The Risk Festivus Is On…

An accommodative Fed, check. A President tied to the markets like no other, check. A domestic economy that isn't afraid to grow sans inflation, check. Equity markets at all-time highs, check. Add that all up and it's a festivus for risk assets across the board. As Robert Earl Keen once sang, 'the road goes on forever and the party never ends'.

The Never-Ending Party

Upcoming Dates

Quick programming note, we will be in Los Angeles and San Diego this week and have time on the calendar for additional client and investment partner meetings. The southern portion of the trip is to attend Charles Schwab's annual IMPACT event for registered investment advisors. If you plan to be there, please let us know.

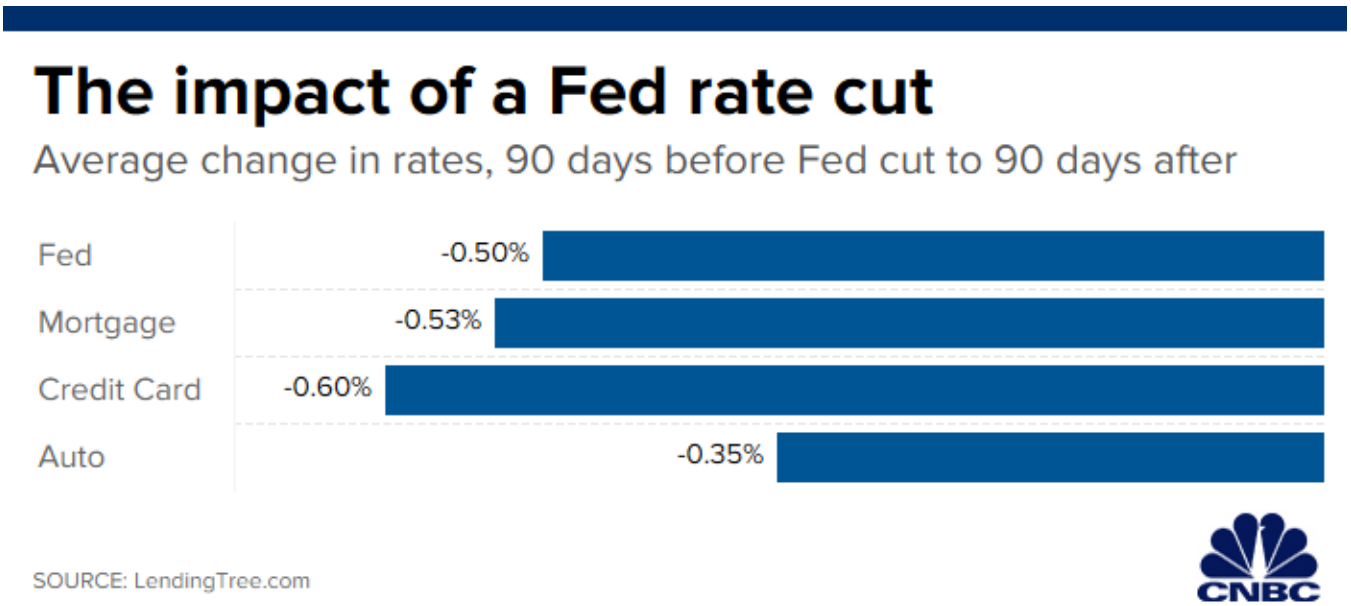
The following week we will be in San Francisco in part to attend the Litman Gregory investor day, where we look forward to hearing live from DoubleLine's Jeff Gundlach about his thoughts on the markets. Please reach out to schedule a time to get together and hear about the good work we are doing for our clients.

Miles of Road Ahead

The Economy

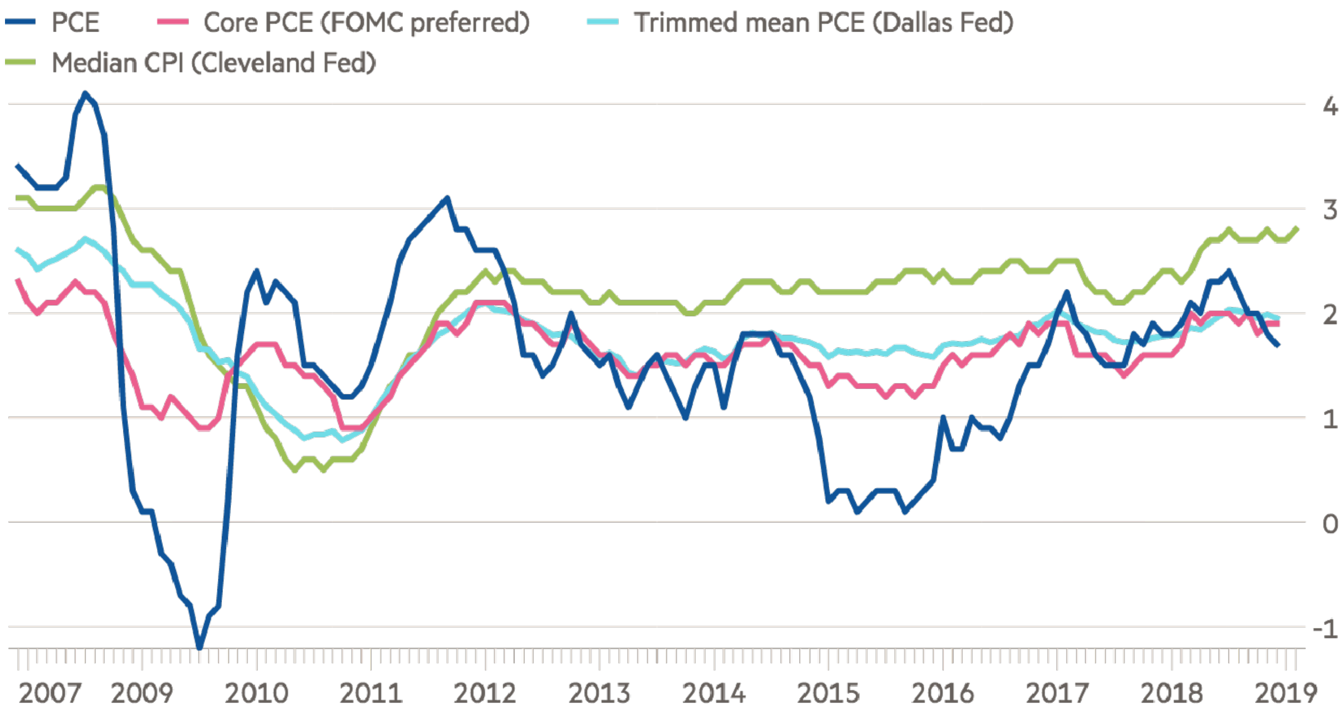
The Federal Reserve met this week and gave the market what it wanted, another twenty-five basis point rate cut, none of which was a surprise. Observers, including the former PIMCO chief Economist, Paul McCully, think Chairman Powell did a really good job at making the case that this 'adjustment' in rates was warranted. McCulley went so far as to call it terrific. He, and fellow economist David Zervos, made an appearance on CNBC to make their point. In news that should be shock anyone, President Trump was 'very disappointed'. Here is how this impacts the real economy and the cost to borrow money.

