Catholic Foundation of Southwest Iowa
Market & Portfolio Commentary – September 5, 2020

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Foundation Stakeholders:

In this edition of our bi-monthly commentary we are taking a step back and reflecting on what we have learned thus far in 2020.

1. Carl Richards got this right, and it's a humbling but accurate view of the world: **"Risk is what's left over when you think you've thought of everything."**

Black swans are real. The biggest economic risk is the one that no one is talking about, because if no one is talking about it no one is prepared for it, and if no one is prepared for it – its damage will be amplified when it arrives.

2. **Catholic Values investing <u>can</u> outperform in difficult times.**

Health care is generally a defensive sector that outperforms other sectors during market declines. Many Catholic Values portfolios have less exposure to healthcare because many of the big pharma companies (i.e. Johnson & Johnson) have divisions that manufacture abortifacients, so ownership of these companies inside Catholic portfolios is heavily discouraged. In spite of this, Catholic Values have been accretive to the Foundation's investment performance thus far in 2020 and over longer periods of time as well.

3. **Taking good risks requires knowing both the odds of failure <u>and</u> how that failure will affect you afterwards.**

These are difficult things to know. Often impossible. Especially because we're likely to overestimate our personal odds of success. You have to overestimate your odds of success, or else you'd be paralyzed most of the time. Optimism is a rational form of ignorance. That's part of what makes risk management really hard.

Risk management comes down to serially avoiding decisions that can't easily be reversed, whose downsides will demolish you and prevent recovery. I think this is true for investments, business models, careers, relationships, etc. And when you frame it like that, risk management doesn't seem that complicated.

The first thing you have to do is value having options. The second is a religious appreciation for unknowns.

Knock those two out and you're ready to take some risk.

4. **Nothing too good or too bad stays that way forever**, because great times plant the seeds of their own destruction through complacency and leverage, and bad times plant the seeds of their own turnaround through opportunity and panic-driven problem-solving.

Remember – this too shall pass. Yes, even 2020.

For some, it was probably tempting to go to cash in March. Had we done so, we would have missed out on the herculean rally that followed. Instead, we rebalanced via buying equities and selling bonds. A recovery from a bear market has never happened as fast as we just witnessed. Selling when the market is off 35% peak-to-trough was, in hindsight, a great way of locking in losses that may have resulted in permanent loss of capital. While it was impossible to know whether the sell-off would deepen, the old adage is right in that "**time in the market is more important than timing the market."**

5. **Two things happen to predictions after you get hit with something big and unexpected:** (1) You extrapolate what just happened, but project it reoccurring or deepening with even greater force and consequence; (2) You forecast with great conviction, despite the original event being improbable and something few, if anyone, predicted.

As human beings, we have a tendency to see patterns everywhere. Pattern recognition is a core part of how we learn and plays an important role when making decisions and judgments or acquiring knowledge. We tend to be uneasy with chaos and chance (Gilovich, 1991). Unfortunately, that same tendency to see patterns in everything can lead to seeing cause and effect relationships that don't exist. Often times, we look in the rear view mirror – with the benefit of hindsight – and attempt to explain relationships within deeply complex systems. Our minds are not terribly powerful probabilistic machines. Daniel Kahneman, the grandfather of behavioral psychology, put it best when he described how we should think about surprises: "What you should learn when something happened that you did not anticipate is that the world is difficult to anticipate. That's the correct lesson to learn from surprises: that the world is surprising." In other words, heed caution when trying to apply predictive meaning to what could be mere randomness.

6. **Think of risk the way California thinks of earthquakes.**

California knows a major earthquake will happen. But it has no idea when, where, or of what magnitude. Emergency crews are prepared despite no specific forecast. Buildings are designed to withstand earthquakes that may not occur for a century or more.

7. **The best ideas are borrowed.**

I want to credit Morgan Housel from the Collaborative Fund for gifting me with many of these insights and perspectives.

Please see estimated performance below for the year as of 9/4/2020:

Strategic Growth Fund: +4.3%
Moderate Growth Fund: +6.1%
Capital Preservation Strategy: +1.2%
US Large Cap Stocks (S&P 500 TR): +7.4%
US Small Cap Stocks (Russell 2000): -7.1%
Global Stocks (MSCI ACWI): +1.7%

As always, please do not hesitate to reach out to us with any questions, comments or concerns.

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