SEVEN SUMMITS CAPITAL

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OCTOBER 2016 INVESTMENT COMMENTARY

ONCE AGAIN THE MARKET IS FIXATED ON... POLITICS, INTEREST RATES & OIL PRICES

When I sit down to write the November investment commentary, I will most likely be getting a late start due to the Presidential Election taking place on November 4th. The stock market is beginning to pay closer attention to the weekly swings in polls as election day approaches.

The stock market is in many ways a barometer measuring uncertainty in aggregate. Democratic candidate Hillary Clinton viewed as the candidate who represents a high level of certainty around policies and temperament. On the other hand, Republican Candidate Donald Trump has stated on many occasions that he prefers to be unpredictable.

Following the first Presidential debate that took place on September 26th, an article written by Anora Mahmudova and Sara Sjolin for MarketWatch, titled U.S. Stocks March Higher in the wake of Clinton-Trump Debate concluded that “The advance in stocks suggest that U.S. equity markets are betting that Clinton benefited the most from Monday’s presidential debate. Stocks are rising at the prospect of a Clinton presidency because the Democrat is viewed as a known quantity while some view Trump as being more unpredictable--a bad thing for stock investors.” I do not attempt to attribute a given day’s stock market performance to any particular event. However, to the extent that markets dislike uncertainty, as the prospect of victory rise and fall for a Presidential candidate who prides himself on being unpredictable, one could conclude that such a candidate’s prospect for winning or losing might have an inverse relationship to market direction.

Market direction turned down during the first half of September as volatility increased ahead of the September Federal Reserve meeting. During the weeks leading up to the Federal Reserve meeting, the markets had to process a third consecutive strong BLS jobs report following the unusually weak report released in early June. This strong jobs reports paired with several comments from Federal Reserve officials, which seemed to hint at the possibility of an interest rate increase at the September meeting, put U.S. stocks on edge.

Oil prices began September with Brent North Sea Crude prices near $45 per barrel, only to rise to $50 per barrel as rumor began to circulate that Saudi Arabia and Iran were close to an agreement that would lead to a cut in world oil supply. Those rumors faded near the middle of September and oil prices fell back to the $45 level. As of the writing of this commentary, oil prices are rising back to the $49 level. The rumors of a supply cut turned out to be true with the first agreement by OPEC to curtail world oil supply since that cartel shocked the world back in November of 2014 when OPEC refused to support oil prices after prices had fallen over 50% from their highs.

As a long-term investor, one has to ask if this election, higher interest rates (they can’t get much lower), and the level of oil prices between $40 and $60 per barrel make a difference when it comes to their wealth.
Not only is the market nervous right now, but so are many very successful and seasoned investors. On the same day, September 27th, Bloomberg published two separate stories illustrating the uneasiness of a Senior member of Blackstone’s management team and

legendary hedge fund manager Julian Robertson. Joe Baratta, Global Head of Private Equity for Blackstone, stated "for any professional investor, this is the most difficult period we've ever experienced. You have historically high multiples of cash flows, low yields. I've never seen it in my career. It's the most treacherous moment." Considered by many the greatest hedge fund manager ever, Julian Robertson stated, "hedge funds are facing the most challenging time he's seen in an investing career spanning several decades."

It is my responsibility to listen to credible and experienced people who offer their commentary on subject matter that can inform me about the market environment and potential investment risks and opportunities. There is undoubtedly a lot of pessimism being reported on, and Julian Robertson, Joe Baratta, and many other notable hedge fund and private equity investors pessimistic comments of late reflect an extremely cautious outlook. On the surface, this pessimism from such experienced investors should give all investors pause. However, below the surface, the hedge fund industry, and to a lesser extent the traditional "leverage buyout" private equity business model are facing significant headwinds. These headwinds may explain why these "smart money" investors are feeling so down.

Josh Brown, a contributing journalist with CNBC, wrote on September 29, 2016, a short commentary on the troubles facing the hedge fund industry. He commented that "The size of the (hedge fund) industry and the sheer amount of competitors is another secular roadblock to outperformance. There are 10,000 funds managing $3 trillion today, whereas, in 1990, it was a few hundred funds managing $39 billion. Size is negatively correlated with outperformance." Many large, long-standing hedge funds have closed over the last 12 months, while the vast majority have experienced significant outflows of investor dollars. CALPERS, the largest teachers pension in the country announced last year that they were divesting from all hedge funds noting the excessive costs and complexity associated with such investments.

