SEVEN SUMMITS CAPITAL

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NOVEMBER 2016 INVESTMENT COMMENTARY

A COUNTRY DIVIDED AND AN ECONOMY IN TRANSITION, BUT BELIEVE ME IT IS GOING TO BE GREAT

The election is over, and for the fifth time in U.S. history, the President-Elect did not win the popular vote. Many state electoral races were won by razor thin margins and the Republican Party retained majorities in the House and Senate but lost seats to the Democrats. We are a country that is divided, and our elected officials are being asked to represent this divided nation. In the early hours of the day following the election, the President-Elect gave a very uncharacteristically civil and conciliatory speech, and this was followed the same day by similarly civil and respectful speeches from the losing candidate and the outgoing President.

The overnight futures markets reacted very negatively once it became apparent that it was likely that Donald Trump would win the election, trading down as much as 700 points on the Dow Jones Industrial Average. However, between President Elect Trump's victory speech and the opening of the U.S. markets that morning, the deep sell off subsided and by the end of the day the Dow Jones Industrial Average closed up 257 points. The markets seemed to take comfort from the civil tone which was struck by all sides. The biggest positive moves occurred broadly among pharmaceutical/biotech stocks, financials and stocks of companies that would benefit from increased domestic infrastructure spending. Negative price action was noteworthy among Treasury securities, utility and technology stocks.

The Trump/Republican Congress assumptions that appeared to be moving the markets are:

1. The passing of significant infrastructure spending bills early next year.
2. Significantly lower risk of government action being taken to force drug companies to lower the costs and/or the shortening of patent protection.
3. A more restrictive set of policies which would limit the pool of skilled immigrant workers who large global technology companies rely upon to fill highly skilled positions.
4. A combination of an expected rise in inflation because of increased fiscal spending and the expectation that Donald Trump will take the opportunity to replace Fed Chair Yellen with a Fed Chair who will be more inclined to raise interest rates.

Jason Zweig, Personal Finance Columnist for the Wall Street Journal published an article about the election results on November 9th titled Afraid of What Comes Next for the Market and the Economy? Read This. In this article, which cautioned investors not to react to the election and the market's initial elation. He stated, "don't be fooled when market strategists and other pundits predict that President Trump is "clearly" going to do this or that. Little is ever clear about an incoming president, and no more than usual — perhaps less — is clear about this one.

I don't expect the immediate stock market rally to be sustained in a way that would provide an all clear signal to investors because the abruptness and strength of the immediate rally was almost certainly magnified by an unwinding of trading positions put on ahead of the election assuming a worst case scenario of a contested outcome. This contested outcome did not come to fruition and a Trump victory, along with narrow Republican majorities in Congress, directed money back into severely oversold areas of the market, such as financials and pharmaceutical/biotech companies.

The markets also quickly sold off Treasury securities and bond proxy stocks in anticipation of a Federal Reserve that would be more open to interest rate increases as the prospect of sizable fiscal spending became a more probable given the election outcome. We had seen several false alarms over the last several years when bonds and bond proxy stocks sold off in anticipation of a bottoming in interest rates and a re-emergence of inflation. What we learned from these false alarms was that interest rates could not bottom and inflation could not be pushed up in the absence of large fiscal spending. To the extent that President Trump is successful in negotiating a very large long-term fiscal spending program with Congress in early 2017, it is very likely that the behavior of the stock and bond markets will be much different than what investors have become accustomed to over the last three to five years.

I would expect that if the Trump administration can successfully pass a long-term infrastructure spending program in conjunction with a reform of both the corporate and individual tax system, the capital markets will become much more fundamentally driven, as opposed to being hinged to macro factors such as interest rates and oil prices. This change would be very welcome at Seven Summits Capital and allow the fundamentally focused research that we conduct to translate into portfolio performance more directly.

I have to acknowledge that the scenario above is just that, as a scenario. Uncertainties abound following the election, and much will be revealed over the next several months that can either validate the base case presented above or invalidate these assumptions. The base case relies upon the pro-growth initiatives of the Trump administration coming to fruition with the help of the narrow Republican majorities in Congress and the most contentious aspects of the new administration's stated policy initiative being blocked or significantly watered down. It is possible that this new administration will end up being an equal opportunity antagonist when it comes to the more establishment constituencies of the two major parties. If this should occur, the markets will need time to adjust to a less predictable and post-partisan Washington DC.

To some extent, a potential post-partisan federal government falls into the category of "show me" in that we have not seen constructive bi-partisan cooperation in Washington DC for decades. The promise of bi-partisan pragmatism in the past has led to repeated disappointment. President Elect Trump, with no public service record and a history of contradictory positions on a wide spectrum of issues, presents an unknown risk and unknown opportunity. Immediately following the election the markets rewarded investors by initially giving the President Elect Trump the benefit of the doubt.

I will be watching very closely over the coming months for signs that a political outsider can bring badly needed pragmatism to our political process. Key cabinet appointments will be the first clues regarding what the tone of the Trump administration will be regarding whether they desire to form alliances to move the agenda forward or whether the approach will send a message of "our way or the highway."

It is clear to me that the election outcome presents many very promising opportunities for investors. Opportunity does not exist without change and the one sure thing that this year's election assures is change. No one knows what degree of change that we are in store for as a country and economy, but change is inevitable. The market's turnaround overnight following the election was driven by nothing more than the tone of Donald Trump's speech. Tone and optics over the next couple months of transition will be very important for investors assess. Policies and legislative initiatives will follow, and those actions will have very real implications for our investments for the foreseeable future.

At Seven Summits Capital, we will be closely monitoring the changes underway in Washington and attempt to gauge the potential ripple effects that will result. I am very comfortable with change and have learned over the years how to temper reactionary tendencies and see clearly during times of temporary chaos and confusion. I have reason to believe that investment opportunities will be greater over the next 12-18 months than we have seen in the couple years just following the financial crisis.

The markets are currently romanticizing about all of the pro-growth promises of the President Elect and ignoring the more controversial and potentially destabilizing aspects of his campaign promises that he "guaranteed." I am going to be much more skeptical and circumspect on the new administration's economic policy, which is built upon over-promising and over-delivering. President Elect Trump guaranteed that if elected "we're going to win so much; you're going to be so sick and tired of winning." In my business, I know full well that nothing is ever guaranteed and that over the top promises can only lead to disappointment.

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