

## Stillwater Capital - This Week in the Markets



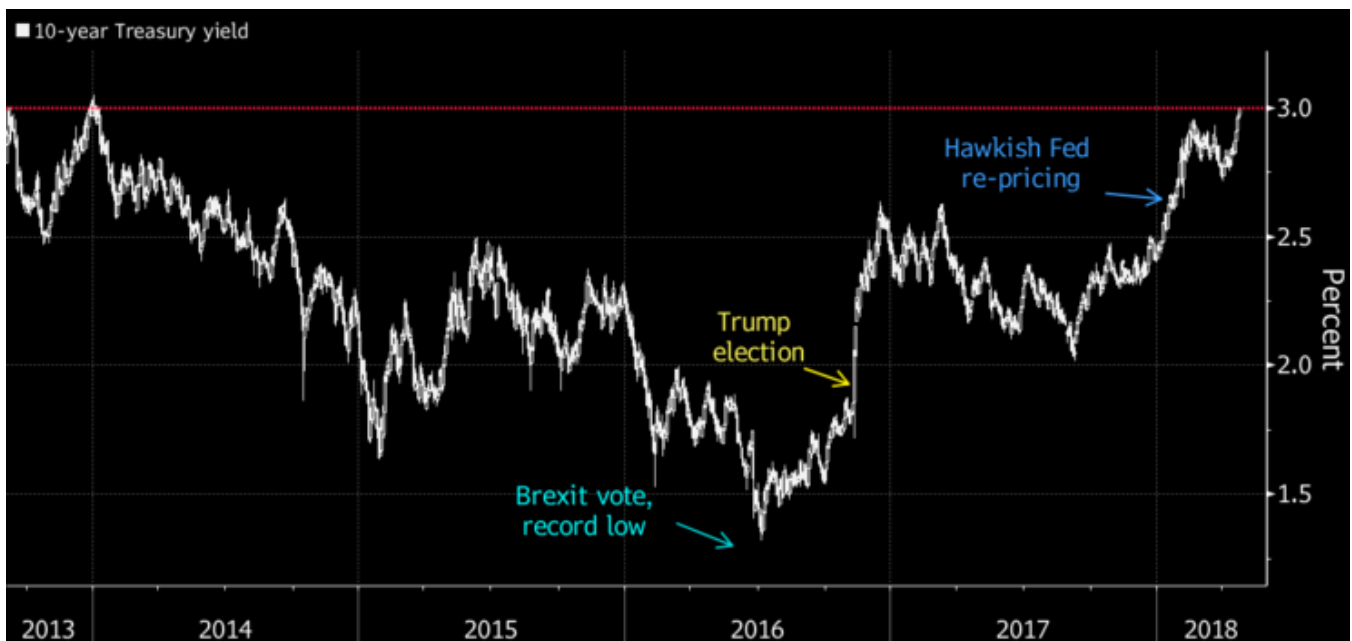
### The Top- Down

First quarter domestic GDP was released this morning, showing growth cooling to 2.3% from 2.9%. Still, this reading was above the 2.0% Wall Street was expecting.

If the chill wind of a change in the economy, and the increased volatility in markets, has your head spinning, you are not alone.

This week, the yield on the ten-year treasury breached the 3% level. Right on cue, the Dow Jones dropped 500 points. Not helping things, Caterpillar's CFO made comments that Q1 earnings would be the highwater mark for the year.

