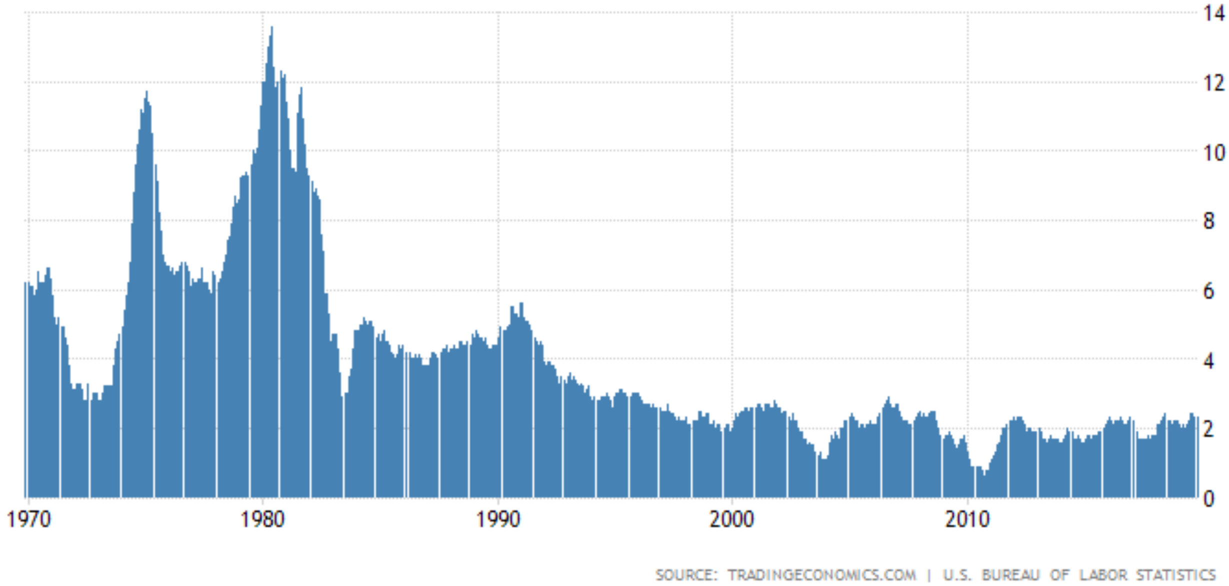
FOMO Turns Into FIMO

The quant machines were at it again this week, buying every long position they could get their hands on when Trump tweeted Thursday that 'we were close' to a deal, quickly ramping the market higher and turning it into one where the 'Fear of Missing Out' is being replaced with 'F$&K, I'm Missing Out!'. Or as Billy Ray Valentine explained when G.I Joe, with the Kung Fu grip was on the line one Christmas, 'See, they're panicking out there."

