An Ownership Mentality

June 30, 2020

Dear Client,

Can you believe we've made it to June 30th? This year has taken a toll on everyone, and as we cope with the pandemic and its resulting physical, economic and emotional fallout, we find ourselves digging deep. First, we want to say that all of you are in our thoughts. We have had a tumultuous few months and we believe society has made some permanent changes for the better. You may not feel it directly just yet, but we believe over time, our country and our way of life will be vastly improved. It seems it takes great challenges to move the collective will of people, but we are living through a period where America and the rest of the world are rising to defeat a very serious health crisis. We have been pushed to summon resolve that we always hoped would trigger deep inside ourselves when pressured, but never quite honestly knowing if we could muster an appropriate response when called upon. We've seen first-hand how our team has responded and we have heard from many of you and wish everyone continued success in fighting the fear and anxiety that seeps into our thoughts when confronting one unknown after another.

There's likely to be much more to confront in the next six months, especially between the pandemic and politics. We'll steward your capital much like we treat our own, and we expect to have good results. Our #1 priority is to create the best financial outcome that we possibly can and do everything within our power to ensure your loved ones are secure. Our hope with this letter is to share the optimism and conviction we have at CORDA and how we plan to successfully navigate the markets in the years ahead.

There's no getting around the fact that we will have to learn to live with COVID-19 until there is a vaccine, which could take just a few more months, or perhaps a year or two, so unless you plan to throw in the towel on the capital market and accept sub-zero real returns (net of taxes and inflation) in a zero interest rate environment, you better have a plan in place to create a winning outcome. We by no means have a crystal ball, but we purposely build a portfolio of businesses in a well thought out manner where we put the power of owning high quality assets in play and let the magic of equity ownership and the sharing of profits drive our returns in the long run. It's simply the force of equity ownership versus the alternative, being a lender, in which one receives a small rate of interest in today's marketplace.

Today you can lend at a risk-free rate of 0.65% over ten years, or in the short term, if you are lucky, 0.10% for 6 months. That's the offset for not seeking equity rates of return. Equity ownership of any kind - public or private - certainly brings with it a wide assortment of outcomes that includes complete loss, but if

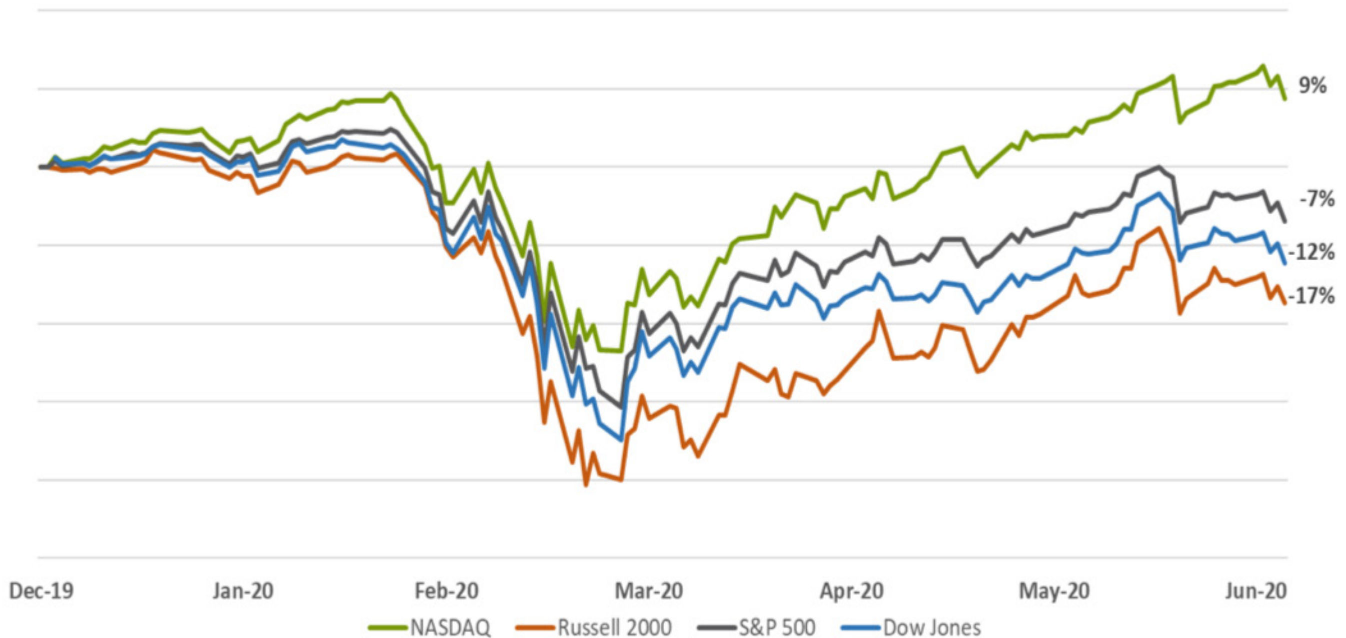
you diversify across businesses and industries and think longer-term, you reduce the risk of permanent loss and place your cards strongly in the camp of creating lasting profits. If you seek to own predictable and stable businesses run by competent and skilled management, your odds go up substantially. The longer your time horizon, the more likely you will be successful. A business with high cash flows, low debt, good returns on capital, insider ownership, and a highly sustainable business model – all these traits increase your chance of long-term gains against any economic backdrop.