Not Rescuing Anyone



We can spend an absurd amount of time looking at this from all angles, even ones we didn't know existed, but at the end of the day, Jerome Powell and the Fed have been given an extremely long leash to do what they want because there is no inflation out there. Which for many observers, present company included, simply doesn't make much sense? Unless of course you release yourself to the belief that this is indeed a new economy, and that a complete lack of pricing power and wage growth has kept a lid on rising prices. The day following the decision, the Wall Street Journal wrote a piece that ran counter to this, and used data from the Dallas Federal Reserve to prove their point.

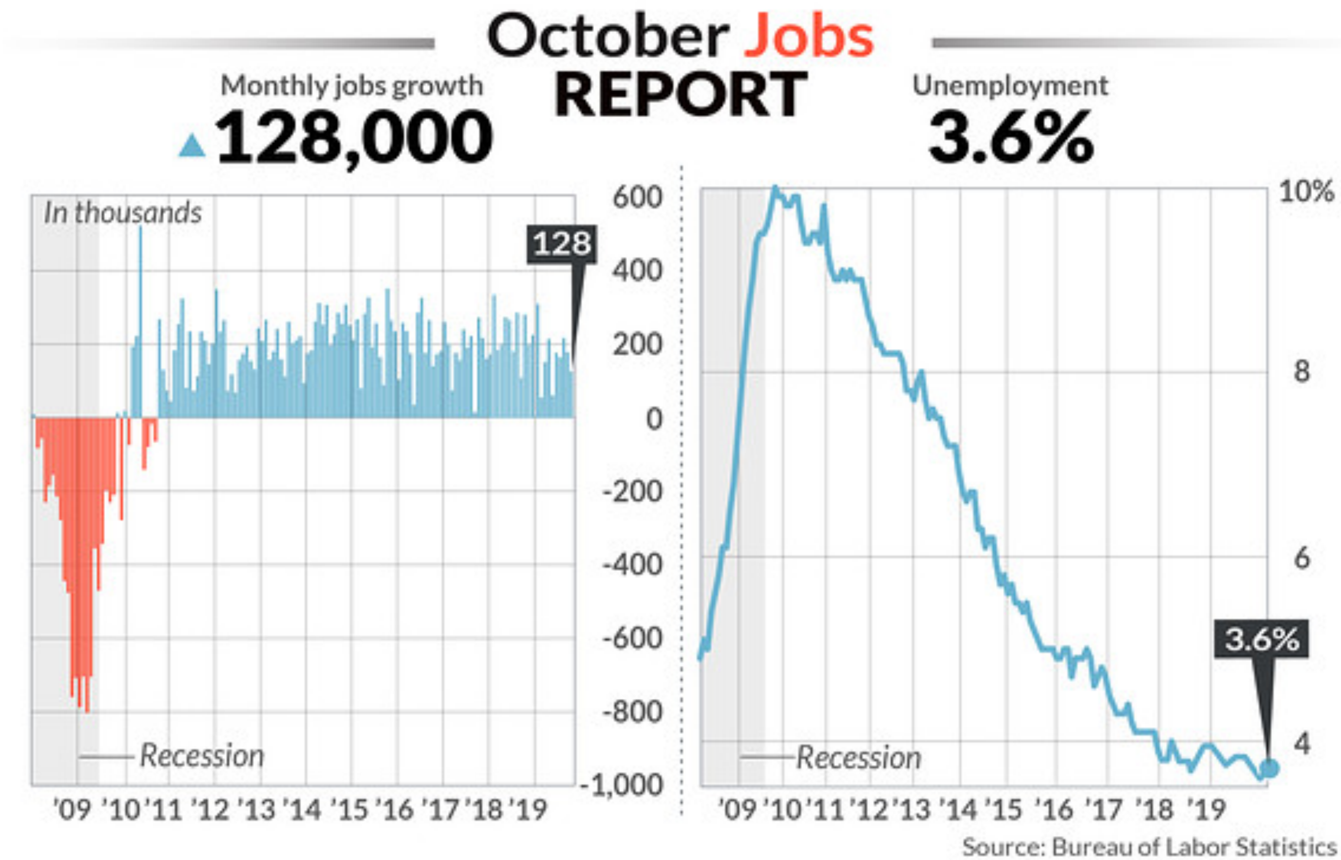
Pick Your Poison



Sources: US Bureau of Economic Analysis, Federal Reserve Bank of Dallas, Federal Reserve Bank of Cleveland
© FT

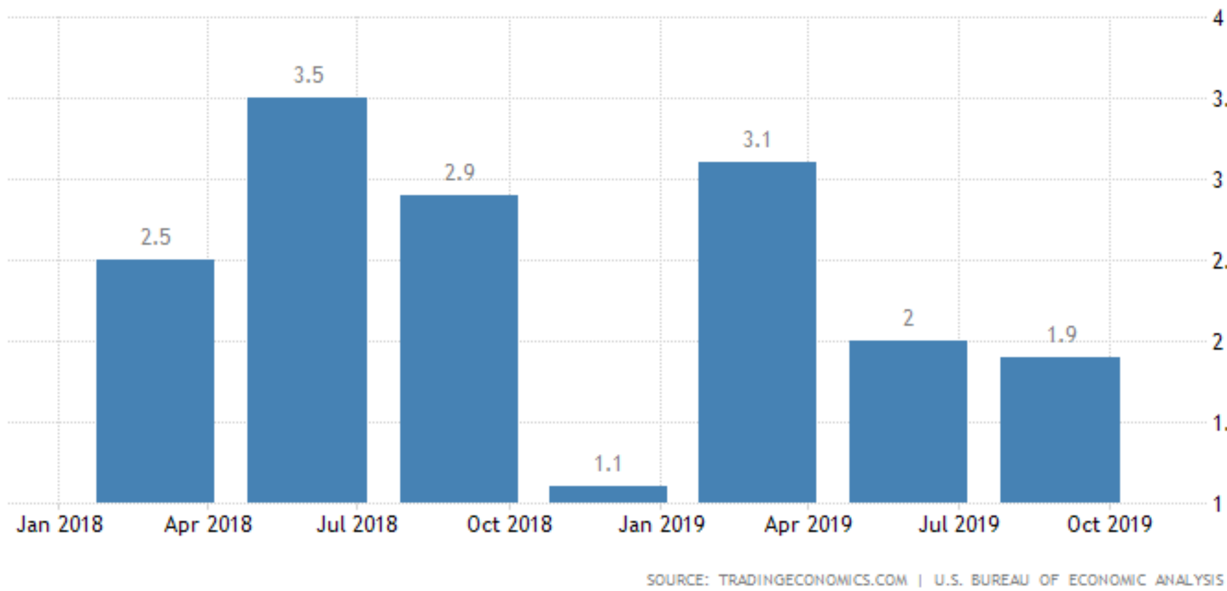
The October jobs number came out on Friday and the little employment engine that could keep's on chugging, this time adding an additional 128,000 fresh bodies to the payrolls. Combine that with a President who wants the markets higher, and a Fed Chair who isn't at all afraid of the consequences of 'lower for longer', and suddenly you have multiple markets at all-time highs.