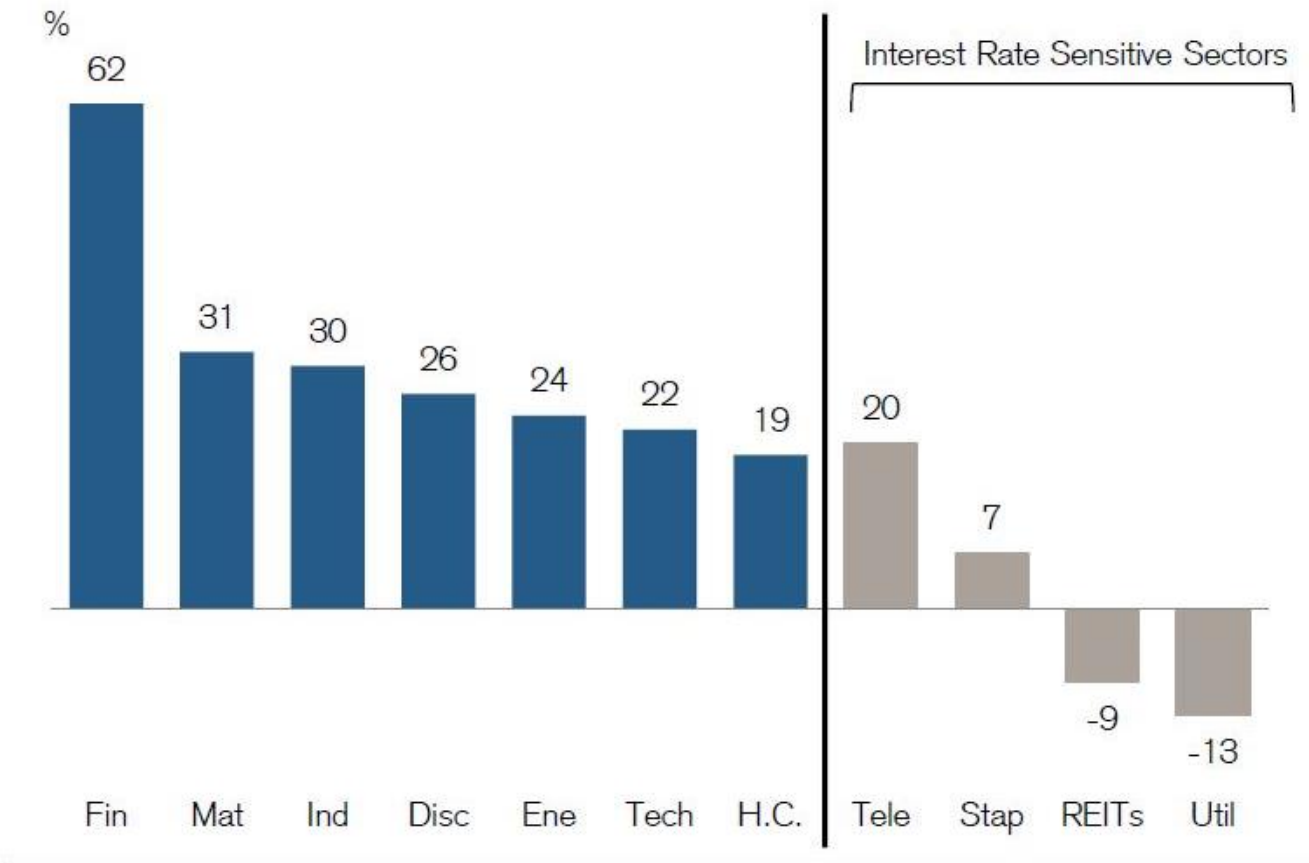
### Ten-Year Treasury Yields



Source: Bloomberg

Credit Suisse provided a look at which sectors perform best on the days rates rise. Financials lead while REITs, utilities and consumer staples lag.

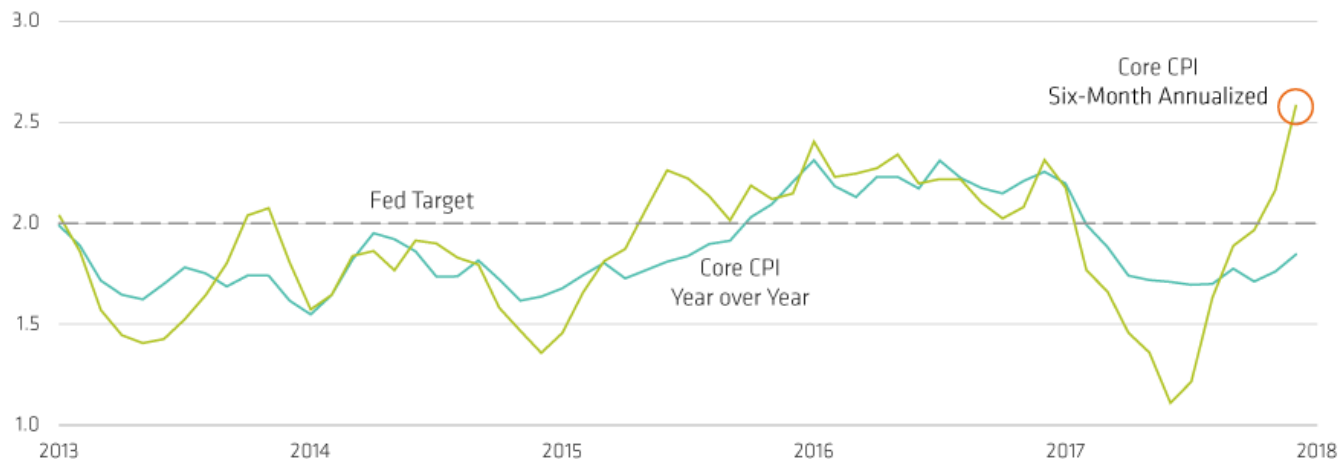
### Sector Returns on Days Rates Rise



Source: CNBC & Credit Suisse

Though we genuinely don't like to laugh at the venerable *New York Times*, we almost had to when the headline ran that we *may* be entering a period of higher rates and inflation.

