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Cadence clips

FOCUSED ON WHAT MATTERS MOST.

Financial Update and Common Sense

By Casey Clarke

At Cadence, our mission is to do everything in our power to help clients navigate financial markets as successfully as possible, thus giving them the best opportunity to achieve and maintain financial security. We relish getting to know our clients, understanding them as people, and serving their best interests along the way. It was our belief almost 12 years ago that the only way to do this was to detach ourselves from bigness and get smaller and more local. The truth is, the bigger and more powerful a firm or corporation gets, the more interests it has to answer to. This is where conflict comes into play. Sure, there are advantages to being large and it can always be spun that these benefits outweigh the drawbacks, but what's very clear to us is that if there is any impediment to serving our clients, no matter how small or seemingly insignificant, it's just a matter of time before it becomes a problem. Our mission to our clients must never be clouded by other competing interests. With this in mind, it's interesting to think about our world today and all of its competing interests in this same way. Not only with respect to current events, but also as it relates to where we might be headed economically. A good understanding of who in the world has our interests at heart and more importantly who doesn't, among other things, can help us better navigate financial markets and make our way through turbulent times.

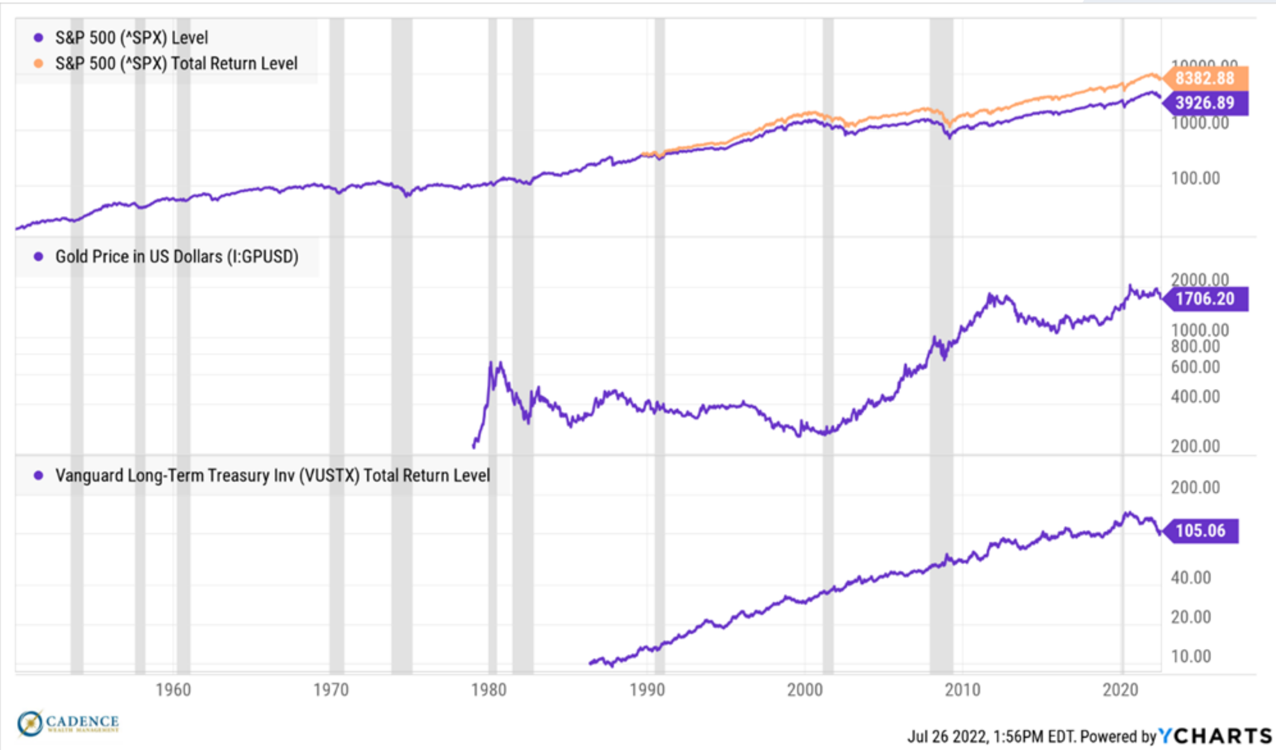
When Thomas Paine penned Common Sense in 1775, the idea was to instill confidence in the American colonists that they should strive for true independence from England and establish a society where everyone is treated fairly under an egalitarian government. He despised monarchy, which is to say unelected officials who hold disproportionate power and wealth and who are entitled to this power and wealth as a function of bloodline – or as he called it, hereditary succession. The ethos of Paine's message was that the true happiness and harmony of a nation comes from community, small groups of people coming together with common interests, where the establishment of a government is only essential to guide and preserve this format. As Paine put it, a "necessary evil". So why the reference to a 250-year-old document rather than just another garden variety economic and market update? Because perspective matters, and planning for the future requires more than just a context-free snapshot of the present. When times are good, which they have been for the last 40 years in this country, we forget. We take things for granted and assume certain levels of independence and self-sufficiency are the rule rather than the exception. We forget the lessons from the past that teach us that true happiness is local and interdependence is how we forge ahead and progress. Tougher times require us to be more in touch with one another locally and help us to realize that most of us share the same boat and have more in common than we were aware when times were better. There's less to gripe about because priorities and perspectives change. Locally, we get through tough times, prosper, and grow. This requires no input from men or women behind curtains.