Good On Ya!



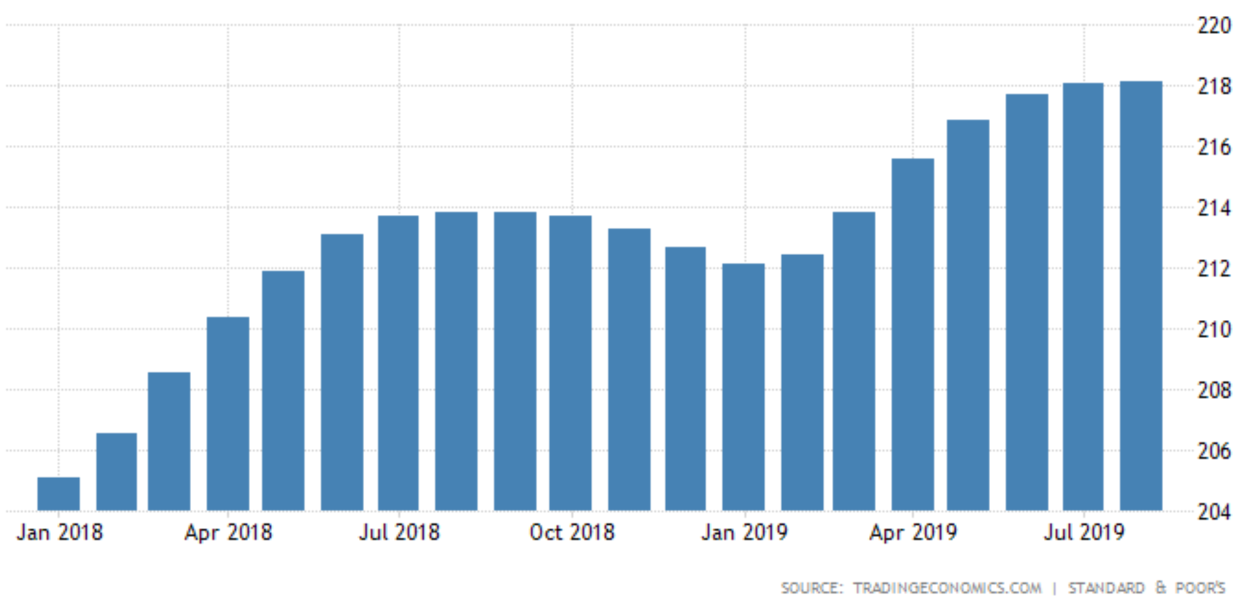
For all the news about how great the employment picture is these days, GDP growth continues to stumble along at around 2%. This week we got further confirmation when the Q3 number printed at 1.9%, versus expectations of a 1.5% increase. While the sluggish number itself shouldn't scare anyone, if we don't start to see a three handle sooner rather than later, the federal budget deficit will start to loom very large as the prospect of growing ourselves out of harm's way begins to diminish.

GDP Growth



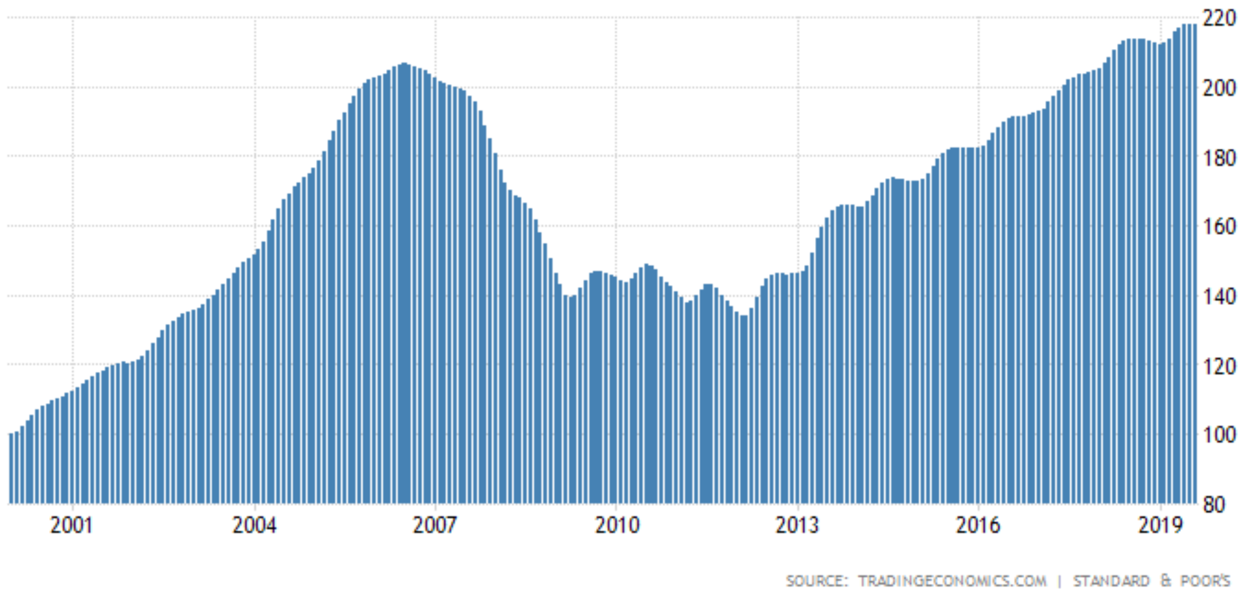
Home prices are settling out at a higher level after the Fed inspired drop in interest rates late last year. What had once looked like shaky ground is turning into a bright spot for the economy. This week we received confirmation via the Case-Shiller reading of home prices. While the data has a two-month lag, August proved to be another good month.

Case-Shiller One Year



Since it's always good to step back from the month to month trees and see the forest, we provide the long-term look at what home prices have done over the past two decades. To this day, it remains surreal to think that the bear market in residential real estate lasted for six years (2007-2013). And it took a full decade to get it back to even. Live in the now, but never forget your history.

