Having jumped ship in Hong Kong, and made our way over to Tibet, we are still very far away from achieving total consciousness. Who could have possibly attained it in this once in a lifetime market? That said, no man can wander too far out onto the edge for too long without running the risk of getting lost and never coming back. So, we are back, once again publishing our thoughts and views about all things markets.

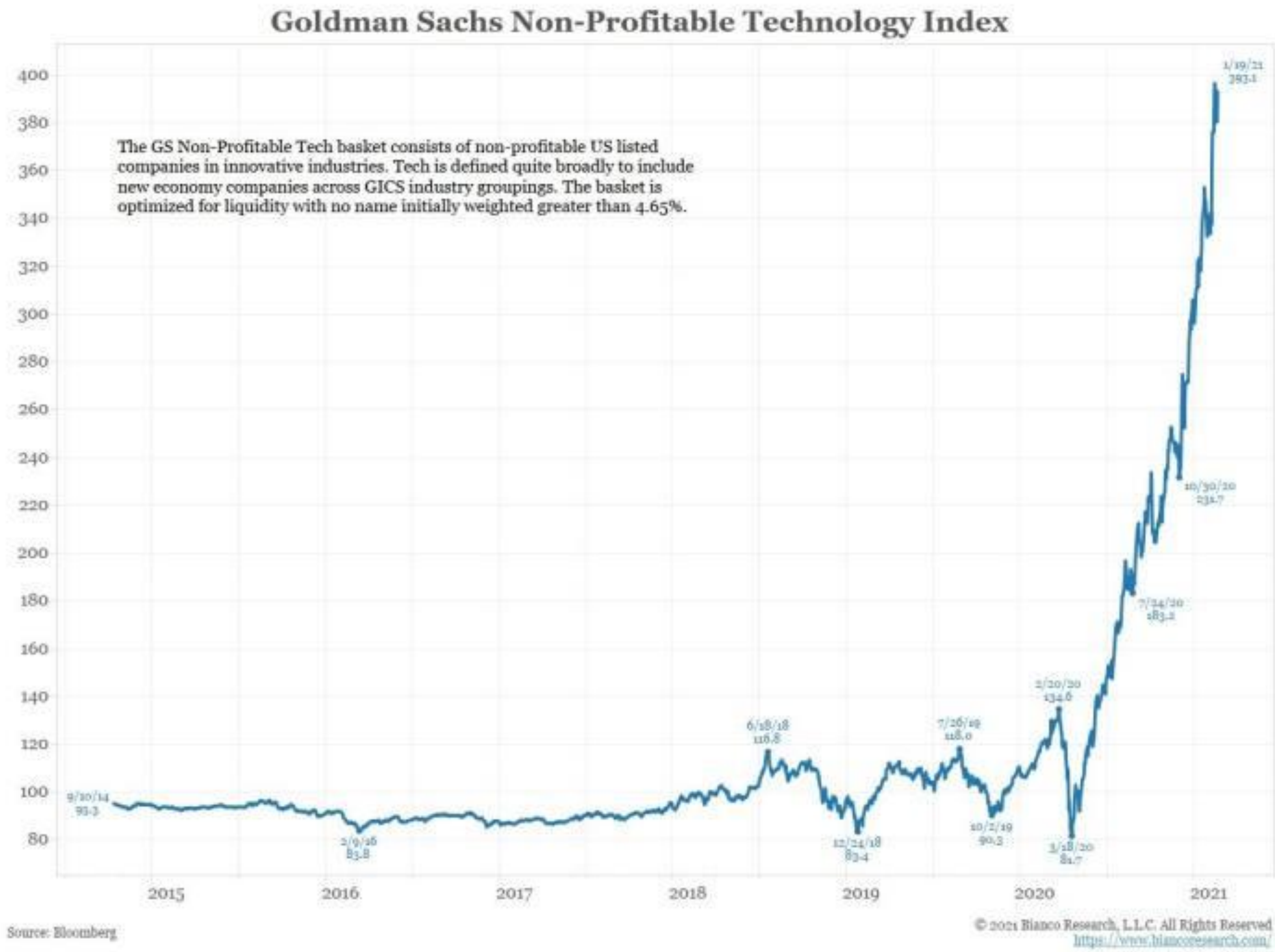
Listen Up

As for the Dali Lama, sixth son of the Lama, he can't hold a candle to the power of the unlimited amounts of (nearly) free money. That's just how impactful the results of the policies of the world's central banks have been on the astronomical rise in asset prices from a year ago. To which Jerome Powell must be saying 'hey, how 'bout a little something for the effort?' right about now. Well played, good sir. Well played.

