Just Markets…

In light of the fact that we are in very uncharted waters right now, we are going to keep it focused only on the markets this week. For perspective, the open on Monday was the third worst in history behind the one seen in the throes of the global financial crisis and September 11th, 2001. At this point in the crisis, and to be clear, that's what we have right now, not much else matters. Not earnings, not fundamentals, not innovation, and not private deals.

Fear Not Seen Since 2009

Right now the financial world will be focused on one thing, the coronavirus and what the rolling quarantines and cancelations of all well laid plans have in store for the economy. What we can counsel is to buckle up for safety, this is going to be a very bumpy ride. David Tepper is, and a month ago he said he was very willing to keep riding the bull market horse that got him there.

Wise Advice

What to Expect Next

On Monday morning, when we published this piece, equity market futures were pointing to a loss of 5% for all the major averages, circuit breakers had been triggered, crude oil had fallen by 30%, and the ten-year yield has now traded to .318%. Unless we are wrong, and we don't think we are, this has all the makings of what one would call a crash, and one that has come about in the most rapid fashion ever. It's important however to keep in mind, all we have really done so far is to return the repo-liquidity gains of the fall of last year. And for all the frightening headlines right now, we are still up 10% from the Fed pivot of one year ago.

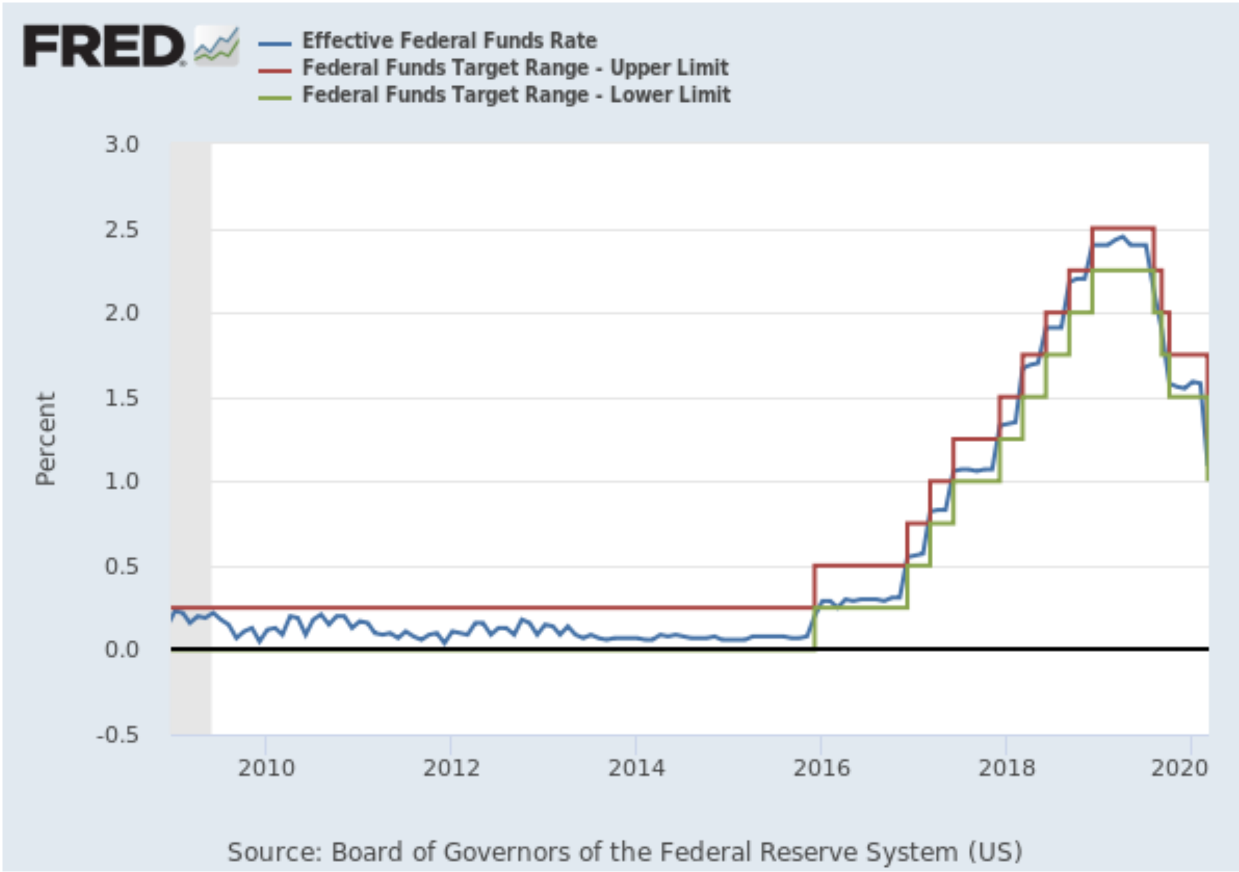
Landing Zone for the S&P…2,750

One of the most frightening aspects of the entire past two weeks is the utter collapse of interest rates. If you were to ask anyone at the end of last year what the aforementioned ten-year would be trading at two months into the New Year, with a high degree of certainty, nobody would have said sub 0.50%. And if they did, please tell us their name so we can send a gift their way.

Screaming Eagle

As one might expect, the Fed is on edge, and dislocations like this must have them preparing for ever countermeasure possible. On Monday, there was a commitment by the New York Fed to further provide liquidity to the repo market. And herein lies the problem. For those of us who were skeptical of the amount of dry powder left on hand, we are about to find out how well placed that skepticism was. And now the White house is crafting plans to drop their own 'shock and awe' on the markets.

