What a Long Strange Trip…

In deference to one of the greatest Rock and Roll bands of all time, the Grateful Dead, the past two years in the markets have been what can be very well described by their famous lyric 'what a long strange trip it's been'. Investors have traveled many miles on this road, with not a whole lot to show for it. But what else are you going to do but just keep trucking on. Too easy?

This week, we take a look back at what's got us here so far in 2019, and more importantly, what the markets hold for us in the next few months. With a high degree of certainty, we think it's going to continue to be a 'motion sickness bag' inspiring windy road. Read on to help make sense of it all and navigate the strange trip ahead, one that we have been navigating with the right tactics quite well over the past two years and look forward to more continued success in the future.

Stillwater Performance

Even in the face of some pretty lean market returns as of late, Stillwater has produced strong results that have outpaced both the broad market as well as those fund categories we compete against. Through the third quarter of 2019, clients invested in Stillwater's**Hedged Equity Income** strategy have seen an **11.8%** return since inception last year. For the same period the **S&P 500** has produced a volatile **9.8%,** a number even smaller after this week. Bloomberg did us a favor and chronicled the journey.

Performance against comparable mutual funds has been even stronger. The**Morningstar Equity Income** category has produced on average a **7.8%** return for the same period, and the **Morningstar Long/Short Equity** category a disappointing **1.3%**return, with limited downside protection during negative months. In each case, Stillwater produced meaningful Alpha, while managing the strategy at a 50% net exposure level to the overall market.

January 2018 – September 2019

Stillwater Hedged Equity Income	+11.8%
S&P 500	+ 9.8%
Morningstar Equity Income	+ 7.8%

Morningstar Long/Short Equity	+ 1.3%

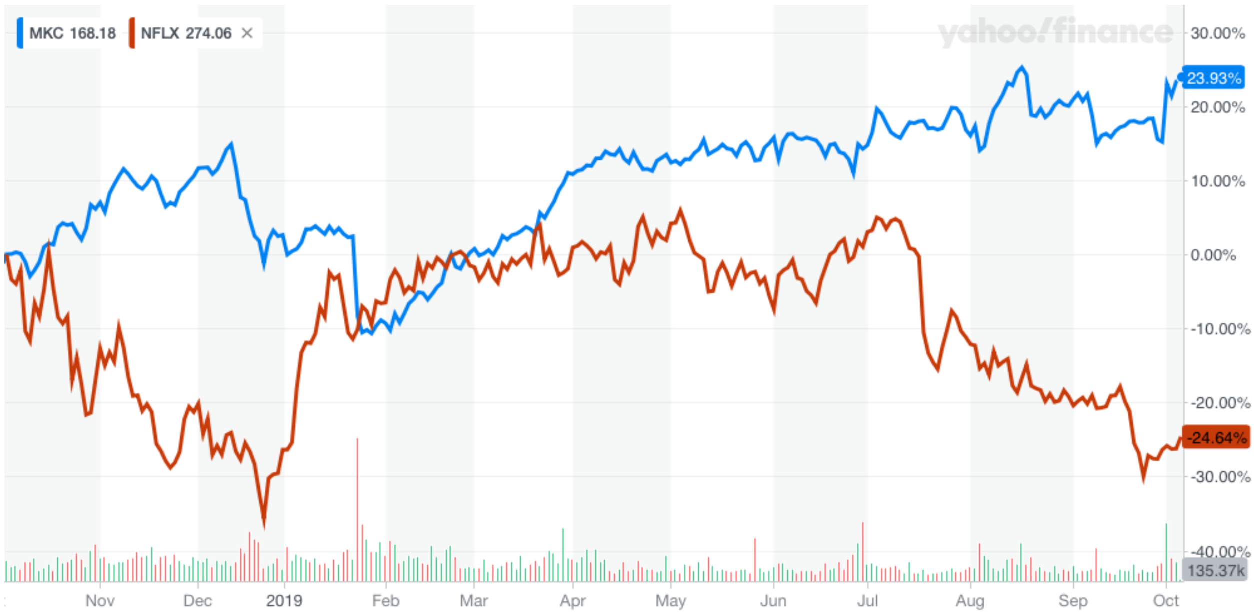
For a fact sheet that describes this strategy, including performance and the fund's largest holdings, click here, **Stillwater Hedged Equity Income**. Please reach out to us if you are interested in becoming a client or want more information on how we manage money: contact@stillcap.com

Keeping the Surface Still

Anatomy of the Trade

Before we jump into the meat of our commentary, we wanted to highlight a couple of positions that have helped produce the results we have attained. On the long side, we have benefited from our largest holding being the ever-exciting spice and condiment maker, McCormick. For the short side of ledger, we went elephant hunting in the FAANG stocks and managed to bag a big one with our negative view of Netflix.

Spice vs. Streaming



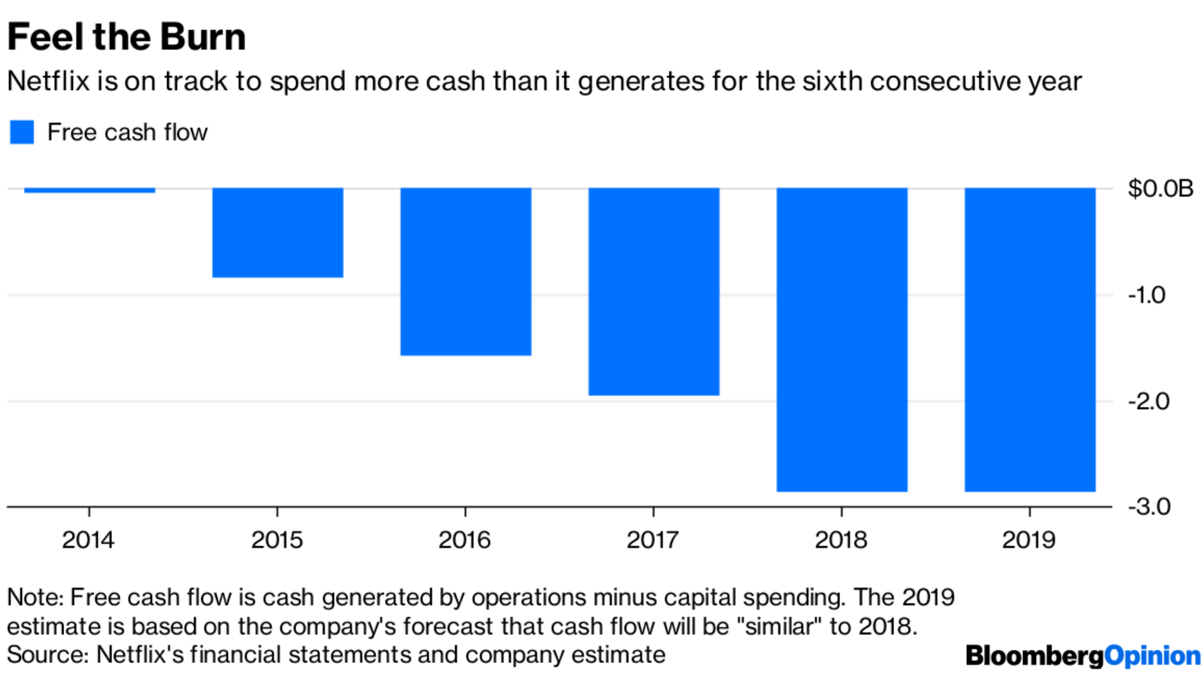
The former is what can only be described as a wheelhouse kind of investment, as McCormick has the stable cash flow generating profile we look for in a company. We also like the fact that it is relatively immune from the negative effects of a slowing economy. To top things off, they have executed well on integrating the 2017 acquisition of French's mustard and Frank's Red Hot sauce. The current 1.4% dividend yield is below our 2% target, but the stock appreciation of 70% over our initial purchase price from the start of last year, more than makes up for it. The company has increased the amount of cash it pays out to shareholders for 32 straight years.