Monetary Everest

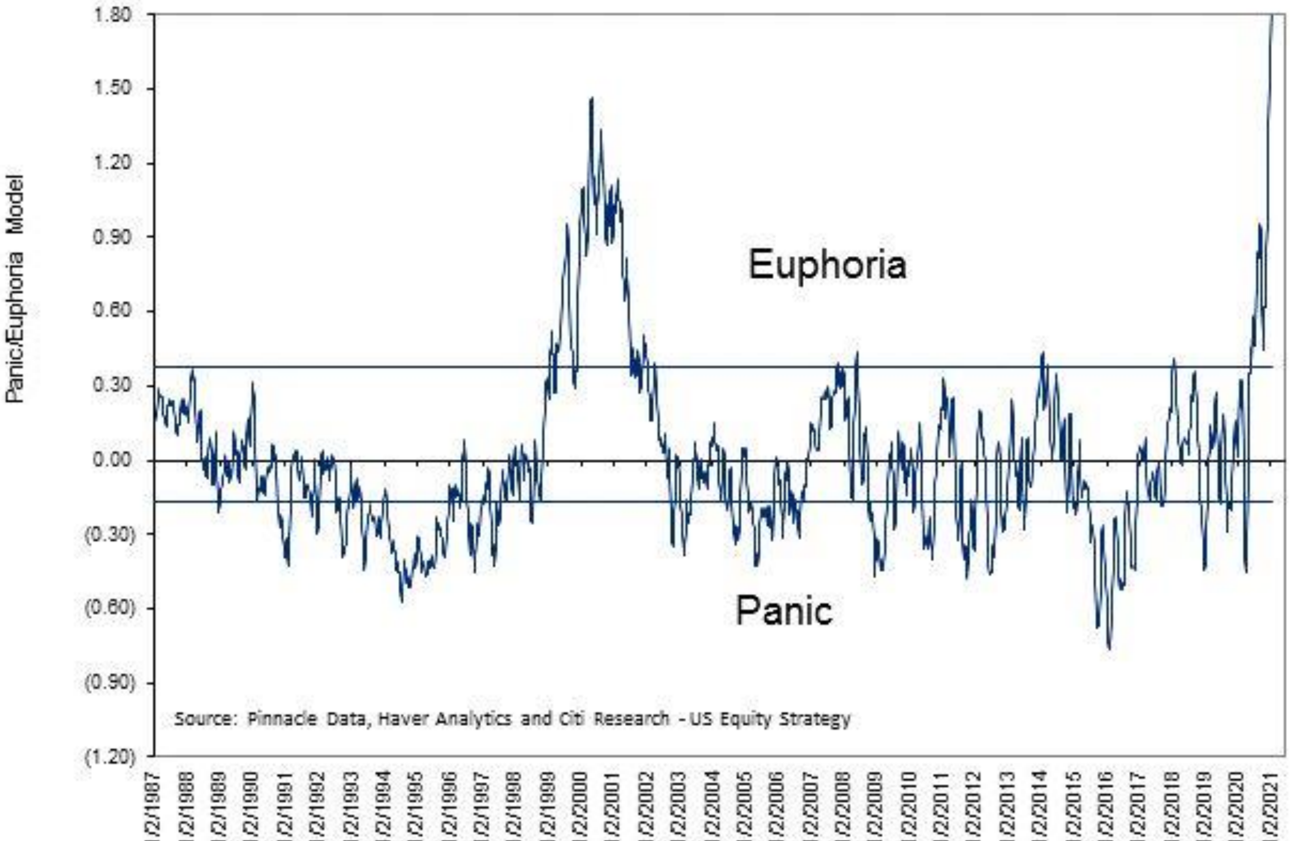
With the world's markets on central bank fueled fire, and inflation now a very real risk, let's get down to business and start pulling apart the pieces. As always, our goal is to separate the noise from the signals. To be clear as the day is long, that job isn't easy, as the noise is currently deafening, and signals are tough to come by. Unless of course you are getting them from Redditt and money losing companies that have just exploded in value.

Who needs profits…?



While on the subject of just how surreal this rally is, take a look at the Citi euphoria to panic reading. The problem is that you could have been fading the bullishness since last May, like we did, and not keep up. And while we stand on the hill of disbelief that this can continue, our clients don't care, as all money is green and fear of missing out has permeated the investing psyche.

