The Economy

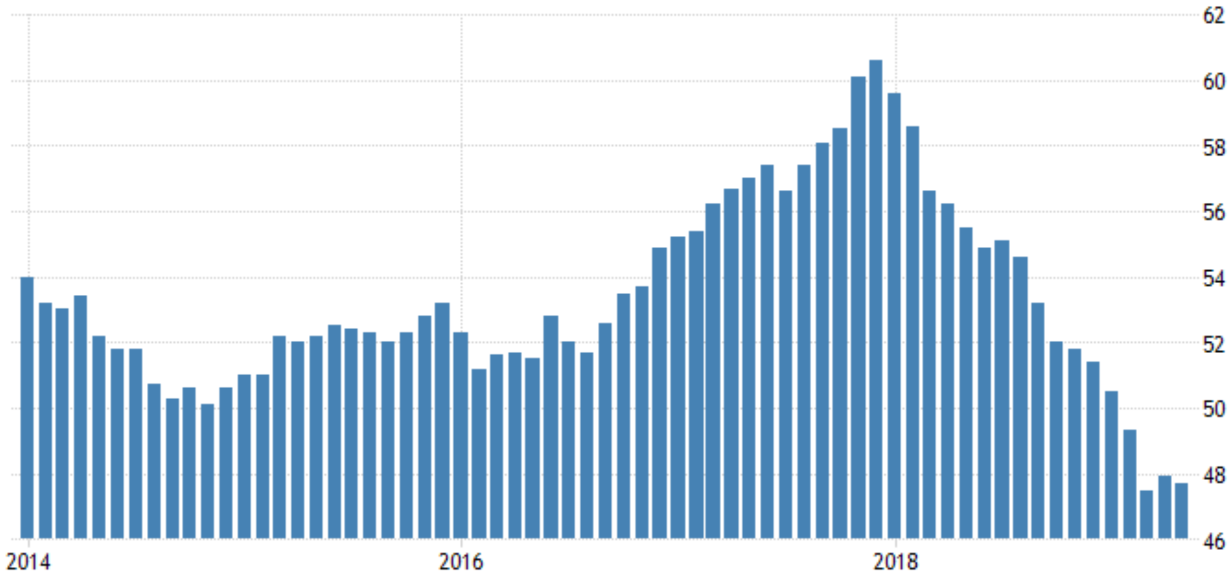
This week in the economy and markets sections, there are eight charts. Seven of them show readings down and to the right, which means bad things for the economy. The eighth is an up and to the right, it's the S&P 500. This rally in stocks and bonds is one massive macro trade that is not based on an economy on fire and great earnings. Central banks have caved, risk is fully on, the IPO market is white hot, and Trump is about to deliver a deal with China. Confused? Don't worry, you're not alone.

Help Me!!!

Source: Live Science

Between the Federal Reserve and the European Central Bank, it's beginning to feel like quantitative easing nirvana all over again. On Monday, ECB Chairman Mario Draghi tipped his hat that they would once again, use 'all measures necessary' to reflate the Eurozone economies.

European Manufacturing



In announcing his intentions, Draghi said, "If the crisis has shown anything, it is that we will use all the flexibility within our mandate to fulfill our mandate. And we will do so again to answer any challenges to price stability in the future." Trades that benefit from this easy money policy are already working. Which in turn, had President Trump on the "fair is fair" currency warpath.

**Donald J. Trump**Verified account @realDonaldTrump
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Mario Draghi just announced more stimulus could come, which immediately dropped the Euro against the Dollar, making it unfairly easier for them to compete against the USA. They have been getting away with this for years, along with China and others.

3:53 AM - 18 Jun 2019

Meanwhile, back here in the good old United States of America, the Federal Reserve met and told the markets what it wanted to hear. That is, you can expect 25 basis points coming in the near term, and then not much more unless the wheels start to get wobbly.

Shortly after the meeting this week, the well-respected chief economist at Goldman Sachs, Jan Hatzius, changed his tune and said that not only were two rate cuts on the table this year, in addition the Fed might as well get it over with and cut 50 basis points in July too. While the background noise is decidedly mixed, yields on government bonds are screaming cut.