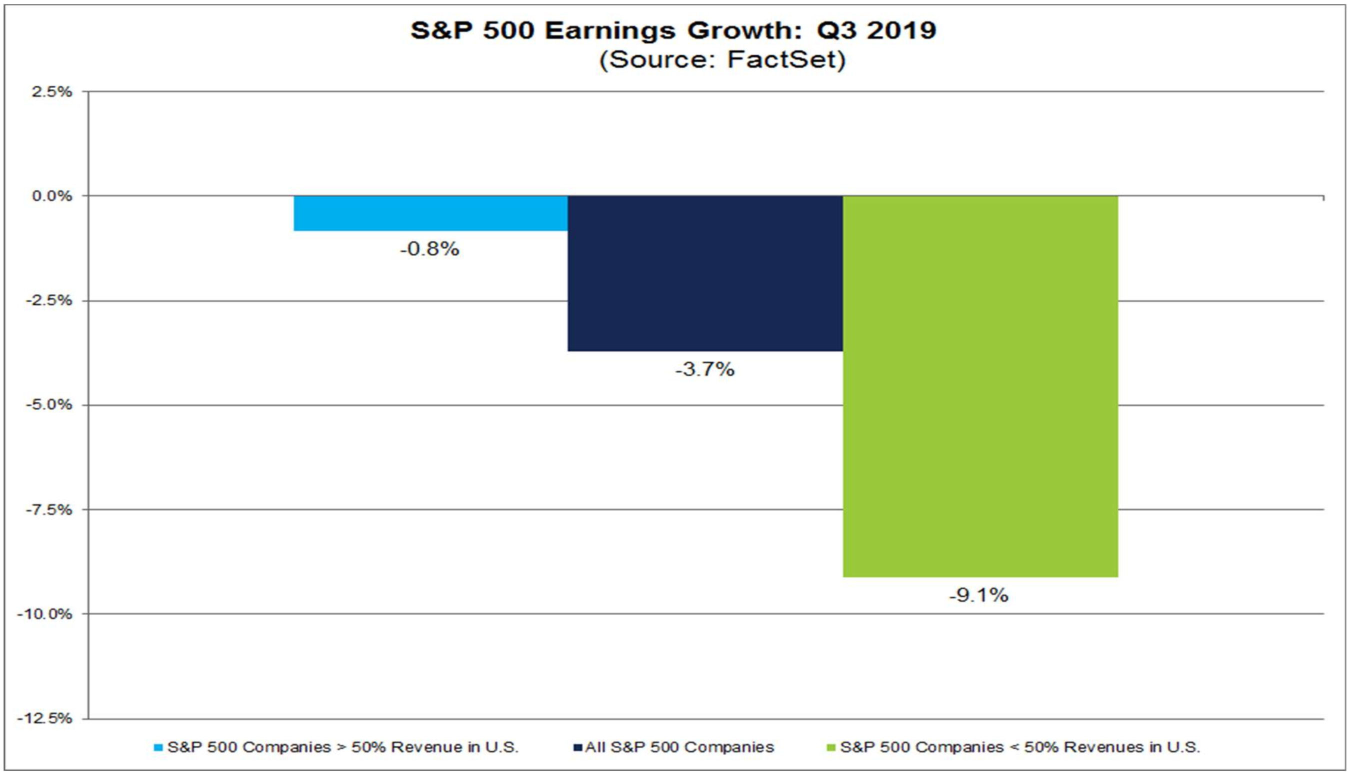
Case -Shiller Twenty Years



Earnings

FactSet did us the favor of producing a great chart that highlights the difference between companies with a U.S. focus and those that have more of their earnings generated outside of our borders. As you can see below, those tied more closely to our piston of growth are doing far better than those tied to a sagging international economy. If somehow, someway, we can get back to some sort of global synchronous growth, the markets will be properly primed for liftoff.

U.S. Uber Alles



The Bubble Basket

When you have the hot hand on the short side of the market and don't tell people about it, do you really have the hot hand? Because that is actually a real question, as we are more than happy to promote ourselves, and the Stillwater 'bubble basket' which also had a great week. First off, there was the 22% drop in the shares of Beyond Meat after they reported what was a good quarter on the top-line but failed to live up to high expectations on the prospect of higher costs associated with growth. Even with the IPO lockup coming off, the CEO has committed to not selling as he is all in on disrupting the food industry. Which is all fine and good, just be aware that there is a target on your back and they are coming for you.

Beyond A Bubble

Source: FoodBev Media

Our second big win of the week was our short position in Pinterest, a company we also profiled in our 'bubble basket' a few weeks back, and one where our clients had a short position. It too saw a 22% drop in share price after a quarterly report that missed Wall Street expectations…badly. To be clear as the day is long, we never understood how this business ever got to the valuation the market adorned it with. Our only lament was not building a bigger position pre-blowup. The stock is now trading below its $19 IPO price set last April.

Lack of Pinterest

Source: Pinterest UK

Accounting 101 - FCF

Last week, we mentioned the importance of free cash flow generation to the companies we like to invest in, and now we peel back the onion to explain what it means, and how it helps define what a healthy company looks like. First up, the math behind the magic.

Free Cash Flow (FCF)

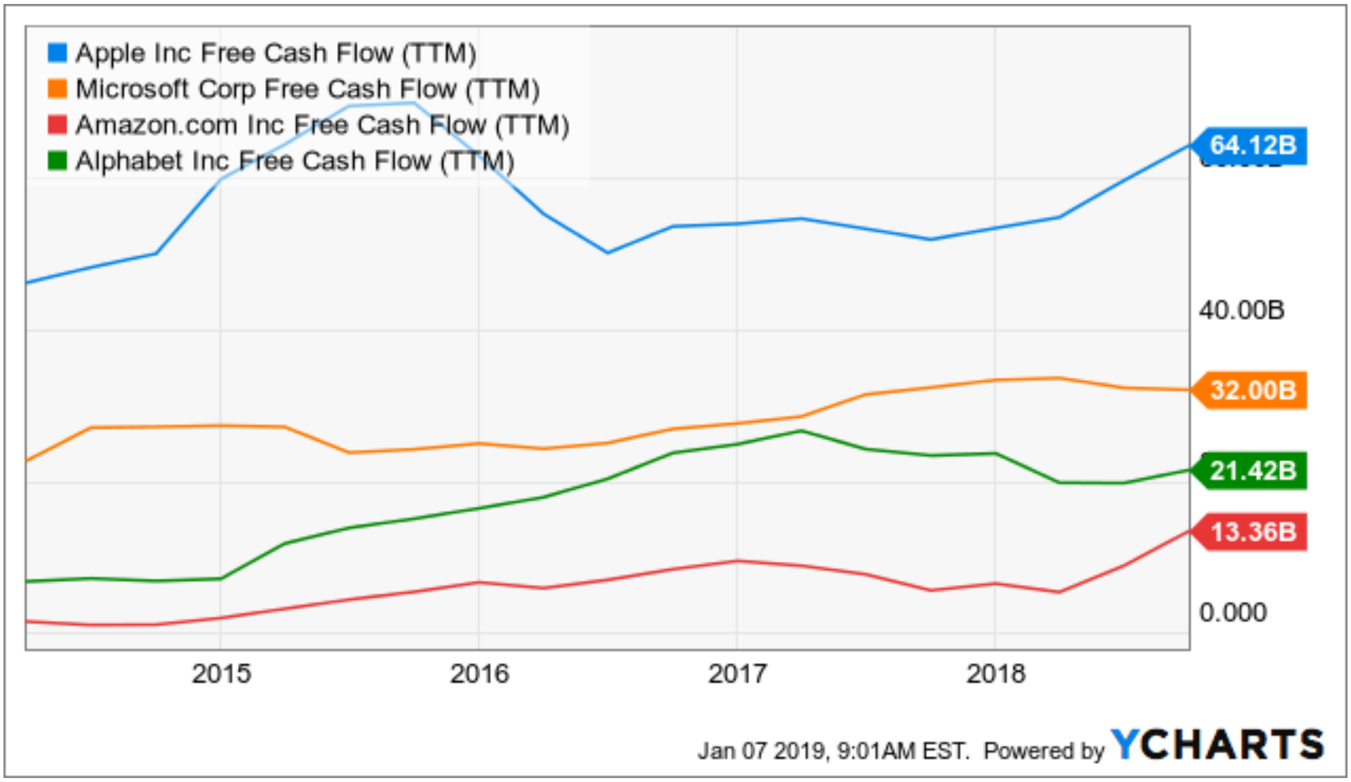
FCF = Cash from Operations – Capital Expenditures