There are two applications for this perspective. The first is a reminder of what brought Paine and ultimately the American colonists to fight for independence – bigness eventually loses touch with what matters most: the small, the people. There are very important corollaries here across every aspect of our society today. Corporations, public institutions, and government have never been bigger or more powerful. If true happiness is in fact small, local, and more personal, then we are a long way from Kansas indeed. As we've written before, this is likely why we have been witnessing the steadily increasing drumbeat of social unrest not only here in the U.S., but globally over the last few years. And this brings me to the second application or reason for keeping this Common Sense perspective in mind. The financial world is absolutely connected to the social one. Understanding both can help us glean insights into the other that can guide our planning. Now the economic and market update…

There are a number of cycles that influence the financial and social worlds, but the one that drives both most directly is the longer generational cycle. Neil Howe and Bill Strauss write about this brilliantly in their book "The Fourth Turning", with a key takeaway being that history tends to cycle back around every 80 years or so due to generational memory and the dynamics associated with changes in generations. The long and short of it right now being that we are in the middle of what Neil and Bill refer to as the Fourth Turning, which tends to manifest after prolonged periods of easy sailing. Generations forget lessons, they take things for granted, and they repeat the same mistakes. This entails everything from investors getting careless and taking too much risk to society placing too much faith in institutions. The last time we experienced a generational Fourth Turning was in the 1930's, the period that encapsulated the Great Depression. With this context in mind, along with everything we've mentioned in letters past about the financial world being at historical extremes, we think it's prudent to expect anything from an economic (and social) standpoint. To expect a short and mild recession is to be unprepared for what's not only possible, but likely. Despite the fact that we should be not only expecting this, but planning for it, it's interesting to observe that the White House only days ago put out a release reminding us that the commonly accepted definition of recession doesn't make a recession "official" and isn't one they'll be using to define recessions moving forward. Tweaking definitions so that reality can be painted in a more favorable light, regardless of the reason, is a trademark of our time – a Fourth Turning phenomenon, which is very important to take note of.

What we know is that regardless of how we define a recession, a contracting economy means more difficult times for more people, and typically declines in stock prices and other risky asset categories. This is what we've been experiencing all year and are likely to experience in the near future. With the Fed committed to bringing inflation down, they are likely to continue raising rates which will further slow economic activity. This week's 0.75% increase in the Fed Funds rate target essentially gets us to the same level that broke the reverse repo market in late 2019 and forced the Fed to pause and ultimately resume rate decreases. The financial world and global monetary system are certainly no less complex than they were then, so it will be interesting to see how the world functions at current interest rate levels. Common sense would suggest that consumers and businesses will find it harder to borrow and spend at these higher rates. With double-digit inflation raising the price of just about everything, spending alone becomes hard, and in a cruel twist of fate, borrowing may be required for some to make essential purchases. This is a witch's brew of economic factors for sure, and without a clear sense as to how long it could last, one should be careful not to overextend with respect to spending or risk-taking.

