What's Your Number Part II

June 28, 2019

Do you remember the last time we asked if you were prepared for the next downturn? Worrying about economic downturns or market corrections might sound unusual coming from your dedicated and downright committed long-term oriented business owner's, but we are always mindful to what might be lurking around every corner.

The mere fact that interest rates in the U.S. are trending down and the astounding amount of sovereign debt that earns negative rates of return ($10 trillion last we checked) would certainly be one indication that perhaps economies are faltering. Recessions can be a main culprit for a market decline but recall that every recession does not have to trigger a bear market, since we calculate 15 recessions since 1929 and only 11 bear markets.

Would you blame a bear market on interest rate volatility? Or moves or lack thereof by the Federal Reserve? On trade wars or the imposition of tariffs on incoming goods by the President? Terrorism? War? Maybe a large-scale cyber threat or the take down of our electric utility grid? It's hard to predict what might cause the next market shift, and more importantly, when it might occur! It could be after another 10% or 20% upward climb before it occurs. Say you give back 1/2 of the recent move, then you'd still be better off staying invested and banking the dividends. The point is not to try to time the market! *However, if you are prone to anxiety and panic and are unwilling to stay the course*, the time to prepare oneself is when things are good, rather than after the fact when emotions are 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, your time horizon, and the specific uses for your hard-earned savings. These are all unique features and quantifying that would be a useful exercise best undertaken when you (and the market) are calm and rational.

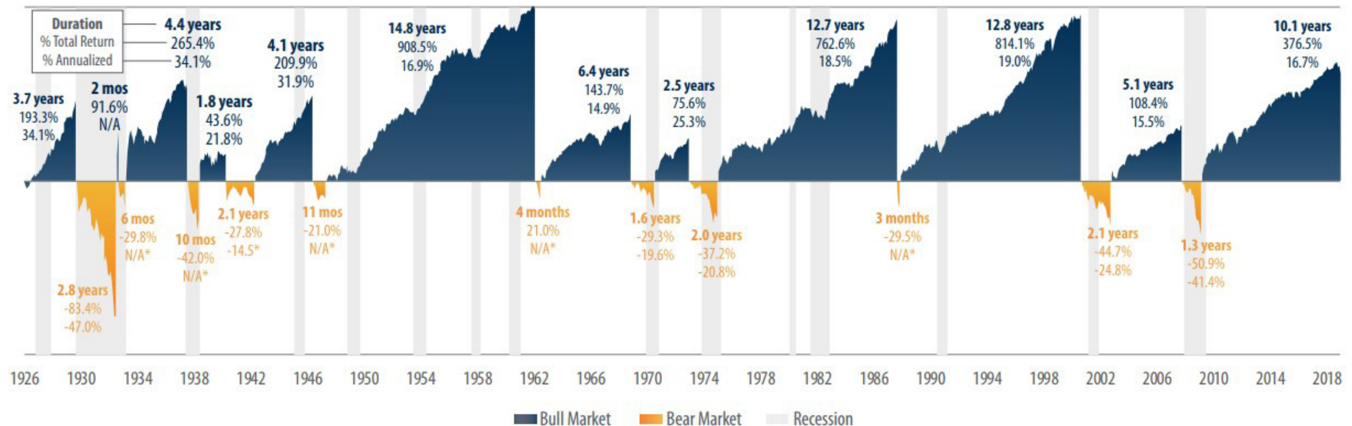
Side note: we have the tools and resources to help you determine how to be invested. You don't have to make these decisions in a vacuum or without counsel. Please be sure to work with your Relationship Partner here at Corda to ensure your portfolio is on the right path.

While the probability of a future recession has inched up, we must be careful about how to frame the narrative if one were to occur. Recall, 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 while 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 lies ahead will not be as dramatic as the Great Depression or the Great Recession time periods. In fact, recent market action and the Federal Reserve's latest signals about the fed funds rate could mean we avoid one altogether. 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 is generally best to stay invested. Outside of those two 50% type plunges in the averages, the typical stock market decline during a recession is 24%. The typical length of a bear market is 1.4 years. So that means your investments typically recover to pre-recession values quickly.

