



ISSUE 10 | VOLUME 9 | APRIL 2021

# Cadence clips

FOCUSED ON WHAT MATTERS MOST.

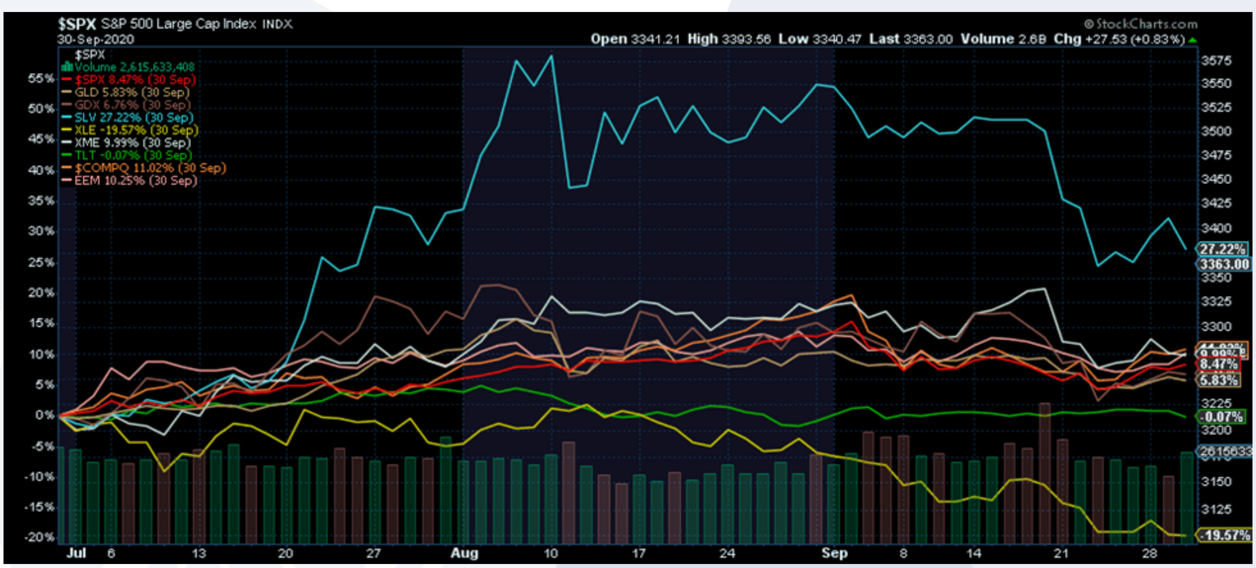
## A Very Divergent and Noisy First Quarter

In an environment that is healthy, stable, and relatively safe, you tend not to see returns across asset classes over a three-month period ranging from -13% to +32%, but that's exactly how 2021 has played out thus far. As you can see in the chart below, there's quite a bit of real estate between the top and bottom performing asset classes; about 45% worth. The first point we'll make here is that performance in the first quarter depending on one's asset allocation has varied widely. If you had a lot of industrial metals and energy in your portfolio, you're quite happy whereas if you had lots of U.S. Treasury bonds and precious metals, you're less so – maybe even a bit nervous. The second point we'll make is that the magnitude of this performance gap typically entices investors to do the exact opposite of what they should be doing at exactly the wrong time – investing in the hot asset class while ignoring the underperformer.

Now to be clear, we're talking about a three-month time period here which has very little to do with longer-term performance. When it comes to investor emotion however, what happens over days and weeks can drive the behavior that can have lasting consequences when it comes to performance. So from that perspective, it's crucial to understand how market dynamics can affect our decision-making.

Imagine for a moment that you own a bunch of the stuff toward the bottom of the chart on the prior page. How would you feel now? If you had another chunk of money to invest, which of the asset classes shown on the chart would you invest it in? Why? Most people would feel regret for not choosing the better-performing investment and would direct additional dollars into it if given the chance. Short-term performance does drive investor decision-making and it's why most 401(k) plans tend to be allocated across the investment categories that have done the best most recently. The problem with this can be that it exposes investors to more future volatility than they're prepared to tolerate. As a general rule, that which goes up a lot very quickly can and often does come down a lot and quickly. Same goes for something that moves lower - it can often reverse course and move higher in similar magnitude to which it moved lower. Volatility trends tend to cluster, which is to say that prices that have been volatile will most likely continue to be in the near future. What goes up or down a lot could continue going up or down a lot – in either direction.

