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Cadence clips

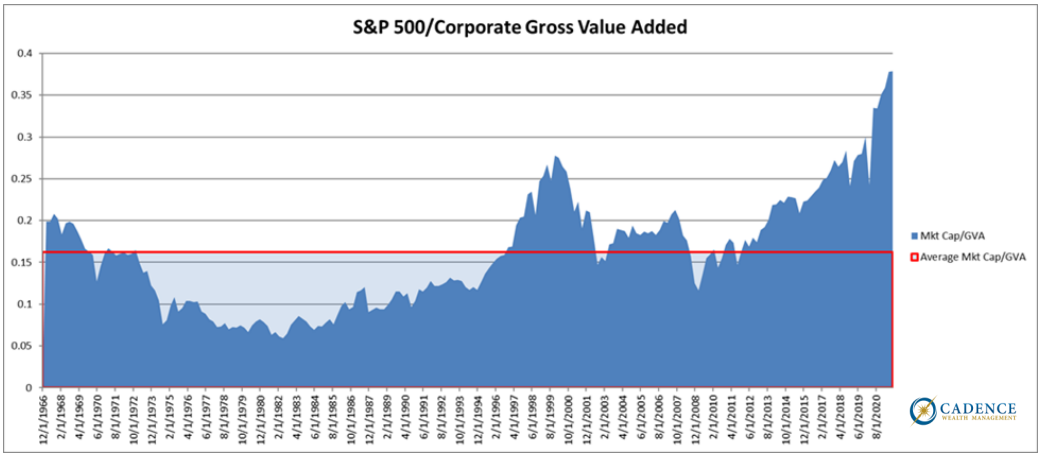
FOCUSED ON WHAT MATTERS MOST.

The Danger of Owning the "Market"

By Casey Clarke

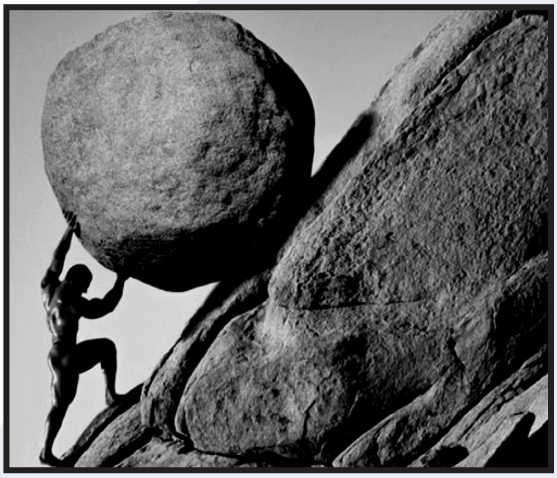
As of the time this article is being written, October has shaped up to be another stellar month for the stock market. Going back to the lows in March of last year, the S&P 500 has more than doubled, pretty much erasing the horrific experience of one of the most acute declines in history from investors' memories. Chalk it up as just another near miss, shot across the bow, or tremor before the ever-so-elusive big quake. As the frequency of these temporary market declines increases, investors seem to grow more and more complacent and take bigger and bigger risks; after all, how else do markets get to new all-time highs? As this chain of events gathers momentum, it becomes harder for people to ignore. Those who have sat out grow regretful having missed the large gains, and ultimately capitulate and invest. Those who have participated in the large (and seemingly easy) gains begin to add leverage in order to magnify those gains. This is how cycles work, because after all, market cycles are driven by humans, and as much as we'd like to think we're smarter than those who came before us, we're not. Although every cycle is different in it's length, magnitude, and particulars, they will always retain the general shape of a sine curve, and will cycle up and down over time accordingly. All this begs the question; where are we currently along the sine curve (our current cycle)?

When looking at the stock market relative to the amount of "stuff" that U.S. corporations are selling (basic definition of corporate gross value added or GVA), you can see from the chart that the value of the S&P 500 cycles up and down over time around an average or mean (red line).



