

Stillwater Capital - This Week in the Markets



Stillwater Capital Update

The start of a new quarter gives Stillwater Capital the opportunity to provide an update on our business before we jump fully into *"This Week in the Markets"*. We are pleased to say, there is plenty to updated.

Stillwater relocated offices in August taking up residence at the historic Balboa Building in downtown Santa Barbara, a stone's throw from what is reported to be Amazon's new presence on the American Riviera.

Stillwater Capital's New Home



Source: The Balboa Building

We are transitioning our e-mail distribution system next week to scale to increased demand. If next Friday morning you don't receive *"This Week in the Markets"* please e-mail us and we will remedy the situation.

"This Weeks" Marquee - Grand Tetons



Source: National Parks Service

We are also proud to announce that Stillwater has been engaged to build out the liquid alternatives business at Oakhurst Advisors, an offshoot of Lido Advisors based in Los Angeles.

The former is a new venture with a blank canvas and broad mandate to provide alternative solution for advisors and their clients. The latter is a \$3 billion registered investment advisor headquartered in Los Angeles. Stillwater will also be the sub-advisor on multiple alternative strategies, with more in the development pipeline.



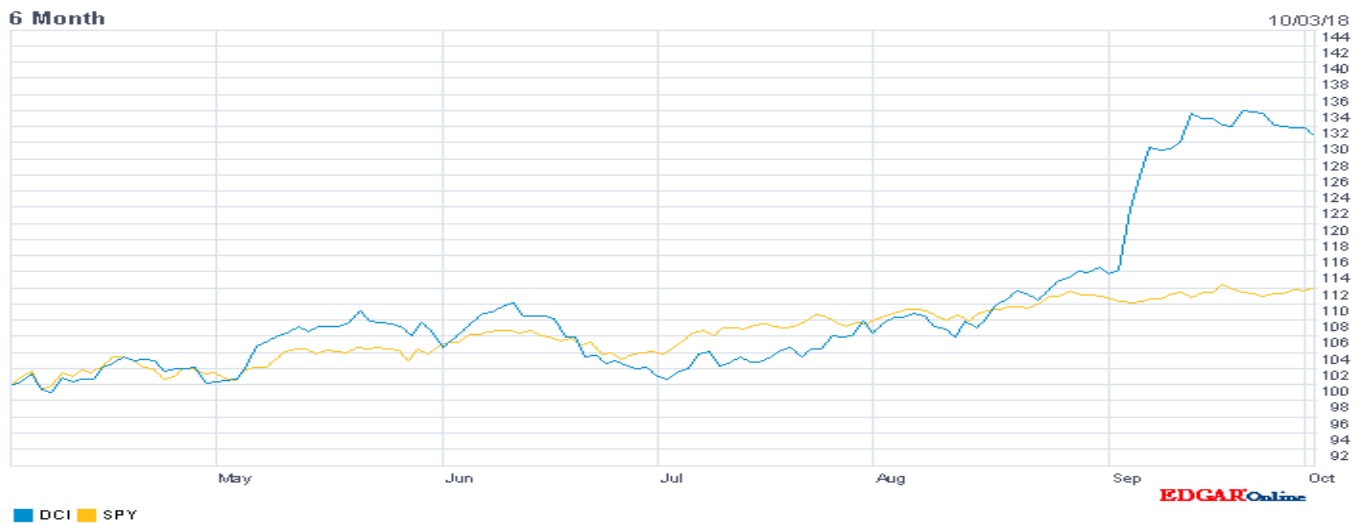
In July, Stillwater was invited to join alternative specialist SumZero asset allocators platform.

One of the prices of admission was a contribution of a single "best idea" on a quarterly basis. Our offering was a buy recommendation on Donaldson Corporation (Symbol: DCI), a \$7 billion market cap manufacturer of industrial filtration products.

Our initial opinion was published in early July with the stock at \$45 and a 12-month target price of \$60, the thesis being that strength upstream at Deere and Caterpillar was bound to trickle down to component supplier DCI.

While we had confidence that our call would be right, we didn't think it would be this right. The stock opened this morning at \$57.71, up nearly 30% from when we first wrote it up as a buy, 90 short days ago.

Donaldson v. S&P 500



Source: Nasdaq

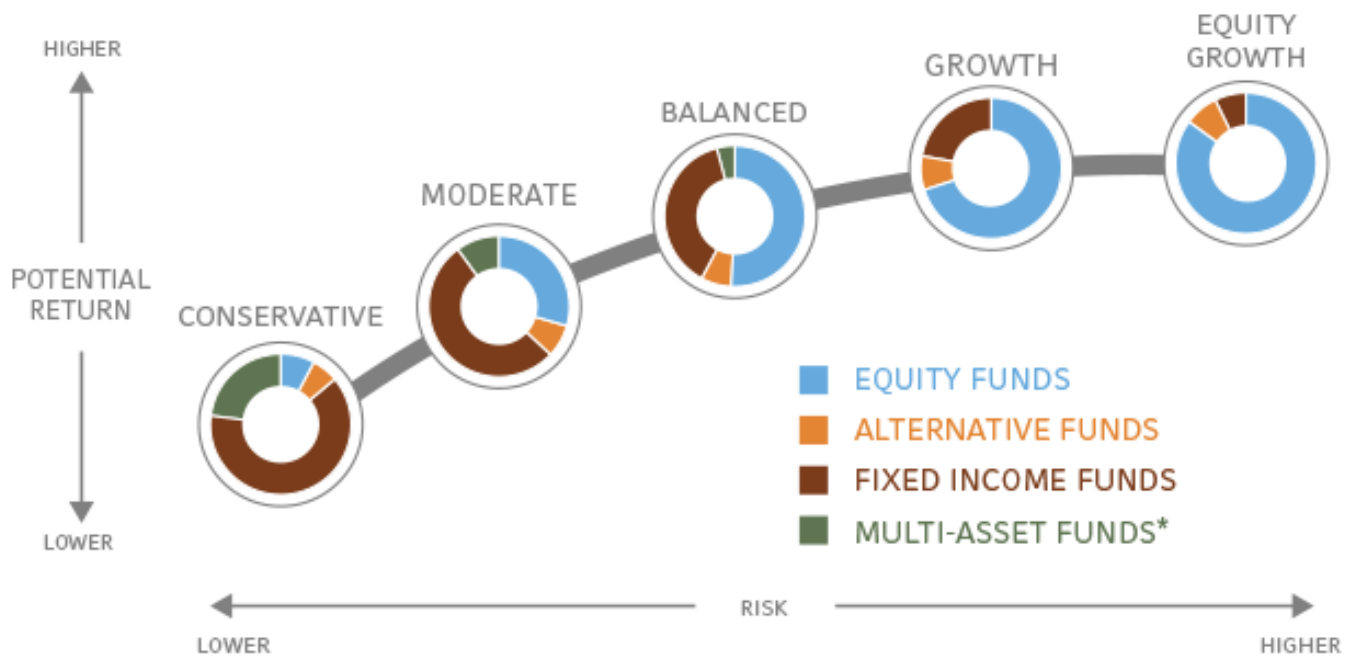
The Stillwater View: The initial research report and subsequent follow up are available for due diligence on the firm or if you are looking to understand our investment philosophy and process. Past performance of an idea does not guarantee future results.