### Inflation Moving Up



Source: Thompson Reuters

*Stillwater View: There should be no need for the 'may' qualifier when talking about higher interest rates and inflation. They are both headed north.*

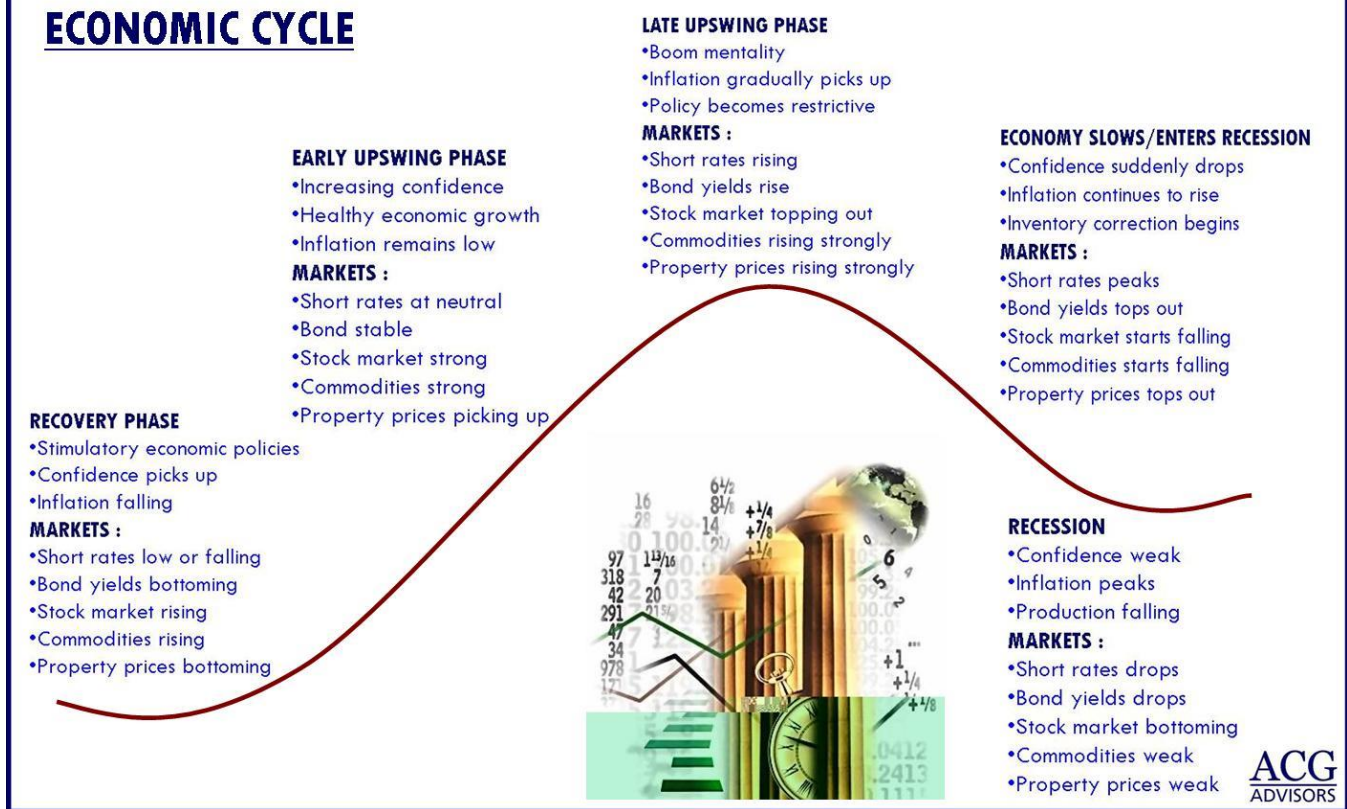
### **The Bottom-Up**

Earnings continue to take center stage as the bulk of the S&P 500 reported first quarter results this week. Here are some highlights, and lowlights.

Dow Jones components 3M and Caterpillar both unveiled healthy top and bottom lines for investors. The challenge for each was the concern that we are closing in on the end of a long cycle, as markets mature and cost inflation begins to work its way through the system.

