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APRIL 2019 INVESTMENT COMMENTARY

In Equity Investing the Idea of Value Versus Growth is a Fool's Errand

The first quarter of 2019 has been the mirror image of the fourth quarter of 2018 for equities. This type of environment, where the stock market overshoots on the downside only to quickly reverse the overshoot, is an environment that plays into Seven Summit Capital's strengths. We have never allowed market sentiment and volatility to impact our conviction to a fundamentally centered process. Regardless of the market direction and level, we assess our portfolio holdings individually using a unique and adaptable approach to valuation. Some of our clients have labeled this approach as that of a "value investor," however, I do not see our approach as that of a traditional value investor. I view our approach as being anchored to various concepts of valuation that help determine where the price buoyancy is for a particular security. Price buoyancy is a term that I use, not a technical, financial market term. Market price action influences the price action of individual securities and causes those individual security prices to vacillate around a fundamentally derived range that I view as the natural buoyancy for security. That fundamentally derived buoyancy helps me develop my conviction around buying, selling or holding a particular investment.

The determination of price buoyancy is where the rubber meets the road in this process. Without a set of processes that can be adapted to a wide variety (e.g. large, mid, small, and micro companies) of investment opportunities, knowing when to buy, sell or hold with conviction is not possible. Without our process and resulting conviction, it would not be possible to avoid being susceptible to speculative and trend following decision-making, which we stridently eschew.

The value opportunity seeking process that we use was born out of bringing to bear the professional experience garnered from working as both a commercial banking credit analyst, a small-cap equity mutual fund stock analyst, and a lifetime of being immersed in entrepreneurship and business management. From these life and professional experiences, I view all equity investments from the vantage point of the intrinsic value of the underlying business. The idea of an intrinsic value derived from a prospective vantage point is the key to developing an informed opinion of what is the buoyancy level or fundamentally derived value range of a particular stock.

There are many different approaches to determining the value of a particular investment and this lack of convention can cause many people to view security selection and portfolio management that is anchored to a concept of "valuation" as unreliable and a waste of time and effort. I will push back quite vigorously on those assertions, as will virtually every time-tested luminary in the investment profession such as Warren Buffett or the likes of Jeremy Grantham and Seth Klarman. Although each of these legendary investors still controls many billions of dollars, the truly

exceptional investment returns which earned them legendary status have largely occurred in the distant past. Even Warren Buffett appears to lament missing many of the truly spectacular investments of the last twenty years, in particular, Amazon. As our economy transitioned from a capital intensive industrial centric economy to an information and technology-centric economy, valuation metrics that served investors well for over half of a century began to become much less effective. This happened because those metrics were designed to discount future cash flows and measure tangible book value of asset-heavy, long business cycle companies. Today our largest companies are asset light and short-cycle companies because the competitive advantage is now created and maintained by intellectual capital, innovation, and rapid change.

I, and Seven Summits Capital by extension, sometimes get labeled as a value equity manager because the investment process utilized in the area of equity securities is focused on the underlying company and it's intrinsic or enterprise value, not the idiosyncrasies and price action of the traded security. I began to develop this approach during the Dot-Com bubble years when I was an equity analyst. The foundational lesson learned during that time was that exuberance and price momentum are very poor signals when searching for superior risk/return opportunities. The core tenants of the approach that has become the foundation of the investment process at Seven Summits Capital is a combination of traditional valuation concepts made famous by the great value managers and an insatiable appetite to understand the disruptive power of technological innovation, consumer preference changes brought about by long-term demographic and cultural trends, and opportunity presented by superior, but misunderstood business models.