Where, FCF is Generic Free Cash Flow

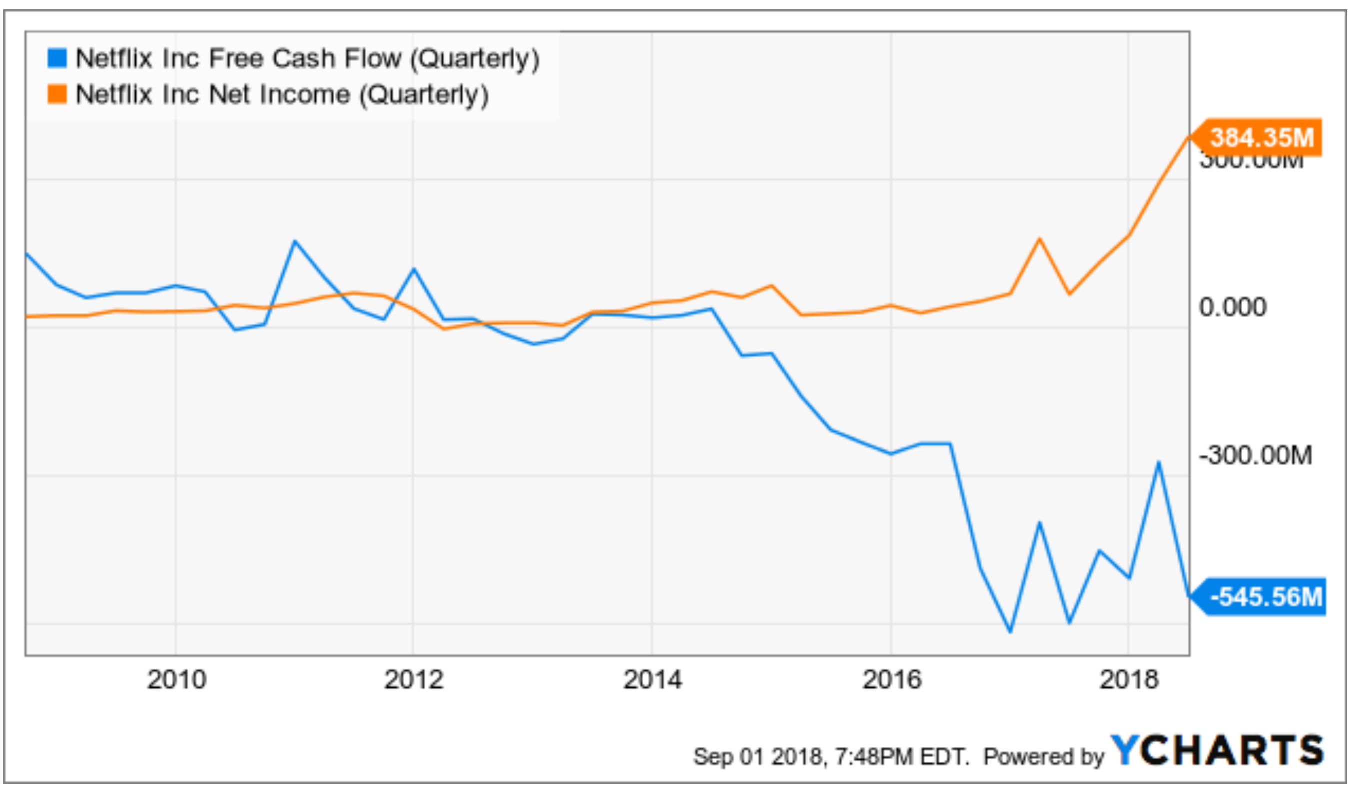
Source: Corporate Finance Institute

What the calculation does for us, is strip out the noise surrounding intangibles and gets down to a clean look at how much cash the operations side of the business throws off. It is found by backing out capital expenditures from operating profits. Some companies are basically ATMs for their shareholders.

Cash is King



Other, not so much…



The lesson to all of us is that when you invest in a company that produces the commodity that most investors want the most, you will be rewarded. This can come in various ways like increased dividends, greater share buybacks, and an ability to continue to invest in the business. Companies that exhibit high levels of free cash flow generation also tend to hold up better than those that don't in times of financial stress. And with that, the search goes on.

Meet Mr. Benjamin

Up and Down Wall Street

Even one of the world's greatest investors can have a bad year, and that's exactly what Warren Buffet is doing. Part of this can be blamed on the fact that value investing has been on its tail for an uncomfortably long time. That said, it does not absolve him from one of his biggest mistakes in recent memory, and that is his ill-fated foray into Kraft-Heinz.

One longtime investor, David Rolfe who manages $2.2 billion at Wedgewood Partners, has seen enough and has sold out of Berkshire-Hathaway's stock this year. His reason? Buffet's

$122 billion of dry powder has remained too dry, and he has missed out on 'this glorious bull market'. Which sounds to us like a capitulation trade.