Hello Zero, My Old Friend

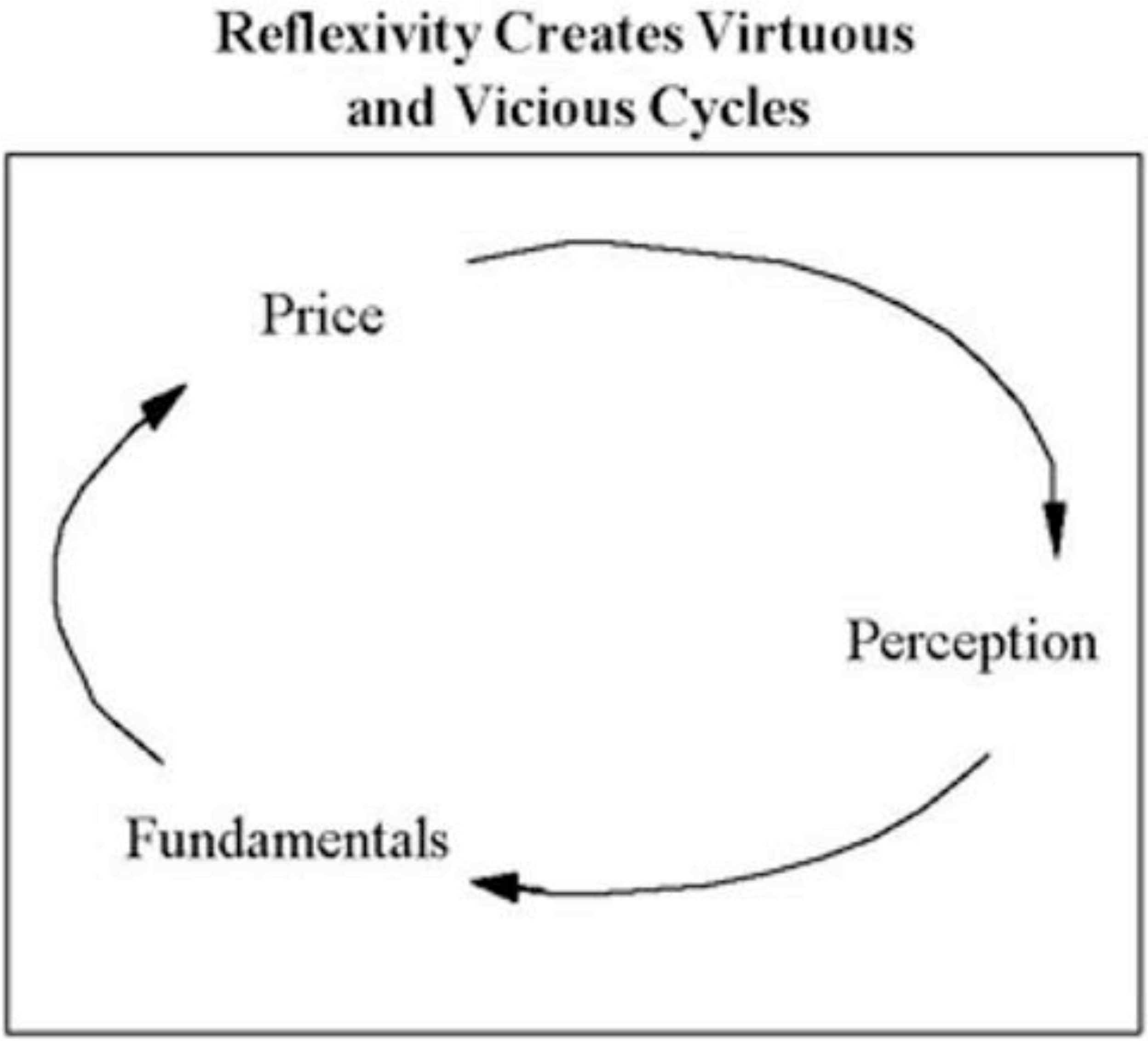


The fed will be cutting by at least another 50 basis points this month, leaving only 75 to 100 basis points left. This is a high risk move as are in uncharted waters in terms of how effective those cuts are going to be in combating a global risk that did not emanate from the economy, but from an outside factor. Not to sound overly hyperbolic, but what we are seeing right now is the closest thing to a shock as the terrorist attacks of September the 11th, 2001. A true black swan event, if ever there was one.

A Very Rare Bird

The last thing we will say about this moment in the markets, is that it almost perfectly encapsulates an idea we mention often, and that is George Soros' Theory of Reflexivity. In laymen's terms, it is the idea that given certain circumstances, myth become reality though the behavior of those around us. In this case, it is the idea that coronavirus is going to cause a global recession. While the question remains unanswered at this point, the behavior of the public thinking it will happen will in fact tank the economy.