### **The Economic Cycle Explained**

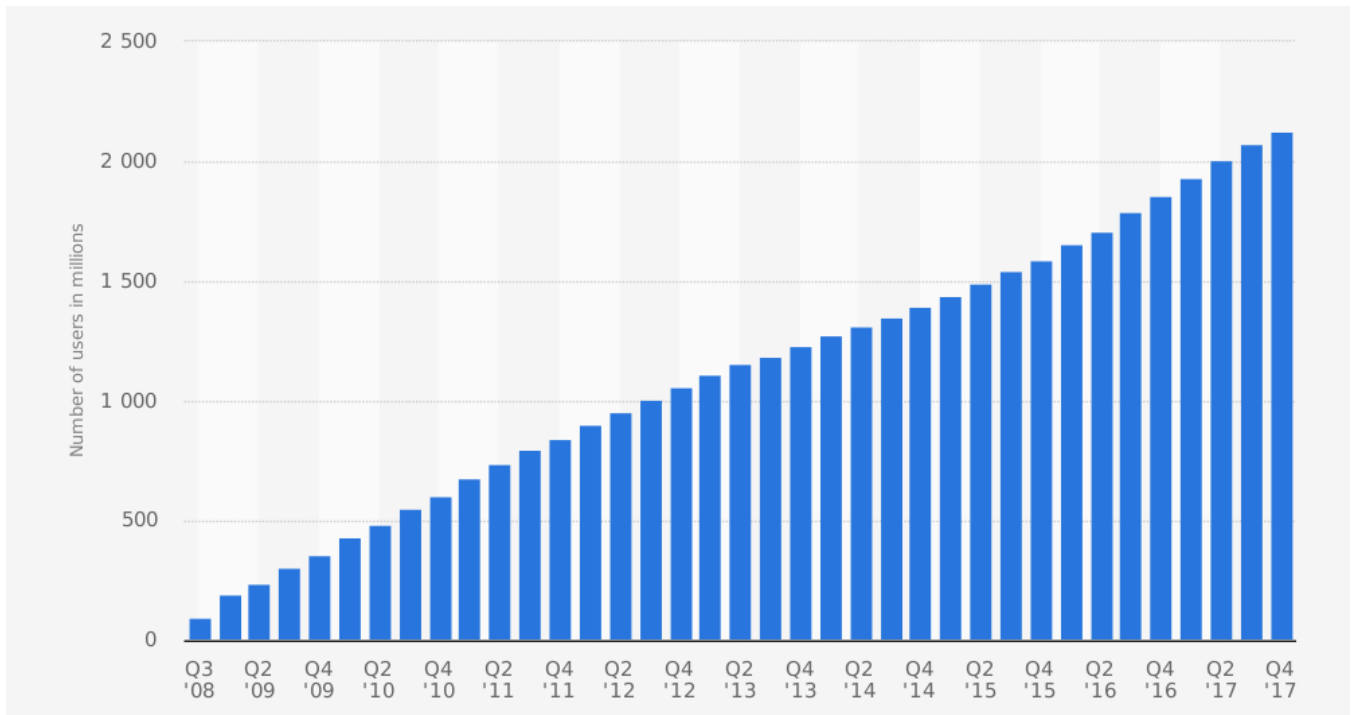
# ECONOMIC CYCLE



Source: ACG Advisors

Facebook put up a huge quarter, despite the self-inflicted wounds brought on by the Cambridge Analytica data breach scandal. Aside from the challenges, the company managed to add 70 million users in Q1 with average daily usage increasing by 13% from the prior year. Here is what Wall Street thought.

## Active Monthly Users



Source: Facebook

*Stillwater View: Even though that is one smooth sloping line upward, Stillwater's alternative equity strategies are currently short the shares of Facebook. This is based on the belief that we are reaching an inflection point where concerns about our data, and how companies use it, will become an increasingly strong headwind.*

Amazon reported last night and that they continue to do what Amazon does best, be a top of the apex feeder in the global IT food chain. Revenue growth was in the 45% range across verticals and geography. Prime members are going to be shelling out 20% more as the annual price is going from \$99 to \$119.

And how is this for surreal math? Amazon Web Services brought in just 10% of revenues for the company, yet produced 70% of overall operating income.