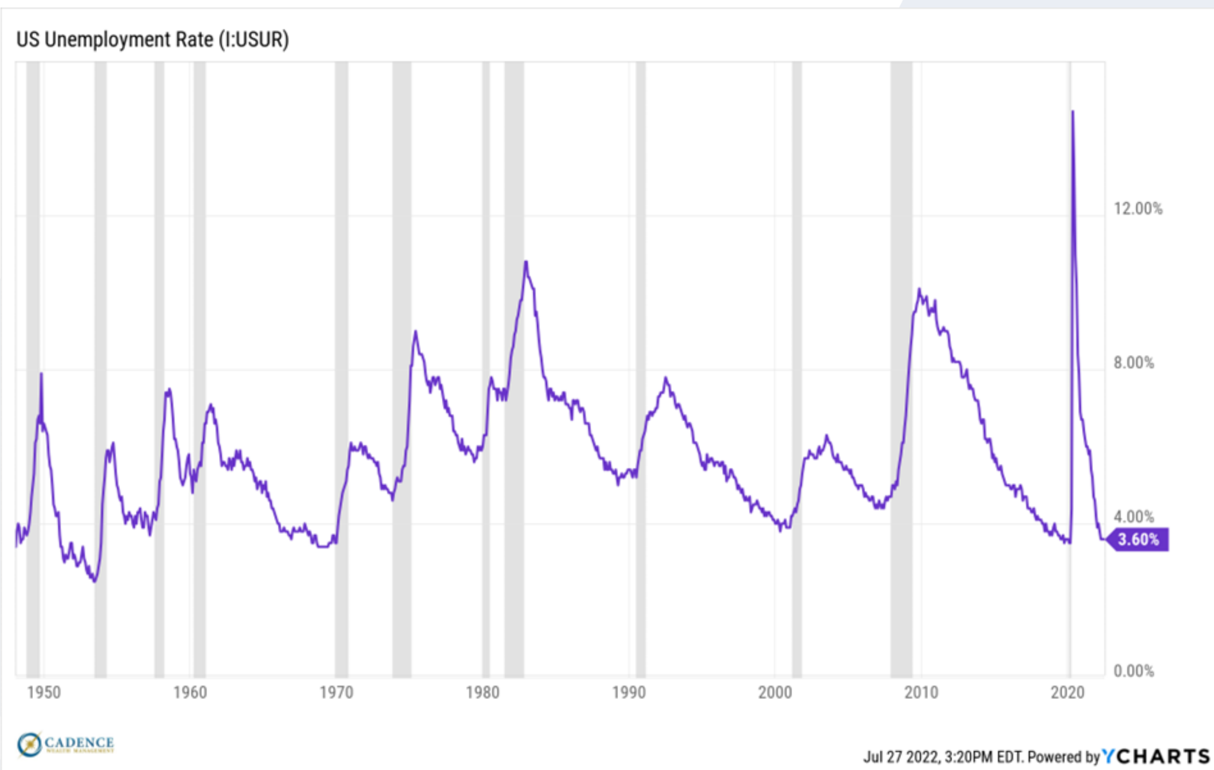
Below we can see the clear relationship between recessions (shaded areas) and declining stock prices (top blue line). In most cases, the two go hand in hand which is why we're currently recommending that our clients have minimal exposure to stocks. That doesn't mean however that all hope is lost on the investment front. The good news is that gold and treasury bonds historically have performed much better through recessions. These are the next two blue lines on the chart respectively. Investors who are aware of this have a much better chance of preserving their capital through difficult times. It's also one of the reasons why we've been particularly interested in these asset classes over the last few years. If you've made adjustments in your portfolio (or if we've made them for you) to reflect the potential for a generational shift back to a more sustainable and balanced system, then you're well ahead of the game.



It's worth noting that common sense sometimes gets lost for periods of time during economic and market transition points. For various, very human reasons, investments that are destined to go down sometimes have upward convulsions, while those that make tremendous sense can't seem to get out of their own way. We've experienced this in every bear market and this one is no exception. People will be inclined to continue believing that things like tech stocks and cryptocurrency will rally once again and recover all of their losses. Old habits die hard in this respect. On the other hand, every time that happens, those investments that actually make good fundamental sense and whose turn at a cyclical or secular bull market is up, struggle as investors express doubts about timing. We've experienced this in precious metals asset classes and to some extent treasury bonds since March of this year. Our view is that this reflects chaos and noise and should resolve as the investment community realizes the full extent of the economic slowdown that lies ahead. Overall, if you're down a good deal less than most stock and bond asset classes, then you're doing just fine. If you're a client of ours, this is the case.

Back to common sense. In this week's Fed press conference, chairman Jay Powell, in response to a question asking whether or not he thinks we're currently in a recession, answered that he didn't think so. He said it just doesn't make sense that with the labor market being so strong, with the number of new jobs added, that the economy would be in recession. What Jay likely knows is that the labor market is one of the most lagging indicators of economic conditions and therefore is one of the last to reflect a recession. So if Jay Powell knows this, why can't he say it? When you're incentivized to communicate a certain message that contradicts with reality, you say things that don't make sense. This is important to keep in mind as it relates to all messaging whether from your 5 year old child or a public official. When the message doesn't make sense, and certainly if it's a consistent phenomenon, it's not because the messenger is dim, but more likely that the messenger is avoiding being honest and forthright for some reason. Anybody listening to Jay and hearing that all is clear on the economic front due to the jobs market being strong is less likely to prepare adequately for what lies ahead. As noble as the incentive for obfuscation may be, it robs people of the opportunity to make informed decisions. We all remember people in the Tech Bubble or Great Financial Crisis who lost their nest eggs because they weren't properly informed as to the inherent risks of those times. So, with the understanding that you won't always be getting the most accurate scoop from those behind a lectern, it's so, so important that you think for yourself and use common sense. To the degree that you empower yourself by leaning on those around you and think and function more locally in this respect, we can think about it as Common Sense.