When I look back over the last several years at Seven Summits Capital's strongest performing equity holdings, I see companies where we identified one or more of the factors above to define our investment thesis. Below is a list of a sample of some of our strongest performers identified at price levels that did not adequately reflect the value creation opportunity that lied ahead:

- FB - Facebook (initiated under $30/sh.)
- GRMN - Garmin (initiated under $40/sh.)
- TSLA - Tesla (initiated under $50/sh.)
- WWAV - Whitewave Foods (acquired by Danone)
- SNE - Sony (initiated under $20/sh.)
- CSCO - Cisco (initiated under $30/sh.)
- DISCA - Scripps Network (Acquired by Discovery Networks)
- SQ - Square (initiated under $40/sh.)
- TNDM - Tandem Diabetes (initiated under $5/sh.)
- NVTA - Invitea (initiated under $8/sh.)

Very few of the above companies would have shown up at the time that we took our initial positions as traditional value companies/investments. I distinguish our approach from pure value investing by the fact that we do not divide the equity universe into style boxes of Growth, Core, and Value companies. Instead, we look for value discrepancies in the market regardless of industry, size, and traditional value/growth metrics. For this reason, I like to label what we do as Fundamentally Centered Value Opportunity Investing.

One of that most important tools that Seven Summits Capital currently uses to assist us in identifying Fundamentally Centered Value Opportunities is a research service created by Brian Nelson known as Valuentum. Brian just had his first book on investing called Value Trap published. Brian recently wrote the following that dovetails very well with my writing in this month's commentary:

"**I need to make sure that you're aware of something very important.** The media and perhaps many investment professionals define the concept of "value" as companies with low price-to-book (P/B) ratios, and the concept of "growth" as companies with high price-to-book ratios. This definition of "value" and "growth" and their corresponding returns have been magnified in writings throughout the media and across quantitative

research, even in prestigious journals. Warren Buffett has been rallying against most quantitative applications and how “growth” and “value” are defined in popular media and quantitative research for decades.”

Here’s one of Oracle of Omaha's most famous quotes:

> *“But how, you will ask, does one decide what [stocks are] “attractive”? Most analysts feel they must choose between two approaches customarily thought to be in opposition: “value” and “growth,”... We view that as fuzzy thinking...Growth is always a component of value [and] the very term “value investing” is redundant.”*
>
> *-- Warren Buffett*
> *1992 Berkshire Hathaway Annual Report*

Brian Nelson goes on to say, “the traditional quantitative “value” factor has been underperforming for the last 15-years or so, and factor distribution tables from J.P. Morgan and Credit Suisse only highlight the value factor’s prolonged weakness. **Why is this important?** Well, many investors may believe that true intrinsic value investors are also underperforming and in a more dire sense that value investing is dead. I cannot stress enough the **vast differences** between the concept of enterprise value, as in arriving at a fair value estimate, and the traditional definitions of “value” that are based on price-observed metrics such as the P/B ratio. It is simply the difference between night and day.”

Partnering with Brian and Valuentum is one of the best decisions that I have made since forming Seven Summits Capital in 2012. Brian and I correspond regularly, and I was honored that he included my praise for his book on the third page of Value Trap. I wrote:

> *“Value Trap is a brilliant encapsulation of the fallacy that underpins the very idea of valuation today and the pitfalls those fallacies create for investors. Brian does not stop at identifying the problem; he does what he does best; he lays out a hypothesis developed through experience and critical thinking and offers a better approach.”*

At no time in my career have I more enjoyed working with clients, finding opportunities and managing portfolios. Improving the process of assimilating information, identifying investment opportunities, and weighing the relationship between risk and return is a never-ending journey at Seven Summits Capital. I am excited with the results of this process over the last several years, and I am dedicated to always strive for better.

I am excited that Spring has arrived in Central Pennsylvania. I hope that everyone makes time to get out and enjoy the sunshine and pleasant temperatures. I will soon be hitting the links at Bent Creek Country Club. I look forward to proving to anyone brave enough to join me for a round of golf why my handicap is so high. If you are a golfer and need someone to make you feel good about your game, let me know, and I will get you out for a round of golf where the only birdies that I will likely see will have wings.

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