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Cadence clips

FOCUSED ON WHAT MATTERS MOST.

Narratives Aside

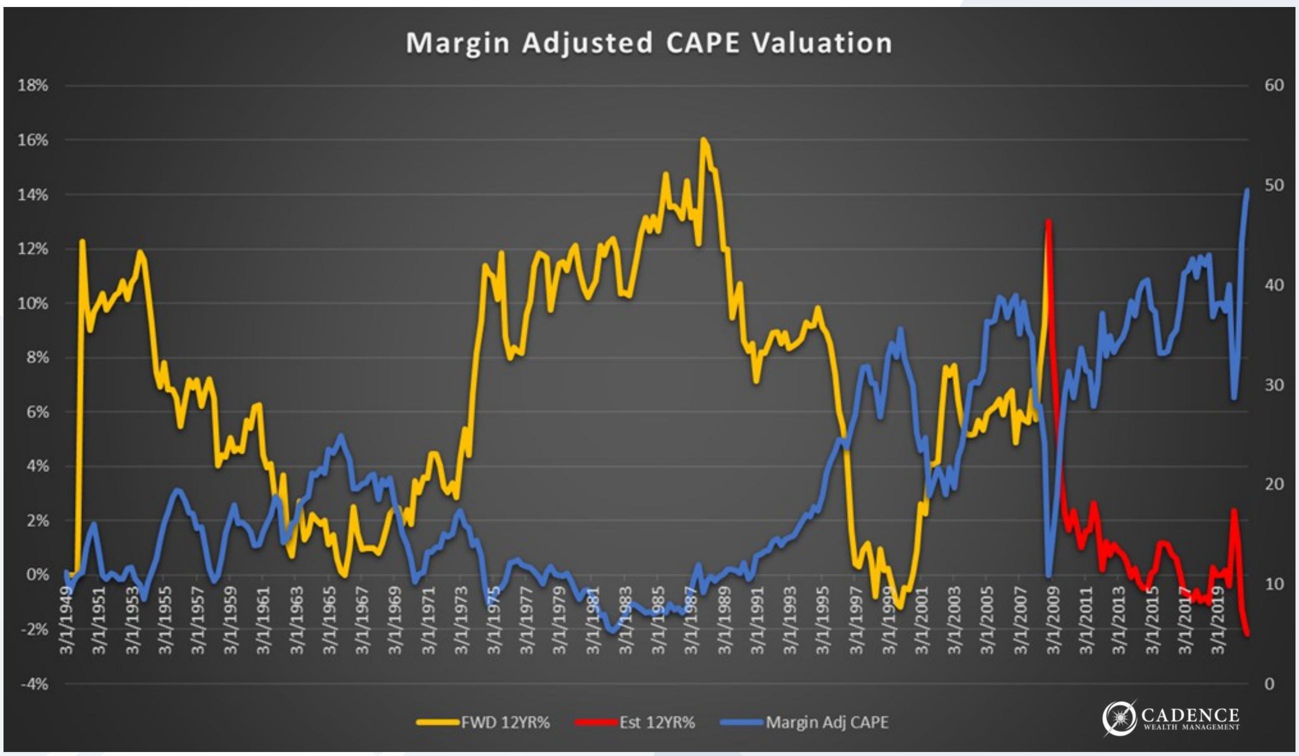
Last month we talked about incentives steering behavior. Well, often times those incentives also shape the narrative around certain issues. When it comes to markets, it's no secret to seasoned investors that a significant part of the "game" is the crafting of a good story to create the appeal and confidence that is required for new investment. It's that new investment that matters most to Wall Street and the financial industry as a whole, so there's always a compelling reason to invest in a hot new IPO despite the lack of profitability or even a sound long-term business model. There is also limitless creativity employed in arguing why markets are fairly priced and should keep going up in perpetuity, with concessions being made for the occasional short-lived and "healthy" 10% pullbacks in price. This is the game and it cares less for the well-being of the average investor than it does for its own survival. The reality is that markets can and do go down a lot from time to time just as winter descends on the northeast every year, and rain comes, and sickness occasionally finds us all. This is the reality we at Cadence try consistently to operate in, where the data along with common sense dictates our view rather than a story of what could or should be. And so with narratives checked at the door, here are the most important high-level data points that we think all investors should be aware of and incorporating into their planning.

