CORDA

TOGETHER WE'RE INVESTED

A Value Buyer Recipe with Dividend Growth Sprinkled on Top

September 30, 2020

The secret to growing wealth was spelled out by the godfather of value investing, Benjamin Graham, over eighty years ago when he wrote, "The real money in investing will have to be made - as most of it has been in the past – not out of buying and selling, but out of owning and holding securities, receiving dividends and interest, and benefiting from their long-term increase in value." The challenge in this endeavor, as we all know, is managing our emotions and making sure we have the fortitude to not get discouraged in the short run and to maintain ownership in businesses that may be temporarily out of favor price wise. This is especially true today as the quick trading mentality exhibited in today's stock market and the denizens of the Robin Hood app have pushed up some share prices in high-flying stocks to unreasonable levels. All the while fundamentally sound and long-established businesses are being crowded out by the hyper kinetic fund flows to a handful of stock market darlings.

America's 30th President Calvin Coolidge once said, "Nothing in the world can take the place of persistence. Talent will not; nothing is more common than unsuccessful people with talent. Genius will not; unrewarded genius is almost a proverb. Education will not; the world is full of educated derelicts. Persistence and determination alone are omnipotent. The slogan 'press on' has solved and always will solve the problems of humanity." The challenges in 2020 could be taken directly from the Coolidge playbook as we continue to confront the pandemic with perseverance and patience. But so too is the art of investing discovered in that quote. People who engage the capital markets are most likely talented, smart, and well educated. Investors fail when they do not follow through on a plan or strategy, or let their temperament get the better of them and make irrational decisions, perhaps jumping from one idea to the next or even moving to cash on occasion – almost always at the wrong time.

Where might we be heading with this letter after leading off with the thoughts of such esteemed gentlemen? Our purpose today is to review our investment philosophy so we can ensure a level of success that you will have with your portfolio. There is a level of frothiness developing within parts of the market that are reminiscent of 1999 and 2000. Our recipe for successfully navigating the market might be a little different than what you are hearing, and we want you to be energized about the good returns we envision in the coming years.

We at CORDA are not in some sort of horse race with the stock market. Dividend growth investing and being a value buyer are not synonymous with owning an index. It's important to distinguish between being an offensive-minded/momentum-based trader versus the calculated and judicious long-term investor. In the late 1990's for example, the offensive investor out-performed the defensive minded one as many growth companies shot up in price much more rapidly than the "old economy" businesses that chugged along. Remember that?! Old economy versus new economy?! Sounds familiar in the context of what is happening today with the "stay at home stocks" versus everything else that may be tied back to normal economic conditions, or the "re-opening trade" as some call it. A few months after the wild blow off top that occurred in March 2000, the momentum strategy got creamed. For those of you who are sports minded – recall the famous quip: "Offense is for show, but defense wins championships!"

