SEVEN SUMMITS CAPITAL

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JULY 2017 INVESTMENT COMMENTARY

MORE THAN MEETS THE EYE... SEVEN SUMMITS CAPITAL | THE MARKETS | THE ECONOMY

Now that we are halfway through 2017, I thought that I would use this commentary to provide a mid-year update for Seven Summits Capital, my impression of both the equity and fixed income markets, and what known and unknown factors might affect client portfolios over the next six to twelve months.

Seven Summits Capital and I continue to derive benefits from an association with Coastal Investment Advisors. Coastal allows Seven Summits Capital clients to benefit from low transaction fees through Wells Fargo Clearing Services (previously known as First Clearing) and Coastal continues to be committed to providing a broad array of non-traded alternative investments that I further narrow down and utilize in many client portfolios. Many clients have had the pleasure of working with Barb Trimbur, one of my Coastal operations support personnel who works in Central PA and is very experienced and efficient.

You may see reference in the near future, to an additional role that I have taken on. I helped Coastal design an investment platform, and I will be acting in the capacity of Chief Investment Officer of this new portfolio management offering. The new offering from Coastal to its advisors across the country is called CAM Investment Strategies. This technology platform will help Coastal with its desire to offer advisors a differentiated and value-added investment tool to better compete in an ever-commoditizing world of passive investment model solutions. This platform will leverage my almost two decades of investment research and portfolio management experience. The investments which will underpin this platform will almost entirely overlap the investments that I research, follow and utilize in Seven Summits Capital portfolios. The biggest difference will be in the way the investments are allocated to portfolios. Client's will be scored from an investment objective and risk tolerance perspective and those scores will directly determine how the investments are allocated. These allocations will be made utilizing a modified robo-advisory algorithmic technology specifically designed for this proprietary platform.

Over the next six months, I will be emphasizing a more formal Seven Summits Capital designed network of specialized professionals that clients will be able to access for specialized financial services such as:

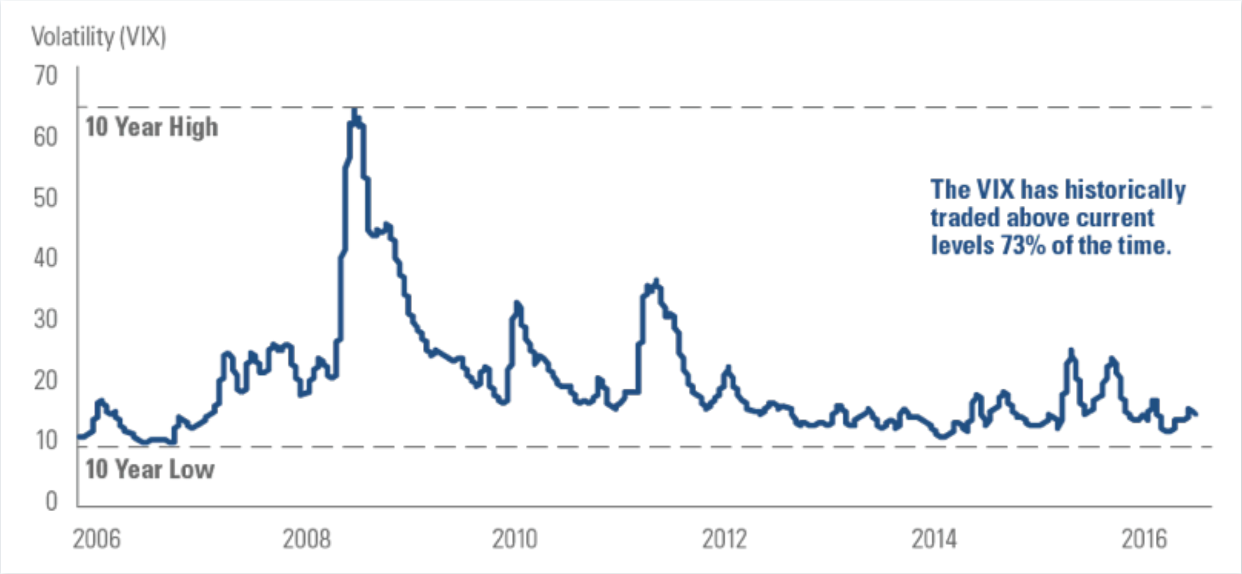
- Estate Planning
- Tax Strategies
- Specialized commercial lending solutions (HUD)
- Personal secured lending requests
- 1031 real estate exchange strategies

We also now have a solution for those clients who wish to explore owning hard assets such as real estate within their IRA accounts. Seven Summits Capital is currently working with a long-time client to help with a large $20 million-plus real estate project financing need, and we are in discussions with several clients who may be able to take advantage of a 1031 real estate exchange. We can leverage long-standing relationships with the very best local, national and global experts to meet an ever-expanding set of financial needs for our clients. These capabilities have always existed in an informal sense, and we are going to be putting a formal structure around these capabilities.

