Being Right When You Look Wrong is Hard….When Confirmation is Realized, Reward Follows

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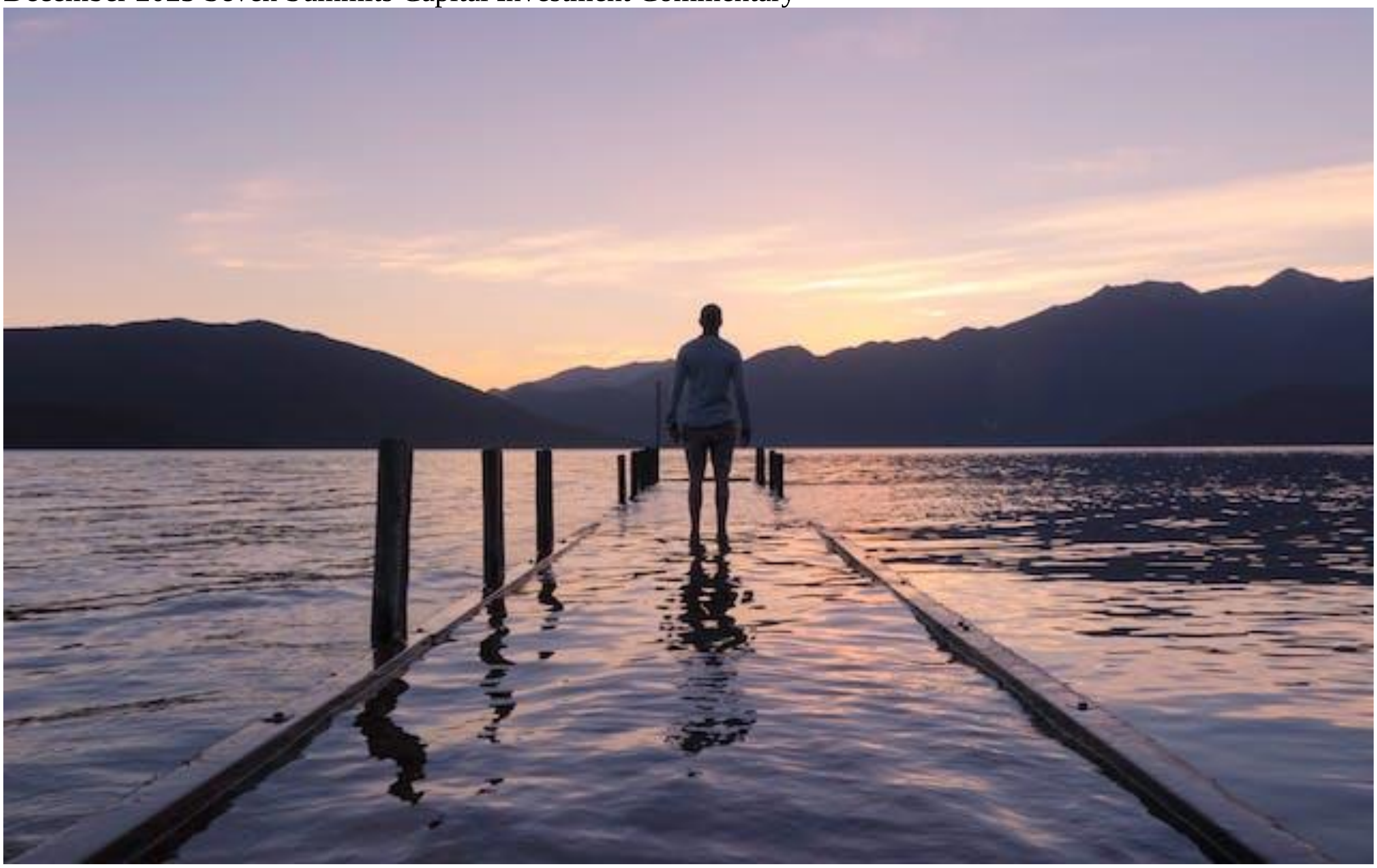


I wrote in our September 2022 Investment Commentary, “Both the stock and bond market look oversold at today’s levels from our view, and when this has happened in the past, markets can turn upward as quickly and violently as they turned down upon the first signs that the Federal Reserve is “thinking” about winding down its rate increases.” We now know that the 2022 Bear Market bottomed one month later.

