CORDA

TOGETHER WE'RE INVESTED

What's Your Number?

September 30, 2018

Are you prepared for the next downturn? As you may know, many significant market declines are associated with recessions. No one really knows when the next recession might occur and making economic predictions is fraught with danger (as discussed in the last quarterly update). Nonetheless, we would argue that the current expansion, closing in on ten years in length, would mean we are theoretically closer to the next recession simply based on the history of boom and bust cycles.

History tells us that every recession does not have to trigger a bear market, since we can calculate 14 recessions since 1929 and only 8 bear markets. A recession would be a likely cause of a bear market, but the ancillary conditions and effects to the economy could also be culprits. For instance, rising interest rates or an inverted yield curve could certainly lead to reduced economic activity and therefore, lead to a recession and potential market decline. So, what came first in that instance, rising interest rates or the recession? Changes in currency values, trade wars, oil and gas shortages, rampant inflation, unusual shocks such as terrorism or war…these could also be associated with a decline in economic activity.

Would you blame the bear market on interest rates (the Federal Reserve) or possibly an act of terrorism or other shock or crisis? It's a gray area. For our purposes, the time to prepare oneself is when things look and feel good, rather than after the fact when emotions are running high and prices have already declined. The key is to decide what kind of investor you are and how you plan to be successful with your savings and investments. Each investor is different, so our recommendations would vary depending upon your goals.

Why is that? The answer lies more with your appetite for risk, your ability to remain steady when experiencing temporary losses, and what your time horizon is for specific goals and objectives for your savings. As you know, we have the tools and resources to help you determine how to be invested. Please be sure to work with your Relationship Partner here at CORDA to ensure your portfolio is on the right path. We are eager to help you plan and prepare for any market turbulence.

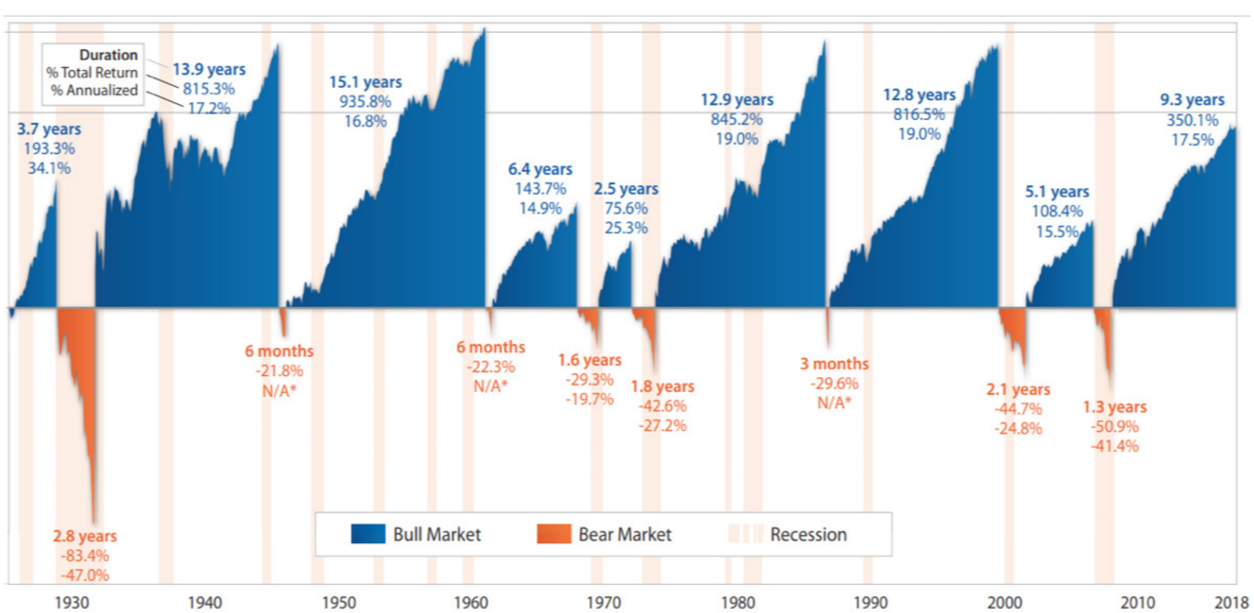
Let's consider the current economic environment, in which we have an expansion that is now at ten years in length and is the second longest in U.S. history. Based on history, it could be said that the expansion is approaching old age. We should all ask - how much longer can it last? Based on historical precedent, the chances for a recession in any given year are about 20%; over three years it is ~ 60%. Since the expansion is in year ten and is the second longest of all time, we'd assume the economy is generally more vulnerable than not.