Louis & Billy Ray Clean Up

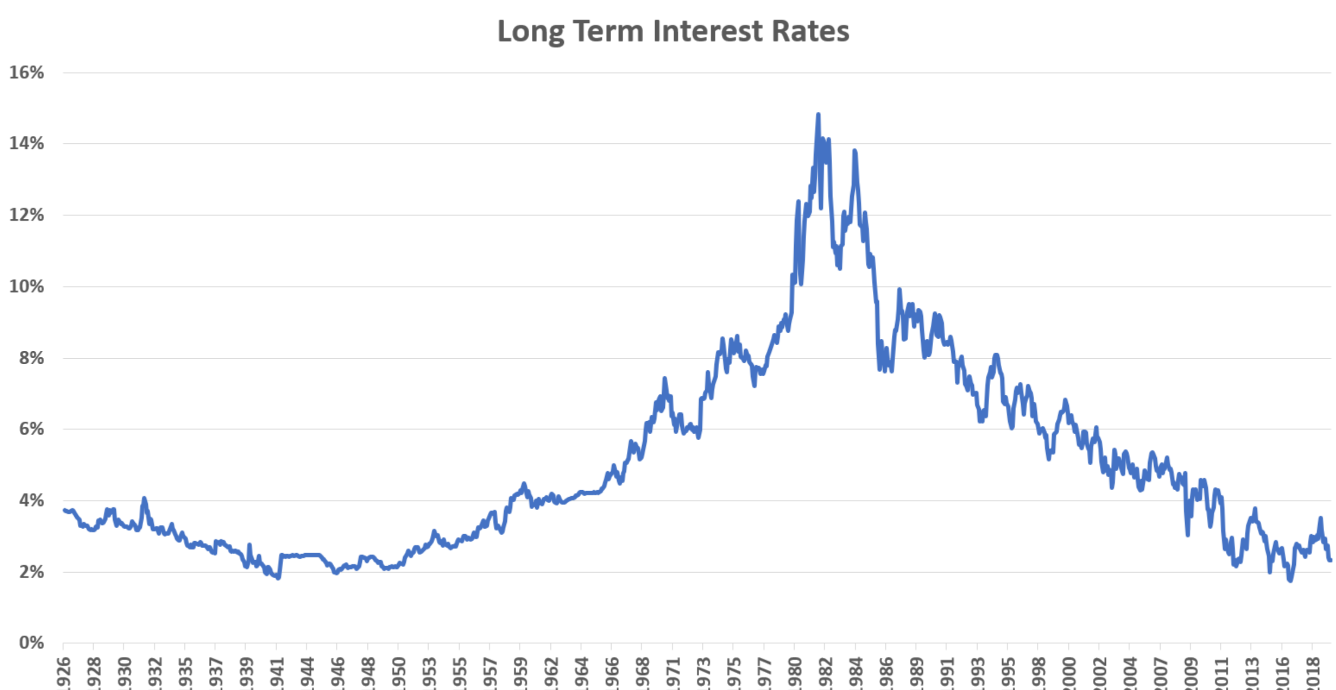
Around the globe it was an avalanche of feel good news. On top of the part one 'skinny deal' with China, the U.S., Mexico, and Canada agreed on a fresh USMCA/NAFTA trade deal, the newly installed head of the ECB Christina Lagarde, declared she too was a buyer of an 'any means necessary' QE policy, and our own Fed Chair, Jerome Powell, saying he won't flinch again until he sees signs of inflation in the economy. Which, for all intents and purposes, is a green light for the animal spirits to grab their party hats. And here is the reason why…

