SEVEN SUMMITS CAPITAL

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FEBRUARY 2015 INVESTMENT COMMENTARY

THE WALL OF WORRY CONTINUES TO STAND; THE MARKET FEELS TEPID SO FAR

With one month into the New Year, many of the headlines have a familiar ring to them. Overall, the markets have been focused on the impact of the recent Greek elections, as well as, the future of the Euro zone, continued military escalation in Ukraine, and extremist groups, such as ISIS and Boko Haram, who continue to shock the world with their atrocities. On the economic front, the first reading of the 4th quarter U.S GDP showed an apparent slowing from the strong 4% growth that was recorded in the 3rd quarter. This deceleration occurred despite U.S. job growth over the last three months having been the strongest in 17 years. Meanwhile, the market has been closely watching Europe, Japan, and China as they engage in different iterations and degrees of monetary economic stimulus.

The last time that Greece was a central issue for the markets was in 2011-2012 when the markets had a hard time digesting European Union's political challenge of agreeing on the best course of action to tackle debt problems. The Greek elections last month, once again, propelled this political issue to the forefront of investors' minds. Similar to 2011-2012, we will again choose to look past these headlines as we believe that a new debt deal will be reached that contains only modest changes to the original debt agreement that is viewed by most Greek citizens as unduly restrictive.

The Ukrainian crisis is reaching its one year anniversary this month, which serves as a reminder of how long this unusual military conflict in Ukraine has been looming over the markets. This geopolitical conflict has sparked very real economic consequences for a select number of industries, specifically commodity-related industries that have been affected by the sweeping economic sanctions imposed on Russia for its role in supporting the rebels fighting inside Ukraine. Energy companies, such as British Petroleum and Exxon Mobil, have had to freeze or withdraw from long-standing investments within Russia's oil companies. Although we know that these sanctions will not be permanent, we must be diligent when evaluating the long-term impact of the sanctions on companies within our universe of stocks.

In regards to the escalating violence occurring in many African and Middle Eastern countries, mass killings by groups, such as ISIS and Boko Haram, have risen over the past six months. This violence, combined with the deadline for efforts to forge a nuclear deal with Iran quickly approaching, the ongoing civil war in Syria, the recent coup in Yemen, and the West's shaky alliance with Turkey, leaves the Middle East arguably more unstable than it has been in many decades. However, all of this uncertainty has not resulted in supply disruptions to oil, the main export from these regions, or even upward pressure on oil futures prices, which regularly occurred in previous times of Middle East uncertainty. In fact, today's oil prices are down 50% from levels seen just six months ago due to the U.S. oil shale revolution that has occurred over the past five years, which has altered the dynamics of the world oil markets. The United States has now become the defacto swing producer of oil, a role that has been firmly held by OPEC for the past forty years.

Turning our focus away from global events and towards our domestic economy, the first reading of the 4th quarter U.S. GDP has again cast doubt about the strength of the U.S. economic recovery. The initial reporting of the 4th quarter GDP showed a decline from 4.0% growth in the 3rd quarter to 2.60% growth in the last quarter of the year. We are not seeing the typical signs of an impending slow-down and like other false alarms over the last several years; we are not worried about the strength of the U.S. economy. We see a continuation of the modest 2.5% to 3.5% economic growth. It is believed that the apparent slowing that occurred in the 4th quarter of 2014 is likely due to Americans increasing their spending on imported goods by 4% combined with a slight slowdown in the export of goods from the U.S to overseas markets. Thus, this shift in the balance between imports and exports created the illusion of a slowing in growth based upon the methodology used to calculate GDP. However, in actuality, the real consumer-driven U.S. economy continues to improve as evidenced by the strong January job growth and the large upward revisions to job growth in the past two months.

The slowdown in 4th Quarter GDP once again illustrates the difference between economic headlines that short-term traders react to and the actual economic situation that lies beneath those headlines. One of the reasons that the balance between imports and exports shifted more toward imports could very well have been due to the strong rally in the U.S. dollar against other currencies over the last year. The U.S. dollar strength picked up momentum in the last four to five months of 2014. A stronger U.S. dollar will bolster the price competitiveness of imported goods and create an opposite effect for U.S. produced goods sold into international markets.

Two new concerns that investors should factor into investment decisions are the strong dollar and the sharp drop in oil prices, which have become major factors for economies and businesses over the last six months. The strong dollar is adversely affecting the earnings of U.S. multinational companies. If this strengthening continues, multi-national corporations will become less globally competitive and they will experience a slow-down in growth. The strong dollar also puts downward pressure on commodity prices, such as oil and copper because most commodities that are sold on the global market are transacted in dollars. Low commodity prices are a double-edged sword for the economy. On the one hand, low commodity prices are good for consumers, but they also can contribute to deflationary pressures and destabilize commodity-dependent economies. Every investor with a diversified portfolio has already felt the effects of the strong dollar and falling commodity prices over the last year. The decisions that an investor makes surrounding these disruptive changes to the economy and markets will greatly influence how well one's portfolio performs over the next several years.

As I mentioned in last month's commentary, I believe that 2014 ended with noteworthy imbalances that will eventually hurt investors who have become complacent in their investing strategies. Currently, the imbalances of concern are created by the yield-chasing tendencies of investors, who have come to believe that the current interest rate conditions will persist indefinitely or that they will know when shift strategy. These types of investors are no different than investors in the past who convince themselves that either it is different this time or that they can time market shifts.

At Seven Summits Capital, we are not complacent when it comes to economic and financial realities and we are certainly not going to try to time the market. With the wall of worry still in place, as it has been for much of the last six years, the market currently feels tepid towards extending last year's gains. High valuations in some areas of the market, overseas worries, and uncertainty over when the Federal Reserve will begin raising rates, appear to have elevated the amount of indecision within the market. It is during such times that the valuation sensitive approach of Seven Summits Capital allows us to stay engaged and forward-looking.

In conclusion, the vast majority of Seven Summits Capital client portfolios have started 2015 off very well in spite of January having been a down month for the broad U.S. stock market indices. Many equity investments that were initiated during 2014 have required patience and for some of these investments, 2015 has already rewarded that patience and conviction.

As always, comments or questions are encouraged and welcome.

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