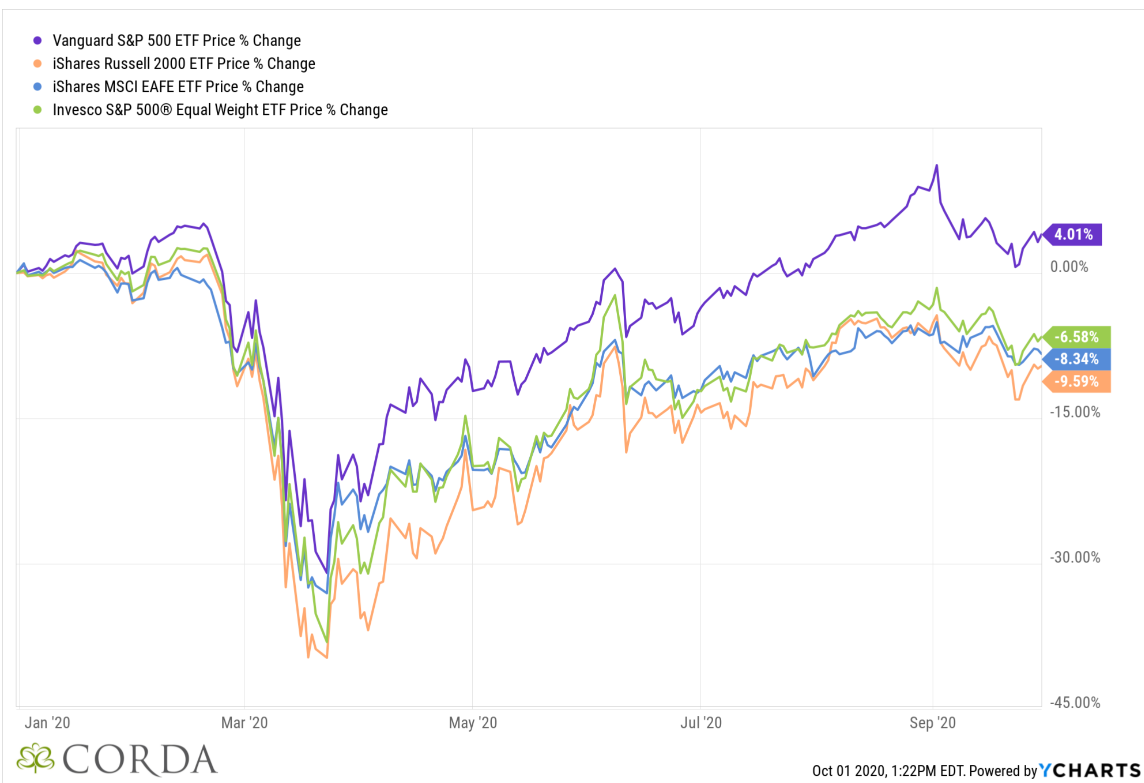
That reminds us of a fascinating comment we heard at an investment conference. Jeremy Grantham, Chief Investment Strategist of Grantham Mayo van Otterloo said, "TikTok is not the steam engine," referencing the dramatic difference with businesses that were created in the industrial revolution versus those today that are defined as social media companies. What exactly is the utility of TikTok anyway?! Keep in mind, most sustainable and predictably oriented businesses that share a portion of their profits via dividends are somewhat defensive in nature. We have always known, especially looking back in time to the internet bubble in 1999/2000, that dividend paying blue chip multinationals, many of which we own, could possibly underachieve in a melt up stock market environment. But we bought them then and still buy them today. Why? Because of the attractive yields, soundness of their business plans, predictable revenues and earnings, and strong balance sheets. We are seeking reasonable AND risk adjusted rates of return on what we believe to be your serious capital. Sure, one can speculate with a small portion of one's net worth, but we would not place hard earned savings that are central to retirement plans in harm's way.

For those of you who have attended or viewed one of our seminars online, you have heard us mention recently how the market is bifurcating in a unique way. For example, the top five businesses in the S&P 500 are now collectively bigger than the top five were back at the bubble peak in early 2000. Just a few weeks ago, Alphabet, Amazon, Apple, Facebook, and Microsoft comprised approximately 25% of the entire S&P 500 Index with a combined market cap of over $7T. That percentage has come down in the past few weeks but is still quite large! See the chart below.

This is a good moment to talk about the S&P 500 and benchmarks in general. As practitioners in the finance industry and passionate investors ourselves, we have frequent conversations about benchmarks and which, if any, is most appropriate! In short, we don't have specific benchmarks here at CORDA. We invest with a goal-based outcome and seek to fulfill retirement dreams or income needs across a wide spectrum of clients where some are extremely conservative and others more aggressive. Each one of us is trying to accomplish unique outcomes.

But, if one were to ask, what benchmark or index should we follow? Should we use a blend of indices since we're an "all cap, all world, value mixed with growth manager with a preference for dividend paying companies?" How critical is a benchmark comparison to the outcome you seek? Isn't it more important that we remain focused on your goals, and essentially not "keeping up with the Jones" mindset? We've thought a lot about it over the years and still don't have the perfect answer.

The following chart shows the year-to-date returns of several different indexes. The picture includes the S&P 500 (VOO), Russell 2000 (IWM), a foreign index (EFA), and an equal weighted S&P 500 (RSP). Why so many? Goes back to our earlier comment about which benchmark best represents the market and/or how we don't fish in just one pond. As you will see, the S&P 500 has done considerably better in part by being heavy in tech AND market cap weighted (the heavy hitters pulling the wagon) as outlined above. The other indices are a better reflection of the overall real economy and expected returns for most investors who own a diverse set of publicly traded stocks. It's fascinating how much the S&P 500 is being pushed by the five biggest components while the average stock has declined in 2020. Also, if anyone had told you last December 31st we would have a serious pandemic accompanied by shelter in place orders and GDP declining by 32% and interest rates near zero, could you have possibly imagined a stock market rebound despite all of the trauma?