The Boogeyman Won't Boogey



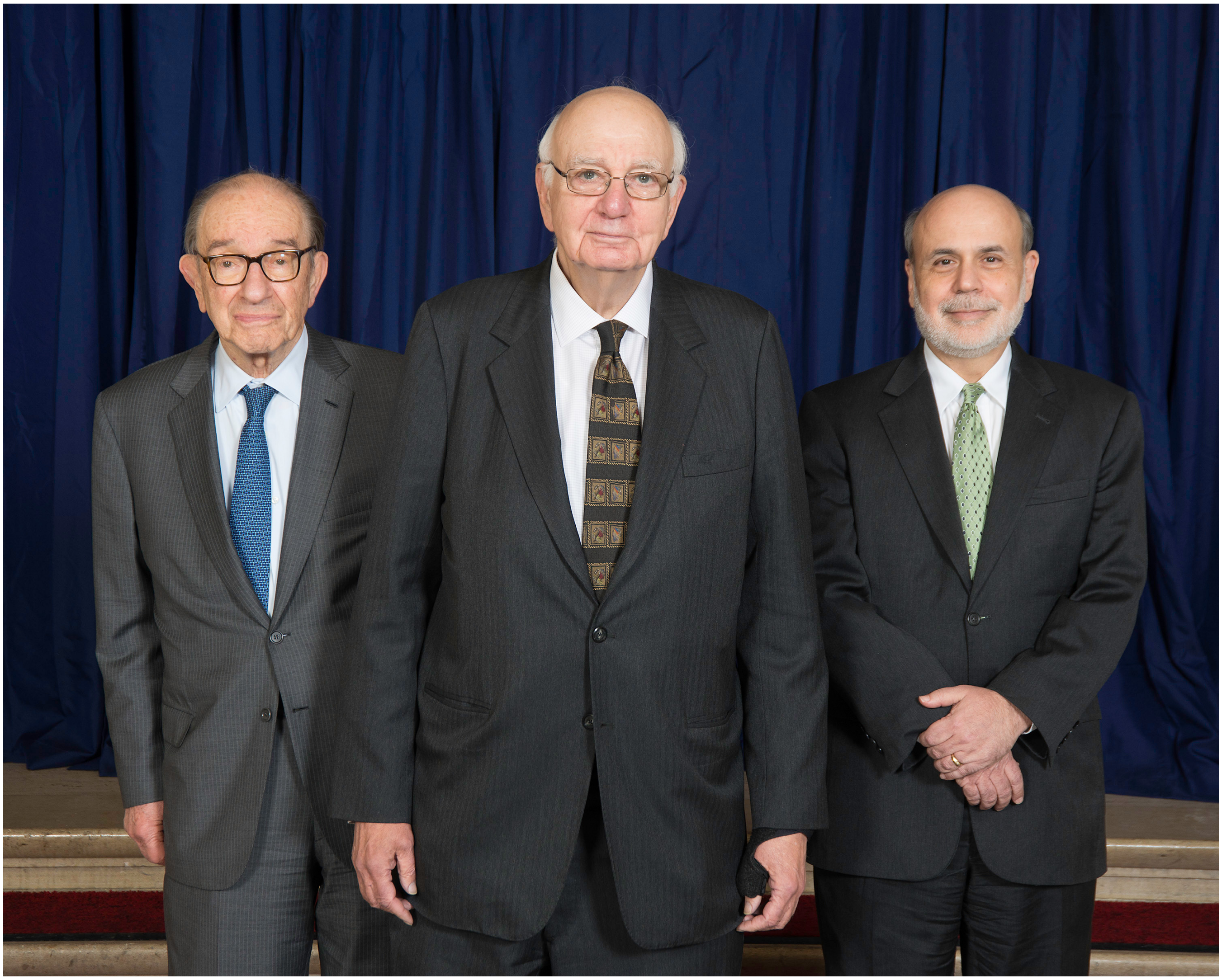
The chart above is that of the Consumer Price Index (CPI). The Fed has held out that something north of 2% and south of 4% is the sweet spot. The problem isn't the latter, it's the former. For twenty years, the reading has held at just above the stall speed the Fed worries about. That being the case, 'lower (rates) for longer' has become imbedded into market expectations. With no reason to believe that this trend will change anytime soon, 'lower forever' is becoming a reality.

