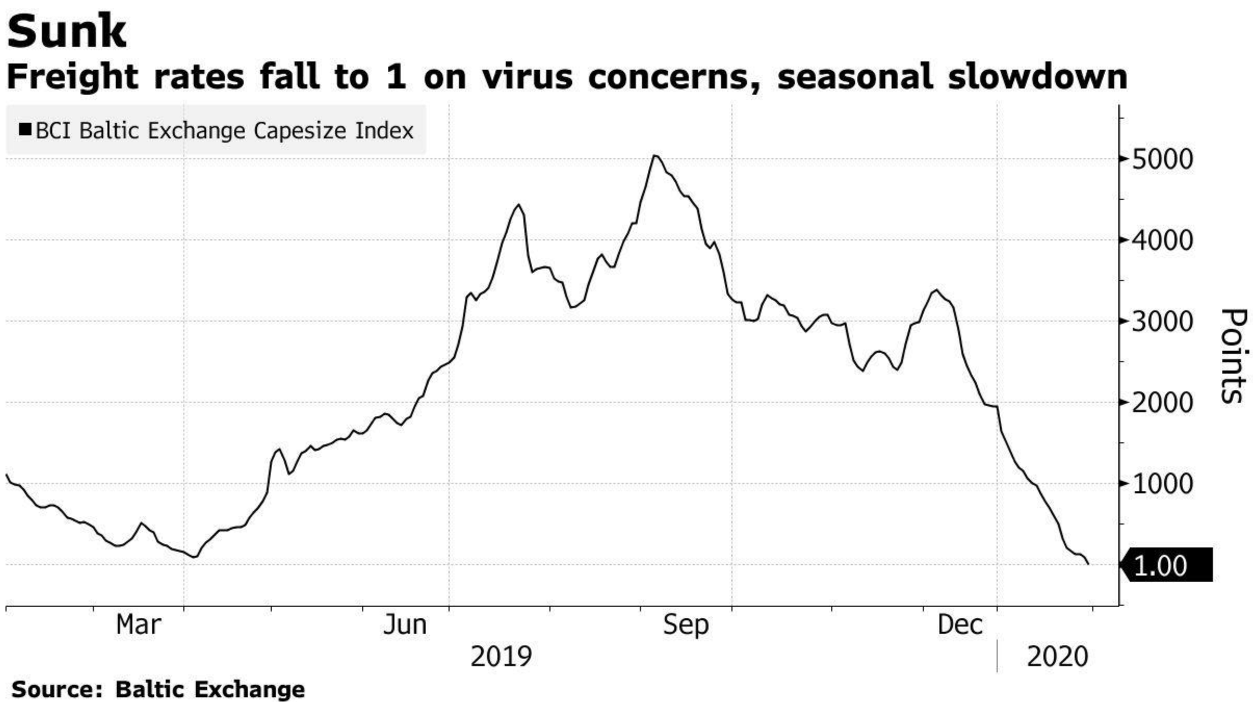
Like a Hipster to PBRs…

First up this week, a quick whip around the markets before we drop into a roundup of hedge funds, private equity, ESG, and venture capital. With this being a "FIMO" market, we wanted to find out where demand stood for various alternative asset classes. So not to ever be accused of burying the headlines, we will say this, risk is still as popular to investors as Pabst Blue Ribbon is to a hipster on a Friday night.

Rack 'Em

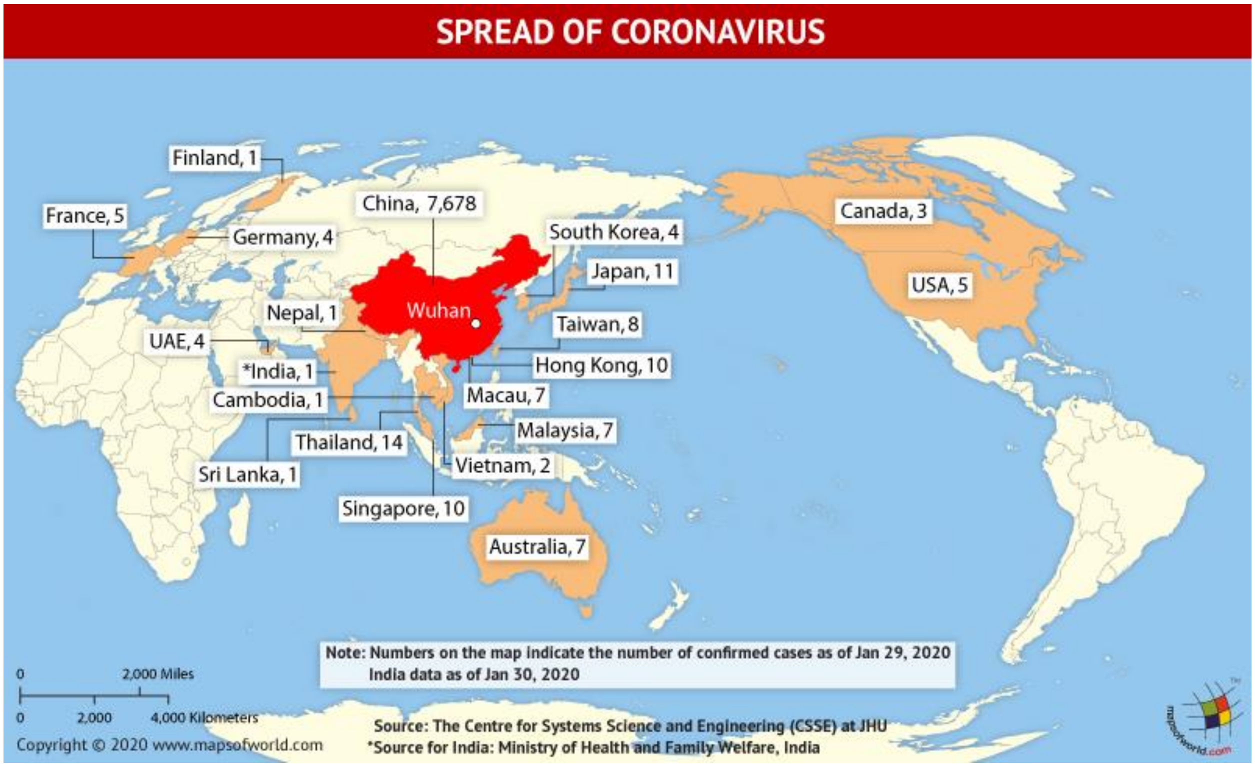
In all seriousness, the markets are grappling with a very serious global macro threat and that is the rapid spread of the Wuhan Coronavirus. The global markets are being put on pause as the ramifications of a possible slowdown in economic activity is priced in. To give you an idea of how bleak the outlook is, the Baltic Exchange Dry Index has crashed out to the tune of 99%.

Baltic Exchange Dry Index



Oil prices are already off 10% on the threat of fewer flights out of China and how that will impact the jet and shipping fuel markets. Every news outlet and publication known to man has their 'what to know about the Coronavirus'. We give you those from Bloomberg, the San Francisco Chronicle, CNBC, and the New York Times. As of Friday night, we had 10,000 cases worldwide, and 200 associated deaths.