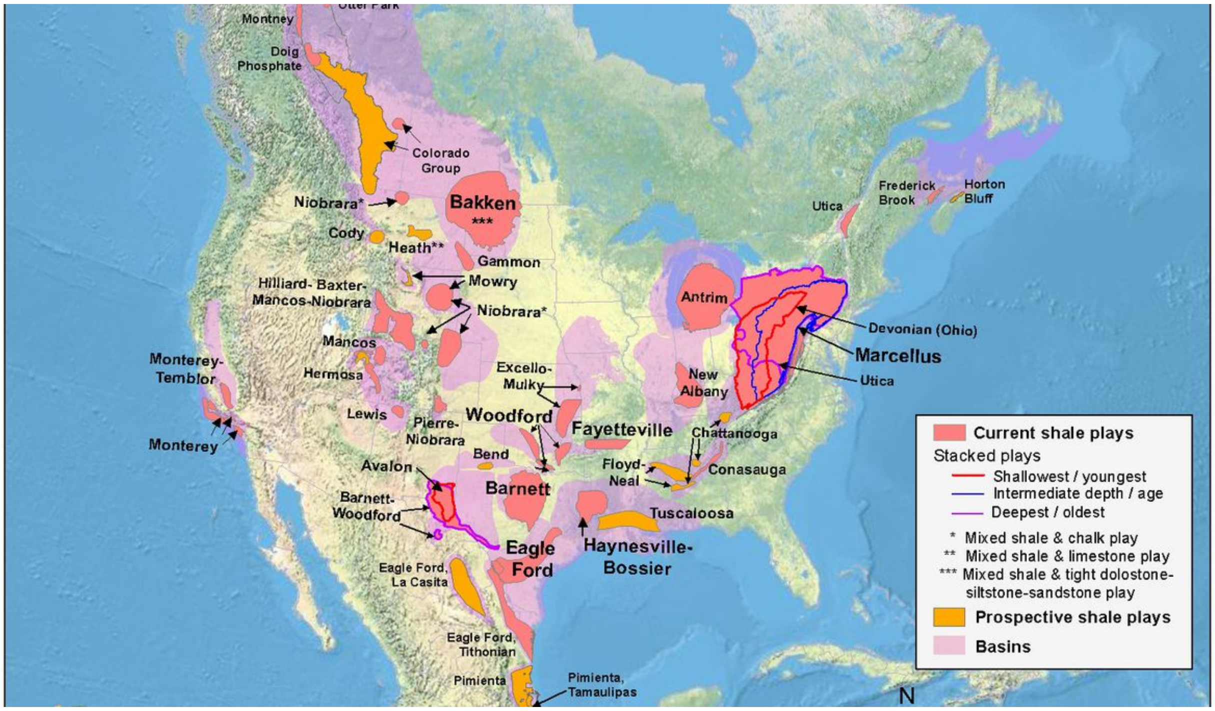
Not to Be Ignored



Crude Oil Markets

The price war that has broken out between OPEC, Saudi Arabia, and Russia will officially put an end to whatever version of the fracking boom is left. Sunday was a somber one for me personally, as I've covered the oil markets as an analyst for over a decade and have met plenty of great people in the petroleum business along the way. With the collapse of oil prices, and the debt rolls that are set to occur over the next two years, we will see many bankruptcies of public companies, and the dismantling of whatever shareholder value is left.