Long Strange Trip



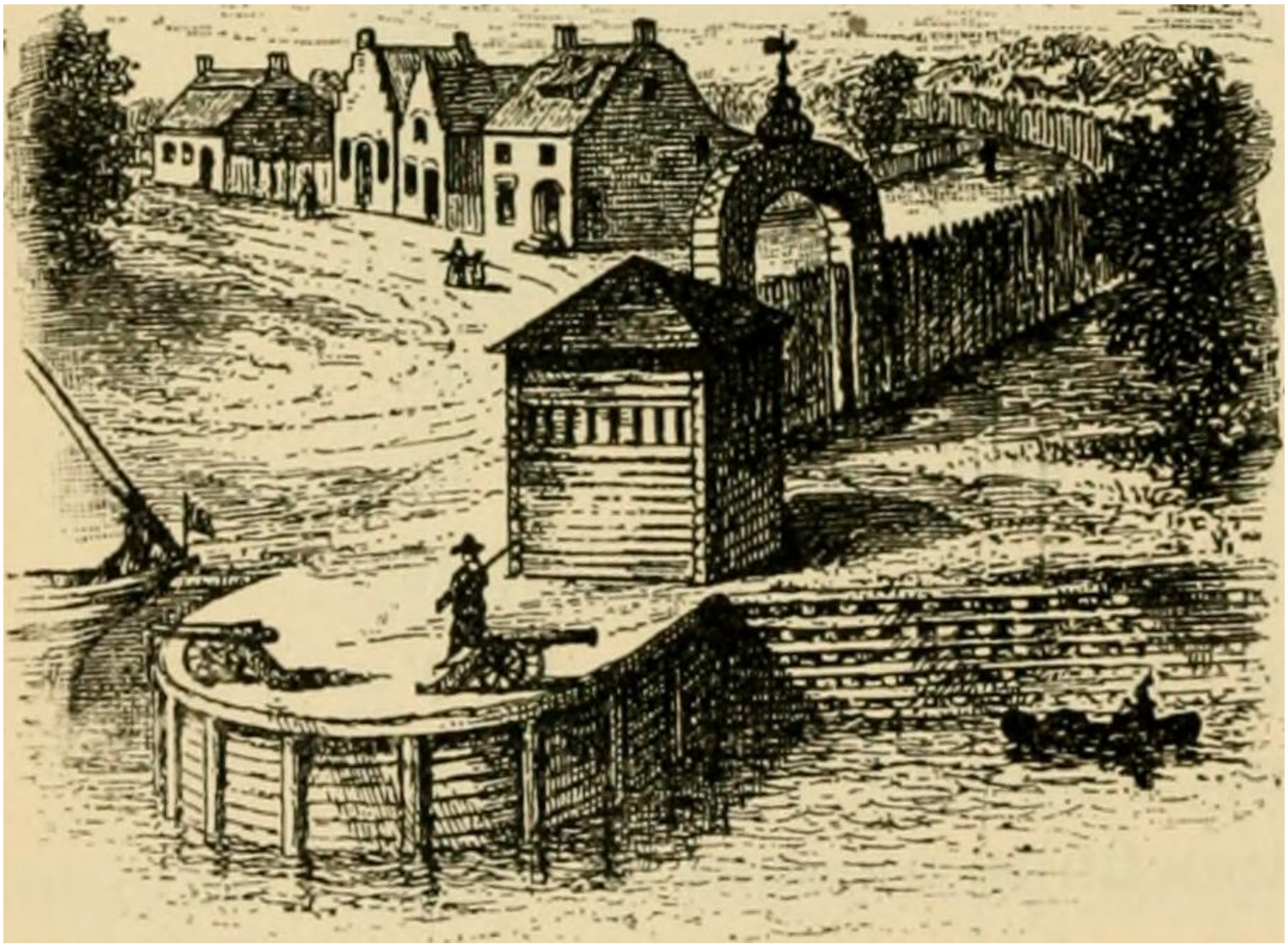
This week we lost the man credited with slaying the inflation dragon of the late 1970's and early 1980's, Fed Chairman Paul Volcker. During his time, the Fed funds rates spiked to a staggering 20%. Today, they stand 90% lower. While Volcker faded from the scene, he was resurrected by President Obama and his administration's effort to de-risk the financial system following the global financial crisis. The president fondly referred to the 6'7" Volcker as a 'Tall Glass of Water'.

