Do Not Fear The Curves

Curt R. Stauffer
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During the 24 years that I have been a professional investor, the S&P 500 has had twelve ten percent plus corrections inclusive of the current correction, including three Bear Markets (periods when the broad market declines 20% or more from peak to trough). Including the recent market correction, seven of the twelve ten percent plus drawdowns have occurred since 2010. Below is an illustration of each correction or Bear Market over the last 24 years:

Cycle Peak	Cycle Trough	Cycle Drawdown	Peak-to-Trough Days	Recover to Prior Peak Days
7/17/1998	8/31/1998	-19.3%	45	263
7/16/1999	10/15/1999	-12.1%	91	319
3/24/2000	**10/9/2002**	**-49.1%**	**929**	**161**
11/27/2002	3/11/2003	-14.7%	104	49
10/9/2007	**3/9/2009**	**-56.8%**	**517**	**1,673**
4/23/2010	7/2/2010	-16.0%	70	410
4/29/2011	10/3/2011	-19.4%	157	301
11/3/2015	2/11/2016	-13.3%	100	1,492
1/26/2018	2/8/2018	-10.2%	13	715
9/20/2018	12/24/2018	-19.8%	95	224
2/19/2020	**3/23/2020**	**-33.9%**	**33**	**422**

Data Source: Ycharts

The S&P 500 measures the market-cap-weighted average price of the 500 constituent stocks selected by Standard & Poor's. An average is inherently a "smoothed" measure of the input values. During most Bear Markets, virtually all constituent members of a market index such as the S&P 500 suffer large price drawdowns. Corrections can vary in magnitude, duration, and cause. Some corrections are broad "risk-off" drawdowns where most stocks within the broad market fall during a fear-induced "risk-off" drop in market value. Other corrections are more rotational events where broad categories of the prior cycle outperformers experience a disproportionate sell-off. In contrast, different broad categories that have been recent historical under-performers are relative beneficiaries. The current correction started as a rotation away from secular growth stocks and pandemic beneficiaries, except for the largest technology stocks. The stocks which benefited from this rotation were energy-related and consumer staple stocks.

Shades of this rotation began early in 2021. The market was prematurely attempting to price in a full reopening of the economy as the original COVID-19 virus infection levels dropped off in early 2020 due to an aggressive vaccination rollout. Both the Delta and Omicron variants interrupted this rotation, which swept through the country beginning in May in terms of Delta and September in terms of Omicron. As we learned more about Omicron and booster shots were approved, the rotation price action began in mid-October. Initially, this rotational correction was isolated to small and mid-cap secular growth stocks and the stocks of companies linked explicitly to the Pandemic such as Moderna (MRNA), Zoom Video (ZOOM), and Peloton (PETON). It wasn't easy to see when just looking at the major stock indices. The rotation began to impact the price action of the broad indexes in early December when Fed Chairman Powell announced that the Fed would be accelerating its reversal of quantitative easing and interest rate increases beginning in early 2022.

Once a correction impacts market psychology, turning greed into fear, the correction cycle will treat all perceived risks as reasons to sell or go short risk investments such as stocks. This behavior reduces market liquidity and amplifies volatility to the downside. It is easy for an experienced investor to understand the dynamics of a correction because corrections are common occurrences. It is challenging to navigate a correction using market timing to inform buys and sells. This is because very different factors cause each correction and the duration and magnitude of corrections vary significantly. This variation can be seen in the peak to trough days and drawdown columns in the chart above.

It looks so easy to use market timing to avoid short-term losses associated with a correction in retrospect. Why is it so hard? It takes time to distinguish a correction from normal periods of heightened market volatility. Thus, by the time an investor realizes the market is headed for a correction, they have already suffered a five to ten percent loss of value. If at this time an investor sells out or moves a portfolio to a much more conservative stance and the drawdown does not continue, the market will quickly recover, and the investor will end up "wrongfooted," missing out on the quick recovery. If the sell-off indeed continues, there will inevitably be strong rally days and a few positive weeks before the market ultimately bottoms and stops making new lows. There will be no way of knowing at the moment which multiple-day rally or positive week represents the end of the correction. Thus, a timing-oriented investor who lost five to ten percent early in the correction will inevitably mistime reentering the market, either leaving five to ten percent of the early recovery on the table or getting in too early and suffering another five to ten percent drop in value before selling out again, which is what I would refer to as "chasing your tail."