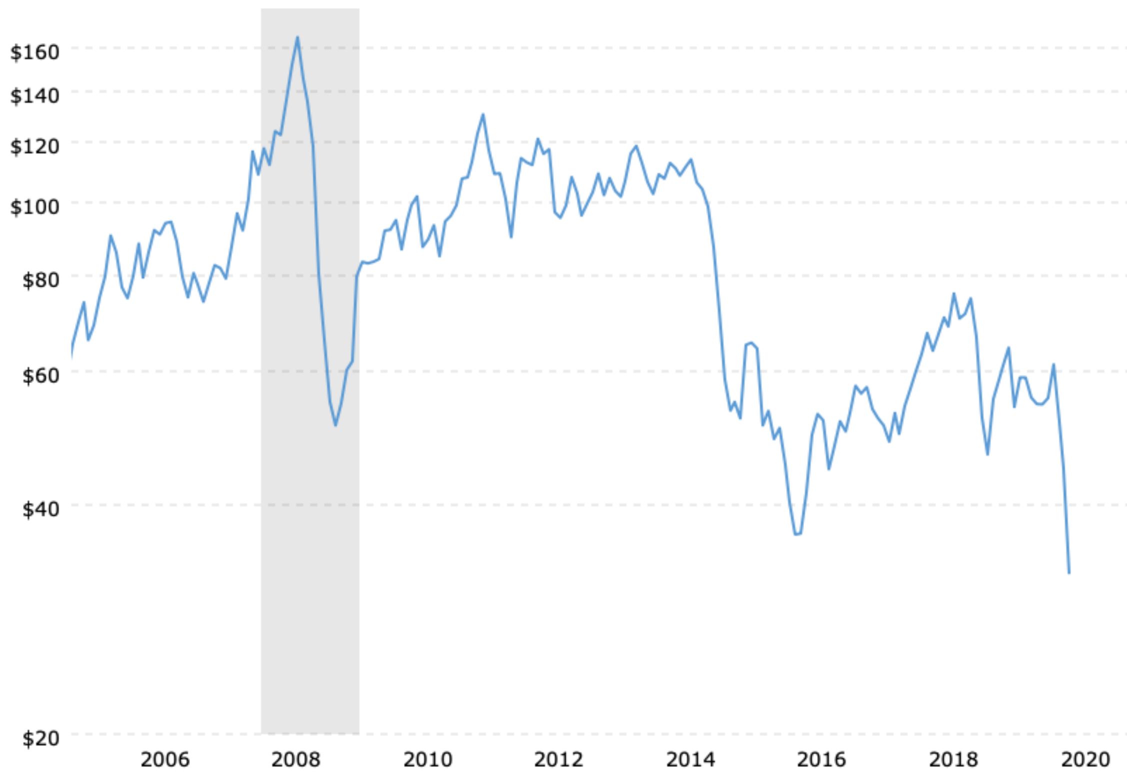
A Once Promising Map



This won't be the last oil bust, but it will be a big one, as we have not seen this kind of crash in prices since the Gulf War in 1991. At that time, they had become elevated over fear that there would be protracted war in Iraq. When that narrative collapsed, so did crude. We would say look out below, but below has already happened.

That said, even though the headlines are as scary as a heart attack, we are back to the same level seen in 2016 when the economy appeared to be slowing materially before the election that fall. And as Trump said on Monday, the American consumer just got a tax cut, and everyone benefits. Though we don't think 'Fake News' is the reason the market seized up.

Crude Oil



We had the trade right in January and booked nice gains on the short side up and down the crude oil food chain. That said, we covered a lot and left good money on the table as this cathartic move of crude over the past seven days has played out. We will go back eventually, but the situation is white hot right now, and we don't want to get close enough to get scorched.

Oil & Gas Exploration and Production

How We Did

As we have been pretty vocal about the importance of hedging and selling short, we have received plenty of calls and texts asking how performance has been over the past two extremely volatile weeks. We have a job to do and that is to protect client money at these moments. With that, we can report to you that as of last Friday, we have participated in abut 44% of the downside on average excluding the relatively narrow February 28th, and 77% of the upside, when there is upside. These are good ratios given the nature that the pullbacks are averaging over 3%.

Part of the reason for this is the long side of the investment book is heavily skewed towards things you need to buy, regardless of the economic conditions. These companies are also now paying a 2.5% dividend, which beats 0.5% on treasuries.

