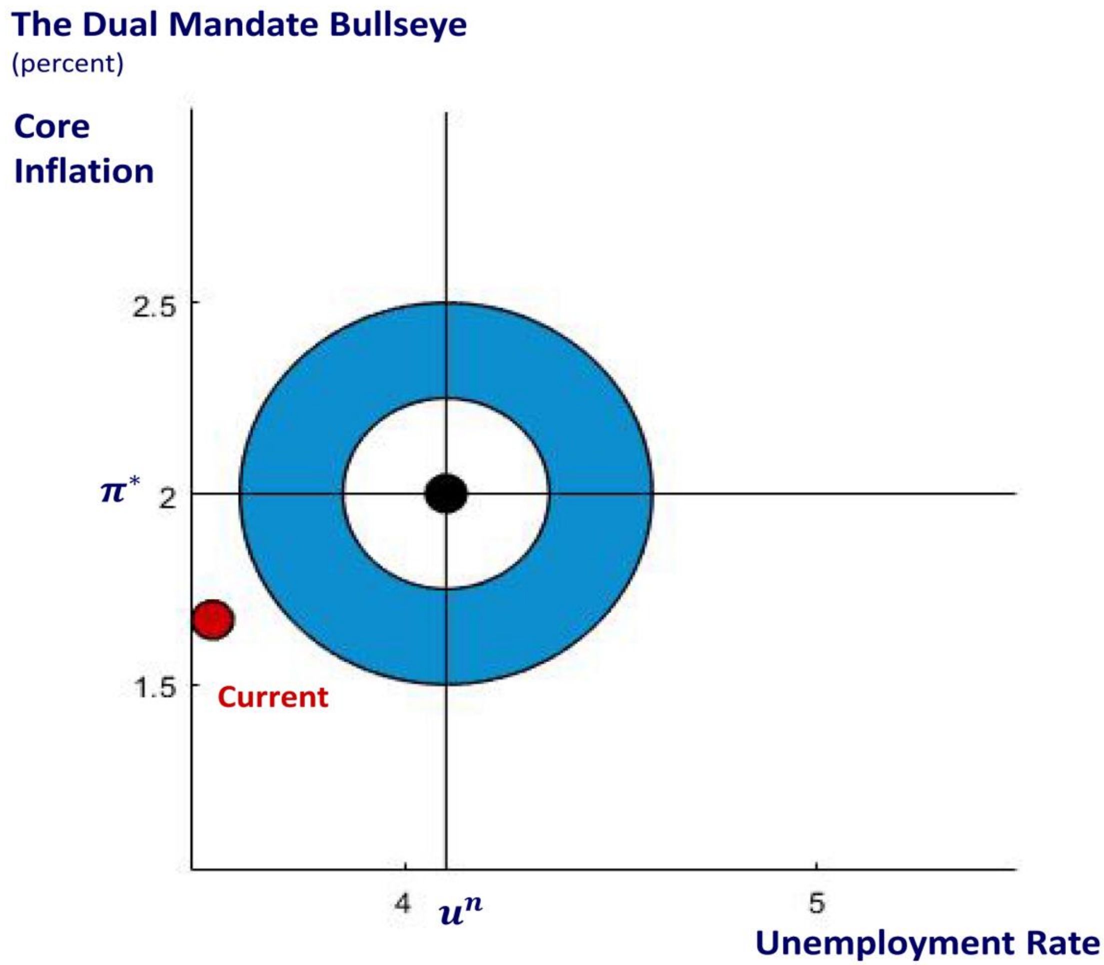
Stuck in the Middle…East

Just when the conventional wisdom had the markets ready to start discounting more risk to the global macro environment, they did the opposite. Even in the face of what looks to be an escalation of hostilities not seen in decades, the markets are saying that even if we aren't one and done in terms of the shelling, quantitative easing is back with a vengeance, and that trumps everything else combined. As Bloomberg opined last week, you have central bankers to thank for your 30% return last year. And they aren't wrong. And by 'they', I mean Bloomberg, the bankers are another story. Where the disconnect lies is with the fact that this round of QE is barely related to its three younger siblings, yet the result for asset prices is the same.

QE Four

Quite literally forget everything you hear about corporate fundamentals, iPhone handset sails, oil inventories, consumer confidence or CEO pessimism. The massive risk on trade that started in October of last year is 100% correlated to the return of quantitative easing after a four-year hiatus. With government reported CPI stuck below 2%, the Fed can lever up as much as they want with little fear that the 'stable prices' side of their mandate gets challenged.

