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

OCTOBER 2015 INVESTMENT COMMENTARY

RETIREMENT INVESTING & MARKET UNCERTAINTY – A NON-MARKET SOLUTION

As we exit September, the equity markets here and around the world are struggling to price in slowing global economic growth, the effects of various aspects of monetary policy reaction to macro-economic challenges, and capital market imbalances resulting from seven years of crisis-invoked central bank interventions around the world. This period in the markets is certainly challenging and has been compounded by the collapse in the oil and base commodity markets over the last twelve months. True to form, I am not going to dissect and attempt to explain the current market price action, but I am going to articulate what we have been doing for many investors in order to remove a significant amount of market risk from portfolios, while maintaining focus on growth and income over a long-term time horizon.

For many investors, whenever the markets become volatile and trends downward for a prolonged period of time, investors instinctually begin to question whether such price action is the beginning of something worse. As I have written many times, I do not attempt to assign a lot of credence to the idea that short-term market action is somehow a leading indicator of what is to come. However, market action, when combined with other more fundamental metrics, may be a validating signal of an inflection point.

In June, I wrote that "If you are counting on the stock market to continue to be the engine by which you grow your wealth or generate a total return in excess of your withdrawal rate in retirement, you will likely be disappointed. According to Ray Dalio of Bridgewater Associates, Warren Buffett, or market forecaster and asset manager Jeremy Grantham, stock market returns are very likely to disappoint over the next five to seven years." Notwithstanding the recent stock market correction, I still believe that the domestic broad stock and bond indexes are poised to materially under-perform historical average returns over the next several years.

The retiring baby boomer generation in the U.S. and greater longevity will continue to lead to an increasing percentage of our population belonging to the retirement generation. Having almost 20 years of experience managing money for individuals, I am fortunate to have many clients who I have helped transition from work to retirement. From a portfolio management standpoint, this transition does not automatically lead to substantial portfolio changes, but it does usher in the necessity of emphasizing goal-based investing versus a relative growth emphasis that most investors fixate on during the accumulation years.

For the last three years, we have been redefining how to best execute a goal-based portfolio strategy. We did this because we anticipated that the outsized returns that broad markets have provided U.S. stock and bond investors since 2009 would not be sustainable. Generational low stock valuations were created by the stock market meltdown that occurred in the wake of the financial crisis of 2008, which set the stage for what has turned out to be one of the longest stock bull markets in U.S. history. The unprecedented monetary policy easing that began in January 2008, and continues today, not only produced a bull market in stocks, but also bolstered the total returns of U.S. bonds, which has lulled conservative investors into a dangerous false sense of security.

Beginning in 2013, we realized that traditional stock and bond balanced portfolios would soon present a conundrum because both asset classes would be simultaneously over-valued in the near future. Thus, traditional rebalancing strategies would not produce the same risk management benefit that they have in the past. Hence, this realization required that we develop a much broader version of our value-seeking process to include wealth-creating non-public investments.

We found that we could identify compelling value-creating investment strategies outside of the public markets through private market investments. By incorporating private market investments into a client's balanced portfolio, we sought to increase income generation and reduce portfolio volatility, while maintaining total return expectations at or above traditional growth-oriented balanced portfolios. Furthermore, incorporating non-public investments into an asset allocation removes market based uncertainty from a portion of a portfolio and replaces that uncertainty with a fundamentally based long-term investment. Transitioning a client's portfolio from a two asset class allocation to a three asset class allocation allows us to provide far greater effective diversification than could have been possible using only public market securities. The underlying investments of these non-traded vehicles include portfolios of growth and income assets, such as apartments, data centers, private equity, pre-developed land, and even specialized debt obligations. Seven Summits Capital believes in diversifying portfolios using this three asset class approach for investors of all ages, however, as our clients approach retirement, we believe that such diversification takes on a much great level of importance. We acknowledge that retirement stage investors were shocked during the financial crisis period of 2008 -2009 when traditional stock and bond diversification failed. This failure was brought about when correlations among virtually all public market securities increased significantly when panic selling did not discriminate between stocks, bonds, and commodities.

In 2013, in addition to incorporating private market investments into retirement-oriented portfolios to better serve the needs of our retirement-oriented investors, Seven Summits Capital entered into a strategic relationship with the McLaughlin Financial Group of Wall Township, New Jersey. This alliance enables the clients of the McLaughlin Financial Group to leverage Seven Summits Capital's customized asset management capabilities and provides Seven Summits Capital clients access to McLaughlin's unique approach of designing strategies to produce reliable lifetime income.

Since we began working with McLaughlin Financial, we have successfully designed retirement portfolios for a substantial number of mutual client relationships. In most of these cases, we have been able to materially reduce exposure to multiple layers of management fees, remove 40% to 60% of the typical retirement client's nest egg from the public markets, and, at the same time, increase annual income generation as well as growth expectations.
We find that it is common for a retired investor to become very uneasy and uncertain about the wisdom of his or her retirement investment plan when public markets go through a correction or the market enters an inevitable prolonged downturn. This reaction is one which can cause significant anxiety and lead to making poor investment choices in order to alleviate the stress associated with the feeling of being out of control in the face of a market that no one truly understands.