Bull Markets, Bear Markets, and Recessions

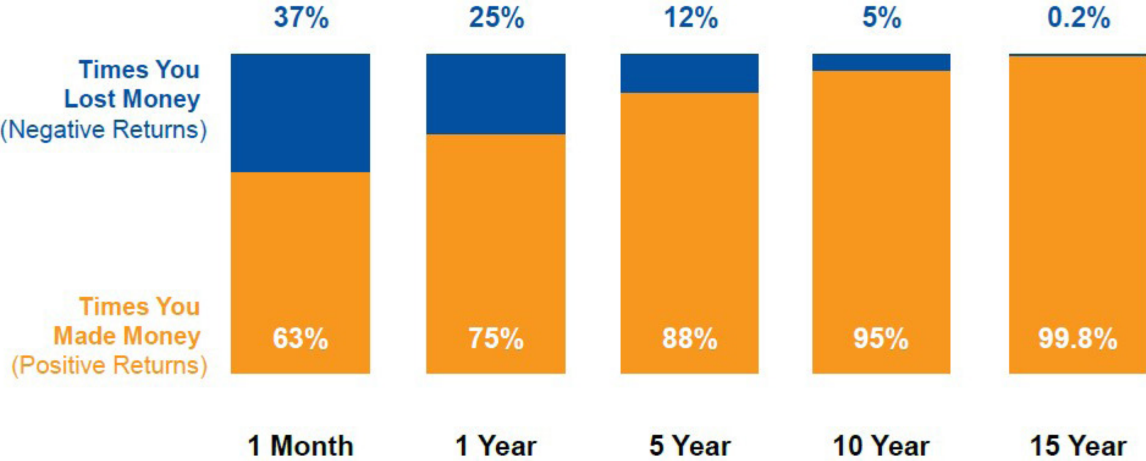


Source: First Trust

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. 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 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. Let us say this again, *fundamentally we believe in the power of capitalism and would never bet against America or the stock market in general*. Recall, over rolling fifteen-year periods in

the stock market since 1926, 99.8% of returns are positive. No one really knows the path the economy will take over the next few years or if the fiscal and monetary policies will be bullish or bearish. Yet for now, the economy is still growing and although odds of a recession seem to be higher, it's possible the economy continues to grow.



Source: BlackRock, Morningstar. Stocks are represented by the S&P 500.

As we mentioned last year, 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. The impact of change here has the potential to be significant. It may 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 last year and potentially boosting tariffs on select countries would remove a huge subsidy of growth for the rest of the world. This means the U.S. economy and its stock market are in better shape than others. Despite the proposed or actual monetary and fiscal changes that may or may not take place, we don't think it makes sense to justify a buy or sell decision based on a forecast about what the broad 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. Try to buy closer to lows than highs.
9. Don't be in a hurry to sell; just because it has gone up 50% doesn't mean it should be sold.
10. Keep in mind overall market PE, interest rates, optimism/pessimism, overall market levels.
11. Assets change slowly. Earnings can change rapidly at any time…so buy assets at a discount.
12. Watch and learn from other successful investors.
13. Fear and greed are the worst emotions…try to stay grounded. It's never as good as it appears and never as bad either.
14. Be careful of leverage, in your own portfolio or that of the businesses you own.
15. Have a philosophy and stick to it. The above is one way we have found successful.

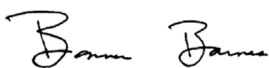
By following these principles, we substantially reduce our risk level relative to the overall stock market averages.

In short, dependent upon your risk profile, we believe it to be possible to build a balanced portfolio with the right type of stocks as well as the right type of bonds that would perform well in both good markets and bad. For those with more conservative risk profiles and seeking a portfolio containing non-equity instruments, we would recommend a fair amount 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 by buying high quality companies and to include some international businesses as they are less expensive relative to their domestic counterparts. In our view, that would make for a formidable portfolio.

No matter how some might call this environment a "late stage economic expansion" or "raging bull market," investors should maintain flexible allocations. Your risk appetite is a starting point to determine what that allocation might look like. Today is a good day to review your overall plan and allocation as we move into the second half of 2019 while the market is near all-time highs.

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

Sincerely,
The CORDA Team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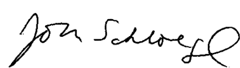
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From the Desk of Our Certified Financial Planners:

Don't' Forget Your Umbrella!

We live in a litigious society, and many people believe their home insurance covers them adequately. That can be a risky mindset. Several factors can put you at a higher risk of being sued, including:

- Owning vacant land
- Teen drivers in your household
- Owning a dog
- Owning a pool or trampoline
- Having parties
- Being on social media
- Owning a small RV
- Having tenants
- Having a home office with visiting clients

Umbrella insurance is coverage that goes above and beyond your basic homeowners and auto policies. If you're sued, and the judgement against you is above the basic amounts, the umbrella coverage kicks in.

Coverage starts at $1 million and goes up to $10 million. You may feel that is a lot, but in today's environment, do you want to risk losing the assets you have worked so hard for?

How much do you need? Your current property and casualty provider can help you decide. Umbrella coverage is relatively affordable, with a $1 million policy premium of around $200-$300 per year.

Life can throw us the unexpected storm. Having a good umbrella can go a long way to shield yourself.