Take last summer and fall as an example. From July through September, most of the asset classes we looked at above behaved similarly with the exception of two outliers; silver and energy. Although silver had already started giving back its monster gains from the summer, it still maintained a 46% outperformance over energy. Investors owning XLE, the energy ETF (exchange traded fund) we're using as a proxy here, would probably have felt horrible and felt some compulsion to add new money to silver. This is a totally normal and human response, but unfortunately as we can see by referring back to the first chart, it wouldn't have worked out so well. Silver continued to digest its gains from the summer while energy experienced a sharp upward move that more than offset the downward move seen between July and September of last year. Silver from the end of September to today has been flat while XLE is up 68%. **Learning: Short-term performance means very little when it comes to returns over subsequent months, especially when that short-term performance was large and volatile.**




So, if we shouldn't make decisions based on short-term performance, how should we make them? The answer to this question is by using a consistent process. There isn't just one process as many can and do work, but the key is to stick with whichever process works for you. For us, our process consists of evaluating the current growth and inflation cycles, choosing investment asset classes that fit our assessment of where we are in those cycles, and risk managing those asset classes over time. We also incorporate valuations and other technical indicators to help us with both the timing of possible cycle changes and asset class selection. Our process neither has us buying and holding asset classes blindly for long periods of time nor chasing the popular investment. It's rooted in data, math, and common sense. So what is our process telling us now?

Our Thoughts on Recent Market Movements

First, U.S. stocks remain at record valuations, while the leverage (debt) underpinning them has never been higher. Without rapid and sustainable economic growth to support and justify this, there will likely be some sort of mean reversion event at some point. When? Nobody knows, but it typically happens during an economic growth and inflation cycle slowdown. Since mid-2020, growth and inflation have not been slowing and we don't expect they will until at least mid-2021. Although we're currently anticipating the potential for growth and inflation to peak in a few months, we'll evaluate the data as it comes in and wait for confirmation of that. For now, we're observing a continued rebound in both growth and inflation which has us leaning toward asset classes that tend to do well in that environment; equities and commodities.

Since we never know for sure when growth and inflation will turn lower or when an event will take place that serves as a shock to growth and inflation, our process has us favoring asset classes that trade at more reasonable valuations than most U.S. stock indexes, but still have the potential to perform in the current environment. This leads us to favor emerging markets stocks, energy, industrial and agricultural commodities, and precious metals and miners. The recent underperformance of precious metals and miners, although somewhat painful, doesn't change our bigger picture outlook. As we saw in looking at energy in the third quarter of 2020, that underperformance can switch to outperformance very quickly. We certainly wouldn't want to miss out on this possibility if the rationale for holding them hasn't changed. Our process has us risk-managing this position over the short term rather than making an all or nothing type decision. If the growth and inflation cycles turn lower sooner than we expect, these positions could help buffer the portfolio against losses.

Second, as we began this piece with, the performance differential between asset classes recently has gotten our attention. It seems when a particular narrative gains traction and becomes commonly shared, investors go all in. Whether it's the inflation narrative we've discussed here pushing up the price of energy and commodity investments, or the SPAC/IPO narrative, Bitcoin, Tesla up until recently, investor reactions are extreme. This has mostly served to push prices higher, but our concern is what will happen when this volatility gets thrown into reverse. Investors won't be able to escape all of it since every asset class outside of cash can and will be volatile, but if they can manage to escape the worst of it, the long-lasting and damaging part of it, then they'll have succeeded.

