CORDA

TOGETHER WE'RE INVESTED

Uncertainty = Opportunity

December 30, 2022

Market volatility dominated the headlines in 2022 as inflation exceeded market and Fed expectations. The record fiscal stimulus following the Covid outbreak and the Federal Reserve's excessive easy monetary policy resulted in inflation stubbornly persisting well above historical levels. Although there are signs that inflation is rolling over, the Fed seems hellbent to continue its tightening campaign as we enter 2023. This is, ironically, the opposite of its approach 18 months ago when it was clear inflation was ramping up. All the while, the Fed continued with its zero-interest rate policy despite the evidence surrounding it. As we have shared many times in the past; those who attempt to predict short term stock market returns or interest rate levels would be acting just like the Fed, *their crystal ball is no better than anybody else's*.

Since interest rate changes affect the economy 6 or 12 months out, the tightening path in 2022 creates risk of future adverse events. However, while everyone is on guard, the market has been discounting the widely publicized recession that we may already be experiencing or that which will occur in the near future. That is why the Nasdaq is down 33% for the year and the S&P 500 about 20%. Also, as interest rates have risen at the fastest pace in history, you have seen recent stock market darlings such as Tesla come cratering down to earth as growth investors find out that valuation does matter, and that high PE stocks can revert to the mean. As you know, we are long term, bottom-up investors, assessing company fundamentals and looking to own businesses for 3-5 years or longer, and our view about the year ahead is a battle of two narratives. Interest rates and inflation on one hand versus GDP growth, margins, and earnings on the other. Returns will be determined by how investors' outlooks change (versus what is currently priced in or expected) and what is perceived for each business not only in 2023 but beyond.

Given the high level of uncertainty in the marketplace, it is not surprising to see consumer confidence and investor sentiment near all-time lows, with investors increasing cash holdings to levels not seen since April 2020. Why is this important? History has shown that higher levels of marketplace uncertainty create significant dislocations which provide attractive opportunities for the patient investor who is able to take a longer view. In the pages that follow, we will show you that although investors are conditioned to flight, and not fight, we will urge you to remain disciplined in a thoughtful way so that your investment returns provide the results that you seek. Investor behavior is so bizarre – ask yourself, why are people more comfortable buying near market highs than during selloffs? We know the *"buy low, sell high"* mantra, but doing so is agonizing! Ask yourself why investors chased stocks in 1999 and early 2000, in what has been described as the internet bubble, only to hold many low-quality names into precipitous declines which occurred afterwards. Again, in the 2008/2009 great recession, many investors liquidated their shareholdings when they were low, only to later buy back after the shares had recovered. We witnessed the same behavior in 2020 with the pandemic induced sell off and the subsequent recovery. All past declines, when viewed on paper, appear to be opportunities, but our minds tell us that future declines are always risky. Why do we feel that way? We speak to investors every single day and most conversations are not about taking advantage of low prices, but about staying the course and turning off the tv (noise) when the media prioritizes danger, hype, and a need for safety all the while most persons should be scanning for opportunities.