FIRST HALF 2017 MARKET DISCUSSION

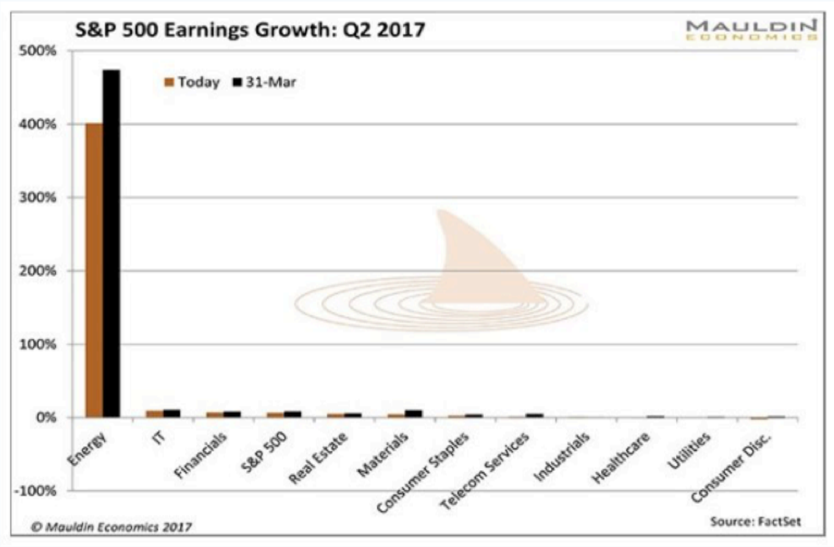
For me, the first half of 2017 was characterized by the following noteworthy characteristics:

1. **Extremely low volatility equity markets (volatility, as measured by the VIX futures index, registered a 35 year low):**



The above chart was used in a Goldman Sach's Q1 2017 "Market Know-How." The VIX index illustrated above continued to decline into Q2 2017, only recently beginning to trend upward. Many Seven Summits Capital portfolios now include an allocation to the VIX Futures ETN (VXX) in order to attempt to add "volatility insurance" to portfolios during this unusual time of historically low equity market volatility.

2. **Corporate Earnings Growth is not exactly what it seems:**



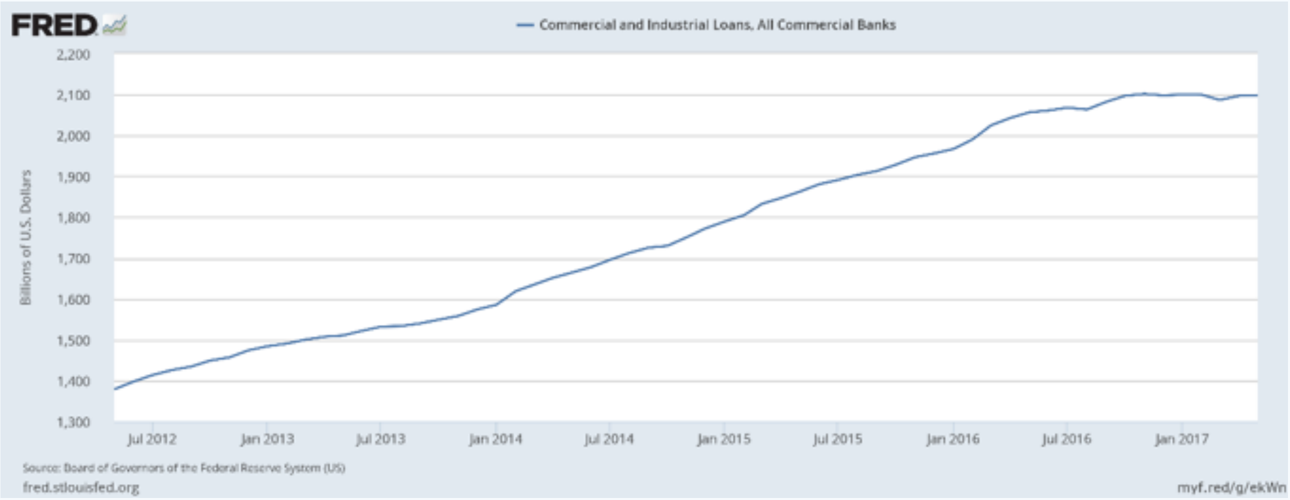
Sector	2Q Estimated Earnings
Consumer Discretionary	-2.0%
Utilities	-0.5%
Healthcare	0.5%
Industrials	0.9%
Telecom Services	1.3%
Consumer Staples	2.5%
Materials	4.4%
Real Estate	5.1%
S&P 500 Average	***6.5%***
Financials	6.9%
Technology	9.4%
Energy	401.3%