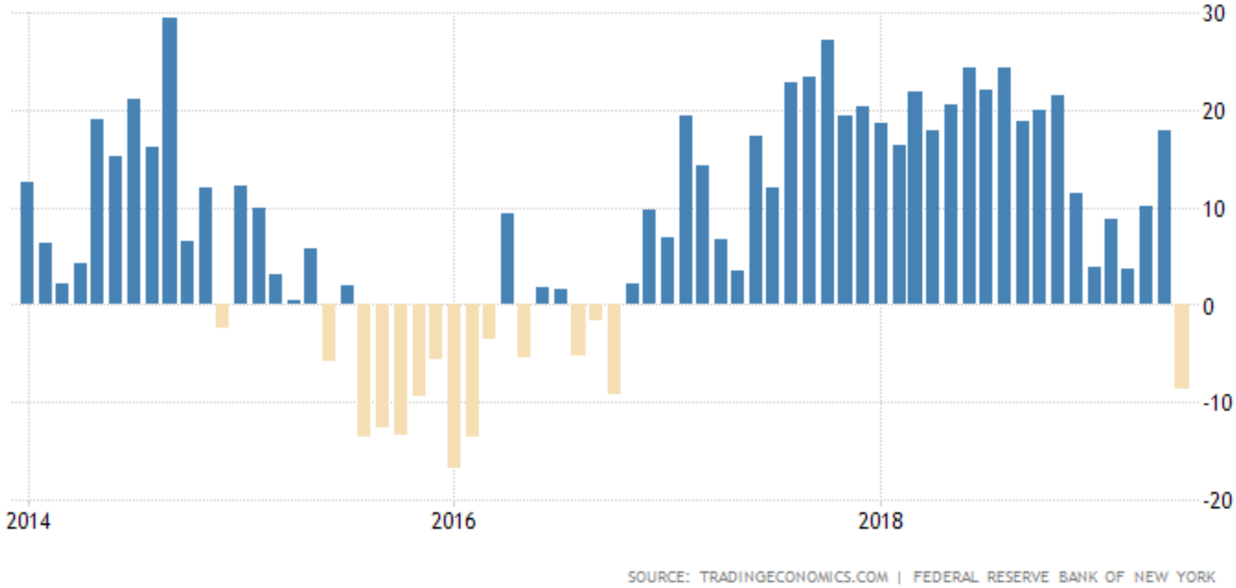
10-Year Treasury Yields

Bloomberg ran an article this week with the headline, 'Markets are acting like a recession is unavoidable', which included four charts showing a dramatic fall off in several key indicators, including trucking, industrial metal prices, and certain manufacturing indexes. Couple that with European inflation expectations, and there is little wonder why QE and a Zero Interest Rate Policy (ZIRP) is now firmly back on the main stage.

Look Out Below

The New York Empire State Manufacturing Index fell off the side of the table, dropping 26 points versus expectations of being in the black by 10. While this is a regionalized reading, it does get added to the list of concerns. The last time it slipped was in late 2015, into 2016, and it was not the only indicator that was flashing yellow. Think what you will of his style, Trump generated confidence and then there was a fundamental turn in optimism shown by the business community. Perhaps four years in things have changed, but to ignore the impact it he had for the first part of his presidency would be dishonest. Ironic, right?

Empire State Manufacturing



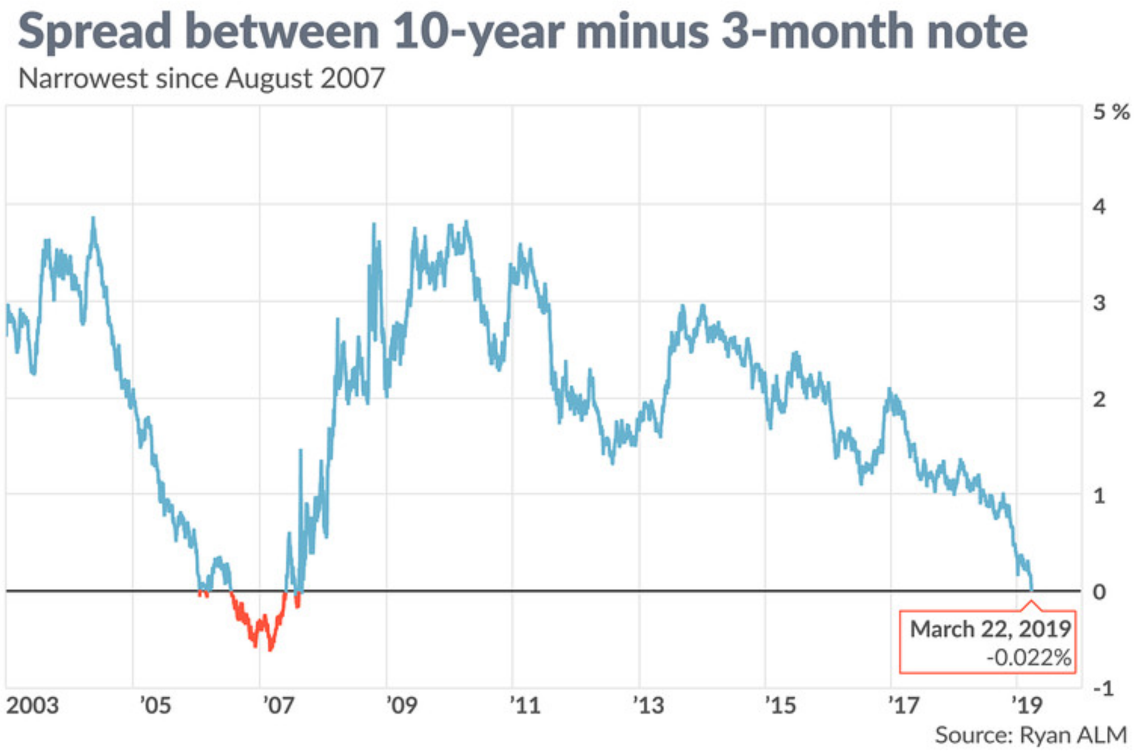
Longtime market watcher, and manager of other people's money, Barry Ritholtz, penned an opinion piece for *Bloomberg* that painted a sober picture for the next two years, and provided a game plan for how to survive the coming recession., and it doesn't entail climbing into a backyard bunker.

Is It Safe to Come Out?