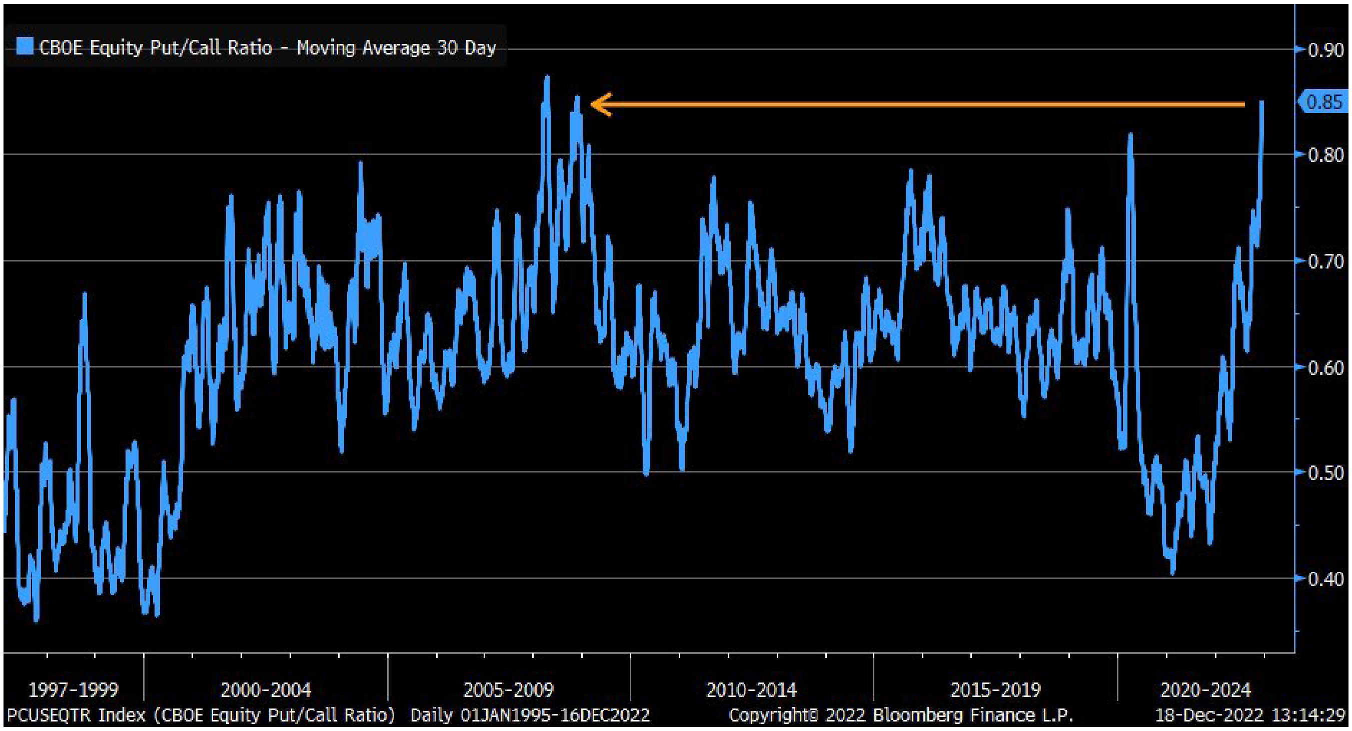
Here's where the rubber meets the road. Investors must endure bear markets, recessions, and drawdowns. Our guest speaker and esteemed author, Morgan Housel, early in 2022 during one of our "speaker series" presentations, shared with us that to achieve those very solid long term stock market returns – the "cost of admission" is handling drawdowns. His words, not ours!

The following chart will show that since 1939, the S&P 500 has experienced 12 drawdowns of 25% or more. From this starting point, there is no historical precedent for losing money over 3, 5, or 10 years. The market notched average annualized gains of 13-14%. Over a one-year period, the market declined only once, during the financial crisis, and even during that extreme period, the 1-year loss was only 7%. On average, your return was over 20% in the year following a 25% drawdown.