Stillwater Hedged Equity

	Stillwater	S&P 500	Delta	Capture
February 24, 2020	-1.16%	-3.30%	214 bp	35%
February 25, 2020	-1.28%	-3.03%	175 bp	42%
February 26, 2020	-0.49%	-3.70%	321 bp	13%
February 27, 2020	-2.67%	-4.39%	172 bp	61%
February 28, 2020	-1.20%	-0.80%	- 40 bp	150%

March 2, 2020	3.82%	4.60%	- 78 bp	83%
March 3, 2020	-1.28%	- 2.60%	132 bp	49%
March 4th, 2020	2.98%	+4.22%	- 124 bp	70%
March 5th, 2020	- 2.00%	-3.25%	125 bp	61%
March 6, 2020	- 0.95%	-2.00%	103 bp	48%

Upside Capture Average: 76%
Downside Participation Average (ex 2/28): 40%

We will continue to do right by our mandate, as tough as it is right now as the losses out there felt by others are painful and adding up quickly. That said, if volatility continues, and if a global recession is in the cards, we like our chances. As always, inquiries are welcome as to the products we create and manage, as are dedicated short selling services for those who want or need it.

The Pros & Cons

As this is a fluid situation, and by fluid we mean as fluid as it gets, market and economic calls are beginning to flow from research shops and investment managers. With that as a primer, we give you the quick whip around Wall Street to let you know what the best and brightest are thinking and doing.

The Endangered Bull

On the positive side of the ledger, this is indeed a panic, and it's fair to say there is now blood in the streets, as this is the fastest correction in history. Never before has this much capital been lost at such a rapid rate of speed. Bank of America is out with a call, one we think is the correct one, that when interest rates are brought into the equation, stocks have not been this cheap since the 1950s. Warren Buffet thinks so, and has waded into the banking sector and is buying.