Off the Mark

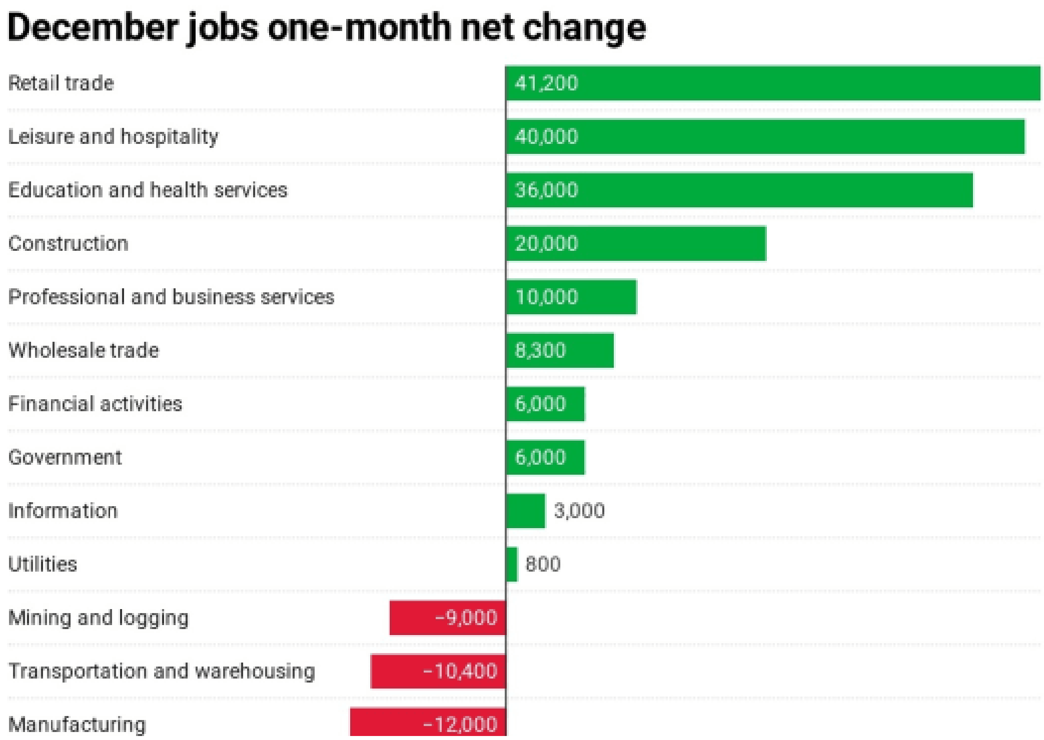


Before we jump into the hard numbers this week, we want to take a step back and interject George Soros' Theory of Reflexivity. While somewhat esoteric, the theory supposes that certain actions by market participants, in this case the Fed, create narratives which in and of themselves aren't real, but when embraced in mass, they become so. Said more simply, there are moments when myth creates reality. And that is a pretty good way to look at the real economic impact of QE versus the impact it has on asset prices. All we know for sure is this, let the wild rumpus roar.

Fed Chair Powell as Max

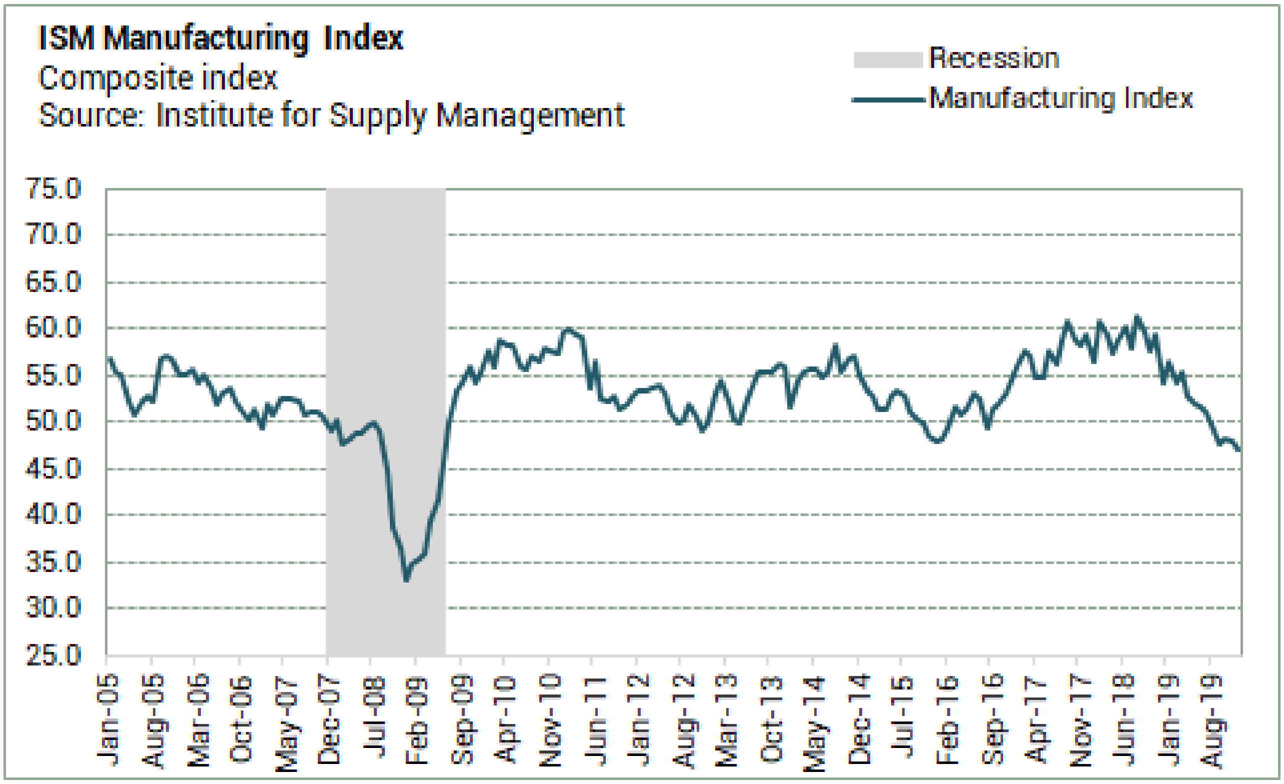
December's employment condition were reported on Friday, and they continue to paint the 'full employment' side of the mandate as well achieved. In the last month of the decade, employers added 145,000 jobs to the payrolls, further juicing the narrative that this economy has nothing but clear air ahead. And who knows, maybe the economic cycle has been revoked by central bankers and it does.