Toward the end of economic expansions and stock bull markets, investors are willing to pay more for stocks (late 60's, late 90's, and now), whereas when the economic situation grows more dire and market experiences less rewarding, it takes far cheaper prices to induce investors to buy them (70's, and a short period of time in 2008-2009). If our chart went back another 50 years, we'd see that investors paid above average prices for stocks in the late 1920's, which led to stocks being valued well below average throughout the 30's and into the 40's. These big, long cycles appear to run in 35 to 40-year increments when left to do their thing in a relatively natural way. Of course, this is the part where we remind you that nothing about the last 20 years has been natural. With central bank intervention running at unprecedented levels and government debt, as a result of aggressive fiscal spending to keep things chugging, shooting from 55% to 125% of GDP since 2000, the natural, cleansing, reset part of this cycle hasn't been allowed to play out. If you're wondering if there are consequences that come with that, just look around. We would venture to say that most of the economic disparity, social strife, and general unease we're witnessing is directly related to our inability to let the economic and market chips settle where they may, but settle they eventually will. Cycles have not been abolished.

We've developed some humility over the years watching Sisyphus continue to roll this boulder up the hill, and so who's to say he can't keep it from rolling downhill a bit longer? When he does finally lose his grip however, that's when the damage done will likely be completely relative to how far up the hill the boulder was perched and for how long. Whole villages get built at the bottom of the hill when the townspeople don't think it's possible that the boulder and gravity will eventually prevail. Back to the chart on the previous page showing the S&P 500 relative to the stuff those companies sell (GVA), or how much investors are paying relative to that stuff, never higher and never more. The boulder is as far up the hill as it's ever been and it's been up there almost uninterrupted for about 25 years.



So, what does this mean?

It means that if over the next 10 years, the S&P 500 works its way back into balance with the long-term average (between its price and the level of corporate gross value added), investors would average -4.2% per year over that 10-year period (table on the following page). They would essentially have 30% less money after 10 years because they paid too much. How does this happen? Simple. It's most comfortable to invest when things are going great and have been for a while. This tends to be the case toward the end of long-term cycles when things are way too expensive. If one wants to make money in markets that they can hold onto and not lose in a puff of smoke down the line, he or she should invest most aggressively when markets are cheap and nobody else wants to buy them. Invest in a balanced way when markets are fairly priced and dial it back a fair amount and impart more discipline as they get expensive. Finally, when the market's price no longer makes sense, find another investment that does.

The assumptions on the next page assume the current dividend of 1.3% applies to the current market level throughout the 10-year period, GVA growth will equal 3% over that period of time. This is consistent with the decelerating trend in economic growth we've seen over the last 20-30 years. We expect the GVA growth rate of 3.7% over the last 20 years will slow to 3%.

Avg Mrkt Cap/GVA	0.162445187
GVA Growth Rate	3.0%
Current Dividend Yield	1.3%
GVA In 10 Yrs	$15,279,337.42
S&P at Mean in 10 Yrs	2482.05
S&P at Last GVA	4307.54
S&P Now	4575
Average Annual Return w/Dividends	-4.2%

How patient should I be?

Let's put it this way. If you're waiting to reinvest in the major stock market indexes until they offer better long-term prospects, you can go on vacation for a week or two and won't miss an opportunity. The table below illustrates what return prospects would be over a 10-year period following different percentage declines in the S&P 500. As you can see, buying and holding a 10% drop in the market only improves your 10-year return to -3.1% annually. More patience please. After a 50% or 60% decline, we're looking better. Again, this isn't an all or nothing exercise. As markets get more and more attractive, one can get more and more aggressive, proceed to fall asleep on the job, and probably still be okay.

Market Loss From Here	S&P Value	Implied Return Over 10 Years
-10%	4117.50	-3.1%
-20%	3660.00	-1.9%
-30%	3202.50	-0.4%
-40%	2745.00	1.3%
-50%	2287.50	3.3%
-60%	1830.00	6.0%
-70%	1372.50	9.5%

