SEVEN SUMMITS CAPITAL

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

JUNE 2016 INVESTMENT COMMENTARY

THIS COULD BE THE START OF SOMETHING GOOD

Something feels different this year. It might have to do with oil prices stabilizing over $40 per barrel or the fact that value stocks are handily outperforming growth stocks year-to-date, as evidenced by the S&P 500 Value index outperforming the S&P 500 Growth Index by 3.41% as of May 31st. It is hard to believe after several years of oil prices remaining stubbornly over $90 per barrel that $40 to $50 per barrel oil is the high end of a long and strange 18 month period that just six months ago had some experts predicting $15 per barrel. Another long and strange period may be coming to end with the aforementioned outperformance of value stocks over growth stocks year-to-date. It is widely discussed that domestic growth stocks have outperformed domestic value stocks for nine consecutive years, making this period the longest consecutive period that value stocks have underperformed growth stocks on record. This underperformance of value compared to growth stocks shows up in the ten year total return performance of the S&P 500 Value Index versus S&P 500 Growth Index with the performance over that period having been 5.71% and 9.00%, respectively.

As a portfolio manager, who has observed markets and individual stock price performance on a daily basis for almost twenty years, I can "feel" when the stock market is moving more with fundamentals versus momentum and macro trends. I cannot say that over the last five months that the stock market has been mostly rational and fundamentally driven, however, I do feel a marketed difference in the stock market compared to the last several years.

The arbitraging of high dividend paying securities against sub-2% risk-free rates here in the U.S. and even negative interest rates in Europe and Japan is still a major distortion that is afflicting our markets. However, it does appear that the interest rate increase that the U.S. Federal Reserve implemented last December has somewhat tempered the aggressiveness of speculators and trend followers. As of June 2nd the stock and bond markets were positioned for another Federal Reserve interest rate hike in June or July, and then the third hike in rates before the end of 2016. That forecast led to weakness in utility stocks and other "bond proxy" equities, while stocks in industries such as banking, which benefit from higher interest rates had begun to outperform.

The widely publicized consensus forecast for two additional Federal Reserve interest rate hikes, with the first coming as early as June, evaporated with the weak employment report issued by the Bureau of Labor and Statistics on June 3rd. This weak report was partially explained away by the nationwide Verizon strike that took place in May. However, the striking workers only accounted for about a 35,000 reduction in jobs during a month where many forecasters were looking for approximately 180,000 new jobs. The report only showed 38,000 net new jobs for the month. My view is that this much weaker than expected jobs report virtually eliminates any chance that the Federal Reserve will hike rates in June and puts a July hike in the unlikely category. Over the span of one-day, banking stocks, which had generally been strong relative performers leading up to the May jobs report in anticipation that the report would be supportive of a June or July interest rate increase, became one of the weakest industry sectors. Conversely, recently weak high dividend paying utility and consumer staple stocks once again became the favorites of income seeking investors.

Fortunately, short-term macro speculation on factors such as the timing of interest rate hikes does not play a meaningful role in Seven Summits Capital's portfolio management process. Therefore, our clients do not have to endure a continuum of buy and sell decisions based upon the ever-shifting perceptions of macro considerations that are impossible to predict accurately and time. However, on the subject of interest rate hikes, I do not believe that the U.S. economy can absorb more than one interest rate hike of 25 basis points between now and the end of 2016 without the risk of inducing at least one flat, or slightly negative, quarterly GDP report. It is not that a temporary pause in our stubbornly slow economic growth trajectory would be devastating that would concern me. It is, however, the market's "glass if half empty" reaction that would be the problem for investors.

From my perspective, the counter-intuitive aspect of May's surprisingly weak job report is that the uncertainty that such a report creates, concerning the durability of our seven-year streak of job creation, may lead to the Federal Reserve only raising rates one more time by year-end. This type of counter-intuitive thinking may be why the major U.S. stock indices registered an initial muted response to the surprisingly weak jobs report.

The near-term macro events that the markets might have some difficulty digesting the resulting uncertainty around will be:

1. The June 23rd United Kingdom referendum on whether or not to stay a member of the European Union.
2. The June 26th Spanish elections which could result in the election of a government that would have the mandate to distance Spain from the Euro imposed austerity measures that were implemented several years ago.
3. The June/July possibility of the U.S. Federal Reserve increasing interest rates.

