



July 7, 2017

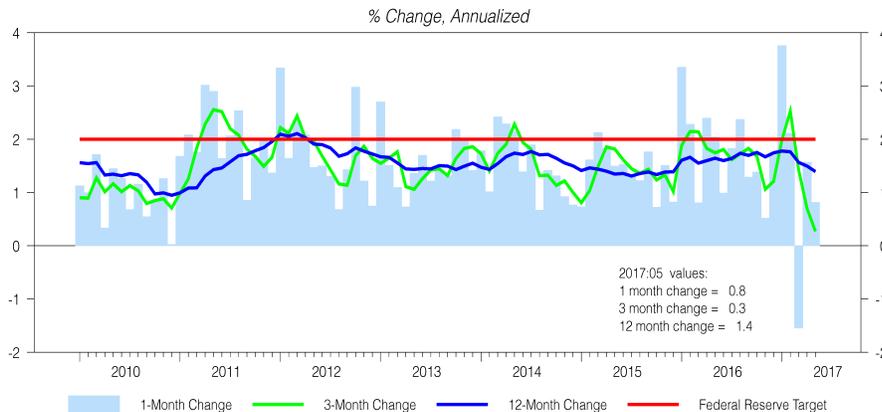
The Top-Down

The [June Employment Report](#) was released by the Labor Department this morning and it showed a solid gain of 222,000 jobs last month, above the 174,000 consensus estimate. Wage growth disappointed again as average hourly earnings increased 0.2%, for an annualized rate of 2.5%. Employment gains are averaging 180,000 per month this year, slightly below the 187,000 for 2016.

DoubleLine’s Jeffrey Gundlach reiterated his view that the 10-year Treasury is [moving towards 3%](#) this year. Playing catchup as rates rise globally. Late Thursday, Ray Dalio posted that the era of easy money is over and his responsibility is to start [dancing closer to the exits](#).

The June FOMC meeting [minutes](#) were released on Wednesday and the talk inside the Fed revolved around inflation, or lack thereof, and where [committee members stood](#) in terms of getting ahead of the curve. Minneapolis Fed President Neel Kashkari remained the lone dissenter for hiking rates as [Core PCE](#) has fallen well below the 2% target.

Core PCE, 1-, 3-, and 12-Month Change



Data via FRED * Chart created: 07/04/2017 10:09

Stillwater View: These are indeed very interesting times for Janet Yellen and the Federal Reserve. The probability of landing higher rates and balance sheet normalization without something going bump in the night are slim.

The Bottom-Up

Most companies are currently in the quiet period before earnings. Single stock and sector volatility will pick up mid-month when second quarter results are reported.

In her expose [“Wells Fargo’s Cheating Heart”](#), *Vanity Fair’s* Bethany McLean provides an in depth look at the scandal that is unfolding inside the company. As she points out, the bank was previously the envy of the financial services industry. Emerging from the global financial crisis relatively unscathed until the drive to cross sell products turned branches into boiler rooms.

Stillwater View: The brand damage, not to mention litigation risk, Wells Fargo faces will not quickly go away. Combine that with the exposure the company has to auto loans and the premium paid to book value versus peers Citigroup and Bank of America, and it’s difficult to see how the stock outperforms.

As we have rounded the halfway point for the year it’s time to look at what sectors have led, technology and healthcare, and what lagged, energy and telecom services. Stepping back and viewing a ten-year period reveals a noisy pattern, if you can call it a pattern. It supports the argument that playing the sector tilt game is a fundamentally difficult proposition. S&P 500 quilt courtesy of [Novel Investors](#).

S&P 500 Sector Performance

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	1H '17
ENRS 34.4%	CONS -15.4%	INFT 61.7%	REAL 32.3%	UTIL 19.9%	FINL 28.8%	COND 43.1%	REAL 30.2%	COND 10.1%	ENRS 27.4%	INFT 17.2%
MATR 22.5%	HLTH -22.8%	MATR 48.6%	COND 27.7%	CONS 14.0%	COND 23.9%	HLTH 41.5%	UTIL 29.0%	HLTH 6.9%	TELS 23.5%	HLTH 16.1%
UTIL 19.4%	UTIL -29.0%	COND 41.3%	INDU 26.7%	HLTH 12.7%	REAL 12.7%	INDU 40.7%	HLTH 25.3%	CONS 6.6%	FINL 22.8%	COND 11.0%
INFT 16.3%	TELS -30.5%	REAL 27.1%	MATR 22.2%	REAL 11.4%	TELS 18.3%	FINL 35.6%	INFT 20.1%	INFT 5.9%	INDU 18.9%	INDU 9.5%
CONS 14.2%	COND -33.5%	S&P 26.5%	ENRS 20.5%	TELS 6.3%	HLTH 17.9%	S&P 32.4%	CONS 16.0%	REAL 4.7%	MATR 16.7%	S&P 9.3%
INDU 12.0%	ENRS -34.9%	INDU 20.9%	TELS 19.0%	COND 6.1%	S&P 16.0%	INFT 28.4%	FINL 15.2%	TELS 3.4%	UTIL 16.3%	MATR 9.2%
TELS 11.9%	S&P -37.0%	HLTH 19.7%	S&P 15.1%	ENRS 4.7%	INDU 15.4%	CONS 26.1%	S&P 13.7%	S&P 1.4%	INFT 13.9%	UTIL 8.8%
HLTH 7.2%	INDU -39.9%	FINL 17.2%	CONS 14.1%	INFT 2.4%	MATR 15.0%	MATR 25.6%	INDU 9.8%	FINL -1.5%	S&P 12.0%	CONS 8.0%
S&P 5.5%	REAL -42.3%	CONS 14.9%	FINL 12.1%	S&P 2.1%	INFT 14.8%	ENRS 25.1%	COND 9.7%	INDU -2.5%	COND 6.0%	FINL 6.9%
COND -13.2%	INFT -43.1%	ENRS 13.8%	INFT 10.2%	INDU -0.6%	CONS 10.8%	UTIL 13.2%	MATR 6.9%	UTIL -4.8%	CONS 5.4%	REAL 6.4%
REAL -17.9%	MATR -45.7%	UTIL 11.9%	UTIL 5.5%	MATR -9.6%	ENRS 4.6%	TELS 11.5%	TELS 3.0%	MATR -8.4%	REAL 3.4%	TELS -10.7%
FINL -18.6%	FINL -55.3%	TELS 8.9%	HLTH 2.9%	FINL -17.1%	UTIL 1.3%	REAL 1.6%	ENRS -7.8%	ENRS -21.1%	HLTH -2.7%	ENRS -12.6%