Third Quarter Performance

Stillwater Capital has three mainstream alternative equity solutions, each with their own slightly different characteristics. We choose the name Trinity, as they hold long positions, short positions, and cash, the three pieces necessary to produce absolute returns regardless of market conditions.

These strategies are designed to complement a broader asset allocation model where broad market exposure in the form of inexpensive ETFs makes up the bulk of your equity holdings, and dry powder is reserved for alternatives solutions that can zig when the market zags.

Efficient Asset Allocation



* Multi-Asset is defined as funds that contain more than one broad asset class (equity, fixed income, alternatives).

Source: Russell Investments

After a year of pedestrian performance we took Trinity Alternative Equity back into the shop to determine what was holding back performance. What we found was that the portfolio was not properly positioned for an economy experiencing late cycle growth.

Are We There Yet?

Economic Cycle Phases



Source: Nasdaq

Adjustments were made, and the result was a strong third quarter which produced a 5.8% return for the period. Year to date, it is up 2.6%, in-line with the long/short equity average. The strategy has been in “flaps down” mode for more than a year, and has 50% to 75% exposure to the overall market.

Stillwater’s Trinity Equity Income strategies have seen strong risk adjusted performance this year, riding the wave of a return to quality in the market. Long positions are held in high quality, strong balance sheet companies, that pay a solid and growing dividend.

On the short side, one version of the strategy uses single company and ETF shorts, the other keeps it strictly ETFs. The former returned an average of 5.4% for clients in the quarter and 5.8% year to date. The latter has produced an even stronger 8.1% return for the quarter and 9.8% year to date.

Blue Chip Triumvirate



Source: Money Magazine

The Stillwater Trinity Equity Income strategies have a straightforward approach, with an objective of 10% to 16% annualized performance, and lower volatility than the overall market. We get there using this math:

Equity appreciation	= 6% to 8%
Dividend contribution	= 2% to 4%
<u>Volatility hedging</u>	= 2% to 4%
	= 10% to 16%

Like all Stillwater strategies, equity income is offered in a separately managed account through several of the major custodians. Long positions are held for at least a year, providing a more favorable long-term capital gain profile.

Stillwater investment solutions charge 1.0% flat, with no additional performance fee. Comparable strategies in mutual fund and private partnership form price well above this level.

The Top Down

This morning's jobs report was a slight disappointment, but just what the market needed. Payrolls increased 130,000 in the month of September, bringing down the jobless rate to a 49 year low. The *New York Times* and *Bloomberg* has everything you need to know about the number.

Jobs, Jobs, And More Jobs

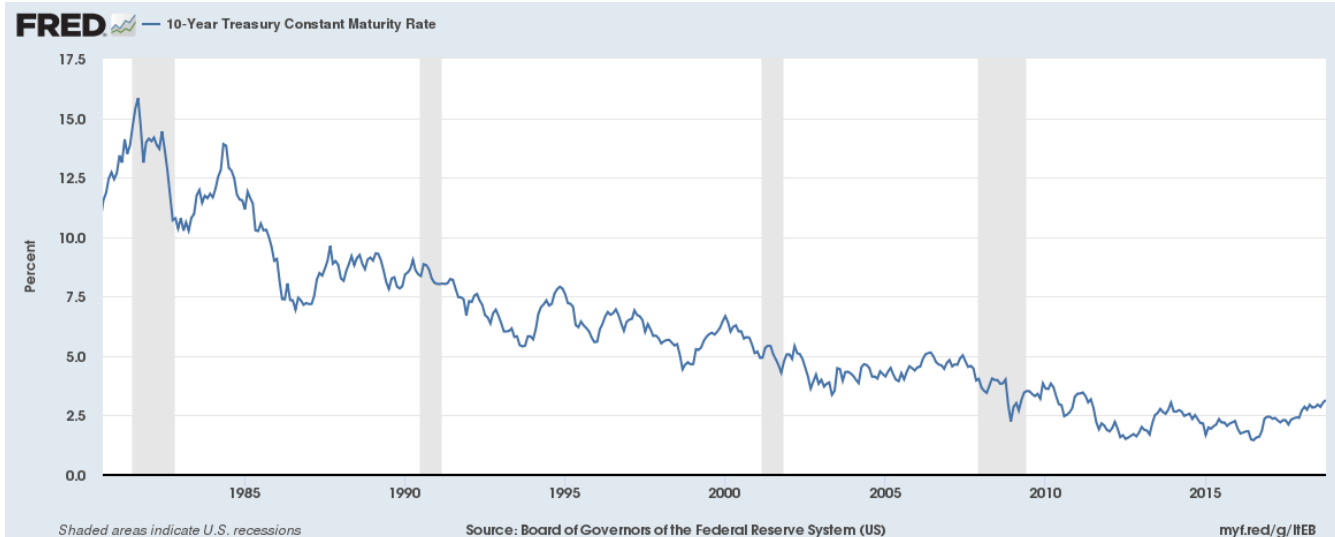


Source: Your Consorteum

The Stillwater View: We say this is just what the market wanted today because a "hot number" above 200,000 would have further spooked the bond market.

