CORDA

TOGETHER WE'RE INVESTED

Success is Where Preparation Meets Opportunity

June 30, 2021

The title to our quarterly letter this month can be attributed to either Seneca, Zig Ziglar, or the head coach of Duke's basketball team – Mike Krzyzewski, all depends on where you have heard it or the result of a Google search. Either way, we are trying to grab your attention right out of the gate and keep it for the next five minutes!

Why? Well, let's just say we continue to hear from our clients and others about concerns for the market and some seeking to time selling near the highs, questions about taking profits and moving to the sidelines, caution about higher interest rates and inflation, and a general fear of what might come next. Ironically, what we don't hear much is general optimism, bullishness, and a desire to get fully invested or fear of missing out! For the contrarian in us, these are all generally positive signs for the market. It means there is still cash on the sidelines waiting to be deployed. Think about it like this: If the average investor is cautious, questioning the level of the market, not fully invested or in fact a seller in general… that means there is ballast for additional buying to take place once that caution turns to optimism. Also, as we have shared in the recent past, the level of cash (M2) is at record highs, up 30% from when the pandemic started. Money market accounts hold trillions in cash deposits, and we have suggested most of that cash is either going to get re-cycled into purchases of goods and services (economic growth) or invested into the capital markets.

In our effort to prepare you mentally for what comes next, let's review our action plan for how to handle the next correction. This way, once it hits, you will know exactly how to navigate it and how Corda plans to execute in that environment. We are reminded of the quote from the Saturday morning "Intelligent Investor" column in the Wall Street Journal attributed to Jason Zweig; **"What every investor always needs to remember is that your results depend far less on how the market behaves than they do on how you behave."** We'll keep hitting on this topic in the paragraphs ahead!

First, there is this:

That was taken straight from our social media account. Think back to the 4th quarter of 2018, the S&P 500 declined about 20% that quarter. This was what some have coined - “a taper tantrum,” referring to the collective reactionary panic that triggered a spike in U.S. Treasury yields, after investors learned that the Federal Reserve was slowly putting the brakes on its quantitative easing program. This was one of many drops we’ve had over the past ten years. Will there be more in the months and years ahead? When the market drops 20%, it’s an uneasy time, right?! And of course, March of last year, when the world, in general, unraveled and markets were down 35-40% in a matter of weeks, that was just a little unsettling, yes?! For those of you who have been investors for over 30 years, you can recall Black Monday, Oct 19, 1987, when the Dow dropped over 20% in a single day. More recently there was the dot.com crash in 2000 and the financial crisis in 2008, all major declines in the stock market. How did you handle those turbulent times?

If you sold at any point in time during any previous correction or bear market, you would have missed the subsequent rise along with the dividend increases that most of your shareholdings passed on to you. And, if you did sell at any point, the decision process from timing your sell to then timing when to “buy back in,” probably added even more complexity and anxiety to a very difficult decision tree!

Markets move too quickly. I bet you didn’t know that some of the markets’ largest one day gains happen within a day or two of their biggest declines. We do not know of any investor who has been able to time markets successfully. The most successful investors are long term business owners, shareholders, and what could even be described as stakeholders. That’s what we are. We do not trade slips of paper but consider ourselves fractional owners of many great businesses. You cannot find many “traders” on any of the so-called “world’s wealthiest” lists. Usually, any timer who attempts to sell and gets it right in the short run is so entrenched on their prototypical gloomy forecast that they will miss most of any subsequent recovery. This pattern has played out time and time again. If you think “this time is different,” remember those are very dangerous words to utter!

Volatility is normal, recall, market declines average about -14.5% every year. So, for investors who tend to think a “stop loss” strategy is fail-safe, we’d suggest it isn’t. The moment you sell down 10% or 15%, you may be selling right near the low. We advise strongly against using some sort of stop loss strategy.

