SEVEN SUMMITS CAPITAL

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AUGUST 2015 INVESTMENT COMMENTARY

AS MARKET LEADERSHIP NARROWS – MOMENTUM STOCKS GROW MORE EXPENSIVE AND EVERYTHING ELSE GETS CHEAPER

Increased volatility, sensational headlines from around the world, and a lack of consistency in economic statistics can cause equity investors to feel uneasy. This uneasiness is understandable given that the major U.S. equity indices are barely up for 2015, corporate earnings are not universally strong enough to propel the broad markets forward, the Chinese mainland stock market has been falling hard, and the Federal Reserve is likely to begin to raise interest rates in September. However, this unease is a symptom, not the cause of why broad U.S. stock markets are virtually flat so far in 2015. When one looks inside the broad index returns, market breadth has narrowed significantly over the last several months. Market breadth refers to the number of stocks in the market that are rising versus falling. Changes in market breadth are not readily apparent on the surface when simply tracking broad market returns. However, what it usually signifies is an over-valued market where leadership is coming from a smaller and smaller number of stocks.

Technical indicators, such as breadth, are important indicators for investors whose strategies rely upon broad market returns to drive investment results. Furthermore, market breadth can be a good indicator to predict the short-term direction of the market. This internal struggle within the broad markets is problematic for market-centric investors who make up the majority of today's retail and professional investors. However, for a bottom-up asset manager like Seven Summits Capital, broad market indicators have little bearing on our stock selection process due to the fact that we place little importance on where market leadership is coming from today and what that means over the next six to nine months. Instead, we are concerned with whether stocks that we select can perform well between now and 2017 or 2018. Many times we find the companies that end up being market leaders one to three years from now are among those that are under-performing today. Hence, this is why we become more active during periods when investors are uneasy and prone to making mistakes.

Sometimes being active as a value-seeking investor in the context of a portfolio is as simple as taking profits selectively on investments that have performed well and reallocating those proceeds into excellent companies whose stocks have been relative under-performers. Thus, this exercise increases the certainty of positive returns over a longer time horizon because profits are used to increase investment in securities that exhibit a greater value proposition leading to a compounding effect. An example would be reducing (selling) companies such as Celgene, Facebook, and Whitewave Foods and buying companies such as Honeywell, IBM, Agrium, and General Motors.

Below are the earnings multiples for the above companies on consensus adjusted 2015 forward earnings estimates at the beginning of 2015 versus the end of July.

(see next page for chart)

COMPANY	1/1/2015	7/31/2015	CURRENT DIVIDEND YLD
Celgene (CELG)	24X	27X	0.0%
Whitewave (WWAV)	31X	45X	0.0%
Facebook (FB)	36X	46X	0.0%
Honeywell	14X	15X	2.0%
IBM (IBM)	10X	10X	3.3%
Agrium (AGU)	10X	12X	3.5%
General Motors (GM)	8X	4X	4.5%

All of the above stocks represent widely held holdings in Seven Summits Capital portfolios. In the case of CELG, WWAV, and FB stocks, these stocks were first purchased eighteen to twenty-four months ago and, since the original purchase, each stock has appreciated between 70% and 280%. Looking at the original purchase price of these holdings versus 2015 earnings estimates, CELG was originally bought at 16X, WWAV was acquired at 16X, and Facebook would have been valued at 13X. We remain committed to the long-term growth thesis for each of these companies and, in most portfolios, we are not selling out of our positions entirely. However, experience dictates that when valuation metrics increase substantially faster than earnings, it is prudent to harvest some profits and reallocate the proceeds to better opportunities regardless of how strong past returns have been.

Honeywell, IBM, Agrium, and GM represent the type of company and stock that we gravitate to when the valuations of select existing holdings can no longer be characterized as "growth at a reasonable price" (GARP). IBM, for example, will likely grow its earnings at approximately 5% per annum over the next two years. Based upon this modest growth estimate, if sentiment around this company can improve even modestly and the P/E multiple is able to rise to 11X over the next two years, the stock would appreciate to $193 per share. With an annual dividend of 3%, this stock appreciation scenario would produce an annualized total return over the next two years of 13%. Given the company's restructuring efforts underway, we believe that it is far more likely that the price earning multiple for IBM will expand from 10X to 11X over the next two years than contract.

The aforementioned two-year IBM forecast and total return expectation illustrates how long-term investing provides a quantifiable level of certainty versus the game most investors focus on which entails, for example, guessing whether IBM will trade down to $150 or up to $170 over the next five months. For out purposes, it does not really matter which direction IBM shares trade between now and the end of the year.

Long-term value can be quantified and stress tested, but short-term price can only be the basis of speculation. We always are searching for the next Whitewave Food or Celgene type of opportunity; however, we will be very satisfied if an investment, such as IBM, produces an annualized total return of 13% over the next twenty-four months.

It is a testament to the "go anywhere" value screening process utilized by Seven Summits Capital that we can identify and capitalize on high-growth companies, such as Facebook, at a time when investor sentiment for a particular stock is low. Once a purchase is made, we are then driven by our sell discipline, which allows us to hold a stock like Facebook long enough to see the stock more than triple as sentiment becomes increasingly exuberant. The flexibility of our process also allows us to capitalize on out of favor dividend-paying value stocks that can reasonably be expected to generate double-digit annualized total returns. Currently, IBM is one of those out of favor dividend-paying stocks.

Our desire to seed portfolios with under-appreciated high growth stocks led us to Facebook two years ago and drives our continual effort to identify such opportunities today. A current example of an out of favor high growth company that we have begun to take an interest in is Zillow. Zillow is the well-known real estate listing website which recently combined with its main rival, Trulia. Now, with the Trulia acquisition, Zillow dominates the online real estate sales listing business for consumers interested in buying or selling a home. Given this dominance, one would assume that in an environment where Facebook pays $20 billion for a small messaging smart phone app called WhatsApp and struggling Twitter has a market value of $21 billion (down 41% so far in 2015), that Zillow would be awarded a rich valuation by the market. In fact, Zillow's market value is slightly under $5 billion, which is exactly where we see opportunity. Zillow's 2015 estimated revenues are approximately one third of Twitter's 2015 estimated revenues, but Zillow's monthly users are approximately one half of those of Twitter. The two companies have very similar consensus five-forward growth rates of around 65%; however, Zillow's market cap represents 7x the company's estimated 2015 revenues, versus Twitter's market cap that is 10X its expected 2015 revenues. If Zillow would trade at 10X 2015 revenues, its share price (currently around $72) would need to be 42% higher than it is today. There are other relative value considerations that we have studied and our conclusion is that Zillow's current market value appears depressed.

A company such as Zillow (down from a high of $158 in July, 2014) represents an opportunity because it is largely ignored by momentum growth investors who are currently herding into a small subset of online/mobile-driven companies whose stocks have performed very well over the last year. What is occurring with Zillow is representative of what happens within a market when breadth is narrowing. This narrowing breadth inflates the already inflated stocks within the market and depresses the valuation of non-momentum stocks. These non-momentum stocks are where we will typically find companies that will drive our portfolio returns over the next several years. The decisions made during challenging weeks and months in the market have a very significant bearing on the returns that our portfolios will produce eighteen to twenty-four months later. When searching for long-term investment opportunities, I like to remember a quote from Warren Buffet, Chairman of Berkshire Hathaway, who stated,

> "A market downturn doesn't bother us. For us and our long-term investors, it is an opportunity to increase our ownership of great companies with great management at good prices. Only for short-term investors and market timers is a correction not an opportunity."

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