Interest rates finally did it, breaking above 3% and staying there. If this move keeps going we will officially have broken the 30 year downtrend that started after Paul Volker put the hurt on inflation with a 20% fed funds rate.

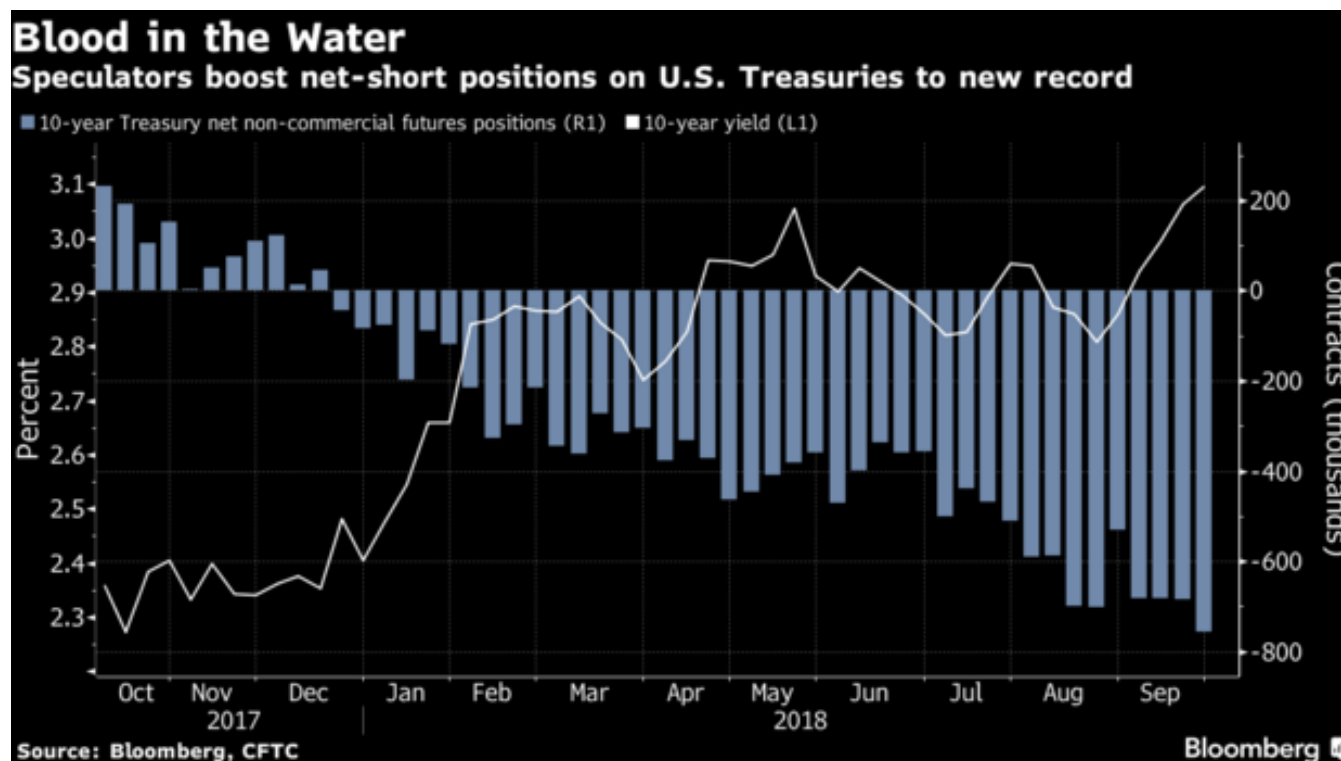
"Hey now, hey now. Don't dream it's over."



Source: St. Louis Fed

And with the buyers at bay, bond bears will play...

Another Big Short



Source: Bloomberg

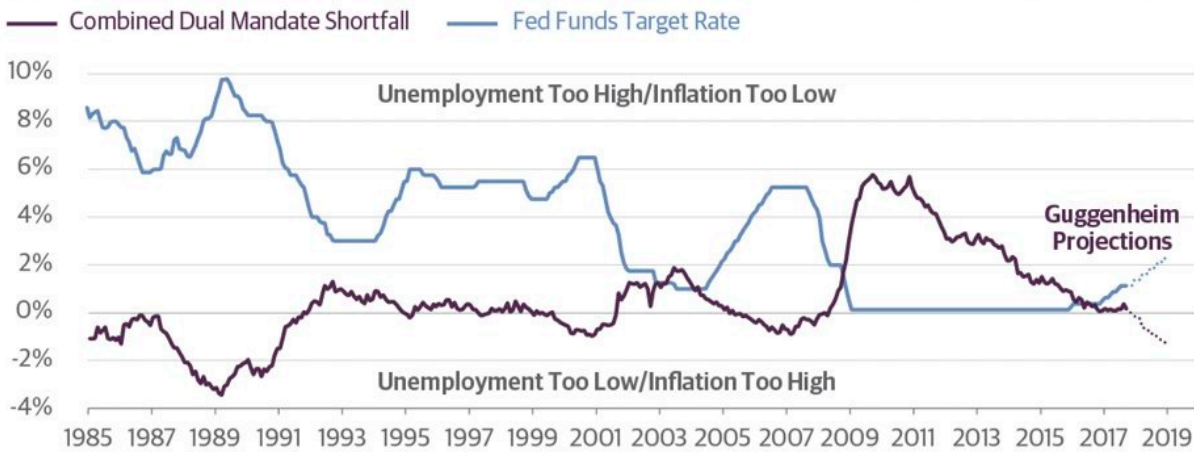
Fed Chairman Jay Powell responded to a question this week asking if the economy may be too good to be true. In Powell's words, "it was a reasonable question". He went on to describe that this period was unique in terms of satisfying the dual mandate of maximum employment and low inflation, calling it "a remarkably positive outlook".