More Jobby, Jobs



The other data point worth noting this week was the Institute for Supply Management monthly reading on the health of the manufacturing area of the economy. Once again, bad no longer means bad, it means good, as ISM came in below 50 for the fifth straight month, confirming what the skeptics think, and that is all is not well below the surface. The 47 reading is the worst in a decade.

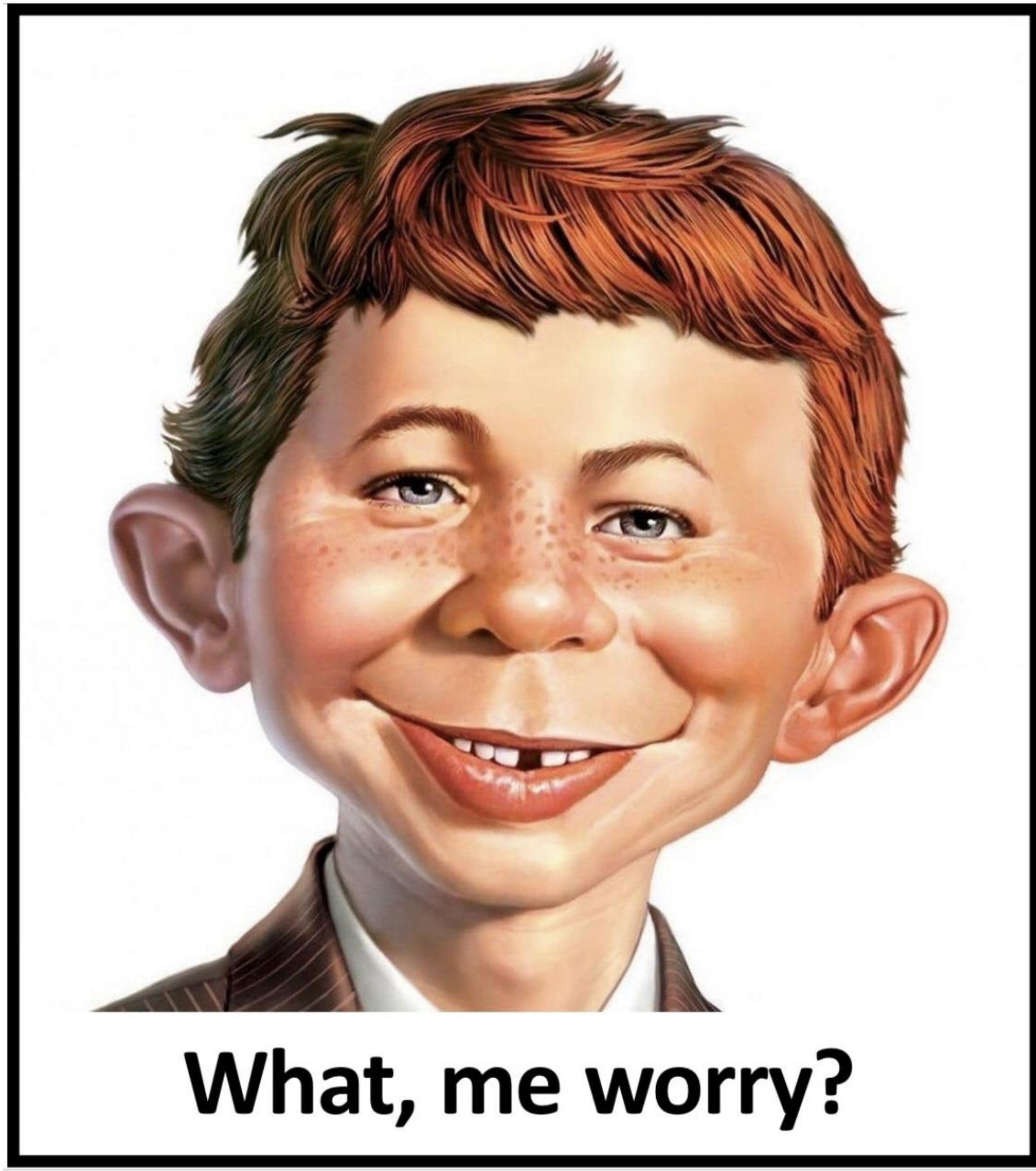
Manufacturing ISM



The Markets

DoubleLine founder Jeffrey Gundlach hosted his annual 'Just Markets' presentation on Tuesday. In his lengthy and wide-ranging presentation, he opined with slightly less gusto than in past years. As Bloomberg reported the morning of the webcast, last years predications proved more cautious than anyone anticipated as a freight train of a market took off and refused to be held back by any sign of fundamental economic or corporate weakening. ZeroHedge provided a full recap of the call, along with the slides Gundlach used to paint the picture for 2020. One of the things he counseled was to not short oil, which we just happen to be through various E&P and oil service companies.

Exactly



Byron Wien's Surprises

Every year Wall Street gets treated to Byron Wien's list of ten surprises for the coming year. And even us younger old timers appreciate the thoughtful process he engages in developing the list, and this year was no different. In the interest of a lively debate with one of the legends of the markets, we provide our thoughts on each surprise. But before we do, here is to one of the great gentlemen of our trade. Last year the Wall Street Journal wrote about the transition Wien was making as he reached his 85^{th} year on our planet, making this his possible swan song.

