SEVEN SUMMITS CAPITAL

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DECEMBER 2017 INVESTMENT COMMENTARY

"LUCK IS WHEN PREPARATION MEETS OPPORTUNITY" - ROGER PENSKE

As an avid fan of endurance motorsports, I find that I am fascinated by the strategy that a race team must develop and execute to position the vehicle, driver, and crew to win the contest. To prevail against a formidable field of competitors a team not only needs a very skilled team of drivers, a competitive vehicle, an experienced crew, but it also needs a strategy suited to the track characteristics, the expected weather conditions, and the duration of the race. Just because a race team is better prepared than its competition does not guaranty victory, however, without this preparation and strategy defeat is much more likely than victory.

I approach investing as an endurance contest. To be successful in the endurance contest of long-term investing, I believe that the following must be a part of any investment plan:

- An experienced professional investment partner who has successfully navigated clients through many challenging periods in the markets.
- An asset allocation that is well suited to deliver desired risk/return objectives.
- Access to a broad universe of investment choices.
- Relatively low fees and expenses.
- A disciplined strategy which, identifies and manages risk, prepares for unanticipated events and continually looks for opportunities to advance the effort toward achieving desired long-term objectives.

Thus far, 2017 has been a year which tested many seasoned and successful investors. By almost any accepted measure of valuation and where the U.S. is within the economic/market cycle, we entered 2017 knowing that we are most likely in the 7th, 8th or 9th inning of the current Bull Market. From a strategy standpoint, this assessment meant that risk was elevated and a cautious approach toward opportunities was warranted. Exacerbating the economic and market risk considerations was the advent of political and policy uncertainty that was, and continues to be, both unprecedented and potentially disruptive.

This year's relatively calm equity markets and above trend returns have proven once again that markets routinely confound investors who expect risks to be efficiently incorporated into price levels. Fortunately, I have learned over many different market cycles that identifying risks and measuring value is critical to long-term investment success but irrelevant when it comes to making near-term market predictions. For this reason, I do not ever issue calendar year market forecasts.

As I mentioned in the first paragraph regarding endurance motorsports, great preparation does not guaranty victory, however lack of preparation does guaranty failure. Markets, like races, are fraught with unpredictable events and therefore no matter how well prepared you are, you have to expect the unexpected. I believe that a good strategist, whether in racing or in investing, needs to separate what can be controlled from what cannot be controlled. Preparation can only pertain to what one can control, managing risk only pertains to what one can anticipate, and all other unknowable factors represent the expected randomness that must always be expected.

It is the awareness that what is knowable is limited and what is unknowable and random represents the true risk within the markets that causes me to avoid making market predictions. My greatest contribution to Seven Summits Capital clients related to the subject of investment strategy and process is my desire to discuss risks and opportunities while reminding clients that the most certain characteristic of markets is the inherent uncertainty.

On average, Seven Summits Capital client portfolios have substantially participated the advance of the major equity averages, in spite of an increasingly cautious approach adopted as 2017 progressed. It is important to note that a cautious approach does not involve market timing, but instead involves more conservative security selection, a modest approach to hedging, and possibly a slightly higher cash allocation. Looking forward to 2018, I do not have any preconceptions regarding whether the S&P 500 will be up 20% or down 20%. What I do know is that the reasons for my caution in 2017 still exist today and are compounded by new potential risks, including the increasing likelihood that inflation pressures will become a concern for the financial markets as we progress through 2018. Although the Federal Reserve and many other central banks around the world have been aggressively attempting to reflate economies, when inflation finally returns, these same central banks may feel compelled to abruptly reverse course from attempting to stimulate inflation to abruptly attempting to tamp it down using higher interest rates. This particular risk was not a high probability concern last year at this time.

Risk management is at the center of the investment management process at Seven Summits Capital, and the keystone of that risk management exercise is to recognize, understand and handicap risks to allow an informed assessment to influence forward-looking decision-making.

Seven Summits Capital top five forward-looking risks that could impact the markets going in 2018 are:

1. The re-emergence of inflation and more restrictive monetary policy than expected resulting in a stagflation economic environment.
2. A major change in trade policies such as the U.S. withdrawing from NAFTA, which would be the first exit from a multilateral treaty by the U.S. since the 1860's.
3. A destabilizing event within the one or more major Western democratic governments, including the United States, resulting in institutional dysfunction and rising social unrest.
4. An escalation of one or more regional conflicts in hot spots such as the Middle East, Korean Peninsula, or Eastern Europe which heightens the risk of direct involvement of the United States, Russia or China.
5. An increase in regulatory action within the United States targeting technology and social media companies such as Facebook, Google, and Amazon.

History teaches me that it is unlikely that any of these known risks will, on their own, trigger a market correction or worse. However, as known risks mount, the likelihood increases that a seemingly benign unknown risk will act as the "straw that breaks the camel's back" and trigger investors to reverse course and become driven by their fears instead of their greed.

I am a firm believer that caution is most valuable to an investor at times when caution is not the predominant sentiment, and conversely, greed is most valuable when extreme caution is prevalent among investors. Legendary investor Shelby Davis famously stated that "***Out of crisis comes opportunity****…A down market lets you buy more shares in great companies at favorable prices. If you know what you're doing, you'll make most* *of your money from these periods. You just won't realize it until much later."* Therefore, conversely, 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.

It is at times like the present that I challenge myself to capture a substantial portion of the market's rise, while at the same time preparing portfolios for the inevitable reversal in sentiment and price level. This process is continuous and incremental. This strategy is analogous to the sports car team competing in a 24 endurance race. In such a race, durability is more important than sheer speed and superior handling. Experienced teams make sure that they stay within striking distance of the race leader during the first 18 hours or so while preserving the car's durability for the end of the race when being in the lead truly matters. If at the end of the race several of those early leaders are now spectators because their car had a mechanical failure or their aggressiveness caused them to be involved in an accident, a casual observer might say that the eventual winner was lucky. Roger Penske, one of the most successful race team owners in history, is famous for saying that "luck is when preparation meets opportunity."

2017 has been a very interesting year to be an investor. I have been through many interesting times in the market and many of those times involved gut-wrenching market sell-offs and significant volatility. This year interestingly ended up being much more pleasing. I have no preconception what next year will hold. However, it is my mission to be ready for the known risks, and I fully expect the inevitable unknown risks to surface.

I look forward to seeing and talking to everyone soon, and I wish you and your families a very Happy Holiday Season!

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