As a general rule, the things that have gone up in price the fastest and whose prices aren't justified by adequate profitability, cash flows, or even a working business model will experience the most rapid and lasting declines when the flip side of volatility plays out. That which went up in price a lot and quickly, but whose profits, cash flows and business model do justify that move are likely to experience more modest declines that don't last as long, while those things that haven't gone up in price or have recently declined in price aggressively and whose profits, cash flows, and fundamentals support higher prices could best serve to buffer against any upcoming downward volatility in markets. Herein lies the conundrum. That which has worked the best and is most appealing to the masses is probably the last place you should be when the tide turns.

And so it comes down to considering positions in all of the above categories at the right point in the cycles, but mostly the middle one; things that are going up, but aren't overly expensive. The first category (things that have gone up a lot without the support of underlying fundamentals) consists of playing with fire, but it could be okay in small doses if well timed. The latter category (things that have gone down a lot but are supported by fundamentals) often isn't one that is sought out, but just happens. Similarly, we don't want too much here either for too long a period of time as nobody aims to lose money over short periods of time, but over time, this category has the best chance of paying off. It's a balance. A balance that a process can help one discover and maintain. Our most important takeaway from current market conditions however, is this: Markets have been extremely unforgiving with respect to winners and losers. Given the extreme nature of them along with everything else in the world today, investors who don't appreciate the true value of what they've purchased could find themselves holding a piece of paper that nobody wants when the mood changes. Volatility works in both directions. It's more important now than ever to understand what you own and why.

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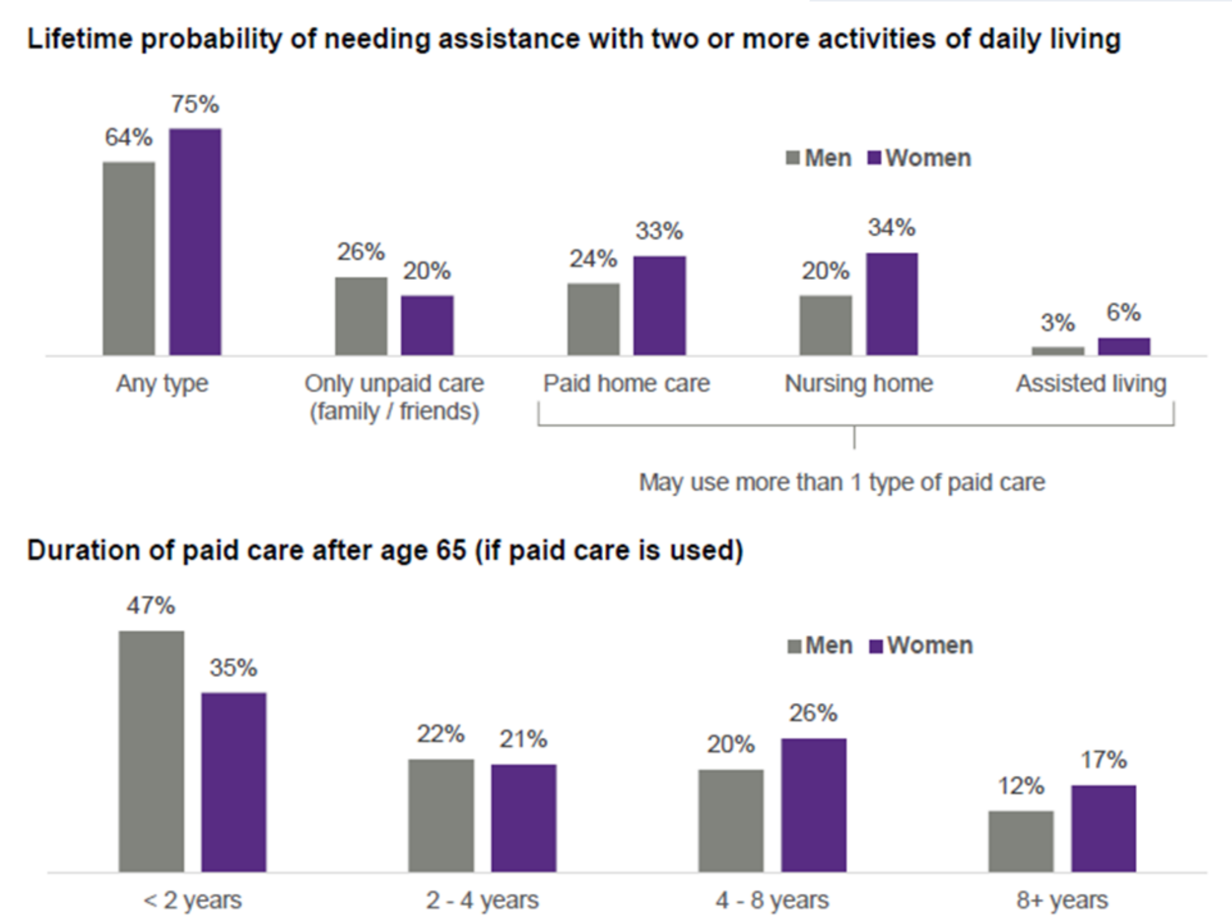
# Long-Term Care Expenses: A Critical Element of Retirement Planning