In The Spice Aisle

On the short side, Netflix represents a great example of how to stay with a thesis until it profitably plays out. For starters, you have in the streaming media company what we call a cult following. By that we mean, portfolio managers have bought into the narrative of growth out to the horizon and for a long time were willing to buy the shares at any price in support of it. Which worked until it didn't. The fact that it was part of the FAANG complex didn't hurt either, as clients grew comfortable with the five horsemen of the market riding higher every quarter.

What many didn't discount is the free-cash-flow burn the company exhibited and the increased competition from those with the likes of Disney and Amazon, who have an equal capability, with far more stable balance sheets. Our wager was that the combination of increased competition and the fact that the company has been burning cash for going on six years would finally catch up with it. In the second quarter of this year it finally did.

This is Bad



As mentioned in the intro, these are the kind of ideas we look for and when they are executed properly create a return profile that is unique in a market where few things are. The good news is that companies are ever evolving, and these types of opportunities are more abundant than one might think. You just need to know how to look for them.

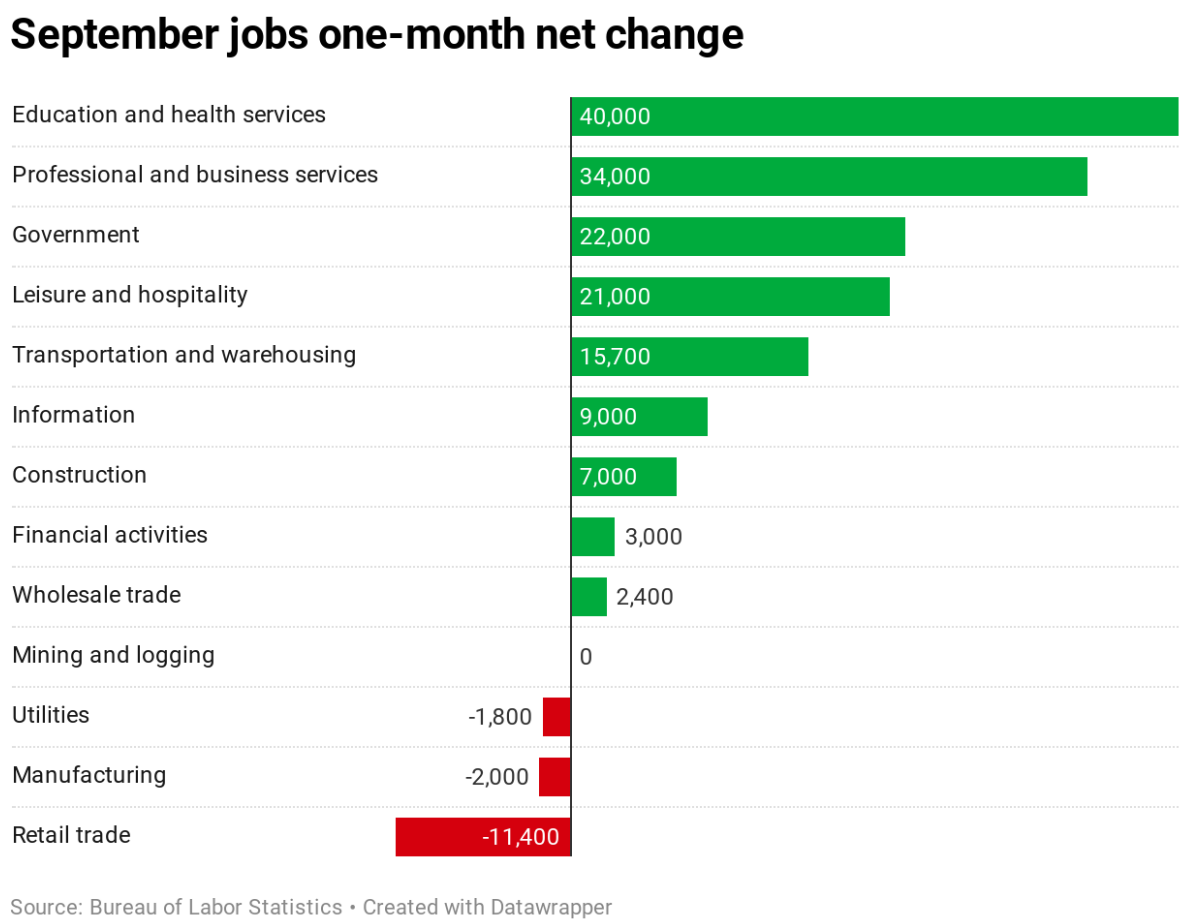
The Economy

The global economic narrative thus far in 2019 has been one where the U.S. consumer was carrying the load for everyone else. Given the strength in employment and increases in net worth as a result of the strong stock market, and stable residential housing market, it's no wonder we continue to spend. Albeit, at a slower clip than before.

Keep Spending...Please!

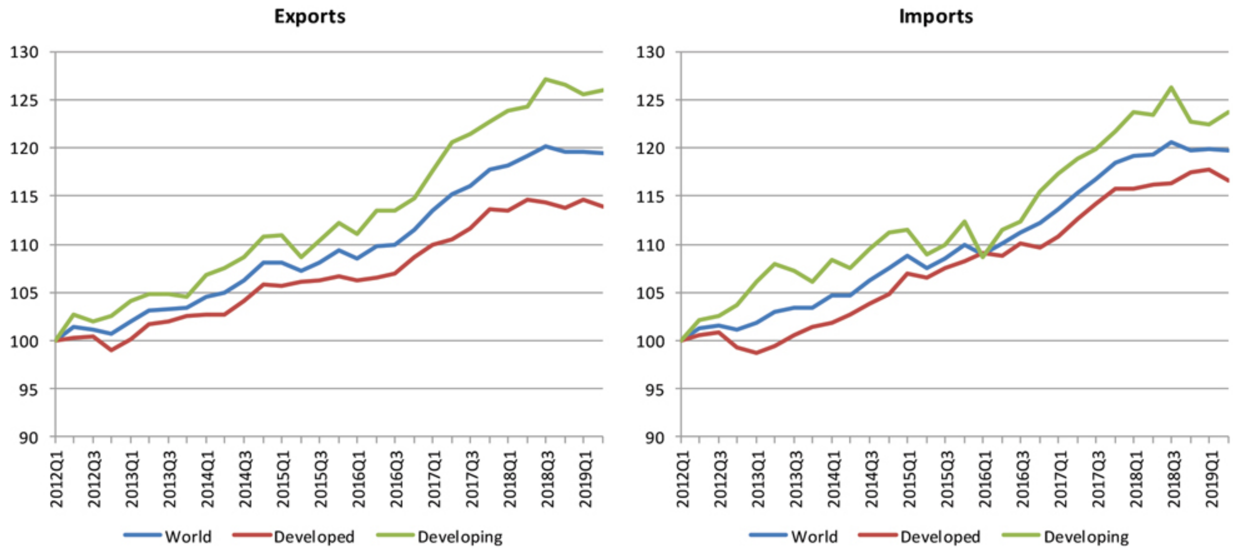
Source: Sputnik News

These trends were reinforced on Friday with another strong gain in employment while the published rate continues to fall through the floor. CNBC provides a look at where the jobs are that are driving this trend.