Stillwater View: Pay as little as necessary for broad market exposure (Beta) and reserve dry powder for alternatives that can outperform (Alpha) or zig when the market zags (Hedge).

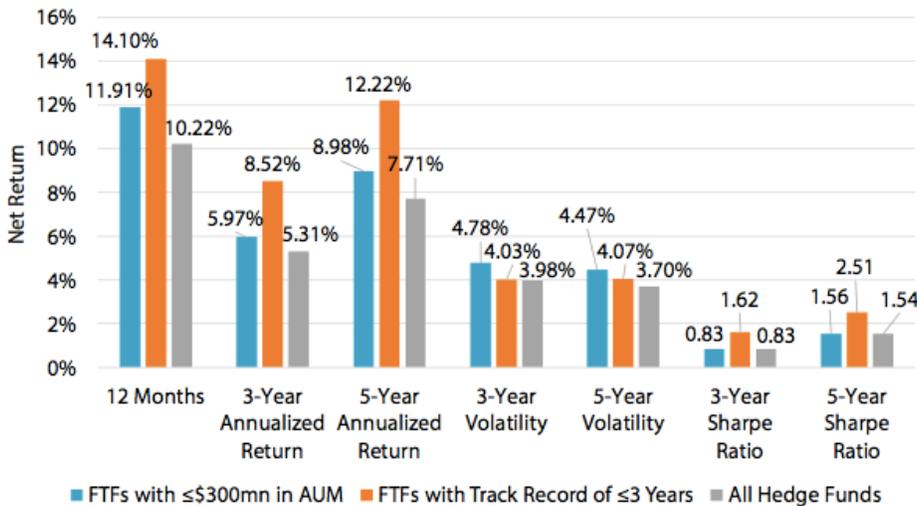
Up and Down Wall Street

Pimco's [Income Fund](#) continues to see a flood of inflows this year as investor appetite for risk wanes. The fund has brought in \$15 billion in assets in the second quarter, growing to \$89 billion. The firm has been beating the "risk reduction" drum aggressively this year. *Bloomberg* profiles the very frugal CIO of Global Credit, [Mark Kiesel](#).

David Einhorn's Greenlight Capital has been [struggling of late](#), though a little less so after a positive 1.0% return in June. The fund is down 2.3% year to date through the end of the second quarter. The 20% correction in Tesla over the past seven trading sessions certainly has helped as the fund was short the shares. On Wednesday Goldman Sachs analyst David Tamberrino predicted a [50% fall in value](#) for the company. Volvo is [going all-electric](#) starting in 2019. Let the full-scale hybrid war begin.

Alternative asset data provider Prequin reports in their [June 2017 Hedge Fund Spotlight](#) that emerging hedge fund managers [tend to outperform](#) their more established counterparts, especially in the first three to five years of operation.

Fig. 1: Performance of First-Time Funds vs. All Hedge Funds (As at May 2017)



Source: Prequin Hedge Fund Online

Stillwater View: The term "emerging manager" can be deceiving. Many firms, Stillwater Capital included, have experience managing hedged strategies within larger organizations and have ventured out independently. The phrase "re-emerging" is probably more appropriate and better defines the skillset brought to the table. Stillwater has further advanced the cause by removing the structural challenges of high fees, illiquidity and a lack of transparency that are headwinds for the industry.

Diversions

The much-anticipated [Earth Live](#) will air this Sunday at 8:00 EST/5:00 PST. This will be *National Geographic's* attempt to marry live animals with live television. What could go wrong?

Summer is here and that means loading up the whole tribe in the [Wagon Queen](#) for that great American tradition, the road trip. Ken Burns' [National Parks, Americas Best Idea](#) provides inspiration to visit one.

Stillwater View: I had the good fortune of serving on the [Yellowstone Park Foundation](#) advisory board. Advice on where to see the semi-reclusive wildlife or which river to drop a fly-line into available upon request.

Architect [Frank Lloyd Wright turns 150](#) this year and the milestone is being celebrated in the places he influenced. The Museum of Modern Art in New York is hosting [Frank Lloyd Wright at 150: Unpacking the Archives](#). *The New York Times* reflects on how [Wright hated the city](#) and originally wanted to paint the Guggenheim pink. *The Los Angeles Times* highlights his [Mayan inspired work](#) in Southern California. [Architectural Tours L.A.](#) is offering a special program to view the structures that bear his mark. The Millard House, Pasadena.



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