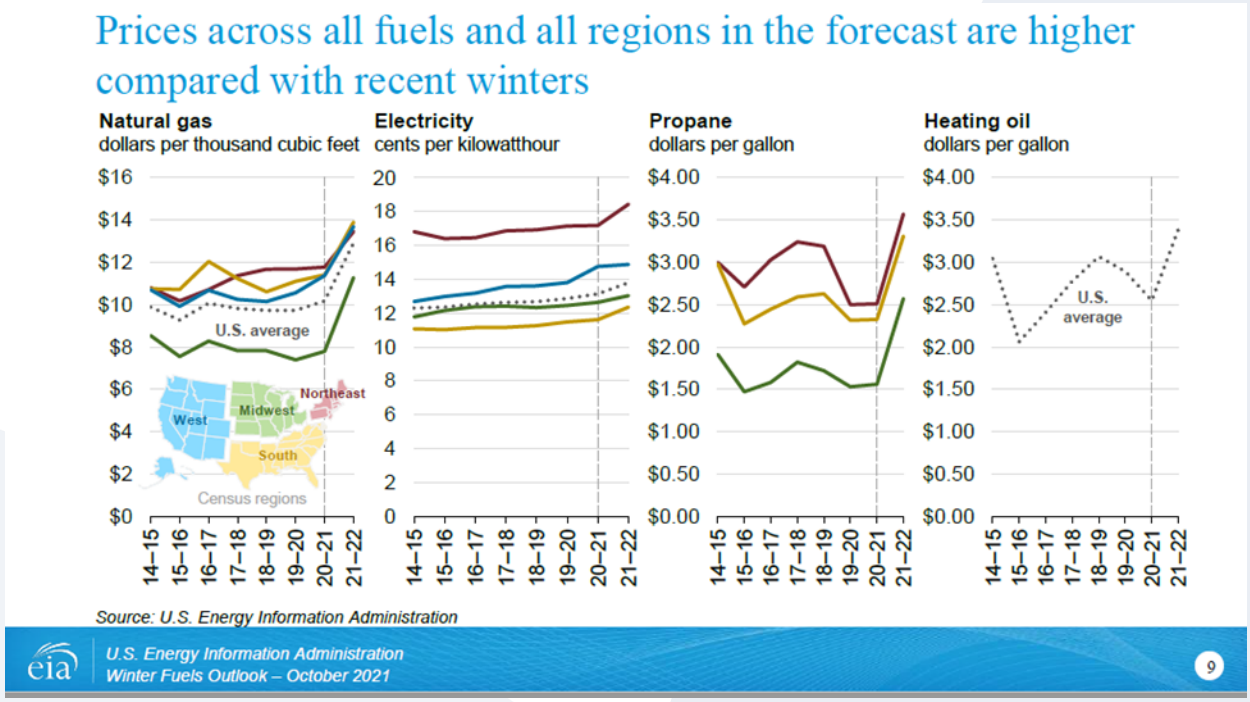
So, the takeaway should be this: If you've turned off the television and are now better able to think longer term, full cycle, then you're probably realizing the investment gains you'll have 10 years from now are not the ones people are chasing today. They're the ones that come either from investments that offer good value right now (not the same ones the masses are focused on) or from the popular investments of the day that are bought at much lower levels at some point down the line. That 100% gain in the S&P since the March 2020 lows? It'll most likely vanish at some point and will be just as much a distant memory as the -35% five-week drop back in February and March 2020 is to investors today. Part of what makes investing so hard is remembering that growth only matters if you keep it. The best way to execute on this is to have a process that doesn't allow you to get caught up in the emotion of the day. Buy what makes sense and wait on the stuff that doesn't. The good news is that there's almost always something that makes sense. Today is no exception.

Home Heating Fuel Price Outlook: Winter 2021-2022

By Steve DeBoth

"Oh, the weather outside is frightful."

It's coming. Winter is coming. That's no real surprise, because it happens every year about this time. However, what may come as a surprise this year is that home heating prices are estimated to be 6% to a whopping 54% higher than last year, depending on what fuel you use to heat your home. Those prices have the potential to be a bit lower or a fair amount higher this season, depending on how certain forces behave. What are those forces, what affects them, and what is someone averse to growing icicles from the end of their nose to do this winter?



Factors Affecting Home Heating Fuel Costs

Every economics professor since the beginning of time has drilled into their students' heads that the price of a good or service is determined by supply and demand, and nowhere is that more true than when it comes to commodities like oil and gas. The major forces affecting supply and demand of home heating fuels include:

1) Globalized Marketplace: Markets for oil and gas get more global every year, so a shortage or surplus in one part of the globe can affect prices in all others. Additionally, geopolitical tensions, especially in the parts of the world responsible for producing large amounts of oil and gas can affect prices. This is mostly a supply-side factor.

2) Inventories: When the current supply of a commodity is low, this will generally increase its price. This is a supply-side factor.

3) Competition: The more providers available to supply your fuel, the more downward price pressure there is. This is a supply-side factor.

4) Government Policies: Any initiative at the state or federal level that influences the supply or demand for a commodity will affect its price. Over time, these have helped natural gas prices as government policies encouraged increased production. However, the more there is a push away from "dirty" fuels like oil, the more expensive those sources will become. Government policies can therefore be both supply and demand factors.