Greenspan, Volcker, Bernanke



The Volcker Rule was part of Dodd-Frank and was the specific piece that forced Wall Street firms to separate traditional banking from proprietary trading, hedge funds, and anything else that looked risky. In the end, it was the right thing to do for Main Street, and a painful evolution for the walled variety.

The Original 'De Waal Straat'



Editor's Note

For consistency, the author does his best to make sure *This Week in the Markets* is posted and ready for an early Sunday morning delivery. This time of year can get tricky, as not only are there Stillwater Capital obligations to take care of, but this is also the season to be making the rounds, professionally and otherwise. Instead of sending out a rushed commentary that might not be up to our standards, sometimes we take the extra time to get it right. Enjoy the content, and more importantly, enjoy the season.

The Short Side

Add Citron Research to our side of the Peloton ledger. Last week the firm run by Andrew Left released a report ripping the company's prospects as its first mover advantage fades into the rearview mirror, with more competition on the way. Citron puts a long-term price target of $5 on the shares, down 80% from today's trading level. As fellow short sellers, we have to give the firm credit, they do a lot of very thoughtful and deep research on the ideas they come up with, Peloton included.

Crushing It...
Or Getting Crushed?

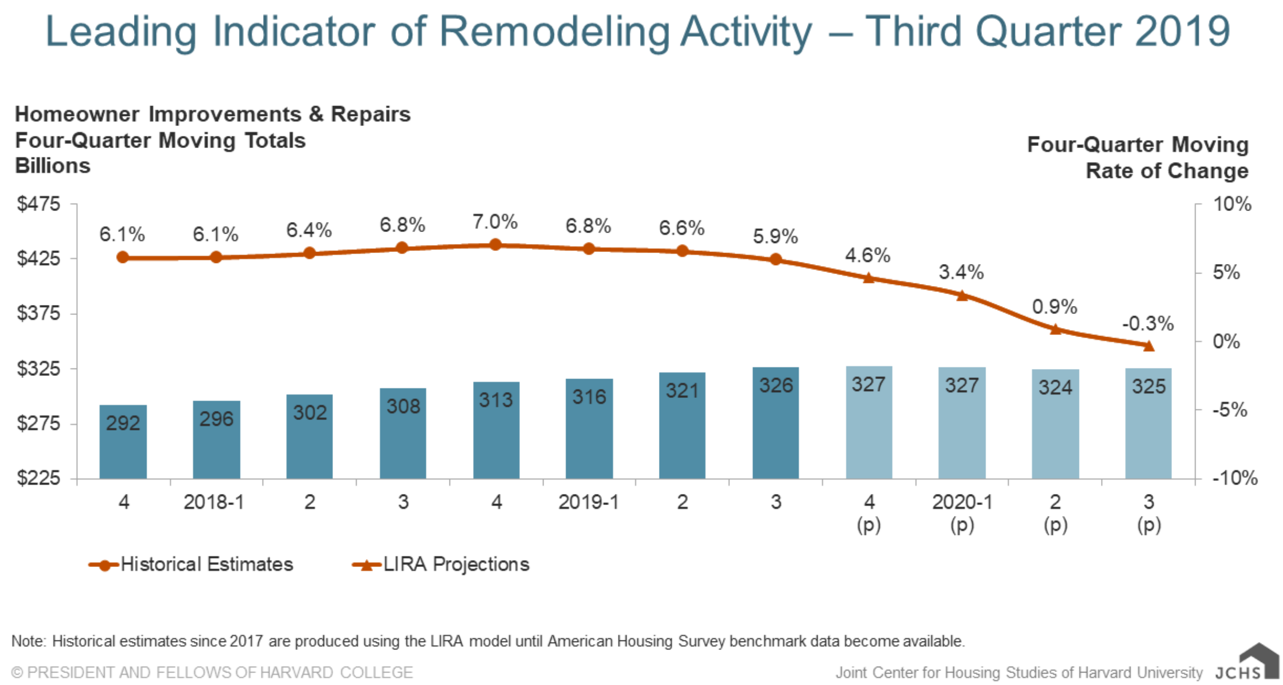
Source: RealMeKnot

There is a not so subtle shift in the medium and long-term outlook for Home Depot, the home improvement giant. And this should provide a good read on what's ahead for the consumer side of the economy and housing. Twice now in the past month, the company tempered expectations. First up is the observation by management that we are indeed late in the housing cycle. Next, a rising rate environment isn't good for anyone in home building. And finally, the country's opioid crisis has led to a higher level of theft that is beginning to impact the bottom line of the Atlanta based company.

The Biggest Big Box

While we already had our opinions on where the housing market cycle stood, our opinions on the home improvement sector were just as dubious. So, it was with professional appreciation that when the Harvard Joint Center for Housing Studies came out two months ago saying that 2020 was shaping up to be a year of headwinds, we respectfully agreed.

Remodels Rolling Over



Boeing took a fall on Monday as news hit the market that production of the 737 Max was likely to be halted as clearance to fly the plane by the FAA is likely to be pushed back further into 2020. One of the huge challenges the company faces is that the 737 program was the biggest cash generator it had. With that in limbo, and the free cash flow generation on hold, there are now serious questions about the ability to maintain their dividend in the near term. Boeing is the biggest industrial company in America by market capitalization, and Stillwater is short the shares, along with 737 fuselage maker Spirit Aero.