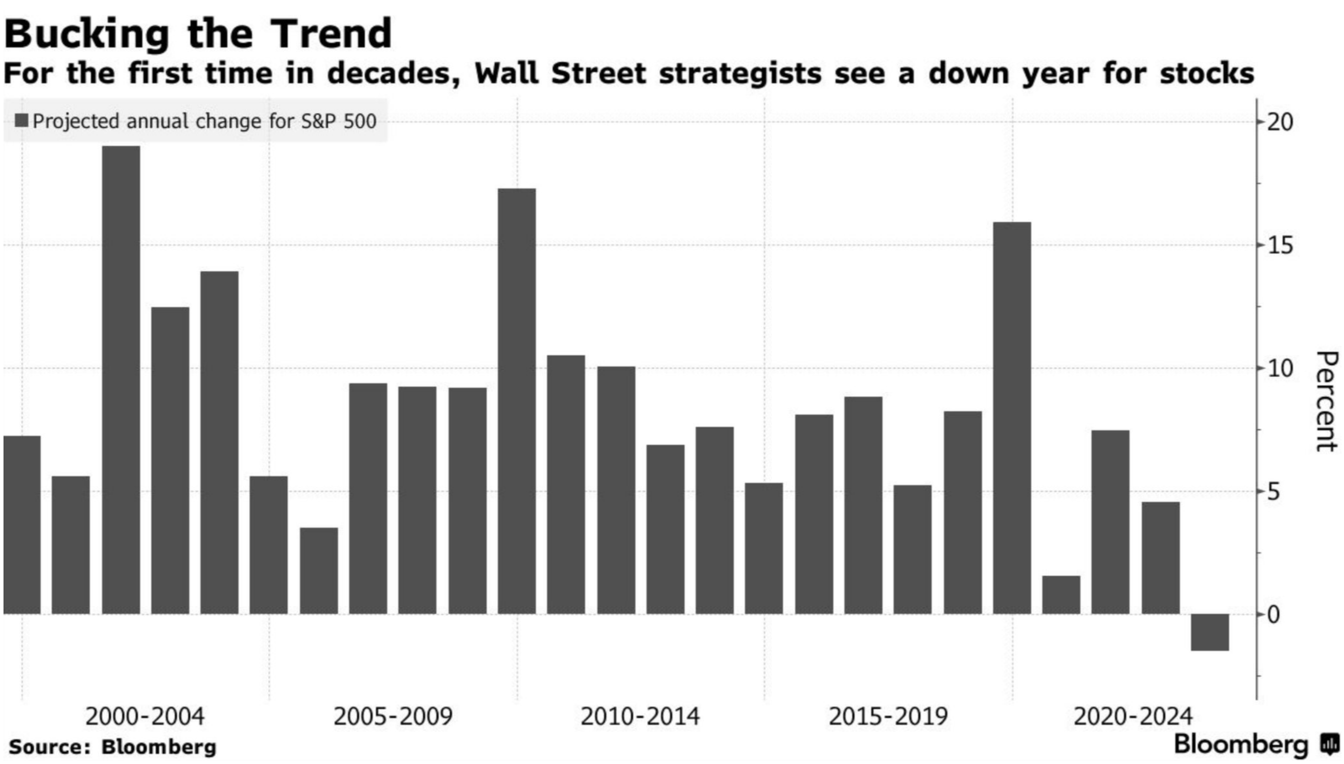
Peak	Trough	Peak-to-Trough Return	Recession	Additional Decline After -25% Drawdown to Trough	Months Until Trough After -25% Drawdown	Forward P/E at -25% Drawdown	Forward Returns after -25% Drawdown			
							1 Year	3 Year	5 Year	10 Year
10/25/1939	6/10/1940	-32%	No Recession	-9%	1 Months	9.2x	3%	14%	15%	13%
11/7/1940	4/28/1942	-34%	No Recession	-13%	4 Months	9.0x	22%	23%	18%	18%
5/29/1946	5/19/1947	-28%	No Recession	-5%	8 Months	10.0x	11%	8%	19%	20%
12/12/1961	6/26/1962	-28%	No Recession	-4%	0 Months	14.6x	34%	19%	15%	11%
11/29/1968	5/26/1970	-36%	Recession	-15%	1 Months	15.4x	34%	13%	5%	7%
1/11/1973	10/3/1974	-48%	Recession	-31%	5 Months	10.6x	1%	7%	7%	11%
11/28/1980	8/12/1982	-27%	Recession	-3%	0 Months	7.9x	61%	28%	30%	19%
8/25/1987	12/4/1987	-34%	No Recession	-11%	2 Months	9.5x	14%	11%	14%	18%
3/24/2000	10/9/2002	-49%	Recession	-32%	19 Months	46.3x	2%	1%	4%	3%
10/9/2007	3/9/2009	-57%	Recession	-43%	6 Months	92.2x	-7%	3%	10%	12%
2/19/2020	3/23/2020	-34%	Recession	-12%	0 Months	26.4x	58%			
1/3/2022	9/30/2022	-25%		0%	0 Months	15.3x				
All Time Periods	Average	-37%		-16%	4 Months	22.8x	21%	13%	14%	13%
	Median	-34%		-12%	2 Months	10.6x	14%	12%	15%	13%
Recession	Average	-42%		-23%	5 Months	33.1x	25%	10%	11%	10%
	Median	-42%		-23%	3 Months	20.9x	18%	7%	7%	11%
Not Recession	Average	-31%		-8%	3 Months	10.5x	17%	15%	16%	16%
	Median	-32%		-9%	2 Months	9.5x	14%	14%	15%	18%
% Recessions (excluding 2022)	55%									

