SEVEN SUMMITS CAPITAL

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FEBRUARY 2017 INVESTMENT COMMENTARY

THE AUCTION HOUSE IS CROWDED AND THE PARTY ENVIRONMENT CONTINUES

I have always explained the market pricing mechanism using an auction metaphor. Prices are not a product of nature; they are a function of various degrees of greed and fear. When greed is prevalent at the auction, many people show up, and the number of bidders far exceed the quantity of items being offered for sale. When this environment is present, prices get bid up very quickly, and the prospect of finding bargains becomes very slim. Conversely, when fear strikes the hearts of prospective auction goers, the number of bidders falls significantly, and bargain hunting becomes much easier.

Markets, at their most basic level, operate very similar to an auction. The prices of marketable securities on any given day are purely a function of the sheer number of motivated buyers versus motivated sellers. From 2013 through Election Day in 2016, fear and greed were fairly well balanced on average and this kept markets within a relatively tight trading range. The election of Donald Trump has seemingly tipped the scales toward greed within the markets for the first time since the summer of 2009. Beginning in July 2009 through April 2010 the S&P 500 rallied approximately 35%. Even during this post-crisis rebound the S&P 500 had four pullbacks of between 4%-6% and one 10% correction over the course of almost ten months.

We are now going into the fourth month following the election, and there has not been any evidence that the stock market wants to pull-back. Unlike, 2009, which followed a stock market crash which finally found its bottom in early March of that year, today markets are entering the eighth year of the post-financial crisis bull market advance. Broad market indices are trading at valuation levels which should give discriminating investors pause, and inflation is finally beginning to gain enough traction that the Federal Reserve should be able to continue to pull the punch bowl of monetary accommodation away from the party goers.

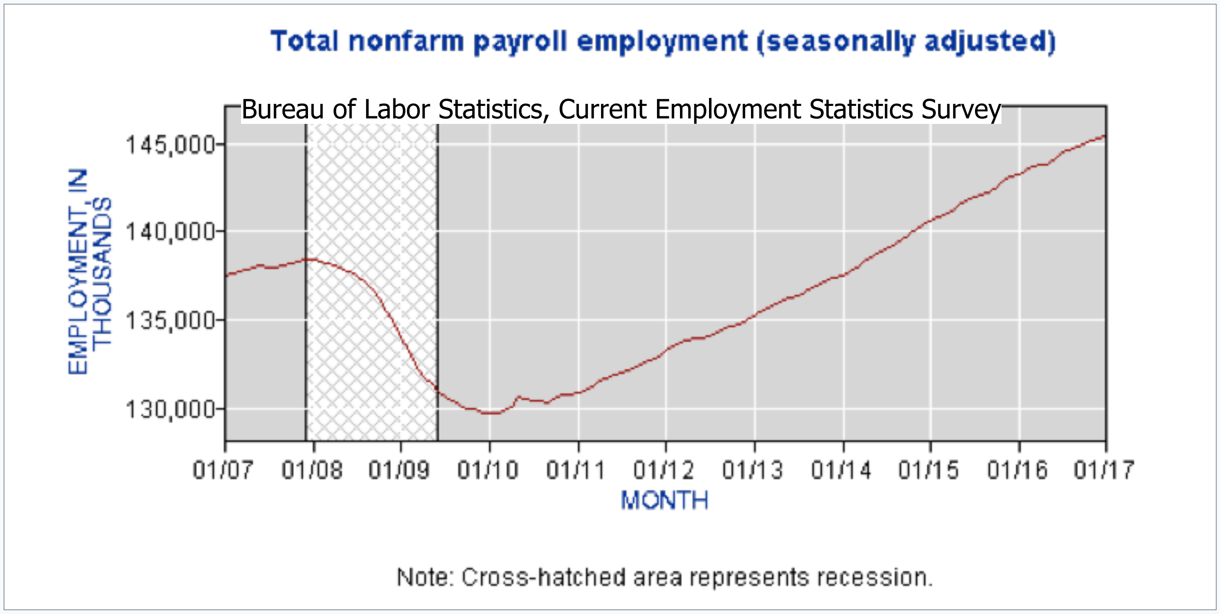
However, the party appears to be just hitting its stride as the otherwise wallflower retail investors are finally feeling a delayed buzz after eight years and they are just now hitting the dance floor. They are dancing to the music of bands with strange names like Foreign Profit Repatriators, The Regulation Terminators, and Phenomenal Tax Reform Crusaders. The music is loud, and the atmosphere is euphoric. With all of this excitement, the party goers do not want the fun to end. Only those who agreed to be designated drivers see the clock and know that all good parties must come to an end, at least for a while.

The equity markets will correct, if not for any other reason than to create a pause for reflection and recalibration of price to fundamentals. At Seven Summits Capital we do not attempt to time corrections with our buys and sells. However, through the normal course of harvesting winners, exiting losers, and cost averaging, when we sense that the market is over-extended, we calibrate our actions accordingly. For example, cost averaging may take longer during a protracted market rally and then become accelerated during corrections. We prefer to be motivated buyers when motivated sellers are driving the market direction.

A major advantage that we have versus most advisors who limit themselves to buying and selling ETF's and mutual funds is that we can sift through an otherwise over-valued market and find under-valued companies. We have been finding value over the last several months in some well-known names such as Cisco Systems and General Motors, as well as, lesser known companies such a Chicago Bridge & Iron and CF Industries. As such, we can continue to reinvest funds when we take profits in stocks which have become over-extended, as well as when we are cost average investing new accounts. What we are unable to do during periods when the broad market is fundamentally over-extended is blindly chase market performance without sensitivity to the underlying valuation metrics of our investments.

Not much has changed since last month's commentary regarding what we see from an economic and earnings vantage point. The January BLS Employment Report released in early February showed a robust job creation level which exceeded expectations. This better than expected non-farm payroll report continued at a general trend that has been in place since 2010 (see graph):

SOURCE: Bureau of Labor Statistics, Current Employment Statistics Survey



From the economic data that we monitor we have seen no indication over the last month or two that the economy is shifting into a higher gear. The stock market rally has created the impression that the economy and the business environment has improved as we entered 2017. At this point, the market is reflecting improved sentiment, but we do not see that improved sentiment translating into improved economic and business performance.

Our concern over the increasingly elevated valuation levels within the broad equity market is not new. The healing of our economy following the 2008-09 financial crisis has been durable and steady over the last seven years, and this healing continues unabated as we enter 2017. The equity market, like the economy, has healed, and of late, the valuations metrics of the broad stock market have increasing been outpacing the underlying earnings and economic fundamentals. The only way that the market's extended valuation metrics can be sustained is if the economy and corporate earnings accelerate to levels that exceed the trends that have persisted over the last seven years.

We will continue to look for evidence that the fundamentals which underlie market valuation are improving sufficiently to justify the current market levels. In the meantime, our focus remains on surfacing individual equity investment opportunities that meet our dynamic and flexible valuation discipline.

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