Source: Bloomberg

On the sobering part, Ritholtz calls in Duke University finance professor Campbell Harvey, who has chronicled and studied every business cycle going back one hundred and thirty years. Harvey's current model is flashing all kinds of warning signs, which do not bode well for the next 24 months. The ever-animated Mr. Harvey provided his view, via YouTube, that the Four Horsemen of the Next Recession are coming around the final turn on the track. His pick to click, the dreaded inverted yield curve, which inverted on March 22nd of this year.

"We Were…Inverted."



In terms of recommending how to prepare, Ritholtz has a pretty straight forward four-point plan. Most of it falls under the umbrella of getting your affairs in order. That being said, there are some nuances as to why, which we think we can explain. In roman numeric order…

I. Clean out your portfolio. Sell risk, high yield, and any other stragglers you have picked up. If you are sitting on illiquid pieces of private equity or venture capital and want out, give us a call.

II. Pay down debt. Don't be in a position to need to de-lever when everyone else does. Do it now while it's sunny and 72 degrees.

III. Be ready to buy when stocks plunge. This one is pretty straight forward, when a panicky "bid wanted" sign goes up, be a better buyer.

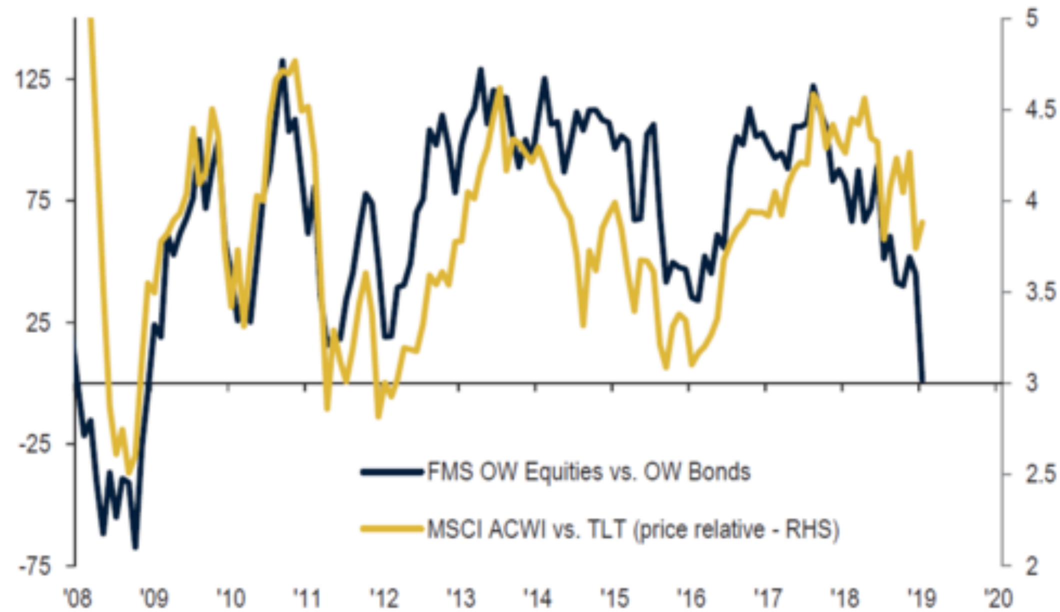
IV. Check and clean up your credit score. Nuanced, but no less important than the others. When it comes time to lever back up, you want access to the cheapest money available.

The Markets

If you are concerned about the foundation of this market, you are not alone. In the past month there has been a major drop in investor confidence and a rise in bearishness. A Merrill Lynch survey of portfolio managers shows concern over trade, global growth, and a phrase new to us, "monetary policy impotence", as the reasons for the extreme caution. The survey also revealed what we already knew, there is an implied Trump and Powell backstop should the markets experience enough weakness to push a trade deal or lower interest rates. For now, blind faith in the latter two have markets within eyesight of new highs.

