SEVEN SUMMITS CAPITAL

1853 William Penn Way, Suite 9 · Lancaster, PA 17601 · 717 735 0013

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FOMO OR THE ASSET CLASS OF LAST RESORT

2020 marks the year in which I am going to change the format of how I organize Seven Summits Capital's monthly and quarterly publications. The monthly publication will now be shorter and more observational, while our quarterly publication will observational, introspective, and strategy-focused.

The U.S. equity markets feel as if they are being driven by something much more behavioral than fundamental. Without the cautionary pause caused by concerns about the economic impact of the Coronavirus, which sparked a several day equity market sell-off at the end of January, broad markets could be up near 10% in the first six weeks of the year. As it stands, the S&P 500 is up a than 5%, and the Nasdaq 100 is up near 10% as of mid-February.

I feel compelled to continually remind investors that the current economic and market conditions are both unprecedented and unsustainable. Below are some harbingers of this unsustainability that should be heeded:

- Negative interest rates in Europe and negative real (inflation-adjusted) interest rates in the U.S.
- Dramatically slowing growth in the second-largest economy (China) and the inability of the largest economy (U.S) to sustain GDP growth greater than 2.5%.
- Inability to spur corporate capital investments in the U.S. in spite of a historically large corporate tax cut.
- Corporate earnings growth is not validating the advance of stock prices, which is causing earnings multiples to expand to cycle highs.
- Narrowing of stock market leadership and breakout stock price performance among "new economy," high momentum leaders:
    - YTD Tesla stock has risen 91%, and by market-cap, Tesla Motors is the third-largest automotive company in the world and worth more than two GM's and two Ford's combined.
    - Microsoft, Netflix, and Salesforce stocks are up nearly 17% or over three times the advance of the S&P 500 YTD.
    - Apple stock is up over 10% YTD or double the return of the S&P 500.
- Gold prices have had a strong advance and currently sit near a seven-year high. Gold prices are negatively correlated with interest rate expectations and positively correlated with risk aversion.
- Industrial production measures have been very weak for the past 18 months, and this weakness has not shown signs of a meaningful turnaround.

My summary of the above bullet points is that the bond market is signaling economic weakness and continuing disinflation ahead. Stubborn slow economic growth around the world has been unresponsive to significant monetary and fiscal stimulus. This backdrop is causing capital seeking "real" returns to rush into the strongest equity market (U.S.) through passive index investing, causing the stocks of largest companies within those indices to advance indiscriminately. The highest returns over the last several years have been in large U.S. “new economy” companies focused on cloud computing, social media, streaming entertainment, and artificial intelligence. Recent high stock returns within these areas, possibly justifiable based upon growth expectations, attract ever more capital (momentum investing). The feedback loop emerges causing an investor reaction known as “fear of missing out” (FOMO). FOMA is akin to musical chairs and is entertaining until "the music stops" or price levels become unsustainably disconnected with even the most aggressive growth expectations (e.g. the year 2000 dot.com bubble crash).

Seven Summits Capital embraces investing in stocks with significant growth expectations. However, we prefer to stocks where future growth opportunities are misunderstood or under-estimated, as opposed to large companies where growth expectations are well-known. We prefer lessor known growth stocks like Teledoc, Invitae, Tandem Diabetes, and Virgin Galtic, where we exploit misunderstood expectations instead of simply riding the wave of momentum (following the herd) until the bubble bursts when “the music stops.” Each one of our “undiscovered” growth stocks was up more than three times the S&P 500 price return over the last twelve months as of mid-February 2020. In fact, Virgin Galactic stock has outperformed Tesla YTD as of February 18th.

We continue to produce strong returns, while doing so without chasing high momentum stocks. Having entered the investment management profession in 1996, I am keenly aware of the dangers of momentum and “growth at any price” euphoric market environments. Today’s market is repricing higher, either because U.S. growth stocks have been the best performing investments globally, thereby motivating a continuation of reallocation from other investments to these “winners” or we have entered the Fear Of Missing Out (FOMO) phase of this Bull Market.

Whatever the motivation, these types of periods in the market are both exciting and can be profitable if one does not allow exuberance to obscure the risks that profit chasing momentum and a FOMO psychology injects into markets.

CURT R. STAUFFER
(C) 717 877 7422
(O) 717 735 0013
cstauffer@ssummitscapital.com