5) Natural Disasters: Anything that disrupts the ability to get oil and gas out of the ground, process the fuel to the point it can be used, and then deliver it to homes and businesses will increase prices. Hurricanes in the Gulf of Mexico, ice storms in Texas, and wildfires in California have all affected energy prices. As the word "disaster" implies, only bad things happen to energy production and delivery when they occur. These can be both a demand and a supply side issue, and they only make prices increase.

6) Weather: The colder the winter, the more fuel it takes to keep your home at its desired temperature. This is mostly a demand-side factor unless the weather reaches "disaster" levels, in which case it can also affect supply.

7) The Economy: The more economic activity that is happening, the greater there is a demand for fuel. This is mostly a demand-side factor, and it is a big one.

These relationships are all pretty straightforward: increased supply and decreased demand make prices go down; decreased supply and increased demand make prices go up. So how are these factors looking going into this winter?

This Winter

The Good:

Some of the elements decreasing fuel prices going into this winter include:

- Domestic Natural Gas Production: Despite recent hits to natural gas production, it has been increasing for decades and is expected to continue increasing, which will push prices lower than they would otherwise be. Additionally, accommodative government policies have encouraged extraction methods like fracking that have increased supply.

- Number of heating oil suppliers in the Northeast: For oil, the Northeast is the area of the country that has the highest percentage of homeowners heating this way. The relatively high amount of heating oil suppliers in our region fosters some level of competition that keeps prices lower than they otherwise would be.

The Bad:

Some of the elements increasing fuel prices going into this winter include:

- Colder winter: Possibly only by a little bit, but even a modest increase in the coldness of the season has a disproportionate affect on energy demand. For example, gas prices are predicted to be 30% higher this year, but if this winter is even just 10% colder than last year, the cost of heating your home with gas will increase an estimated 50% as opposed to the current 30% estimate. The same disproportionate increase affects the other heating options as well.

- Inventory: Crude oil stockpiles are around 6% below their five-year average. Even though natural gas production has been increasing for years, interruptions to production do still occur and can take quite a while to bring back fully. Working natural gas in storage is currently lower than it was last year, and lower than its five-year average, in part because production decreased in 2020 and is not expected to be back to pre-pandemic levels until 2023 according to the U.S. Energy Information Administration report from February 3 of this year. Lower inventories of crude oil and natural gas lead to increased prices.

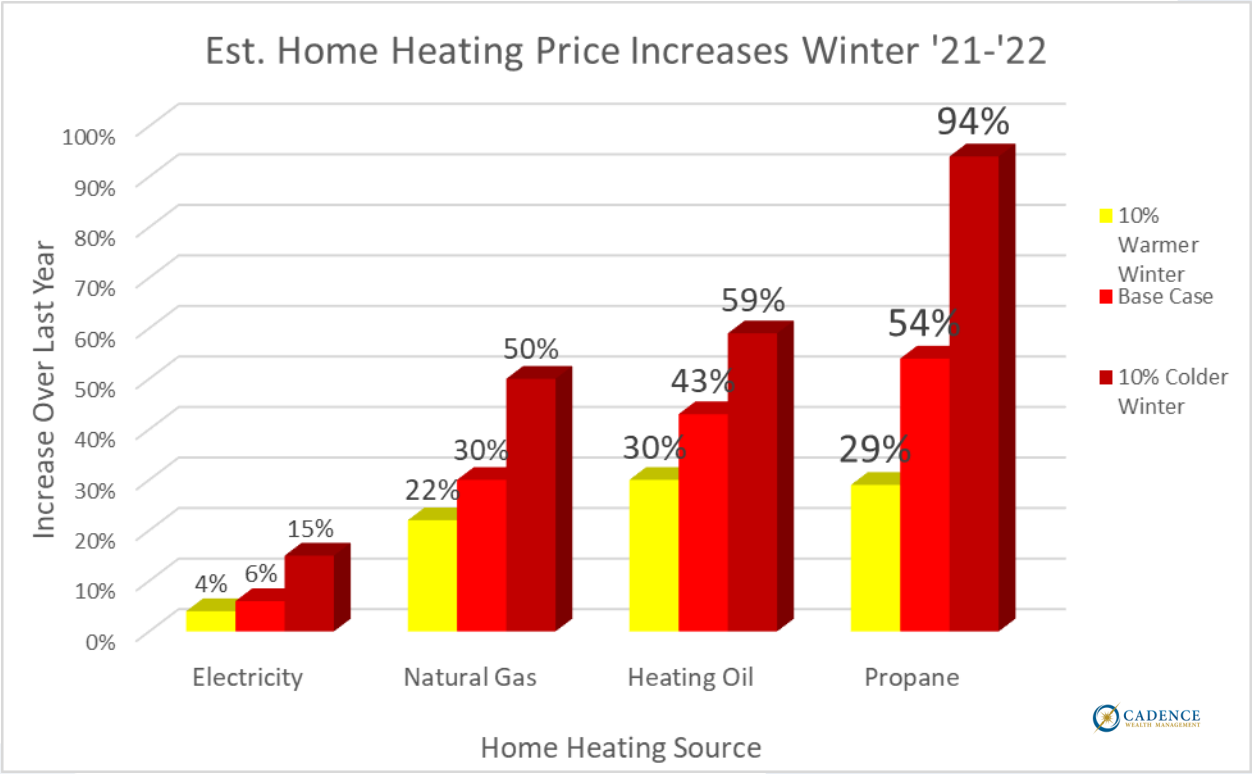
- Global Demand: For a variety of reasons, natural gas prices have reached all-time highs in parts of Europe. With a global market place, many producers will choose to ship to the region in which they can generate higher profits, reducing supply to the US and increasing our gas prices.