Meanwhile, the New York Times reported this week that the World Trade Organizationhas downgraded its growth estimate to 1.2% for goods traded between countries in 2019. Six months ago, that estimate topped 2.6%. The current reading is the worst since 2009, when the global financial crisis wreaked havoc on trade.

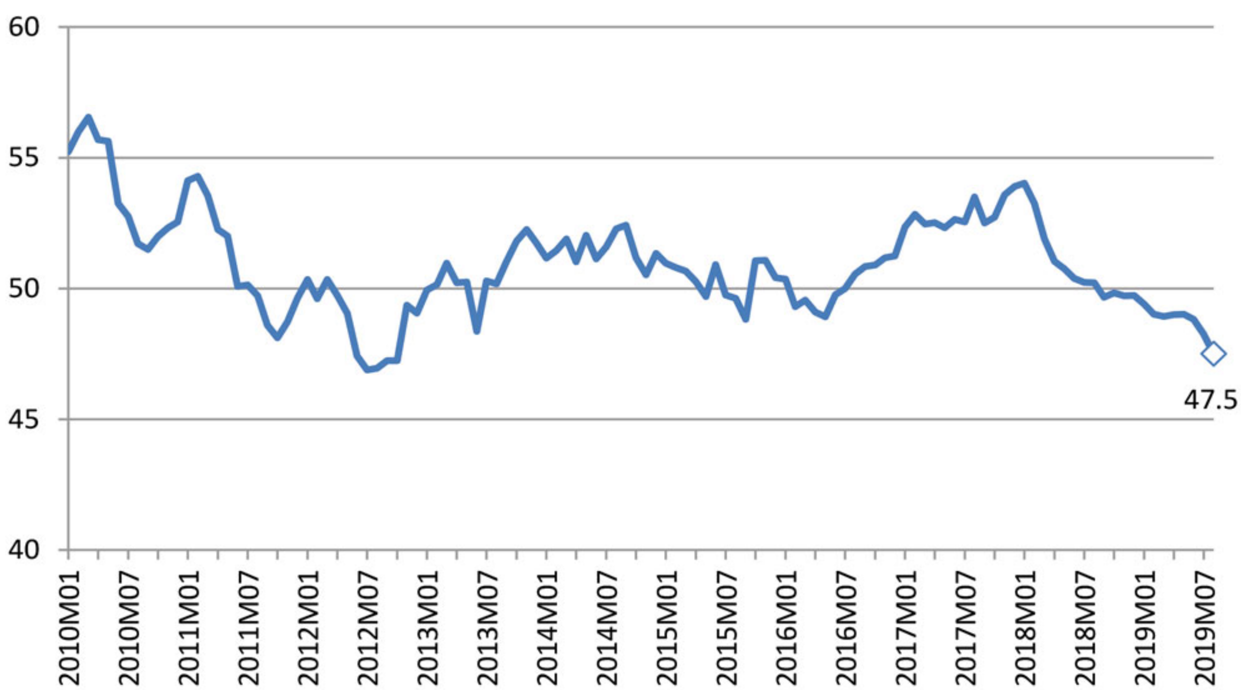
Trade Topping Out



Source: The World Trade Organization

This should come as no small surprise to those paying attention to the trends in industrial production and manufacturing, which began rolling over in the middle of last year, with little slowing the descent in 2019. Readings below 50 indicate economic contraction, and that's where we have been for twelve months now.

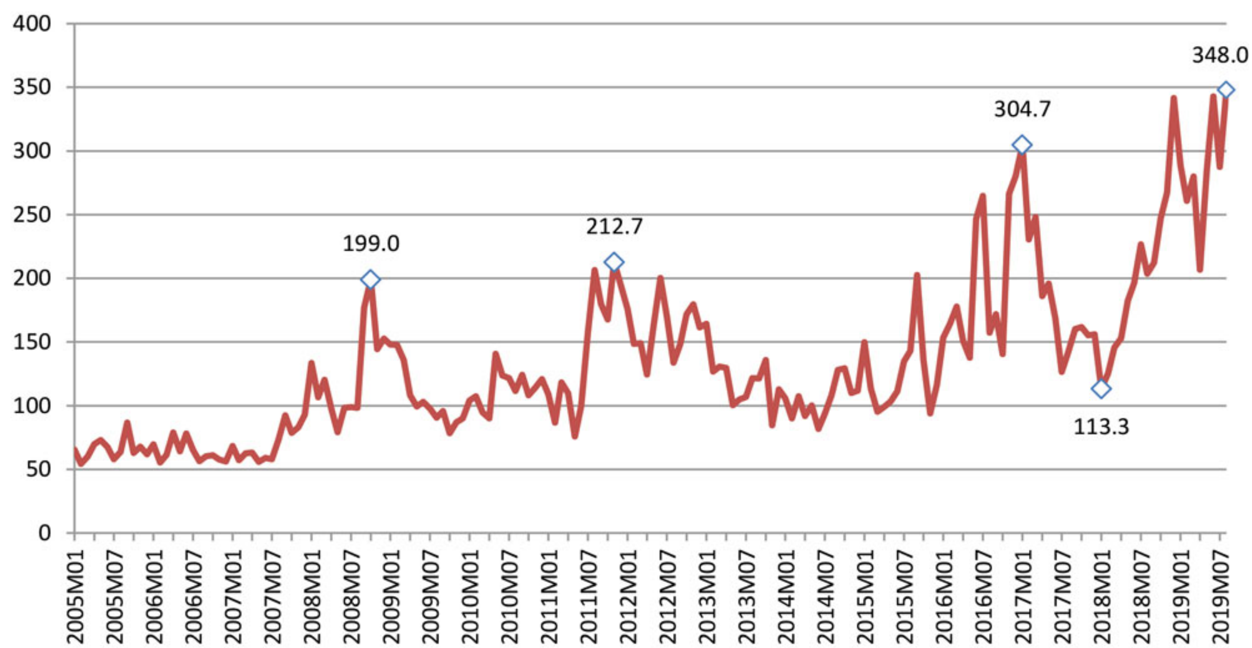
Global PMI



Source: The World Trade Organization

The last chart the WTO provided shows the frequency of negative comments or concerns pulled from the headlines. While it's an interesting idea to put on the table, the data hasn't really shown much of an ability to predict recession. The spike in 2011 fell around the same time there was concern over the Eurozone holding itself together. Same thing in 2017, all sizzle and no recessionary steak. All that being said, the tense mood gripping the world right now appears palpable.

