360

Harrison Ford's childhood home near Chicago just went on the market for the first time since 1970. The current owners of the stone style English Tudor are asking \$399,000. It's located blocks away from where future first lady Hillary Rodham grew up.

The Home Where Han Once Lived



Source: Realtor.com

Country legend Merle Haggard's Bakersfield home where he penned his first hit, "Okie from Muskogee", is for sale. The spacious 3,600 square foot home with 5 bedrooms and 3 baths and pool can be had for \$359,000. The aspirational sellers had it listed for \$517,000 in 2007.

4007 Brae Burn Drive, Bakersfield



Source: Taste of Country

News hit late yesterday that “The Bandit” had rode out to the big car chase in the sky as Burt Reynolds passed away at age 82. Rolling Stone called Reynolds “A Zen Master in a Convertible” while the website “Mental Floss” provides us with 10 things we probably didn’t know about the man. The fact that he played football for Florida State was not one of them.

A special gem from his film work were the playful bloopers and outtakes that showed up when the credits rolled. Best of the best were from Cannonball Run and Smokey and the Bandit.

See You on the Other Side, “Bandit”



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