

STILLWATER CAPITAL

THIS WEEK IN THE MARKETS

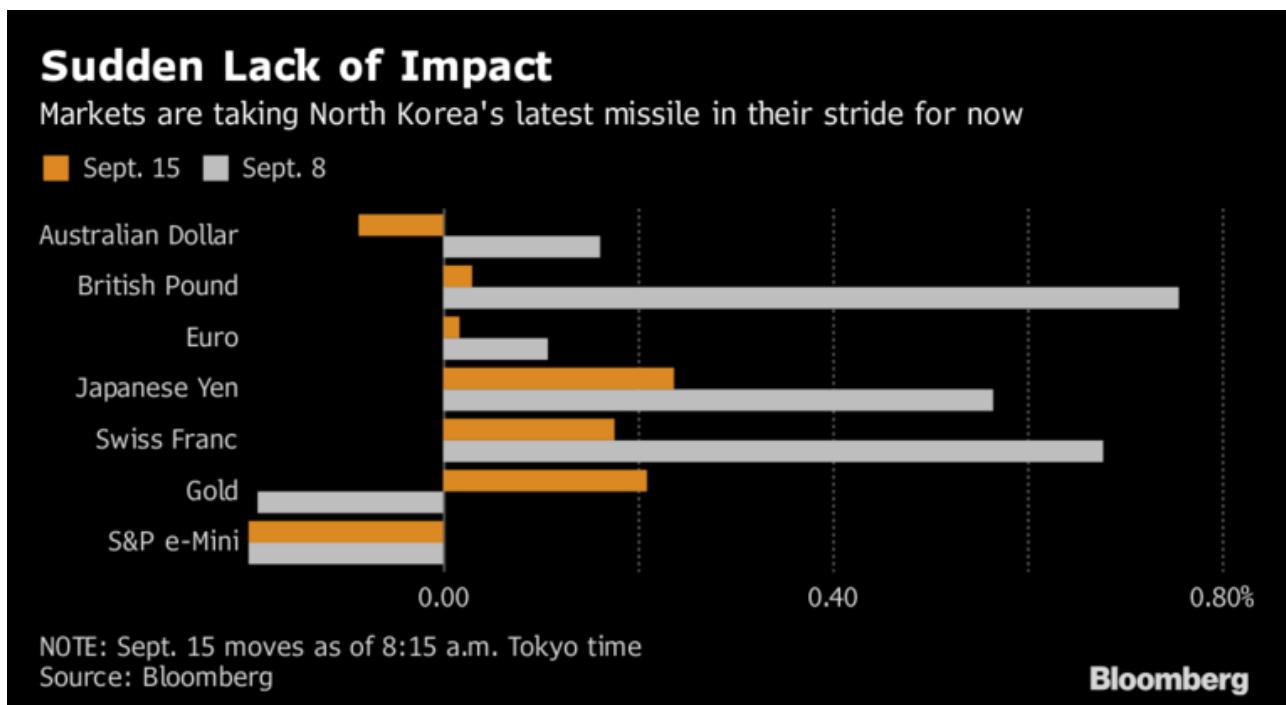


September 15th, 2017

The Top-Down

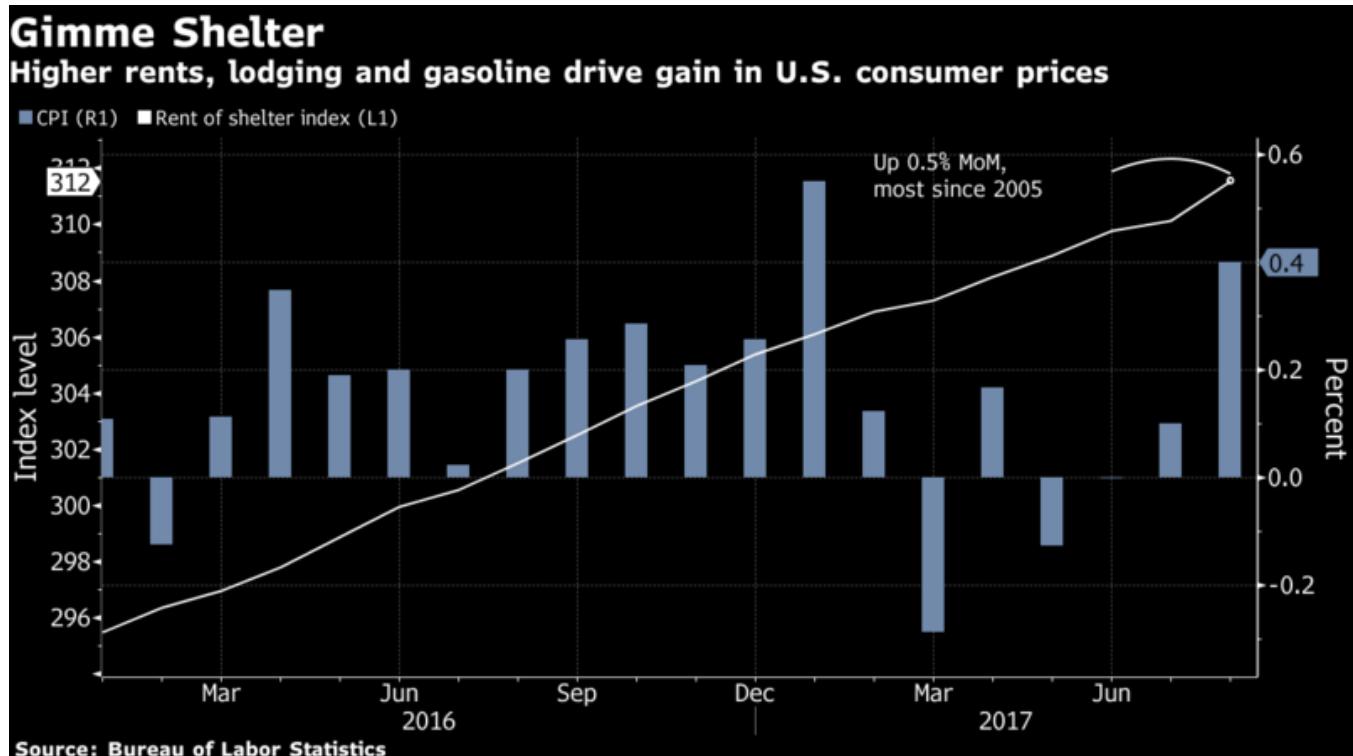
While much of the Caribbean suffered heavy damage from Irma, South Florida avoided a direct hit. The twenty mile move west by the storm reduced the estimated damage by more than [\\$150 billion](#). Hurricane Irma [in pictures](#).

Last night, North Korea fired a [ballistic missile](#) over Northern Japan. The second such launch in as many months. Asian shares were unchanged on the news. *Bloomberg* points out that markets are now suffering "[missile fatigue](#)" and are no longer reacting to the news.



The only economic release of note this week was the [August Consumer Price Index](#). Increases in gas and rent were the main drivers of the 0.4% gain. This was higher than the 0.2% Wall Street was