Bear Trap

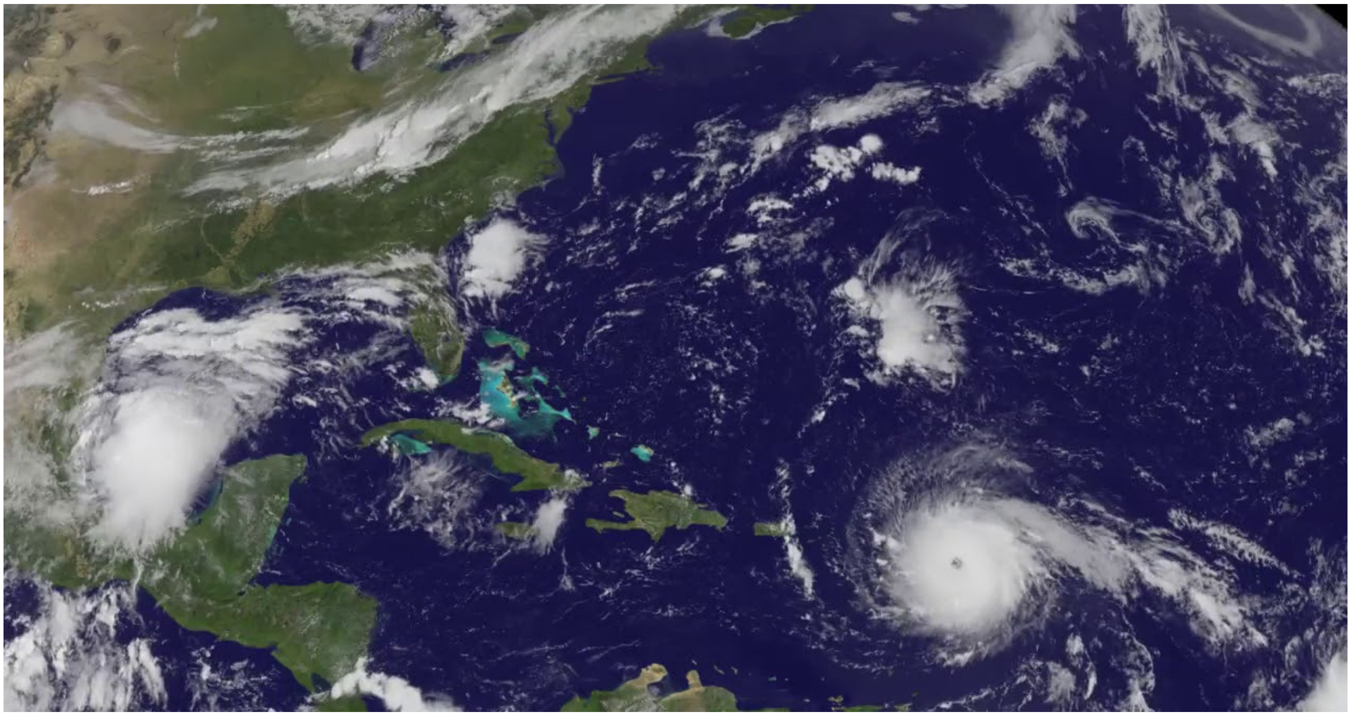
Exhibit 3: FMS asset allocation implies recessionary conditions



Source: BofA Merrill Lynch Global Fund Manager Survey

A week doesn't go by where we aren't trying to think up a new analogy to explain the economy and the markets. This week we think we have a good one. Imagine for a moment there are some decent sized tropical depressions off the southeastern coast. For now, they are only depressions and might never result in a hurricane. Although that hasn't stopped the authorities, in this case the Fed and the ECB, from issuing a warning that they see it coming on the horizon, and will pull out all the stops to make sure its impact is as minimal as possible.

Storm Clouds Approaching



Source: NASA

Because the response from Powell and Draghi has been so quick, forceful, and open ended, the markets are bidding up risk assets that would be the hardest hit if the storm turns into something real. So, think about that for a minute. Every indicator says there is something bad brewing out there on the horizon, overriding that is a market conditioned to think that QE is greater than everything else. It's akin to an already rich oceanfront property being bid higher even through there is a threat that the house could get ripped off its foundation. And insurance to cover that risk has gone to almost zero. A quandary it is.

