SEVEN SUMMITS CAPITAL

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FEBRUARY 2018 INVESTMENT COMMENTARY

HALLELUJA! THE COILED SPRING OF VOLATILITY HAS BEEN SPRUNG.......IT'S TIME TO HUNT FOR BARGAINS

I am sitting down to begin writing this month's commentary following the market close on February 5, 2018. Today will be one of those days in market history that will be remembered along with October 19, 1987 (Black Monday), March 10, 2000 (Internet Bubble Crash), September 11, 2001, and September 16, 2008. Today the Dow Jones Industrial Average dropped 1,175 points, which followed a 665 point drop Friday, February 2nd. On a percentage basis, these historically large point losses are not as noteworthy. The DJIA closed at 26,187 on Thursday, February 1st; thus over the course of market days, the DJIA declined 7.30%.

Stocks kicked off 2018 with the DJIA rising 5.80% for January. January 2018 was the best monthly gain since March 2016, which saw a rebound from a 15% market correction that took place during the first two months of 2016. This January's 5.80% gain in the DJIA marked the best January gain since the Dot Com bubble market era, namely 1997. The historic January rise in stocks followed a year which uncharacteristically contained no negative months. Lastly, one of 2017's most noteworthy characteristics was the extreme absence of volatility, which pushed the most common measure of volatility, the VIX, to 35-year lows. 2017 made investors begin to believe that a Bull Market that began in early 2009 was beginning anew. My experience over the last 20 years caused me to be cautious, not exuberant. I wrote in my December 2017 commentary, which was written to convey my appreciation for contrary thinking and preparation, "I believe that the most precarious times within markets for long-term investors is when markets are flying upwards, and investors are more worried about whether they are keeping up than how much they are overpaying at the time".

I have mentioned many times in the past that the stock market is populated by all types of investors, short-term traders using varying technical and momentum driven strategies, passive asset allocators, and fundamentally driven long-term investors. It only makes sense that market prices over short-to-intermediate time-periods will predominately be driven by the short-term oriented momentum traders and the asset allocators who are informed by herd mentality.

I mentioned in last month's commentary that the current market was characterized by an overwhelming "the trend is your friend" mentality. After the sharp market correction on February 5th, JP Morgan market strategists, Marko Kolanovic and Bram Kaplan wrote in a note "Selling from trend-following strategies contributed to the mini flash crash that hit U.S. equities around 3:10 p.m. on Wall Street."

After repeating myself many times in commentaries throughout last year regarding market imbalances, eerily low volatility, and elevated valuation, all of that seems to be coming home to roost over a period of just several trading days. I wrote extensively about preparation and the unpredictability of markets in

December. In early February, we are now witnessing a rapid and sharp correction during a period of solid economic news and great optimism regarding the 2018 corporate earnings expectations, bolstered by the recently passed tax reform.

Much is being discussed, relative to the stock market correction, regarding leveraged volatility exchange-traded notes (ETN's), risk parity strategies and over-crowded passive ETF securities. These products and strategies were at the root of the last year's uncharacteristically low volatility and the unusual string of positive return months during 2017. If it takes a sharp and violent correction, as we are currently experiencing, to break the hold that these strategies have had on the market, I welcome such a correction. At Seven Summits Capital we do not even try to play with leveraged ETF's, we do not gamble with derivatives, and we do not believe that there can be a well-functioning market when discriminating buyers and sellers are displaced by an increasing number of purely passive investors. Markets are healthy when investors are working hard to find opportunities, thus producing robust price discovery. While much of the discussion during the current correction is centered on concepts such as the 200-day moving average, the retesting of lows, and money flows in and out of volatility instruments, I am spending my time today reading a passage from one of my research providers in order to better understand Gilead Sciences:

> *<u>Valuentum's Comment on Gilead Sciences Fourth Quarter Conference Call</u>*
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> *Gilead Sciences (GILD) received a nice boost from the FDA's approval of its triple combo pill BIC/FTC/TAF, which is branded as BIKTARVY, for the treatment of chronic HIV-1 infection in adults February 7 despite reporting a material decline in fourth quarter revenues after the close February 6. HCV product sales were more than halved in the quarter from the year-ago period, though HIV and HBV sales growth was able to partially offset the decline. Top-line erosion is expected to continue in 2018 as net product sales are expected to be in a range of $20-$21 billion compared to $25.7 in 2017, but management remains optimistic on the potential of its oncology and cell therapy programs with the approval of Yescarta, the first CAR T cell therapy for the treatment of adults with relapse or refractory large B-cell lymphoma after two or more lines of systemic therapy, a key positive in the fourth quarter.*

I very much like Gilead Sciences stock at current price levels. Gilead Sciences is a $105 billion biopharma company, and the company has a legacy of innovating treatments for previously untreatable conditions such as HIV-AIDs and Hepatitis C. Gilead has spent the last 30 years revolutionizing the treatment of HIV-AIDs, and due to Gilead's efforts, most HIV-AIDs patients do not die from this disease. Over the last ten years, Gilead was the first company to market with a very effective cure for the previously incurable disease of Hepatitis C. With current in-house research, combined with the recent acquisition of Kite Pharmaceuticals, Gilead is turning its attention to the cancer treatments. Gilead has a very strong balance sheet and strong cash generation, which provide Gilead with significant capacity to invest in research and development and/or further acquisitions. Gilead is a core component of Seven Summits Capital's proprietary Biotech portfolio strategy. Over the last several months Gilead has been added to our clients' diversified portfolios at prices between $70 and $82 per share.

I strongly believe, for 2018 and beyond, that being more discriminating and making larger commitments to the most compelling ideas will serve our clients well. Gilead, along with core holdings such as IBM, Cisco, Accenture, Discovery Networks, Berkshire Hathaway, Sony, Under Armor, and Macy's represent values that we believe should be overweighted in most portfolios. I welcome the current correction and what I hope will be a return of more normal levels of volatility. Volatility provides an active manager, such as myself, more opportunity to build stock positions when they are selling well below our future price targets.

I will keep this month's commentary on the short side. The current volatility has precipitated a great opportunity to realign portfolios around high conviction opportunities that the present correction has temporarily put on sale.

Thus, I must get back to work!

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