Then Powell dropped this one, "There's really no reason to think that this cycle can't continue for quite some time, effectively indefinitely," It's never fully "different this time". It just looks like it is for a while.

The Risk of a Fed "Overshoot"

GUGGENHEIM

Fed Rate Hikes Are Set to Continue as the Fed Overshoots Its Dual Mandate Goals



Source: Haver Analytics, Congressional Budget Office (CBO), Guggenheim Investments. Data as of 10.11.2017. Combined dual mandate shortfall adds the deviation of core PCE inflation from the Fed's 2 percent objective and the deviation of the unemployment rate from the CBO's estimate of the natural rate of unemployment.

Source: Guggenheim

The Stillwater View: President George H.W. Bush once wrote to his family about moments like this when he was flying in the Navy, referring to the occasions when the sky was clear and you could seemingly see forever. In Naval aviation terms it is called CAVU. Short for "Ceiling And Visibility Unlimited." For the economy and the markets, the outlook is certainly CAVU.

More important than any translation into the economy was the way President Bush took the idea and applied it to the life he lived with his family. Anyone looking for something beautiful in a world that at times has seemingly gone crazy, listen to the words he wrote to his children invoking CAVU and the peace he had achieved in life.

Kennebunkport, Maine



Source: George H.W. Bush

The housing market continues to appear as though it has “shifted”, with inventory piling up and more and more prices needing a “newly offered” price. The latter of course refers to bringing down the ask to something that resembles fair value. Zillow said in August that 15% of houses nationwide were being marked down in order to sell. Bloomberg reports that even in places like “dreary old Manhattan”, inventory is rising while sales are falling. The canary in the coal mine is also whistling a tune as it walks by the grave yard.

CNBC piled on Wednesday with a report that it wasn’t just the high end that was hurting. And it was a resounding opinion again yesterday, when they handed the mic over to the co-founder of the Economic Cycle Research Institute who opined that we have a “red flashing light” going off in home price growth.

Manhattan Inventory Up



Source: New York Times

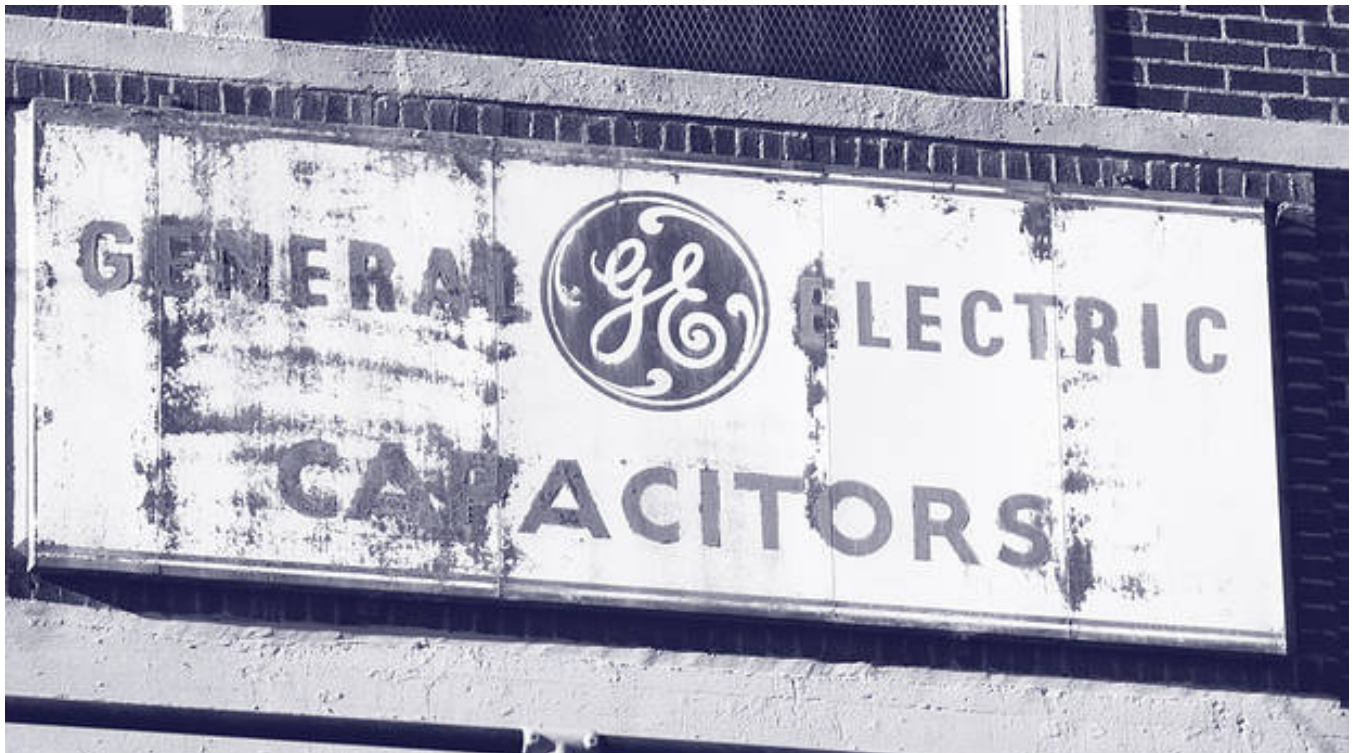
Source: Bloomberg

The Stillwater View: After top-ticking the market for coastal California real estate in May of 2007, the author stepped out of an eleven year residential real estate trade at par last Tuesday. Which is nothing shy of a small miracle given the crash in prices that ensued. Goodbye inflated housing market, I'm going to miss you...maybe just a little. I'll be waiting for you on the other side, compadre!