Parking Lot Full

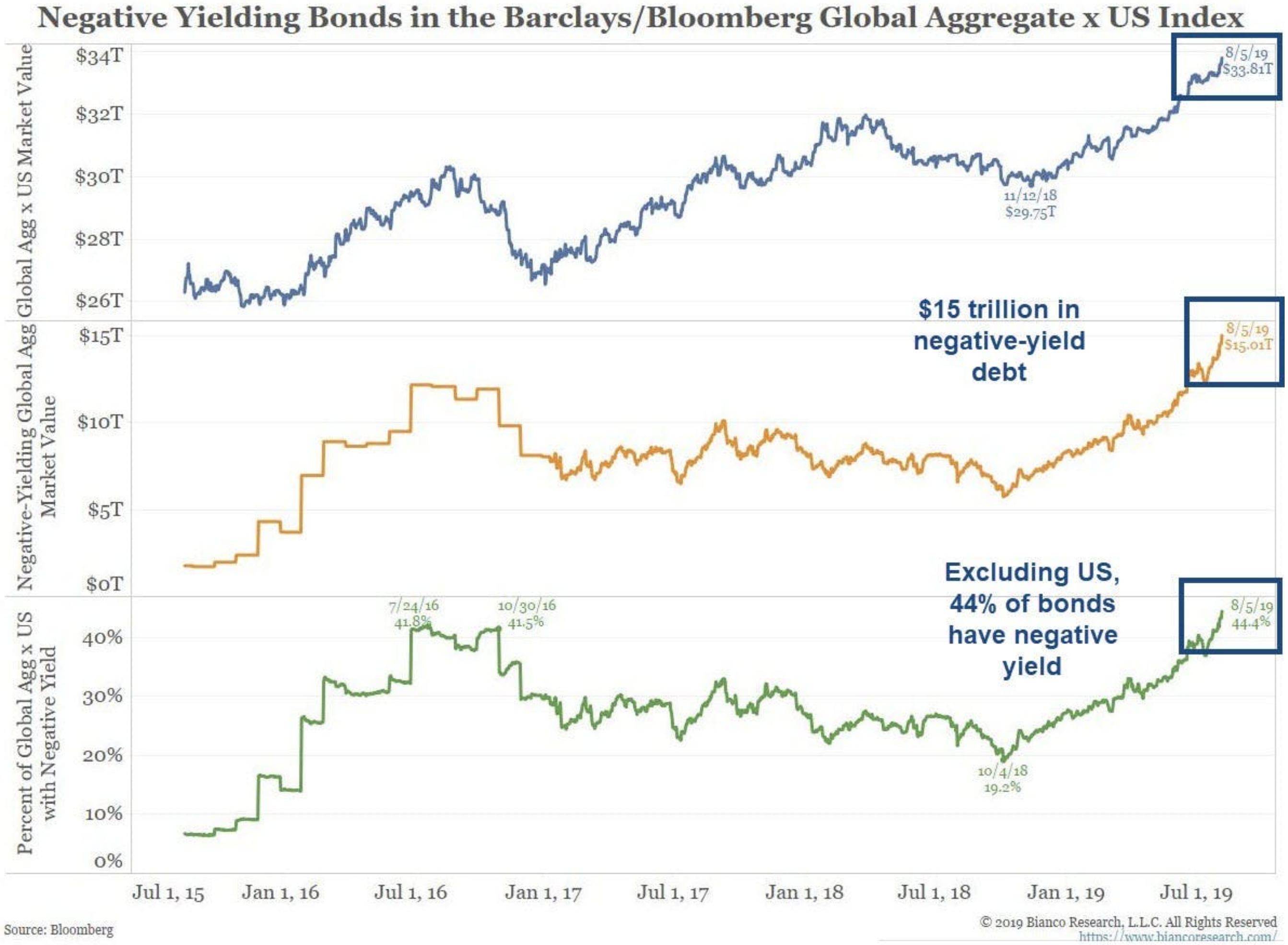
The Markets

Bank of America is making the call that the market melt-up we've seen since October 1st is set to continue into the new year, with an expected gain of 5% through early March. Their thesis is light on fundamentals and long on 'nothing to stand in the way'. Which is exactly what a 'melt up' looks like. Note the BofA target line in green in the chart below. For reference, we took care of 20% of that call on Monday when the S&P 500 went up 1%.

Higher Still

From a boots on the ground portfolio management level we can report, with first-hand knowledge, that the world changed beginning at the outset of the fourth quarter. Prior to that Stillwater was able to post returns that matched roughly 115% of the S&P 500, with 35% the exposure over the prior year and three quarters. That changed when global bond yields bottomed and one of the biggest short-term risk on trades we've seen took off.