<u>The Next Decade at Least is Likely to Disappoint!</u>

The price we pay determines the return we get. Pay too much and although we may make money in the near-term, over time our returns will be lower than expected. Anything that fluctuates around some sort of mean (average) eventually reverts back to that mean and through it in the other direction. In New England, 105-degree days are rare and don't last for very long when they arrive. It would be completely foolish to assume that just because we've endured 3 or 4 in a row that somehow they would become the new norm or average temperature. If there's one thing that we've all witnessed in recent years, whether due to climate change or not, it's that extreme temperatures and weather phenomena occur in both directions. Markets are no different.

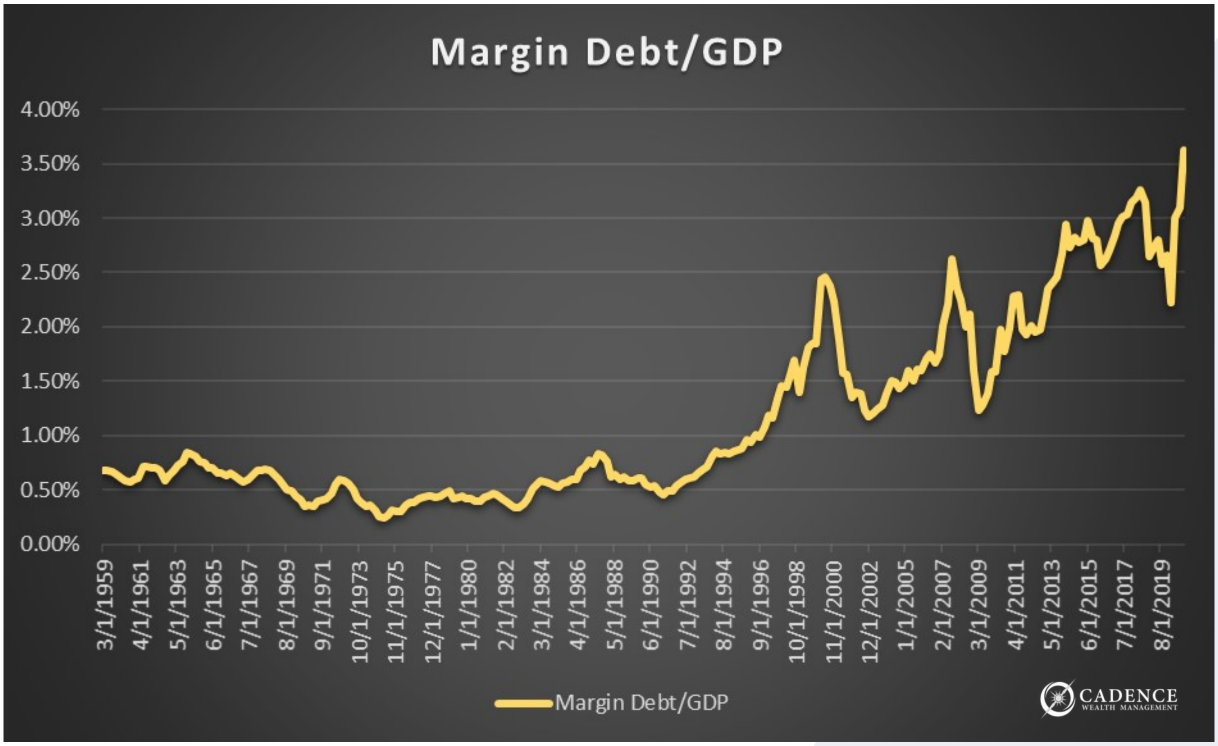
When we look at the level of the stock market today relative to corporate profits (that are smoothed out over

10 years to adjust for ups and downs in the business cycle) and adjust those profits for ups and downs in profit margins, we get the blue line in the chart below. It fluctuates up and down over 70 years around an average. If we went back further, we'd see even more evidence that this relationship – the level of the stock market relative to company earnings – goes up and down over time, in cycles. Fact – we have never been more expensive than right now. Observation – Returns over the next 12 years if we invest anywhere along the blue line are indicated by the red line. When the blue line is high, returns over the next 12 years (red line) are low. When the blue line is low, long-term returns tend to be high. There is roughly a 90% correlation between the price we pay for stocks and the long-term return we get. Based on where valuations have been over the last 7 years, gains received over that period of time have a very real risk of being wiped out completely by the time 12 years are up, somewhere around 2025. Even worse, this relationship suggests that as valuations cycle back toward their mean level, investors today could stand to lose more than -2% annually over the next 12 years. We have nothing to gain in sounding hyperbolic. These are the numbers as they relate to history and the math behind them. The likely reality as we see it is that stocks will do more to hurt investors at current levels over the next 12 years than help them. They will do more harm to financial plans than help. Although they may make many feel rich and well-prepared for the future in the moment, they'll probably do the opposite in time.