Our objective when working with a newly retired or soon-to-be retired client is to remove as much uncertainty as possible without sacrificing income generation and long-term growth. If, like most financial advisors, we only utilized publicly traded securities, this objective would not be a realistic possibility. However, combining the "go anywhere" value seeking philosophy of Seven Summits Capital with McLaughlin's system of designing strategies to create reliable lifetime income, we have demonstrated that we not only can increase diversification, lower volatility, increase income, and maintain a growth orientation, but that we also can lower fees.

Let's look at a hypothetical comparison between a typical market oriented retirement portfolio allocated to

60% stocks and 40% bonds using mutual funds versus a representative example of a Seven Summits Capital/ McLaughlin Financial Group retirement portfolio:

	SSC&MF	Representative Example
All-in Fee	0.65% - 1.25%	1.75% - 2.50%
Annual Income Yield	3.50% - 4.50%	2.05%
LT Total Ret. Expectations	7% - 8%*	2.61% - 3.36%
Std. Deviation (volatility)	8% - 9%**	11.79%

*Based upon 50% traditional equity, 25% non-traded alternative investments, and 25% contractually guaranteed product. Return expectations: 9%-10%, 8%-10%, 4% -6%, respectively. Illustrated return ranges are net of an average 1% annual management fee. This data is representative data compiled using broad asset class category forecasts and does not represent a composite, therefore the data may not represent actual performance, does not guaranty future performance.

**Based upon an assumed 18% standard deviation for the 50% allocation to traditional equities and zero standard deviation for 50% allocation to non-traded alternative investments and a contractually guaranteed product.

Note: The above representative traditional 60/40 stock and bond portfolio example presumes a 1.25% to 1.50% wrap management fee and a weighted average mutual fund/ ETF internal expense ratio of between 0.50% and 1.25%. The annual income yield of the 60/40 portfolio is based upon a weighted average of the S&P 500 dividend yield and the yield of the U.S. 10 year Treasury Note. The LT Total Return Expectations are based upon 100 year average annualized returns for a 60/40 stock and bond portfolio using the S&P 500 index and 10 year U.S. Government Bonds, less the illustrated range for the “All-in Fee”. The Standard Deviation (volatility) is based upon the same 100 year averaged for the aforementioned 60/40 stock and bond portfolio constituents. This data was sourced from the book Global Asset Allocation written by Meb Faber. The related excerpt from the book can be found at (http://mebfaber.com/2015/03/06/chapter-2-the-benchmark-portfolio-6040/).

The representative 60/40 portfolio illustrated above is meant to be a proxy for a typical brokerage sold 10-15 mutual/ETF model portfolio that I routinely review when working with prospective clients. These portfolios tend to be very domestic oriented and own thousands of underlying securities. Such a portfolio generally produces a statistical profile that is very similar to the broad U.S. stock and bond indices.

Many retirement oriented investors who we speak with have never before been introduced to an investment management solution beyond the typical balanced stock and bond mutual fund model portfolio. When these investors learn about the types of non-traded alternative investments that we utilize, they often are surprised that such investments are accessible.

The benefit of operating as an independent, fee-based asset manager, that has no ties to any particular mutual fund companies, SMA platforms, or insurance companies, is that we can directly apply our assessment of opportunity to our portfolio strategies without any conflicts of interest. In summary, as we have stated on numerous occasions since the beginning of this year, that we believe that the current economic, valuation, and corporate earnings conditions will limit broad equity returns for the foreseeable future. Compounding the disappointment that is in store for broad stock market investors will be bond market total returns that are far below average in the face of slow, but deliberate normalization of interest rates over time. Recently, we were joined in this assessment by the likes of Morgan Stanley.

Morgan Stanley’s Head of Investment/Portfolio Strategies, Lisa Shalett, was quoted extensively in a September 25th, Business Insider article titled “A Radical Shift is Coming to the Markets,” written by Akin Oyedell. In this article, Ms. Shalett stated that “Over the last six and a half years, the S&P 500 has compounded roughly 15%, at the same time that the US bond market has compounded at 9% ... So if you had a balanced portfolio of stocks and bonds, you experienced superior returns, and that portfolio had double-digit returns. Our outlook is that that a balanced portfolio that delivered those double-digit returns probably over the next five to seven years is going to return something a lot closer to four to six percent." Being on the same page as one of the large investment banks when it comes to investment outlooks is not something that we are accustom to. However, any similarity ends with our assessment of below average future market returns, as Ms. Shalett endorsed a strategy prescription for her assessment that shifts equity allocations away from domestic equities toward international markets. We do not dispute that valuations are superior in many international markets versus those in the U.S. markets, however, we believe that valuation considerations and spreading exposure among different public markets does very little to achieve true diversification when asset class correlations converge when those markets are under stress from macro or geopolitical fears. The limited effectiveness of traditional diversification is not greatly appreciated when markets are orderly and moving higher, and yet, when public markets decline in lockstep as risk aversion becomes elevated, diversification takes on a much greater importance.

At Seven Summits Capital, we will never be satisfied with the portfolios that we manage and as our clients' needs evolve and the markets change. Instead, we will exhaustively search for value on their behalf. We will continue to form alliances in order to increase the breadth of our capabilities, while maintaining a close relationship with those who entrust so much to us.

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