Source: Miller Opportunity Equity

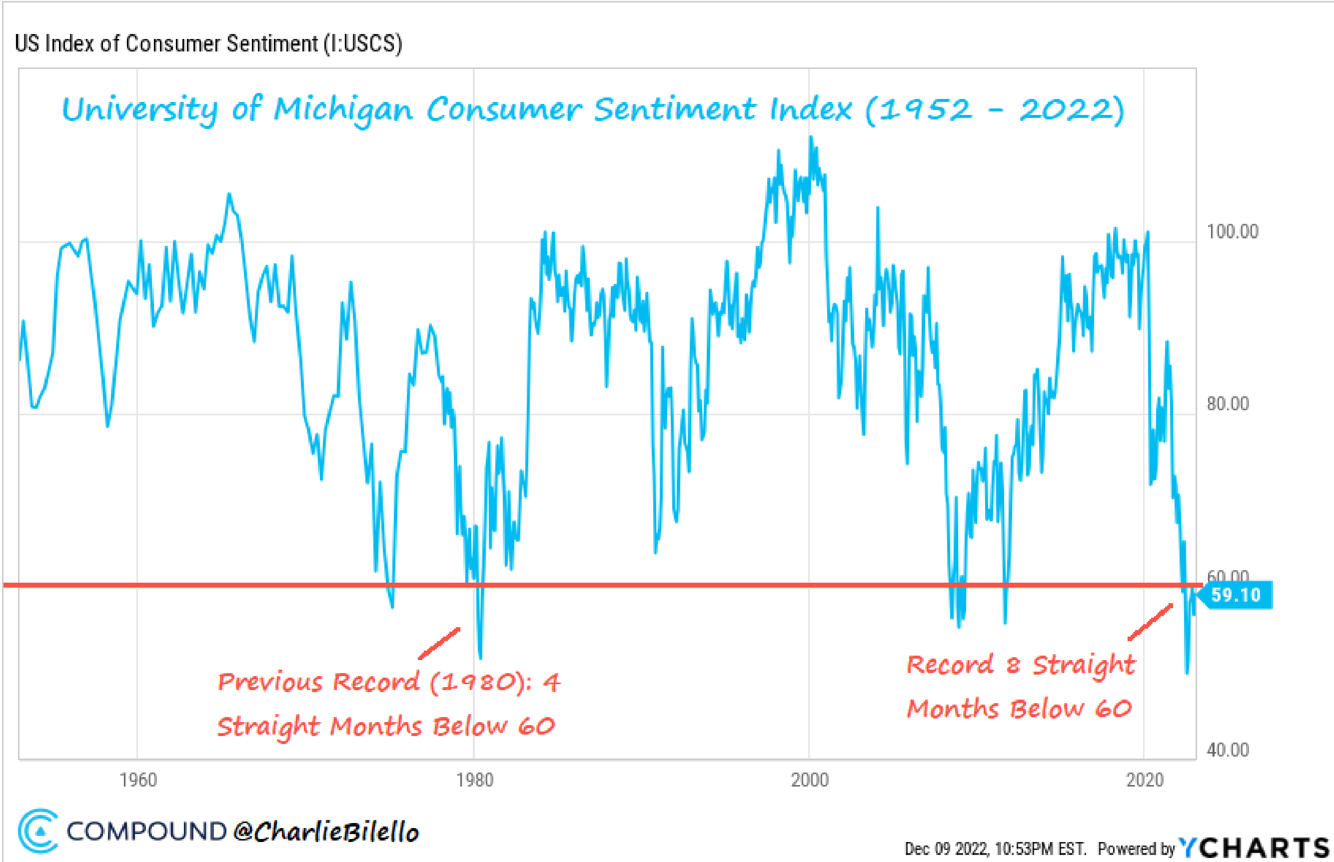
The best returns come from doing something different from others. Here are some examples. Right now, the crowd is highly caffeinated with the biggest exposure to put options since the financial crisis. Again, this is a contrary indicator that has a good track record of being wrong.