If you view the world through the prism of a glass half full – the pandemic and economic upheaval will be a short duration event, and businesses most willing to adapt, change, and move quickly will be rewarded for their efforts in the coming years. With every recession and past economic or social upheaval in our nation's history, new companies are formed and later thrive as economic expansions take hold. Creative destruction is at work, the weak get left behind or are acquired, while the strong flourish and soar to new heights. Why would it be any different this time around?

We mentioned those willing to lend at paltry interest rates. We see it every single day, this tug of war between a lending mentality versus equity ownership. Today we see scores of businesses launching themselves at new opportunities and showing us their entrepreneurial spirit and ways to be nimble during the present downturn. What do we mean? Take for instance Goldman Sachs – they have a new business unit running ads on CNBC and in print publications suggesting money market rates at 1% or higher. As explained moments ago, with Treasury yields at .10% in the very short term and at 0.65% out to ten years, there is no risk-free way to be paying 1% or more in a money market fund. Flows to this new financial company have been humongous, but mind you, the small print says the rate they are paying can change at any time! Let's not get caught up with semantics here or whether this will end badly for them or their customers, just consider Goldman's point of view. They are willing to pay 1% as they believe they can create enough margin in excess of that cost to generate tremendous profits. They are the owner here, raising capital and reinvesting where they hope to generate excess profits, all the while those lending at 1% have effectively given up on the inherent power that this capital contains to willingly accept a rate of return that is more than likely to get cut at any time without their consent. The starkness is dramatic, is it not?! This is classic equity verses lending rules of engagement, and who do you think is going to win?!

Isn't it fascinating to see how the market has bifurcated this year and the bigger in size that you are, the more insulated to the chaos around you? To the absurdity of Goldman Sachs offering a high teaser rate and hoping to generate substantial margins on it, the Nasdaq Composite Index is proof positive of a handful of large businesses powering the index higher. It is dominated by 5 companies – Alphabet, Amazon, Apple, Facebook, and Microsoft. These five businesses make up about 37% of the Nasdaq benchmark. In fact, these five companies represent about 21% of the more broad-based S&P 500 index. Did you know that the Nasdaq and S&P 500 are being pushed higher by the huge weighting of these 5 stocks? It is astounding how much influence five individual companies have on our stock market!

You can see why both the Nasdaq and S&P 500 have returned much more than the broad economy represented by the Russell 2000. (See the chart on next page) The Russell 2000 is the smallest two thousand of the biggest three thousand companies in the U.S. and more indicative of the overall economic situation that we find ourselves in at the present time. If one were to just look at Amazon or Facebook for instance, it is obvious what the economic shut down and shelter in place orders have meant to these companies. Could conditions be any better for them?? However, when you expand the universe to 2000 or 3000 publicly traded equities, of course the narrative is much harsher. It's been a brutal economic period – virtually a depression - although we believe that pundits will eventually call this one of the fastest and shortest recessions on record. That is remarkable!!