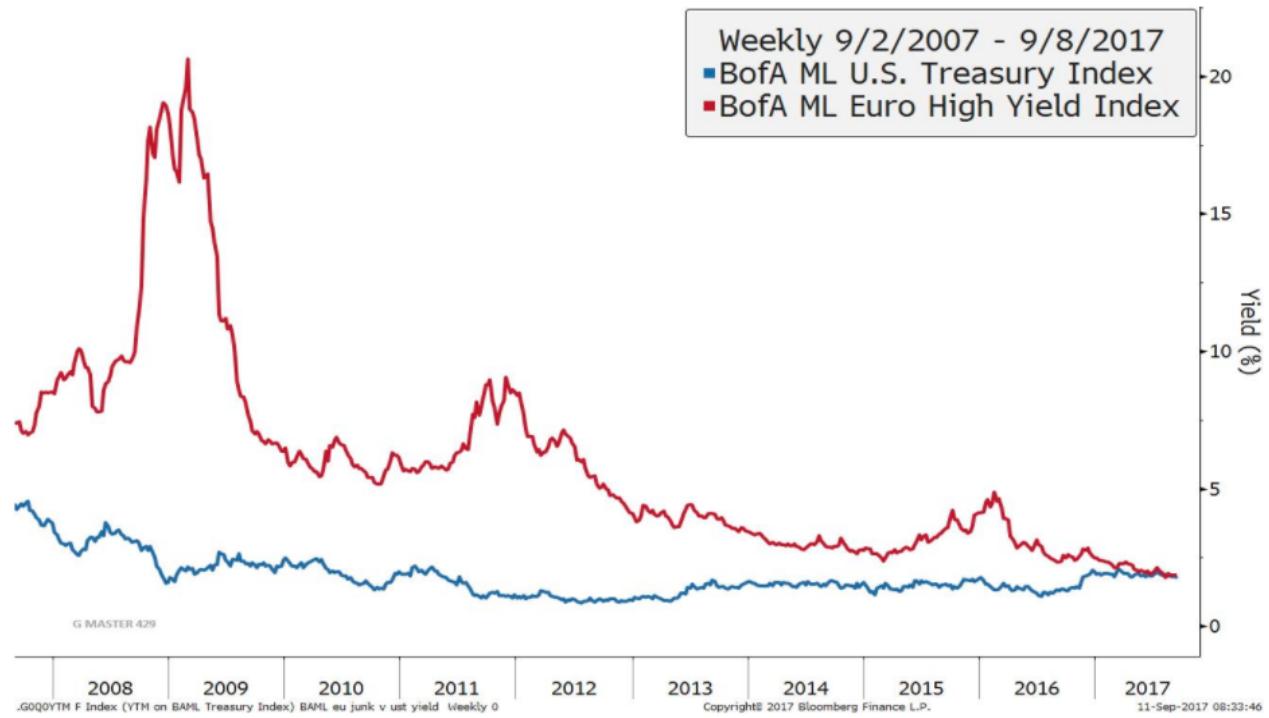
expecting and is the first meaningful rise in six months. This added a small amount of fuel to the rate hike fire. The market is still pricing in [one more increase](#) for 2017.



DoubleLine hosted a call with founder Jeff Gundlach on Tuesday to review the performance of several of the firm's fixed income strategies. This call lacked the fireworks of some of his past commentaries, but contained plenty for the markets to consider. Of Bitcoin he said, "I'm going to let this mania go on without me." Presentation summary and slides courtesy of [Business Insider](#).

Mr. Gundlach sees nothing in credit spreads to indicate we are headed for a recession in the next six to twelve months. On the contrary, the pricing of risk is completely missing in some places. Part of his "wacko season" theme is the fact that European high yield debt is paying the same as U.S. Treasuries.

Euro Junk Rally Pushes Yields Below U.S. Treasuries



Source: Bloomberg

BofA Merrill Lynch US Treasury Index (GOQO) - The Merrill Lynch US Treasury Index tracks the performance of US dollar denominated sovereign debt publicly issued by the US government in its domestic market. Qualifying securities must have at least one year remaining term to final maturity, a fixed coupon schedule and a minimum amount outstanding of \$1 billion. **BofA Merrill Lynch Euro High Yield Index (HEO0)** tracks performance of EURO denominated below investment grade corporate debt publicly issued in the euro domestic and Eurobond markets. Please see index definitions in the appendix. You cannot invest directly in an index.

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The Bottom-Up

The data breach at [Equifax](#) is an unmitigated disaster for the company, losing 40% in market value since the hack. Senator Warren is [circling](#). NPR reports that consumers are [on their own](#).

The equity market is quietly moving on from the retail bear market narrative as most companies in the industry are no longer reacting to negative headlines. Nordstrom is close to hiring private equity firm [Leonard Green](#) to find a buyer to take the company private.

The shares of Class B mall REIT's CBL Group ([CBL](#)) and Washington Prime ([WPG](#)) bottomed in May and have been slowly trading higher ever since. Both are throwing off yields north of 12%. Shares of grocery chain [Kroger](#) on the other hand are not out of the woods yet.