Hope & Despair



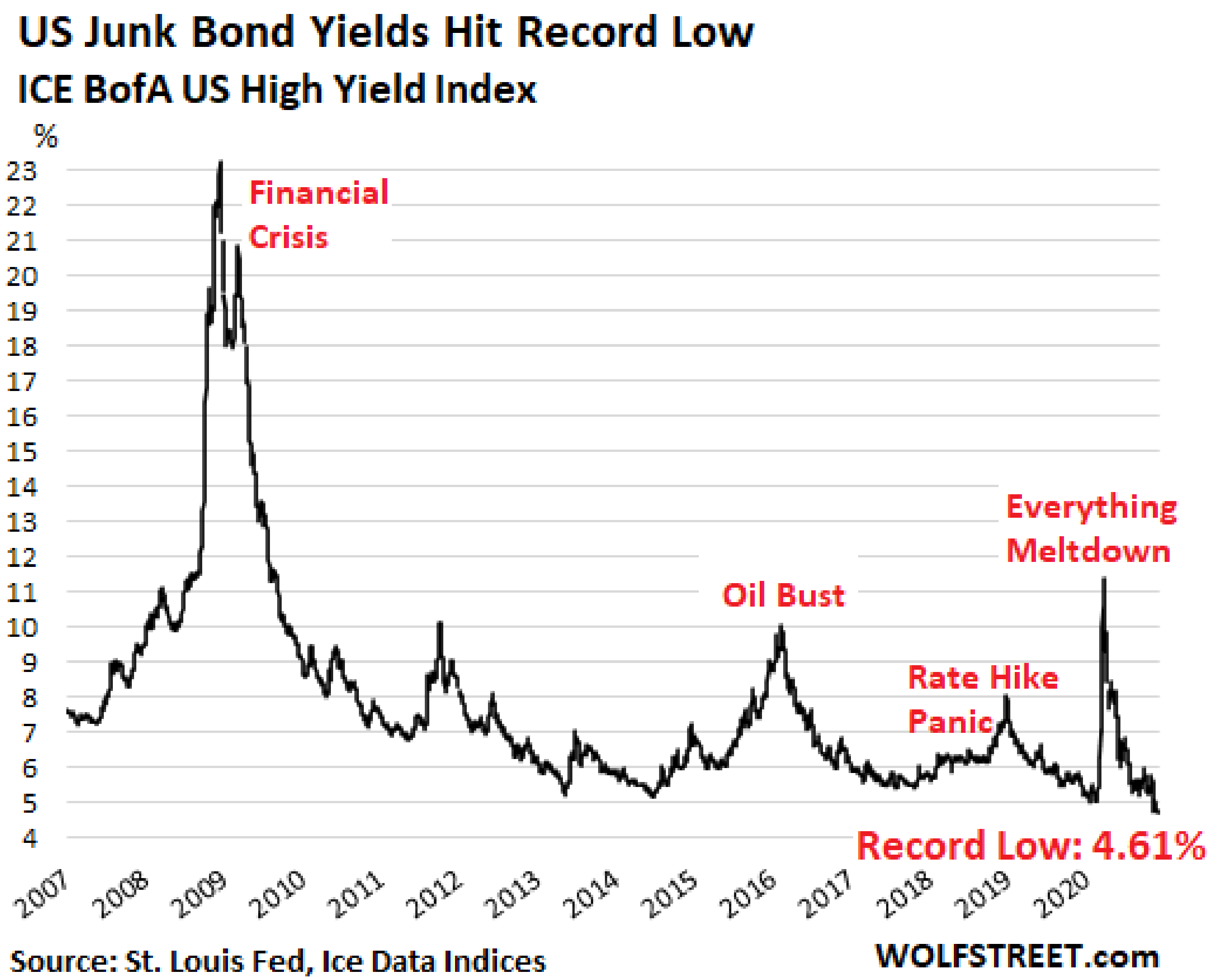
Everything Changes

Where do we start with what changed? In a word, everything. On January 1st of last year, we would have never thought the Fed would be stepping in sixty days later to be buyers of junk bonds and the purchaser of high yield ETFs. Those slow on the uptake as to what this meant for asset pricing, selves included, missed a non-inconsequential power move to the upside in risk assets that was enjoyed by those who stepped into the briny breech and bought everything.

Risks Behind, Not Ahead

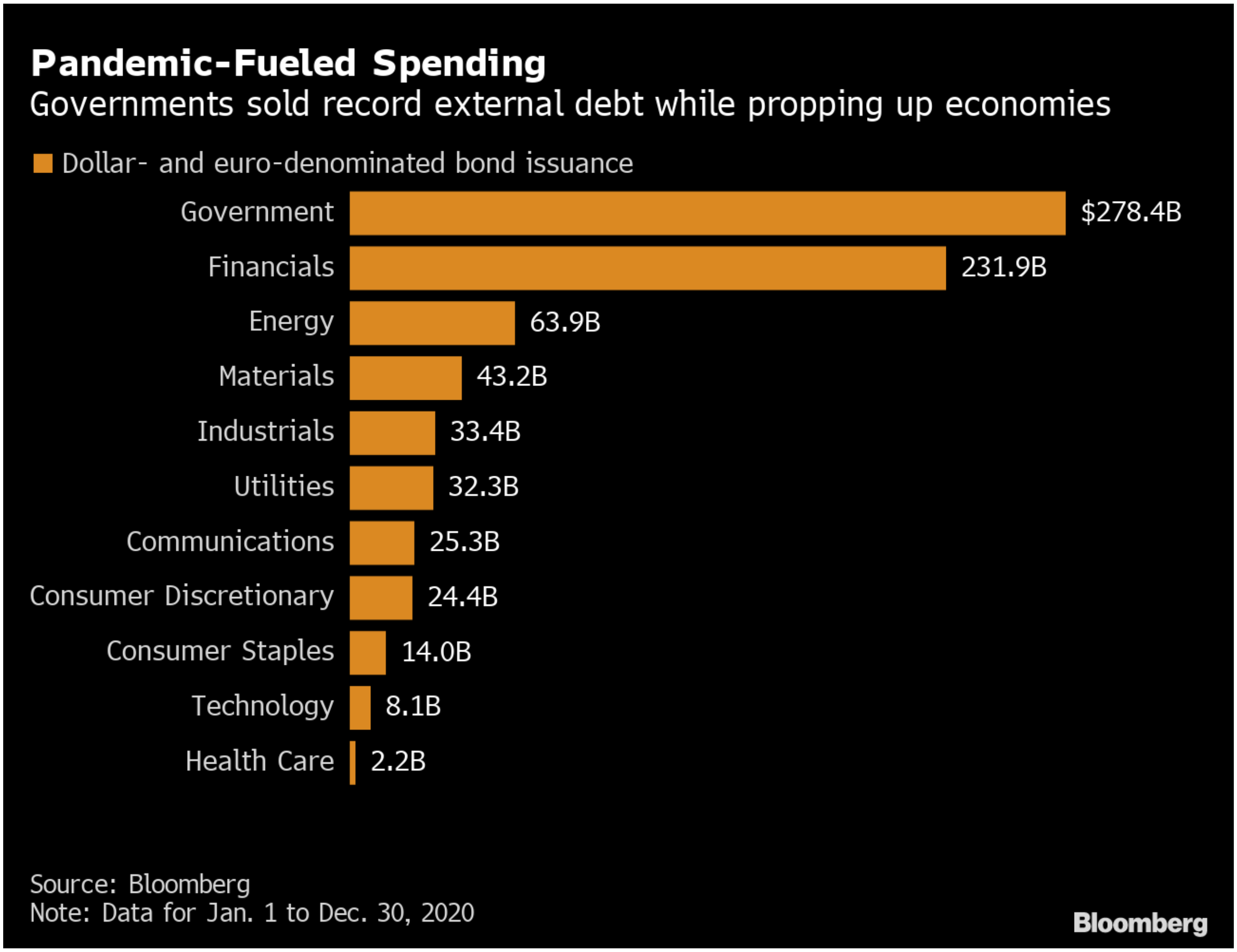
While we continue to champion letting markets be markets, the other side of that trade has way more dollars than we do. It's crazy to think that high yield now yields what the 'riskless' long dated treasuries at one point did in the not-too-distant past.