Though not at the same level of certainty as death and taxes, long-term care expenses are not all that far behind. Per the U.S. Department of Health and Human Services, 64% of men and 75% of women will need help with at least two of the six activities of daily living at some point in their lives. According to the same survey published in April 2019, if paid care is used to help with those activities of daily living after age 65, 69% of men and 56% of women will need some form of skilled care for at least four years.




*Source: U.S. Department of Health and Human Services, ASPE issue brief April 2019, What is the Long-Term Risk of Needing and Receiving Long-Term Services and Supports, Table 3 and Table 5.

Activities of Daily Living and Skilled Versus Unskilled Care

The types of activities that most people will need help with as they age are grouped into these six activities of daily living:

- Bathing: personal hygiene and grooming.
- Dressing: dressing and undressing.
- Transferring: movement and mobility.
- Toileting: getting on and off
- Continence: control and hygiene.
- Eating: preparing food and feeding.

These are the traditional "ADLs", though over time the list has been expanded to the 7, 8, or even 12 activities of daily living per certain sources. The bottom line is if you cannot comfortably and consistently perform at least two of the activities of daily living, you will more than likely need some form of regular care. From a skill perspective, care can take two forms: unskilled and skilled care. Likewise, from a facility perspective, care can take two forms: at home or in a facility. Lastly, from a time-intensive perspective, care can be occasional, regular, or round-the-clock.