### **Amazon Web Services**



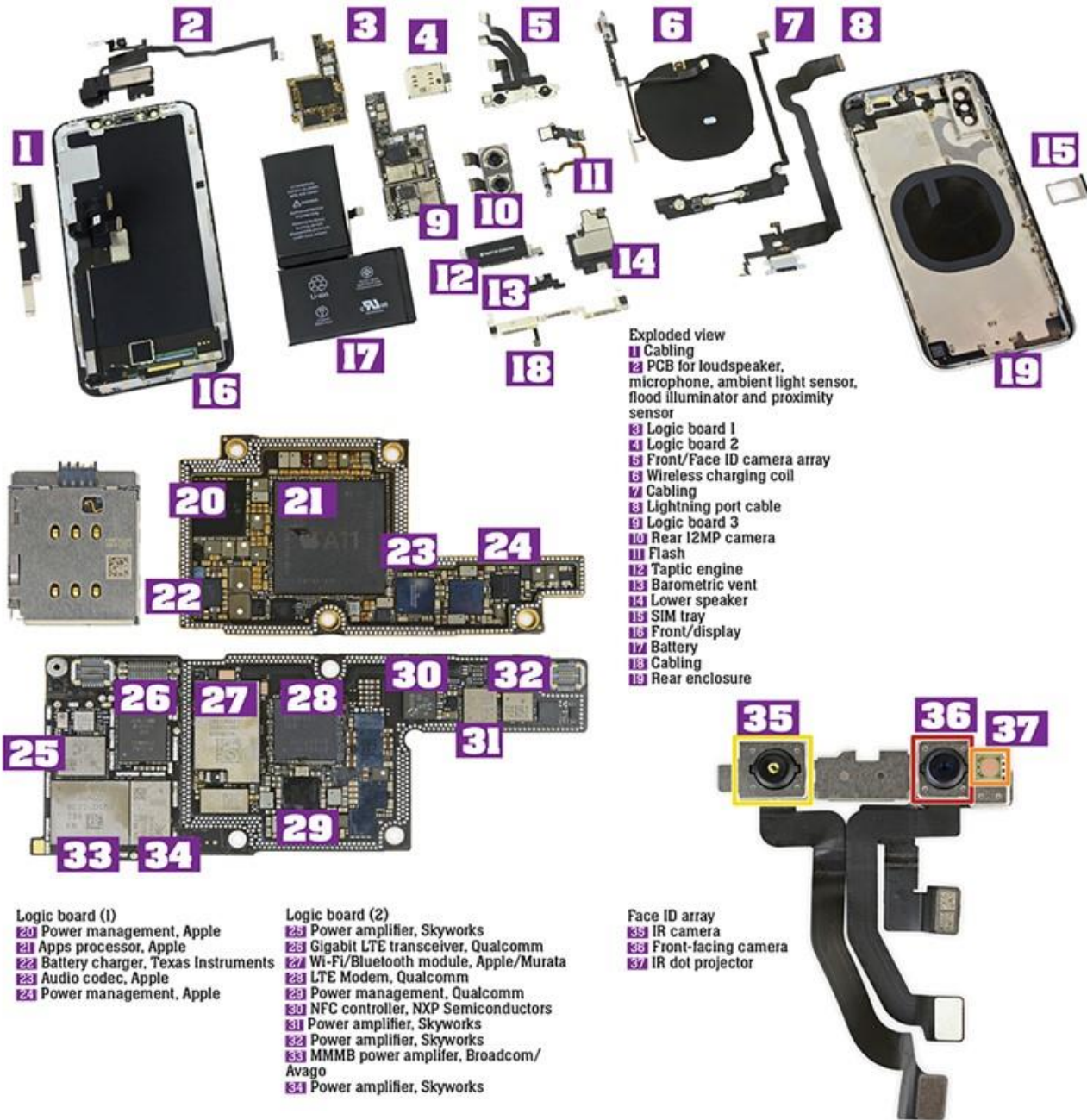
*... and much, much more!*

Source: Amazon

Samsung was the latest company to raise the red flag, further warning that the high-end smart phone business is hitting a wall. The company announced this week that sales of displays used in both the Galaxy and the Apple iPhone X are showing signs of softness. Samsung supplies to both.

The 'tear down' shown here provides a good visual reference to the components that go into making the X and the various companies, including Broadcom, Skyworks, Qualcomm, Texas Instruments, etc. that rely on sell through to make money.

### **An iPhone X 'Tear Down'**



Source: E&T Magazine

We got a look into the defense sector as Lockheed Martin and Boeing both reported earnings. For the latter it was smooth skies, while the former sold off on news that it wasn't going to raise the cash flow forecast at this time. Dividend centric investors took notice and sold the shares down 6%.

While Stillwater's hometown of Santa Barbara can't claim much in the way of contribution to heavy industry, it can indeed take ownership as the birthplace of Loughhead Aircraft, later to be re-named

Lockheed. The brothers Allan and Malcolm started the business here and launched some of their first aircraft from the soft sand of West Beach.

### **The Early Days of Loughhead**

# LOUGHEAD AIRCRAFT

EVERY LOUGHEAD AIRPLANE

A

## SUCCESS

Builders of Commercial Aircraft

since

# 1912



Loughead Seaplane Model "U" - Made two motor carrying flight at P.M.I. Exposition San Francisco, 1915.



Showing passenger carrying capacity of record breaking two-motored Seaplane



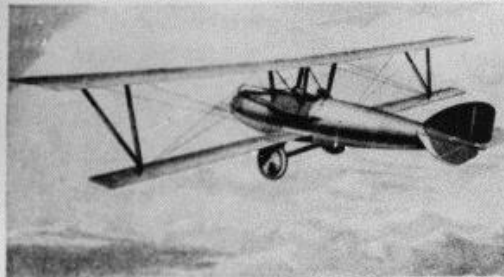
H-S. 2 L. Seaplane Type built for U.S. Navy



Christening of H-S. 2 L. Seaplane Built for U.S. Navy



Twin-motored ten passenger Seaplane on dock



Latest type developed by Loughead designers Sport Biplane-Model S-1



Twin motored Seaplane in operation at Santa Barbara, California.

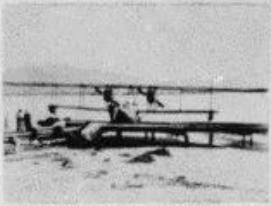
### Contractors to U.S. Navy



Twin motored Biplane - Model F1A

### Incorporated under Laws of California

CAPITAL STOCK \$250,000



Loughead twin-motored-ten passenger seaplane in passenger carrying business

## LOUGHEAD (pronounced "LOCK-HEED")

# AIRCRAFT MFG. CO.



Model F1-A in record breaking cross-country flight



Twin-motored Seaplane in record flight from Los Angeles to San Diego.