The Lion in Winter

Byron Wien and Joe Zidle Announce Ten Surprises for 2020

New York, January 6, 2020 – Byron R. Wien, Vice Chairman together with Joe Zidle, Chief Investment Strategist in the Private Wealth Solutions group at Blackstone, today issued their list of Ten Surprises for 2020. This is the 35th year Byron has given his views on a number of economic, financial market and political surprises for the coming year. Byron defines a "surprise" as an event that the average investor would only assign a one out of three chance of taking place, but which Byron believes is "probable," having a better than 50% likelihood of happening.

Byron started the tradition in 1986, when he was the Chief U.S. Investment Strategist at Morgan Stanley. Byron joined Blackstone in September 2009 as a senior advisor to both the firm and its clients in analyzing economic, political, market and social trends. In 2018, Joe Zidle joined Byron Wien in the development of the Ten Surprises.

Byron and Joe's Ten Surprises for 2020 are as follows:

One: The economy disappoints the consensus forecast, but a recession is avoided. Federal Reserve Chair Powell lowers the Fed funds rate to 1%. Without a comprehensive trade deal in hand, President Trump exercises every executive authority he has to stimulate growth and ward off recession. He cuts payroll taxes to put more money in the hands of consumers.

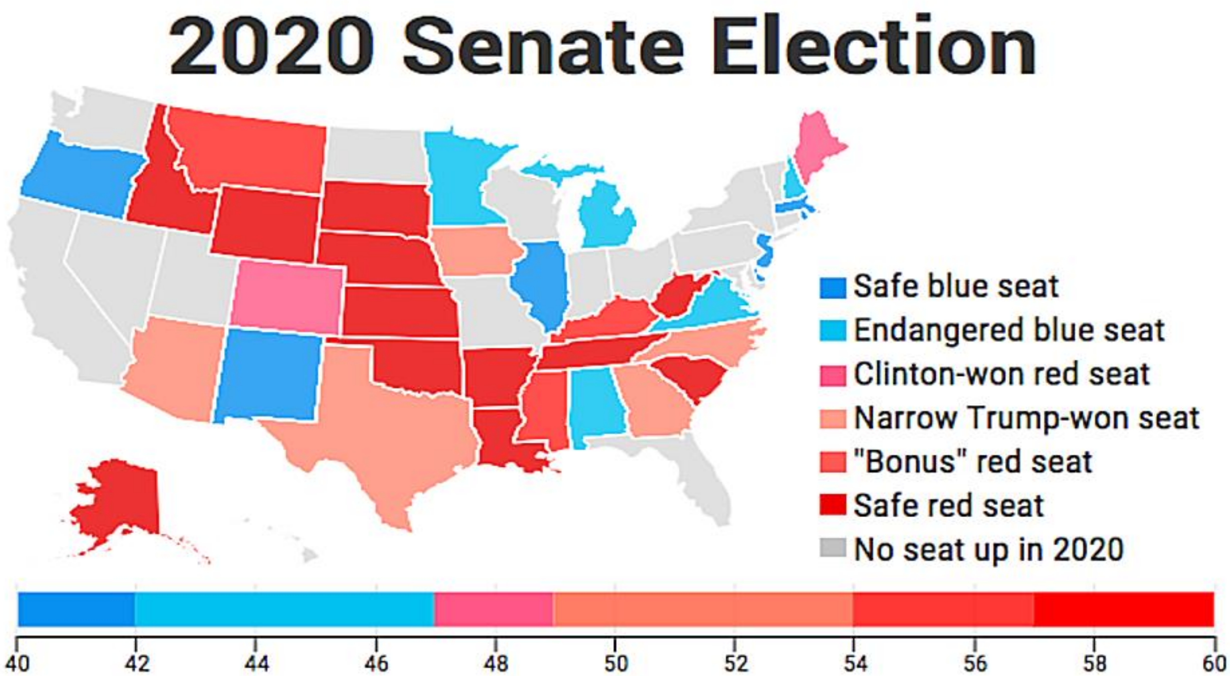
This one looks like a pretty solid prediction given the direction of both Powell and Trump's actions. As everyone knows, the president has the levers to pull to stimulate the market, and he only needs ten more months of doing it to win a second term. But even Fox News asks, 'can we boom, without a bust?'

Not Afraid

Two: Concepts of inequality and climate change become important election themes, but centrist ideas prevail. The House of Representatives sends articles of impeachment to the Senate, but Donald Trump is not convicted or removed from office. Enough information is revealed in the proceedings to cause some of his supporters, as well as many independents, to throw their support to liberal candidates in 2020 state races. The Democrats take the Senate in November.

This one too seems pretty spot on. With the economy hammering on all cylinders, and markets at all-time highs, the more progressives from the left just aren't ready for prime time. That said, and like Ray Dalio thinks also, the next economic contraction could very well open the stage door for them.