This is high yield?



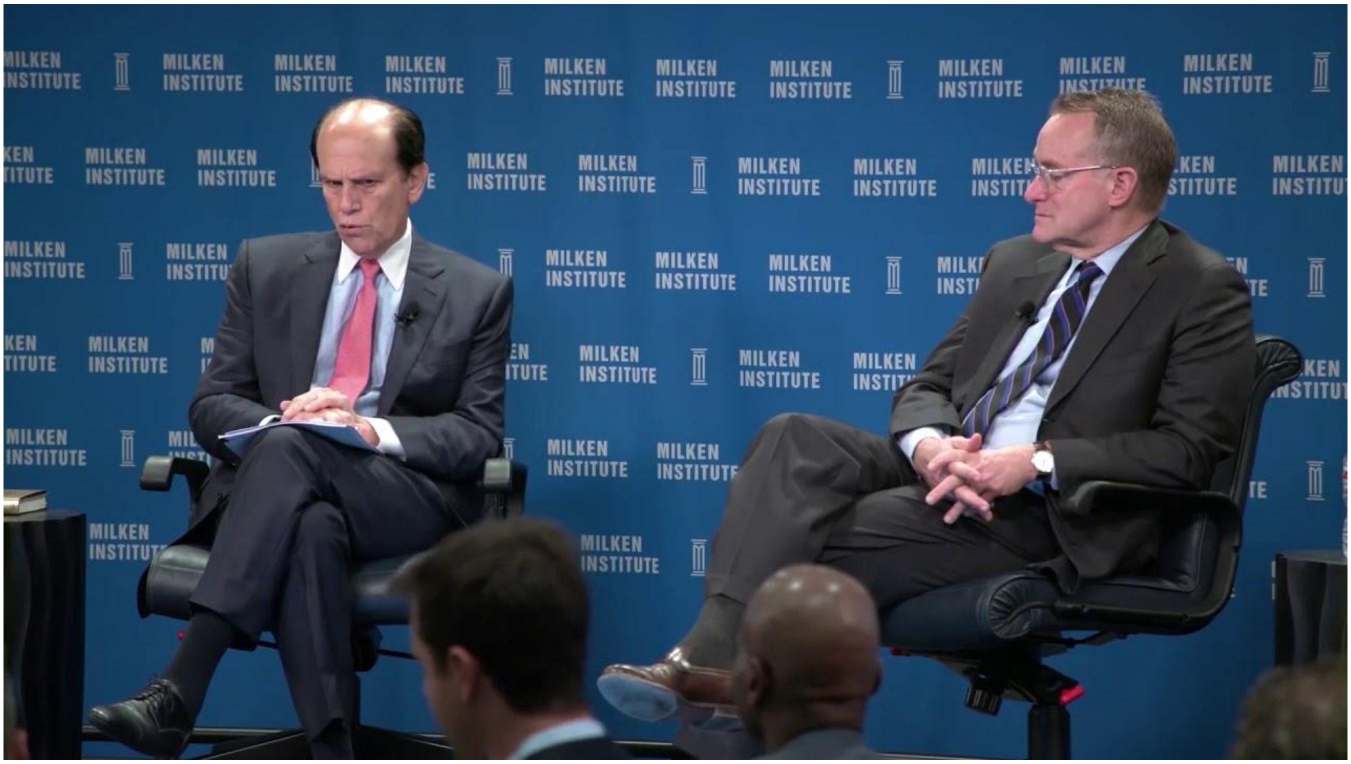
Sidebar story, as told by Oaktree founder Howard Marks, on how Michael Milken really created the 'junk' bond business. In the early '80s', insurance companies had to sell bonds if they fell into a certain grade. At that time, there wasn't much liquidity, meaning you could take a bond trading $0.75 to par and bid $0.55 and probably get filled. To give you an idea how big the market for bond issuances in 2020 was, high yield, or otherwise, Bloomberg gives you the look.