### Santa Barbara, California

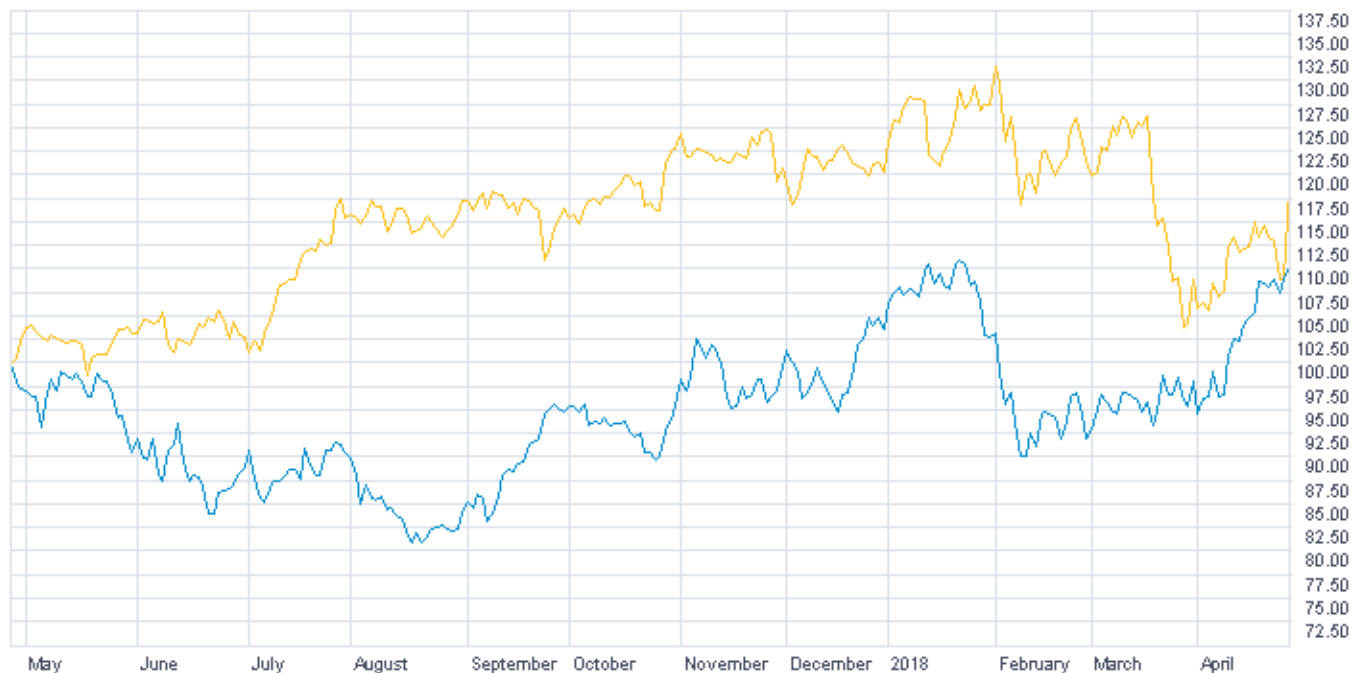
Source: Aviation Week

### Up & Down Wall Street – Sohn Conference Focus

Stillwater is taking the week off from news around the ‘Street’ to instead focus on the news coming out of the Sohn Conference in New York, the annual gathering of headline makers from the world of finance. A constituency that Dealbreaker referred to as attendees at the ‘wake for the Golden Age of hedge funds’.

DoubleLine’s Jeff Gundlach thinks that a close above 3% on the ten-year would clear a path to higher rates. Perhaps in an unruly manner. He is long oil and gas (XOP) and short Facebook (FB), in a trade he calls a technical “thing of beauty”.

### Oil & Gas v. Facebook



Source: Nasdaq

*Stillwater View: We would say ‘great minds think alike’, but that would give far too much credit to one side of the equation. Having said that, Stillwater Capital and DoubleLine are simpatico in the long XOP short FB trade.*

DoubleLine’s name comes from the metaphoric risk that exists when you cross over the double yellow line in the roadway.

“The name ‘DoubleLine’ voices our cardinal mandate: like a careful motorist on a winding mountain road, the manager must not cross the double line into the oncoming lane of risk.”