Hot Zones



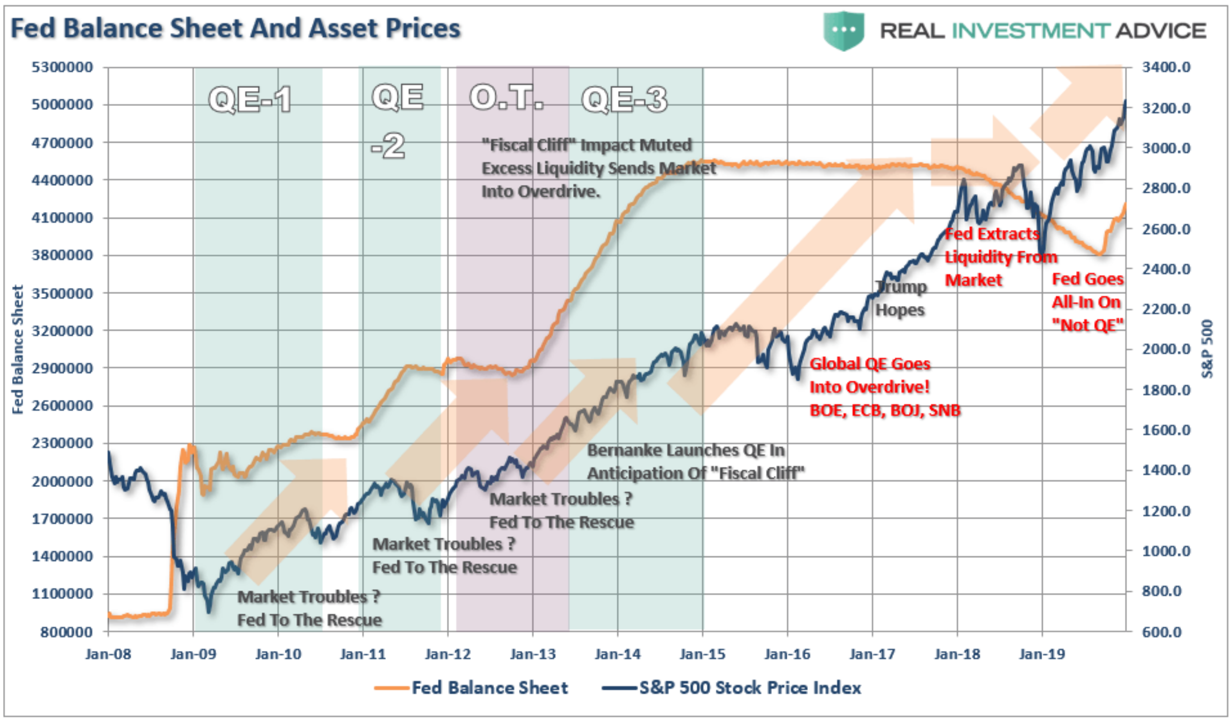
Before we go on, we want to again remind everyone that right now on Wall Street there is barely a soul alive who wants to tell you to sell this rally. The parade of Wall Street analysts and strategists continue to raise price targets where they have little edge. But like everyone else with a mortgage, they want to keep their job. With that, the game of keeping up with the quants continues, and we creep deeper and deeper into the red zone with no human left to man the switch.

The Rise of Quants

The Economist

At the end of the day, if higher stock prices have a high correlation to quantitative easing, who cares about the quality or the reasoning behind why the Fed opened up the spigots. Which in this case is designed to grease the wheels of the little understood overnight repurchase obligation, or 'repo' market. To be clear, and this should not be taken lightly, the United States doesn't have a growth problem, we have a liquidity problem in the overnight lending market. The longer that this is confused, the bigger the disconnect becomes between asset prices and fundamentals.

Follow the Fed

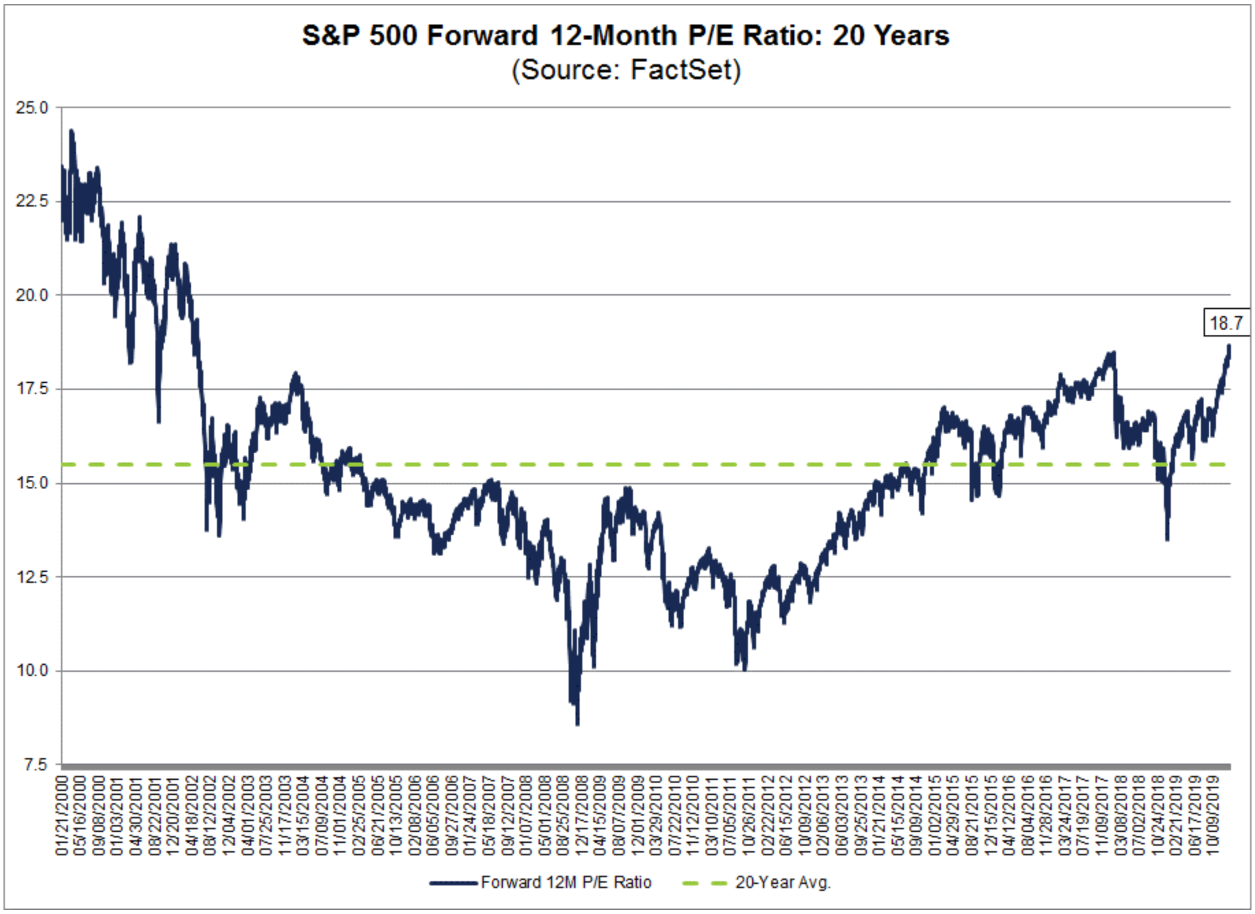


With that, we wrap up an abbreviated run through the markets and move onto a look at the state of alternative investments. But before we do, lets re-iterate where we see things. Our overall view remains that this a rally inspired not by improved earnings and stocks catching up to an improved fundamental narrative. Instead, this a derivatives and algorithmic based race that keeps the market bid because past models show that is the path of least resistance. Will the fire hose run out of water anytime soon? That's the trillion dollar question.