Fuel for The Fire

We've discussed how debt levels in general have a stifling effect on economic growth and dynamism, but as it relates to margin debt (the debt that's used to buy more stocks, bonds, and other financial instruments), the more leverage that's used to speculate, the more active and volatile things can get. This is true on the way up and on the way down. We can argue all day that a stock should go up because it has a good business model and healthy profits, but in the end, it's demand for that stock - investors putting money into it - that drives it higher. The more money that flows into a stock or the market as a whole, the higher it can go. Leverage is nothing more than an additional source of money to help drive prices higher. We can see in the chart on the next page that even after normalizing investor margin debt levels for economic output (GDP), we stand at all-time high levels. It goes a long way toward explaining why markets are at all-time highs even though we're still mired in sluggish economic growth and a very sobering unemployment situation. There's been tremendous speculation in markets and record levels of debt with which to do that speculating.



More important though is the effect this leverage can have when stocks start moving lower. When you borrow someone else's money to speculate with and you start losing, you lose at a much faster rate than had you just stuck to investing your own money. For example, let's say you had $100,000 in a brokerage account, and feeling good about your ability to pick hot stocks, you borrowed an additional $100,000 to invest. Now you have $200,000 invested in hot stocks that "only go up", but for some strange reason, the stocks start going down. They drop -20% in a hurry, which wouldn't be the end of the world normally, but since you borrowed money, you're actually down -40% in account value. A -20% loss on $200,000 is $40,000. You now have $160,000 in stock value, but after paying back your margin loan, you'd only have $60,000 left. That's a -40% loss. This is how high debt levels can hurt just as much on the way down as they helped on the way up. They create faster losses and forced selling, which can cascade into even more selling. At record market valuations and record speculation as measured by margin debt levels, risk of large, sudden and lasting losses quite literally has never been greater. Everyone with money in markets, especially those close to or already retired should take this very seriously. History is replete with examples of how these environments tend to resolve. We're not doing much guessing on this. The guessing would be speculating as to how exactly it plays out. We don't have the answer to that. It's unique every time.

Finally, as asset managers and fiduciaries, we have to make decisions on how to best navigate this reality. It's not easy, but it entails a combination of the following:

- Find investments that are more reasonably valued. Again, if the price we pay is fair, the odds of a better return over time go up. What this translates into is the risk of the investment being down for an extended period of time is lower than if the price paid is too high.

- Carry more cash than normal. When the risk of losing money is high, there is absolutely nothing wrong with earning nothing for a period of time. 0% return beats the socks off of -20%, -30%, or -50%.

- Invest in expensive asset classes, but do it at the right times with a process for getting in and out. This is complex, but for those investors who have a sound process, are macro aware, and can exit before small losses turn into big ones, it can work. Our process at Cadence allows for some level of this.

We continue to live in interesting times. Despite all the challenges we've faced recently and those that still lie ahead, there will be tremendous opportunities. Goals can still be achieved, but it's not going to come easily for most. Those who can see past the narratives and view the world and investment landscape for what it is can adapt and overcome.

People Are Dying To Access Your Financial Accounts: Don't Let Them

It's a pretty common occurrence to hear someone has had their identity stolen, or credit cards duplicated, or bank account compromised. Despite the security industry's best efforts, there are still weak links in the chain when it comes to our financial information and access. The best time to add additional security to your online or phone access is *BEFORE* someone tries to log in or call in as you. Because Cadence Wealth custodies most of its client assets at Charles Schwab, we are able to pass along the various ways to increase the security on Schwab accounts, but we encourage you to explore how to increase the security on all your financial accounts, regardless of the institution. It does not take that long to add additional security, and as secure as you may feel your current level of access is, it's not as secure as it could be if you haven't taken these steps.

For your Schwab accounts, verify that the mobile phone number and email address attached to your accounts are correct. For many of these steps, and any time you try to access Schwab from a device for the first time, you will need to be emailed or texted a passcode.

ON-LINE SECURITY:

To prevent someone from logging into your Schwab accounts via the Internet – Including if you've never logged in and never intend to do so!

1. Two-Factor Verification.

Most of us have already had to receive a text from our wireless service provider or any other number of companies with which we do business to verify who we are when trying to access information or perform a task, even when we already have a username and password established. Schwab offers a similar level of additional security every time you log in to your accounts via the Schwab Alliance website or via the Schwab mobile application. Anyone trying to log in as you would also need to have physical possession of your phone, or to whichever device you have your secure code sent.