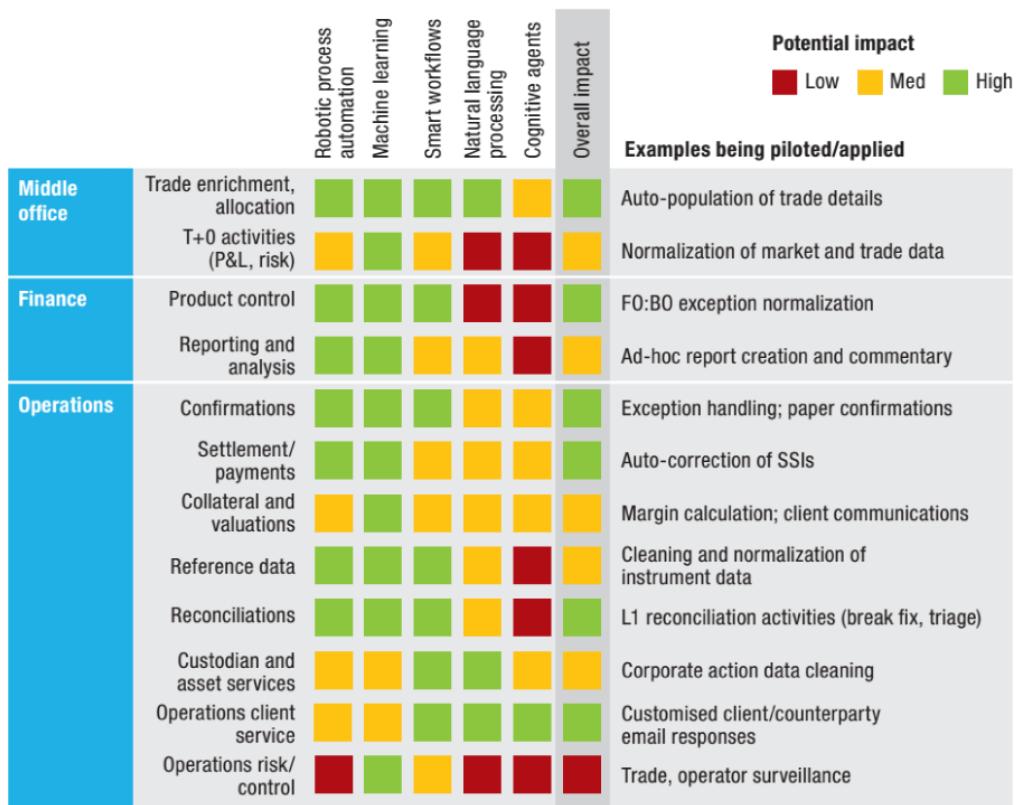
The iPhone 8 and iPhone X were introduced by Apple this week with features we didn't even know we needed. The [New York Times](#) provides the review of how the company sells us a [better vision of ourselves](#). *Bloomberg View* columnist Leonard Bershadsky shared his opinion that the [future of the iPhone is boring](#) as the incremental improvements are becoming less and less valuable. A decade ago Steve Jobs presented the [original iPhone](#) to an unsuspecting world.



Up and Down Wall Street

The tough times for employment on Wall Street were highlighted again this week as Citigroup's former CEO [Vikram Pandit](#) shared his thoughts on technology and artificial intelligence. He believes 30% of bank jobs may disappear in the next five years. While mostly operational, the trends are certainly not favorable for those looking for a long career on the Street. This chart from McKinsey shows who should be concerned. Nice to see that risk managers appear safe.

EFFECTS OF AUTOMATION ON WALL STREET



Source: McKinsey & Company

SOURCE: McKinsey

BUSINESS INSIDER

CNBC's annual Delivering Alpha conference took place on Tuesday. Former and current top-of-the food-chain money managers were out in force. Omega's [Lee Cooperman](#) thinks a correction of 5-8 percent can start anytime soon. [Boaz Weinstein](#) recommended avoiding junk bonds, especially those of retailers. [Jim Chanos](#) is short Tesla and U.S. shale driller Continental Resources. [Julian Robertson](#) said that "we are creating a bubble" in stocks. Full recap of [Delivering Alpha](#).



As cryptocurrencies continue to take up a larger amount of the market's bandwidth, some prominent members of the Wall Street community are taking very public shots at it. This week J.P. Morgan CEO Jamie Dimon called Bitcoin a "[fraud](#)" and said that his daughter made some money trading it and now thinks she's a genius. Defenders were quick to [call him out](#), accusing Jamie of defending his banker turf.