Let it Flow

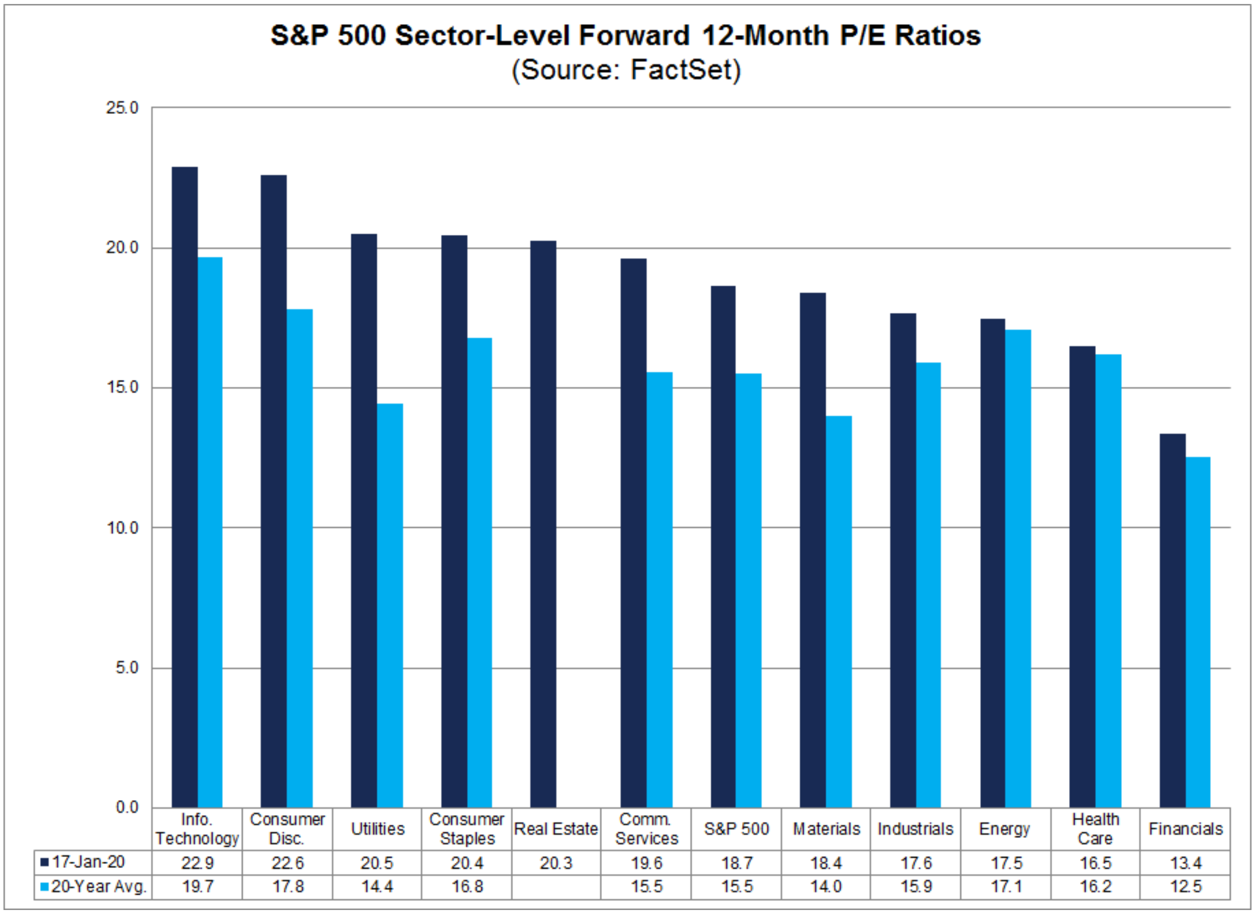
What that does for valuation can be seen in this FactSet image. What it shows is the current rise in valuation is not being driven by corporate profit growth. Instead, it is being driven almost exclusively by P/E expansion, the level to which was last seen in early 2018, and then prior to that in 2003. None of which means the party has to end, you simply need to be aware that paying higher multiples for stocks just to keep up doesn't tend to end well.

Can I Get 19?



Dropping it down to the sectoral level, every single industry is trading above their 20-year average. Energy, financials, and health care are at a slight premium. Others, like technology and consumer discretionary, are over by a lot. Interestingly, the relative higher yields found in utilities, communication services, and REITs, has those groups trading with some of the highest valuation spreads.

Paying More…For More



	Info. Technology	Consumer Disc.	Utilities	Consumer Staples	Real Estate	Comm. Services	S&P 500	Materials	Industrials	Energy	Health Care	Financials
17-Jan-20	22.9	22.6	20.5	20.4	20.3	19.6	18.7	18.4	17.6	17.5	16.5	13.4
20-Year Avg.	19.7	17.8	14.4	16.8		15.5	15.5	14.0	15.9	17.1	16.2	12.5

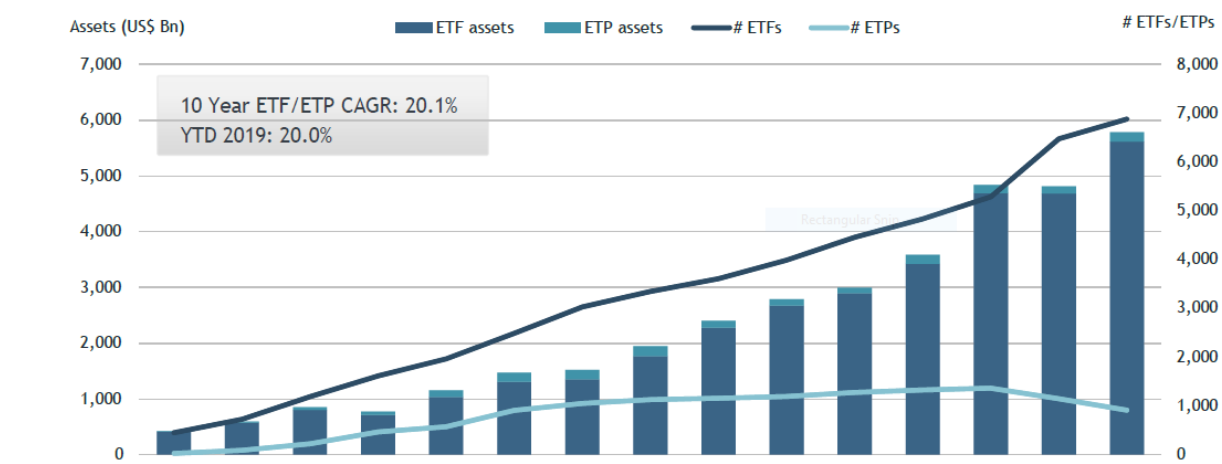
Disclosure Statement

Before we jump all in, we want to emphasize that because we've been hanging around Wall Street for nearly a quarter century, we have seen a thing or two. One of which is the unyielding nature of purveyors of financial products to take a theme to the edge and sell the hell out of an idea until it stops working. The bigger the carrot the better, but that doesn't mean better tasting or at all more effective.