The Fundamental Bottom Up

For the first time in its 125 year history, General Electric has gone outside its ranks to find a new CEO. On Monday, the board fired John Flannery after 14 short months on the job. He took over for Jeff Immelt and was given the charge to clean up the mess left behind. Flannery was a 30 year GE veteran and only the fifth CEO in company history.

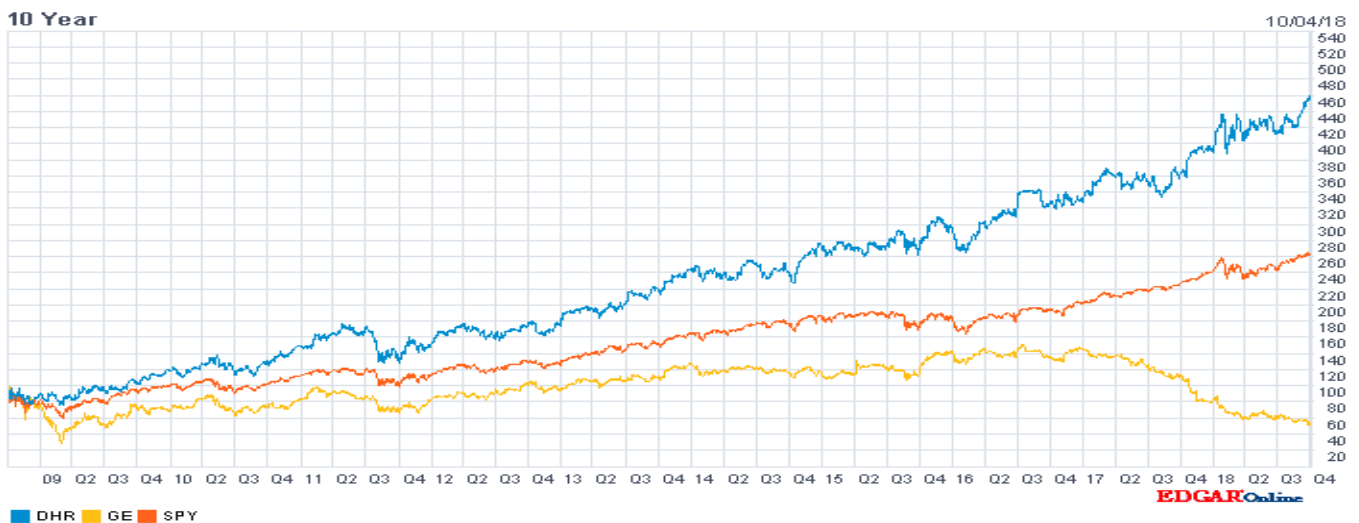
The Old General Electric



Source: NPR

GE stock rose 15% on the news that Larry Culp was taking over for Flannery. Culp was the fifteen year CEO at the helm of industrial giant Danaher. *The Wall Street Journal* reports that Larry has \$300 million reasons to make this work out at GE. During his tenure at Danaher the stock massively outperformed the market and General Electric.

Danaher, General Electric, S&P 500



Source: Nasdaq

The Stillwater View: In honor of the playoffs we give you a baseball analogy. Immelt was your starting pitcher and had a good game going through five, finally got gassed and gave up 10 runs before he got pulled. Flannery was brought in as middle relief and let in another 5 in one inning. The board, acting as manager, had seen enough and gave Flannery the hook and Culp the ball to shut things down. Good luck Larry. We hope you like your new role as a starter. Game on!!!!

The guys at Instagram have seen enough of parent Facebooks attempts to move the company further into the firms ecosystem and are leaving the building as a result. Co-founders Kevin Systrom and Mike Krieger announced they are headed out the door last week.

Why Are These Men Smiling?



