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Cadence *clips*

FOCUSED ON WHAT MATTERS MOST.

Buying The Dip

"Buying the dip" is an investment concept that most of us are aware of, and for those tuning in to financial media television, you probably hear it multiple times a day. The idea of course is to take advantage of price declines so that one can establish an investment position that is either more profitable down the line, profitable faster, or both. Buying after declines can make tremendous sense, but it has to be done correctly. Every sharp market decline starts with a dip, just as every long-term bear market begins with a dip, so investors need to make sure they are executing on this concept within the context of a more comprehensive process. The two most important considerations being first, to make sure the probabilities favor the dip being short-lived, and the second being that there is also a plan to take profits along the way so that there is cash with which to buy future dips.

A dip or the start of something bigger?

There are a couple of ways investors might seek to put the odds of successfully buying dips in their favor. The first is to make sure the economic backdrop is supportive of the investment in question. When it comes to the stock market, most large declines and bear markets tend to occur when economic growth is slowing. Thus, if one is considering buying the dip in a traditional stock, doing so in an environment of expanding economic growth would likely keep that decline from turning into a large or long-term one. By contrast, U.S. Treasury bonds tend to perform better when economic growth is slowing, so although investors should think twice about buying dips in stocks as the economy is weakening, high quality bonds could make more sense. The same goes with inflation. Commodities tend to perform well when inflation is accelerating, so adding to commodity investments on declines when this is the case can make sense.

The second way to increase the odds of dip-buying success is to buy only those investments that are trending upward over a short to intermediate period of time. There are a number of ways to measure and define this, but the point is to only add to investments that are behaving well and most likely still in their price-expansion phase. Unless there are other compelling reasons to do so, which there very well could be, buying dips in investments that have been trending downward for some time have a tendency to turn into longer-term investments – which is to say, the downtrend often continues after the dip is bought. So, making sure the economic backdrop and the intermediate price trend are both in your favor can increase the chances that your efforts pay off not only in the shorter term, but in a more repeatable way.

Taking Profits

The second consideration for buying dips is to make sure you have a process in place to take profits from the things that are performing well in your portfolio. After all, continually buying investments on declines is only possible if there is money available with which to buy them. There are a number of ways to evaluate and measure when it might be a good time to take some profits in an investment, but the important thing is that there is a discipline in place to do so. In some cases, it might be after a certain percentage gain is achieved whereas in others it could be upon observing a shift in macroeconomic or internal market conditions. At Cadence, we use a proprietary tool that models a security's volatility-adjusted price range to help us determine when it might be a good time to trim and add to positions that fit within a given macroeconomic framework. For example, if we are observing an acceleration in inflation, we will look to both trim and add to commodity positions as their prices move between certain price ranges. Once we observe a change in the inflation cycle from acceleration to deceleration (disinflation) however, we might look to trim positions only rather than add to them on dips. In this case, if growth is also decelerating, we might look to redirect those purchases to treasury bonds, which tend to perform best in an environment where both growth and inflation are slowing. The key is to take some profits along the way so that we're always ready for the next decline. There's an old expression in investing that "nobody ever went broke taking a profit".

The mistake many make is investing in things that are falling in price thinking that they are buying low. Although it's true that they are buying "lower" than before, they may or may not end up buying low since in many cases, a price decline may only be in the early phases of a much larger decline. The mistake is not thinking through the many conditions that could be suggestive of the decline being only a temporary dip rather than something potentially bigger. Again, if the economic and inflation cycles aren't supportive, and the market signals and trends aren't supportive, then dips can turn into disasters very quickly. To be clear, no process is perfect and disasters can always happen despite one's best effort to avoid them. In investing, it's all about putting the probabilities in your favor. If most of the dips you buy are short-lived and shallow, then over time you'll come out ahead. So, the questions investors should be asking themselves now are:

- What am I taking profits in next so that I have cash to add to other positions on weakness?
- What are those other positions I'd like to add to when they decline in price?
- How do I know if those declines are likely to be temporary in nature rather than the beginning of something greater?

If you have the answers to these questions today and a process in place that can continue to provide you with these answers tomorrow, then you're a step ahead of almost everyone else.