The Ugly:

The main element increasing fuel prices going into this winter:

- The Economy: Whether it's Asia, Europe, or the United States, economies all over the world have improved dramatically since last year. More people will be back at work this winter compared to last winter, increasing the energy demands. Big buildings just take more energy to heat than houses. More cars on the road drives the price of crude oil up, which also drives the price of home heating oil and propane up. Increased demand on natural gas prices also drive up prices for electricity, with roughly a third of the electricity produced coming from burning natural gas. With so many of the world's large economies in the northern hemisphere, and with all of them entering the cold months of the year at the same time, the demand for heat skyrockets when economic activity increases, especially as it has since last year.

When you add up lower inventories, unfavorable supply and demand conditions in other parts of the world, and a robust global economy, all of those factors add up to prices being higher than last year, even with a few other factors being favorable. Warmer temperatures may reduce these affects to a degree, but colder temperatures will push them disproportionately further in the wrong direction:



What You Can Do About It

Examples of how to protect yourself from higher prices this winter, including the winters to come:

1) Manage your thermostat. It is estimated that for every degree colder you keep your house in the winter, you decrease your home heating costs by up to 3%. In a winter like this winter, that 3% savings per degree may be fully realized, so reduce your thermostat by 3 degrees and you may achieve somewhere in the neighborhood of a 9-10% decrease in heating costs. The higher your thermostat is set to begin with, the bigger savings you get by turning it down 1 degree, especially in a colder winter.

2) Reduce your spending in other areas. If you want to insulate your budget from higher heating costs, look for other expenses you can decrease. Watch your holiday gift buying, cook more meals at home, hunt down and eliminate monthly subscriptions you don't really use. This would be a good year to cut back on what you can, because home heating prices will work against you and you have no control over those.

3) Invest in electric space heaters. In the event you heat your home with something other than electricity, consider using electric space heaters the way you would use window air conditioning units in the summer. This

strategy only works if you pay enough less for electricity than you do for what you use to heat your home. Monitor your electricity bill to make sure using space heaters actually does save you money. This strategy will help you manage your thermostat per point one.

4) Make your home more energy efficient. Cover windows with plastic, buy "door pillows" to block drafts, and get your furnace serviced as soon as you can so it is burning as efficiently as possible. Open the shades on your south facing windows during the daytime to let the sun in, and close your shades at night to help insulate your windows. Over the longer term, consider adding storm doors, getting new windows, and adding insulation to your attic.

A variety of factors have driven home heating costs noticeably higher this year, with heating oil at prices not seen for seven years, and natural gas for thirteen years. Knowing these higher expenses are coming your way now before the really cold weather arrives can hopefully help you strategize in advance of those first snowflakes. The list of suggestions on how to handle the prices this year is only a partial list, and over the long term making your home as energy efficient as possible will probably be worth it, provided you plan on living there long enough to make what you spent pay off. Whatever you choose, we advise you do something to reduce your home heating spending before Jack Frost starts to really nip at your nose.