In the Behind the Scenes email we sent last week, we showed how Wall Street professional forecasts a year ago were off about the direction of the stock market, all significantly higher than where the market finished. So, what raises eyebrows here as we enter 2023 is the forecast has completely flipped, now the consensus is for lower returns in 2023.

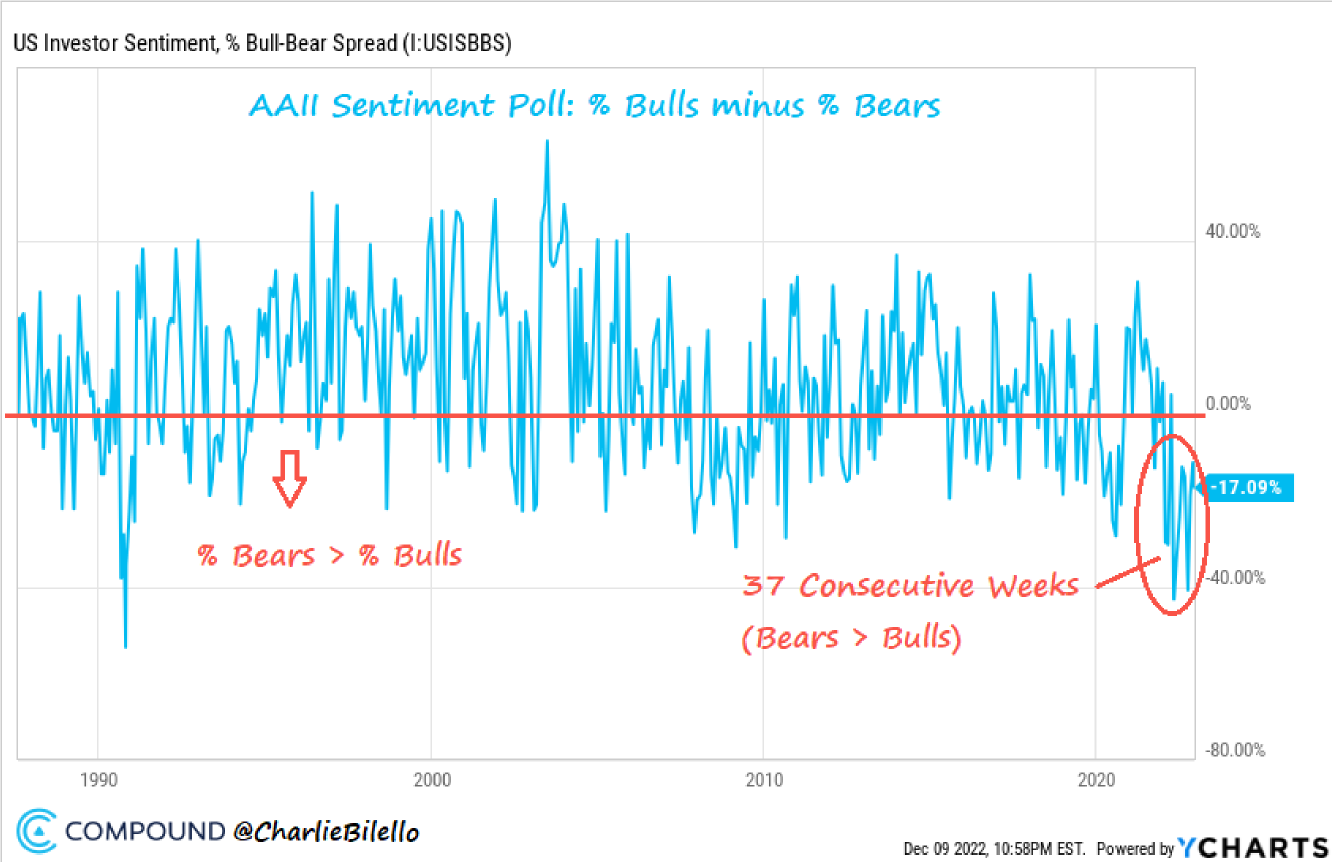


Another contrary signal, the University of Michigan Consumer Sentiment Index going back to 1952, is at extreme low levels. We have had 8 straight months below 60, this is the longest streak on record. The prior record was 4 months in 1980.