Big Carrot

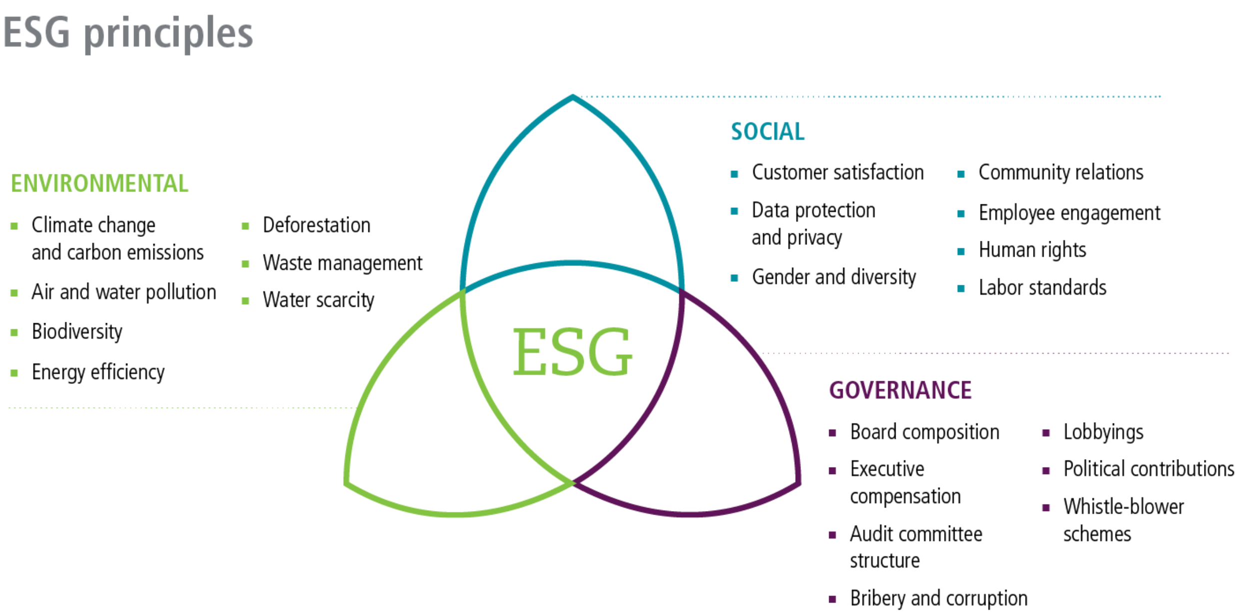
But such is the nature of the business. So, if we sound at all jaded or somehow cautionary, it comes from a place of reasonable industry knowledge and good intentions for clients and partners. Case in point, does the world really need 8,000 ETFs? It better, because that's how many it has.

ETFs Abound



Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Sep-19
# ETFs	453	729	1,193	1,618	1,969	2,488	3,031	3,346	3,609	3,988	4,458	4,835	5,286	6,476	6,880
# ETFs/ETPs	483	827	1,421	2,091	2,548	3,400	4,087	4,479	4,771	5,186	5,736	6,166	6,652	7,626	7,797
ETF assets	417	580	807	716	1,041	1,313	1,355	1,772	2,284	2,675	2,899	3,424	4,691	4,685	5,617
ETF/ETP assets	426	603	857	774	1,158	1,478	1,526	1,952	2,403	2,788	2,998	3,553	4,840	4,817	5,781

CNBC further emphasized this point over the weekend when they ran a story highlighting the surge in ETF assets under management in 2019. And by surge we mean 30%, or $4.4 billion in AUM. How much of that increase is market appreciation was not disclosed, but given that a 30% gain in global markets was the number, it's hard not to imagine that it played a big part. The article also emphasized that the hot dot right now is, you guessed it, ESG. We think this is a growing bubble on Wall Street, as so many of these strategies look and act like index funds with a sprinkle of environmental, social, and governance filtering.



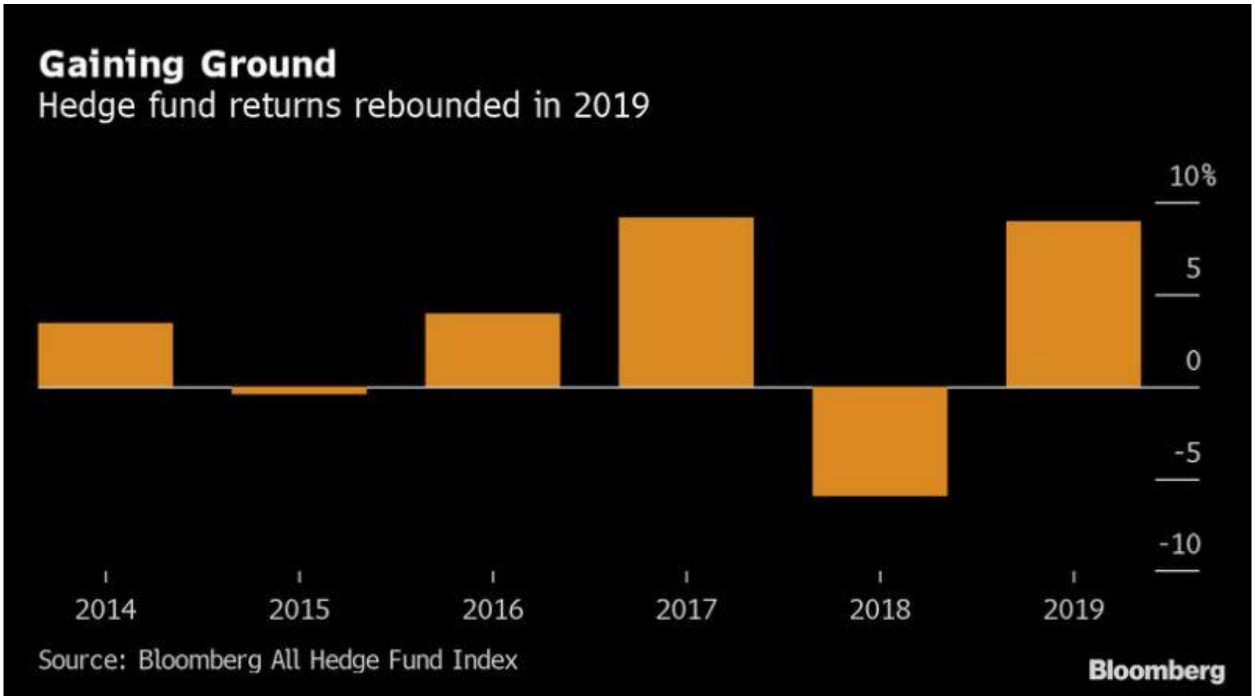
Hedge Funds

We are starting off our alternatives tour with a well-known commodity to us, and that is the hedge fund group. Unless you live under a rock, you are most likely aware that those that ply their craft in this corner of the market have been under assault for a while now, and that a 'while' is almost a decade at this point. And as we've highlighted on many occasions, those that made their money, and their fame, in the Golden Age of Hedge Funds, are now shadows of themselves and closures continue to outpace openings as the towel is being thrown in by many an 'old timer'.