The Financial Sector

On the flip side, we have some very ominous warnings, from some very formidable places. The venerable bond shop, PIMCO, is saying that the worst is yet to come for the economy and we will likely experience a 'technical recession' in the first half of this year.

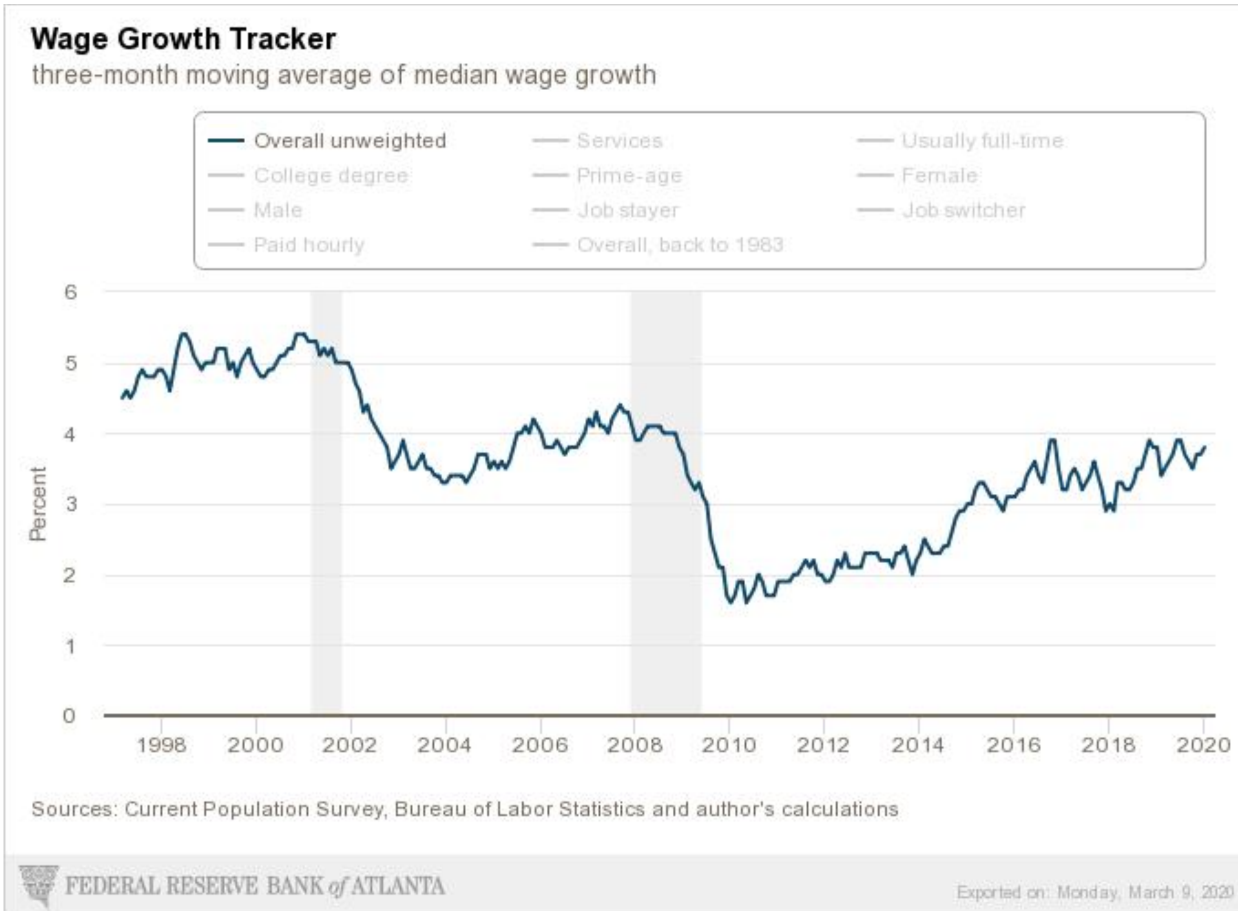
Inversion & Recession

Another one of those places is Allianz and the notable Mohamed el-Erian, who has been ahead of the curve on the situation for a while now. His projection is for a 20%-30% correction in the market before all is said and done. The good news is that we are about to hit the low-end of that threshold.