That said, back to the CORDA strategy and why we have the conviction we do. Many times, high quality companies sell at a premium, so we typically pounce any time the dividend yield is attractive, and the valuation is compelling. If we purchase at a low entry point, our future gains can be substantial. We are typically expecting a business cycle that will rise and fall over time (expansion/recession) but we position ourselves for the long term. We talk so much about predictable income, owning dividend paying stalwarts and capturing those important cash flows that sometimes we fail to emphasize that our goal of finding attractive opportunities where significant capital gains can be achieved is equally important.

We have owned businesses with flat share prices – many with annually increasing dividend payouts – for 3-5 years, and then suddenly and without warning, the share price rips significantly higher. You need to be invested to catch these sudden changes or you will miss out. As an example, there is one company we own that raised its dividend in early February, coming off a record quarter and their best results ever – for a 120-year old company no less! Unfortunately, the pandemic hit a mere few weeks later and the share price has languished ever since. Now the good news, its dividend is well covered by profits and it allows us to continue to reap the income flow while we patiently wait for the economy to open and positive sentiment to return to that sector. What is compelling about this business is its past ten-year dividend history - and if the next ten years looks anything like the past ten, watch out. Those future payments will be the ballast that will force the share price higher. You must have conviction and patience, or your efforts will not be rewarded. We've been investors long enough to know the timing of share price gains is unknown.

Dividend growth investing is a long-term strategy that uses the power of compounding to outperform over the long term. The longer the time period, the more likely you are to be successful. Most investors know that investing in – as opposed to trading in and out of - equities is the best way to generate wealth. But many people cannot deal with the volatility, which is becoming more frequent and pronounced. The daily price swings feel like a rollercoaster ride. When the stock market dropped over 30% during those twenty or so days this past Feb/March, many investors couldn't stomach the decline and capitulated near market lows. The key differential is viewing your portfolio as fractional ownership in some of the world's best companies as opposed to a handful of green and black colored chips on the casino floor. Plainly, we own enduring businesses, some with histories that go back 100 years or more.

We are looking to own businesses that generate profits and create dependable cash flows without having to worry about income, timing the market, or even the volatility that comes with it. In fact, we use the volatility to our advantage when we have additional capital to deploy. To enjoy the gains, we embrace the fluctuations and accept them as a cost of doing business. Seth Klarman once said, "Risk is not inherent in an investment; it is always relative to the price paid. Uncertainty is not the same as risk. Indeed, when great uncertainty drives securities' prices to especially low levels, they often become less risky investments." Any meaningful goal we set often requires us to pay a price. Enduring the fluctuations of stock prices is the price we must pay to achieve the compounding effects of owning high-quality dividend paying businesses!

William J. Bernstein, a financial theorist and author, explains risk in two ways, "Shallow Risk" and "Deep Risk." Shallow risk is defined as a temporary drop in an asset's price. Shallow risk is as inevitable as the change in the temperature, the mood swings in your teenager, or how quickly your golf game can go from good to bad in a single round. You can't invest in anything other than cash without being exposed to shallow risk.

Deep risk is where you can suffer a loss of your capital and never recover. The four cases of deep risk are inflation, deflation, confiscation, and devastation. These forces can make you lose, and you may never recover. Sell a security when it's down significantly or when the market is in decline and you will suffer from deep risk. Ownership of high-quality dividend paying businesses with wide moats and substantial balance sheets comes with low risk of permanent impairment of capital. Price weakness in these companies should be viewed as shallow risk – temporary price declines that won't last forever. Certainly, you increase the number of holdings and diversify across twenty or thirty entities and the chance of permanent loss via any one business is dramatically mitigated. This is central to our thinking. A dividend growth investor should only be in high quality businesses for the long term. Safety and growth of dividends over time will lead to a successful result.

As for the current state of the real estate and banking sectors, the challenge now is to not to be fooled into suffering permanent losses by selling a beaten down sector. Be mindful of the quality of the business you own! Those with strong balance sheets, access to capital, and shareholder focused management teams will be the ones who thrive once the economy recovers. The capital market will not be so kind to leveraged firms and those unable to withstand a drawn-out recessionary period. We're clearly betting on an economic recovery over the next few years! We own what we believe to be strong businesses that not only sustain during this anxious time but will emerge with business plans intact and earnings growth resumed leading to higher share prices that will follow. The timing is always uncertain, but we feel there is great opportunity amongst these businesses today.

As always, we appreciate your fortitude thus far in 2020. It's been an extraordinary year! The markets will reward us in due time, and we are invested right alongside you and plan to reap those gains in the years ahead!

Sincerely,
The CORDA Portfolio Team

Bonner C. Barnes   John Schloegel   Brian Raupp   Dustin Slater