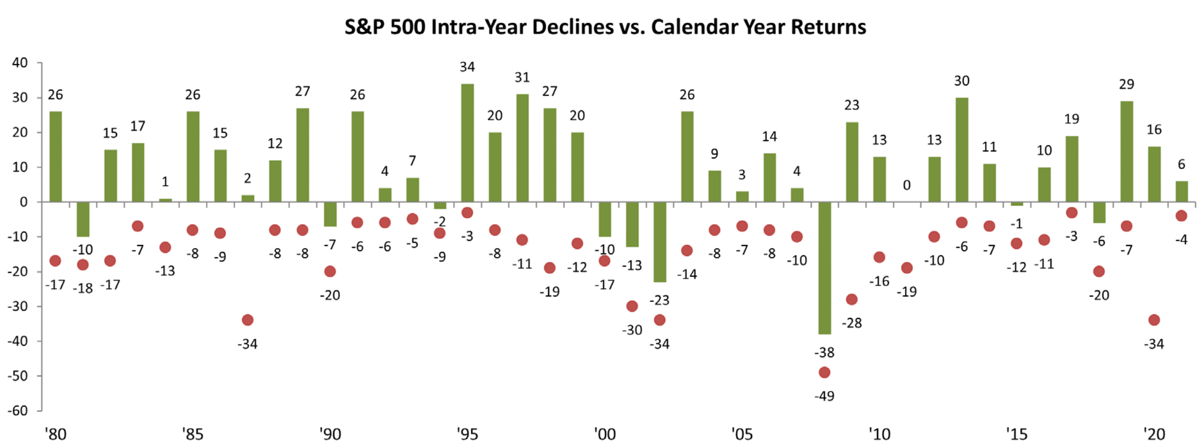
The best example of care, prudence, and conviction regarding your ownership in shares of great American and overseas businesses: The “Flash Crash” of May 6, 2010. The Dow tumbled 1000 points in minutes that afternoon. Take what happened to Procter & Gamble (PG) on that day. Shares were trading between $61-$63 most of that day, but around 2:30pm the market suddenly plunged and shares of PG, minutes after being quoted in the low $60’s, plummeted to $40, erasing billions off its market cap in seconds! The shares bounced right back that day to close above $60, but many investors with sell stops and those who placed sell orders around that time got taken to the woodshed! That day the headlines were “European debt worries.” Does any of this sound familiar?! Then SEC Chairwoman Mary Shapiro called the swings in share prices that day “unacceptable” and announced an investigation (which didn’t reveal much), but some stock exchanges did cancel some trades, but many stocks even as big as P&G, a member of the Dow Jones Industrial Average, were left out of the mix!

Our crystal ball tells us little about when and where and why the next correction will hit. We can surmise of course, like the rest of the investing public, and surely you will get 19 opinions from the Corda crew! Seems most these days are fixated on inflation and higher interest rates. We’d ask, if that was the case, why are interest rates subdued? The ten-year Treasury bond is below 1.5%. Pre-pandemic, that yield was over 3%. We are below where the bond may yield in the future if inflation hawks are right, and even a doubling would only get us back to where we were a few years ago. But why so much fear about higher interest rates? Frankly, we'd welcome something more normal than rates near zero!

To attain those good long-term returns, we must also accept periods of low, little, or negative returns. Again, Q4 of 2018 was less than three years ago. That was a 20% doozey!

Considering a range of future possibilities is an endeavor we consider essential. Volatility over the past 15 months has been a harsh reminder that stocks tend to go up in escalators and down in elevators. Selloffs are emotionally taxing because investors tend to amplify loss aversion and other powerful emotional responses. As declines worsen, many investors simply throw in the towel because they can no longer take the pain. And that is where the decision tree gets even more complex – how in the world are you to time when to sell, then exactly when to buy back in? Fractional ownership of shares, especially ones which pay good and solid dividends, should be treated like ownership of your home, or other real estate investments. Generally, we don't seek to value our home on a daily or hourly basis, so wise investors should not review the tick-by-tick change in the value of their businesses every day. Did you know that Corda does not have a single TV tuned to Bloomberg news or CNBC at its office?