A Trillion Here, a Trillion There



Back to high yield, along comes Milken who keeps calling the Citi high yield desk in New York looking for inventory. The trader he got on the other line was none other than Marks. At some point, the head of fixed income asked who this Milken was, and who wanted to fly to Los Angeles to meet him. The hand that shot up was Marks', and the rest is Predators Ball material.

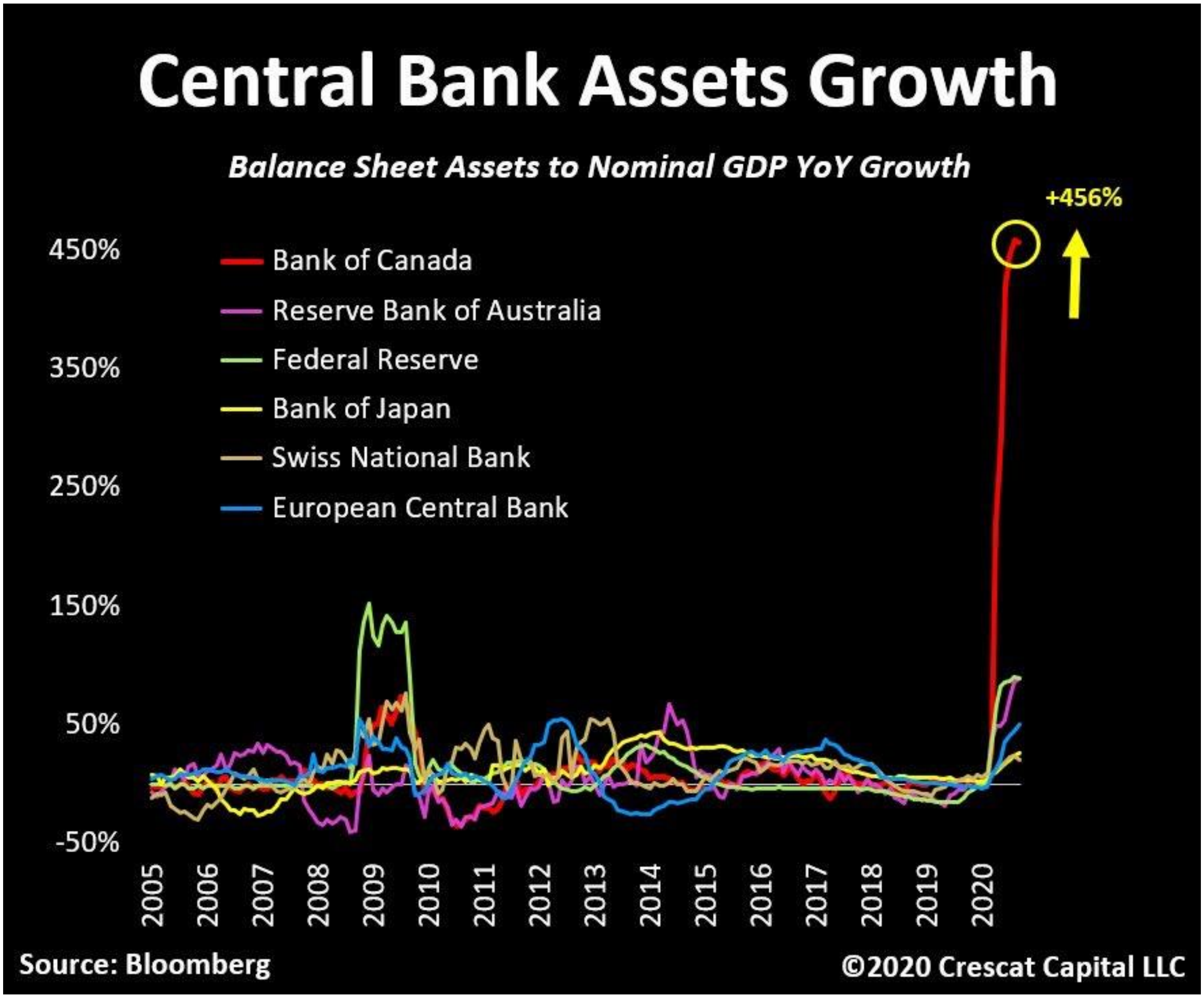
(Not) Strange Bedfellows



Everything Stays the Same

What has stayed the same, is that no matter the reason, when the economic shit hits the fan, central banks around the world, led by our very own Fed, are there to seemingly backstop losses. As a good friend and fellow manager of money, John Gomez once said, this chart is as serious as a heart attack. While Canada stands out in terms of debt to GDP, the rest of the pack are not immune to spiking ratios the likes of which we have not seen since the Global Financial Crisis.

Eye Popping



Which of course for those of us who rely on asset mis-pricings to make our living, are now having a tough time of it. While this chart dates to the middle of last year, it tells the story about how the slow and steady race hedge funds have run, has been losing ground for the past half decade.