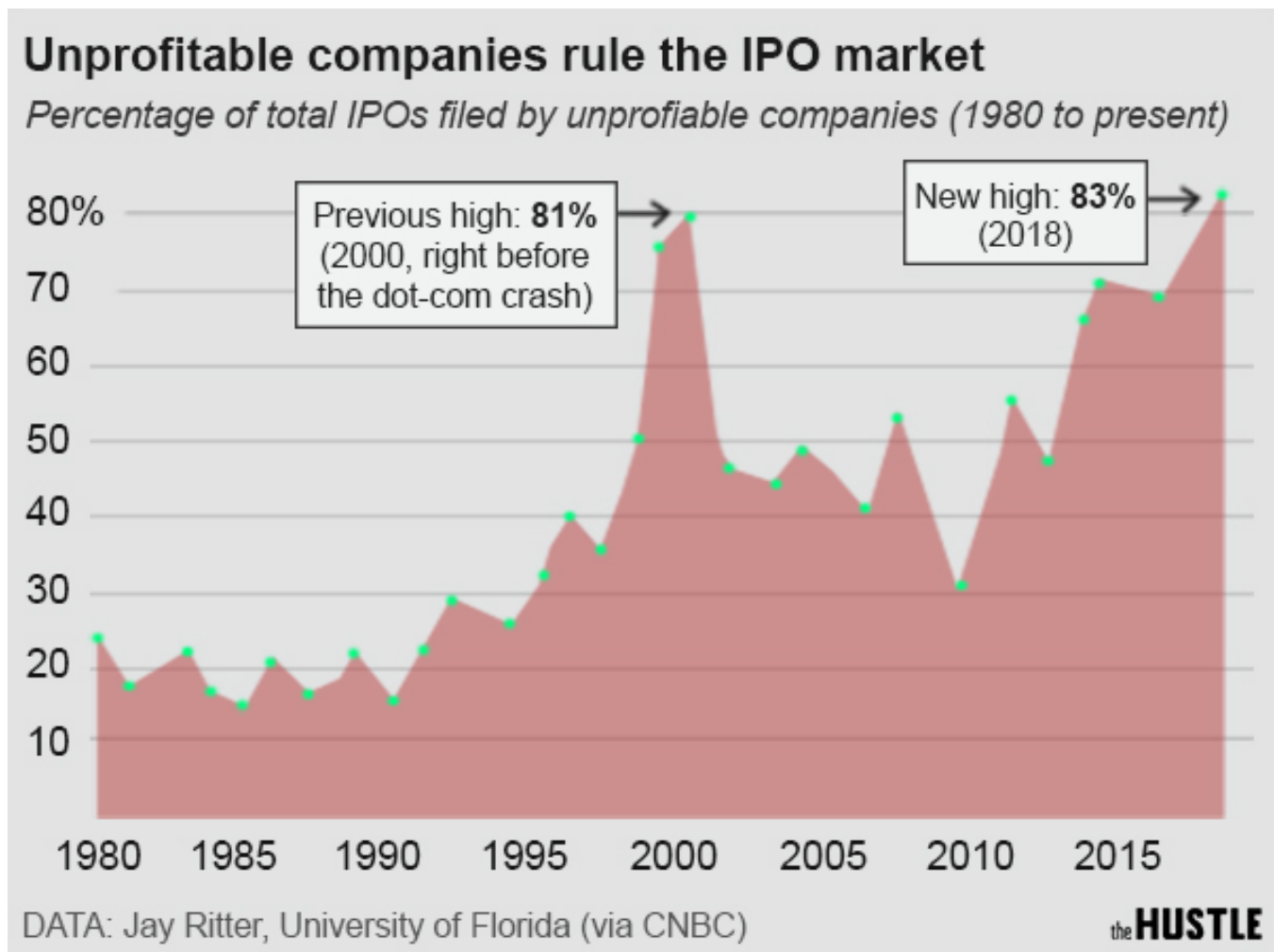
Source: Business Insider

When the company founders sold to Facebook in 2010 for \$1 billion Instagram had one million users. Today they can count more than one billion. Yes, that's right, billion with a "b". *Bloomberg* reported in June that Insta was now worth more than \$100 billion.

The Stillwater View: A billion here, a billion there. Pretty soon you are talking real money.

In a possible sign that technology might be headed towards a top, money losing companies are going public at a rate not seen since 1999 and 2000. A full 83% of new listings have lost money in the 12-months prior to their debut, and some of the newer issues have languished. Stich Fix was the most recent, preceded by Snap Inc., Dropbox, and Survey Monkey. The situation is so bad at Snap that it has caused the unthinkable, actually rendering Jim Cramer speechless.