### **Risky Roadway**

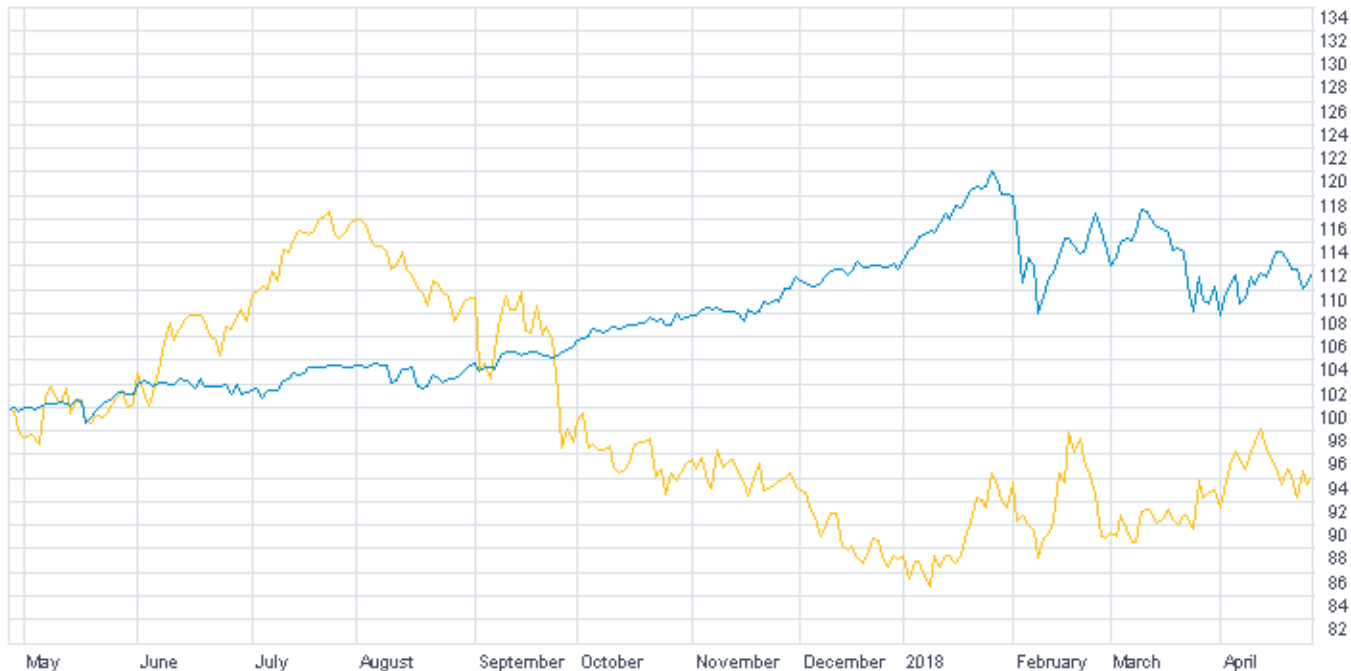


Source: Colorado DOT

Greenlight’s David Einhorn is bearish on the shares of bond insurer Assured Guarantee because of the company’s exposure to Puerto Rico GO bonds. He opened the kimono as to how he hedged the

position. "If you think Puerto Rico's bonds are worth 80 cents, buy them and sell AGO, that's what we did".

### S&P 500 v. Assured Guarantee



Source: Nasdaq

*Stillwater View: There is nothing more fulfilling than a well-executed short of an over levered insurer with a potential hole in the balance sheet. We wish Einhorn well with the trade.*

*He is going to need more than AGO working out to make his investors whole in 2018, as his main fund posted a 13.6% loss in the first quarter. Sadly, for David and the hedge fund industry, that's not a typo.*

Healthcare specialist Larry Robbins likes, you guessed it, healthcare. He thinks that Amazon's ability to enter the market is being overstated. Regulation and complexity will produce barriers to entry that are higher than the market is discounting.

Bill Gurley of Benchmark Capital, provided some relatively 'down the fairway' thoughts on how Uber's model is going to negatively impact Hertz and others that are on the wrong side of the 'peak car' trade.

Apparently Ford and General Motors are in on it as well. Morgan Stanley agrees with the move to pare down options. "Virtually eliminating Ford's North American car portfolio makes a lot of sense, in our view," said Adam Jonas, an analyst at the firm. "No more Fusion. No more Focus. No more Fiesta. No more Taurus."

## **‘It’s a Ford, It’s a Fiesta!’**



Source: Motor Trend

*Stillwater View: The firm is short the shares of Tesla, Ford, and General Motors on the clouded ‘peak auto’ outlook articulated by Gurley.*

Chamath Palihapitiya, an early executive at Facebook and founder of Social Capital, called Box Inc. his ‘best idea’ at the conference. He also took the other side of the Facebook trade. Saying to those who are short ‘we can agree to disagree’. We are going out on a limb and guessing Chamath’s cost basis in FB is less than a dollar.