Source (both charts): Mauldin Economics

The above illustrations were cited in the July 4, 2017, Business Insider article titled Half of the S&P 500 Earnings Growth is Coming from One Sector and was written by Patrick Watson of Mauldin Economics. Mr. Watson points out the paradox that investors who focus on data comprised of averages have to recognize. In this article, he focuses on the current consensus corporate earnings growth of S&P 500 companies for the second quarter of 2017. He wrote, “The 6.5% average disguises considerable variation. Five of the 11 sectors have 1.3% earnings growth or less. Two are actually declining. Then there’s energy, where earnings growth is not just above above-average, but ***61 t mes more than average***. Earnings growth is way out of balance. The energy sector’s big recovery skews the average. Remove it and the average drops from 6.5% to 3.6%, according to FactSet. In other words, almost half of this quarter’s S&P 500 earnings growth originates in a single sector that probably won’t keep growing at its present rate”.

Long-term clients and readers of our monthly commentaries know that I do not like the S&P 500 as a proxy for “the market.” because it’s composition and weighting can easily produce misleading valuation and performance data, which many investors rely upon to determine the health of the market.

3. **The equity markets have been reflecting expectations of stronger economic growth, whereas bond yields have not been confirming the equity market optimism.**
   - Job Growth as measured by the BLS monthly jobs report has averaged 174,000 net new jobs for the first six months of 2017. This average number of new jobs is slightly lower than the 180,000 average for the first six months of 2016.
   - Real Gross Domestic Product is a broad measure of U.S. economic growth from quarter to quarter reported by the Bureau of Economic Analysis (BEA). The first quarter of 2017 registered a 1.4% inflation-adjusted growth in Gross Domestic Product versus the fourth quarter of 2016. The most recent forecast from the Atlanta Federal Reserve Bank for the second quarter GDP growth currently stands at 2.7%. Should the Atlanta Federal Reserve forecast be correct, the average real GDP growth rate for the first half of 2017 would stand at 2.05% versus a 1.10% average fro the first half of 2016. For all of 2016, the average real GDP growth rate was 1.95%.
   - Commercial and Industrial loan growth is a metric that I have been paying attention to over the last couple years as a barometer of future U.S. economic growth. An expansionary environment for Commercial and Industrial loans is a good indicator of productive monetary growth and the willingness of businesses to make long-term investments. This measure had been steadily expanding for the last several years until the second half of last year. The St. Louis Federal Reserve Bank tracks this economic metric and produced the five-year chart below:



To summarize the preceding observations, anyone following the markets day-to-day or week-to-week cannot help but take note of the eerie lack of stock market volatility that set in shortly following last year's Presidential election. Human nature is to translate this lack of volatility as a sign that the market is safe because for most investors volatility equals risk. I take a contrary view which leads me to conclude that a historically significant lack of market volatility is a warning sign. I cannot necessarily point to the reasons that are leading to this unusual environment. However, when I see very low levels of investor nervousness combined with investor and business owner sentiment measures running high, without this bullishness being confirmed by noteworthy improvement in economic indicators or, for that matter, unblemished improvement in corporate earnings, I think that it is only prudent to proceed cautiously.