Herd Culling

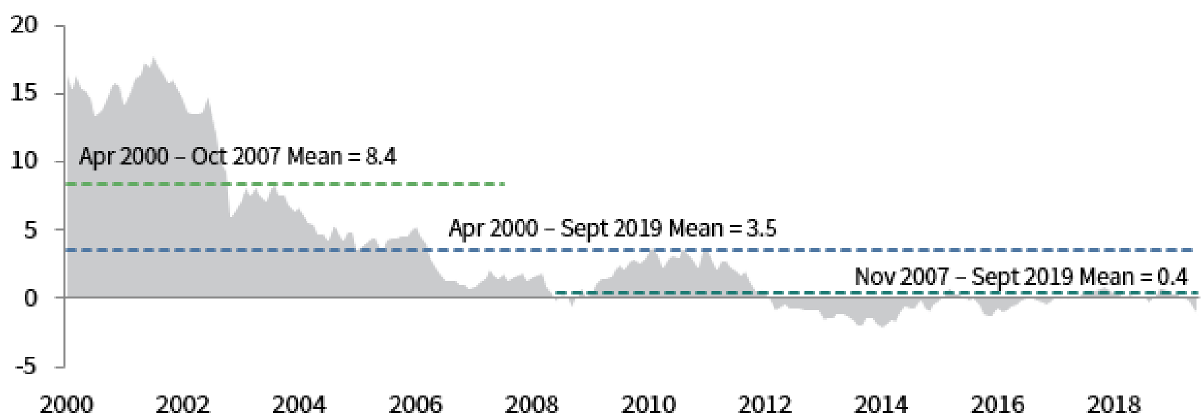
So, how did hedge funds fare in 2019? Turns out it was the best year in a decade. But what does that look like? Drumroll please, the average return across the entire spectrum of strategies was around 10%. In and of itself this is a pretty good number, assuming any fund who was positive also had a return in the black in 2018. Therein lies the problem as most of the funds we follow were down anywhere from 2% to 8% last year, not good when you are promoting yourself as the protector of the downside.

Be Better!



If you are a long/short equity manager and are already feeling down in the dumps, don't read what Institutional Investor had to report about redemptions in the space. To which we say to anyone in the business of long/short, be better before we all go out of business.

Long/Short Equity Alpha



Before the final obituary is written, there were some decent sized rebounds from a few high-profile funds. Most of them were smaller in size and some big macro funds that caught the rally. There was also David Ackman who rebounded big time, up at least 50% after four years of sucking tailpipe. Funny thing though, while he calls himself a hedge fund, he doesn't hedge. In fact, due to public disclosure 13F rules, you too can go about owning his entire portfolio without the management fee or performance carry. True story.

(Very) Full Disclosure

May 17, 2019

Dear Shareholder,

Pershing Square Holdings generated strong performance during the first quarter of 2019 and year-to-date. NAV per share increased 36.9% during the first quarter and by 38.4%[1] year-to-date, compared with the S&P 500's year-to-date total return of 13.9%. All of our portfolio companies have generated substantial positive performance in line with their continued business progress as we discuss in detail below:

Portfolio Update

Below are the contributors and detractors to gross performance of the portfolio for the first quarter of 2019 and year-to-date 2019[2]:

January 1, 2019 - March 31, 2019	
Chipotle Mexican Grill, Inc.	10.1%
Restaurant Brands International Inc.	4.8%
Automatic Data Processing, Inc.	4.2%
Federal National Mortgage Association	3.8%
Lowe's Companies Inc.	3.2%
Hilton Worldwide Holdings Inc.	2.5%
Starbucks Corporation	2.5%
United Technologies Corporation	2.3%
Federal Home Loan Mortgage Corporation	2.2%
The Howard Hughes Corporation	1.0%
Platform Specialty Products Corporation	1.0%
Other Income and Expense	-0.4%
Net Contributors and Detractors	**37.2%**

January 1, 2019 - May 14, 2019	
Chipotle Mexican Grill, Inc.	9.8%
Restaurant Brands International Inc.	5.3%
Hilton Worldwide Holdings Inc.	4.5%
Automatic Data Processing, Inc.	4.0%
Federal National Mortgage Association	3.4%
Starbucks Corporation	3.2%
United Technologies Corporation	2.9%
Lowe's Companies Inc.	2.5%
Federal Home Loan Mortgage Corporation	2.1%
Platform Specialty Products Corporation	1.0%
The Howard Hughes Corporation	0.7%
Other Income and Expense	-0.5%
Net Contributors and Detractors	**38.9%**

Chipotle Mexican Grill ("CMG")

CMG's first quarter results continued to demonstrate the significant progress that CEO Brian Niccol and his team have made in dramatically improving performance and positioning the company for long-term sustainable growth. Same-store sales grew 10% in the quarter led by transaction growth of approximately 6%, a significant acceleration in sequential growth – better than that of any other large publicly traded restaurant company.

Management raised its full year same-store sales guidance to mid-to-high single-digit growth from mid-single-digit growth. Digital sales doubled from the prior year quarter to nearly 16% of sales, including robust growth in delivery, which has driven incremental sales and improved margins. Key drivers for

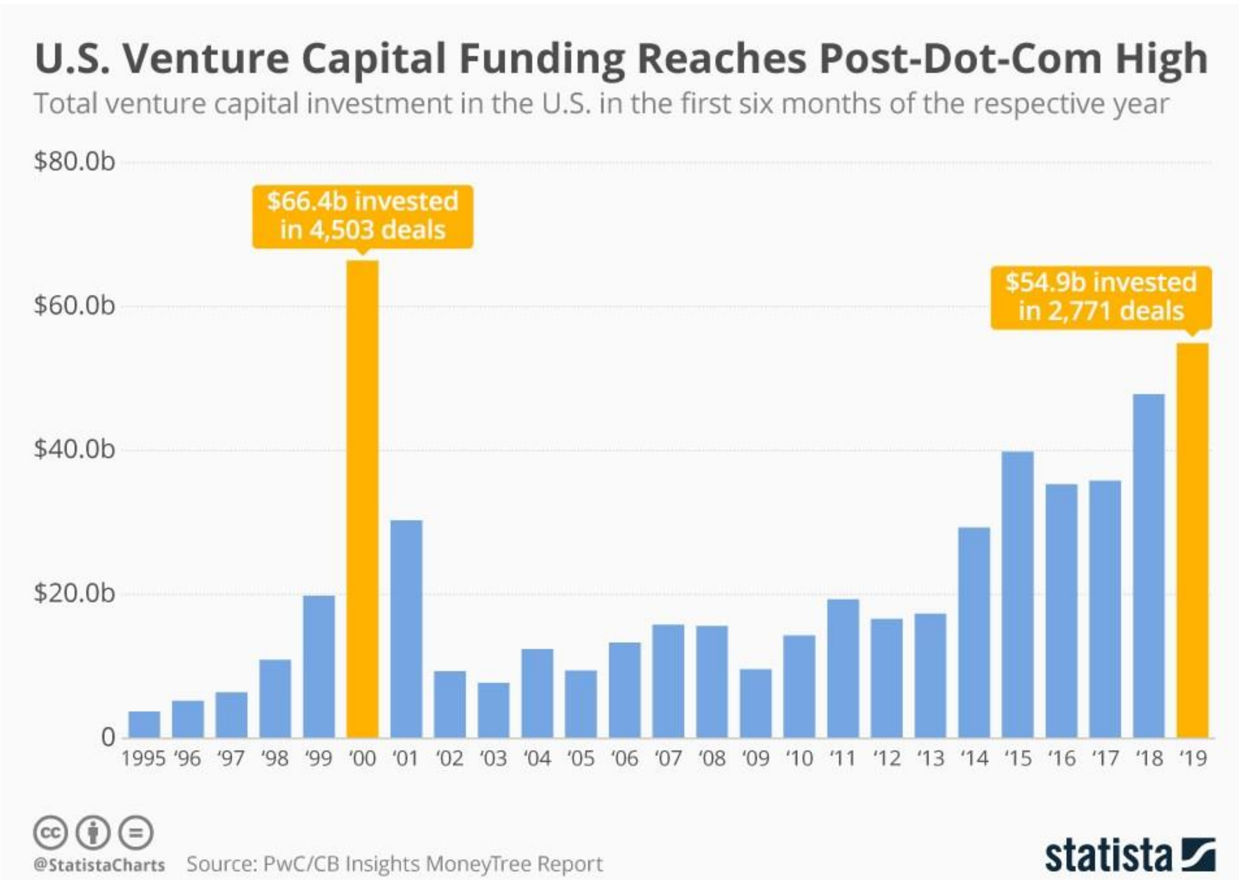
[1] Past performance is not necessarily indicative of future results. All investments involve risk including the loss of principal. Please see the additional disclaimers and notes to performance at the end of this letter.