Source: YCharts and Morningstar through June 26, 2020

On a side note, if you take the cumulative market capitalization of the top five companies, it adds up to $6.1T. Here's where it gets interesting. The cumulative market cap of the smallest 350 companies in the S&P 500 adds up to about $5.5T. Chew on that for a bit! 5 businesses have more influence than 350! If there ever was a time to use the word *KOWABUNGA*, that time is now! If you watch our YouTube channel, we put out a video called "Market Anomalies" two weeks ago and the portfolio team termed it the "Elephants versus the Peanuts." In fact, a shameful plug, be sure to like or follow our YouTube, Facebook, Twitter, and Instagram pages, you can glean additional insight from our whole team on those pages.

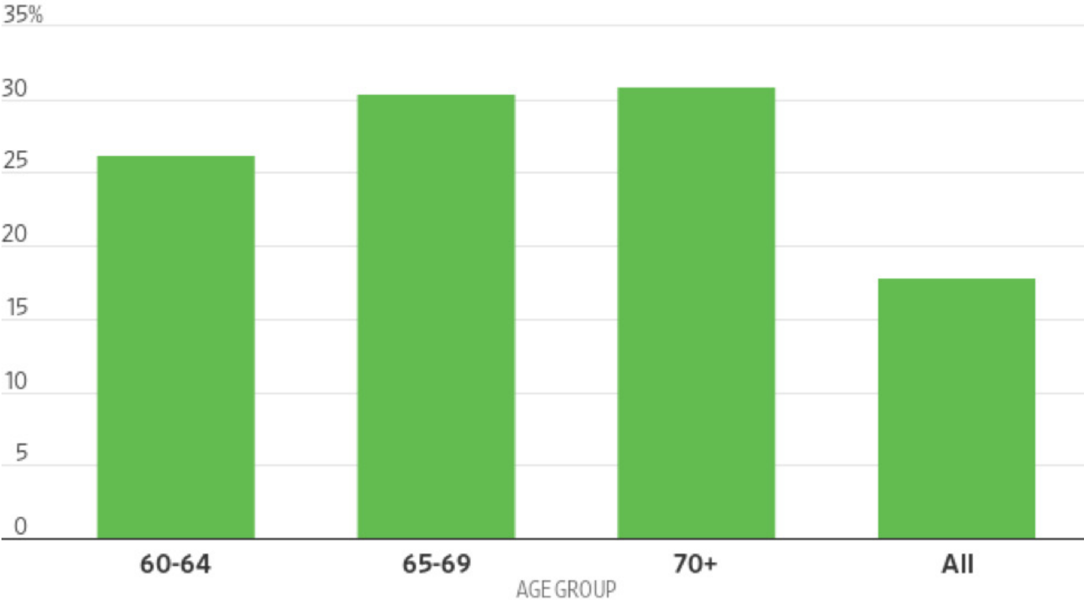
Largest Businesses in NASDAQ per Market Cap

Business		Market Cap ($ millions)
Apple Inc	$	1,588,664
Microsoft Corp	$	1,531,172
Amazon.com Inc	$	1,378,821
Alphabet Inc	$	999,342
Facebook Inc	$	690,167

