SEVEN SUMMITS CAPITAL
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SEPTEMBER 2018 INVESTMENT COMMENTARY
DON'T ASK ME WHAT I KNOW, ASK ME WHAT I THINK

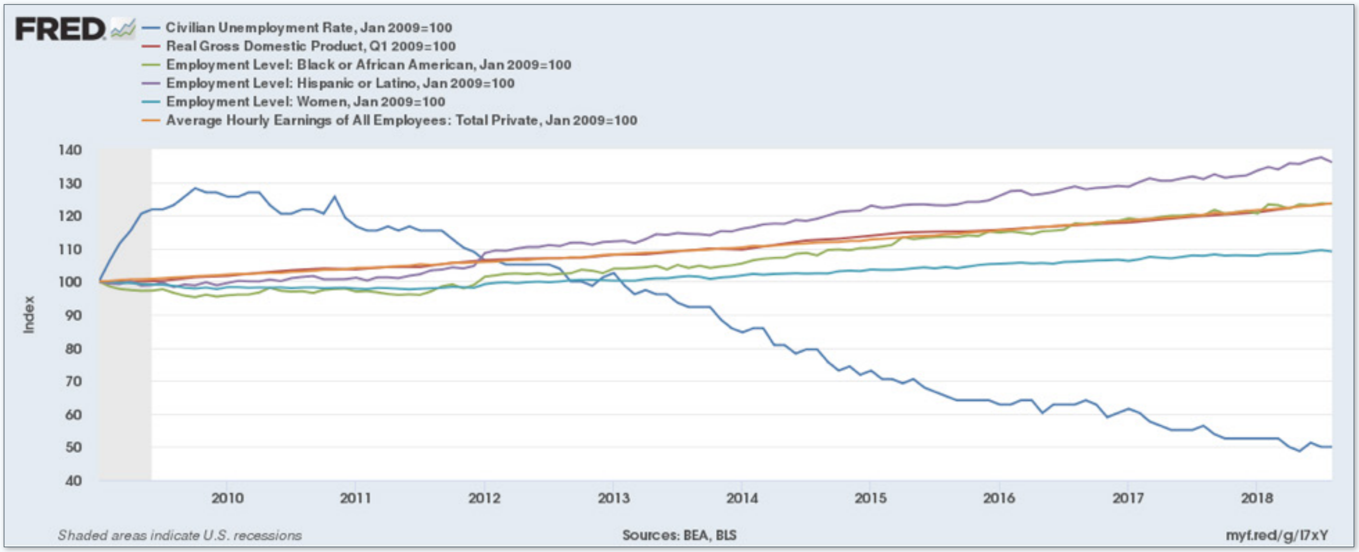
One of my greatest professional challenges, which I attempt to address by writing monthly commentaries, is to provide clients a window into the Seven Summits Capital investment process. To do this I share information and assumptions that I use to manage a wide range of economic, market, and other known risks that can impact portfolios.

I have come to realize over the course of my career that I have developed certain disciplines which enable me to process information, measure risk, and make decisions efficiently. Investment related decisions, which are informed by a combination of information and risk assessment, are executed with an acceptance that a certain percentage of decisions will turn out to be incorrect. When a client discussion turns to the subject of poorly performing investments, even if those investments only make up a small percentage of an otherwise well-performing portfolio, that discussion is always uncomfortable. The discomfort associated with the discussions of mistakes or bad luck is due to the fact that most people are conditioned to avoid risk and minimize mistakes. This commentary will delve into the concept of disciplined decision-making in the face of a combination of known unknown factors, as well as a healthy dose of luck.

I find that a common denominator among effective decision-makers, regardless of whether they are in a profession that demands risk minimization through a strict adherence to established standards or within a less structured environment, is to start with the most complete and accurate information as possible. For example, thinking about the investment profession, an investor today has to decide whether conditions warrant going further out on the risk spectrum or call for caution and lowering the tactical risk stance.

Today a person would have to live in a cave not to hear, almost daily, how well the U.S. economy is performing. It is clear that the current economy remains healthy, but how healthy and where it is in the cycle are up for debate. Some leading indicators could be seen as signs that our long economic recovery may be about to wane. These indicators include new housing starts, existing home sales, and new car sales. Recent weakness in these areas, which historically have been viewed as leading indicators, gets lost in the prevailing sentiment that the U.S. economy has shifted into a higher gear and is structurally healthier than it has ever been. The exuberant sentiment is a function of overt exaggeration, for political purposes, of data points and persistent puffery that accompanies cherry-picked strong economic trends. The reality is that for the most part, our economy is simply following long-standing trends that naturally produce new post-financial crisis milestones as time passes. Broadly speaking, areas such as employment, average hourly earnings and GDP are currently following cyclical trends that began in 2009.