On the other hand, if an investor chooses to invest in individual company stocks, valuation metrics can be much more effective tools to gauge the attractiveness of a stock price. What can trip up an individual stock investor when it comes to investing during heightened risk aversion and volatility is falling prey to being disappointed should prices move lower after making a buy decision. Instead of being thankful that the market has provided an opportunity to buy at fear-induced price levels, many investors feel deep regret that they could have purchased at a lower price. Expectations management is a critical part of being a successful long-term investor. An investor should not expect to be able to knowingly pick the price bottom of a stock or the market in any market cycle. When buying a new stock position, our goal is to enter at a price that will be seen as very attractive in the future, not necessarily the most attractive price that it will trade at in the near term. We also expect and hope to get market-induced opportunities to buy more shares at even more attractive valuations.

For this commentary, I will discuss two portfolio companies that highlight why price volatility has minimal bearing on long-term returns. The investment decision is driven by an expectation-driven valuation thesis and time arbitrage. One such company is Sony Corporation (SONY). We first purchased Sony stock in early 2014 under $20 per share based upon an internal valuation analysis and a constructive outlook for the company in the future. I use this example because the original purchase decision was entirely valuation and expectation driven, with no consideration given to market timing. As one can see in the weekly price chart below, our entry price for Sony Corporation (SONY) in early 2014 did not immediately result in gains. The price vacillated between lower, sideways, or just modestly higher over the next twelve months. As one can see from the chart, this stock produced significant wealth appreciation over the next eight years, but only if held through volatile periods. Thus, benefiting Sony stock price, appreciating nearly 250% over this period, required a high level of confidence in one's investment thesis and valuation analysis. That confidence must be steadfast enough to override any temptation to sell and harvest profits during interim 50% rallies or to sell to preserve gains out of fear during associated 30% to 40% price drops. Investing in individual company stocks based on valuation and long-term outlook considerations can only truly create outsized wealth creation for an investor if one can continue to hold shares and even add to them over time so long as the valuation remains rational. Not all our selected equities end up being held for five years or longer and result in multiple hundred percent returns. However, our process of owning 25 to 40 individual companies is designed to make sure our winners have a meaningful impact and those investments that are much less profitable, or even the ones that generate a loss, have a minimal negative impact.

Chart by QUODD

The green line shows a weekly price, while the orange line illustrates a smoothed moving average price.

Another more recent widely held portfolio position originally purchased over the summer of 2018 is Porsche SE (POAHY) at prices between $6.60 and $7.00 per share. At that stock price, this German holding company's price derived market value was approximately $25 billion. The company is the holding company controlled by the Porsche and Piech family, the founding family of Porsche, Audi, and Volkswagen. The holding company's largest single asset is a 52% ownership of the voting shares of Volkswagen, which currently is the parent company of Volkswagen, Audi, Porsche, Lamborghini, Bentley, Bugatti, as well as lesser-known brands to U.S. investors such as Skoda. In the summer of 2018, the Volkswagen company's market value was depressed due to the "dieselgate" scandal from which the company was struggling to recover. The conglomerate's market value at that time was approximately $80 billion.

We had paid close attention to Fiat's spin-off of Ferrari 2017, noting how much value was unlocked by disentangling Ferrari from its larger parent company. The market initially placed a value of $10 billion on Ferrari. However, by the summer of 2018, Ferrari's market value had swollen to around $32 billion. Knowing that Porsche AG was larger than Ferrari in terms of sales, had a better growth outlook, and very similar profitability metrics, we quickly assessed that Porsche's market value was being significantly held down by being a part of the Volkswagen conglomerate. We chose to capitalize on this disparity by buying shares in Porsche SE, the Porsche, and the Piech family holding company. We surmised that Porsche SE would likely control a future independent Porsche AG.