## **Facebook on IPO Day**



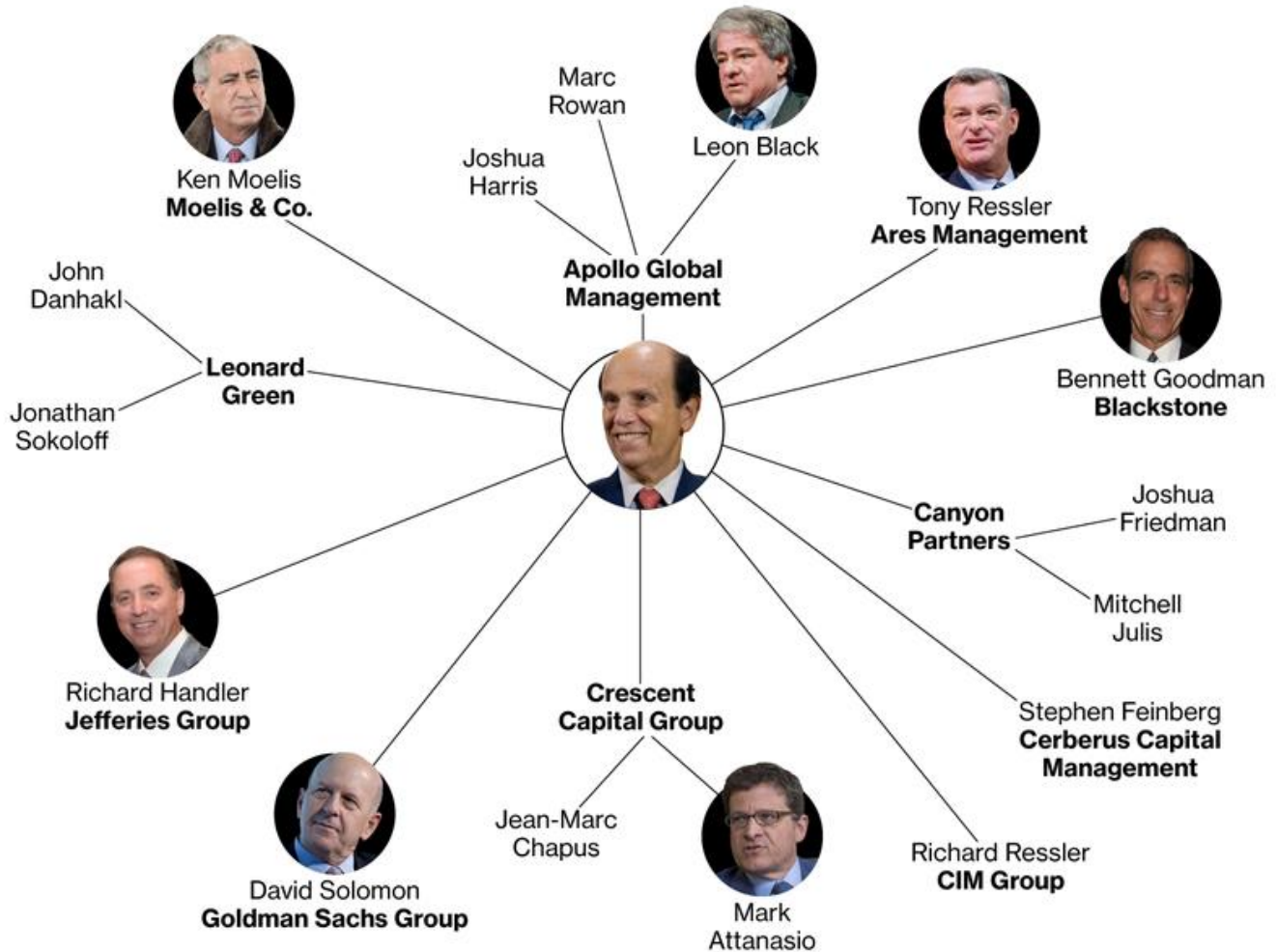
Source: Money

Next week it's the Milken Global Conference in Los Angeles. *Bloomberg* is ahead of the event with an interview with the man who started it all, Michael Milken.

In it he talks about the web of former colleagues that have gone on to become true titans in the industry.

### **Drexel Dysphoria**

Acolytes of Mike Milken can be found at the top of banks, hedge funds and private equity shops



Source: Bloomberg

### Diversions

It was a sad week for those of us that came of age from 1975 to 1985 as School House Rock composer Bob Dorough passed away at the age of 94.

What a legacy he left as there isn't a one of us who can't remember at least some of the words to "I'm Just a Bill" or "Conjunction Junction". The New York Times lists the 5 they will never forget. The Stillwater Capital house favorite is The Preamble.

### **The Kids Are A Rockin'**



Source: Disney

The 2018 NFL Draft continues today in Las Vegas. Oklahoma's very entertaining Baker Mayfield became the number one pick by the Cleveland Browns. USC quarterback, Sam Darnold went fourth to the New York Jets. SBNation grades the entire first round.

Bruin fans rejoice as 'our guy' Josh Rosen was selected tenth by the Arizona Cardinals. And he is already 'pissed' as there were 'nine mistakes made ahead of me'. Awww Josh, we miss you already. Stay classy, amigo!

**Josh And His Dorm Room 'Water Lounge'**



Source: TMZ

Every April, the grounds of the Empire Polo Club in Indio, California becomes the epicenter for music and entertainment. Last week it was Coachella for the ever expanding alt hipster crowd. This week it's the Stagecoach Music Festival for the ever expanding alt hipster country crowd.

In 2016 the San Diego Tribune provided a history of how Stagecoach became the world's largest gathering of country music fans. Meanwhile, Los Angeles Magazine reviews the upgrades at Coachella 2018 along with a comparison of the two events.

### **Stagecoach v. Coachella**

	<b>STAGECOACH</b>		<b>COACHELLA</b>	
Bud Light	<b>MAY RUN OUT OF</b>		Glow sticks	
Charlie Daniels vs. the Devil	<b>BACKSTAGE BATTLE</b>		Wu-Tang Clan vs. the DEA	
The ethereal Becky Stark	<b>BEST SMALL-FONT ACT</b>		The grungy Kurt Vile and the Violators	
Darius Rucker from Hootie & the Blowfish	<b>BLAST FROM THE PAST</b>		The mascaraed men of New Order	
Cowboy	<b>POLITICALLY (IN) CORRECT COSTUME</b>		Indian	

→ *Stagecoach Country Music Festival: April 26-28, [stagecoachfestival.com](http://stagecoachfestival.com). Coachella Valley Music and Arts Festival: April 12-14 and 19-21, [coachella.com](http://coachella.com).*

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