CORDA

TOGETHER WE'RE INVESTED

Predictably Unpredictable

January 5, 2017

As we head into a New Year, we are prone to reflect on the past and it seems somewhat mandatory to drag out our crystal ball to help set a course for the upcoming year. Our customary optimism about owning high quality, cash flowing, and shareholder friendly businesses at the right price is a permanent feature to our investment plan, virtually set in stone. However, you can be assured we maintain a cautious mindset about how to deploy capital in an ever changing environment.

Our sense for 2017 is that we will have our hands full, as we grapple with a new president and the ramifications of changing interest rates, growth rates, fluctuating currencies, potential trade wars with China or Mexico, and last but not least, a head of state with a twitter feed that could literally move markets in the middle of the night! One could decide the world is fragile and fraught with risk and just too complicated, but we view the template with excitement and see opportunity and a decided advantage to succeed where many others may fail.

So what does a Donald Trump presidency mean for the capital markets? Without making any political judgements, our view is that this president-elect is less predictable than previous leaders. Trump and the Republican-controlled Congress may attempt to force broad changes, but it isn't exactly clear if he will have the moxie or if the Republicans in his own party will allow him to push through many of his campaign promises or not. Since the election, he has called for increased infrastructure spending, less regulation, and a dismantling of the Affordable Care Act. There has been tough talk on trade and many new free-trade deals seem less likely, but a hostile view and major disruption in trade would have adverse effects on the economy. On the flip side, an overhaul of the tax code could have tangible impacts on nearly all companies doing business inside the United States and domestic focused firms would see the greatest benefit. A tax cut could be less meaningful for multinationals with lower effective rates, though they could still benefit from repatriating large cash balances many of them maintain overseas.

Some of these anticipated changes may have been priced into the market already, so the caveat is to be careful as we move into 2017 and prepare for volatility as the market sways from one extreme to the other. But isn't that always the case?

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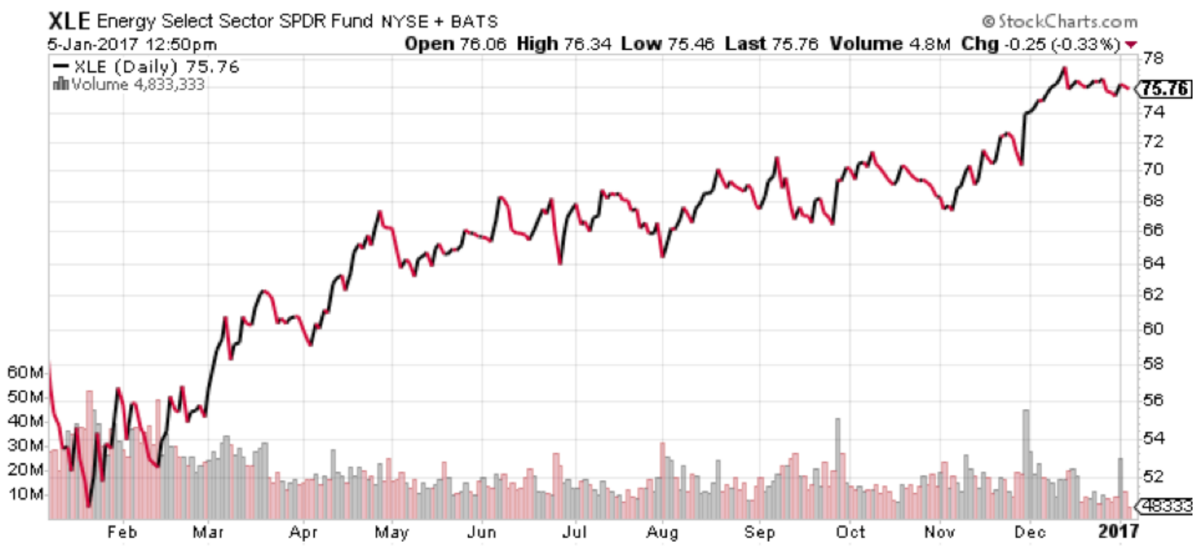
Preparing yourself for unpredictability should be standard operating procedure by now, but we have seen how investors let their emotions get the best of them and sometimes make regrettable decisions when the stakes are highest. For example, a year ago, as the price of crude oil sank below $30 per barrel, many investors were selling their energy and commodity related businesses in a bout of anxiety as they could not anticipate a recovery in those markets. Many bell-weather oil and gas firms were getting sold off hard in 2015 and into early 2016, but within days of crude hitting $27 barrel, the shares touched bottom and began a slow and steady ascent. We advised holding many of our commodity and energy related businesses at those levels as our contrarian nature dictated a recovery was more than likely. You can see the price action by looking at the Energy Select Sector SPDR fund (XLE) ETF, a behemoth in the industry with over $17B in assets (see chart below), as it recovered nicely in 2016.

There is certainly room to go with many of these businesses and we monitor our portfolio each day to see if they are on course or not. Fortunately, the benefit to a diversified portfolio with exposure to the financial, consumer, healthcare, and industrial sectors allows us to forge ahead even when there are parts temporarily lagging behind. We have a variety of businesses operating across many industry groups and by design, not all of them will be rising or falling in unison. As you know, many times the laggards propel the portfolio forward in future time periods.