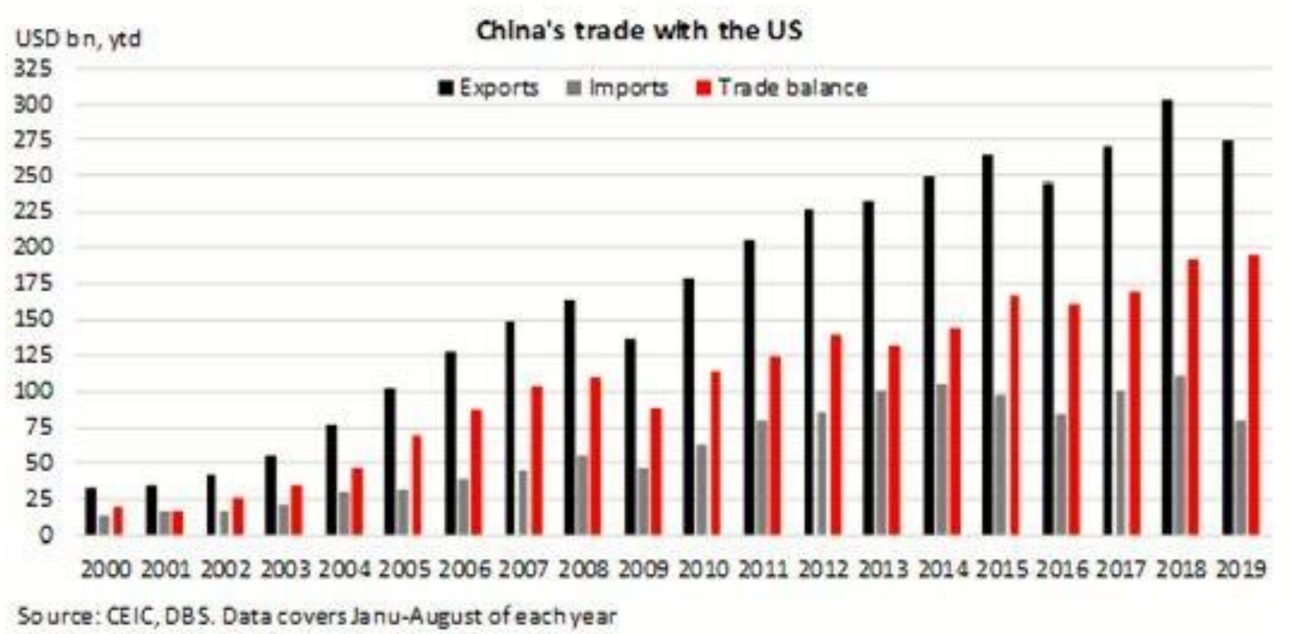
Up for Grabs?



Three: There is no comprehensive Phase Two trade deal that limits China's ability to acquire intellectual property. National interests result in the Balkanization of technology. The development of separate standards for 5G and other tech hardware proves to be bad news for the future of world economies. The move toward "decoupling" gains traction in negotiations with China. US economic co-dependence with China erodes. Both China and the US keep their hands-off Hong Kong and let the protest settle down by itself.

While there is a lot to digest in there, the one thing we think won't happen is a Phase Two deal, as President Trump has no reason to advance the cause during the election year unless he gets a China crushing deal, which won't happen. China on the other hand, will be willing to roll the dice and see who they will be dealing with on the other side of the table come November. Keep in mind, Phase One was a ceremonial agreement with little in the way of true heft except for some soybeans trading hands.

Trade Imbalance



Four: The prospect of a self-driving car is pushed further into the future. A series of accidents with experimental vehicles causes a major manufacturer or technology company to issue a statement that they're no longer developing self-driving technology.

This one is above our pay grade to understand. That said, it's an interesting sight spotting these on the leafy streets of Palo Alto.