My assessment of the first half of 2017 is that corporate earnings growth, excluding the Energy Sector aberration due to a recovery in oil prices from the sharp drop between late 2014 and late 2016, is much weaker than the headline consensus number of 6.5%. Simply excluding the earnings from the Energy Sector from the calculation results in an average S&P 500 earnings growth of only 3.5%. S&P 500 earnings growth is a part of the equation that one must use to decide how overpriced or under-priced the broad equity market is at any point in time. With a forward P/E ratio of the S&P 500 at 17.5X, as reported by Yardeni Research as of June 29, 2017, valuations do not look overly stretched if S&P 500 earnings can continue to grow in the 7% range. However, if the ex-energy S&P 500 sectors do not see accelerated growth going forward to offset moderating energy earnings growth to historical trend levels, the broad market could struggle to sustain the current earnings multiple and price level.

The U.S. economy for the first half of 2017 has been a dichotomy which saw sentiment driven indicators, which had been rising since election day, diverge from actual economic metrics. Employment numbers have been slightly weaker than the same period in 2016, while GDP growth numbers continue at levels not significantly improved over previous years. With no concrete evidence of economic performance which confirms the improved, but more emotionally driven sentiment indicators, it is important to attempt to discern the probability that the sentiment indicators end up being reliable forward indicators. One of the more reliable barometers of future economic activity has been bank lending, particularly commercial and industrial. By stepping back and looking at the St. Louis Federal Reserve chart of Commercial and Industrial loans over the last five years, it becomes obvious that the upward trend that persisted from June 2012 began to flatten out shortly after the first Federal Reserve interest-rate tightening in December 2015. This measure of Commercial and Industrial loans fully flattened out by September 2016, and there has not been any sign that loans have picked up over the last ten months. We will be watching this metric and other related metrics very closely over the next six months to evaluate whether the flattening of this trend will lead to a resumption of the upward trend or will rollover.

NEXT SIX TO TWELVE MONTHS

The assumptions that I am working with as I look forward to the second half of 2017 and through to this time next years are as follow:

1. Economic growth will continue to face monetary policy headwinds and fiscal policy uncertainty. These two drags on growth will result in economic growth that is similar to previous years, with a downside risk resulting from an external geopolitical shock or a policy misstep that disappoints.

2. Interest rates at the short-end will continue to tick up with each subsequent Federal Reserve tightening (2-3 interest rate rises over the next 12 months). At the long-end of the interest rate curve, we could see these rates pulled higher by policy shifts in Europe and Japan moving from aggressive easing to neutral or tightening. The central banks in Europe and Japan have tethered our long-term rates at an unusually low level for the last several years in spite of our Federal Reserve taking steps to tighten policy beginning in September 2015.

3. Hopes for greatly improved corporate earnings growth rely on meaningful corporate tax reform and a tax break for repatriation of overseas profits. Without a fiscal policy shot in the arm corporate profit growth is likely to remain moderate at best given historically high profit

margins, a tight labor market contributing to wage pressures, and the prospect of disruptive and counter-productive trade-related policy concerns.

4. I expect that volatility will reenter the markets in the second half of 2017. The current period of ultra-low volatility is highly unusual, and frankly, it confounds those of us who have either studied the markets or managed money for many years. In the July 10, 2017, issue of Barrons, Ben Levisohn authored "The Trader" column and quoted Allen Root, Senior Analyst with Baird on the subject of the current puzzling issue of low market volatility. Mr. Root analyzed the S&P 500 and divided the index into two groups, one being economically fragile companies and economically durable companies. He noted that "in a sane world, the weaker companies would trade that way. Instead, they have a beta less than 1, a fancy way of they're less volatile than the market as a whole. The more fundamentally sound companies, meanwhile, have a beta above 1, meaning they're more volatile than the market". He ended his quote with "beta doesn't seem to be working anymore as a primary risk metric." Casual observers of the markets do not easily "feel" or observe the abnormalities that are currently present.

I am glad that the first half of 2017 have produced equity market gains. However, I am not willing to ignore the risks that are not readily apparent. Similar to times when the markets have sold off and the investing environment "feels" risky, but opportunities are abundant, today markets have continued to rise, and the lack of volatility makes the markets feel safe, but opportunities are not easy to come by. I am not engaged by clients to chase or replicate the broad market. An index fund can do that far better than any professional money manager. I am engaged in order to identify investment opportunity and manage both fundamental and systematic risks.

I hope that everyone is taking the opportunity to enjoy the summer months by spending time together with loved ones traveling or simply barbecuing in the backyard. I like to think that my job is to try to worry about the market so that you can put those concerns aside and focus on areas of your life that bring much more enjoyment.

As always, do not hesitate to reach out with any comments or questions on the subject matter discussed in this month's commentary.

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