As of the writing of this commentary, the S&P 500 is up over 25% since the cycle lows of October 2022. The stock and bond markets have risen significantly since the 10-year Treasury Yield October peak, which exceeded 5%. Investors finally began to price in Federal Reserve rate cuts as early as March 2024. My base case for the first cut is the early May Open Market Committee meeting.

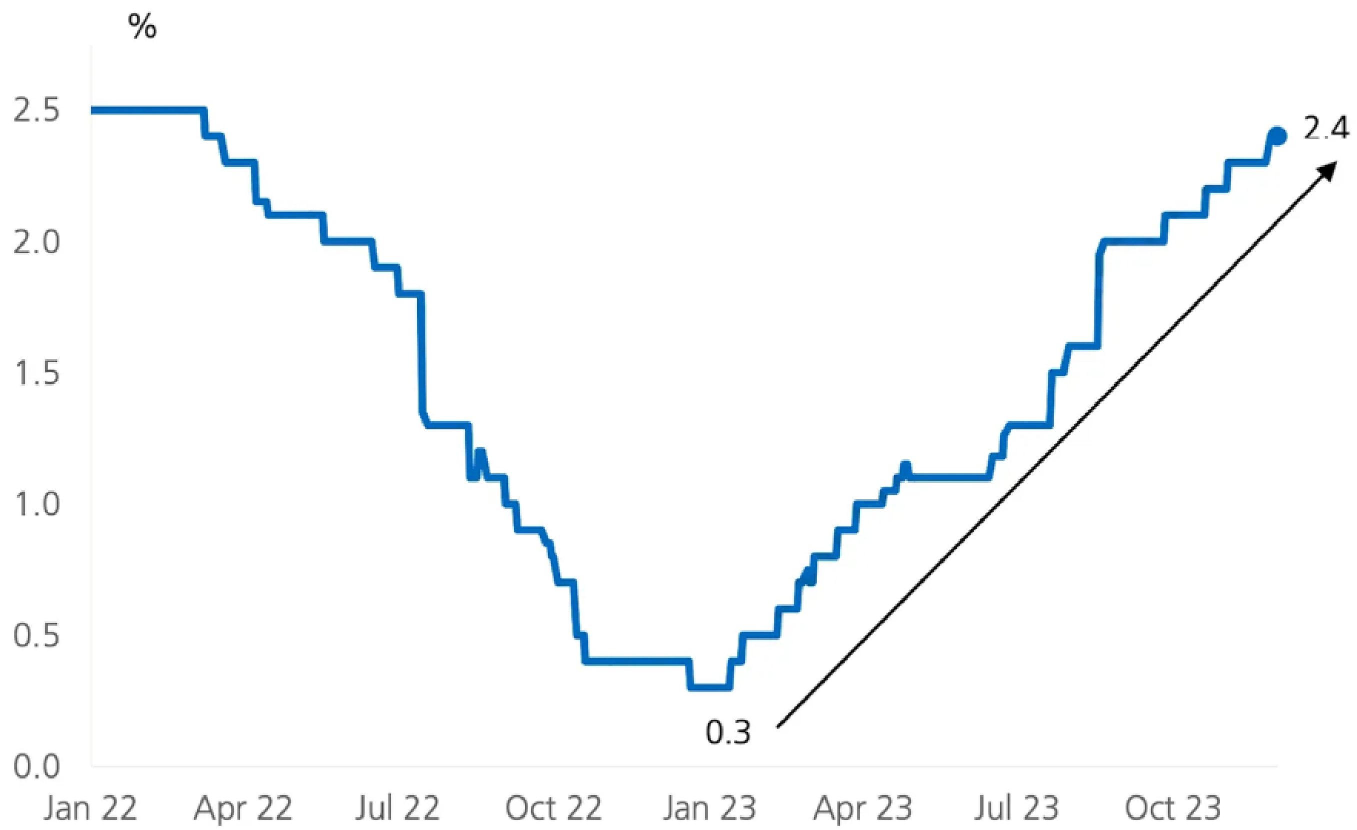
The chart above shows the growth of $10,000 in the S&P 500, the Russell 2000, and the iShares Moderate Growth Allocation ETF (AOR) since the S&P 500 bottomed on October 22, 2022. It is common for investors to hear reports on television about the performance of the major stock market indexes, such as the S&P 500, Nasdaq 100, and Dow Jones Industrial Average, and compare that performance with their investment accounts and portfolios. All indexes, allocations, and portfolios generate different performance experiences, especially over shorter periods. Portfolios actively managed by Seven Summits Capital will never intentionally resemble a broad market index. Over the last several years, our client portfolios have experienced volatility and returns, which would fall between the black (Russell 2000) and green lines (iShares Moderate Growth Allocation) shown in the chart above.