One Year Time Frame:



One big change that has occurred since the election is the price action in the bond market. The decline in some of the longer dated maturities has been stunning. Our nation's 20-year Treasury note has declined by 10% since Monday 11/07/16 (i.e., the day before the presidential election). Many ten year maturity bond and bond funds that we track are off by 5% since the day before the election. Those holding fixed income for safety and yield may be in for a rude awakening at year end.

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There has been a massive amount of capital deployed and tied up in longer dated fixed income that is now under pressure and we have seen the early stages of a rotation out of the bond market and into equities. We have advocated (for years) staying in high quality short duration bonds and that view is still our recommended course moving forward. Higher interest rates can help in three ways; 1. It means the stress across the economy and in the capital markets of a disinflationary environment has diminished 2. The outlook for higher GDP growth rates is picking up and will directly translate to corporations and businesses with increased sales and net income should the economy pick up speed, and 3. Those with fixed income needs will achieve higher rates of the return on their capital in the future. So should you hear about higher interest rates or the Federal Reserve Bank raising rates in 2017, that does not directly correlate to a negative stock market outcome.

Harping on dividends, capital appreciation, and staying the course:

Our long term view is that the path to successfully grow your capital, whether the end result is to provide for your retirement, legacy, education, or peace of mind needs, is to seek the highest quality, financially strong, iconic and shareowner friendly businesses with the ability to increase their dividends over time. We believe our philosophy is a powerful prescription that should lead to excellent results. It is a view shared by other highly successful investors such as Warren Buffett, Seth Klarman, Ben Graham, Guy Spier, and Joel Greenblatt. We view it as the surest path towards success and our own capital is deployed right alongside yours in a commitment to participate wholly in your outcome.

The vagaries of the market will create periods of complacency when one should stand aside and watch and wait, while at other times, when fear is more palpable, one should be a buyer. We experienced both of those scenarios in the past year when some investors sold out when the market declined in January as well as just before the election in October and early November, while others were recently buying in earnest more than a month after the Trump rally had begun, chasing 52 week and all-time highs. There is a middle ground between the two extremes where we like to choose our skirmishes. The “buy low and sell high” strategy sounds simple to replicate, but few do it successfully over time. The Dalbar study, which we highlighted in last quarter’s update, proved empirically that many investors do the exact opposite. This behavior was on full display in 2016, and will without a doubt be re-enacted in future time periods. The market is not a rational being. Successful investors will use the manic depressive state of the markets to their advantage!

What does this mean? A newer investor or someone with large cash holdings waiting to invest should act prudently and judiciously at the moment. Holding some in reserve as the market hits new highs is our recommendation. There will be the inevitable correction, and when that occurs, it will be a better time to move aggressively with cash.

We have written time and time again about CORDA’s unique investing principles, and here is a run-down of them again for your review. We call it: **What is Necessary for Success.**

1. Price is the most important factor when assessing value
2. Try to determine what a company is worth
3. Book value is an important feature - attempting to forecast earnings is more difficult
4. Remember you do not own slips of paper, but shares of a business

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5. Have patience, the odds of picking the lowest point in any period are a million to one
6. Have the courage of your conviction; the crowd, public and media will try to shake your faith
7. Fully accept there is no certainty and you can be wrong, but search for blind spots
8. Have a philosophy and stick to it - the above is one way we have found successful
9. Try to buy closer to lows than highs
10. Don't be in a hurry to sell. Just because it has gone up 50% doesn't mean it should be sold.
11. Keep in mind the overall market PE, interest rates, optimism/pessimism, overall market levels
12. Assets change slowly, earnings can change rapidly at any time...so buy assets at a discount
13. Watch and learn from other successful investors
14. Fear and greed are the worst emotions....try to stay grounded. It's never as good as it appears and never as bad either
15. Be careful of leverage, in your own portfolio or that of the businesses you own

In closing, the key as we move into 2017 is to expect the unpredictable and to keep your laser-like focus on the rewards possible for you when you own high quality companies at the right price. The dividend and interest income will sustain you in the near term and the growth of your principal over time will likely help you achieve all of your hopes and dreams.

We thank you for your commitment to the value, contrarian, and growth and income strategy that we have put in place for you. Please let us know if anything has changed to your financial plan. Also, for those with large cash needs or are looking to make a home or second home purchase or any substantial withdrawal from your account for any reason, be sure to give us plenty of advance notice so we can ensure the capital is transferred in a timely fashion. Don't forget it takes three business days to create cash if we need to liquidate something and additional time to transfer money from point A to B. Also, for your safety, our custodians sometime require a copy of a driver's license or we need your verbal instructions to move money from one location to the next. In an age where cyber security is paramount, we hope you understand our unwillingness to act upon any email messages and our requirement is to verbally confirm instructions from you. This is all for your safety and our mega serious intent to protect your savings.

With that, our sincere wishes for a wonderful 2017 and no matter what happens, let's make it count!

All the best from the entire CORDA Team.

Bonner C. Barnes | John Schloegel | Brian Raupp | Dustin Slater