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Cadence clips

FOCUSED ON WHAT MATTERS MOST.

Sea Change

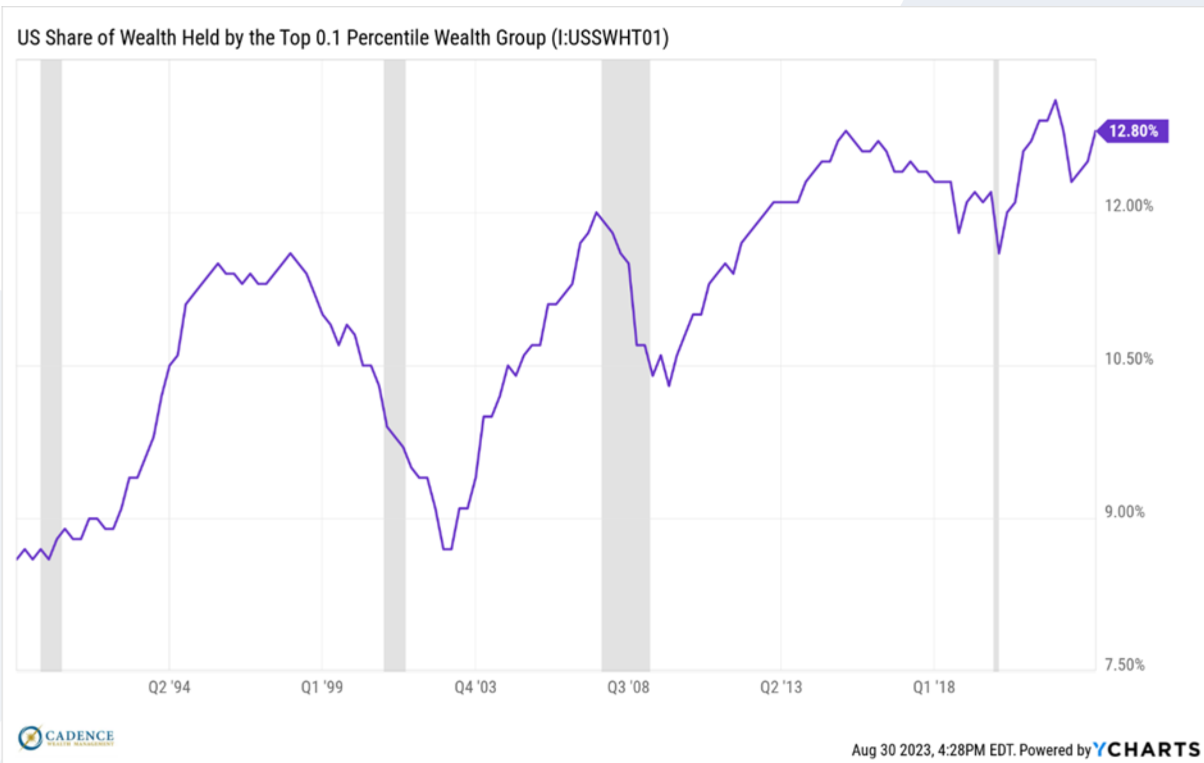
By Casey Clarke

It's hard to grasp the significance of a situation that plays out one day at a time over years. Little changes happen periodically and intermittently that get us to a place that eventually looks and feels very different. But, because we were part of those changes along the way, we have to work to shake off the familiarity of the world around us and remember the one that existed before. And, if we reach the edges of our lived experiences, we may lean on historical record to paint an even broader, more objective picture. There are only a limited number of times in modern history where we observe such persistent and dramatic changes over time as to usher in sea changes in thinking around financial markets, social issues, and personal priorities. Neil Howe and William Strauss, in their book "The Fourth Turning", talk about this phenomenon occurring over cycles spanning roughly 80 years and being largely related to lived and learned experiences and generational memory. Eventually, we forget the lessons learned by those before us and repeat the same mistakes. Human nature almost guarantees it. Humbling as it is to admit, we are no different today in terms of our fears, desires, motivations, or collective wisdom than our predecessors. Regardless of the technological differences between generations, we will continue to make similar mistakes.