Hare Spanks the Tortoise

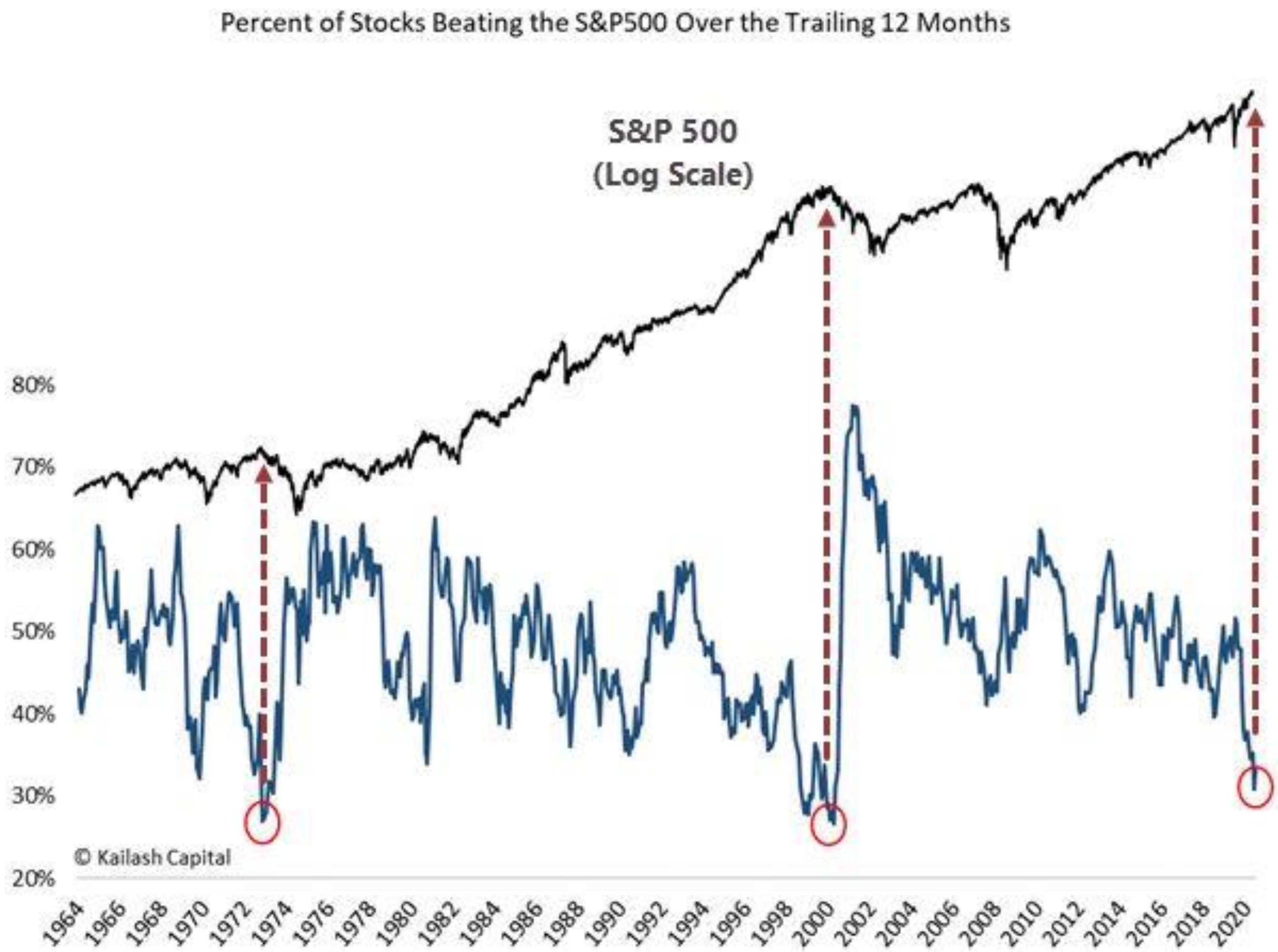
While all of this sounds like sour grapes from a hedge fund manager that can't keep up, as long as inflation doesn't rear its ugly head, the long side of the ledger is going to keep rolling along to new highs. That said, this remains a tale of two markets, where the haves are really having it, while the have nots are not enjoying the ride as much. And count us in the camp that this too shall pass, we simply don't know when the fever will break, and rational asset pricing will return. In the meantime, 'laissez le bon temps rouler'.

Good Times, Good Times

Markets

As has been chronicled many times, in many places, this has been a very narrow market of late. The chart below tells that story well. If your portfolio can't keep up, you aren't alone, as only 30% of stocks in the S&P 500 can actually beat the S&P. Is it different this time? Maybe it is. If it's not, that period of 'moderate returns going forward might just be upon us.

