Friday, May 12th, 2017

The Top-Down

Speculation grew this week that the positive policy momentum the market has been experiencing since November was in jeopardy. The Washington Post account of Director Comey's dismissal provides a view into why.

This morning core consumer prices for April were reported up a benign 0.1% and retail sales rose 0.4%, with March revised higher. The narrative for retail sales is moving to one where demand is stable but the sourcing and delivery has shifted.

You can access the full list of the week's economic releases through the Bloomberg Economic Calendar.

There were no less than ten speeches by Fed governors this week and the primary topic remains how quickly, and by how much, they will raise rates. On Wednesday Goldman Sachs offered their opinion that the economy was strong enough to accommodate three to four hikes annually through 2019.

At the Sohn hedge fund conference on Monday, DoubleLine founder Jeffrey Gundlach made headlines with his call to go long emerging markets while short the S&P 500. He views the spread between the 22x paid on earnings in the U.S. with the 14x paid for emerging markets as too wide to ignore. And he doesn't need a correction in the U.S. to make money, just for that gap to narrow. Here is the (very) basic relative value trade math.

Money Maker – The $100 short position in the S&P 500 appreciates 15% and emerging markets appreciate 30%. The investor makes 15% while positioned dollar neutral. Winning trade.

Wash – Both positions appreciate 15% and the investor makes and loses an equal amount on each side. The gain and loss cancel each other out and there is no profit.

Money Loser – The $100 short position in the S&P 500 appreciates 15% and emerging markets depreciate by 15%. The investor loses 30% while positioned dollar neutral. Pair trade gone wrong.

Yogi Berra would enjoy this moment as the "lack of volatility in the markets has investors on edge". Templeton's Mark Mobius provides a very interesting opinion on the subject as he links low volatility to social media.

Former Fed Governor Kevin Warsh speculated on what happens when the "gilded age" of easy central bank money ends. If you are looking for what could possibly go wrong with a Fed that doesn't evolve read his presentation from Stanford's Hoover Institute Monetary Policy Conference.

The View from Stillwater

Favorable view on Jeff Gundlach. And by favorable, I mean we would all be well served by listening to everything he says. He is deliberate in his thinking, maintains conviction in his ideas, and has $100 billion in assets under management to prove that he knows something.

Favorable view on the allocation shift away from the U.S. into international and emerging markets. This is quickly becoming the consensus top-down view on Wall Street and was highlighted again on the front page of the WSJ.

The Bottom-Up

Weekend at Warren's. The full recap of the Berkshire Hathaway annual meeting from the Wall Street Journal, CNBC and Fortune.

The Sohn Conference made headlines this year even though the picks and pans were more sedate than usual. Bill Ackman provides a way through the Howard Hughes Corporation that "you too can invest like Donald Bren!". David Einhorn says don't believe the hype on Core Labs, it's just an oil service company. And Stanley Druckenmiller will have you marinating ice cubes early today with his view that policymakers have no end game, markets do, buy gold. Full recap.

Coach announced it would acquire Kate Spade for $2.4 billion, highlighting the consolidation of brands that have felt the brunt of the department store and mall implosion. And the Amazon effect continues as WalMart is (still) trying to figure out how to compete.

Following on from last week's comments on the oil & gas sector being a trader's market, Bloomberg reported that shale drillers are throttling up spending to the tune of $84 billion and that means overhead supply is real and will be lasting. Price weakness in crude oil is not to be confused with economic slowing. Aside from continued production cuts by OPEC, the single strongest tailwind for a price above $60 is the increasingly strong theme of synchronized global growth.

The View from Stillwater

Favorable on Warren Buffet and Charlie Munger and everything they can teach about having the long-term view in mind and taking ownership for mistakes made along the way.

Continued negative view on department stores, retail and mall REITs. Even though this trade is splashed across every paper in the land, the Amazon effect casts a very long shadow.

In early 2016 I was providing short ideas to a decently sized hedge fund. When the subject of retail came up I offered the portfolio manager a basket of companies that included Macy's and Michael Kors. He and I debated whether this negative view of retail was consensus or not. The manager has a reputation for catching the early part of trend changes. My counter was that while it was no longer in that category, there certainly was a long way to go before it ended. My view was that the sector fundamentals were so challenged that any long position would be very difficult to defend to the investment committee of a slow moving mutual fund. A great position to be in if you are selling stock short.

Up and Down Wall Street

One of the better quotes from the Berkshire Hathaway meeting was from Buffett when he said that "money spent on plumbers is better than on hedge funds." He followed that with some simple math, "If you have a billion dollar fund and get two percent of it, for terrible performance, that's $20 million. In any other field, it would just blow your mind."

While it wasn't this week's news, I have included the recent Goldman Sachs Asset Management house view on liquid alternatives and their role in portfolios. As a long-term advocate, I agree that when designed and managed properly they can function as diversifiers of core assets and provide the potential to reduce risk and mitigate the effects of severe drawdowns.

The raging bull market in avocados and fidget spinners continues. Blame avocado toast and edgy fourth graders. And just as Wall Street loves "new and innovative solutions", be on the lookout for the 3x levered inverse guacamole ETF coming soon to a broker near you.

The View from Stillwater

The commentary from Warren Buffet and the article on liquid alternatives from Goldman Sachs underscore that hedged equity investing isn't alchemy. It's owning good businesses and shorting bad ones, hopefully before the market figures the two out. This produces the potential for upside capture and downside protection through any market. Offer it in a liquid and transparent manner at a reasonable flat fee and you have in your portfolio a real solution.

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