At the beginning of this year, in our January 2023 Investment Commentary, I wrote, "To look at the stock market's performance this year (2022) and conclude that we're headed for a sustained economic downturn would be a mistake." During many client conversations early this year, I reinforced this statement by stating that I thought the broad market indices could see a 15-20% advance in 2023. I also wrote and expressed my belief that the U.S. economy would continue to be more resilient than most people believed it could be given the extent of the Federal Reserve tightening of monetary policy, seemingly dour public sentiment, and technical indicators such as the inverted yield curve.

After the latest revisions to the third quarter real GDP growth rate, the Federal Reserve's latest forecasts for the full year have been raised to 2.50%. Most expert economists and market pundits have been in the "recession camp" until recently. The one exception has been Dr. Claudia Sahm, who has been more correct than any other high-profile economist, and she just published an article titled "Claudia Sahm: it is clear now who was right." You will likely see Dr. Sahm mentioned again in future commentaries. Her analysis of the post-pandemic economy has been both controversial, non-consensus, and very accurate.

As can be seen from the graph below of consensus GDP growth rates from the beginning of 2023, it has taken almost all year of those consensus low growth forecasts to catch up with my beginning of the year non-consensus statement that looking for economic weakness would be a mistake. As illustrated, it was only in the early fall of this year that the sub-1.50 % sluggish growth outlook finally collapsed after a third-quarter GDP growth announcement of greater than 5%. The consensus comprises economists employed by Universities, Wall Street banks, and brokerage companies that make up the economic punditry class competing for attention on any given day.