The Big Lag

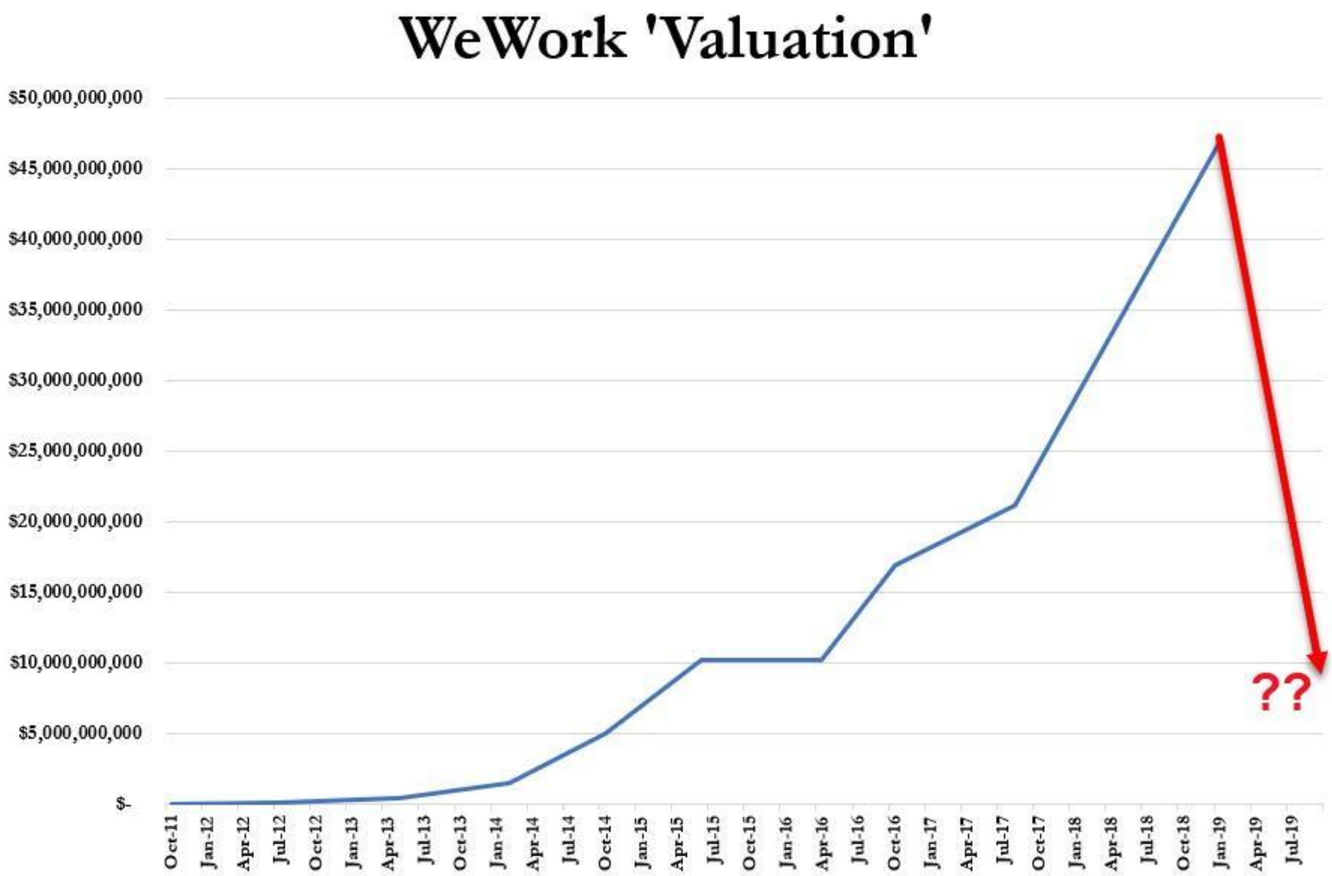
Falling Short

Berkshire shares have underperformed the S&P 500 Index in 2019

Source: Bloomberg

The once untouchable Mayoshi Son, and his tech investing Softbank, now carries the scarlet letter that WeWork has adorned upon it. Two months ago the company was valued at close to $50 billion, in the absence of an intervention by Son, the company would likely have gone bankrupt.

We Don't Work



Source: ZeroHedge

This week we were reminded once again of that fact, as a less than robust, nay sparse crowd, attended his panel presentation at the large scale Saudi Arabian business conference. The Kingdom had previously committed close to $45 billion for his latest potentially profitable incarnation, The Vision Fund. Announced last year, Softbank plan was to raise $100 billion for the effort. If it falters, it will take the bloom off of the market for unicorns, and their bubble valuations. Meanwhile, Softbank's shares continue to suffer.

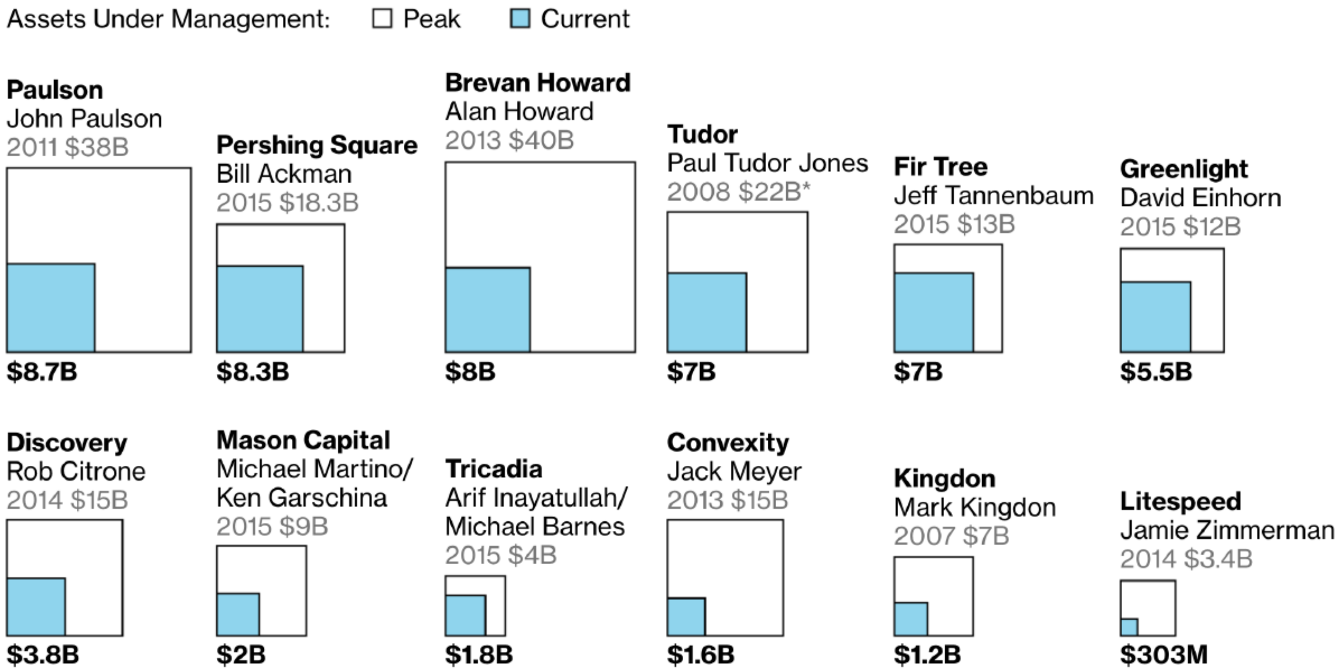
Mayoshi Son's Vision

Source: MSN

The Golden Age of hedge funds continues to get dismembered by the media. This week it was the Wall Street Journal that once again reminded us that those who have stuck to a broken business model are having their day of reckoning forced upon them. This follows on the heels of once star manager Jeff Vinik, calling it quits after failing to launch this year.