Strauss and Howe make a compelling case in talking about these "fourth turning" points in history, which Howe continues to assert, we are in the middle of now. The concept of difficult periods every 80 years or so makes intuitive sense and aligns very well with what we see in financial markets looking back hundreds of years. What's most interesting to me is how closely related long financial market cycles and their extremes are to social developments and their extremes. The reality is that the world doesn't function without money at the center, and because humans are generally motivated to acquire as much of it as possible, the structure of monetary incentives and conflicts of interest tends to influence social change over time. For example, in the 1920's easy credit and monetary policy helped to drive financial markets dramatically higher while simultaneously increasing the wealth divide between the haves and have-nots. This in turn affected political points of view that played a big role throughout the subsequent Great Depression period of the 1930's. As normal as the 1920's may have felt, for those fortunate enough to be in the right social "class", in hindsight it turned out to be a very extreme period of time – one that Strauss and Howe would categorize as a Fourth Turning period that led to the broad sea change of the Great Depression.

A bit more than 80 years hence, we sit in an eerily similar spot. Historically easy money and credit spanning over a couple decades have led to financial market valuations that are even more extreme than they were in the late 1920's. We're also seeing a nearly identical and historically large wealth divide between the richest Americans and the rest, and the social issues being prioritized and fought over seem both very unusual and very heated in relation to those that have been more customary across time. Just like financial asset bubbles, we don't necessarily see or appreciate them in the moment, but when we woke up this morning, we woke up in a world that is dramatically different than what history would consider more typical.

(The chart below shows the percentage of U.S. wealth held by the top 0.1% of the wealth strata near long-term highs at 12.8%. Also note significant rebalances in this wealth distribution taking place in and around economic contractions in gray.)



We often talk about and take questions centering on the possibility of this being the "new normal". What if markets stay perpetually expensive, the wealth gap permanently wide? Expensive and wider for a day, week, or year longer than today, sure, but eventually the cycles of life play out. Extremes beget extremes, and one Fourth Turning ushers in sea change or paradigm shifts that start the cycle all over again. Mistakes made, lessons learned, rinse and repeat.

What happens in financial markets when the last drop of profit is squeezed from the fruit? What if costs have been cut as far as they can, the consumer no longer has the capacity to buy more widgets, and business growth going forward is no longer assured? Simply put, this is an environment where investors see no opportunity for return.

Speculators may continue to gamble while markets are rising, but investors are taking a hard pass. It's this situation - a market bubble driven exclusively by speculation - where falling prices perpetuate falling prices. Throughout this process and over time, the wealth gap shrinks, personal priorities change, and collective sea changes begin to occur. Thoughts on markets change in wholesale ways, the role of government in providing support and backstops and to whom changes, and the list goes on. This is the lifecycle of a multi-generational extreme and we're smack in the middle of it.

The most important thing to us at Cadence in understanding the enormity of this is not discounting the impact it could have on our clients – not getting sucked into the sleepiness of it all and the trap of feeling like just because it's played out slowly over years that it's completely normal. It's not. The most important and constructive question we can ask is what to do about it and how to best prepare. Although far from easy to carry out, our thinking is relatively simple:

- Avoid those investments and assets that don't make investment sense (are in a bubble). Over time, we are nearly guaranteed to lose money by paying too much for something regardless of how much we make in the near-term.

- Keep speculation to a minimum. When bubbles pop, speculation gets destroyed. A good idea at the wrong price at the wrong time can go to zero.

- Stick to assets that make good investment sense. This often means an attractive return on investment from both a profit and dividend perspective. If the investment goes down in price for a period of time, the dividend and ongoing profitability of the company or investment can help one ride out that period of volatility.

- Don't reach for yield. Companies or investments paying too high a dividend yield or interest rate are often in financial trouble. If you lose a good amount or all of your principal investment, it doesn't matter how high the dividend or interest rate is.

- Be patient. Just because speculative bubble assets haven't popped yet, and the more attractive long-term investments haven't been broadly recognized, it doesn't mean the process isn't underway. These things take time. Old habits die hard. Think about it in terms of risk. If the risk in a speculative investment is excessively high, then that's it. The risk can't and shouldn't be taken, period. Forget about it, move on and let someone else play that game of musical chairs.