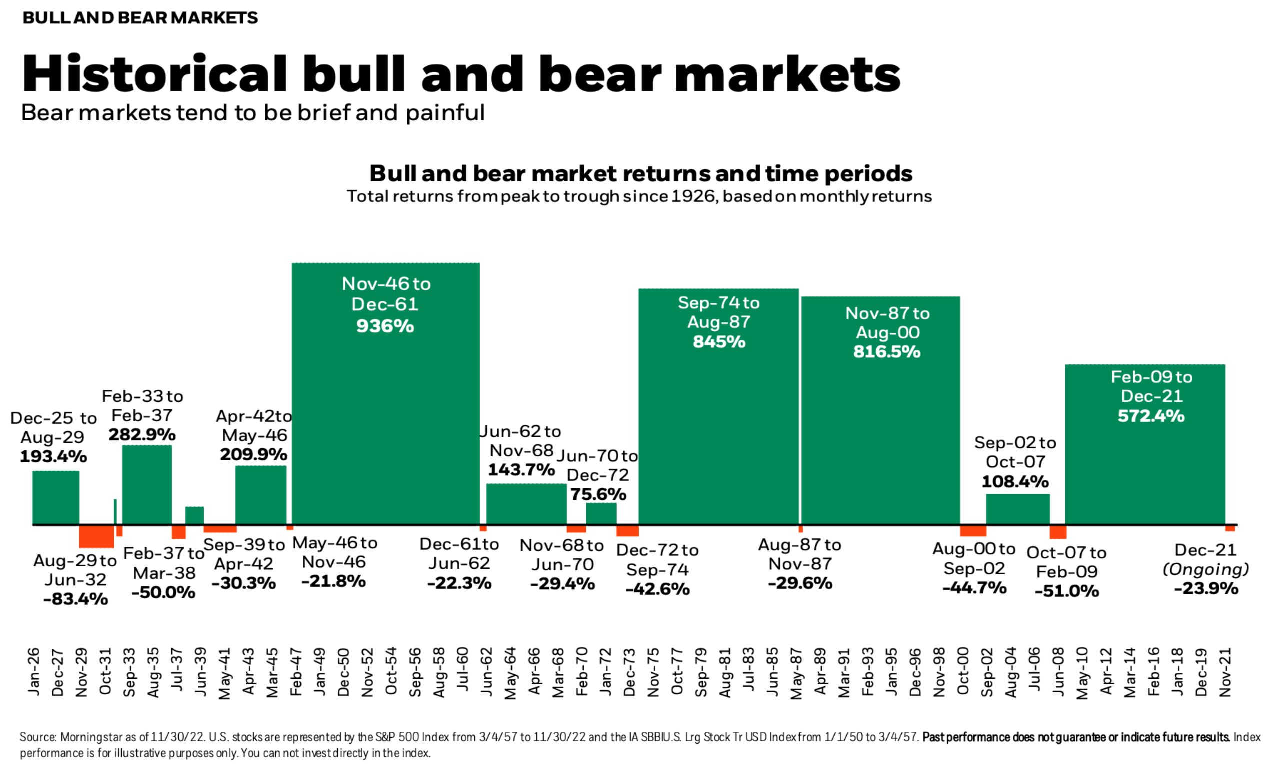
Animal spirits are dead. Bitcoin has collapsed, nobody talks about NFT's or how much a Bored Ape costs anymore. Market darlings such as Tesla, Meta (formerly Facebook), Paypal, Netflix, Nvidia – household names - have had losses significantly larger than the overall market decline. These are signs of capitulation and not speculation. ***There is blood in the streets.*** We haven't even mentioned the bond market having its worst year ever. When so-called safe investments like government bonds perform so badly, you know dislocations have been heavy.