Managing private wealth for individuals is not the same as managing a multi-billion hedge or private equity fund. These large institutional oriented funds are measured against quarterly and annual hurdle rates. Thus, the managers of these funds need to have plentiful large opportunities that can be traded successfully to deliver consistent short-term returns. Unlike multi-billion dollar hedge funds, Seven Summits Capital can make a meaningful difference for their investors over time by matching clients' time horizons to a flexible and opportunistic valuation-centric process along with the conviction necessary to be a contrarian.

There is a reason that Howard Marks of Oaktree Capital is the one living professional investor that Warren Buffett has stated that he pays very close attention to. Howard understands just how effective a combination of contrarianism and long-term investing can be in the hands of a value-focused investor. The ValueWalk website posted on September 28, 2016, a Bloomberg interview between Howard Marks and Eric Shatzer. During this interview, Marks addressed the current large chorus of pessimistic voices within the ranks of hedge fund and private equity managers. Marks stated that he is "not seeing bubble prices in most areas (of the market) and that "when people are talking about risks in the market, this is a healthy thing."

I agree with Howard Marks that increasing skepticism about the markets is more a positive indicator than negative. This type of skepticism can lead to an occasional sharp, but a very temporary correction in stocks, however, skepticism is a "bullish" sentiment from a contrarian point of view. It has been said that the current bull market in U.S. stocks that began in March 2009 and continues today is the most hated bull market in history. The doubters and doomsayers who have been looking for a bear market or crash for the last seven years are the very same people who have enabled this bull market to continue to grind forward. If anything, this long hated bull market in U.S. stocks may be creating bubble through a caution trade. The caution trade has turned the market on its head. The perceived safety of blue chip dividend paying stocks have turned them into today's investment grade "bond" investment, and the relatively high yields on junk bonds have seen these risky fixed income investments be treated as the high return "equity" portfolio allocation. Thus, "safe" stocks are being seen as providing the safety of bonds, and risky bonds are being seen as a proxy's for growth-oriented stocks.

This perversion of traditional asset classes has created distortions in our capital markets that I have been discussing for almost two years. Being able to recognize risk is necessary to being able to manage risk. Seven Summits Capital portfolios are attempting to steer clear of these distortions. Managing these risks has come at the expense of missing out on capturing a 20% return in utility stocks in the second half of 2014 or capturing the excess returns produced by many large consumer staples stocks over the last 12 months. We have maintained our discipline, and this discipline has led us to many very fundamentally sound investment opportunities that have already produced very impressive returns within portfolios. Whitewave Foods (WWAV), originally purchased over two years ago under $20 per share recently agreed to be purchased by Danone for $56 per share. Sony Corporation (SNE) was a classic contrarian value opportunity and was originally purchased in January 2015 for around $17 per share. Sony stock now trades for just over $33 per share. Qualcomm was just rumored to be interested in buying NXP Semiconductor (NXPI) for as much as $100 per share. NXPI was originally purchased over two years ago under $50 per share and is currently owned throughout many Seven Summits Capital portfolios.

Seven Summits Capital managed portfolios rely upon a value-seeking process, combined with patience. Experience has taught me that riding market momentum or trying to guess where the strength and weakness will be within the market is a fool's game. Therefore, we happily miss some momentum driven rallies while we diligently monitor our investments, add to them during periods of temporary weakness, and wait for the market to recognize the value that is intrinsically embedded in the underlying company. As with Sony, the passing of time and better than expected results act as a cure for market short-sightedness. Other times when the market under-prices a stock for too long, an acquisitive organization will be willing to buy the entire company for a premium over the market price, as was the case with Whitewave Foods and possibly NXP Semiconductor. No matter which scenario comes to fruition, our investment thesis is validated.

The bottom line is that we seek value, quantify value, monitor value, and profit from value-driven investment actions. If the concept of value is not the central focus an investor's buy and sell actions, the investor is not investing, he or she is simply playing the market price guessing game.

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