You have two options with Schwab: load a security code application on one of your devices, or have a text sent to you any time you want to log in. Either method will get you a six digit code you add to the end of your password when logging in. It's a different number every time you access your accounts. We at Cadence use the security application on our phones and are very comfortable using that method. One head's up: If you go that route instead of receiving a text from Schwab and you replace whatever device you load the application on, you will have to disable the two-factor verification on your account before you re-load the application; if you choose the texting option, you will not have to contend with that.

To establish the two-factor verification for using the Schwab website or Schwab mobile application, you have to log into your account via the website in order to turn the feature on – even for the mobile application. After that you can use the mobile application with the security code or text message addition and not have to go back into the website.

Here are the steps. If you're going to use the security token option, you will first need to load the VIP Access from Symantec application onto a device via your device's application store. It is free. You only load it onto one device.

1. Log into Schwab. If you haven't yet created a Schwab account, you will need to do that first.
2. Select "Service" toward the top of the page.
3. Select "Security Center".
4. Go to 2-step Verification.
5. Select "Always at Login".
6. Choose between text and security token.
7. Whichever you choose, follow the steps that appear on the screen.

2. Security Alerts.

While establishing your two-factor authentication, you will see there are additional security options. One is the ability to receive a text message any time changes occur to your login ID, password, email address, or phone number. All you have to do is put a check in the box to select that feature. We recommend that as well. Inside the Schwab mobile application, you would go into the "Alert Settings" to enable this functionality.

3. Extra Mobile Device Protections.

Just like phones and tablets can be passcode-enabled in order to access them, you can establish a passcode for just the Schwab mobile application. After you choose the six digit passcode, it's the same every time. Two-factor authentication protects you from someone who doesn't have access to your phone or tablet; the mobile application passcode protects you against someone who can get into your phone or tablet from also being able to get into your Schwab accounts. You just need to get into the Security Settings in the mobile application to enable that.

Additionally, for devices that allow you to log into password protected accounts via a thumb scan or facial recognition, you can also enable that with your Schwab mobile application. You can either select those toggle switches when you log into your Schwab mobile application, or you can go into the Security Settings in the Schwab mobile app to enable that.

4. Completely Disabling Online/Mobile Access.

If you do not use online access at all to view your Schwab accounts, or if you would like to temporarily suspend it, you can have online access completely disabled for you and anyone else who may try to log in as you. You would just have to call Schwab at 800-515-2157 to get your online access completely locked up, and also opened up again if you change your mind. Even if you've never accessed your Schwab accounts via the Schwab Internet site or a mobile application, you can have it locked up so no one else could try to create a username and password to try to gain access.

TO INCREASE SECURITY WHEN YOU CALL SCHWAB:

To prevent someone from calling Schwab and posing as you to gain information or remove funds.

1. Adding a Password.

Someone cannot just call Schwab and pose as you; they would need additional information about you and your Schwab accounts. However, that may be more possible than we think, so you can add a verbal password or passphrase for phone access. Nothing can be done over the phone without that word or phrase. If you enable this level of security, you really, really do not want to forget the password as it's a real pain to re-establish access if you forget the password. That is not meant to discourage you; protecting phone access to your accounts SHOULD be a serious matter, so re-establishing or changing the password should not be easy once you have it enabled.

2. Adding Voice ID.

You can also add a voice ID, whereby Schwab records your voice and that becomes the security token. According to Schwab, it's virtually impossible for someone to fool the technology. You would call Schwab and tell them you want to enable this feature. You will then repeat the phrase "at Schwab, my voice is my password" as many times as prompted, and that is that.

3. You could do both #1 and #2 if you want to lock phone access up as tightly as possible.

TO SUMMARIZE ALL YOUR SECURITY OPTIONS:

1. Use two-factor verification to prevent someone who does not have access to your mobile phone (or similar device) from being able to log into your Schwab accounts.

2. Use mobile device safeguards like an additional Schwab passcode, thumb scan, or facial recognition to protect against someone who may have access to your mobile devices from logging in to your Schwab accounts.

3. Enable security alerts to let you know if the username, password, email address or phone number associated with your accounts change.

4. Use 1, 2, and 3 together.

5. If you are never going to use the Internet to access your Schwab accounts, call Schwab to have that access completely locked down.

6. Add a password or phrase to your phone access to prevent someone from posing as you on the phone. If you do, make sure you write that information in a secure place where you can remember where it is.