June 23, 2020 market close valuations

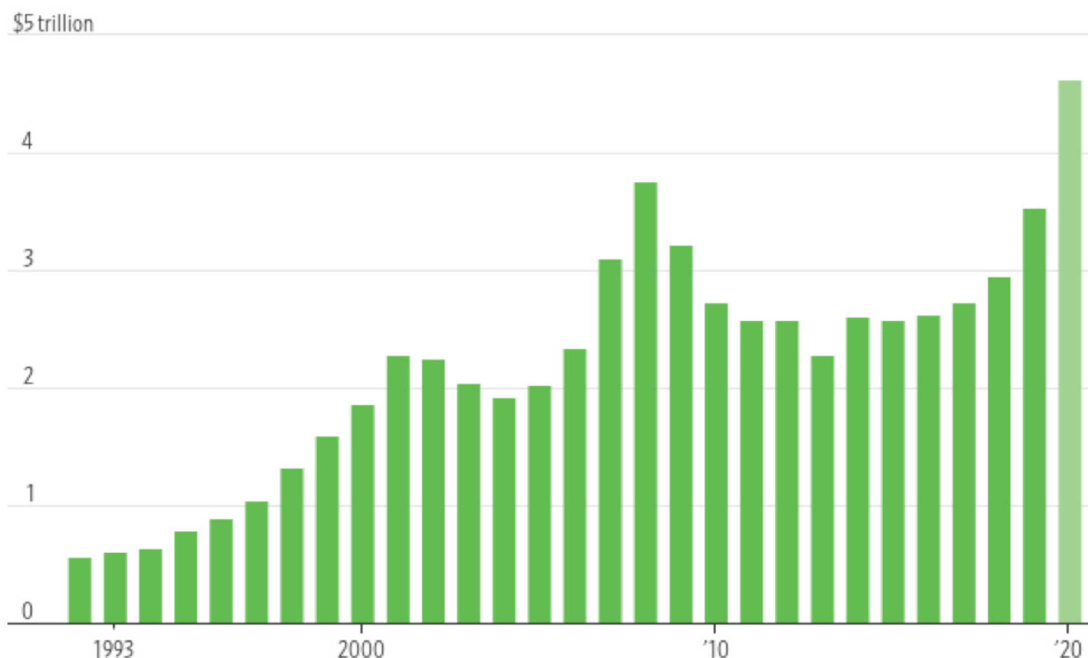
Ok, let's switch gears for a moment. Can we talk trillions of dollars of stimulus?! The Federal Reserve, Treasury, and Congress have put in place policy tools and stimulus plans that are enormous. They accomplished these feats in a matter of weeks back in March and April that took them a year or more in 2008 and 2009. In fact, there may be more from where that came from depending on the length and depth of this pandemic, but these programs will help stabilize economic conditions until we can get back to whatever we might call "normal" going forward. Our expectation is that the economy will recover over the next few years and we are not concerning ourselves with how someone might describe the type of recovery that's ahead of us. We are sure you have heard the creative ways economists are using letters in the alphabet to describe the path of the economy going forward – a V, or U, and even a W, or better yet – the Nike swoosh sign has been mentioned breathlessly! We could handicap the unemployment picture too, but it looks like it will take several years for it to get back to the historically low 4% area. The key point, we will have a gradual recovery, but a recovery, nonetheless. Remember, creative destruction!! And you can choose to be invested in businesses or you can lend at rates near zero.

Speaking of those who choose equities, unfortunately over 30% of people age 65+ decided to sell their equities between February and May. Fidelity issued a report recently that was truly sad to see. We find it awfully difficult after so many years as investors and business owners, to understand how investors believe they can accurately make so many "right" decisions when choosing a trading mentality. If you sell, then you must decide where to go with your money, and then most likely, decide when to re-enter. There is a multitude of decision points and each has so many potential outcomes. In the meantime, you lose out on the recurring income that would have been generated on those very same assets you just liquidated.



One thing we must emphasize if it isn't crystal clear - these are long term assets, not pieces of paper. You don't trade real estate or your home, nor should you buy and sell stocks like chips at a casino. Over 90% of the value of any stock – virtually any stock – is dependent on its profits more than 12 months in the future. If you're selling at a 20 price to earnings ratio, that means if we wipe out completely the first years' profits and the rest bounces back to where it would have been before, you should see a 5% decline in the stock price; that's it. You own a stream of future profits and dividends that has an assumed valued based on projected cash flows into the future. The market recently declined by almost 40% between February and March! Do you think it over-shot the downside?