Global Economic Uncertainty

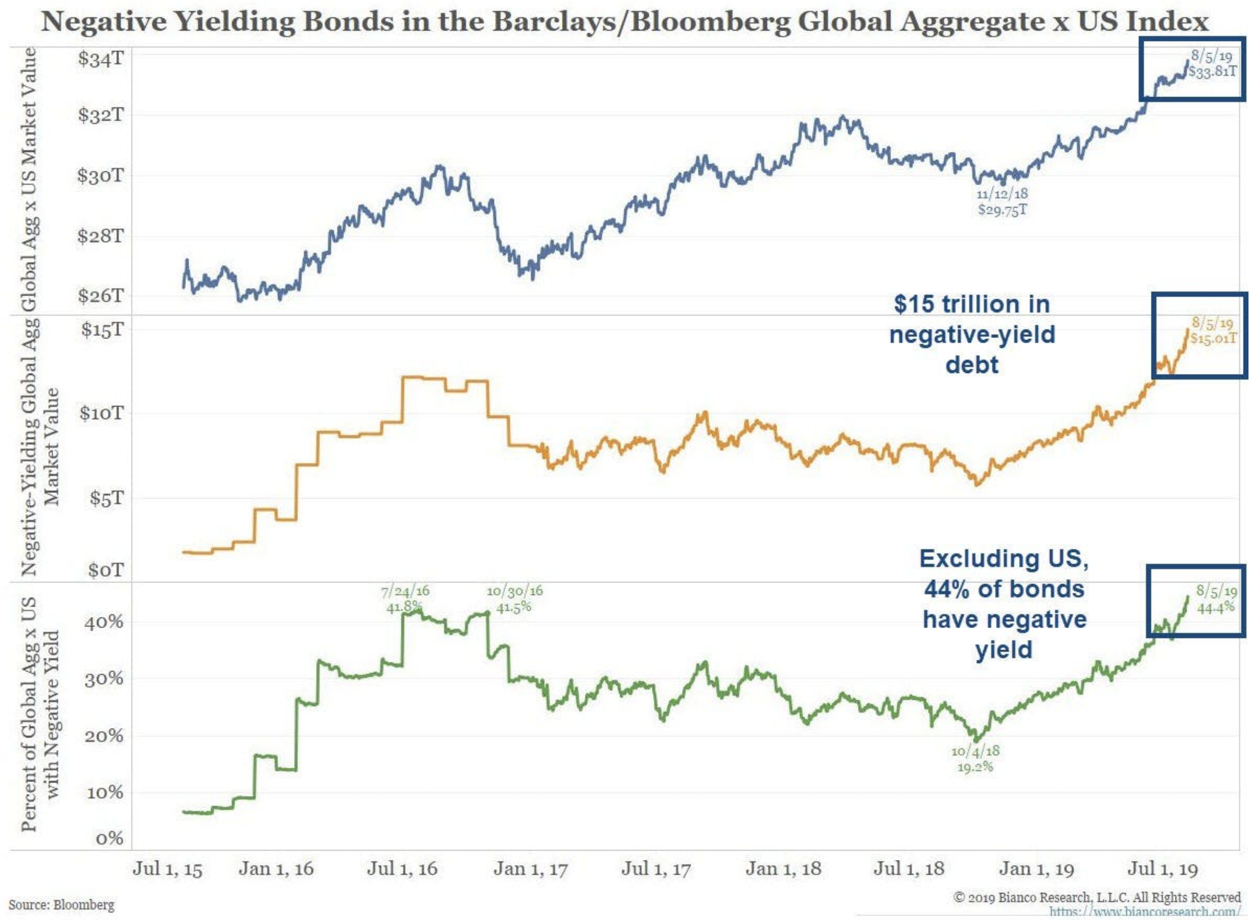


In a year full of surprises, one of the biggest has to have been the tanking of interest rates both here and abroad. The situation reached a nadir in late August when a full quarter of all investment grade sovereign debt was trading negative. The massive irony being that buyers of debt instruments issued by others are the ones now paying interest, not receiving it. Highland Capital co-founder, Mark Okada, went on record once again saying 'negative rates are simply negative'. Okada announced his retirement from the $15 billion money manager earlier this week.

The Retiring Mark Okada

Source: Reuters

If you back the United States out of the equation, the number gets closer to half of all debt where you get to pay the owner to borrow. The situation has become so extreme that speculation has begun to mount that we might be next. In our opinion, there is simply no way this situation remedies itself without something big going bump in the night.



A huge beneficiary of this falloff in rates has been the precipitous drop in the cost to borrow money to buy or refinance a home. This was not lost on the market, and an imbalance of sellers to buyers appears to have been remedied as the latter has begun to show up for the weekend open house tour.

Going $25 Million Big in Atlanta

Source: Mansion Global

Markets

Never has political posturing had a bigger impact on the markets than it does today. Both ourselves and countless contemporaries are racking our brains trying to make sense out of how to best manage assets in this environment. For those of us who ply our trade on the short side of the market, it is particularly frustrating.

One acute reason is because today there exists algorithms that under the guise of Artificial Intelligence that are set to buy large futures contracts if President Trump Tweets some combination of 'China, trade, resolution, meeting, soon'. CNBC's Jim Cramer called him out on it, as did fellow short seller Jim Chanos, saying he was using it as a way to deflect attention from the newly emerged news regarding Ukraine.

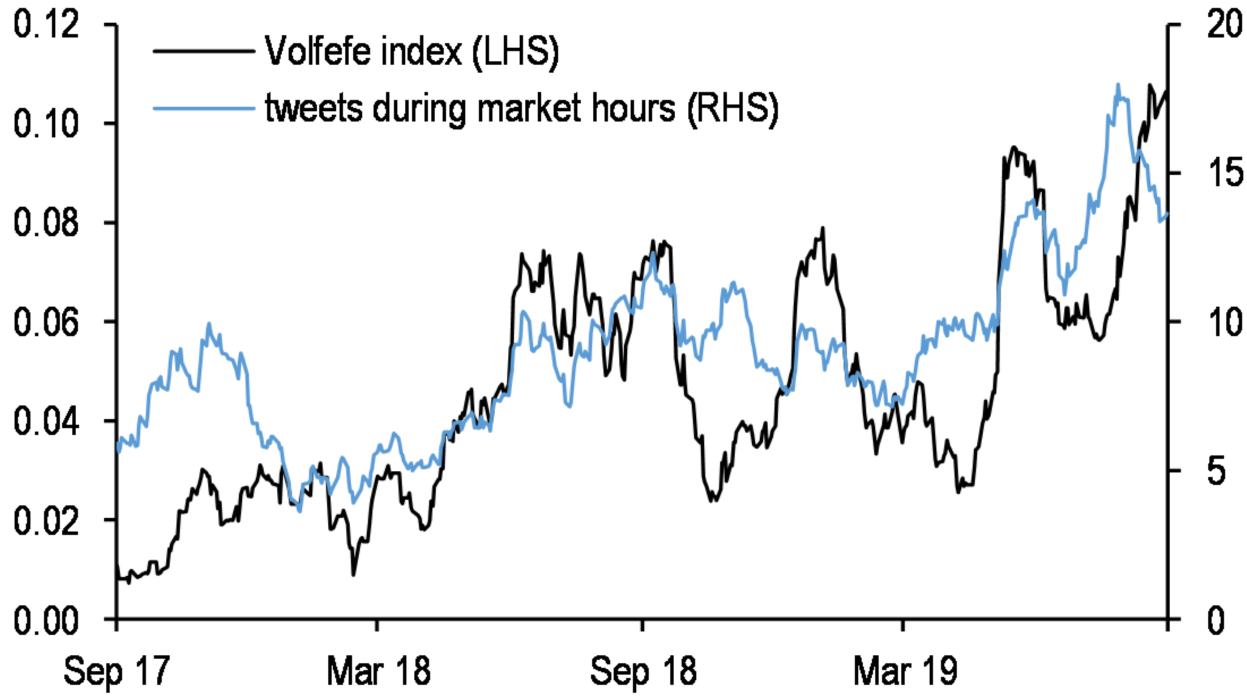
Short Squeeze

Trump is so in tune with this fact and he is not afraid to use it to his advantage. At the G7 meeting in late August he said the following about a phantom exchange between the U.S. and China, it was later confirmed that no such call ever occurred.