7. Add voice recognition to prevent someone from calling in and posing as you.

8. Use 6 and 7 together!

9. If you have any other security needs, or would like help with any of this, call Schwab at 800-515-2157.

It would be great if we didn't need these security enhancements, and it would also be great if Monopoly money was real, but that's the world we all live in. The amount of time it takes to add these security measures pales in comparison to the amount of time it takes to get money added back into an account, and for fraudulent activities to be investigated. We are not able to catalog every single kind of device our clients use, and every last bit of device security they may experience as they access their Schwab accounts, so if you experience anything different from what is described above as you take action on these items, please call Charles Schwab at 800-515-2157. We do appreciate their willingness to keep our clients' assets secure.

We cannot urge you enough to take action on these items; protect what you've worked so hard to accumulate!

Roth IRA Reminders

As we approach the 2020 tax filing deadline, here is a friendly reminder to top off those 2020 contributions to your Roth IRA. You have until April 15, 2021 (or October 15, 2021 if you file for an extension) to max out your 2020 contributions. Limits are $6,000 a year, but if you are age 50 and up, you can save an additional $1,000 for a total of $7,000 a year. There are income limits to participate in a Roth IRA. For 2020, contributions start to phase out if your Modified Adjusted Gross Income (MAGI) is $125,000 for single filers and $198,000 for married filing jointly, and contributions are eliminated at MAGI of $139,000 for single filers and $206,000 if you are married filing jointly.

So why is saving into a Roth IRA a good idea? Here are a few reasons:

- Roth IRA contributions will grow tax-free. This means that growth will never be taxed so long as you don't take it out too early.
- This tax-free growth translates into more money for you and your family in retirement.
- Funds that are left to children or other non-spouse beneficiaries pass along tax-free as well.

Something to watch out for:

- In order for growth to remain tax-free, the Roth must be established for longer than 5 years before withdrawals are taken and the account owner must be over the age of 59 ½. If both of these criteria aren't met then the earnings would be subject to a 10% penalty along with federal and state income taxes (with certain exceptions). Contributions however, can be withdrawn before age 59 ½ without any taxes or penalty due.

As we mentioned earlier though, contributions to a Roth IRA are only allowed if you fall under the MAGI income limits. What are some other options if you earn more than the MAGI limits but would still like to take advantage of Roth benefits?

- Check with your work retirement programs and see if a Roth contribution option is available. Many work plans have added this feature in recent years and there are no income limits to participate in a workplace Roth 401(k), Roth 403(b), or Roth 457 plan. Just like with a regular Roth IRA, these contributions grow tax-free which means the growth is never taxed so long as you don't take it too early.

- If there is no work Roth option available, you could make contributions to a non-deductible IRA which could be converted to a Roth down the line. There are no MAGI limits though you are subject to the same $6,000 annual contribution limit and an extra $1,000 if you are 50 and over. The same April 15, 2021 contribution deadlines for 2020 apply as above. Please note, however, that accounting for taxes can be tricky and complex when using this strategy. We would advise consulting with your tax advisor on this one.

Lastly, as we mentioned, Roth IRAs pass favorably to non-spousal heirs. With the 2020 enactment of the SECURE Act, IRAs and work retirement plans must be completely distributed in 10 years when the account owner dies and leaves it to a non-spouse. No longer can an Inherited IRA be 'stretched' and distributions taken over the life expectancy of the non-spousal beneficiary.

- For example, a $500,000 Traditional IRA passing to heirs evenly distributed over 10 years would mean $50,000 a year in distributions that gets added to the beneficiaries' taxable income for that year. It could certainly push someone into a new, higher, tax bracket and assuming 25% in federal and 5% in state and local taxes, that $50,000 is reduced to $35,000 after taxes. Assuming the same taxes every year, that amounts to $150,000 in taxes paid over the maximum 10 year distribution period. That's the best-case scenario; we often encounter beneficiaries that are eager to claim and spend their inheritance more urgently, which could put one in an even higher tax bracket. Good grief!

- When a Roth IRA is inherited (by someone other than a spouse), the distributions still need to be taken over 10 years, however no taxes are owed. $50,000 a year over 10 years. That's $500,000 kept versus $350,000 kept in the above example, which is quite a savings!

In summary, a Roth IRA can be a great way to save for retirement and pass along assets to heirs in a tax-favorable way. If it makes sense for you, you still have time to make contributions for the 2020 tax year. If you haven't already, we'd suggest discussing the options with your financial advisor and tax professional.

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