An Ownership Mentality Through Thick & Thin

December 30, 2021

As we head into a New Year, we reflect on the year past and it seems somewhat mandatory to drag out our crystal ball to help set a course for the upcoming year. Our customary optimism about owning high quality, cash flowing, sustainable and shareholder friendly businesses purchased at the right price is a bedrock of our investment plan, and it hasn't let us down over the long haul. Yet we must remind ourselves that stocks do not move straight up and mentally prepare for a potentially volatile market that did not have a single 10% correction in 2021.

It's hard to believe we are embarking on year three of the pandemic, and its variants continue to persist. Hopefully one day soon we will lose the pandemic label and move towards the endemic stage of this troubling virus. That means we must adjust our lifestyles and learn to live with it - however maddening and agitating as that may seem right now. The other perhaps more difficult transition for the economy and capital markets will be how investors grapple with higher short-term interest rates and a Federal Reserve seeking to balance robust near-term inflation with continued growth for the economy and labor markets. Another derivative challenge will be deciphering whether the Fed is behind the curve when it comes to squashing out troublesome and sticky inflation rates. You can be assured as ever we will maintain a cautious mindset about how to deploy capital in an ever-changing environment.

Although the COVID variants and inflation are the primary concerns for investors as we enter 2022, history tells us that it's usually something other than what's front and center that moves markets. The public and private sectors have had nearly two years to confront the virus, and many have adapted quickly. As for interest rates and inflation, this topic is substantially well dissected and the discounting nature of the capital markets so efficient, that we believe something other than a central bank policy move or other unanticipated event will move the market up or down in the coming months.

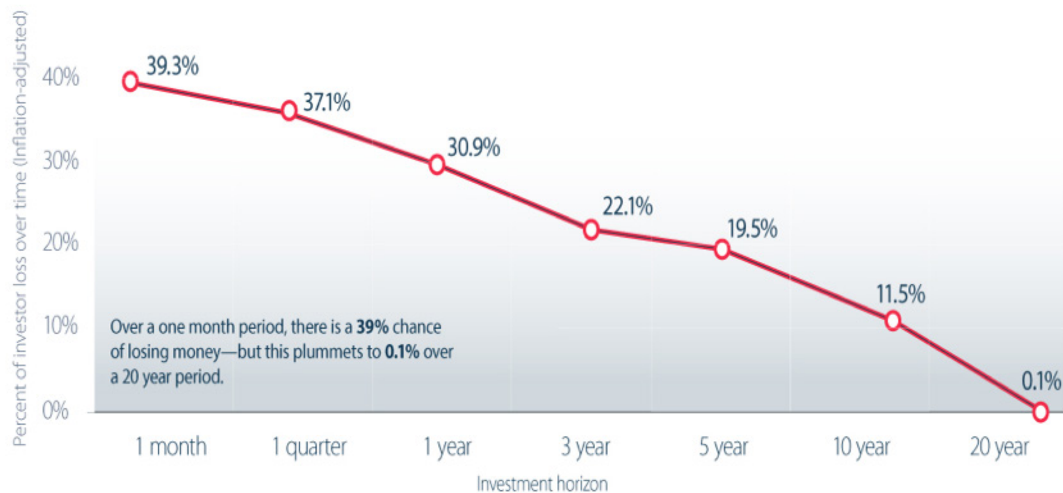
Speaking of discounting, one might ask why the ten-year Treasury note is yielding only 1.45% if inflation is set to soar? Are you not surprised or wondering what the continued low level of interest rates might be telling us about the future?

Frankly, the market will do what it is going to do. Although the world seems fragile and sometimes confusing, the market has an unusual way of seeing through the gloom and rewarding those who stay invested. Every day we live and invest in an uncertain world. Corrections and pullbacks are necessary and healthy, and we advocate using them as opportunistic moments to get and stay invested in great businesses.

Despite the double-barreled risks of COVID variants rippling through society and the Fed hiking interest rates, we must also contend with trade disputes, government shutdowns, strained relations with China and Russia, and the unpredictable behavior of politicians the world over. It is difficult to predict how the financial markets will trade over the short term when something goes awry, but history suggests most will prove passing and manageable. We are confident in our process of identifying and owning high quality companies and investing only when we believe the target companies are trading below their intrinsic value.

One other battle shaping up in 2022 is the fading fiscal stimulus trend against a return to normalcy. The budget deficit will still be large in 2022 even if the "Build Back Better" proposal doesn't pass. The deficit will be much smaller than the previous two years, but this is still a headwind for growth. However, more businesses will be getting back to normal and hopefully we will continue to see a surge in new business start-ups gradually replacing the businesses that were killed off by strict COVID rules and regulations.

Our decided advantage is the ability and patience to invest for the long term. That is simply the one major ingredient that you can control and where you can set yourself up for continued success if you stay the course. Again, history suggests all things are manageable, and if your time horizon is one month, you might not want to be involved in the equity markets at all. But the farther out your time horizon is, the better chance you will have for a good outcome! Below is a chart from Robert Shiller/Schroders which shows how your risk (chances of losing money) declines the longer you stay invested.



Another data point that we believe to be ballast for the markets in the years to come - record cash balances on the sidelines. As of December 17th, data from Goldman Sachs indicates investors added more than $43 billion into money market funds through that week, bringing the total amount of cash raised in the previous seven weeks to a massive $226 billion. The money market stockpile has not declined at all in 2021 despite the rally in stocks, with assets under management in cash equivalents standing near a record $4.7 trillion, the data showed.

