SEVEN SUMMITS CAPITAL

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MAY 2019 INVESTMENT COMMENTARY

REVISITING OUR CAUTIOUS STANCE AND STANDING PAT

It is May, and the broad U.S. stock market has fully recovered from a "flash bear market" in the fourth quarter of 2018. We have a near flat Treasury yield curve and the U.S. Federal Reserve, poised in December to raise rates at least three more times in 2019 is now expected to hold rates steady or even cut rates at least one time this year. U.S. GDP has snapped back from a lethargic 2018 final quarter reading of 2.2% to log an initial reading of 3.2%. U.S. employment numbers had a hiccup in February but bounced back very strong in March. Core inflation measures remain relatively stable at just under 2%. Long-term U.S. Treasury bond rates have fallen sharply over the last eight months. Both new homes sales data and residential investment have been vacillating between sluggish growth and contraction for the last year. China and Europe's economic indicators appear to be showing that the weakness in those regions has abated.

What type of economic picture does this paint looking forward? Let's do a pro/con list for and against continued above trend economic growth. See the indicators listed above in such a pro/con format below:

ECONOMIC INDICATOR	PRO	NEUTRAL	CON
Stock Market Near Record Highs (Leading)	X		
Monetary Policy Outlook (Leading)		X	
Latest GDP Trend (Lagging)	X		
Non-Farm Payroll New Jobs (Lagging)	X		
Treasury Yield Curve (Leading)			X
Residential / Home Indicators (Leading)			X
Global Economic Growth Outlook (Leading)		X	
Geopolitical Risk (Coincident)			X
Policy Risk (Coincident)			X

The illustration above reflects how I view the economic outlook at the present time. The most important economic indicators when it comes to predicting the outlook for short and intermediate term economic conditions are the "Leading" indicators. With this in mind, the illustration above shows one positive leading indicator, the stock market, one negative, the Treasury Yield Curve, and one neutral indicator, Monetary Policy. There are two "Lagging" indicators that are positive and two "Coincident" indicators that are negative.

Last June I wrote that I was going to begin to slowly lower equity allocations and add fixed income, market neutral or hedge oriented exposure to many accounts in order to prudently manage what I saw as mounting economic, policy, geopolitical, and market risks. These actions allowed many Seven Summits Capital client accounts to come through the October through December "Flash Bear Market" much better than they otherwise would have had I not been actively removing risk from the typical balanced investment portfolio. I did use the opportunity that the Flash Bear Market provided to add to some existing equity positions and establish several new positions as certain attractive stocks became extremely oversold.

Now that broad market levels are near the highs last seen at the end of September 2018; I have resumed the tactical management of downside risk. I do not see an impetus to add to equity risk at this time. Fundamentally, broad equity valuations reflect fair value at best. Geopolitical risks continue to mount surrounding the President's ongoing confrontational actions in the Middle East and the seemingly broken North Korean peace talk progress. I wrote over a year ago about my concern regarding the timing of a large fiscal stimulus in the form of tax cut legislation. From an economic, market and monetary policy view, I believe that one of the following three probable outcomes will unfold over the next 12-18 months. The first potential outcome that I see possible as a result of the large fiscal stimulus injected into a late cycle and low unemployment economy is that labor will become increasingly expensive and corporate profit margins will come under pressure. The possible second outcome could be that the higher labor costs produced by an increasingly tight supply of workers are passed through to the consumer. This would result in higher inflation expectations and lead to a more restrictive monetary policy response. The third outcome, and potentially most worrisome, could be that labor shortages, trade disputes, and policy uncertainty mute the expected economic growth, while at the same time, concern over deficits and debt adversely impact the ease with which we are able to sell bonds to finance our deficit spending.

Based upon my reading of the pros and cons of leading, lagging and coincident economic indicators, as well as evaluating possible 12-18 month economic, market, and monetary policy scenarios, I do not see reasons for Seven Summits Capital to abandon its incremental approach to lowering portfolio risk within most balanced accounts.

Although Seven Summits Capital cannot fully insulate client portfolios from broad market systematic risk, we have the luxury of not fully having to rely upon steady and rising broad market price levels to achieve objectives. Fortunately, our process and long-term performance can be improved by an investment discipline that is designed to be contrarian during "challenging" market environments. While broad market price levels are elevated and our perception of mounting risks increase, our discipline causes us to maintain a cautious stance. However, if price levels are depressed and market sentiment is driven by fear, our process will dictate removing caution and seizing upon opportunities to capitalize on long-term fundamentals.

Once again, I greatly appreciate the trust and loyalty of our clients who value the unique and disciplined fundamentally centered investment approach used to customize and manage portfolios for all differing client objectives and risk tolerances.

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