2020 Tested Us All - We Stand Tall & Look Ahead

Curt R. Stauffer
December 14, 2020

Investing is a profession that I contend is more of an acquired craft that only those with a certain temperament can master. I have compared investing to championship poker or extreme mountain climbing, as opposed to chess. Paraphrasing a famous Warren Buffet quote, 2020 has been one of those years when the tide went out and revealed who was swimming naked.

As we entered 2020, at Seven Summits Capital we were on high alert for something that could derail a nine year old, stall speed, economic expansion. One cannot be an effective investor without staying abreast of current events and developing contingencies around various opportunities and threat scenarios.

By mid-January we began to read about a novel virus outbreak in Wuhan, China. Our immediate response was to dig into what was known at the time about the virus and what companies would be best positioned to develop a vaccine or a therapeutic to address a significant global public health threat. Fortunately, over time, I have developed a strong background in pharmaceutical and biotech company equity investing. This background enabled me to quickly assess where health science was in 2020 when it comes to developing countermeasures against the spread and serious symptoms of a respiratory coronavirus.

From the quick assessments that we made in mid-January, we began buying Moderna stock, which was under $20 per share at the time. Because of its unique position as a "new age" vaccine developer many growth oriented equity portfolios had positions in Moderna by the end of January. Moderna uses a proprietary mRNA science and artificial intelligence (AI) computing to very quickly formulate a genetically engineered protein which fools the human body into thinking that it is the target virus in order to promote an immune response which will act as a defense against the actual virus should a person come in contact with it.

There were other companies that we identified who we believed would be part of the solution to this virus should it become a global pandemic, but most of those companies were very large pharmaceutical companies whose financial performance would not be materially impacted in a positive manner from the successful development of a virus vaccine.

We strongly believe at Seven Summits Capital that small to medium size companies possess the nimbleness to react to rapid changes better than very large and mega-cap companies in the health sciences space and Moderna and BioNTech, Pfizer's partner, proved this out by being the first fully developed, tested and approved COVID-19 vaccines. From an investment standpoint, these small and medium size companies provide the greatest opportunity for out-sized portfolio returns if they can be identified and invested in early enough. (It should be noted that we mostly exited our Moderna positions by April after nearly a 100% run-up from late January levels, which in retrospect was too early of an exit.

The premature exit from Moderna was in part due to not fully appreciating how ground-breaking that company's drug develop process was and what that portends for the company after the COVID-19 pandemic is behind us. The other part of why we exited Moderna was due to seeing a plethora of significant "stay at home" investment opportunities. By early March, it became clear to us that the pandemic would infect millions of Americans and the only way to mitigate the infection rates and deaths was to significantly reduce close human contact, travel, and other activities which enabled the virus to move from one person to another. One of the first "stay at home" investments that we made was in shares of online pet food company Chewy. We established initial positions in CHWY under $30 per share and we have seen this stock rise steadily over the last nine months to almost $80 per share. We were fortunate to have already initiated an investment in tele-medicine leader, Teladoc late in the third quarter of 2019. The unfolding pandemic caused us to add to that perfectly positioned company. Over the last fourteen months, Teladoc stock has gone up over three fold.

During that February/March period, we very quickly restructured equity portfolios by emphasizing health science companies, "stay at home" companies, and mega-cap high quality companies that had seen their stock prices cut in half or worse within the span of two to three weeks. We bought shares in companies such as Home Depot, McDonalds, MasterCard, Disney, and Medtronic. It is remarkable for me to think back over my career and realize that the only time that I really am motivated to buy large blue-chip stocks like these are during times fraught with investor panic such as after 9/11, in the midst of the 2008-09 financial crisis, and again this year. Each time that I have done this, these companies have presented significant margins of safety on the downside, and a business model resiliency which enables stock prices to recover rapidly.