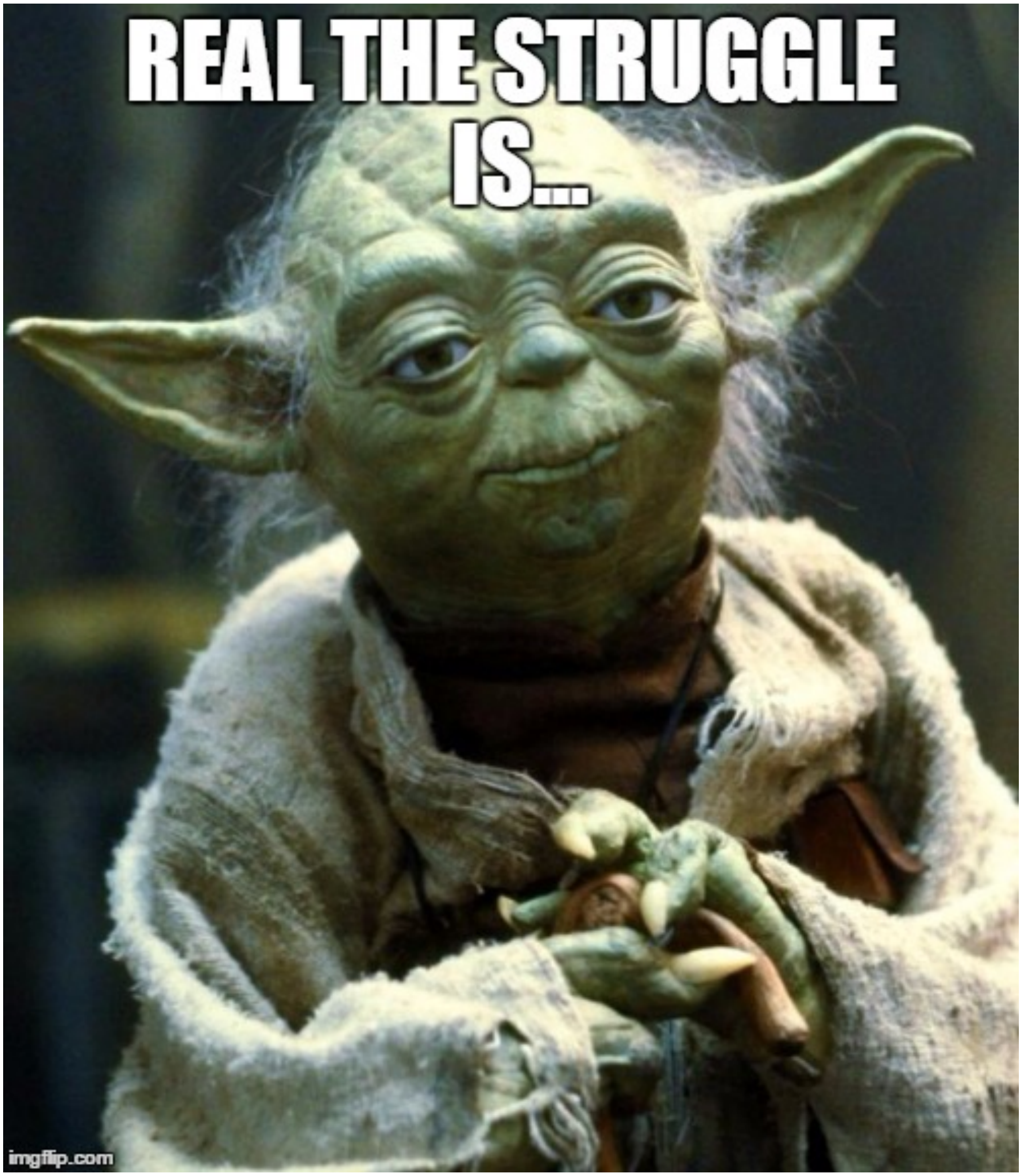
Still Standing

Source: The New York Times

The last thing we will say about the markets this week is that they continue to confound just about everyone. On the one hand you have guys like Paul Tudor Jones who say to quite simply go to the macro trading library, pull out *What to do When the Fed Cuts Rates*, and then get long as much of the market as you can. On the flip side, a growing number of hard economic indicators are flashing yellow, while bearishness and skepticism run rampant. What has us really confused is how efficient is the market these days? Our guess is far less so than you think.

S&P 500

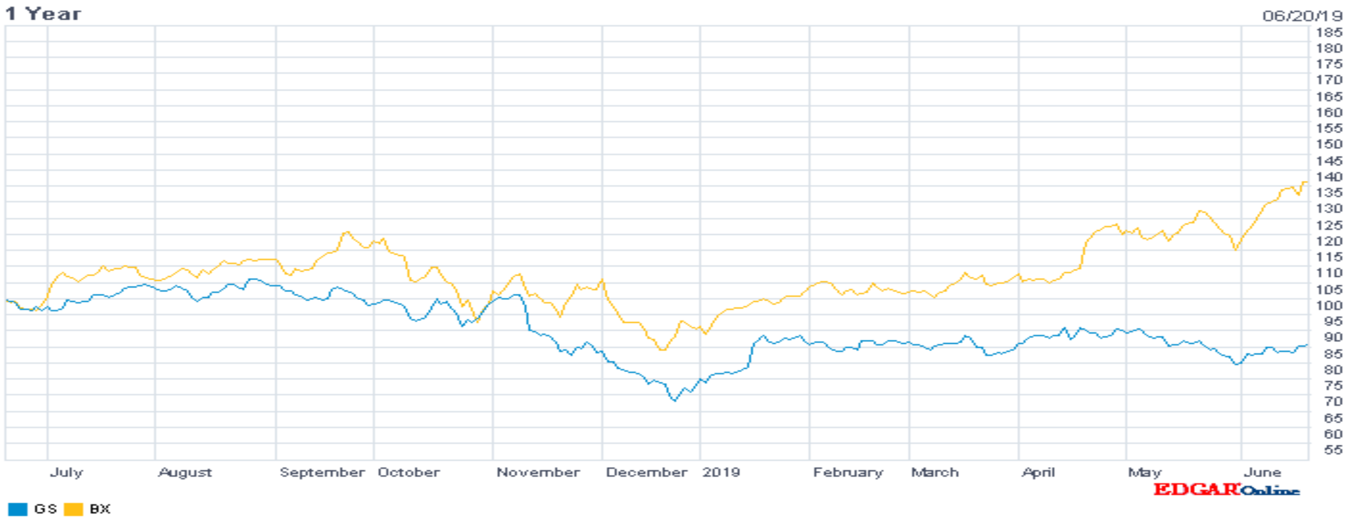
This week we received evidence that affirms this view. On Monday, President Trump tweeted that he would meet with China's President Xi at the G-20 next week, market goes up 350 points. The next day Draghi says he is all in on *QE, The Sequel*, up another 150. Then on Wednesday Powell told us exactly what the market already knew, the next rate move is a cut, up another 1%. All in that's a 4% rise off of three events that should have been pretty well telegraphed to the market. The struggle to navigate it continues, and it is very real. Or as Yoda might say…



Companies & Industries

Goldman Sachs CEO David Solomon continues to put his mark on the storied franchise, this week announcing the reorganization of several alternative investment groups that include private companies and real estate holdings, along with a basket of other hard to trade, and hard to value, assets. As the story in the Wall Street Journal highlights, to beat Blackstone, you have to look like Blackstone. The former is down 10% over the last year, the latter up 40%.

Blackstone vs. Goldman Sachs



Crypto is alive and well again, after a huge rally recently. Facebook added some extra juice this week when it announced that it would be joining the fray with its own currency to facilitate commerce amongst partners.