The economic situation suggests we are later in the cycle with full employment and lack of pent up demand. Employers are finding it harder to add qualified workers, wages are increasing, and as the Fed raises interest rates to head off inflation and asset bubbles, we'd consider the term "vulnerable" to be a reasonable assessment. We've heard other economists use analogies such as the expansion being inning 7 out of a 9-inning game, or some calling it extra innings or over-time already! Another point to consider is that we have thrown a little extra fuel onto the economic expansion here in 2018 with substantial fiscal stimulus via tax cuts. When these effects fade, the economy will grow a little more slowly and slow growth with an exogenous shock or an overly aggressive Fed could still trigger a recession. If so, then you might expect a decline in the stock market.

While there is a good chance for both a market decline and a recession, investors must be realistic about the narrative and how to invest in such an environment. The last recession was dubbed the "Great Recession" since it was the biggest decline post WWII and the stock market went down by about 50%. Does that mean the magnitude for the next decline has to be as large? It is difficult for investors to shake off the lingering effects of two significant drops in the past 20 years when for some, it is still fresh in their memories. The internet bubble collapse in 2000 and the sell-off that started in 2007 were substantial, and that makes a host of investors generally uneasy to this day.

Outside of what happened in the 1930's and the crisis of a decade ago, most recessions are fairly mild. Therefore, we are inclined to think what might lay ahead will be generally not as dramatic as the Great Depression or the Great Recession time periods. Also, recall bear markets are short and expansionary periods are much longer, so in many cases, in the absence of trying to time the market, it might be best to stay invested. Outside of those two 50% type plunges in the averages, the typical stock market decline during a recession is just 24%. The typical length of a bear market is a mere 1.4 years.

Bull Markets, Bear Markets, and Recessions:



If the next bear market is serious yet manageable, investors need a prudent and judicious way to weather it. The question is how does one get the best risk adjusted returns before the onset of a bear market or recession, and subsequently, how does one prepare and invest when the bear market occurs? This is where you might want to know your overall risk profile and whether you should be allocating 100% of your capital to equities or if you should add some fixed income. Some of you have taken a short online survey that calculates the level of risk you are comfortable with, how much loss you can endure, or the type of gains you are seeking. It seeks to understand your proclivity for risk and return and/or for your desire to avoid losses. It calculates a “Risk Score” which helps determine how much of your portfolio should or should not be invested in equities. Traditionally, exposure to an asset class such as bonds would serve as a buffer to losses one might expect in a bear market. Holding bonds and cash would normally help investors lose less in a bear market. However, today one must be careful about the type and duration of fixed income because it could be argued bonds are as fully valued or even more excessively valued than equities at this time.

As you know, fundamentally we believe in the power of capitalism and would never bet against America or the stock market in general. Recall, over rolling ten-year periods in the stock market since 1926, 95% of returns are positive. No one really knows the path the economy will take over the next few years or if the fiscal policies will have lasting impacts and the expansion rolls along or even picks up speed, but it is clear the U.S. economy is benefitting from an increase in investment and growth due to more business-friendly initiatives.

For decades, the U.S. has subsidized the world via holding trade tariffs below those of most foreign countries as well as maintaining a higher corporate tax rate significantly greater than the rest of the world. The impact resulting from some of these changes will be huge, and it will force other countries that were previously able to have high tariffs on U.S. goods to come back to the negotiation table. Cutting the corporate tax rate to 21% and boosting tariffs on select countries and products is removing a huge subsidy to growth for the rest of the world. This means the U.S. economy and its stock market are in better shape than others. There is real momentum in the economy and it’s possible the expansion powers ahead and surprises most people. Also note that the Chinese stock market is down over 20% from its peak. Real change is happening in the global economy and capital markets, and it’s not all bad! For now, the U.S. is benefitting. It wouldn’t make sense whatsoever to decide about a business we owned based on some forecast about what the economy might or might not do.