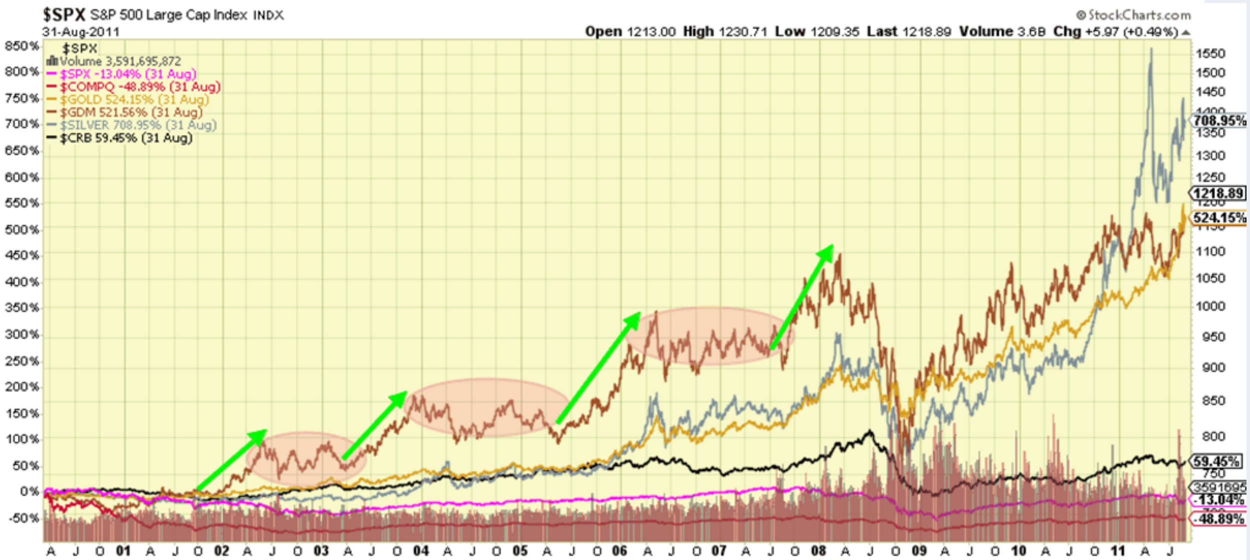
Market Update

For those taking an alternative path with their investment game plan in an attempt to insulate themselves from the biggest financial asset bubble in history, the last few months have been a little rocky; September being no exception. Commodities as a broad category have struggled despite energy and agriculture performing reasonably well; metals and mining have performed poorly. This is against the backdrop of stocks and bonds remaining near all-time highs, at least until the last month, which makes it all the more difficult for investors charting their own course. Most clients in periods like these ask us, “Are you worried?” and “Should I be?” Our answer to these questions is “no”, and here’s why.

Longer term, commodities are priced about as cheaply relative to stocks as they ever have been. As you can see from the chart below, relative prices are near where they were in the early 2000’s right before they began a 10-year bull market in performance. Everything moves in cycles; commodities are no different in this respect. The last 10 years or so have been horrible, which would suggest that the next 10 should be significantly better. We expect the exact opposite from the major stock indexes for this reason.

The chart on the following page shows the difference in performance in the 2000’s between commodities, precious metals and miners and the S&P 500 and Nasdaq indexes. From a very similar relative value starting point as we’re witnessing today, you can see the stark difference in outcome over a longer period of time. As our clients are well aware, our priority is to avoid as best we can the experience stock market investors had in the 2000’s, and to seek one that more closely resembles that of commodity investors.

What’s also important to note from the chart are the periods of sideways to down price action in the first few years of the bull market uptrend and how long they can last (outlined in red circles). This is common after sharp upward moves in price and are referred to as consolidation. Since nothing goes up in a straight line from the point A to the eventual and final point B, strong bull markets are often marked by sharp increases, periods of consolidation where price does very little, followed by another sharp price move. Rinse and repeat until point B is reached, which for the last commodity bull market, was in mid-2011. Again, the takeaway is that the difficulty commodity markets (precious metals in particular) have experienced lately may well be one of these consolidation phases that is setting the stage for the next upward thrust in price. Time will tell.



Shorter term, gold and precious metals are highly (negatively) correlated with real interest rates, which is simply long-term treasury bond rates minus the inflation rate. Given where real rates are now, gold should be trading much higher, which to us indicates that the recent weakness in gold and precious metals prices isn't justified. There may be other forces at work that are more noise than signal. If one of these forces is a concern that interest rates are headed higher again, it's fair to say that much of that anticipated move higher in rates is already priced in given the size of the disconnect. In other words, for correlations between gold and real rates to sync up, interest rates on the 30-year treasury bond would have to rise by over 2% relatively quickly. Given how leveraged our financial system is currently and the pattern we've witnessed in recent years of things breaking within the financial system after much smaller increases, we'd view this development as extremely unlikely. If rates did increase by over 2% within a short period of time, we'd have much bigger issues to worry about. So, the bottom line here is that precious metals prices are more likely to recover significantly than are interest rates.