"China called last night our top trade people and said, 'let's get back to the table,' so we will be getting back to the table and I think they want to do something. They have been hurt very badly but they understand this is the right thing to do and I have great respect for it. This is a very positive development for the world. I think we are going to have a deal."

Because Wall Street has never met a theme it doesn't want to exploit for commercial purposes, J.P. Morgan has introduced the Volfefe Index to better take advantage of this 'once in a lifetime' opportunity to profit off what a skeptic might conclude is market manipulation.

Market Tweet Storm

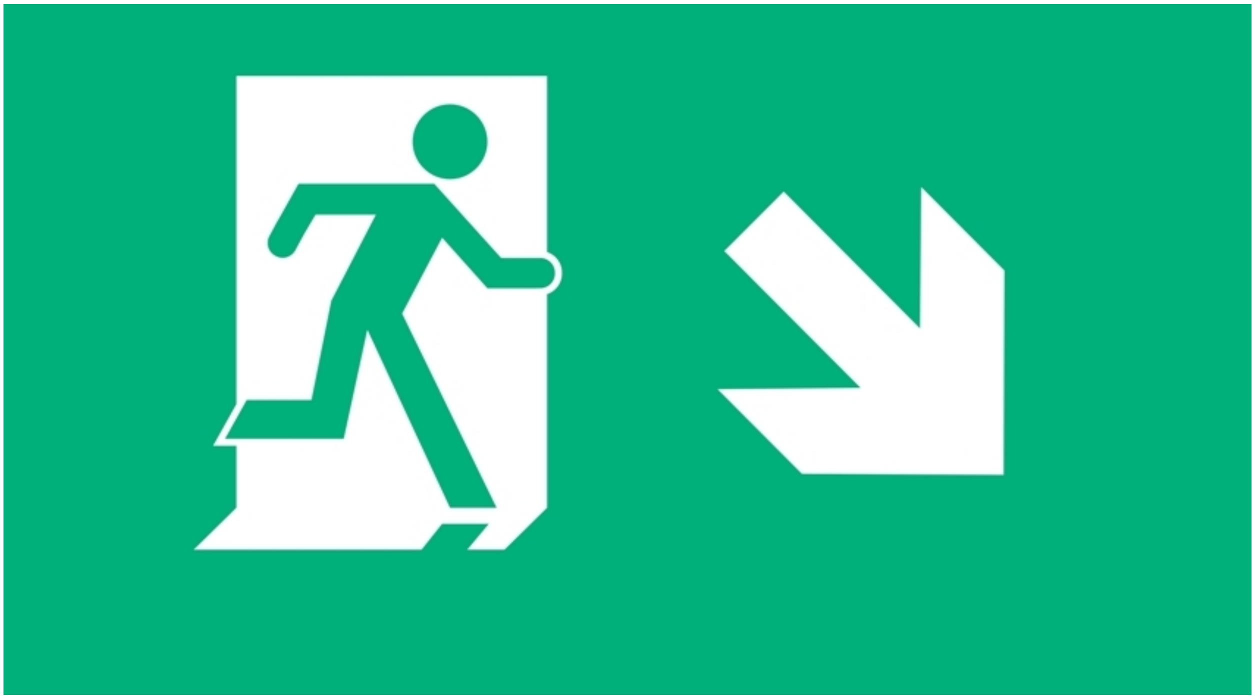


While we are entering the last quarterly lap of the year, investors are still scratching their heads at the August unwind of the long growth, short value trade. Those of us who were on the playing field when it happened know how programmatic it looked and felt. With a high degree of certainty, human hands were not pulling the trigger at the time, and they won't be again if there is another abrupt reversal in interest rates.

Ten-Year Treasury Yield

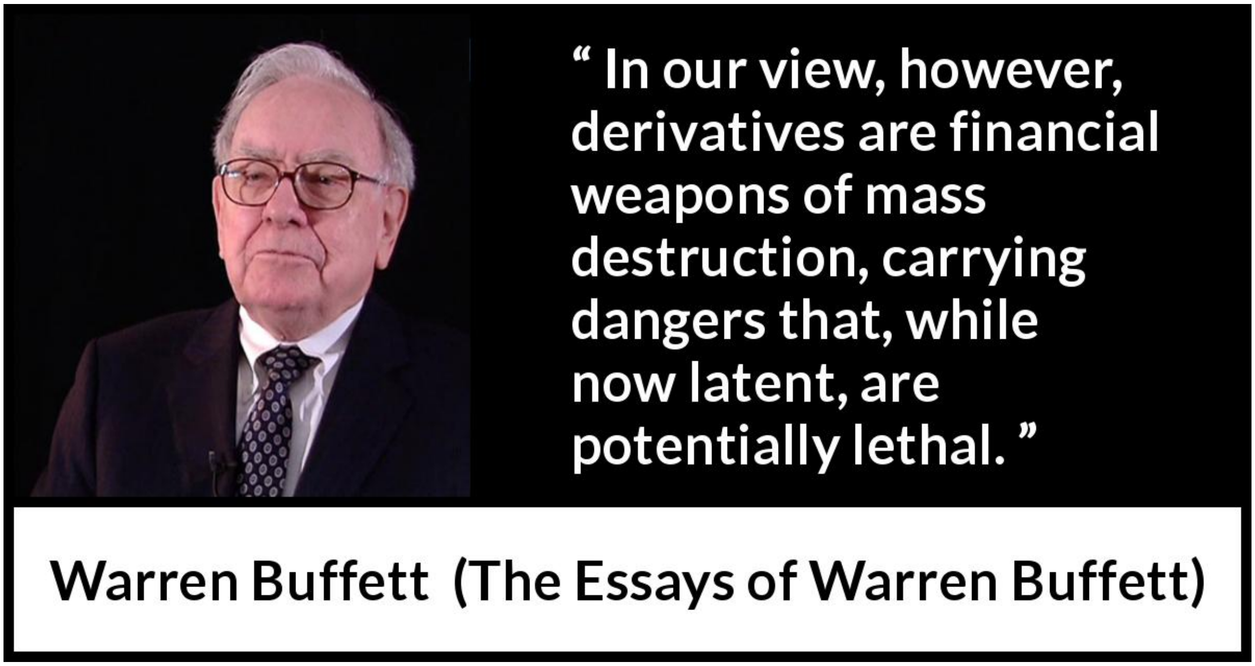
At some point, and it might be soon, rates will reverse again. And when they do, be prepared for another two or three sigma event as levered trades will once again be exposed to loss, and 'cut and run quickly' is a far better way to keep your job than waiting for a forced sale when the trade reaches its nadir, which in our very strong opinion will happen again, and exits won't be big enough for everyone.

Running for The Exit



You would be hard pressed to call us conspiracy theorists when it comes to what moves the market these days, and we have been on record for a long time saying that the decade long expansion of ETFs and quant models that operate on signals will have a moment of truth sooner than later. We saw a big episode last fall, and a minor one in the past sixty days.