With the unveiling of the news Wall Street did what it does best in these situations, that is run to the highest of hills to announce to the world that this is a 'game changer'. The crypto bulls were even more obscene in the flogging of the concept. With the hype at a fever pitch, we covered our FB short position with a small loss, and will revisit it down the road. The coins name will be Libra, and *CNN Business* provides you with all you need to know.

The Libra Association

Source: CNN

The Paris Air Show review of who won what…Boeing comes up goose egg.

Up & Down Wall Street

Before we jump in the ring and start rope-a-doping hedge funds, we want to first take a shot at more traditional asset managers. This time it's Legg Mason, a position we have been short alongside Blackrock in a paired position. The *Wall Street Journal* helped us out on Tuesday with an article about how tough the model is for large hub and spoke asset managers.

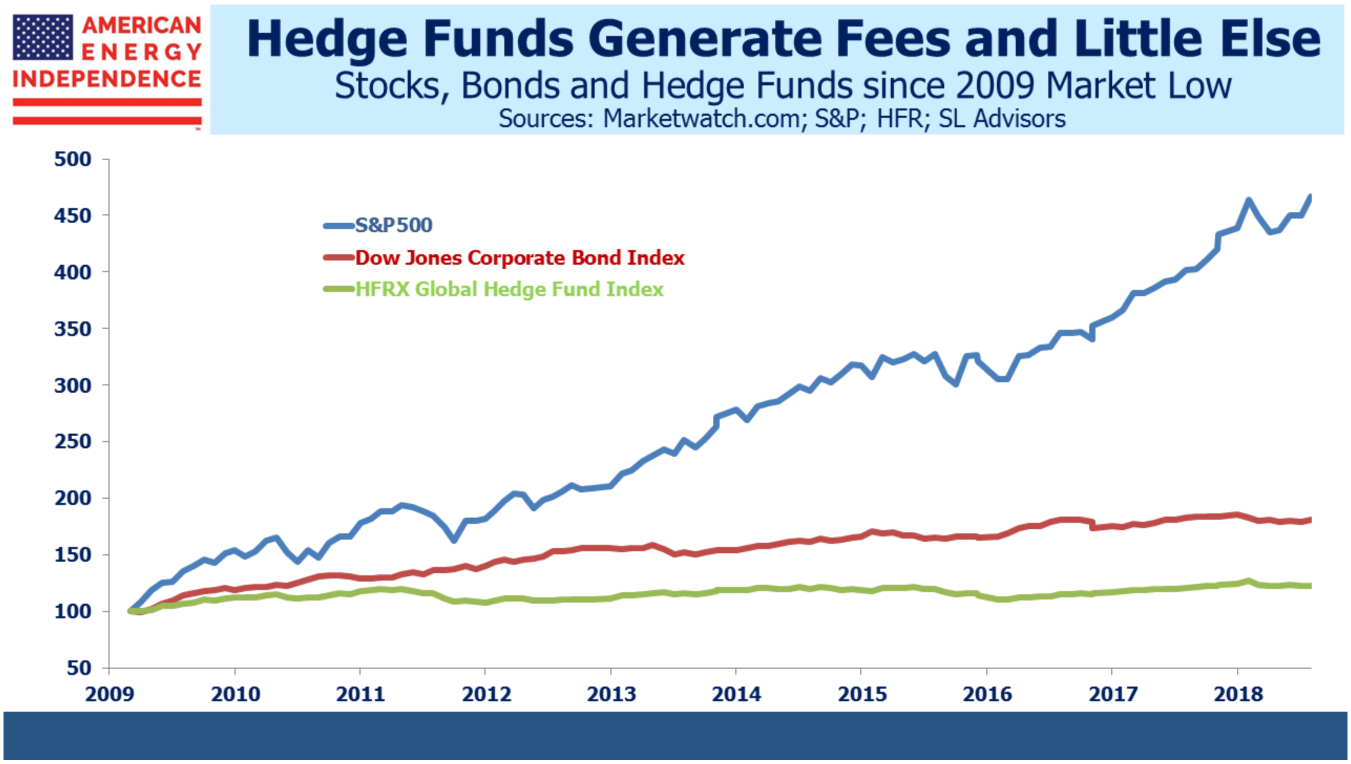
We saw this first hand when the author worked as part of Nuveen Investments, and the conglomeration of managers they strung together. While it was always supposed to be pretty on the showroom floor, inside the factory it was a completely different story.

"One piece at a time…"

Source: Pintrest

Goldman Sachs' prime brokerage division released a report on the health of the hedge fund industry this week, and while not quite terminal, the prognosis isn't good. The news should come as little surprise to those who follow the industry. The average annual returns of 4% to 6% simply doesn't justify the 2% management fee and 20% performance carry most funds employ.