Some view the long side of Bitcoin as the [most crowded](#) trade in the world. Allianz's [Mohamed El-Erian](#) believes the currency should be valued at half the current price. Former host and current CNBC contributor [Ron Insana](#) piled on saying that Bitcoin was in a bubble that was guaranteed to crash. Social Capital's founder [Chamath Palihapitiya](#) and cyber security entrepreneur [John McAfee](#) are both in on the long trade. On Wednesday, the market handed Mr. Palihapitiya [\\$600 million](#) and free reign for him to do with it what he wants in a rare "[blank check](#)" IPO.

Most Crowded Trade? Bitcoin enthusiasts remain undeterred



While cryptocurrencies can be conceptually difficult to grasp, [Goldman Sachs](#) counseled clients to manage their skepticism appropriately as real dollars are being put to work and the subject deserves proper attention. For those interested in venturing down the digital rabbit hole Stillwater Capital provides Crypto 101. A primer on cryptocurrencies, blockchain and initial coin offerings.

Cryptocurrencies – The name crypto derives itself from cryptography, the process of taking legible information and converting it into secure code. The currency itself is nothing more than an unregulated digital creation that can be used for secure payment or speculation. Bitcoin, the first cryptocurrency, was introduced in 2009 and has become the largest by market capitalization at roughly \$45 billion. All cryptocurrencies lack a central authority or backing by governments. However, they have the convenience of low transaction costs, anonymity, and no need to open a traditional bank account to send and receive payment.

Stillwater searched high and low for a tutorial that could help advance the cause of understanding cryptocurrency and “[Ever wonder how Bitcoin \(and other cryptocurrencies\) actually work?](#)” is the best we could find. The spa music in the background certainly helped to create the mental calm necessary to process the explanation of the “cryptographic hash function”.



The increase in the number of coins and the velocity of cryptocurrency transactions is increasing at such a rate that coin farms are cropping up in some unusual places. Like the one [profiled](#) by the *New York Times* in Dallad Banner, Mongolia. Owned by Bitmain, this row of low slung industrial buildings is where 5% of the worlds cryptocurrencies are mined.