[2] All year-to-date performance information is as of May 14, 2019. Each position contributing or detracting at least 50 basis points when rounded to the nearest tenth is shown separately. Positions with smaller contributions are aggregated. Please see the additional disclaimers and notes to performance at the end of this letter.

Venture Capital

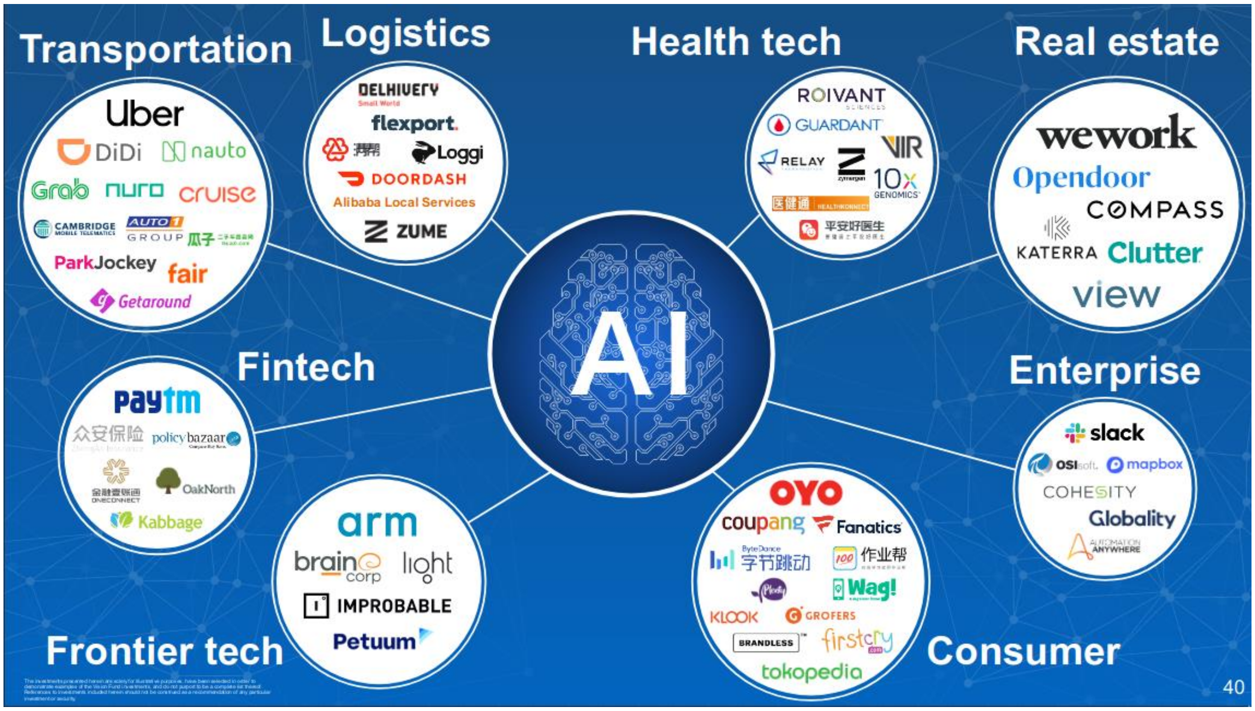
While it is a very different world than the one we experienced in the dot.com era, the high level of venture capital funding can't be ignored. The good news is, this time there are more real businesses with stronger cash flow and balance sheets, getting the elevated levels of investor cash. The bad news is, it's winding up in fewer and fewer deals, which means that by the time the Unicorns get to market much of the easy money has been made, and sometimes all of it.

Let's Make a Deal



While we are a little dubious in terms of how SoftBank reports their returns, we don't mind using their marketing decks to show where investor funds are being allocated. In the chart below, you can see how Mayoshi Son and Company break out their artificial intelligence investments into various verticals. The company also gives you a clean look at what companies are actually in the portfolio.

AI Hierarchy

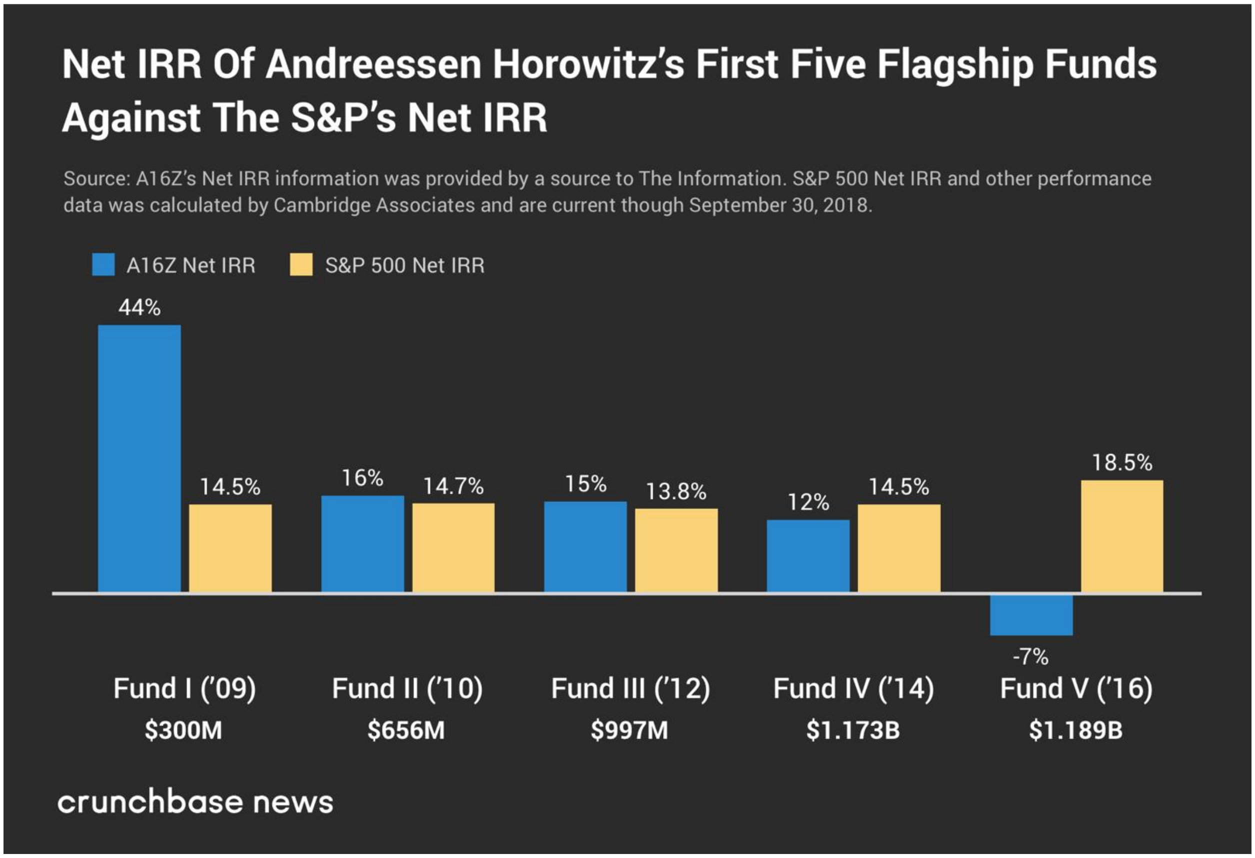


A guy who made a life changing amount of money as an early employee at Facebook, Chamath Palihapitiya, maintains a vocal, and we think to be a correct narrative of the late stage venture funding market. His bold call? That it's nothing more than a very high level Ponzi scheme. This is an extension of what tech entrepreneur Steve Blank wrote about in 2016, the gist of which that everyone is in everyone else's deals, pumping up valuations to an unsuspecting public market.