Partying Like 1999



Inflation

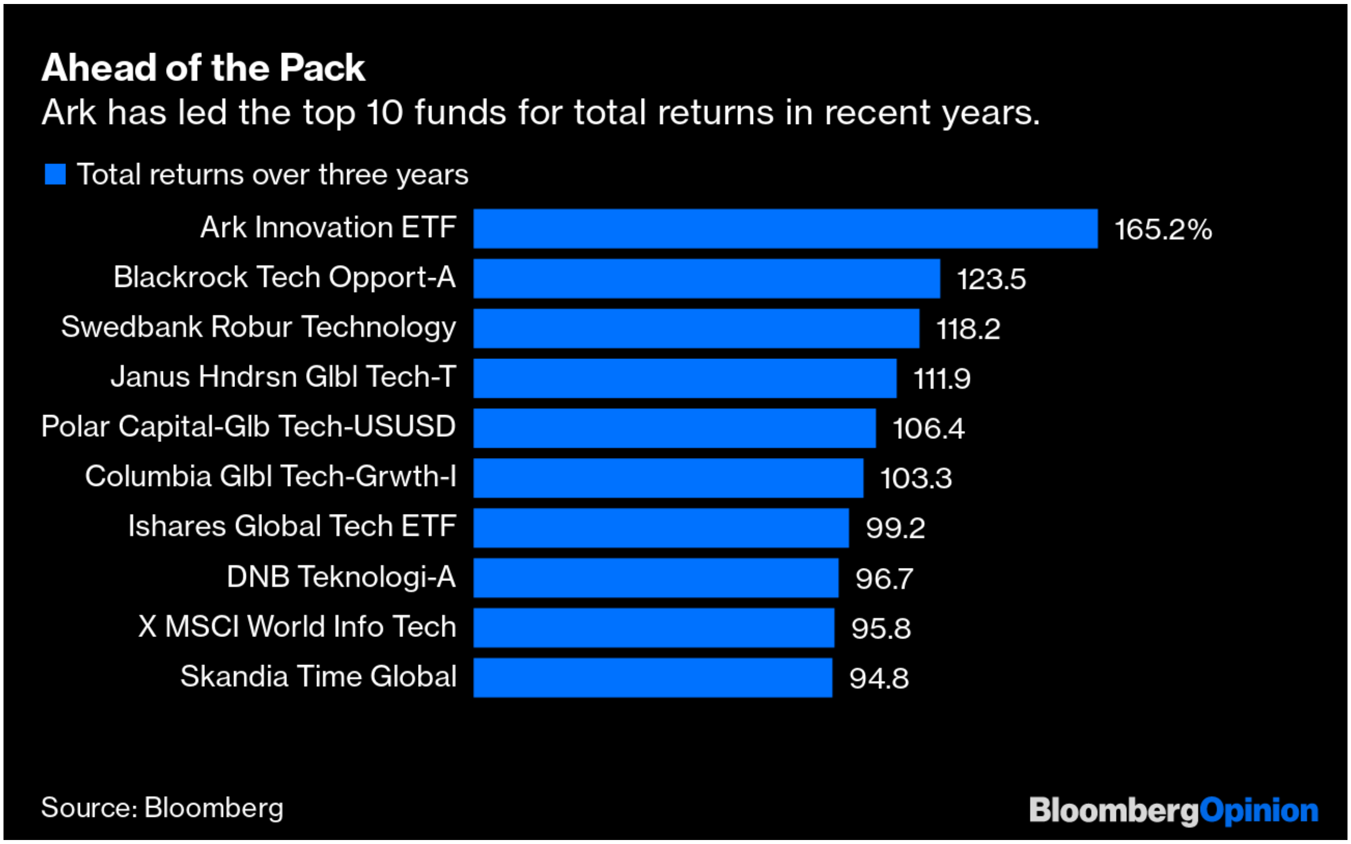
With the recent rise in interest rates from something close to zero (0.80%) on the ten-year treasury, to something well north of that (1.60%), the question of inflation returning at some point in the near future is back on the table. From where we sit, inflation is running rampant in asset prices. Whether it be in residential real estate, equity holdings, or in the private market value of growth companies, you have been more than re-flated. If that's not your condition in life, and you have been holding on for dear economic life over the last year, you are probably 'shit out of luck' in a big way and will be even more down the road if the inflation dog starts barking at the door. Our view is that if the canine doesn't come calling this time, it never will. Like ever, ever!

'All Bark, No Bite'

Cathie's ARK

Fine, we didn't coin the phrase, but we also aren't afraid to use it. The story of the past year in the world of ETFs has been the explosion in performance and assets under management of Cathie Woods ARK funds, specifically the ARK Innovations Fund – AARK. You quite literally can't watch CNBC for a full market's day of coverage and not hear about inflows or what the plan is if assets flow from the business because performance rolls over. That said, if you are up 165% on your holdings in the fund, do you really care if it pulls back 20%? Probably not, as the return has far outpaced the risk.

Scoreboard!



But with performance like this, there has to be someone who wants to take the other side. And take the other side, the short sellers have, as the interest of bets that are going the other way has spiked through the roof. So far that trade has seen one air pocket of note. Outside of that, it has been a one-way trade. A very serious one-way trade. We wish those who want to take the other side well, as in our younger years we would have done the same thing. But not this time, as our older and wiser self says there are easier ways to get to financial heaven.

Good Luck, Shooter!