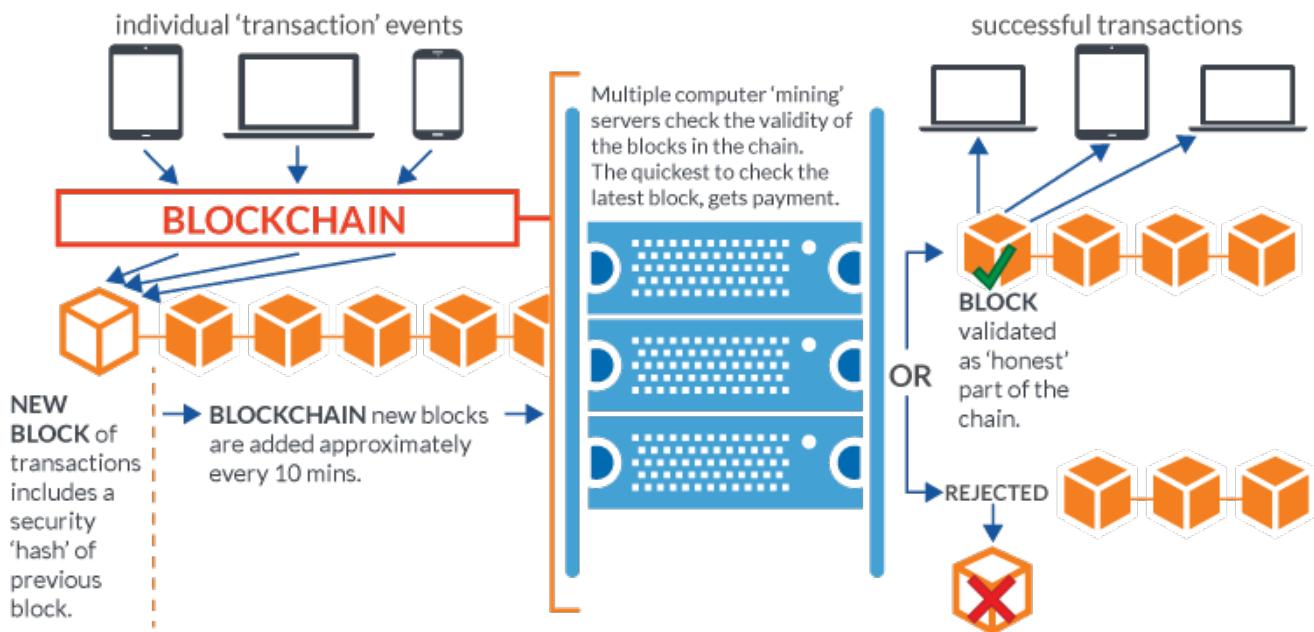


Blockchain – A blockchain is a series of digital records that grows as new transactions, or blocks, are added to the list of previous transactions. A very basic blockchain could show the sales history of a property and would include information like title holder, close date, price, and buyer and seller. This type of series would be easy to validate and require little in the way of processing power due to the limited data points and the long duration between entries.