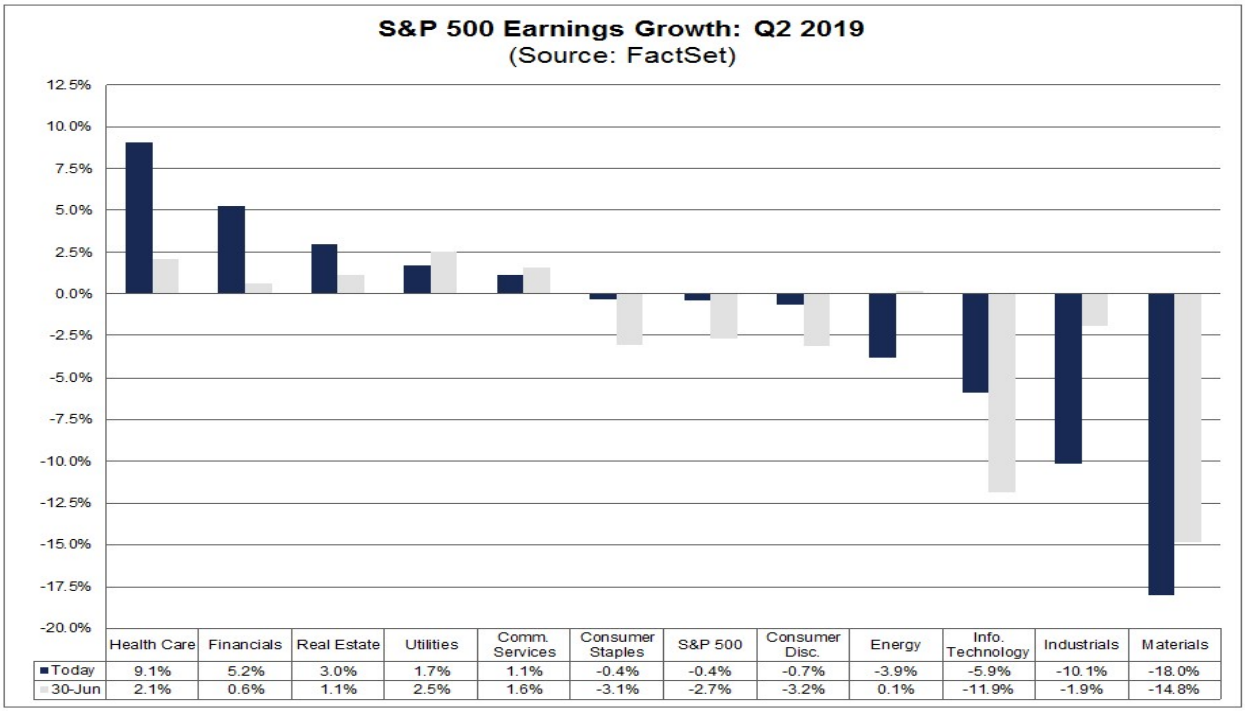
Our warning to everyone with a pulse that observes, or tries to trade these markets, there will come a dislocation the size of which the public is not ready to absorb. Think flash crash on steroids. This warning comes from a position of strength, as we made similar comments prior to this most recent market dislocation and know that the system is still over levered. How over levered remains to be seen, and we aren't alone in thinking that the outcome could be 'lethal' in an messy unwind.



The Bottom Up

With Q3 in the books, the market will be anxiously awaiting earnings season to see if the 3.7% decline projected will actually come to fruition. As the people at FactSet pointed out in their most recent Earnings Insight research piece, if we do see a drop, it will mark three straight quarters of decline. This would match the Q4 2015 through Q2 2016 period which saw the economy on recession alert going into the general election that fall. Here is where we saw strength and weakness coming through in the second quarter.

Full Spectrum



With that as the backdrop, Stillwater now takes you on a quick whip around the various sectors of the economy as the later cycle, global economic slowdown inspired narrative plays itself out. You had better buckle up, buttercup, because here we go.

Financials – Stuck in neutral as an inverted yield curve makes it tough for banks to make money. Wall Street isn't helping much either as the race to zero margin on products and services is on.

Industrials – In the crosshairs of the global slowdown in growth and the simmering trade war with China. This can change overnight if there is a resolution, the speculation on which has turned into an extreme example of a parlor game.

Technology – The name of the game in technology is bi-furcation. Some of the biggest and most stable companies in the space are on cruise control, for now. Others are on a different path, suffering from headline risk out of Washington, and slowing demand for some of the most basic products in the industry. Apple, we're feeling you.

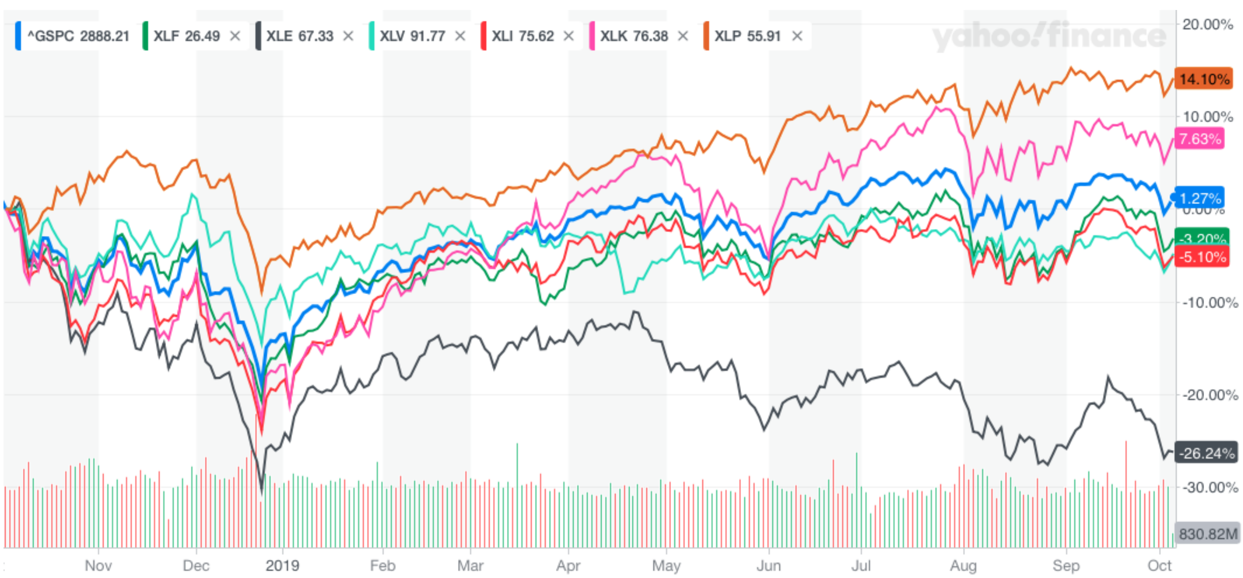
Health Care – For a while it looked like health care could be a contender with its economic moat intact. Turns out that moat is also being threatened by the folks in D.C. and particularly by the current resident of 1600 Pennsylvania Ave, and the dwindling ranks of those who want to get their hands on the front door keys to the White House this go-around.

Consumer Discretionary - As is true to form, discretionary remains a game of the haves and the have nots. In one corner, are the few innovators or companies finding their second round of product innovation. In the other is legacy retail operators and those who failed to successfully wean themselves from the store shelves.

Consumer Staples – Like clockwork, staples have been in favor this year as the threat of end of cycle consumer behavior continues to hang over the market. With their strong balance sheets and sought-after dividends, staples continue to be one of the best places in the market.

Energy – We would call energy left for dead, but we wouldn't want to insult anyone else who was left for dead. It has been a long time since we have seen a sector like this so completely abandoned by the Street. Even with oil in the middle of its range, cash-flow and profitability concerns abound.