On Tuesday, February 22, 2022, a press release from Volkswagen and Porsche SE announced that a Porsche AG spin-off and IPO are in advanced stages of discussion. We have felt that if Porsche was spun-off from Volkswagen, the market would value Porsche between $90 and $110 billion. Since 2018, the price of Porsche SE (POAHY) stock has risen to around $10 per share, which equates to a market value of approximately $35 billion. We assume that Porsche SE will end up owning between 50% to 60% of the common and preferred shares of an independent Porsche company under a spin-off scenario. At this ownership level and a Porsche AG market capitalization of between $90 -$110 billion market capitalization, it follows that Porsche SE (POAHY) stock could ultimately reach $25 per share or more.

As one can see from the chart below, the price of Porsche SE (POAHY) has been as low as $3.60 and as high as $12.20 per share over our holding period. Thus, POAHY was a positive contributor to portfolio performance at certain periods over our holding period and other times a materially adverse contributor. The stock price is simply the price that the market offers the shares at on any given day. We did not, and never will, allow the market's price of a stock like Porsche SE, where we have a long-term thesis of what we believe the company and stock price should be worth, change or alter our valuation thesis.

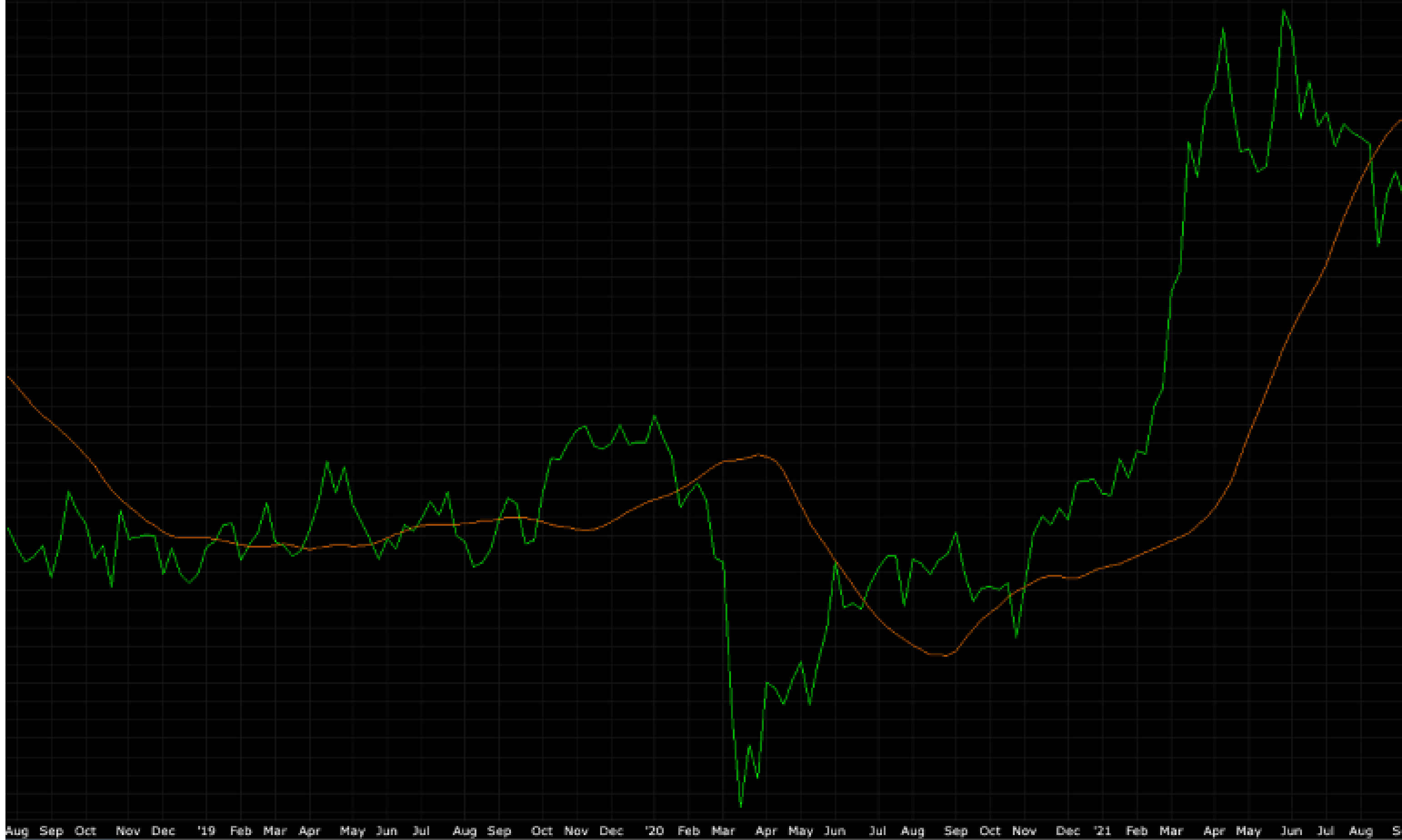

Chart by QUODD

The green line shows a weekly price, while the orange line illustrates a smoothed moving average price.

Will our spin-off thesis and valuation estimate of Porsche AG end up being correct? Most importantly, will our assessment of such an outcome on Porsche SE stock be reasonably accurate? We cannot know for sure, but all publicly available information and the latest press release reinforce our thesis.

Investing in stocks is hard because the market challenges you daily by repricing a company's market value in the absence of new company-related information. The market forces an investor to continuously reassess the strength of a conviction in a thesis and any decision to buy or sell shares. In speaking with clients, I must sometimes explain why we have no control over stock price changes, either up or down, and why we do not act on these price gyrations. Price changes themselves, as illustrated by the charts of Sony Corporation (SONY) and Porsche SE (POAHY), generally tell an investor nothing of importance relative to a long-term thesis. Stock price fluctuations do not jeopardize an investor's long-term wealth accumulation so long as the investor understands why the original investment decision was made and maintains conviction in that thesis. The risk is that price volatility forces an emotionally motivated error. Many times the best course of action is to do nothing.