Unlike the financial crisis period and the years that followed, we could not do much this year to take advantage of the panic when it came to corporate bonds. The Federal Reserve reacted very swiftly to enable most weak companies to avert bankruptcy. This quick action kept bond prices from dropping significantly and creating a "throw baby out with the bath water" opportunities to take advantage of as an investor. There was one industry that was not directly able to benefit from the Federal Reserve or Treasury Department actions, and that was cruise lines. We were able to selectively buy Carnival Cruise bonds maturing in October, 2020 at around 88 cents on the dollar. This investment worked out very well because, in spite of cruise lines not being able to receive direct financial assistance from the Central Bank and Treasury Department, policy action was successful in keeping the corporate bond market liquid and functional. With a liquid and functional bond market, Carnival Cruise Lines, which had the strongest balance sheet of the publicly traded cruise line companies, was able to issue new bonds to pay off the ones that we purchased at a steep discount.

Another opportunity that surfaced in late 2019 and early 2020 was the advent of SPAC's, or Special Acquisition Companies, also known as "blank-check" companies. In late 2019, Seven Summits Capital bought into a SPAC stock which owned Virgin Galactic. By design, the SPAC spun off Virgin Galactic, which began trading under its own stock symbol, SPCE. We were able to acquire Virgin Galactic through the SPAC at an initial cost of just under ten dollars per share. As of the writing of this commentary, SPCE stock is trading in the mid-30's per share.

The other area where we took advantage of a SPAC structure, as well as buying into a UK company that had recently acquired a Canadian company, was the advent of legalized online sports betting and gambling. We acquired initial stakes in Draft Kings through a SPAC investment. We acquired access to privately owned FanDual indirectly through a UK/Canadian company. Our initial cost of Draft King stock was just under $20 per share and it is currently trading near $50 per share. The indirect FanDual investment required several twists and turns in order to be in a position to own FanDual prior to it becoming a listed U.S. company. The FanDual investment is one that we became aware of through research into the online sports betting industry landscape. We discovered that a company listed on the UK stock exchange was a significant equity owner of privately held FanDual. We became aware that this company was acquiring a Canadian online table gaming company with shares listed on the U.S. stock exchanges. We decided to acquire stock in the Canadian company prior to the deal closing in order to get ownership in the UK company, which did not at the time have U.S. listed shares. Once the merger was complete, U.S. investors received newly U.S. listed Flutter Entertainment stock. As of the writing of this commentary,

Just recently, Flutter has announced that it has agreed to buy most of the remaining FanDual stock and it plans to spin it off so that it trades under the FanDual name on the U.S. exchanges. So far, this convoluted investment has worked out extremely well. Our original cost basis on Flutter Entertainment, once we received the exchanged shares from the completion of the Canadian company acquisition, were just under $110, and today the stock is trading around $200 (there are two U.S. OTC listing for Flutter. One has been trading around $200 and the other near $100, each representing a different ratio of the UK stock).

These aforementioned investments are simply representative investments. Because each portfolio is managed individually, not all portfolios held all or some of these companies due to differing risk tolerances, investment objectives, the timing of liquidity flows, and the timing of account openings. I chose to highlight these particular investments in order to illustrate what goes into successfully navigating a year like 2020.

Investment success for Seven Summits Capital comes down to an insatiable thirst for knowledge that can be applied to identifying opportunities, and achieving a high level of confidence and conviction to support prompt decision-making. The success of our process relies on not being afraid to be both contrarian during times of market stress, and not being afraid to stray from the beaten path to find unique situations where the value proposition is obscured for one reason or another.

Even though this commentary only looks back at a sampling of our 2020 successes, over the last several months we have been almost exclusively focused on 2021 and beyond. Portfolio repositioning began to take shape in September and has continued since. I am personally very excited to leave 2020 behind in spite of our investment successes. As the world begins to get back to more normal social and business interactions, we know that status quo portfolios will not be a viable investment strategy going forward.

Both the equity and fixed income markets are currently bubbling over in excess exuberance. This exuberance is a product of massive monetary and fiscal stimulus, with more likely to come in 2021, and investors who are inebriated by the allure of fifty to one hundred percent stock gains in certain well known pandemic era winners. We entered 2020 on alert for an event which would derail economic growth. We now are about to enter 2021 and we are optimistic as we identify what we believe will be the drivers of excess returns over the next several years, but we are feeling great concern for the lack of valuation fundamentals in certain parts of the equity market.

Happy Holidays,

Curt R. Stauffer