

Market Commentary Third Quarter 2022

It seems that inflation is settling in for an extended stay in the United States because the Federal Reserve lacks the tools to tackle factors driving inflation rates. Given current economic trends, at 7Summit we're focusing investment research on inflation-resistant assets, in addition to companies and countries that we expect to experience significant growth.

While you're aware of the pressure exerted by the war in Ukraine, this summer's massive drought and heat have added to pressures on the prices of energy and food. The scale of the drought is reminiscent of the 1540 megadrought that "saw vicars beg God for rain and soldiers guard water fountains."¹ In fact, 2022 may turn out to be "the driest year in the past 500," according to Andrea Toretì, a senior scientist at the European Commission's Joint Research Centre.²

The current drought and heat wave appear to be due to climate change, which is changing the behavior of the jet stream, the high-velocity air currents circling the Northern Hemisphere. A wavier jet stream can "make extreme weather events worse, sometimes causing storm systems or heat waves to move more slowly or get stuck in place," according to an article on ScientificAmerican.com.³ Certainly, we've seen evidence of this here in California, where record high temperatures in September strained the power grid almost to the breaking point.⁴ Heat and

drought are also affecting other U.S. states and Europe.

Obviously, heat and drought fuel the rising cost of food. Less obviously, an extended dry spell can affect energy supply because nuclear power plants depend on water for cooling. Water also plays a key role in natural gas extraction.

With regard to food and energy prices, the Federal Reserve can't directly offset the impact of weather—or supply chain issues due to the war in Ukraine. The Fed can only raise interest rates to depress demand. With U.S. employment remaining robust, inflation is likely to remain strong. Indeed, U.S. consumption of goods is ahead of its projected trend, in contrast to consumption of services.⁵ As a result, significant interest rate hikes are likely needed in order to push inflation down to the Fed's 2% target. On September 8, Federal Reserve chairman Jerome Powell said, "Restoring price stability will take some time and requires using our tools forcefully to bring demand and supply into better balance."⁶

Given the Fed's dual mandate to tame inflation and support employment, now might be a good time for the bank to consider raising its inflation target to protect employment, as suggested in 2016 by Nobel Prize-winning economist Joseph Stiglitz and *New York Times* columnist Paul Krugman.⁷ In a 2019 interview,

¹ <https://inews.co.uk/news/1540-megadrought-heatwave-beg-for-rain-1739942?ITO=msn>

² <https://www.politico.eu/article/hot-dry-aint-bad-1540-yet/>

³ <https://www.scientificamerican.com/article/storm-steering-jet-stream-could-shift-poleward-in-40-years/#:~:text=Some%20experts%20believe%20climate%20change,or%20get%20stuck%20in%20place>

⁴ <https://www.nytimes.com/2022/09/05/us/california-heat-wave-record-labor-day.html>

⁵ <https://lusk.usc.edu/events/geopolitics-monetary-policy-and-real-estate#transcript-expand>

⁶ <https://www.nytimes.com/2022/09/08/business/powell-federal-reserve-interest-rates.html?searchResultPosition=1>

⁷ <https://twitter.com/businessinsider/status/780875686231748608> |

incoming president of the Boston Federal Reserve bank, Susan Collins, showed openness to raising the Fed's inflation target, so there may be others in the Fed's leadership who would also consider such a move.

In the past quarter—partly due to markets' reactions to the Fed's interest rate policy—there have been times when price declines offered an opportunity to buy good companies cheaply and by using cash, to realize profits in energy investments or by reducing our risk hedges to fund new purchases at an attractive return. We have taken advantage of the current market by buying select U.S and emerging market debt and equities including commodity related shares. As billionaire David Rubenstein, author of *How to Invest*, says, "The best investors are buying ... when the prices are down, there's blood in the streets, and they have enough self-confidence to go ahead and buy when other people are telling them not to do so."⁸

Attractive pricing isn't our only consideration in asset purchases. Commodity related purchases reflect our confidence in assets that will do well despite inflation because their prices will rise with inflation. Our emerging market purchases reflect our interest in growth. While representing only 10% of stocks worldwide, emerging market stocks have the potential to grow rapidly, especially as relatively young populations increase their wealth and spending.⁹

We are also looking to participate in companies that will be

⁸ https://www.cnn.com/videos/business/2022/09/02/david-rubenstein-investing-advice-jg-orig.cnn-business?utm_term=video&utm_medium=social&utm_content=2022-09-05T13%3A10%3A07&utm_source=twCNN

⁹ <https://www.westernsouthern.com/touchstone/insights/us-vs-emerging-markets-equities>

tomorrow's leaders. For example, enterprises advancing the field of physics. In school, you probably learned that a falling apple inspired Isaac Newton's gravitational theory and the first great phase of physics. A couple of centuries later, Albert Einstein added a fifth dimension—time—to Newtonian physics, ushering in the nuclear age followed by technologies as mundane as GPS, among other advancements.¹⁰

Now, we're looking forward to a third great advance: the age of quantum physics. Quantum computing will be "vastly more potent than ordinary digital computers," as Michio Kaku says in *The Future of Humanity*.¹¹ For example, quantum computing will make our current tools' attempts at encryption virtually useless. We allocated to a company that looks to be positioned to advance in this arena.

With regard to more immediate business matters, I'm very pleased to announce that our firm registered of our separately managed accounts composite performance on The Nasdaq Fund Network. Our ticker symbols are [SVNSMX](#) and [SVNSTX](#). I'm truly grateful to all who have helped make this step forward possible.

As always, I thank you for the trust you have placed in me and in 7Summit Advisors. We work hard to earn that trust each day.

Sincerely yours,

Li Chang

¹⁰ https://en.wikipedia.org/wiki/Theory_of_relativity; <https://www.tennessean.com/story/opinion/2021/03/30/how-albert-einsteins-work-seen-todays-technology/7051814002/>

¹¹ Kaku, p. 135