CORDA’s investment philosophy is consistent. We believe the surest path to preserving and growing your wealth is through the ownership of sound businesses bought at compelling valuations with the potential to capture ever increasing dividends and cash flow along the way. Another way to summarize the CORDA philosophy is that we will succeed by investing with a long-term mind set, through a diversified portfolio of sound and stable businesses, with the goal to avoid permanent loss of capital. Our strategy will be ownership of profitable companies that distribute those profits through the form of dividends and have the capacity to increase those distributable cash flows over time.

Our guiding principles to decrease risk and to succeed over time can be summarized here:

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.
5. Have patience, the odds of picking the low 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 look 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 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.

By following these principles, we substantially reduce our risk level relative to the overall stock market averages.

With these guiding principles in mind, another way to seek opportunities is to reduce one's equity exposure to the most richly valued parts of the market and invest where valuations are lower. For example, overseas markets are dramatically less expensive than the U.S. and that could be one way to hedge your investments.

S&P 500 ETF (SPY) Relative to the Vanguard All World Excluding the United States ETF (VEU) past 10 Years:

In short, it is possible to build a balanced portfolio with the right type of bonds as well as the right type of stocks that would perform well in both good markets or bad. For those with more conservative risk profiles and seeking a portfolio containing non-equity investments, we would recommend a heavy dose of short duration high quality investment grade bonds for the fixed income allocation. As for equities, we would continue to adhere to our value and dividend approach and continue to include some international businesses as they are less expensive relative to their domestic counter parts. In our view, that would make for a formidable portfolio.

No matter how we might define a late stage economic expansion or aging bull market, investors should maintain flexible allocations. Your risk appetite is a starting point to determine what that allocation might look like. Again, the timing of these discussions could be good here as we head into Q4. Have you heard the phrases; "Make hay when the sun shines or fix the roof when the sun shines?" Given the healthy disposition of the economy and stock market right now, should investors actively prepare for the next storm or continue accumulating winning while the going is good? The answer, of course, is a little bit of both.

Finally, sometimes we forget to tell our clients about our 401k offering. Over the years we've had business owner clients and others who simply participate in their company sponsored plans tell us how lousy their plans are at work and ask if we offer an alternative. The answer is, Yes. We have leveraged relationships with TD Ameritrade and a firm called Retirement Horizons to help design and implement 401k plans for a handful of firms. What is unique is that we have built turn-key 401ks that have a wide breadth of investment choices and deep selection of exchange-traded-funds geared towards do-it-yourself investors at very low cost. In some cases, we are also able to deploy investment strategies so that participants in these 401k plans can choose one of the strategies that fit their objective, and we'll manage it on their behalf, again, at no extra cost.

The 401k we offer is the same as the one we have here at CORDA for our team. It's an exact replica and one we are proud to call our own! If you'd like more information about how CORDA is working with TD and Retirement Horizons to build, manage, and implement a 401k...from the ground up or an existing plan, please let your Relationship Partner know. We will be happy to get you more information and discuss your needs.

Thank you again for letting us be stewards of your capital.

The CORDA Team,

Bonner C. Barnes John Schloegel Brian Raupp Dustin Slater

From the Desk of Our Certified Financial Planners:

5 Interesting Nuggets About Insurance

1. During 2012-2016, fire and lightning was the number one home owners claim measured by dollars, but wind and hail was the most frequent claim.

2. The total cost of insurance fraud (non-health insurance) is estimated to be more than $40 billion per year. That means insurance fraud costs the average U.S. family between $400 and $700 per year in the form of increased premiums.

3. Your insurance company decides whether you qualify to receive LTC benefits. Not your doctor.

4. During your career, you are three and a half times more likely to be injured and need disability coverage than you are to die and need life insurance.

5. Though a few states ban the practice, in most cases your credit history affects what you pay for home insurance. The better the credit rating, the lower the premiums you are likely to pay.

The CORDA financial planning team can help answer your questions about life, personal property, disability and long-term care insurance.