Our advice to all involved in the business, start by being less bad, get your fees in line with what the market wants, and if you can’t do either of those things, get out of the business and let those of us who know what we are doing take the wheel. The long road of denial our industry is traveling down is getting to be a little long and tiresome.

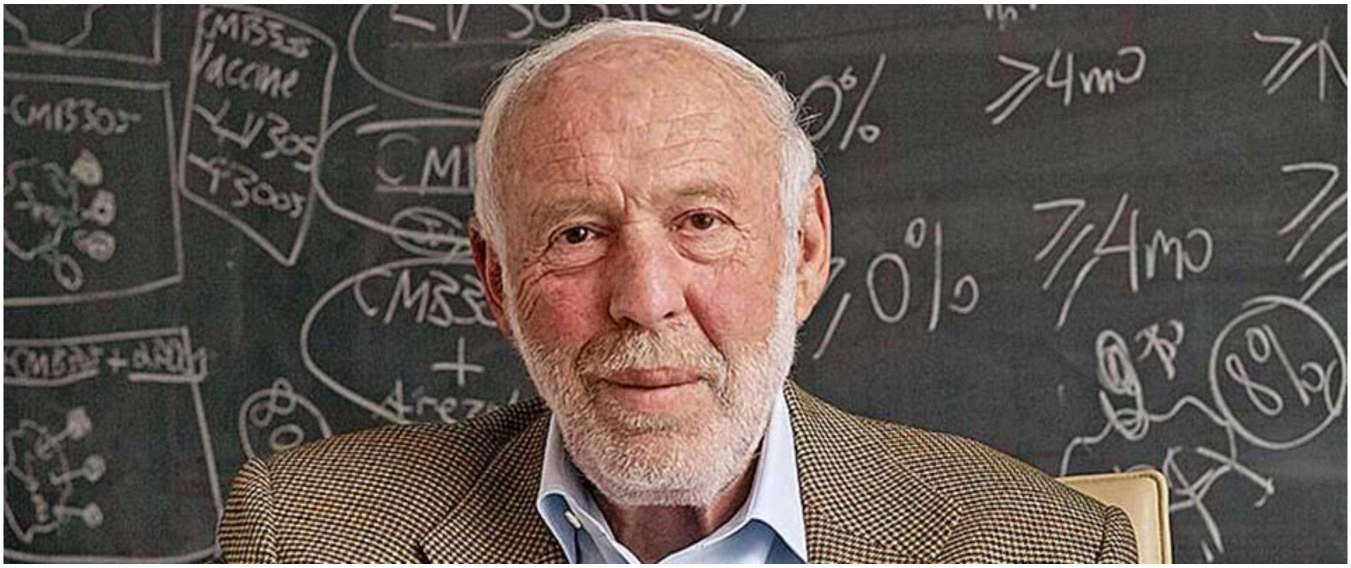
Tough Travels



Source: Bloomberg

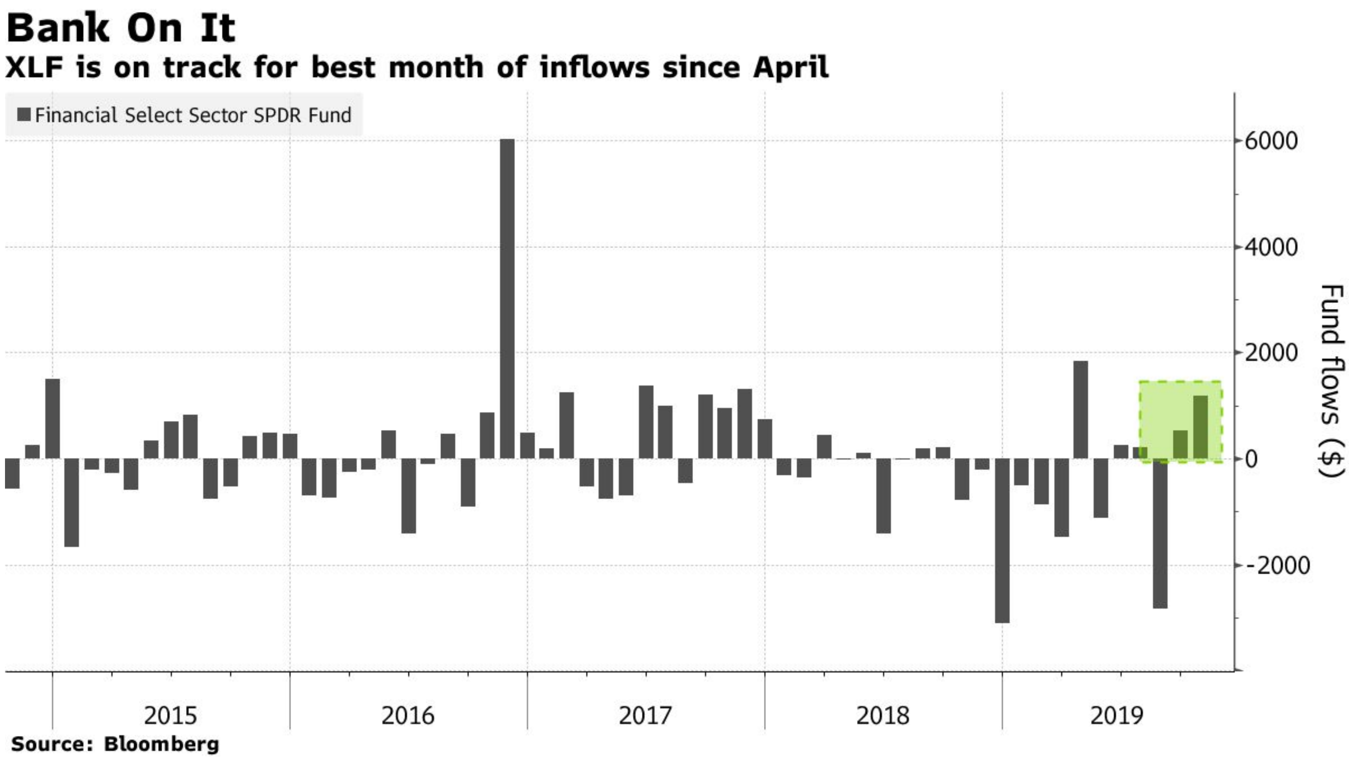
In a counter to what the Journal reported, Jim Simon's Renaissance Fund is seeing no end of success as one of Wall Street's greatest money-making machines of all time. For those of us who are into learning how these beautiful things are built, financial reporter Greg Zuckerman is about to tell us how. Next week, the book he penned, 'The Man Who Solved the Market' get released, and in it he tells us how Simon's went from operating out of a Long Island strip mall to building the most successful quant trading fund ever. Taking those that backed him and invested alongside of him into the world of flying private.