It is my hope that the stock market will continue to find its way back to a more fundamentally normal state as the year progresses. Obviously, 2016 is an election year, and will not possible for the market to totally ignore the ever escalating election-year rhetoric during this unconventional period in U.S. politics. Like short-term macro trends, Presidential election year results are not something that should alter investment strategy or portfolio tactics. The United States and its economy have historically been too stable and institutionalized for a President, who is either just right or left of center, from a political ideology standpoint, to be meaningfully affected one way or another. For over 100 years we have selected Presidents from the two major political parties. Although these two parties differ on many issues and in many ways hold a differing vision of the future of our country, they, for the most part, adhere to a conventional set of principles. With the apparent inevitability of the nomination of a non-politician in the Republican party, 2016 introduces a dynamic to the Presidential election that is in many ways unprecedented.

For everyone old enough to remember the original Star Trek TV series, the television show's creator and writer Gene Roddenberry, interjected a complex political subplot into the storyline. The leadership of the Starship Enterprise was generally in the hands of James T. Kirk, an intuitive and brash leader. At times, when Kirk was not able to captain the starship, his first office Spock assumed control. Spock's personality and decision-making process could not have been more different than Kirk. However, whether or not Captain Kirk or First Officer Spock was at the helm of the Enterprise; decision-making did not change nearly as much as style because they were both loyal officers of the Federation and as such, adhered to a common set of principles. For more than 100 years the U.S. political system benefitted from the stability and predictability of a two-party system that was rooted in a common set of broad principles.

The global capital markets have not yet turned their focus to the potential outcome of our Presidential elections. As we have seen many times over the last eight years following the financial crisis of 2008, capital markets can react badly to high levels of uncertainty. Historically, the U.S.'s economic policy trajectory, which is the primary focus of the capital markets, does not radically change from one President to another, regardless of party affiliation. For this reason, our capital markets have generally been very orderly ahead of, and just following Presidential elections.

2016 could be the exception given the influence of public discontent and the resulting populism that has sprung up within both of our major parties. This discontent and populism have resulted in a backlash against the status quo. This populist sentiment has so far resulted in an unconventional outsider situated to be the Republican Party nominee. Revisiting my Star Trek analogy; the markets can easily tolerate either a Kirk or Spock, who at the end of the day will work within the system. However, if the markets legitimately thought that Khan, a brilliant nemesis of Kirk and Spock, had a chance to assume control, the reaction in the markets could end up being very unpredictable. The Khan character in the original Star Trek series and a subsequent movie was a genetically modified human from the past. He was stronger and smarter than ordinary human beings. However, his downfall was his over-confidence, innate desire for revenge and predictable tendency to over-react when provoked. Khan always ended up being his own worst enemy and never succeeded in his quest to defeat Kirk and Spock and take over the Enterprise. Khan was a complex character and represented both the best and worst of humanity. However, his superiority complex blinded him from seeing the traits that would repeatedly lead to his defeat.

For now, the capital markets appear to be treating the prospect of a Khan type of character ascending to the highest office in the land as highly unlikely. Only time will tell whether the markets' will be correct in dismissing the prospect of an election outcome that would present an unprecedented level of uncertainty onto the world stage. If events cause the markets to have to shift their expectations toward a more uncertain outcome, we will know it.

I started this commentary out stating that something feels different this year. I was primarily referring to the stock market and my sense that markets are less monolithic and narrow than they have been over the previous couple years. If this dynamic continues, regardless of whether or not we have a couple of periods of event-driven volatility, this will be good for long-term investors. The sharp correction at the beginning of the year was likely partially caused by an inflection point marking a change in investor behavior. For whatever reason, the end of the calendar year 2015, along with the first Federal Reserve interest-rate increase in nine years, was enough to induce investors to begin to shift to a more value-seeking and fundamentally underpinned approach than we have seen in many years.

I wish everyone a great start to the summer!

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

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Coastal Investment Advisors), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from Coastal Investment Advisors. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. Coastal Investment Advisors is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice. A copy of Coastal Investment Advisors' current written disclosure statement discussing our advisory services and fees is available for review upon request.

Curt Stauffer is an Investment Advisory Representative of Coastal Investment Advisors. Coastal Investment Advisors is not affiliated with Seven Summits, LLC. Investment Advisory Services are offered through Coastal Investment Advisors, a US SEC Registered Investment Advisor, 1201 N. Orange St., Suite 729, Wilmington, DE 19801.

Any mention in this commentary of a potential securities or fund investment should not be construed as a recommendation for investment. Investors should consult their financial advisors for advice on whether an investment is appropriate with due consideration given to the individual needs, risk preferences and other requirements of the client.