Here's the chart that explains why panic selling is almost always a bad idea. Green bars represent the annual price return of the S&P 500 each year since 1980. Maroon dots below highlight the largest drawdown (peak-to-trough decline) each year.



For example, in 1987, the S&P 500 ended up 2% despite dropping a whopping 34% at one point during the year. In 2009, the market dropped 28% at one point but ended up 23%. Last year was a wild one with a large drawdown and a significantly large recovery!

Here's what's worth noting:

- Drawdowns happen annually. This data set is over four decades long, and they occur every single year.
- Since 1980, the average intra-year decline is ~ 14.5%
- Drawdowns are common, but the market ends higher in 78% of the years.
- Over half of the years when drawdowns exceeded 15% or more the market still delivered a positive return.

What does this all mean? Most drawdowns were short-lived. The next time you question your age or investing time horizon, understand drawdowns and big nasty bear markets come and go relatively quickly. Investors who kept cool and resisted the urge to sell were rewarded. This may not always be the case and future surprises and market corrections will always all be unpredictable, but if you keep a margin of safety with your purchase prices, you are afforded the ability to withstand the occasional corrections more readily than someone buying at 52-week or all-time highs.

Again, there are periods of HIGH returns, LOW returns, NO returns, and NEGATIVE returns....

We NEED to go through ALL of these to achieve long term returns!

Permanent Losses versus Temporary Losses; A Primer

We've grown accustomed to a rising stock market since last spring; we may have forgotten that volatility should be treated as a friend and not a foe. Permanent losses can occur two ways. First, a company can go bankrupt. Maybe it's malfeasance and something as dramatic as the Enron collapse in 2001. Things can change suddenly and without warning which could lead to a dreadful loss of capital or complete bankruptcy filing when you own a business. The second more dangerous form of permanent loss with severe damage to your asset base can occur when viewing a paper loss, succumbing to the emotional pressures, and selling at the depths of the market. You can avoid the first scenario by being diversified across many businesses - if malfeasance, fraud, or other corporate tragedy happens to strike from out of nowhere. Owning a diversified portfolio can minimize the sudden impact of that something "out of the blue" scenario. However, fear and greed will always manifest itself in the stock market, and if you let your emotions get the better of you, selling a security just because the price is down will surely negate any possible chance for success.

In investing, stocks can go up many times the value of your initial investment and cover a handful of 20-30% losing stock holdings. Allowing the math of common stock investing to be your ally is good permanent loss prevention.

Since we are always looking for clues to be successful investors, we are reminded of the impressive performance of Peter Lynch's Fidelity Magellan Fund during his tenure. From 1977 – 1990, the famous fund manager guided the Magellan fund to 29% average annual returns. Despite such an outstanding rate of return, according to a study of its shareholders over that time, Fidelity found that the average investor in the fund lost money! During periods of poor performance, investors would run for the doors (sell low) and return after periods of good performance (buy high). This behavior plays itself out in the capital markets time and time again. It's a good lesson for all of us. Being diversified negates the potential for permanent losses and managing our emotions per Jason Zweig will allow us to avoid temporary ones.

Prepare for: Dividends, capital appreciation, and staying the course:

Whether your goal is to provide for retirement, legacy, education, or peace of mind, Corda's long-term philosophy is to successfully grow your capital by owning the highest quality, financially strong, durable, and shareowner friendly businesses with the financial discipline to increase their dividends over time. We believe our philosophy is a powerful prescription that should lead to good results. 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.

In closing, the key as we move into the second half of '21, 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 financial security.

We appreciate your confidence in the entire Corda team, and we are grateful to have accomplished so much in the past few years and are dead set on keeping you on track to meet your goals.

All the best from the entire Corda Team.

Bonner C. Barnes   John Schloegel   Brian Raupp   Dustin Slater