Jim Simons



In a move that runs counter to our belief that we are in the twilight of this lending cycle and an inverted yield curve is really bad for business, investors are once again pouring money into the banking sector. This time, piling into the XLF financial sector ETF at a rate not seen since last April. Our conviction is so strong that we are carrying a decent sized short position in the aforementioned XLF. As they say in our business, that's what makes a market.

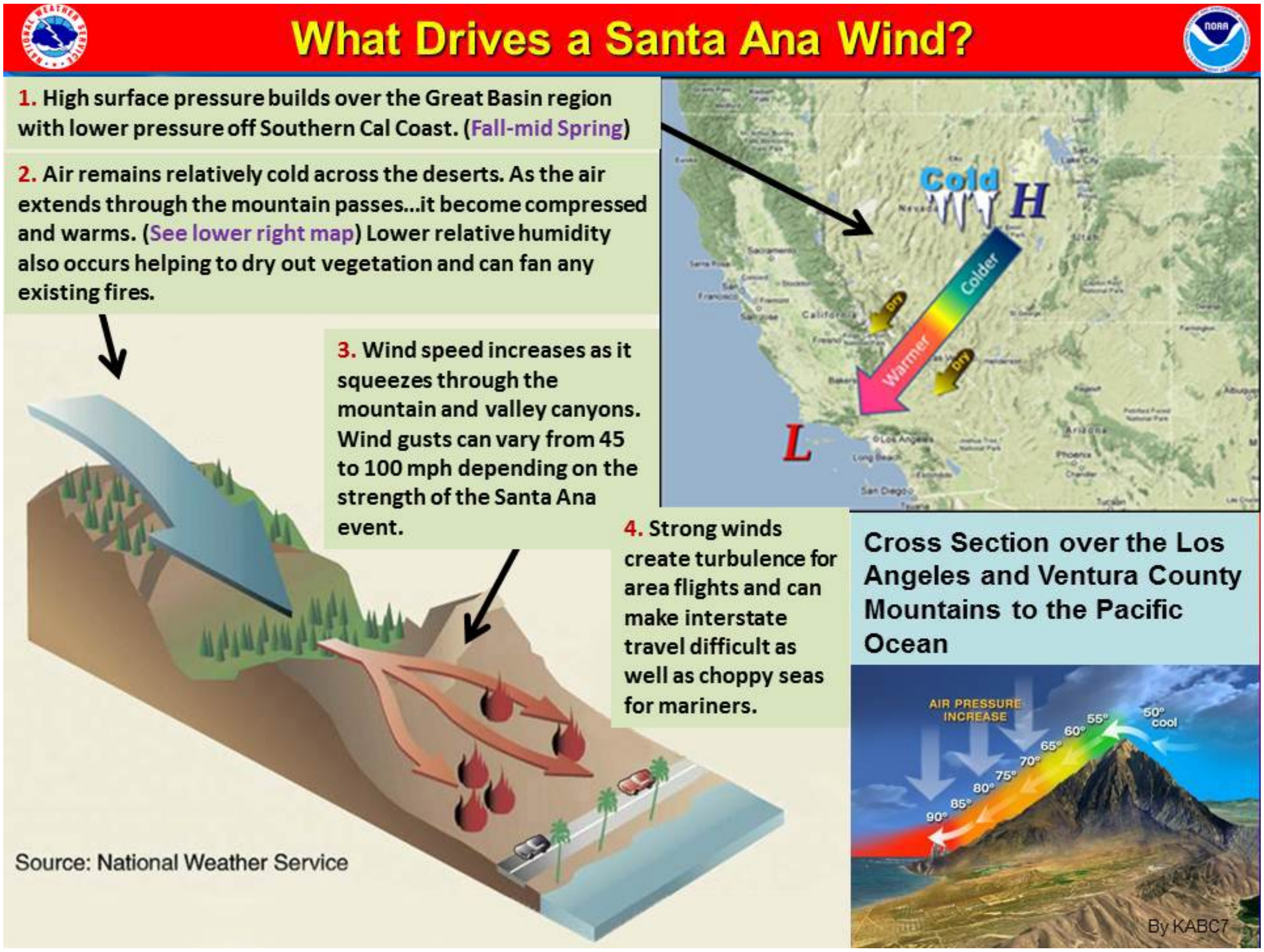
Not So Fast



Diversions

We are going to start off our Diversions section this week on a slightly more serious note, and provide readers with a scientific explanation of what a Santa Ana wind is, and how these 'sundowners' are impacting our way of life in Southern California. The effect starts off in the Great Basin of Nevada and Utah, where cold pressurized air starts making its way to the lower pressure areas of Coastal California. As it moves from one area to the other the change in pressure compresses the air and heats it up. Once that pressurized air hits the canyons, the effect is intensified. The NOAA map below describes it all.

The Santa Ana Effect



While we can't speak for everyone who calls this area home, sadly we know from our perspective that fire season has become a 'normalized' occurrence. This time of year, a day rarely goes by where we don't get notification that another fire has broken out. As we have now seen, or heard, over countless times, sadly there is no longer a shock value to it. Generally speaking, residents find out the location and size of the blaze, and whether any structures have gone up in smoke. Then it's on to a regular day, with the occasional check back in to see if things have gotten worse. If we are traveling by car, there is a required check of the freeways to determine if our route has been impacted. LaBron James got his first taste of life in the fire zone on Monday.

The New Normal?

Source: KABC

Over time, CalFire and the other local agencies, have made this process less stressful as bodies are quickly put in place and equipment hits back on the blazes hard, just as they did this week when flames came uncomfortably close to both the Reagan and Getty Museums.

Reagan Museum, Simi Valley

Source: The Los Angeles Times

Two weeks ago, high in the Eastern Sierra mountains, human skeletal remains were found in a rock grave and later identified as one of the Japanese Americans interned at Manzinar. The bones were that of Giichi Matsumura, who was a member of the camps legendary fishing club whose members would sneak out of camp and travel up the canyons in search of wild golden trout. Matsumura was part of one of those expeditions and separated off on his own to paint and was consequently caught in a freak snowstorm.

We mention this, because there is a great documentary titled 'The Manzanar Fishing Club' that details the exploits of these young men who were simply trying to find some peace at a time when it was tough to come by. We also appreciate anyone who seeks out the solace of a fly line properly dipped in a cold and clear mountain stream.

Club Member Heihachi Ishikawa

Source: Seattle Times

Sticking with our 'fish' theme, a little song called 'Baby Shark' has recently taken over, first by World Series champion Washington Nationals, and later by a group of Lebanese protestors who were trying to soothe a frightened child. The song was the 2010 creation of a small Korean company named Samsung Publishing. Its founders are now making money at the clip of a few million dollars a day. The stock of their company has also benefitted, rallying over 80% since the World Series started. We file all of this under the 'isn't life grand' tab.

'I'm Just a Dolphin, Mam'

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