Parting Thoughts

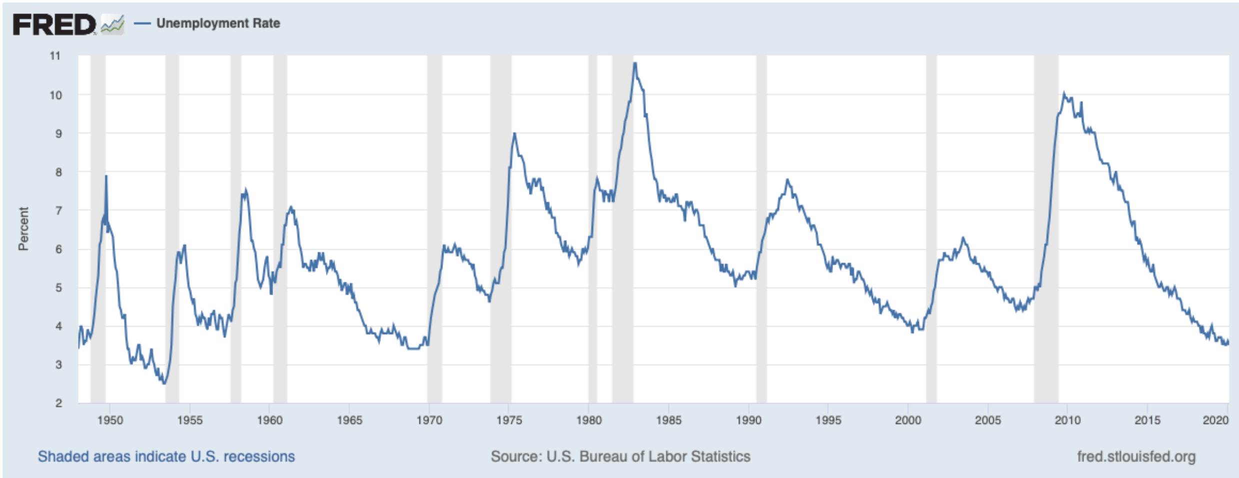
Above and beyond anything, we hope the spread of coronavirus slows and the world can get back to a normal order sooner rather than later. This is both scary and deadly, the trickle-down impact on the economy is going to be real and material, costing jobs and wages where it hurts the most.

Stunted Growth?



The March jobs report is going to be a huge marker for how quickly the impact of the current crisis is having on the economy. Keep in mind, the market bottomed in 2009 when the news on employment stopped getting worse. If we start to see a job growth slow, or reverse, that will be a key signal that recession is on the way. Or as DoubleLine's Jeffery Gundlach said last week 'put a fork in it'. All eleven recessions of the past 70 years started with an increase in unemployment.

Don't Forget History



Our counsel now, and one we have been consistent with is to 'high grade' the long side of your portfolio with strong balance sheet companies that are in more defensive sectors of the market. Start with staples as the market just handed you a gift in terms of better equity prices and fatter yields. The latter being an important point because of the utter and complete retraction in interest. No endowment or pension plan is going to make its bogey with rates where they are. None.

Ten-Year Treasury Yield

In terms of hedging, the next twelve to eighteen months is when skill will either be demonstrated, or those who claim skill and prowess in that field will be found out. We think cyclicals and special ‘single name’ situations are where we will make most of our money. While there is a lot of wood to chop as they say, and some tough weather to do it in, we think we have a good chance of coming out on the other side protecting client assets well by running at lower exposure levels, with solid short positions.

As mentioned prior, if this profile of risk and reward interests you and fills a need, contact us, contact@stillcap.com. Likewise, if you are a hedge fund struggling on the short side of the ledger and need proven expertise, connect with us as well. We are always open to conversations about how we can leverage our already existing work. After all, we named the company Stillwater as an acknowledgement of our goal of keeping the surface water still, even while the undercurrents swirl mightily at times, this being one of them.

Grand Teton, Wyoming