Keep in mind, it's not a stock market, but a market of stocks. In the long run, the stock market has little to do with the results that a shareholder of a great business will earn. Successful operating results of the individual business invested in will drive shareholder returns. Prudent long-term investors should not be worried about what the market may or may not do in the short run, but be very concerned about the future operating performance of the business they are invested in. Based on a wide variety of sentiment indicators, the market is exhibiting signs that pay little heed to how businesses may perform over the next 3-5 years and once the recession is past us. As Warren Buffett once said, "the time to get interested is when no one else is. You can't buy what is popular and do well." Another way to see the negative sentiment and signs of capitulation, the AAII Sentiment Poll:



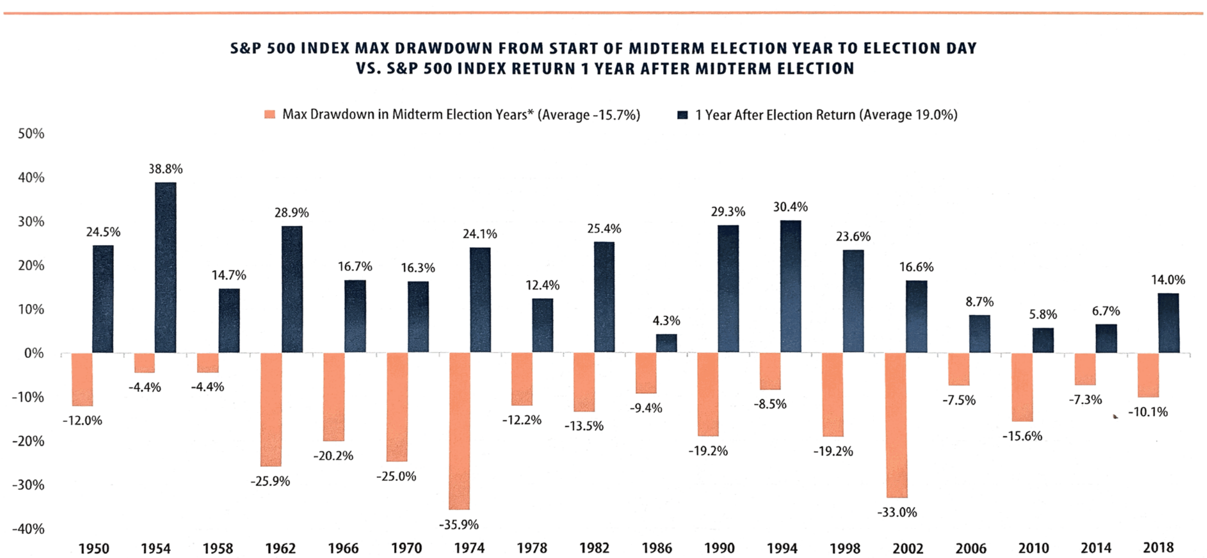
With data going back to 1987, this is the longest streak *ever* for bears outnumbering bulls for consecutive weeks.

Consequently, **there is a silver lining to all of this**. Bear markets come and go a lot faster than you think. Although they are brief and painful, the key is to stay the course. Blackrock has a good chart showing how quickly bear markets come and go (see below). Even if you only buy yellow bananas, you can be optimistic that we might be closer to the end than just the beginning.



Source: Blackrock, Student of the Market, Dec 2022

Another fascinating set up for the market is the post midterm election year cycle. See this incredible study by First Trust showing how since 1950, there has *never* been a down year following a mid-term election year.



Source: First Trust

The orange color is the max drawdown in the midterm election year, and the blue is the subsequent 1-year return after the election. Will this indicator once again turn out favorably?

How Soccer and the recent World Cup matches can be our guide as we enter 2023…

I bet you didn't know that soccer goalies almost always dive to one side or the other when defending penalty kicks. Instead, the research says they should stay put! An Israeli academic by the name of Ofer Azar performed a study where he found that 32.2% of penalty kicks went to the left, 28.6% went down the center, and 39.2% went right. However, goalies only stayed put 6.3% of the time! He posited that goalies nearly always dive to one side or the other because they had an *"action"* bias. Staying still is inaction – diving is an action. And if they just stand there and miss the shot because it is to either side, they look stupid. Can you imagine on the grandest scale and those representing futbol's best teams as a goalie in the 2022 World Cup final, which pitted France against Argentina, just standing still while the opposing player blasts a soccer ball at the net?! Picture 100,000 raucous fans inside the stadium, or the 3.5B people watching live around the globe, and the goalkeeper stands in the middle with his legs and hands outstretched – and subsequently the penalty shot hits the back of the net to his left or right. The ridicule and outrage from the fans watching would be intense! So, what we have here is *"regret avoidance."* That goalie is not making the best decision but one where it will be seen as *"less stupid."* If he dives and misses or simply dives the wrong way, fans will think at least he tried. But staying put, although increasing his chances dramatically to block a shot, he will choose otherwise. Isn't that remarkable, just to consider the stress a goalie is under?!