'Gambling? I'm Shocked!'

To wrap venture capital up, and to prove that not everything that appears to be Silicon Valley gold is just that, we came across the returns for the acclaimed Andreessen-Horowitz. What we saw surprised even our skeptical eye. Given the hype associated with their collective pedigree's and access to deals, aside from their first fund, one with a 2009 vintage, returns have been in-line with those provided by the broad public equity market.

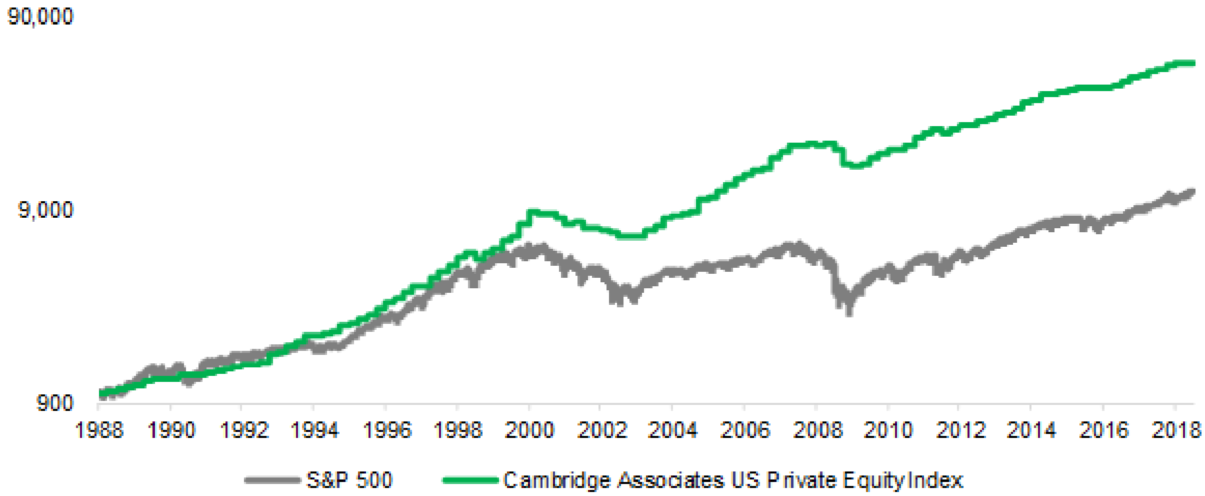
Not Lights Out



Private Equity

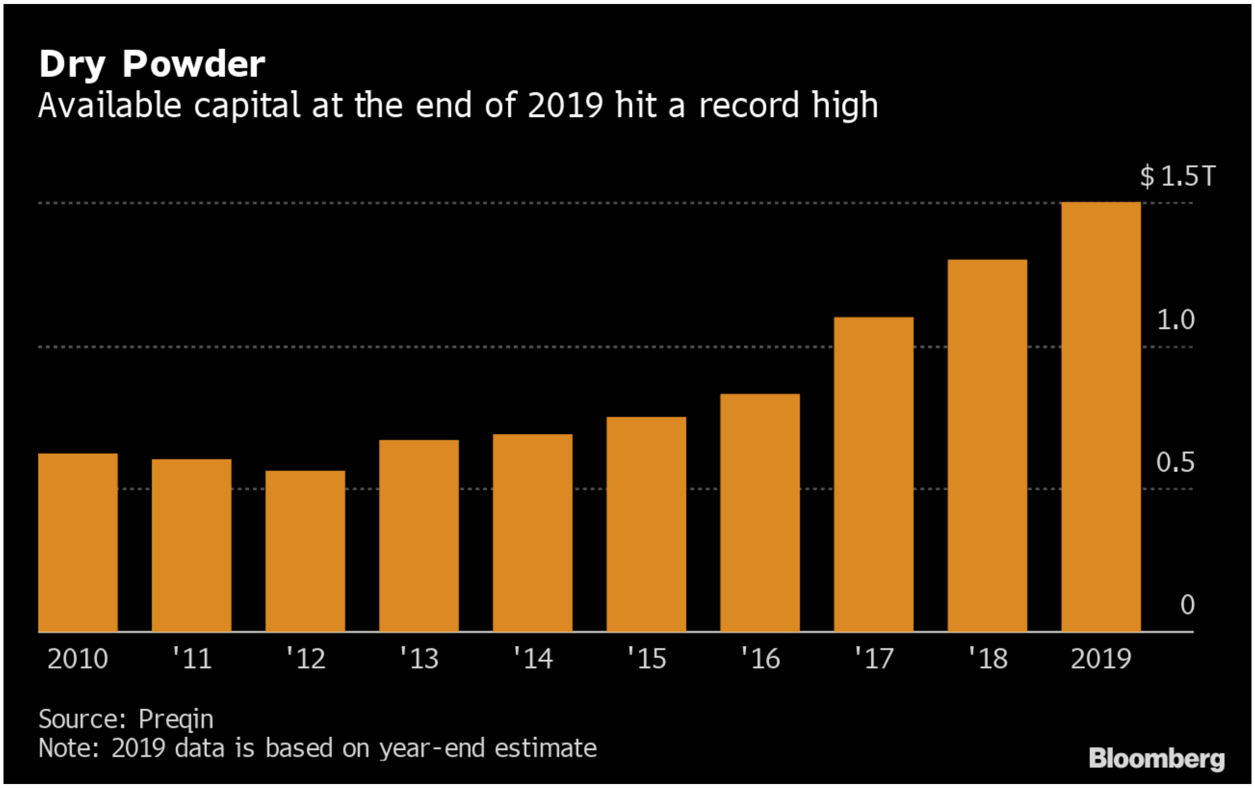
If there is a 'hot dot' in the alternative investment universe, it is private equity and private capital. And why not, the returns have been not only consistent, but well above the public equity and fixed income markets for the past 20 years. Though financial writer Nicholas Rabener did a good job of dispelling the 'low-vol' reputation that P/E has achieved of late.