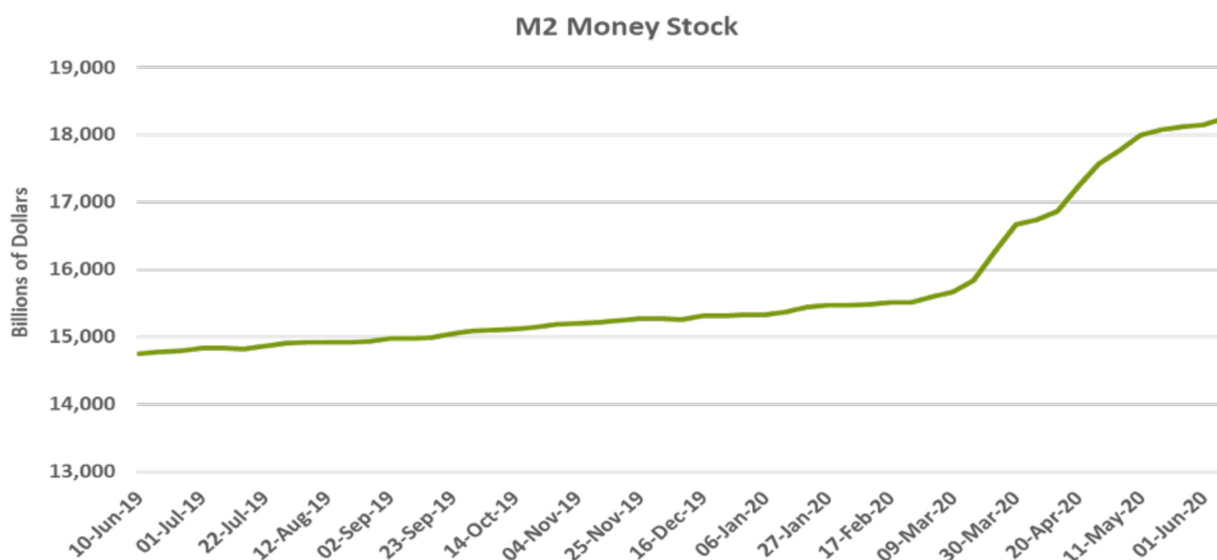
Now with all that cash on the sidelines earning nothing, guess what's going to drive up share prices in the years ahead? We have hit all time high money market balances.



Note: Figures for 2020 are through June 10.
Source: Refinitiv Lipper

See how the spike in money market funds occurred in 2008 and again here in 2020, as this pent-up money flows into goods and services or back into the stock market, it will propel both the economy and the stock market in 2021 and beyond. It may take years to bleed off the huge amounts of cash on the sidelines. Here's our question to you: Is it possible we have entered the beginning of a new multi-year expansion and new bull market? It's awfully hard to see through the pandemic and dire economy, but the narrative will be better in a year or two. You want to own stocks ahead of the recovery, it may be very costly to buy later.