Driver-Less

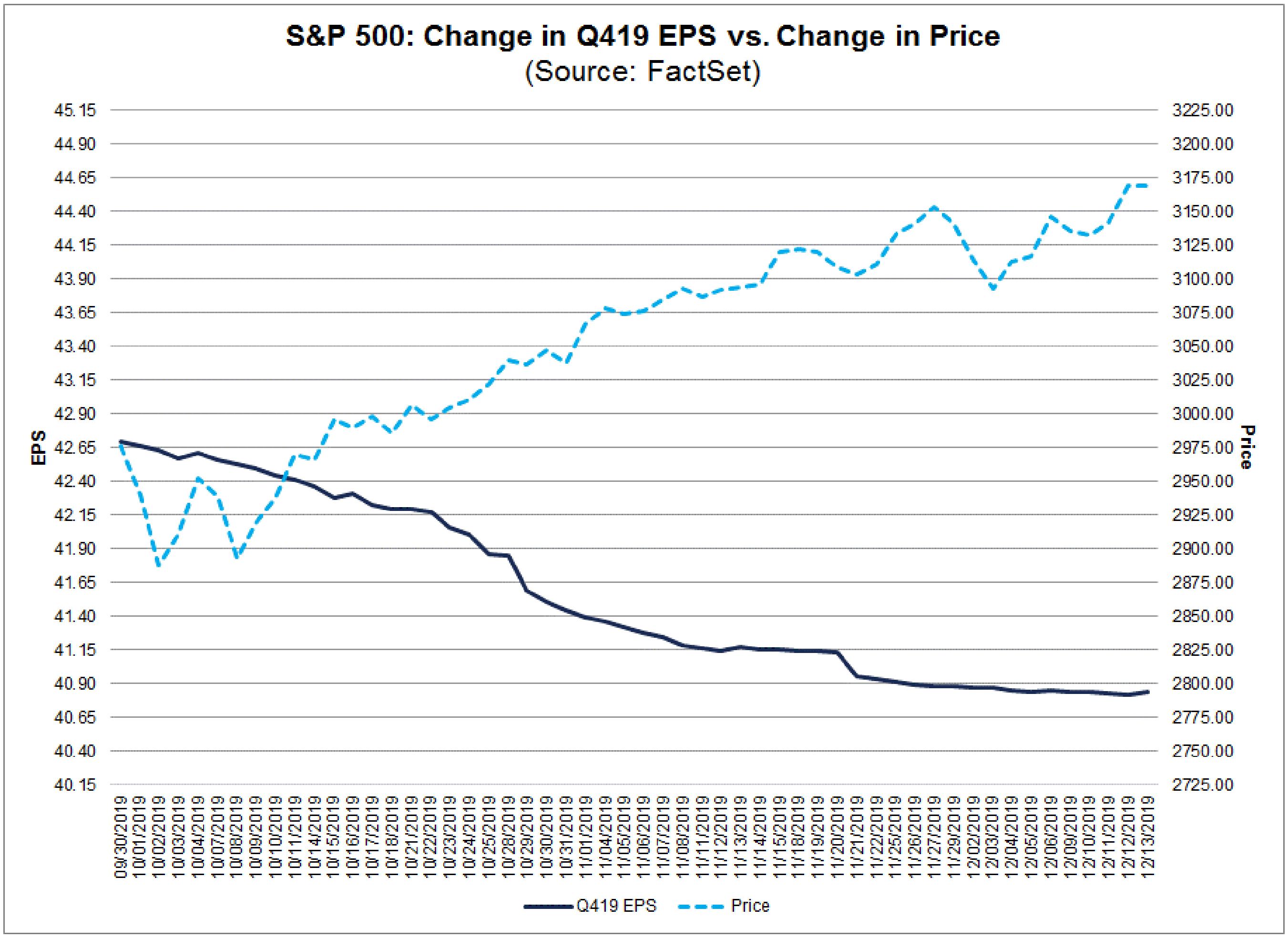
Five: Emboldened by the pain of economic sanctions, Iran capitalizes on a lack of American leadership abroad by stepping up acts of hostility against Israel and Saudi Arabia. The straits of Hormuz are closed and the price of oil (West Texas Intermediate) soars to over $70/barrel.

This one looks to be DOA right out of the gate. Perhaps Donald Trump reads what Byron Wien writes and took exception. That said, and to show you how changed the oil markets are these days, the escalated tensions between the U.S. and Iran barely did anything for the price of crude.

Six: Even though some observers believe valuations are stretched, a surge in investor enthusiasm pushes the Standard and Poor's 500 above 3500 at some point during the year. Earnings only increase 5%, and S&P 500 multiples remain elevated because monetary policy is easy and investors become more comfortable that intermediate interest rates will rise slowly. Volatility increases and there are several market corrections greater than 5% throughout the year.

Bingo, bingo, bingo! Winner, winner, winner! This is the trade that is currently going down, and there is now sign that it will moderate until the markets see the whites of the global central bankers eyes, and they actually blink. Next stop on this crazy train, Bubblesville.

Spread Widening



Seven: Big tech companies face growing political scrutiny and social blowback. Once the market leaders, certain FAANG stocks underperform and the equal-weighted S&P 500 outperforms. There are popular plans proposed to break up the largest social media platforms and increase regulation and government oversight. This has greater success than prior government efforts against Apple, Microsoft and IBM, because it has widespread support from the American people. A millennial in New York City puts their phone down and makes eye contact with another human and finds it non-threatening and refreshing.

Another winner, in our opinion. There has already been some bifurcation amongst mega-cap tech stocks, the FANGs being exhibit A through Z. Of that cohort of companies, we have been long Apple and Amazon, while short Netflix and Facebook. While last year was a tough one to put short selling points on the board, we managed to pull a full 2% out of the latter. We call that a victory.

Eight: Having secured a workable Brexit deal, the United Kingdom turns out to be the winner in its divorce from the European Union. The equity market rises and the pound rallies. The U.K. benefits from a long transition period and growth exceeds 2% as foreign direct investment resumes now that the outlook is clarified. The EU economy remains soft, and European markets other than the UK underperform the US and Asia.

We appreciate the depth of thought here, but have to admit, the market seems to have moved on from Brexit and is now fatigued by the whole thing. The saga has been going on for three years, and the deliberations are now a sideshow to what is taking place between the U.S. and China.

'You Listen Here!'

Nine. The bond bubble starts to leak, but negative rates continue abroad. Even though the U.S. economy is slowing, the 10-year Treasury yield approaches 2.5% and the yield curve steepens. Japan and China pull away from the Treasury auctions. Rather than economic fundamentals or inflation, supply and demand drive yield higher.

A 2.5% yield gets you back to the five-year average, which given the current rate of growth would be a more normalized rate, no arguments there. What a backup in rates like that would do for dividend yielding equities is another question. In terms of the latter point Wien makes, we are getting to the point where we no longer believe fundamentals matter, and everything is being driven by behind the scenes technical levers.

Ten-Year Treasury Yields

10. The problems with Boeing's 737 Max are fixed and deliveries begin. The plane becomes a fixture around the world, enabling airlines to operate more efficiently and increase profits. The stocks become market leaders.