The chart below, produced by the St. Louis Federal Reserve, clearly shows these consistent, long-standing trends over the last nine years:



It is my responsibility to assemble data points, evaluate analysis and do so without prejudice in order to provide a meaningful backdrop for all decisions. I always strive to remain objective and honest in the interpretation of data in order to avoid falling prey to prevailing sentiment. Decision-making can easily be tainted by a consensus sentiment which does not line up with objective data. Processing basic data in an objective manner is the very foundation of a decision process that underpins success, whether applied to investment management, professional endeavors or life itself.

I have recently read a book titled "Thinking in Bets" written by well-known professional poker champion Annie Duke. Her book was recommended by Howard Marks, the legendary founder of Oaktree Capital Management and one of the best risk managers in the investment profession. Marks wrote about this book that "The insights that Duke offers in this book are incredibly helpful when we contemplate decisions in the face of multiple possible outcomes, and that renders her book enormously applicable to the world of investing." After reading the book, I very much appreciate what Howard Marks saw in the writing of Annie Duke.

The book repeatedly contrasts poker with chess. Duke accurately states that the game of poker holds valuable lessons for life itself and many other activities involving constant decision-making in the face of luck, and both known and unknown variables. Whereas chess is a complex game to master, it is a procedure-driven activity where your opponent's game pieces and moves are known to you in real time. Duke describes chess the following way, "Chess contains no hidden information and very little luck. The pieces are all there for both players to see. Pieces can't randomly appear or disappear from the board or get moved from one position to another by chance. No one rolls dice after which, if the roll goes against you, your bishop is taken off the board. If you lose at a game of chess, it must be because there were better moves that you didn't make or didn't see." Like Marks, I found Duke's book tremendously informative and reinforcing of many of the disciplines that I have developed during my career. Like poker, investing incorporates the benefits of discipline developed through experience, probabilistic thinking regarding the assessment of risk, and the acknowledgment that both unknown variables and luck will inevitably impact the frequency of desired outcomes.

Through much of the book, Duke compares poker to life, however for this commentary, I am going to substitute the word ***investing*** for life in certain Duke quotes. For example, Duke in her discussion of chess versus poker, she writes, "Chess, for all of its strategic complexity, isn't a great model for decision-making in ***investing***, where most of our decisions involve hidden information and a much greater influence of luck. Poker, in contrast, is a game of incomplete information. It is a game of decision-making under conditions of uncertainty over time." This is very similar to an investment decision to buy, sell or hold a security. I inherently process known information while being fully aware that such information is incomplete and that the future holds a significant amount of unknown risk and luck. For example, an unforeseen technological innovation could render ten years of R&D obsolete overnight or a natural disaster could destroy a pivotal new infrastructure investment. Both unforeseen events would very swiftly adversely effect a very well thought out investment thesis.

Annie Duke wrote that "What good poker players and good decision-makers have in common is their comfort with the world being an uncertain and an unpredictable place. They understand that they can almost never know exactly how something will turn out." This resonates with me, as I never know exactly how any investment will turn out. However, I try to incorporate discipline around concepts such as valuation and the avoidance of overly complex investments, in order to reduce uncertainty and limit downside risk, should an unforeseen risk or bad luck adversely impact the outlook for an investment. ***Thinking in Bets*** repeatedly emphasizes that the outcome of a decision should not be the determining factor as to whether we judge a decision, in retrospect, as good or bad. On this point, Duke states "An unwanted result doesn't make our decision wrong if we thought about the alternatives and probabilities in advance and allocated our resources accordingly." I benefited from this particular lesson in decision-making early in my career as a commercial banking credit analyst.

I was taught that a good loan, as defined as a well-underwritten credit can go bad and there will be no adverse consequences on my career. However, if corners are cut in the underwriting, and information that should have informed decision-makers to decline the loan request are omitted, and this results in the loan being approved, should that loan go bad, my career would suffer as a result.

I have applied this lesson of decision-making in life and work since those early days of working as a credit analyst. In conversation with clients, when I dedicate more time to discussing research and the investment process than the most recent results, it is not because I want to avoid talking about mistakes or don't like to brag about big winners. Instead, it is because I believe that successful long-term investing is determined by how much time is dedicated to research, as well as following a consistent process. Investment results do not happen in a vacuum. Results are simply a reflection of how an investment manager's research and process are working during a finite period within a particular market environment. Uncertainty and luck are always factors that are impossible to account for when executing an investment strategy. What good poker players and good investors know is that a good decision-making process, if applied with discipline, will result in more good outcomes over time than bad, which is the key to long-term success.

The most meaningful conversations that I have with clients will not focus on what I know. Instead, those conversations will focus on what I think regarding an expansive number of subjects. I find it much more interesting to discuss matters that are unsettled. Every time that I make a decision on behalf of clients to buy, sell or hold an investment, I am expressing what I think relative to other market participants. When I buy a stock, I can execute that transaction only when someone else disagrees with me and is willing to sell at a price level that I deem to be attractive. Each buy/sell transaction results from the conscious decision of two individuals who have access to the same information, however, reach opposing conclusions. It is this intellectual conflict that I love about what I do on a daily basis. Neither party in a transaction has perfect information. However, one party will be more right than the other, over time. The winner of that contest will be determined only by who executes on a superior decision process.

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