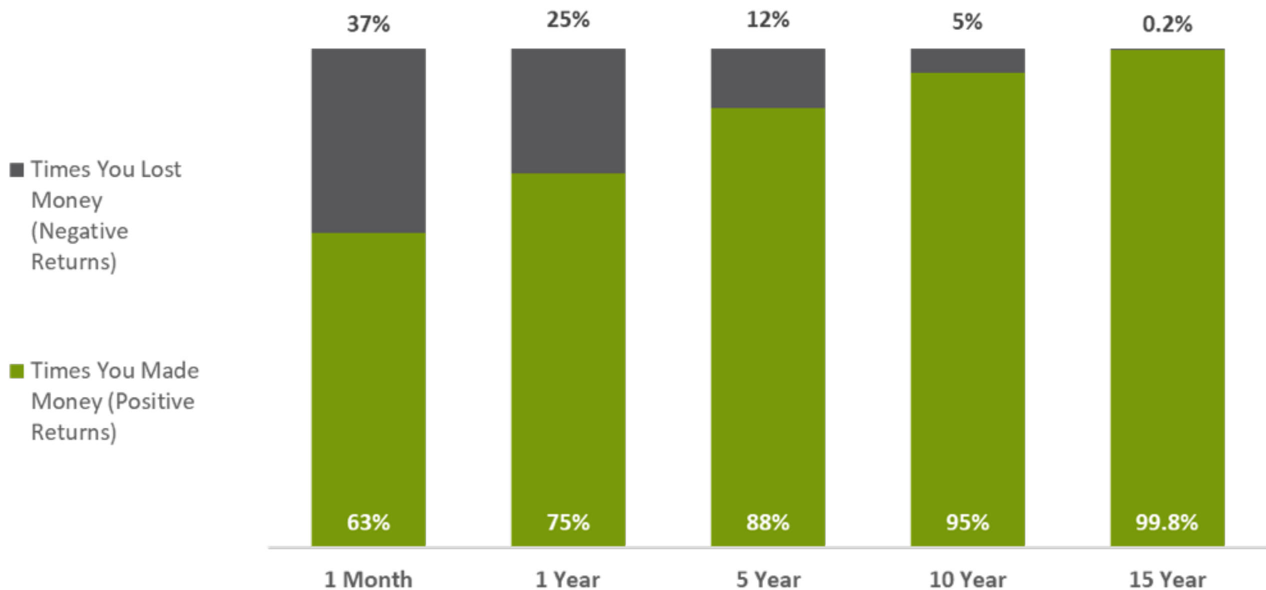
These same numbers are evident in the Federal Reserve's statistics on M2. M2 is cash and checking accounts and all money that can be quickly converted to cash which includes savings deposits and money market securities. We added **$2.5 Trillion** to M2 between March and June. That gain was set at an unprecedented pace. This pent-up source of buying power will drive the economy and potentially the market in the years ahead.



Source: Federal Reserve Bank of St. Louis

Bottom line, the pandemic has changed us – but are we tentative and fearful or are we going to take advantage of the opportunities in front of us. Things won't be the same, but when it comes to capital flows, creative destruction, and money moving from weak to strong hands - these concepts are still very much alive and well in the pre and post COVID-19 world. We plan to be on the right side of that equation. We'll let our businesses navigate the landscape and pivot to where the economy is going. We believe most if not all our businesses will achieve record high revenues and profits in the near future leading to greater dividends which will ultimately lead to higher share prices. We'll be patient to the exact timing because we know it's unpredictable. The key is to not let your emotions get the best of you and scare you out of long-term assets. Be on guard as the market wants to fool you time and time again. Nobody ever said investing was easy. **Your 2030 version of yourself will thank you!**

Remember, markets are resilient, and if you can extend your time horizon and understand how the types of businesses you own are durable and consistent in their results, you will more firmly believe in staying the course and not get upset at the fluctuations and noise that comes along the way. The odds are in your favor. The price differential of 5% or 10% here or there or having a -500-point day in the Dow Jones Average spook you will pale when you look back at today's prices in ten years. Look at the next chart, the odds over ten years are stacked 95% in your favor.



Source: Blackrock & Morningstar

Our promise to you is to continue to do our best to keep you on track and in the proper allocation where your odds are tilted for a winning outcome. For those where bonds and cash are appropriate, we'll need to set short term expectations that yields will remain low until we get the necessary pickup in the economy next year. We might even get a whiff of inflation, and that should carry bond yields higher. The potential for higher interest rates in 2021 and 2022 will be the effect of the trillions of dollars of stimulus coursing through the system. We are on watch for what that does to the bond market. Investors with long maturity bonds will get hurt in such an environment. The stimulus does have a cost, and we believe bond holders will bear the brunt of that.

These are extraordinary times. The road ahead will be volatile. An end to the pandemic will be a much-needed step to get the world back on to its growth trajectory. In the meantime, the market will move well ahead of fact, but it won't be in a straight line. Stay positive and thank you for being on this journey with us.

Sincerely,

Bonner C. Barnes   John Schloegel   Brian Raupp   Dustin Slater