A chart for Jay below. Notice how the unemployment rate is lowest BEFORE recessions start. If one doesn't anticipate recession due to a strong labor market, then he/she will never anticipate recession.



It's safe to assume we're moving into more difficult economic times. As this plays out, the impulse will be to depend on "big" more often. If Paine were alive today, he would probably be writing furiously in an attempt to remind all of us of how resilient we can be when we stick together as equal, interdependent people. We consider our role at Cadence as being positive, productive members of our community in which you as clients also play a critical role. Our job is to help inform and empower you to make the best decisions you can given the actual set of circumstances we're up against, not the ones we wish we were facing. Being small and knowing and caring for each and every one of you allows us to do just that. There are no conflicts and we serve nobody other than our clients. Now Steve will discuss some "Common Sense" action steps that can be taken to help you better prepare for the likely slowdown ahead.

Managing Cashflow During Inflationary And Recessionary Times

By Steve DeBoth

Nothing reminds you of what you should be doing but aren't like a good dose of uncertainty. Inflation and recessions both have the ability to add uncertainty to our lives in the form of higher prices for our necessities, temporary investment losses, and the potential for reduced income. When you are used to having a certain level of income, be it from employment or investments, and a certain level of expenses, any changes in the wrong direction can be a good wakeup call that what you should be doing to overcome these challenges is probably what you should have been doing all along.

Despite how abnormal these times may feel, there really is no unique way to protect your cashflow and ability to save that you shouldn't already be doing. That being said, when times are good it's really easy to take your eye off the ball every now and then without dire consequences. When gas prices are low, driving more than you have to doesn't carry many consequences. When prices are low in the grocery store, there are not many repercussions to putting whatever you feel like in your cart, and if some of the food in your refrigerator spoils you can just replace it without any real pain. However, when those prices start to climb, we suddenly become aware just how much we drive and how much we spend at the store.

So now is a good time to review some of the spending strategies that help to trim fat from your expenses, which though helpful all the time, are certainly helpful when your expenses, from the every day items to the large, infrequent ones have gotten so much more expensive.

Create and follow a budget if you aren't already, and if you can't bring yourself to do that, at the very least track your spending.

Obviously, setting goals for anything increases your chances of actually achieving them. Even though it may feel weird to set spending goals for everyday things like gas and groceries, paying for those items comes from the same cash inflow that funds bigger goals, like vacations and special purchases. Therefore, your ability to save enough for the bigger goals is directly affected by how much you spend on the everyday things. The more you save on your everyday expenses, the more you can spend on the fun things. Put together a monthly budget for as many everyday expenses as you can and then do what you can to achieve those numbers. If you just can't bring yourself to do that, then at least track what you are spending. Tracking alone can sometimes cause a helpful behavior adjustment.

Bunch errands together so you're using less gas.

Pre-planning your errands can reduce the number of trips you take and thereby reduce how much you spend at the pump.

Walk and bike where you can.

Come on, you know you've been meaning to do it. You see people biking to stores, putting stuff in their backpacks and biking home. You know it's healthier, and with gas prices this high biking for small errands can add up over time. So if you've been meaning to walk and bike more, either for errands or just to get from A to B, high inflation may be the push you've needed.

Cancel unused or little used monthly subscriptions.

It's pretty convenient to subscribe to monthly services like entertainment options. Now is a good time to reevaluate how much you use certain monthly services and discard what you do not. Personally, I cut the cord with cable last year and cobbled together a group of alternative options that will save me easily over $1,500 per year, and I don't even miss the cable! Everything I or my family watched before can be accessed in other ways. Cutting out the little used or unused subscription services adds up over time. Also, if you find you need too many different subscriptions to fit your needs, then pay for some for a month or two at a time, watch or listen to what you want, then pause that one and subscribe to a couple more. That way, if you just can't live without HBO or Netflix content, you're not paying for it every month when you can get the same enjoyment having and paying for it only half the year.

Be smarter at the grocery store.