We understand this to be the likely 'long game' for the 737 MAX. That said, Boeing is going to be blowing through a sizeable amount of cash as it is forced to wait this out. In the meantime, the company will have to deal with headline risk like the report that employees referred to the way they navigated the FAA was akin to using 'Jedi mind tricks'. Another e-mail included the description of the situation as this …'That plane was designed by clowns who in turn are supervised by monkeys.' We have been short the shares of Boeing and fuselage maker Spirit Aeronautics.

Parked 737 Max

Up & Down Wall Street

Next week, we will turn our focus on what's working on Wall Street, and what isn't. From ETFs to Opportunity Zones, and everything in between, we have you covered. And in true Stillwater form, we will be pulling no punches and calling those out by name who we think are doing right by investors, and those who are not. Trust us, there are plenty of both.

The NYSE

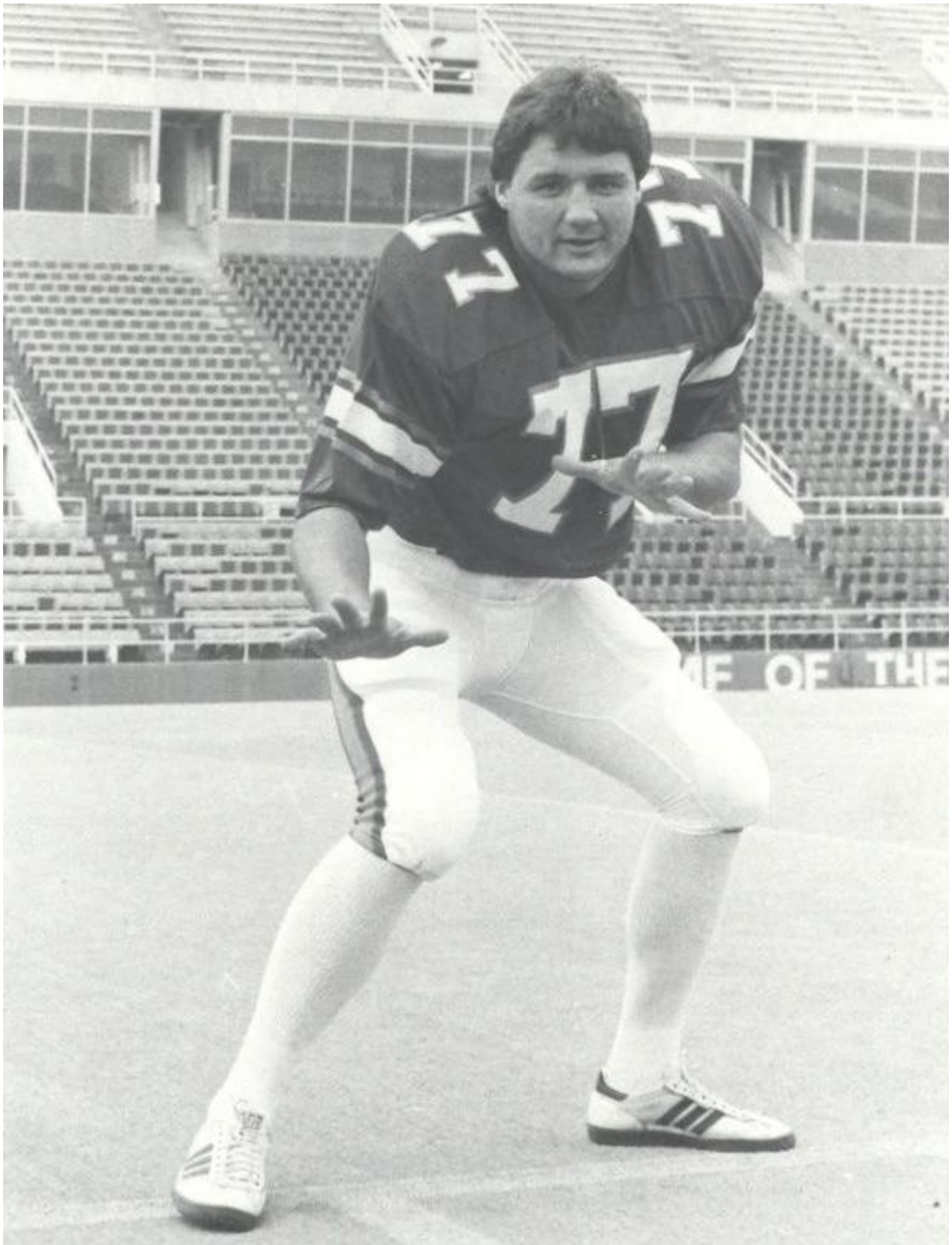
Diversions

We have a big one on our hands down in New Orleans on Monday night, as the Bayou Bengals of LSU are taking on the Clemson Tigers, led by the QB with the flowing locks, Trevor Lawrence. His hair is such a big deal, it has its own Twitter feed, TrevoreLawrencesHair (@TLawHair), and ESPN ran a profile on it before the college football season started. But lest we digress, if this game at all lives up to the hype, it should be a great one, as the guy snapping the ball for LSU won the Heisman and recently dismembered a talented Oklahoma Sooners team to get to the National Championship.