Painting in Color



The Bubble Basket

Every so often a 'fat pitch' comes across the plate, and if you are in the business of making money for clients regardless of market conditions like we are, you had best be ready to swing the bat. In our opinion, that fat pitch has arrived in the form of a bubble in the public market value of recently privately held companies. The so-called unicorn hunt we are about to go on will include the following recently public companies' stock. Drumroll please…

- Chewy
- Peloton
- Beyond Meat
- Slack
- Uber/Lyft
- Pinterest
- DocuSign
- 9F
- Dynatrace
- SmileDirectClub
- Revolve Group
- The Real Real
- Zoom Technologies

What they share in common is that they were born into the public markets in the last year, are challenging to look at from a valuation perspective, have the shiny new IPO 'can do no wrong' glow around them. And We Work would have made the list had they actually worked.

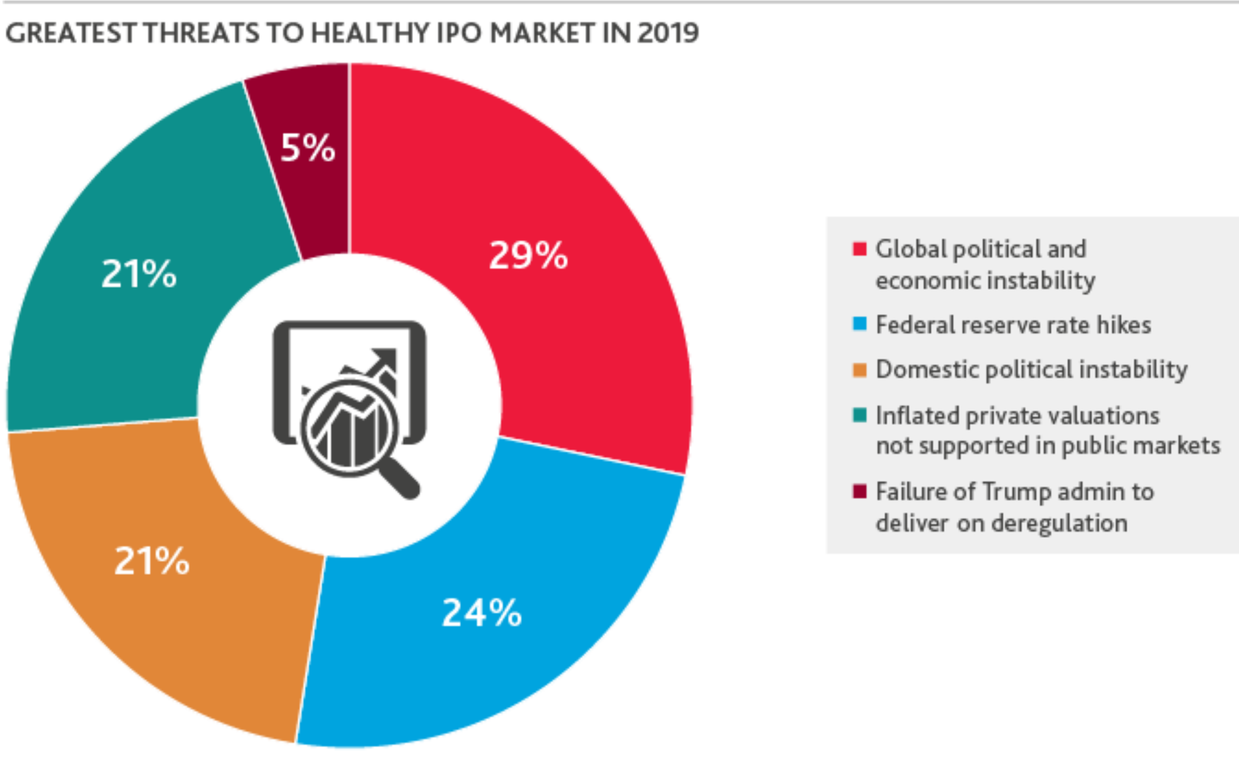
Bloomberg highlights for us that a huge flow of unprofitable companies has made their way into the public markets recently, the most since 1999. We believe that underperformance is ahead for these companies as we move into 2020, and the 'risk-off' trade returns. Will there really be the blood in the streets that some anticipate? If there is, we plan to be there to profit from it.

Unicorn Season

The plan to make money off the trade looks like this. From here through the end of 2020 we will be reserving a 10% portfolio allocation on the short side to the 'bubble basket'. We've chosen our first twelve names to work with and will use our portfolio management skills for selecting the time and place to enter and exit short positions.

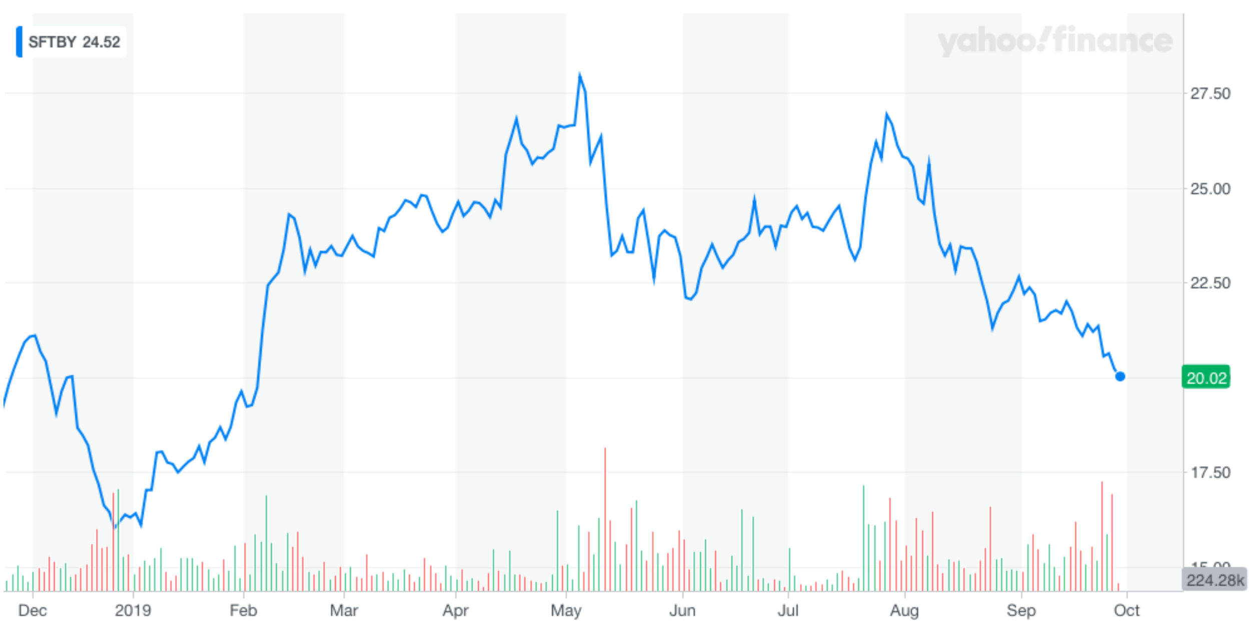
Our objective is a minimum contribution of 250 basis points with a higher end target of 500. While the latter is ambitious, it's very well within the realm of possibility and would put serious Alpha on the Stillwater performance ledger.

Risks Abound



Just for good measure, we plan on shorting the shares of Softbank as well, it too won't do at all well in an environment that begins to question private market valuations and the ability to move them through the pipeline.