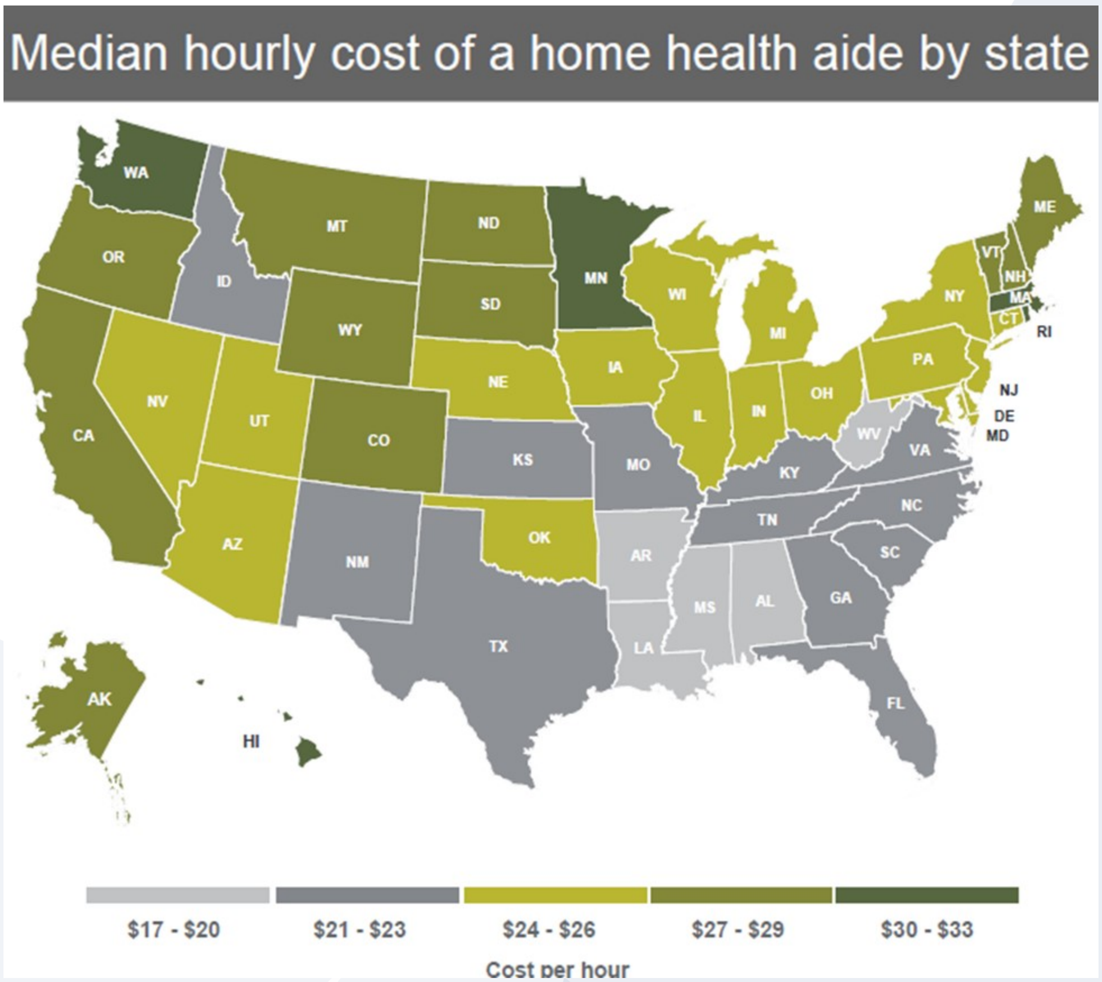
The majority of the care provided to people who need help with at least 2 of the traditional 6 ADLs is considered unskilled, which is why it can frequently be done at home. Things such as helping someone bathe, dress, and eat do not take much in the way of schooling, if any, to learn. Skilled care, on the other hand, is usually medical or therapy-related and must be provided by someone licensed to perform that care. Injecting medication, speech pathology after a stroke, and physical therapy after an injury are all forms of skilled care. Though the majority of nursing home residents are paying for unskilled care, it can still be expensive. In general, unskilled care is cheaper than skilled care, care at home is cheaper than care in a facility, and occasional care is cheaper than regular care, which is cheaper than round-the-clock care.

The Continuum of Care and Non-Financial Considerations

Very rarely do people go from being able to manage all their own care to straight into a nursing home. Usually there is a continuum of care where over time, more and more care is required, more and more skill may be required, and care may have to be given in a facility as opposed to at home. Most Americans start by either having a family member deliver care, which may or may not be convenient for the family member, or by having a caregiver come to their homes as it is quite a bit cheaper than being in a facility. Many of the factors determining if a family member can provide care include if someone is available to provide it all the times it may be needed, if it is unskilled versus skilled care, if someone is physically able to do it, and whether or not activities must be performed that a family member would not want to do, or someone would not feel comfortable asking a family member to do. When it comes to long-term care planning, it is understandable to focus on the potential costs, but we must not forget to also consider the quality of life we may still want to enjoy as we age, and having children or grandchildren perform some of these activities of daily living may not allow some people to maintain their dignity in the eyes of their family to the degree that they want. Privacy issues should not be overlooked.

Geographical Differences in the Cost of Care and Where Costs Are Headed

The costs of care, whether it be a home-based caregiver, an assisted living facility, or a nursing home, vary widely per state, and frequently vary widely based on different areas within a state. According to the Genworth 2020 Cost of Care Survey, the hourly rate of a home health aid is around $17-$23 mostly in the Southeast, but up to $27-$33 on the West Coast, upper Midwest, and Northeast, with both Massachusetts and Rhode Island in the highest tier. Where you live will have a large impact on what you would pay, with the lower end paying around $27,000 per year for 30 hours of care per week, and the higher end paying up to at least $51,500 per year.