The Picture Then

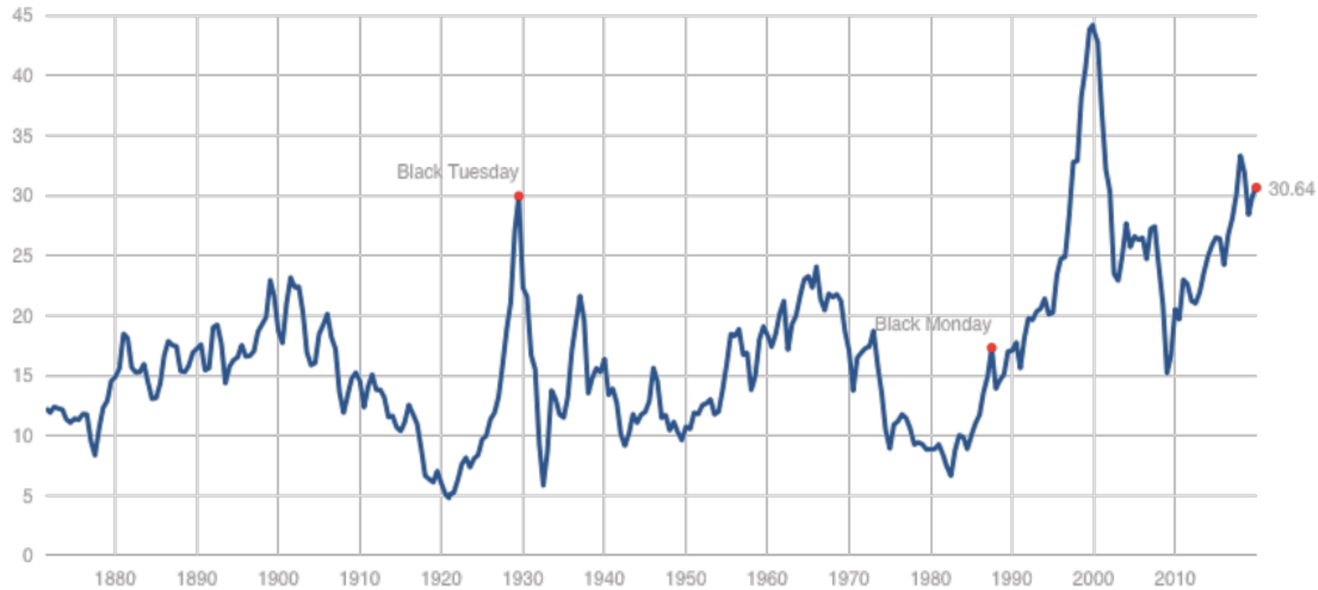


To place it into a relatable football analogy, we had been scoring points with a 'three yards and a cloud of dust' offense. That stopped working on October 1st as the new money-making playbook called for four receiver sets running deep routes against an overmatched secondary that didn't stand a chance. The good news for investors, if you have a solid asset allocation strategy in place, you likely have all the players you need on the field at one time.

Go Deep!

One thing we look for at moments like this when our style has quickly gone out of favor is to realize that we are headed into valuation territory seen only a few times before, all of which didn't end well. But as John Maynard Keynes once said, and it is sage advice for times like this, is markets can stay irrational longer than you can stay solvent. Buyer beware, and short sellers too.

CAPE P/E Ratio



Long/Short ESG

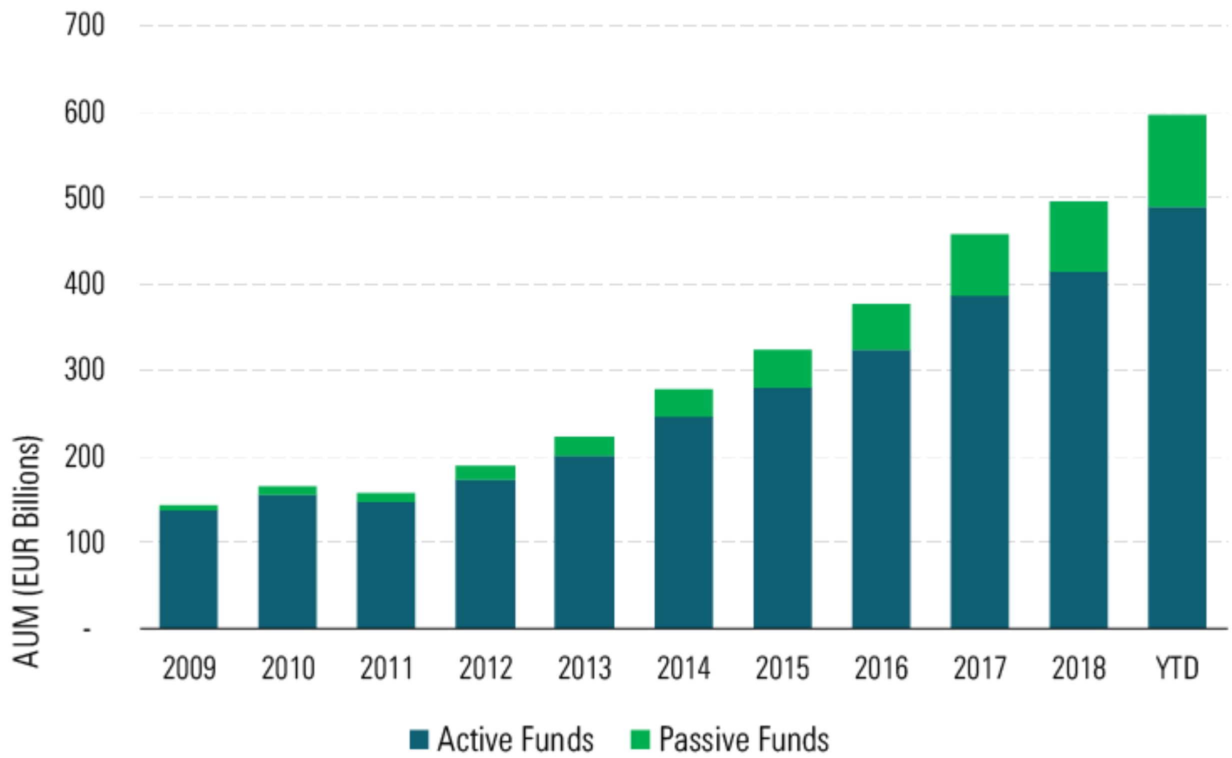
As an extension of Stillwater's alternative equity lineup, we have begun to pull the pieces together for an ESG strategy that will be able to take both positive and negative positions in companies exhibiting environmental, social, and governance qualities. This follows along with our Hedged Equity Income product that was designed to take the concept of dividend investing further, adding downside protection, and the ability to navigate challenging markets with hedges. So far, so good, on all fronts.