When any of the fixed expenses you pay on a monthly or weekly basis increase, you notice it almost immediately. When prices at the grocery store go up, it is a lot harder to notice unless you track these expenses regularly. Additionally, since you're not buying the same things week in and week out, you usually only know how much you've spent after everything is already all bagged up and the checkout person announces the total. It's at that moment when you wonder how so few groceries can add up to so much.

The most effective overall strategy to minimize your grocery bill is to:

- See if there are any items on sale you could use for meals this week by going to the store's website.
- Plan your meals ahead of time, with an eye on using up items already in your refrigerator and pantry, especially those that will spoil.
- Make a shopping list and stick to it.
- And then either go to your grocery store's website and price check your items, or order for delivery or pickup. This last strategy allows you to see how much you are actually spending before it's too late and the groceries are already sitting in the bags. This will also allow you to reconsider a meal or two if something else happens to be on sale, or something has just priced out as too high for your weekly grocery budget. Do not dismiss this step, though it may be a change to how you shop. It's really the only way to know how much you are spending before you do. Go to your store's site, assemble a cart online, and you will see how much you'll spend before you have to commit.

There are other grocery store tactics that work well, like cooking in instead of eating out, buying the cheaper store brands than the name brands, buying from multiple stores to get the best prices, and buying in bulk where possible to get the best per unit cost. However, nothing saves quite so much as planning ahead, using coupons, using up those items that may spoil, and assembling your "basket" online so you know how much you're spending before you do.

Accelerate necessary purchases if you feel the price will be higher in the future.

This is a touchy one, as it works against you in the event of a loss of income due to a recession as we are about to cover, as well as no one has a crystal ball. However, if you fear the price of something you intend to buy in the coming weeks and months is only going to go higher and you have the cash to spare now, then consider accelerating your purchase to buy before the price hike. But again, this is a tricky one.

Special Consideration #1 – if you are at all worried about what a recession may do to your income.

Though the strategies for inflationary times are pretty much what we should be doing any way to maximize our cashflow, the threat of a recession and possible job loss or income reduction do require some different considerations. If you fear a coming recession may affect your income status, there are things you can do ahead of time to help.

Conserve cash.

A general rule of thumb is to have an amount saved as cash that equals 3 to 6 months' worth of living expenses. However, if you fear losing your job during a recession, then much depends on how quickly you could find another job and whether or not you would be making the same amount. 3 months' worth of cash does not seem adequate when entering a recession for those fearing a job loss, which is why boosting your reserves now, if you can, would be a smart course of action. Hopefully, should an income disruption last 6 months or more, you would be able to reduce your expenses in the meantime to help stretch your reserves.

Put off large purchases.

As painful as it may be at the time, if you fear a disruption to your income due to a recession, it would make sense to hold off on any large purchases or cash outlays that are not necessary just in case you would need that money to stay on your feet while you look to replace lost income. This obviously supports the strategy of conserving cash, as nothing depletes your cash reserves quite as quickly as writing a big check. If you don't need to spend it now, and if it won't just end up costing you more later like critical repairs, then put it off. If you don't absolutely need to buy a bigger house now or get a new car, don't.

Special Consideration #2 – Winter is coming, again.

It is never too early to think ahead toward winter. All home heating sources saw relatively large price increases last winter, but not much has changed to give us optimism that this winter will be any better. In fact, there is already speculation that European supply issues will push global natural gas prices higher once again this year, which will more than likely have knock-on effects to the other fuel sources. Between now and then, consider what you can do to prepare your home for winter to be as fuel efficient as possible. For more information, see the second half of the November 2021 Clips piece, "Home Heating Fuel Price Outlook: Winter 2021-2022".

It's unsettling when you keep your behavior the same, yet end up paying more. It is unsettling to see your monthly savings decrease, or dry up altogether and start eating into your emergency fund. Kind of like a trip to the doctor that makes you feel like you need to "shape up", inflationary times hold a microscope up to those things that we really should be doing all the time anyway. The less you spend, the more you have. The more you have, the safer you are and the more you can do. So as your financial doctor, heed my advice: shape up where you can. It is worth the time spent.

However, if you fear a disruption to your income were the economy to shrink, then it is time to do a few things that you maybe wouldn't normally do. If this causes you to save more than you need for a little bit, then I judge that to be an acceptable outcome. As Americans we really have no problem finding ways to spend excess cash, but you will thank yourself if the rainy day actually does arrive and you can navigate it with a lot less stress than you would have had you not prepared.

We will get through this. We always do. Use your head, make smart decisions, and keep impulse, non-planned purchases to a minimum. In the meantime, I have a great, cheap, black bean taco recipe any time you want a very cost effective, yet tasty dinner. I'm not kidding.

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