The point of this story is to urge you to consider your action, or inaction, when it comes to fruitful investing. Back to the flight or fight analogy. Loss aversion, getting shaken out, not being able to tune out the negativity from media outlets, reading scary headlines, etc. etc… this is the trip wire which forces you to do harmful things to your financial health. Just like the goalie, you feel compelled to do something, when probability says the best course is to stand still. Over-trading is to the benefit of the brokerage firms and exchanges and not to you personally! (That is why we own some of them.) We advocate staying the course and using volatility to your advantage. If history repeats, and it often does, we will get through these challenging times. Markets and economies will recover, and share prices will one day return to all-time highs. Of course, the caveat here: stable, predictable, large moat, good management, strong balance sheet companies - those with sound financial discipline – these types of businesses will thrive in future years and those are the ones to stay committed to. Chasing fads, hot stocks, some crypto currencies, NFTs, etc. - all those assets that could be defined as venture speculation, there is no telling if they might recover. The dot com bust in the early 2000's took out many businesses that never came back. However, if you had invested in well established companies, many with consistent and growing dividends, those were (and are) the ones with staying power. Temporary losses can and will occur, but capitalism suggests these assets can perform well over time and if you hold on to them - the temporary losses do not become permanent. Our view is that if we identify and hold an asset with growing cash flows, the share price will eventually be driven up primarily because its profits distributed via a growing dividend stream will make that asset more valuable as time goes by, regardless of the ever-changing socio-economic environment that it operates in.

This is our plan for 2023 and beyond. The narrative as defined as the faceoff between inflation, interest rates, and economic growth will play out before our eyes. We will continue to invest with a longer timeline and our expectation is that ultimately the cream will rise to the top and most high-quality businesses will again trade at all-time highs.

We know the pathway to good returns is never easy. The price of admission to obtaining strong returns is handling drawdowns when they occur. We will get past this one and be better for it. Stay strong as we roll into 2023 and best wishes to those looking at things as half full and not getting trapped in the negativity that seems to pervade everything around us. Take care and we will talk to you soon.

The CORDA Team.

From the Desk of the Certified Financial Planners:

The beginning of a new year is a wonderful time to pause and think about the array of considerations that allow us to match an investment strategy to your preferences and objectives. We like to characterize this as your investor profile. It includes things like your investment time horizon, your risk tolerance, and your overall investment objective. For most investors, these things can change throughout their investment life cycle. Other important factors and considerations change as well. Examples are your annual income, liquid net worth, number of dependents, and tax bracket.

Admittedly, some of these things can be difficult to define and articulate. That's where our financial planning professionals, working in conjunction with your relationship manager and our portfolio team can assist you in helping us fully understand your situation and objectives, and custom designing a portfolio to help you achieve your goals.

Start 2023 off right with these financial planning suggestions.

- Check the beneficiaries on all your accounts to make sure they match your wishes. If you don't have beneficiaries, consider adding them to help make things easier for your heirs.
- Update your estate planning documents (will, durable powers of attorney, medical directives and living will). If you don't have all four, you can get them drafted on-line through a site like legalzoom.com or with an estate attorney. Having all four can help protect you and your family if you become incapacitated.
- Check out your credit report to make sure it's correct by going to freecreditreport.com or annualcreditreport.com. Both sites are free. Download Credit Karma on your phone to see your FICO score.
- Review your insurance coverages. Do you have enough or too much life, home, auto or umbrella coverage? You can potentially save considerable money by tuning up your insurances.
- Contact your relationship manager for help with any of the suggestions above or with any other financial planning questions.