It may seem odd following a month when markets are experiencing a meaningful correction, geopolitical risks have escalated with Russia's brazen military invasion of Ukraine, and oil prices near $100 per barrel that I am discussing Sony and Porsche. The choice to write this commentary under the current circumstances is to highlight, during a period of significant share price volatility and associated fear, why significant price volatility among our investments should not have a bearing on long-term wealth creation. The experience and history with investments such as Sony and Porsche SE, as well as many others, provide the confidence that the current market correction, and contraction in the share prices of many of our portfolio equities, will not have any meaningful adverse impact on the future wealth creation for clients over the long-term. We have this confidence

because our investment process relies upon arbitraging time and value opportunities. We have a thesis for each investment that identifies milestones and catalysts that we expect will unlock value. Unlike most advisors and investment managers that individual investors have access to, we do not meaningfully base our security selection and portfolio construction decisions upon simply riding an "ever-rising" broad market.

The shared success of Seven Summits Capital and our clients relies upon our dedication to our process and our clients being comfortable knowing that they own investments chosen based upon a forward-looking value principle, a strong management team, an opportunistic business strategy, and long-term competitive advantages. Seven Summits Capital invests in a small number of companies relative to the market. We do not trade stocks, we do not play markets, and we are not attracted to a stock simply because it looks like the share price is going to keep rising, we must see the quantifiable value and an underlying long-term thesis.

Warren Buffett wrote in his latest shareholder letter published February 26, 2022, how important being comfortable with one's investments is to achieve long-term success. Below are his words from his latest letter:

"People who are comfortable with their investments will, on average, achieve better results than those who are motivated by ever-changing headlines, chatter, and promises."

Curt R. Stauffer

President & CIO

Seven Summits Capital

Disclosure:

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