Not Afraid

Stillwater will have seeded strategies beginning in the first quarter of the fast-approaching New Year. On the long side we will be using traditional ESG filters, while on the short side we will take a stronger approach and go after companies we feel that represent just the opposite. This current year would have been a great one to exhibit that negative bias in shares of tobacco companies, oil & gas frackers, social media, and special situations like Johnson & Johnson, Boeing, and Wells Fargo. Please reach out and connect with Stillwater to open up a conversation about investing with us.

Getting on Board

Sustainable Fund Assets: A Decade of Growth



Source: Morningstar Direct. Data as of 30/06/2019.

Holiday Wine Diversions

We hope our readers have successfully navigated the season of cocktail parties, luncheons, and holiday open houses well this year. With a little more than a week to go before Christmas, it's time to dig a little deeper with your gift and imbibing wine selections. And by deeper we mean both in quality, and in price.

Here is Stillwater's 2019 selection of the ten bottles of fermented grape you want on hand to make an impression, yet not a statement. They are all from California as the 'grassy' European vintages can wait until next year. We've done you the favor of excluding both Screaming Eagle and Opus One, as we do have our standards. Your price point on these is $30 and up. Sometimes way up!

- JCR Vineyard Pinot Noir – A lesser known name than the legendary Seasmoke, but no less a quality full bodied Pinot Noir. It's from Santa Barbara, so it has to be good.

- Ridge Vineyards, Monte Bello Cabernet – From one of the only fully commercial vineyards overlooking Silicon Valley. While they have countless varietals, you want to stick with the Monte Bello label.

- Tablas Creek – This winery sits in Paso Robles and their many varietals are American versions of French classics. The name 'Tablas' comes from the chalk rock table the grapes are gown off of.

- Rombauer Chardonnay – Choose your audience for this one wisely as it's affectionally known as 'Cougar Juice', and for good reason. And no, we aren't making this up.

- Moraga Bel Air Winery – Shockingly good wine from grapes that come from the greater Sepulveda Pass appellation. Just know that your purchase is going into Rupert Murdoch's pocket…like he needs it.

Moraga Winery, Bel Air

- Gundlach-Bundschu Cabernet, another not to be messed with full bodied cabernet. Opened in 1858, this producer is the oldest family run winery in California.

- Duckhorn Winery Merlot, not to be confused with Duckhorn Decoy. Too easy? While this selection might be an obvious one, it's obvious for a reason. And sometimes you just need to go for the pin.

- Heitz Cellar Cabernet, like the aforementioned Duckhorn, obvious for a very good reason. Their Martha's Vineyard Cabernet might make the single best pairing for a properly oak fired filet steak.

The Pioneering 1974 Vintage

- Babcock Winery, another Santa Barbara producer owned and operated by our friend Brian Babcock, who is not afraid to get funky with it and put together blends you are never going to taste elsewhere. He and his wife Lisa have put together one of the best destination wineries in existence.

- The Bucket List Six Pack, so we ran out of roster spots before we got to include six more from the Golden State that should be had before room temperature calls. In no particular order…Justin Isosceles, Jordan Cabernet Sauvignon, Chateau Montelena

Cabernet Sauvignon, Grgich Hills Chardonnay, Silver Oak Cabernet, and finally, The Mayacamas Cabernet Sauvignon.

Rudolph Does the Driving

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