SEVEN SUMMITS CAPITAL

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OCTOBER 2017 INVESTMENT COMMENTARY

UNCERTAINTY ... WHAT TO DO?

As I woke up early Monday, October 2nd I saw the news alerts regarding the horrific mass shooting that occurred several hours earlier in Las Vegas. This shooting is not only shocking and heartbreaking; it caps a list of "the worst" of their kind events that have occurred since September 1st. Houston was hit with the worst flooding in its history due to hurricane Harvey, and then Hurricane Irma broke records with its size and strength as it devastated the U.S. Virgin Islands and several other Caribbean islands, and then Hurricane Maria registered a direct hit on Puerto Rico as a Category 4 storm and ravaged this U.S. territory. Tens of millions of people have had their lives changed forever for the worst over the last month due to totally unforeseen events that will, unfortunately, be memorized in the record books. These events have devastated the lives of millions of people, and for the most part, our country has risen to the challenges through the heroism as we saw in Las Vegas and Houston, through charity and good works. It is invigorating to see the good of the human spirit shine through during challenging times. However, the unexpected aspect of these massive catastrophes reminds me that we can never predict with any certainty what we wake up to each morning.

I worked as a professional money manager through unexpected 1998 Long-term Capital collapse and Asian Currency Crisis market sell-off, the bursting of the dot.com bubble, the sell-off following the attacks of 9/11, and finally the worst bear market since the 1929 Crash that occurred in late 2008 and early 2009. My experience does not allow me to be complacent when I am entrusted with the responsibility of managing so many clients' life savings.

Below is a passage from a recent interview with Howard Marks published by Finanz and Wirtschaft on September 29, 2017, in an article titled Nobody Knows What Will Happen:

> *"As an investor, you have to deal with two risks: The risk of losing money, and the risk of missing out on opportunities. It's the job of a good investor to balance the two: You invest, but with caution. You should certainly have less risk exposure today than you would have had five or seven years ago. I think it's better to turn cautious too soon rather than too late. Most people can't think of what might cause trouble anytime soon. It's precisely when people can't see what it is that could make things turn down that risk is the highest. It could be an economic slowdown, rising interest rates, the effect of central bank tightening, or geopolitical events. Or it could be «something else.» It's always the things we don't know about that really bite us in the end."*

I could not agree more with Mr. Marks' statement above, and the balance that Mr. Marks is speaking about is what I have attempted to do so far in 2017 as an investment manager. I have slowly been reducing the weightings of traditionally higher volatility securities in favor of lower volatility risk assets. I have also utilized, so far unsuccessfully, a hedge position in many accounts against a spike in volatility that has yet to occur. That being said, such a hedge has typically been a relatively low portfolio allocation, except within several portfolios that entered 2017 significantly uninvested. Although most people dislike seeing any of there portfolio positions sitting with a material loss, with a hedge such a one which is designed to help mitigate the adverse effects of a significant market correction, the fact that such a hedge position is sitting with losses means that the rest of portfolio is likely doing quite well.

For the most part, most clients are experiencing a solidly positive year so far. Although I am very cautious right now, I am encouraged by a larger than average number of stocks within Seven Summits Capital portfolios showing strong advances based on fundamental company-specific actions or catalysts, such as better than expected earnings and takeover activity. Thankfully, the advances that portfolios have experienced thus far this year are not simply due to being overly tied to the persistent advances in the broad markets. What the current market environment has done is seemingly lower overall risk premiums, which has provided a green light for investors to bid up undervalued equities in ways that I have not seen in over four years. This greater appetite for risk is good news if you have held onto undervalued equities such as GM, which has been in a trading range between $28 and $34 per share for three years and is now trading at $45 per share. I am very content to buy an undervalued and out of favor equity, as GM has been since it's emerged from bankruptcy over six years ago, especially when it pays a four percent or higher dividend. GM stock has been a classic situation of getting paid to wait for the market to recognize what you have seen for quite a while. I purchased GM stock in many portfolios over the last two to three years whenever I could pick it up around $32 per share or lower. My two to three-year target price on GM stock had been $50 per share. I am currently reevaluating the target price for the next two to three year period, and I can clearly see a justification for a share price above $60 per share at this point. GM is still trading at a forward P/E ratio that is less than half of that of the broad market. Given GM's expected 6-7% forward earnings growth rate, GM has a PEG ratio of 1:1, which is still in the category of cheap.

For Seven Summits Capital being cautious does not mean avoiding risk, it means quantifying risk and managing it in a manner that allows portfolios to participate in continued market advances, while at the same time preparing for the inevitable meaningful correction or bear market. There are mounting geopolitical, policy, and economic risks that a prudent money manager must be understood to the extent possible in order to attempt to discount the probability of market disrupting events. This method of risk assessment is the opposite of complacency.

I would like to end this commentary by sharing some information that you may want to pass along to your friends and family.

- Don't be afraid to invest for your future when the world around you seems uncertain.
- When you invest, and positive returns become the routine, don't be greedy, be skeptical and cautious because successful investing is not supposed to be easy.
- Always know what your investment expenses are:
    - EFT's and Mutual Funds have published Expense Ratios that you are paying in addition to what you are paying your broker or advisor.
    - Mutual Funds, in particular, have "hidden" fees (costs) in addition to the published Expense Ratio.
    - Forbes published an article on April 4, 2011, titled The Real Cost of Owning a Mutual Fund. In this article, the Forbes author broke down all of the disclosed and undisclosed costs that an investor bears when invested in the average equity mutual fund. The analysis

showed that the total costs, depending on whether the fund is held inside or outside of a retirement account such an IRA or 401K ranged from 3.17% to 4.17%. **(Remember, these costs are in addition to what you pay an advisor.)**

- Lastly, remember investing is about knowing what you are paying for a given investment versus a rational estimation of its future value and giving that investment the necessary time to realize that value estimation. Investing is not a game of trying to simply capture gains on the way up and hopefully getting out before everyone else. This type of activity is not investing; it is speculating at best and gambling at worst.

Every day I am thankful that my clients allow me to help steer them through good times and bad as a professional who operates within an industry that is infamously littered with bad actors, pretenders, and trained salespersons who survive on selling complex products that they make sound simple. Be careful out there and don't let your friends and family make one or more of the potentially costly investing mistakes listed above.

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