*Source: Genworth Cost of Care Survey 2020, August, 2020.

Nursing homes typically cost at least double and sometimes triple what 30 hours of a home health aid would cost. States on the lower end of the nursing home cost continuum include Texas, Missouri and Oklahoma, which average around $5,100 per month for a semi-private room. On the other end are most of the states in the Northeast, like Massachusetts, New York and Connecticut, which average around $12,000-$13,000 per month for a semi-private room in a nursing home. If that sounds expensive, especially compared to the Texases and Oklahomas of the world, then do not plan on moving to Alaska, where the average cost of a semi-private room in a nursing home runs around $37,000 per month due to some of the remote locations of its facilities and labor force, as well as Alaska being an expensive state in general.

It is difficult to know with certainty where these costs will be in the future, other than higher. Some long-term care expenses have increased at rates just a little bit above the general level of inflation, and some by 5% or more. To give a feel for what that looks like, a 55 year old needing full-time nursing home care in 25 years that costs $120,000 per year today would pay over $400,000 per year at age 80. Even though being in a nursing home reduces or eliminates many every day expenses, that is still a big amount to drop right in the middle of a retirement plan. The biggest risks we see to properly funded retirement strategies are what would happen in the event someone needs long-term care, and per the government statistics mentioned earlier, between 64% and 75% of us will need some form.

## How Do People Pay for Care?

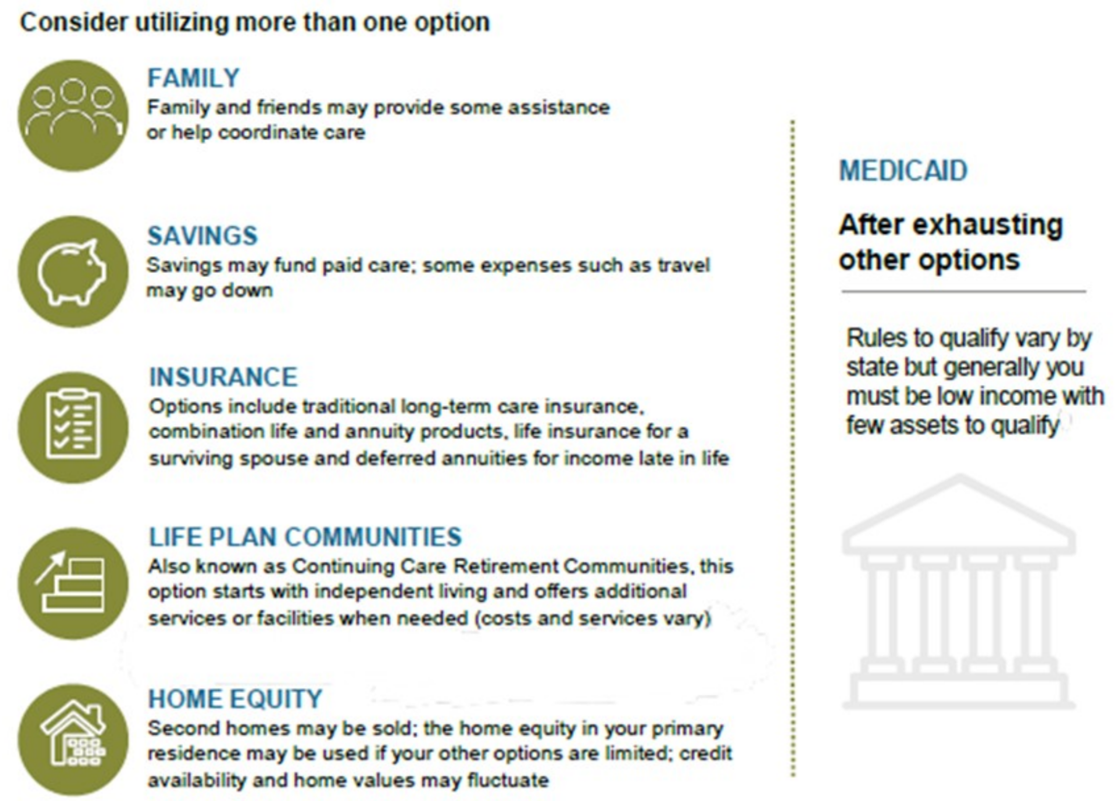
While Medicare and other forms of health insurance may pay for skilled care resulting from hospitalizations for a limited amount of time, they usually will not pay for ongoing care beyond a few months, they will never pay the full cost of the care, and they will not pay for much in the way of unskilled care. Likewise, though Medicaid pays for skilled and unskilled long-term care for millions of Americans, a patient has to be pretty much destitute in order to qualify. Even if that person is married, their spouse would not be allowed to have much in his or her name, certainly not enough to maintain a desirable lifestyle during retirement. The Medicaid qualifications vary by state, but in general to qualify a person, or a couple, have to have very little in the way of income and assets.