Blockchains that track, validate and enable crypto currency transactions are the opposite. Here millions of chains of data are validated second by second to ensure the currency has not been corrupted and the transaction history is valid.

The applications for blockchain are vast. So much so that even if cryptocurrencies fade, blockchain will [remain relevant](#), providing transparency to every imaginable transaction series. To paraphrase Jamie Dimon as *Fortune* did, [Bitcoin Bad, Blockchain Good](#).

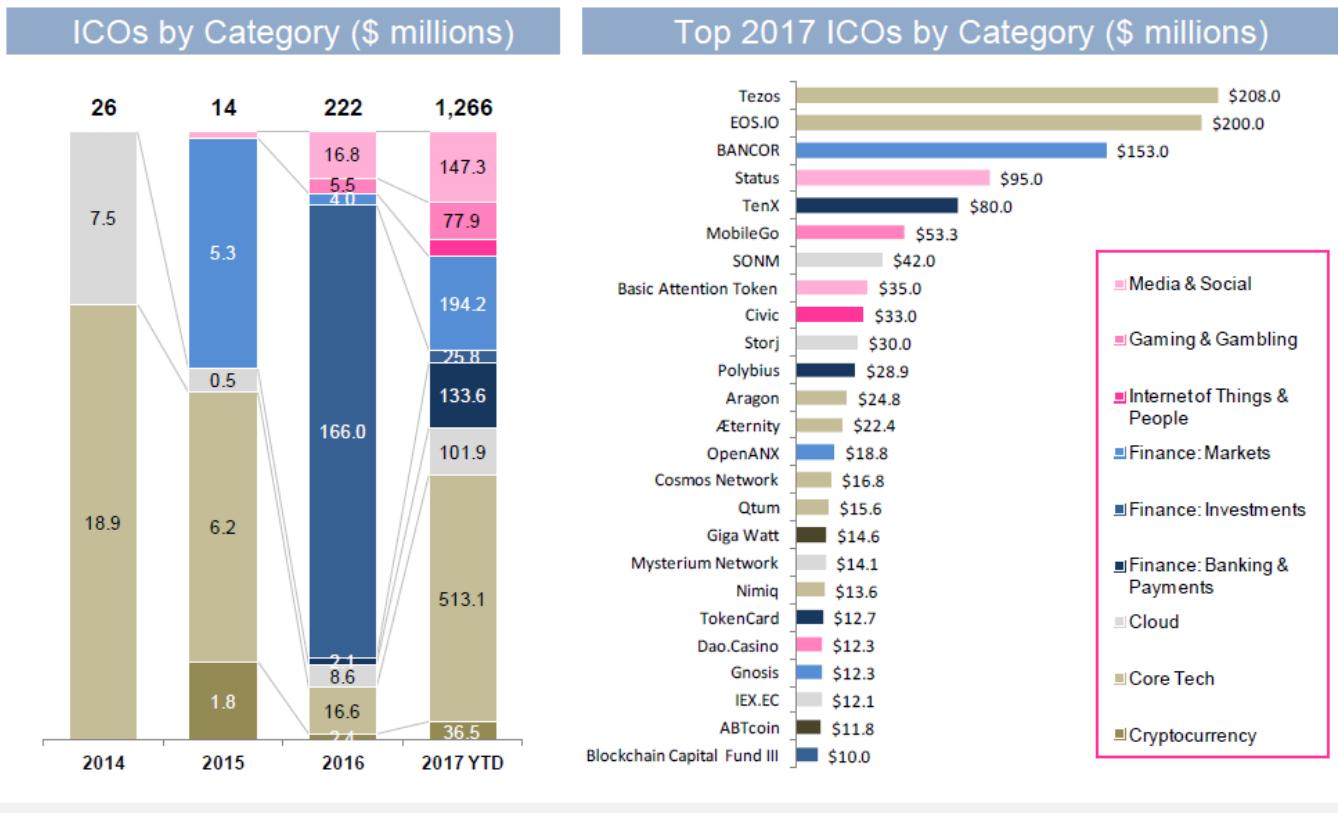
How blockchains record “transaction” events and validate the data series.