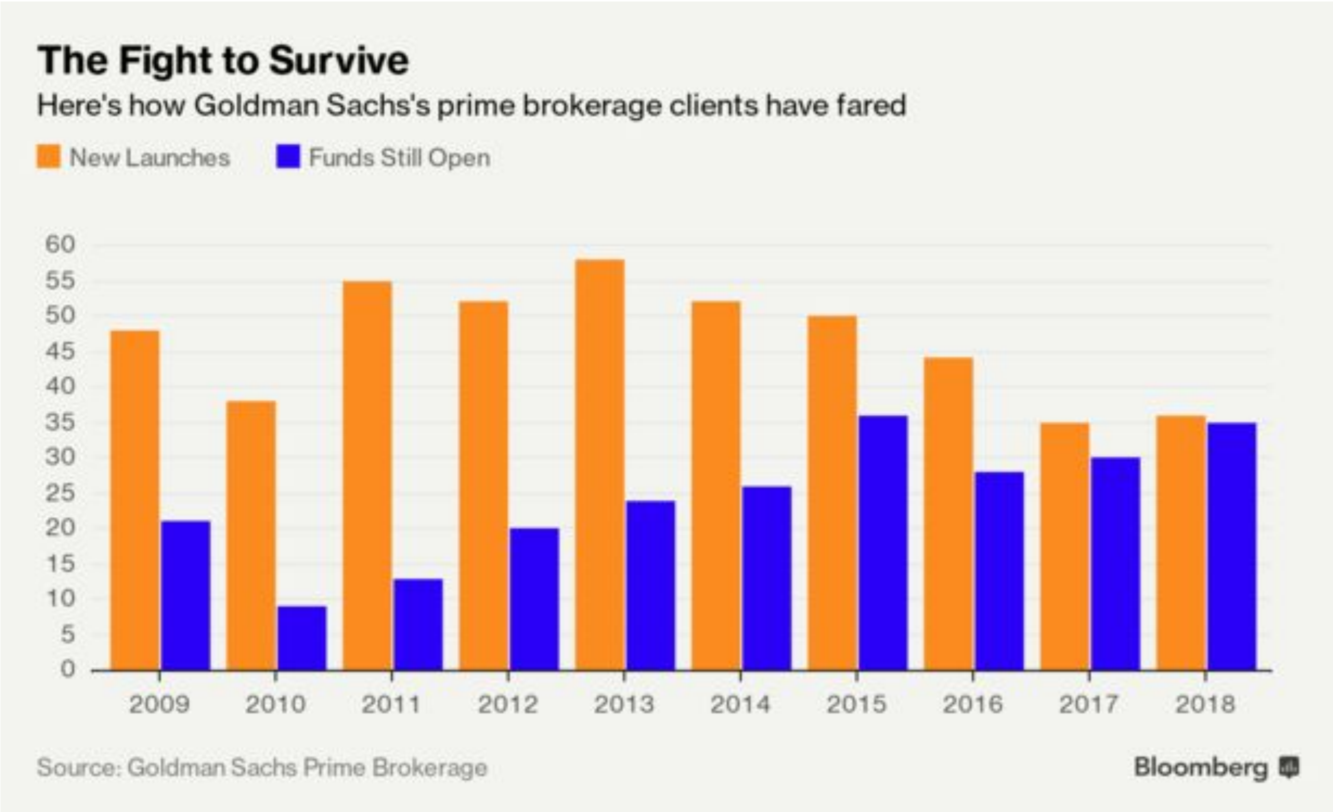
Sad, But Very True



Source: SL Advisors

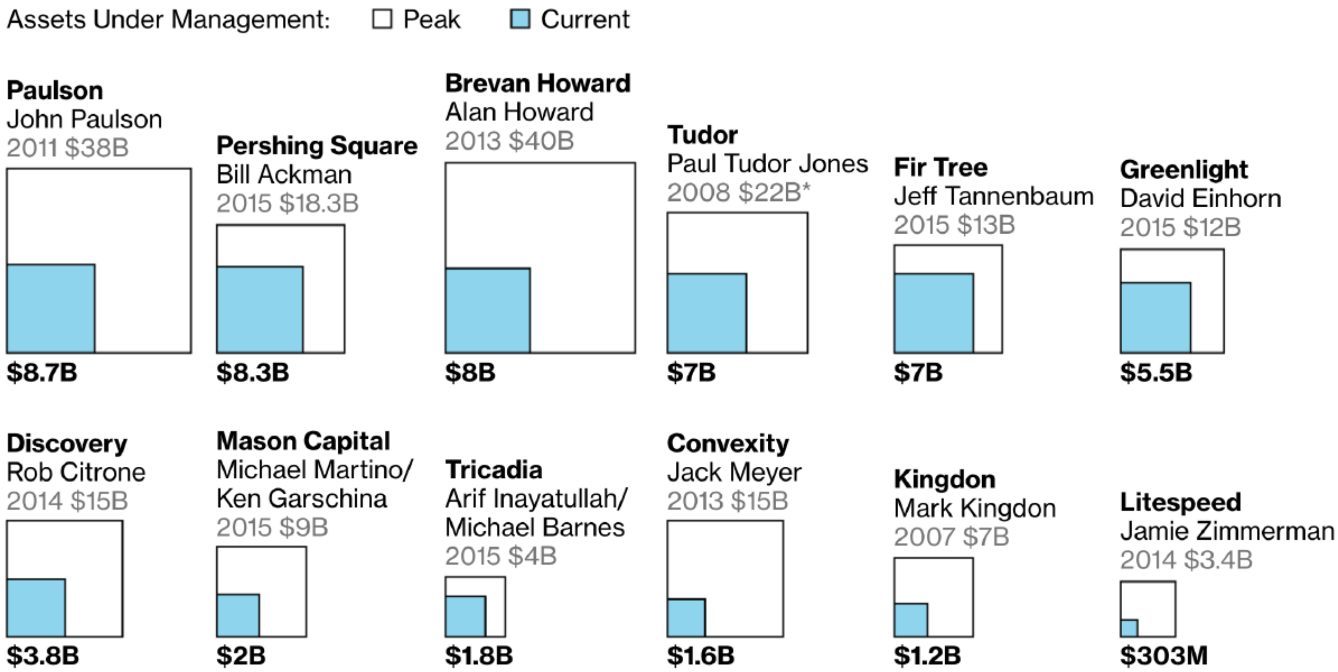
When you put these returns up against the 9% the S&P 500 has averaged, and you can get that in an ETF that is basically free, hedge funds are tough to defend. That is unless you are Bridgewater, Millennium, or Renaissance, all of which seem to never lose a dime. The report also included this chart showing the small number of funds that have survived after launching over the past ten years.