So what is a person to do? People who do not have long-term care insurance must either pay for care from their income and assets, or have Medicaid pay for it if they qualify, or they pay for it from their income and assets until those are depleted to the point they qualify for Medicaid. Instead of purchasing insurance, people can opt to save extra to pay for some amount of future long-term care, and the upside to that approach is that if care is never required, then you have extra to pay for retirement expenses or to pass on to your beneficiaries. The downside is that it is very difficult to save enough to pay for something that can already cost over $100,000 per year. Additionally, if people withdraw from their IRAs or 401(k)s to pay for care, those dollars are usually fully taxable, knocking them into a much higher tax bracket, which also frequently increases the taxability of their social security and of their Medicare Part B premiums. Taken out in big lumps, it is easy to lose a third or more of your IRA withdrawals to taxes, and you will end up paying more in total for long-term care than the cost of the long-term care itself.

As a result, many people choose to transfer some of the financial risk of needing long-term care in the future to an insurance company. Policies can take many forms, but in general they provide a monthly amount of benefit that may increase over time for a certain amount of years. So a common benefit would look like $5,000 per month in benefits increasing by 3.5% per year for 3 years. The higher the starting monthly benefit, the more likely the policy will pay for the full cost of care in the early days. However, given how costs in the healthcare industry have been increasing at a rate well above general inflation, it is possible if not probable that even with inflating monthly benefits, you may still need to pay for some amount of care out of pocket even after you begin collecting the policy's benefits. That does not negate the effectiveness of buying long-term care insurance, as it has the potential to still save a policyholder hundreds of thousands of dollars over the duration of their care.

Like most insurance products, we ask our brains to compare the cost of the coverage to the likelihood that we will need it, which is like comparing apples to elephants when it comes to long-term care. With a 64%+ likelihood that we will need to pay for this care in the future, what we should ask is whether or not we would be able to pay for it completely out of pocket if we needed the care and still leave a spouse or beneficiaries in good enough financial shape to meet their needs. Having to pay hundreds of thousands of dollars above many of your planned retirement expenses is one of the few things that can completely crash your retirement plan. Although long-term care insurance is more expensive than term life insurance and most disability insurance, if you had to work an extra year to pay for insurance that would protect your ability to meet your retirement goals, for example, were you to need to pay for long-term care, would you be willing to do that? It is very likely it would not be as drastic as that, but when faced with this question, most people would be willing to delay their retirement for a bit in order to protect it.

# Paying for Care




<u>Take Action</u>

No one knows what the future holds, save for death and taxes, of course, but the irony of life expectancies increasing and medical care improving to the point many things that used to end someone's life can now be managed, is that the need to pay for care as we age has increased with our lifespans.  For those who want to live good, long lives, that may be seen as a good problem, but it is still a problem.  We advise that when you consider how you would pay for long-term care, you assume that you will actually need it some day and consider some kind of game plan for how you will handle it. For most Americans diverting dollars into insurance premiums or extra savings for one particular goal means there are fewer dollars for other important needs. It isn't easy to decide which area of life may have to be left a little more uncertain than others.  These are decisions a trained financial advisor can assist with, and fortunately for our clients, this is one of our core competencies that can be addressed as part of our financial planning process.

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