Initial Coin Offerings – An [ICO](#) is similar to crowdfunding and is a way for crypto related companies to issue currency and raise capital. Unlike a traditional initial public offering, the ICO [does not require registration](#) or extensive business risk disclosures. Instead, it simply requires a white paper description of the business. And [therein lies the risk](#) as described by the highly regarded digital currency observer and professor [Andreas Antonopoulos](#).

Paris Hilton and boxer Floyd Mayweather are getting in on the act, lending their names to [celebrity endorsed ICOs](#). Attention to the subject ramped up earlier this month when Chinese authorities [banned the practice](#) and our own SEC is [getting more vocal](#) in their attempt to [warn investors of the risk](#).

Autonomous NEXT research analysis of the \$1.25 billion raised via Initial Coin Offerings (ICO) in the first six months of 2017. Assets raised by crypto category on the left and by company on the right.



Source: Autonomous NEXT analysis

Stillwater View: As Goldman appropriately pointed out, ignore the subject of cryptocurrencies and blockchain at your own risk. Keeping in mind that the former may be this decade's signature bubble moment and the latter is real and has vast applications. Blockchain will be the focus of countless white papers and most certainly a new crop of freshly minted startups looking to be the next "Google/Uber/Facebook/Netflix of blockchain".

Stillwater is currently short the shares of Advanced Micro Devices on the belief that there is significant near term headline risk to cryptocurrencies. A perennial also ran to Intel, AMD found new life as the processing engine behind many crypto mining operations.

Diversions

There is a bull market in “essence” flavored seltzer water and you need to look no further than the ubiquitous cans of [LaCroix](#) as proof. Founded in 1981 in LaCrosse, Wisconsin the company was acquired by [National Beverage Co.](#) in 1992 for \$25 million and rebranded with the [unorthodox label](#) it has today.

The [Wall Street Journal](#) tried to get to the bottom of what makes it so special, with little success except to say those devoted to it really don’t care. None of which is lost on Wall Street as shares of National Beverage (FIZZ) have traded from \$51 at the start of the year to a closing price of \$120 yesterday.



No sooner had *Diversions* complimented the L.A. Dodgers on “playing some good baseball of late” did they decide to embark on an epic [12-game losing streak](#). Should they right the ship and manage to win the World Series they would set the mark for the team with the longest set of losses in a season to still win it all.

In other baseball related news, the Cleveland Indians are indeed “playing some good baseball of late” as well. Breaking the major-league record for consecutive wins with a ten inning [3-2 victory](#) over the Kansas City Royals last night. It was the team’s [22nd victory](#) in a row.

*Stillwater View: We apologize in advance to any Cleveland fans who believe comments made in this firm’s *Diversions* section about the quality of recent play may somehow cast a future shadow over the team.*



The college football game of the week is once again at the Los Angeles Memorial Coliseum where the [USC Trojans will host the Texas Longhorns](#) on Saturday night. This will be the first matchup of the two teams since the 2006 national championship game where Texas prevailed.

Described by many as the [greatest game ever played](#), it featured two [Heisman Trophy](#) winners, one [runner-up](#), a failed [fourth and short](#) and one legendary [run to the corner](#) of the end zone by Vince Young. All called by the indisputable voice of college football, [Keith Jackson](#), in his final broadcast.



Memories of the game and the impact it would have on the players on and off the field were recounted this week by the *Los Angeles Times* in “USC-Texas Revisited”.

- Why soldier [Travis Toei](#) kept his football career a secret.
- A look at the [little plays](#) that set up the game-changers.
- [Vince Young](#) was scary good in 2006 Rose Bowl, but he was also a little scared.
- LenDale White and what happened after [fourth-and-two](#).



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