Profits? We Don't Need No Stinking Profits



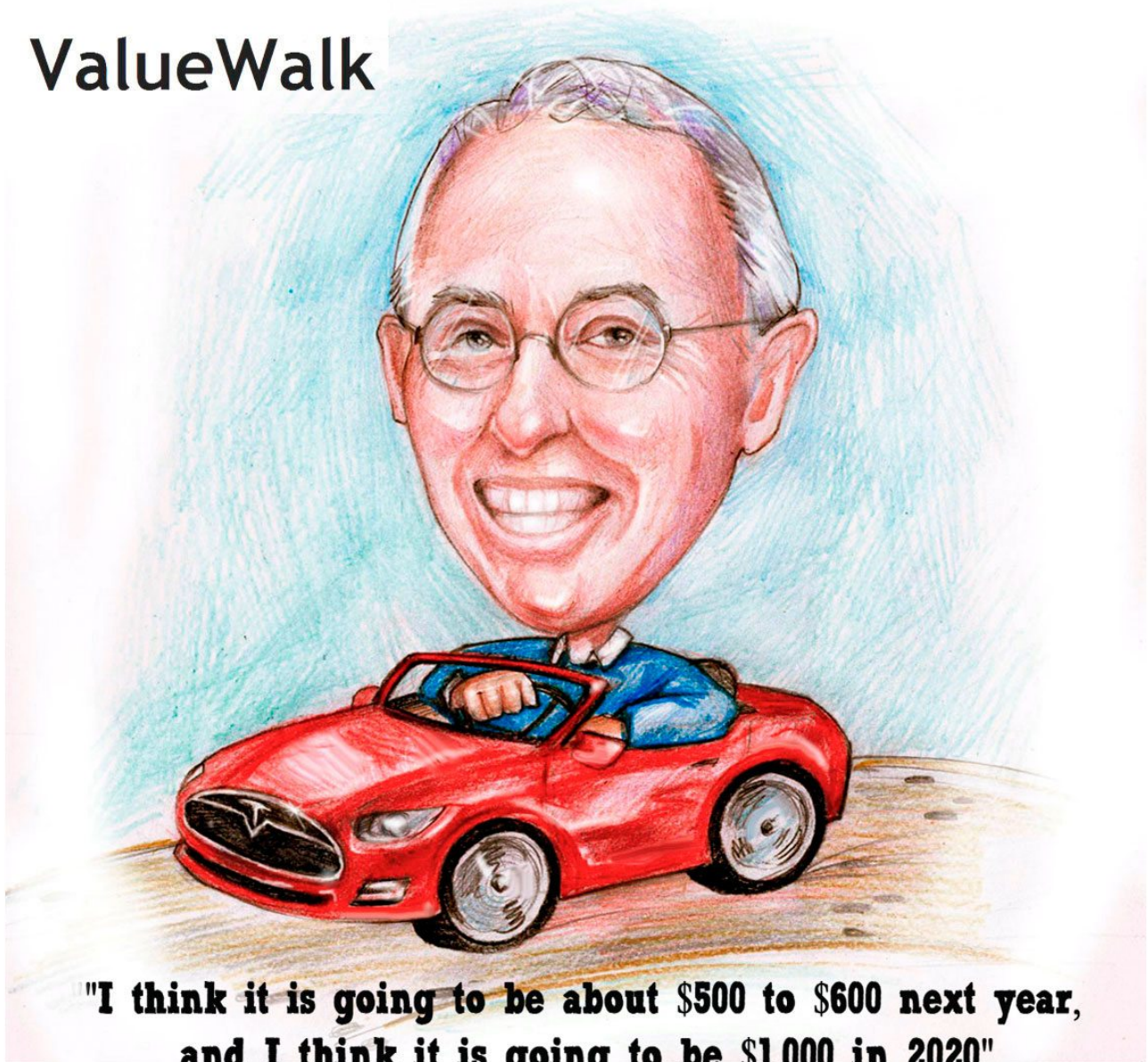
Source: The Hustle

Looks like we got off the Tesla crazy train just in time. While many aspects about the company remain clouded, some things are clear. Their CEO made some major errors in CEO judgment after apparently smoking the “wacky tobacco”. Production expectations are all over the map, competition is coming, and Tesla will probably need a big slug of outside cash at some point soon.

Yet still the believers continue to believe. In an appearance on *CNBC* this week, billionaire investor Ron Baron said again that Tesla will have \$1 trillion in revenue by 2030. Ron is a pretty smart guy who never met a TV camera he didn't like. Baron also has \$20 billion under management for which he is able to charge an above market premium. We call that winning!

Big Ron, Small Tesla

ValueWalk



**"I think it is going to be about \$500 to \$600 next year,
and I think it is going to be \$1,000 in 2020"**

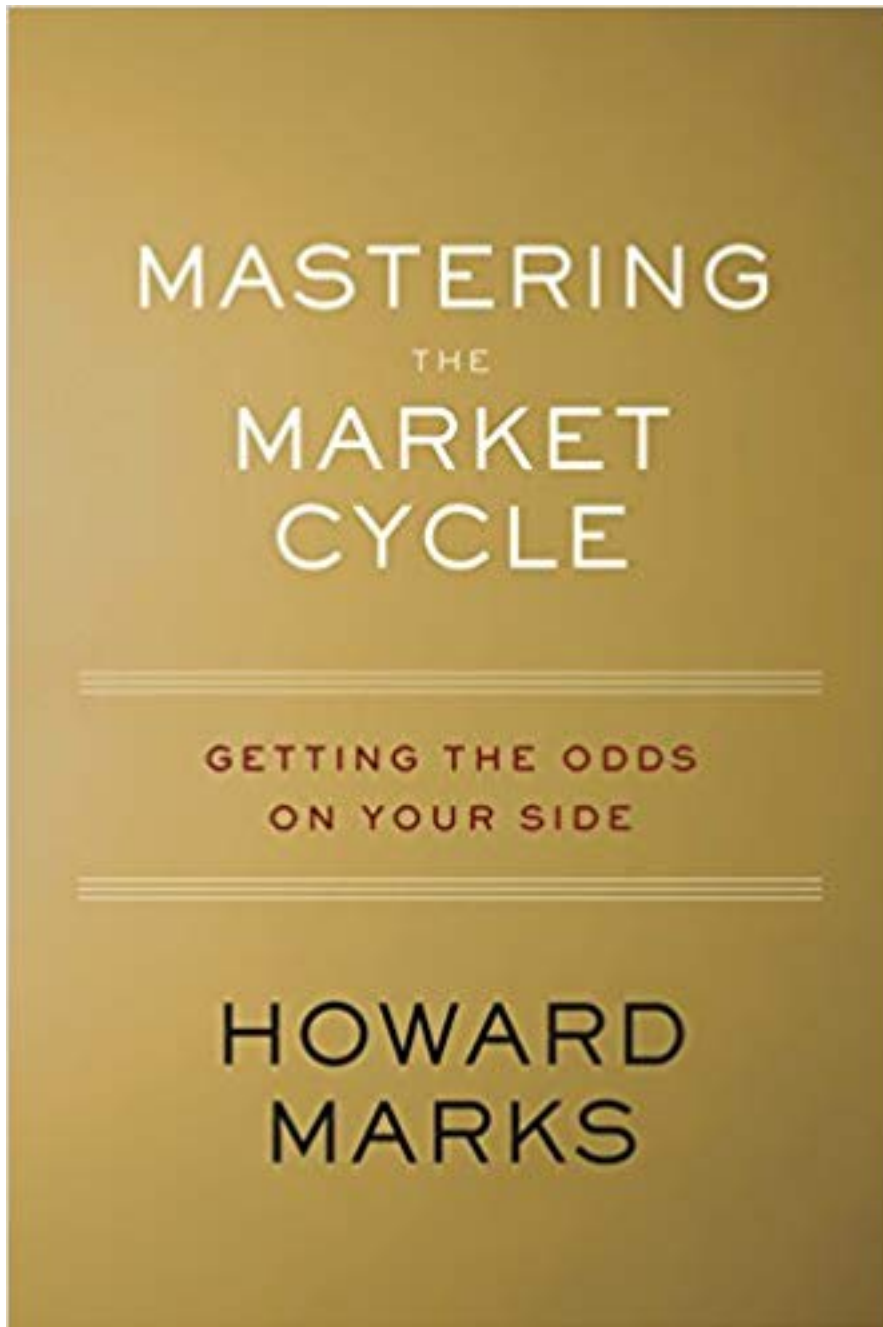
Ron Baron on Tesla Stock (Source: CNBC Interview 13 Jun 2017)

Source: Value Walk

The Stillwater View: Stillwater got off the Tesla crazy train two months ago and feels like we might live a few more years because of it. This position, long or short, has sucked the life out of more managers than you can possibly imagine. And all for what? The stock has traded in a \$100 point range between \$275 and \$375 for a year and a half. If it's going to Ron's \$500 - \$600 its going without us. Godspeed.