As for the rest of the commodities category, those tend to march to the beat of a different drummer. If inflation is persistent, which we think it is, then they should do just fine. Additionally, energy and agricultural commodities tend to perform much better in rising interest rate environments than precious metals, so there would be a diversification effect here if rates continue to rise modestly. Given that our view is still that we're in a modest economic deceleration (slowdown) and inflation is likely to be sticky, commodities as a broad category should stabilize and serve us just fine in the intermediate term. Longer term, it's also important to keep in mind that given where they are in their cycle and relative valuation to other financial assets, any downward volatility should be modest and fairly short-lived. We can't say the same about traditional stocks and bonds. Hang in there and remember that anything worth owning gets difficult from time to time. If it's easy and comfortable to own, it's probably in a bubble, which means it only works right up until the moment it leaves you wondering what the heck just happened.

Open Enrollment Time: Things to Consider

As summer ends and fall begins, another seasonal event is about to happen: workplace open enrollment. If your employer offers benefits, now is a good time to reexamine your options and coverages to see if you should make any changes before enrolling for your 2022 plan year. Not all employers have their open enrollments in the fall, but this is still a good time to evaluate what is on offer so you'll be ready when the time comes. And of course, at Cadence we're available to help you navigate through your options.

Health Insurance Plans

Even if you plan to keep your existing coverage, take a look and see if your plan's features will remain the same. If you are married and your partner's employer also offers a plan, it may make sense to compare what they have available to see if it would offer you a better cost-benefit than your existing coverage, especially if your situation has changed since the last time you enrolled in a health insurance plan.

Premiums are getting more expensive every single year. Deductibles and co-pays are increasing in addition to monthly costs. Some employers may offer a high-deductible health plan (HDHP) with much lower premiums, so consider whether it is better to pay a higher monthly premium for a lower deductible or a lower monthly premium for a higher deductible (which may allow you to use a Health Savings Account).

Health Savings Account (HSA) and Flexible Spending Account (FSA)

To participate in an HSA, you must be enrolled in a high-deductible health plan (HDHP). An HSA allows you to save pre-tax money in an account to use for eligible health care expenses. Any money that is not spent in a calendar year can be rolled over every year, which makes an HSA a great way to save pre-tax money that will not be taxed later for health care costs.

Contribution limits for an HSA in 2022 are:

Individual:	$3,650
Family:	$7,300
55 & older:	$1,000 (catch-up contribution limit)

If you don't have a high-deductible health plan (HDHP), a good way to save pre-tax money for health expenses is a Flexible Savings Account (FSA). Unlike an HSA, FSA plans typically require you use what you have saved during the calendar year or lose it. Only $500 can be rolled over into the next year, though this exception can vary by employer, so check your company's options. You may also lose your FSA balance if you leave your job, so check your company's rules regarding FSA rollovers.

Contribution limits for an FSA account for 2022 are:

Individual:	$2,850
Married Households:	Each spouse can contribute $2,850 to their individual account

Other Insurance Benefits (Life, DI, LTC)

Open Enrollment is also a good time to look at your current life insurance amounts, disability insurance coverage (long -term and shot-term options) and if your employer offers it, long-term care insurance. Work with your advisor to make sure you are taking advantage of what your employer offers and to discern the proper amount of coverage.

Workplace Retirement Plans

If your company offers a 401(k), 403(b), or 457 retirement plan, see if there is a Roth option and review with your advisor to determine if contributing any amount to the Roth portion makes sense. Keep in mind, even if you save some in your company's Roth 401(k), and some in your company's traditional 401(k), you cannot save the maximum employee contribution dollar amount in EACH of them. The total amount you can save, whether it goes in to one kind of 401(k) or into both, is the maximum contribution limit plus catch-up contribution if you qualify.

If your company has a match, try and take full advantage of the free money your employer is offering by saving at least the amount that would qualify you for the maximum employer match. Taking full advantage of the match is a great way to help grow the size of your account.

For 2022, contribution limits are:

401(k)/403(b)/457 Employee Contribution:	$20,500
401(k)/403(b)/457 Catch-up Contribution:	$6,500
SIMPLE IRA:	$14,000
SIMPLE IRA Catch-up Contribution:	$3,000

Some employers may also offer deferred compensation plans available for highly compensated workers. Unlike a 401 (k)/403(b)/457 plan, deferred compensation plans normally offer no protection from an employer's creditors. Usually open enrollment is the time where you need to make the election to participate in next year's deferred compensation programs so work with your advisor to determine the risks of your company's plan, and if you participate, the proper amount to contribute.

This is by no means a complete list of all the company benefits that may be available to employees during open enrollment (legal plans and employee stock options are a few that come to mind) but they are the most common options we see. As mentioned earlier, we're available to help answer any questions you may have regarding your company's benefits and help tailor your open enrollment selections for your family's needs.

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