“My core thesis is that money will come out of negative real yielding cash and out of bonds aggressively early in 2022 following December board room asset allocation meetings,” Scott Rubner, an analyst at Goldman Sachs’ global markets division, said in a note. “Every private wealth advisor in the world is conducting ‘year-end allocation review’ meetings right now. The feedback will be largely that investors hold too much cash with rising inflation.”

According to a Bank of America fund manager survey, investors’ cash allocation jumped 14 percentage points this month from November to a net 36% overweight, the highest cash exposure since May 2020. The contrarian in us would take the other side of that, and just as investors were stock piling cash in the spring of 2020, that was a time they should have been buying shares of businesses. That might be exactly the case today! Why? Although the broad indexes like the S&P 500 are trading near their all-time highs, we have had a stealth bear market in most stocks that trade publicly. For example, the Russell 3000 is an extremely broad benchmark, and as of Dec 17th although it was about -4% from a 52-week high, 2,288 stocks (76.2% of the index) were -10% or more below their respective 52-week highs. 1,564 stocks (52.1% of the index) were -20% or more below their 52-week highs. Finally, a whopping 793 stocks (26.4% of the index) were -40% or more below their 52-week highs. That is a huge number of stocks deep in bear market territory or perhaps even massively over sold. Some of that cash on the sidelines might be missing a terrific opportunity to buy when some businesses are on sale. We have always championed using the market volatility to your advantage and to scoop up companies with solid prospects going forward. What is the likelihood your 2031 self will be pleased with the businesses you may have purchased in 2021 or 2022 when you look back in time ten years from now? Think of what the dividend cash flow alone might be in ten years from those holdings! Don’t forget the power of rising dividends!

Russell 3000 Index, Percent Below 52-Week High:

# of Stocks	% of the Index	% Below 52-Week High
2,288	76.20%	-10%
1,888	62.9	-15
1,564	52.1	-20
1,283	42.7	-25
1,068	35.6	-30
913	30.4	-35
793	26.4	-40
559	18.6	-50

Recall, there are trillions of dollars invested in negative yielding bonds worldwide. Last we checked it is roughly $14T deployed at both nominal *and* real interest rates well below zero! Per the comment from the Goldman Sachs analyst above, what if some of this money gets reallocated away from bonds - where will it go? We have record cash on the sidelines already - what if some of that moves into equities?

For those who are more risk-adverse and what we’d consider conservative and/or moderate seeking rate of return investors, we continue to invest the targeted bond portion of an allocation to high quality short duration securities. Higher interest rates can help in three ways; 1. It means the stress across the economy and in the capital markets of a disinflationary environment has diminished 2. The outlook for overall economic

growth is good and will directly translate to strong earnings from corporations as business activity continues to recover, and 3. Those with fixed income needs as bonds mature will achieve higher rates of return on their capital as they roll those maturities forward. So, should we get higher interest rates and/or the Federal Reserve Bank moves the fed funds rate higher in 2022, one should not assume a negative stock market outcome. It means the economy is strong, unemployment is low, and we are moving towards a more "normal" world and one many of us would embrace! If you read between the lines above, one must wonder why interest rates are still so low and what the probability of some sort of deflationary spiral exists in the future. We are certainly mindful of that possibility.

A Bumpy Transition Ahead: Harping on dividends, capital appreciation, and staying the course:

Our long-term view is that the path to successfully grow your capital, whether the goal is to provide for your retirement, legacy, education, or peace of mind, is to seek the highest quality, financially secure, sustainable, and shareowner friendly businesses with the ability to increase their dividends over time. We believe our philosophy is a powerful prescription that should lead to excellent results. It is a view shared by other highly esteemed investors such as Warren Buffett, Seth Klarman, Ben Graham, Guy Spier, and others. 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.

The vagaries of the market will create periods of complacency when one should stand aside and watch and wait, while at other times, when fear is more palpable, one should be a buyer. The "buy low and sell high" strategy sounds simple to replicate, but few do it successfully over time.

We have written time and time again about CORDA's unique investing principles, and here is a run-down of them again for your review. We call them our - **Guiding Principles for Long-Term Success**.

1. Price is an essential 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. Do not be in a hurry to sell; just because share price has risen 50% or more does not mean a stock 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 is 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.

In closing, the key as we move into '22 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 your hopes and dreams. The path forward won't be easy, but as our grandmothers taught us, things worth doing are never easy. One last thought: There are roughly 250 trading days a year, making it 2,500 days for a decade. Major portions of a company's equity return in a decade happen in approximately 50 to 60 trading days. This means that what happens in 2% of the days decides your decadal returns. Refer to Rule #5 above - don't time. Stay invested with good companies and patience is crucial.

We thank you for your commitment to the value, contrarian, growth and income strategy that we have put in place for you. Please let us know if anything has changed with regard to your financial plan. We are also maintaining our strict adherence to protecting your privacy and capital, in a day and age where cyber security threats are ever-present. We always welcome your emails, just know that any instructions, especially for withdrawing or adding money to your account, must be made verbally, and that is to protect your hard-earned capital. We cannot over emphasize the need to keep good communications habits.

With that, our sincere wishes for a wonderful 2022 – one filled with less anxiety and a resolution to enjoy a fruitful journey through life and a determination for lasting experiences with our families and loved ones. We'll continue to do our best to guide the money you have entrusted to our care.

Happy New Year from the entire CORDA Team.