Lawrence v. Burroughs

The fact that the game is being held in the Superdome in downtown New Orleans gives LSU the clear homefield advantage. That said, Clemson fans are not afraid to travel. One of our favorite stories going in is the long strange trip Coach Ed Orgeron has taken to get to this place. He most certainly faced down some pretty big daemons early on, admitted to it, and has let it help shape the next more successful chapter in his life. Anyone who orders in an extra 15 pounds of crawfish to make sure a highly sought after QB commits to play for him is good by us. ESPN profiles the story, and many of the other now legendary escapades of this true Cajun. Golf Digest, of all outlets, paid tribute as well.

Coach O



In news that should surprise very few, the mega high-end real estate market is not what it at all appears to be. From Bel-Air, to Manhattan, to Silicon Valley, the asking price isn't even in the same zip code in terms of where the bid might be. Case in point, the almost 50% haircut that Sun Microsystems founder Scott McNealy had to lop off to re-energize his listing.

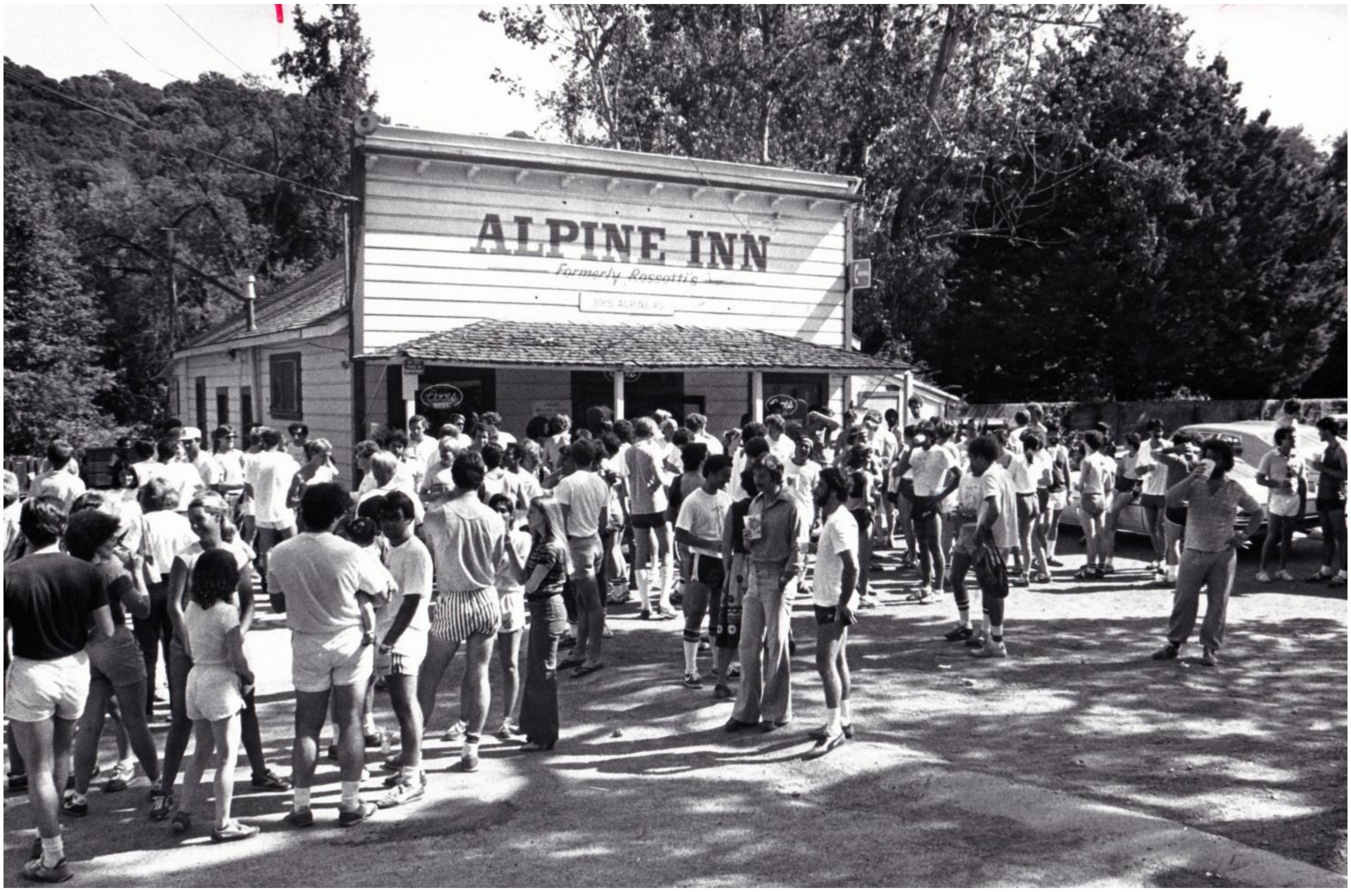
610 Los Trancos Road, Portola Valley

The San Francisco Chronicle reported this week that the home also needed a complete re-staging inside to bring in potential buyers. While we have seen and heard some pretty funny things in real estate, this one from the listing agent is right up there at the top.

"They were not serious when they had put it on the market earlier," said Chattha. "It was an exclusive listing. They were testing the market. The children were at home. Now, the kids are leaving. They're ready to make the move. It's too big a house for them now. Now, they've listed on the MLS."

Good to know that with the kids out of the house, and the listing now being on MLS, you can get it for $50 million less than the original non-serious listing. All we know is that whoever the buyer shall be, they are lucky enough to be walking distance to one of the Peninsula's all-time great burger joints and Stanford hangouts, the newly renovated Alpine Inn.

Go Cardinal!



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