It Seemed Like a Good Idea



Keep in mind, we love it when a firm of such high repute as Goldman sends a reminder that the market for hedge funds has changed forever. This is a big driver in why Stillwater has a distinctly different approach of offering hedged based strategies with fees set at a flat 1%. Join us now, or join us later, but this is the direction our business is headed. For proof of that, take a look at the tombstones from the Golden Age of hedge funds.

Ghosts of the Past

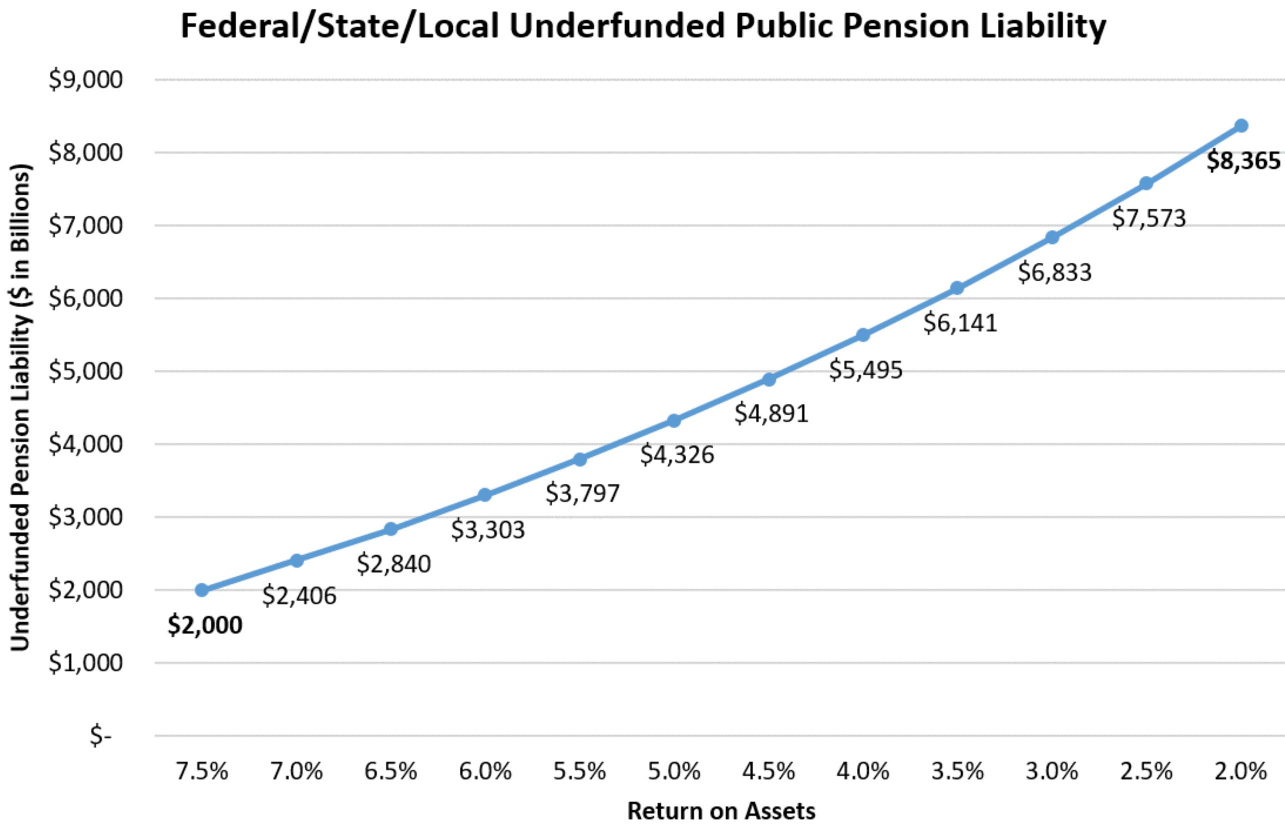


Source: Bloomberg

In news that should interest every Californian, because we are ultimately on the hook for the underfunded state of affairs at the state's biggest pension, CalPERS has backed off the calls to divest from industries and asset classes that are challenging to the social and environmental conscious.

This comes at a time when the Wall Street idea factory is running all out to produce as many ESG (Environmental, Social, and Governance) products as possible. Because the public is on the hook, and the lower the return the higher the cost to school budgets, we stand with CalPERS on this one. Because the lower the return, the farther out to the right we slip.

Get Left, Please Get Left!



Source: ZeroHedge

Diversions

Brisket prices are through the roof

Chick-fil-A now the 3rd largest restaurant chain

Beyond Meat's Teflon run.