Figure 7: Forecasted Consensus 2023 Real GDP



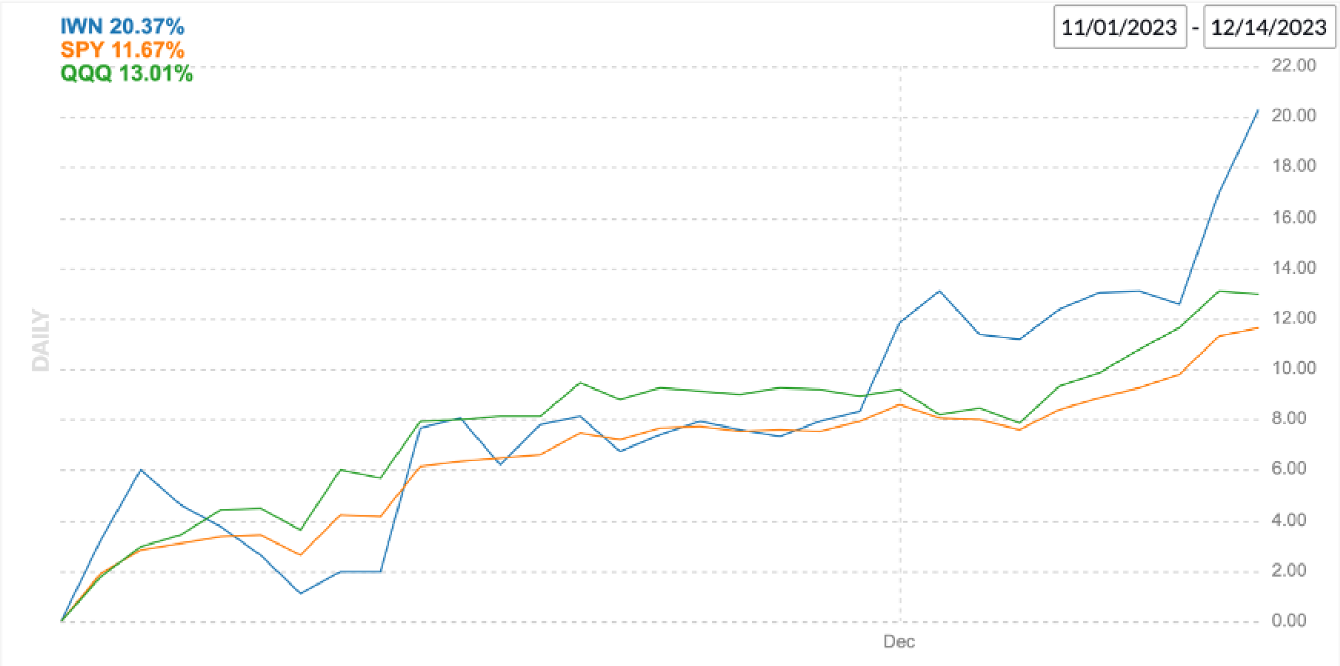
Source: BEA, Bloomberg, UBS

Most of the time, I view this punditry class with great skepticism. The advent of financial media outlets and social media has compromised the objectivity of many “financial experts.” Instead of focusing on rigor and unbiased judgment, they are motivated to create sound bites and present provocative views.

Just last month, I wrote, “Our base case remains that we avoid a meaningful recession in 2024, the initiation by the Federal Reserve of cuts to the Federal Funds Rate by May, and a meaningful outperformance over the next six to eight months of small and mid-cap equities versus the S&P 500.”

After the conclusion of the December 13th Federal Reserve meeting, which saw the central bank again refrain from raising interest rates, Chairman Powell admitted for the first time that the committee had begun to think about cutting rates. Reuters wrote, following, quoting the Chairman as saying, "We are seeing strong growth that ... appears to be moderating. We are seeing a labor market that is coming back into balance ... We're seeing inflation making real progress," Powell told reporters. "These are the things we've been wanting to see ... Declaring victory would be premature ... But of course, the question is 'when will it become appropriate to begin dialing back?”

Because I have not been forecasting a recession, I have been confident in the “soft landing” scenario of inflation coming down; I have stuck with and even increased exposure to small and mid-cap equities over the last year and a half. Since the beginning of November, through December 13th, the Russell 2000 (the most widely followed smaller company index) has risen 20.37%% compared to the S&P 500 at 11.67% and Nasdaq 100 at 13.01%. See these returns through December 14th in the graph below:



Monthly performance from Jan 23 **to** Dec 23

	Jan 23	Feb 23	Mar 23	Apr 23	May 23	Jun 23	Jul 23	Aug 23	Sep 23	Oct 23	Nov 23	Dec 23	Total
IWN	+9.66%	-2.28%	-7.79%	-2.53%	-1.82%	+7.37%	+7.41%	-4.77%	-5.88%	-6.01%	+9.08%	+11.13%	+11.37%
SPY	+6.29%	-2.51%	+3.31%	+1.60%	+0.46%	+6.09%	+3.27%	-1.63%	-5.08%	-2.17%	+9.13%	+3.42%	+23.42%
QQQ	+10.64%	-0.36%	+9.32%	+0.51%	+7.88%	+6.16%	+3.86%	-1.48%	-5.22%	-2.07%	+10.82%	+3.74%	+51.49%

The table above shows the monthly and cumulative price returns for the Russell 2000 (IWN), S&P 500 (SPY) and Nasdaq 100 (QQQ) since the beginning of 2023 through December 14th. One can see the great return disparity between the mega-cap technology-dominated QQQ, the SPY, and the laggard IWN exchange-traded funds. Even with the strong performance of the Russell 2000 over the last six weeks, we still see quite a lot of "catch-up" price-performance likely in 2024 from small and mid-cap stocks versus their larger-cap brethren.