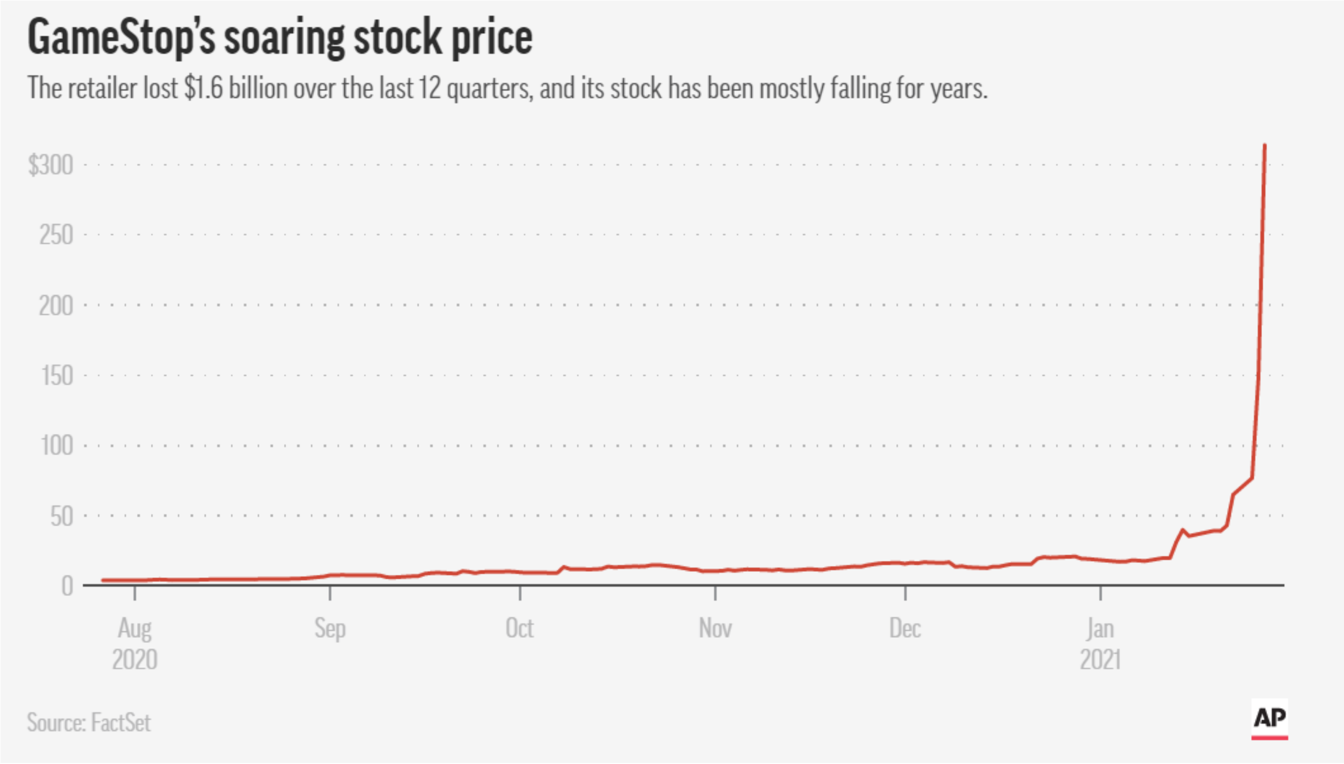
Short Selling

Not since the great Jedi purge has there been a larger evisceration of a class of individuals than the one delivered to short sellers this year. Having been one for the better part of two decades it was painful to watch. The biggest short selling domino to fall was Melvin Capital, which lost three billion dollars during the GameStop route.

Order 66

We can't overstate enough how much the world has changed for those of us who actually attempt to hedge via short selling. It's been a losing trade for us since May of last year, and we have investors who let us know that every week. What I would say to anyone who doesn't live and breathe with a daily long/short P&L, is that this was indeed different this time.

Unmitigated Pain



We honestly don't think short selling will ever be the same. The walls of the castle have been breached, the moat drained, the defenders on the rampart summarily killed, and the tower taken down. Think that was hyperbole, it was not. Maybe, just maybe, a couple of us got out the back door alive and will be there when the craft is needed again. Until then my brothers and sisters, 'may the shorts be with you, always'.

Mercy!

'Get Busy Living…'

This Friday, Stillwater will be running a special 'get busy living or get busy dying' edition. Why not, given that the world is beginning to open back up and we have a lot of catching up to do. From our inside the ropes look at the best single day experience at the Masters, to the simple fine art of the best burger in all of Los Angeles and best gator benedict in Baton Rouge, we have something for everyone. Until we meet again, be well.

Namaste

DISCLOSURE: *Stillwater Capital, LLC is a Registered Investment Adviser. Advisory services are only offered to clients or prospective clients where Stillwater Capital, LLC and its representatives are properly licensed or exempt from licensure. This website is solely for informational purposes.*

Past performance is no guarantee of future returns. Investing involves risk and possible loss of principal capital. No advice may be rendered by Stillwater Capital, LLC unless a client service agreement is in place.

Stillwater Capital, LLC provides links for your convenience to websites produced by other providers or industry related material. Accessing websites through links directs you away from our website. Stillwater Capital, LLC is not responsible for errors or omissions in the material on third party websites and does not necessarily approve of or endorse the information provided. Users who gain access to third party websites may be subject to the copyright and other *restrictions on use imposed by those providers and assume responsibility and risk from the use of those websites.*

General Notice to Users: While we appreciate your comments and feedback, please be aware that any form of testimony from current or past clients about their experience with our firm on our website or social media platforms is strictly forbidden under current securities laws.