P/E vs. S&P



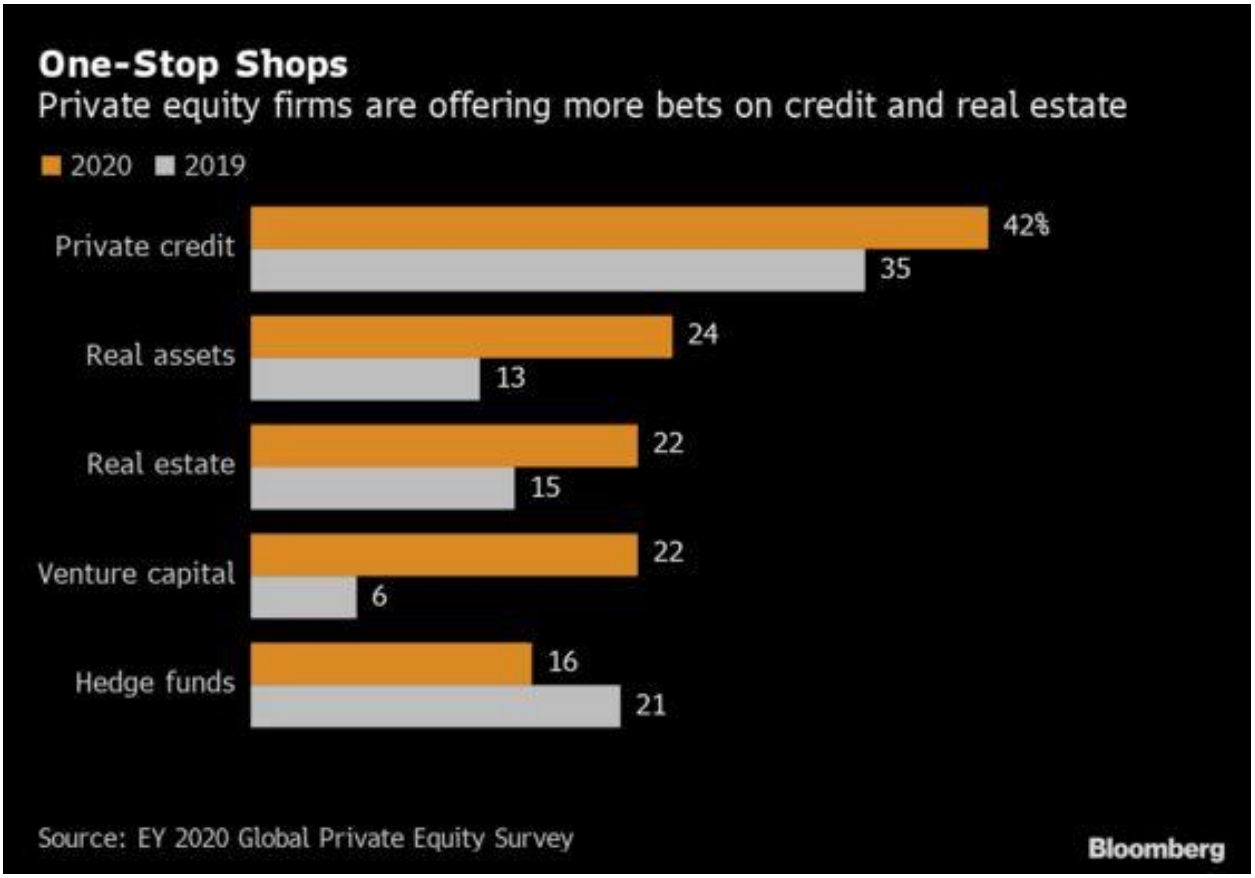
Beginning about a decade ago, Wall Street started bringing access to the likes of Blackstone, Oaktree, KKR, and Apollo funds down to the masses with $100,000 sleeves made available via Merrill, Morgan, UBS, and Goldman Sachs to the mass affluent. These P/E firms were opening up the doors to independent registered investment advisors as well. What resulted is the situation we find ourselves in today, and that is too much money chasing too few deals. So, what has Wall Street done? Expanded out to the edges and grown the number of products being offered.

Money, Money, Everywhere



Because private equity firms have been so successful over the past decade at both raising and deploying capital, they have evolved into integrated managers of almost every variety of private capital, and private credit has become a huge piece of the pie. So much so, that if we were to point to one shadow market of the financial system that runs a serious risk of disruption in the next recession, this is the one. Direct lending was born out of the global financial crisis, and therefore has not had a real-world stress test of any kind…ever.

Is There a Cleanup Coming?



In the interest of time, and your ability to get on with your Super Bowl Sunday, we are going to conclude part one of our two-part series on the alternatives. Up next week we look at distressed assets, the liquid alternatives, cannabis, and opportunity zones. Our endgame is to remind you that for every opportunity worth your time and investment dollar, there is an abundance of others served up from the Wall Street carnival barkers, and for better or worse, that will never change.

Step Right Up

Diversions

Our visit to the cavernous caverns of Wall Street in Manhattan last week was a successful one. Lots of optimism for some areas of growth, namely credit. And some areas where managers still can't get out of their way, namely in the hedge fund world. But boots on the ground knowledge wasn't the only thing we planned on bringing back. So, as promised, here is our 'outsiders, insider' view of New York.

The Island of Manhattan

Let's kick things off with something on the arts and architecture side of the ledger, with two museums that are barely off the grid, but well worth the effort. The first is The Morgan Library and Museum, a few blocks south of Grand Central. The property is the site of J.P. Morgan's home in Manhattan, and while the residence isn't open to the public, the library is. And by library, they really mean library. One of the very surreal and stunning aspects is standing in front of the desk of the man who ruled banking for a time.

The Morgan Library

The other museum of note, and one very well worth the time, is the Ronald S. Lauder Nueu Gallery. It sits inside the former home of Cornelius Vanderbilt residence on Park Avenue, across the street for the Metropolitan Museum of Art. The reason for the visit was to see Edvard Munch's *Scream,* but my efforts were thwarted by the exhibit being closed for renovation. What we did however get to see was an exhibit with an incredible story involving a looting by the Nazis, a long dormant search, a judgment by an international court, with an eventual acquisition by the Lauder family and presentation in the museum. The story was so rich it was the subject of a 2015 film, The Woman in Gold, starting Helen Mirren and Ryan Reynolds.

Klimt's Woman in Gold

Looking to scratch a big culinary itch while in town? We've got three places to consider, from varying ends of the spectrum. Let's start on the lower key side of things with the introduction to a dim sum place around the corner from the Lincoln Center that is one-part haute cuisine, another major part old school stacks of steamed meat and vegetables, wrapped in varying kinds of doughy buns or friend won ton skins. The place we are referring to is Shun Lee West, and it plays every bit the part of nice, but not too nice, old school Chinese. We give their Mai Tai's a six, on a good day.

Shun Lee West

Another pair of restaurants of note have the same owner, with a different vibe altogether. The owner in question is Ron Perlman, and the restaurants are Le Bilboquet and Fleming. In 2013 the New York Post called the former 'The snobbiest restaurant in New York', and while that image has changed over time, and the flash has turned into a softer patina, it is still a place on the Upper East Side where you show up just to see what might happen. In terms of the latter, it is a graceful quite place where one can have a sophisticated adult beverage along with a well crafter French-American meal. And if this story is at all true, it's nice to know I'm one of the 'special people'.

No Comment

A place we have always found very welcoming, and not fussy or uptight at all is the bar at the roof of the Mondrian Hotel in Midtown. Because of its location in the business central part of the city, the place can be lightly populated on a Friday night. Which is fine by us as sipping a properly distilled juniper berry Martini or glass of fermented grape juice on the patio looking down on Fifth Avenue seem like a nice way to roll into the weekend. The Alpine Terrace was a unique component, and worth a visit as well. In true New York Times fashion, they are not afraid to opine on which rooftop bars are the best.

The Mondrian

The last two recommendation we will give you would have some New Yorkers calling foul as they might seem too touristy for an 'outsiders, insiders' guide, but hear us out. There are two places in New York that we know of that contain markets that are satellites of well-respected purveyors of fine food. Keep in mind, we want you to be efficient with your time and places where you can kill several birds with one stone appeal to us. With that we give you the Chelsea Market in the Meat Packing area of town, and the Grand Central Market inside the terminal. A visit to both is like owning a call option, you get a lot exposure, for not a lot of money up front.

Grand Central Market


GRAND CENTRAL MARKET
GRAND CENTRAL
MARKET