The last two years have not been a lot of fun as an asset manager and advisor to individual investor clients. That's an understatement; the last two years have been the most challenging of my long career. This is saying a lot because that career takes in the "Dot.com bubble" bursting, the shock of the 9/11 terrorist attacks, the 2008-09 Financial Crisis, and the 2020 pandemic. What made the last two years so difficult? It was not the economy or markets themselves but the energy and fortitude I had to maintain to hold onto my well-researched and experience-driven actions.

I have been able to hold onto my convictions regarding factors such as economic growth, inflation, and interest rates because I have learned from experience that once investor sentiment turns bearish (pessimistic), the narrative (consensus) coalescences around the bearish trends, which leads to a form-fitting of almost all incoming data to all types of bearish scenarios. This is exactly what we have experienced over the last two years and why this period has been so challenging for professional and individual investors. Let's go down memory lane as I paraphrase many of the bearish narratives that I have heard and that have turned out to be 100% wrong:

- The Federal Reserve will need to crush the economy to temper high inflation.
- Inflation is sticky, and the Federal Reserve will need to raise rates higher than expected and keep them high until inflation returns to 2%.
- With short-term interest rates higher than long-term interest rates, the yield curve is inverted, which means we will fall into a recession.
- When the 10-year Treasury Bond yield rose significantly beginning in August 2023, the un-inversion of the yield curve is historically a sign of a recession.
- The Index of Leading Indicators has been negative for 20 and counting as of November, and that signifies that a recession is around the corner.
- Milton Friedman said, "Inflation is always and everywhere a monetary phenomenon, in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output." Therefore, the argument is that inflation cannot be brought down until budget deficits are reduced, and the Fed reduces its balance sheet.
- Fed Chair Jerome Powell wants to avoid making the mistake of the 1970s Fed Chairman Arthur Burns, who cut rates a couple of times when it looked like inflation was coming down, only to have inflation rise again. Therefore, Jerome Powell will keep interest rates higher for far longer than most expect.

I will conclude this commentary with a couple of quotes from the recently deceased Charlie Munger:

"If I can be optimistic when I'm nearly dead, surely the rest of you can handle a little inflation"

"If you're not willing to react with equanimity to a market price decline of 50% two or three times a century, you're not fit to be a common shareholder, and you deserve the mediocre result you're going to get."

I wish you all a healthy and happy holiday season, and I very much look forward to 2024.

- The Standard & Poor's 500, or simply the S&P 500, is a stock market index tracking the performance of 500 large companies listed on stock exchanges in the United States. It represents the stock market's performance by reporting the risks and returns of the biggest companies. Investors use it as the benchmark of the overall market, to which all other investments are compared.
- The NASDAQ Composite Index is a large market-cap-weighted index of more than 2,500 stocks, American depositary receipts (ADRs), and real estate investment trusts (REITs), among others. Along

with the Dow Jones Average and S&P 500, it is one of the three most-followed indices in US stock markets. The composition of the NASDAQ Composite is heavily weighted towards information technology companies.
- The Dow Jones Industrial Average (DJIA), also known as the Dow 30, is a stock market index that tracks 30 large, publicly-owned blue-chip companies trading on the New York Stock Exchange (NYSE) and the Nasdaq.
- The Russell 2000 index is an index measuring the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest US stocks. The Russell 2000 serves as a benchmark for small-cap stocks in the United States.
- The Russell 2500 Index measures the performance of the 2,500 smallest companies in the Russell 3000 Index, with a weighted average market capitalization of approximately $4.3 billion, median capitalization of $1.2 billion, and market capitalization of the largest company of $18.7 billion.