Softbank



Stillwater Discloser: The 'bubble basket' is something we will be managing in house and is not to be considered a recommendation. Unless you have prior experience, and can handle the volatility, do not try short selling at home. That's why we're here for, and we do a pretty good job of it as is proven by our perfomance.

Up and Down Wall Street

Bombs were dropped in the e-broker world this week, when every major custodian of assets cut the price to trade stocks and bonds to zero. That's right, now you can trade all day and you pay nothing in commission. The move was kicked off by Interactive Brokers last week, and quickly spread like wildfire to Schwab, TD Ameritrade, and E-Trade. Which means you can now add this to the list of ways Wall Street is on a glide path to lower and lower margins. This trend does not discriminate, as there is barely a corner of the business where costs aren't coming down. The good news is that this is a binary trade and the beneficiary is your pocketbook.

Schwab Goes to Zero

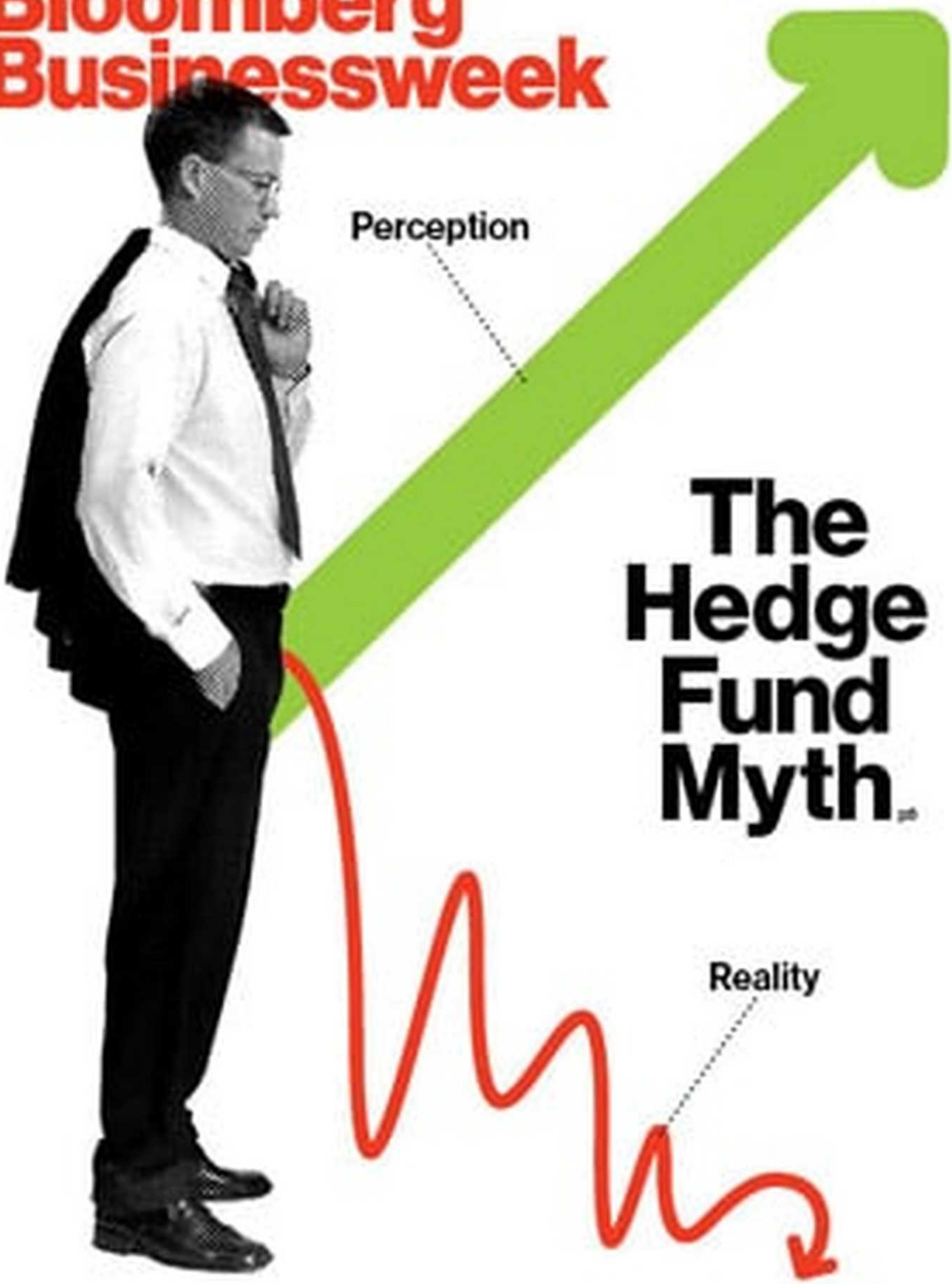
CHANGES TO COMMISSION STRUCTURE PER TRADE/OPTIONS CONTRACT

	CURRENT	As of 10/7/19
U.S. stocks	$4.95	**$0**
ETFs	$4.95	**$0**
Options	$4.95 +$0.65 per contract	**$0 commission** $0.65 per contract
Account minimum	$0	$0

On Thursday, Morgan Stanley put out some sobering news that the hot streak for hedge funds abruptly ended in September, with several high-profile funds losing anywhere between 5% to 15%. Among those mentioned were Tiger Global, Coatue, Whale Rock, and Light Street Capital, the Wall Street Journal reported. Steve Cohen's closely watched Point72 was down 2% but is still up roughly 11% on the year. This year marks one of the best for hedge funds in a decade. That said, with the S&P up 20% it would be tough for a long-biased fund not to be up big, at least relatively speaking.

Big Expectations

Bloomberg Businessweek



The Hedge Fund Myth

Diversions

The Major League Baseball playoffs goes into full swing this weekend with the Dodgers taking on the Nationals, and the Braves battling the Cardinals for a chance to represent the National League in the World Series. If the Dodgers advance, this will mark the third year in a row they play in the big game. For fans of the blue, your best hope is that the Braves knock off St. Louis. Sadly for Angelenos, the Red Birds have owned Kershaw and the boys when the chips were down. In the American League, it's the small market, low budget Tampa Bay Devil Rays taking on the Astros, and the Twins against the Yankees. For the second time in as many years, we beg of you God to give the world what it wants, and that's a matchup of the two teams who once called New York home. Is that too much to ask for?

In further sporting news, the Rugby World Cup continues in Japan this weekend. This global experience started on September 20th and concludes November 2nd. The big names are all still intact after a few opening round scares with Australia, France, New

Zealand, and South Africa as the favorites. The United State is also in it this year, though expectations are as low as a limbo stick for them to make any noise. ESPN acknowledges that while we won't win this year, there is still hope for the future. NBC has the broadcast, with all access streaming coverage running at the low price of $229.

Don't let the sport confuse you. For all intents and purposes, rugby is a set of linemen and running backs. The former feeds the ball to the latter, who in turn passes it and passes it down the line until one of them gets a shot at the end zone. The sport goes really well with a frosted beer…I think.

U…. S…. A!!!!

Fall is hunting season, and even if you don't harvest the creatures of the land, there are plenty of ways to get your fill of quality wild game. Two sources that stand out areD'Artagnan and Steaks & Game. Both have a useful function on their websites which allows you to work through a recipe while selecting each item you need to complete the meal.

As is the case with most all wild game, don't be afraid to use a heavy hand when it comes to added fat and seasoning. Living off the land tends to make you leaner than factory animals, and you will need to add some of that back. Thankfully, they all pair well with a glass of fermented grape juice.

Whole Roasted Pheasant

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