Markets

Howard Marks continues with his "Mastering the Market Cycle" book tour, this time landing on Bloomberg TV. Delivering the same message he professed two weeks ago, that it doesn't look like we are at the end of the cycle, although we may be knocking on its door. In a surprise to nobody, he is a better seller than a buyer.



Mention was made during the interview, that private lending was becoming a behemoth in credit circles, topping the one trillion mark earlier this year. Los Angeles based Ares Management authored a [white paper](#) in April, deep diving into the subject.

The Stillwater View: Who knows how, why, or when this cycle will end. What we do know is that private lending has become a huge business that the public by and large doesn't know exists. And if during the next downturn it takes a dirt nap, the ramifications could be huge for the economy. This is not a prognostication that it will go wrong, just an acknowledgment that it may.

George Soros' famous trader Stan Drukenmiller sat down with Kiril Sokoloff to talk markets and his future in trading. Put him down for being on "triple red alert" as he sees a chance to take a big shot "somewhere around year end", as bombs are going off in emerging markets. Drukenmiller, another lion of the golden age of hedge funds who is facing down his own professional immortality, lamented the rise of the machines and what it has done to his "signals".

Stan and George Circa 2000



Source: The Wall Street Journal

Hedge Funds

After 30 years in business, \$12 billion hedge fund Highfield announced it would be closing up shop. Founder Jonathan Jacobs said what many of us think on a regular basis, "after three and a half decades of sitting in front of a screen, I realized I am ready for a change." *Pension and Investments* reports that the funds meandering returns of late included a positive 5.7% 2016, a negative 6.2% in 2017, and a negative 1.6% through June of this year.

The \$2 billion San Francisco based Criterion Capital also called it quits this week after 16 years in business. The technology media and telecom long/short manager says it wants to focus on a longer time horizon of 4 to 10 years and the current structure doesn't allow for that.

The Blinking Lights of Pain



Source: Bloomberg

The Stillwater View: Special thanks to trading desk partner, and co-conspirator on many a brilliant idea, Warren Wibbelsman, for introducing the author to the phrase "Blinking Lights of Pain" twenty two years ago.

Diversions

Baseball has moved into divisional series mode as eight teams compete for the chance to play in the World Series. The National league has the Rockies taking on the Brewers and the Dodgers playing the Atlanta Braves. Over in the American, its Cleveland versus defending champ Houston and the Boston Red Socks facing off against the New York Yankees.

Bottom line, these should all be great games. But the spotlight will clearly be on Fenway Park, at 7:30 tonight as the Red Socks and Yankees meet once again in one of the greatest rivalries in all of sport.

Pedro Makes 72-Year-Old Don Zimmer Pay



Source: SILive

The Stillwater View: Not that God cares a stich about this one. If he does you will get to see the Yanks take on the Brooklyn Trolley Dodgers in a very once sided rivalry that dates back to 1941. The all-time record is 8-3 in favor of the boys in pinstripes. Play Ball!

While we touched on the subject of a “shifted “real estate market earlier, Stillwater takes it one step further bringing you three properties that have seen steep price cuts or closed at a fraction of their original ask.

First up is Johnny Carson’s former Malibu mansion. Originally listed for \$81.5 million in 2017 the house can be yours for \$65.2 million today. Hey, what’s a cool \$16.3 million between friends.

Heeeeeerrrrsssss Johnny’s House



Source: LA Daily News

Looking for a home with a bit of history? Dark history that is? Look no further than the Miami waterfront mansion where Al Capone planned the St. Valentine's Day Massacre. Originally listed at \$15 million in April, the home took a 10% price cut and is now available for \$13.5. The new owner might want to burn some sage as the massacre took out seven members of the rival Irish mafia.

93 Palm Ave, Miami



Source: The Daily Mail

These two take a back seat to the price reduction at the Imus Ranch in Santa Fe, New Mexico. Owned by the original shock jock Don Imus, it had been listed for \$35 million. It finally closed out at a cool \$12.5 in April. The new owner is Patrick Gottsch, a media kingpin from Omaha, Nebraska.

The Imus Ranch in New Mexico



Source: The Santa Fe New Mexican

The Stillwater View: It's a wild world out there. If you don't like the news, go out and makes some of your own.

To subscribe or unsubscribe to Stillwater Capital's "This Week in the Markets" please e-mail contact@stillcap.com.

DISCLOSURE: Stillwater Capital, LLC is a Registered Investment Adviser. Advisory services are only offered to clients or prospective clients where Stillwater Capital, LLC and its representatives are properly licensed or exempt from licensure. This website is solely for informational purposes. Past performance is no guarantee of future returns. Investing involves risk and possible loss of principal capital. No advice may be rendered by Stillwater Capital, LLC unless a client service agreement is in place.

Stillwater Capital, LLC provides links for your convenience to websites produced by other providers or industry related material. Accessing websites through links directs you away from our website. Stillwater Capital, LLC is not responsible for errors or omissions in the material on third party websites, and does not necessarily approve of or endorse the information provided. Users who gain access to third party websites may be subject to the copyright and other restrictions on use imposed by those providers and assume responsibility and risk from use of those websites.

General Notice to Users: While we appreciate your comments and feedback, please be aware that any form of testimony from current or past clients about their experience with our firm on our website or social media platforms is strictly forbidden under current securities laws.