- Broaden your personal knowledge base, skill set, and overall value proposition. People tend to define themselves in terms of their profession, which oftentimes is highly specialized. The reality is that life is multi-disciplinary. When and if things get difficult as they have in prior Fourth Turning periods since the founding of the United States of America, one's ability to understand the changing world around them, adapt to it, and function in a way where they are broadly productive and able to bring value to the community is crucial. We suffer from the myopia of specialization today which creates a narrowness of competencies and views. In an information-age world where one could literally acquire the equivalent of a college education and beyond in anything they wish within weeks or months at virtually no cost, there is no excuse for not seeking the knowledge one desires. We have never been more empowered in this respect.

Along those last lines, some of our clients take an interest in financial markets, the economy, and the complexity of it all, which we welcome wholeheartedly. That's not to say that we don't have fantastic clients who find it all very dull, but it speaks to the collaborative aspect of a successful relationship. Although we love and take our profession very seriously, and have dedicated countless hours toward educating ourselves on these matters in order to do the best we can for our clients, we don't have a monopoly on it. Anybody, from any walk of life, can take an interest in financial history, economics, and markets, learn about them, seek to understand them, and aspire to place themselves and their loved ones in a better position. This mindset of empowerment, collaboration, and community is not only what makes life more rewarding and enjoyable, but gets us through difficult times. This is our goal at Cadence – to help foster that community mindset as we strive to take the most productive financial steps forward in leading fulfilling lives. There will be a sea change in how people think about markets, money, and life matters ahead. We'll traverse it together.

Big Changes to the Federal Student Aid Process Starting this Fall

By Steve DeBoth

In order for returning college students or incoming senior high school students to be eligible to receive federal financial aid, like Pell Grants, they need to complete the Free Application for Federal Student Aid (FAFSA®) by the fall of the year BEFORE they are to attend college. So, for anyone intending to attend college in the fall of 2024, they need to fill out a FAFSA form in 2023. Normally, the soonest the forms can be accessed is October 1st of every year, but this year will see significant changes to the FAFSA forms and the access to those forms will be delayed. There will be winners and losers as a result of these changes. Federal aid is not the only thing based on the results of the FAFSA as many colleges use it to decide how much aid they will offer students based on those results.

Considering just how much hinges on the accurate, timely, and successful completion of the FAFSA form, and considering the magnitude of the reported differences between the old form and the new one starting this year, what follows are some of the most important changes to the FAFSA form and process for 2023:

1. The FAFSA Will Be Much Shorter and More User-Friendly.

The current 100+ questions will be reduced to around 40, and the wording of many questions will be easier to understand.

2. Name Change: "EFC" to become "SAI".

The term Expected Family Contribution (EFC) will now be known as the Student Aid Index (SAI). "EFC" incorrectly implies that it is either the amount of money a family will have to pay for college or the amount of aid they will receive. The hope is that the new term, SAI, will help clarify that this number is not the amount that families should or must pay, but rather a number used to assess their financial need.

3. Discount Eliminated for Multiple Children in College.

Currently, financial aid eligibility increases for families with more than one child enrolled in college at the same time. However, under the new legislation, the FAFSA will no longer provide this discount.

This change will reduce financial eligibility for families with more than one student enrolled in college at the same time. For example, prior to the change, a family with a calculated EFC of $40,000 could see that drop by as much as 50% if they had two students in college — that would be an EFC of $20,000 per student. Without this discount, the calculated EFC (SAI) would be $40,000 per student.

4. In Divorce or Separation, Which Parent Fills Out FASFA Changes.

Currently, if the applicant's parents are divorced or separated, the custodial parent, defined as the parent with whom the child lives for the majority of the 12-month period ending on the day the FAFSA is filed, is required to fill out the FAFSA. A big advantage of this is that if the custodial parent is the lower wage earner, then only that parent's income and assets will be counted for financial aid purposes.

The new legislation will require the parent who provided the most financial support in the "prior-prior" tax year to complete the FAFSA, instead of the custodial parent. The term "prior-prior" means that the financial aid system requires parents to submit their two-year tax returns instead of their most recent ones.

Thus, the parent who provided the most support in 2022 will be required to complete the FAFSA for the 2024-25 award year. This will typically, but not always, be the parent who claims the student on his or her tax return. In cases in which the support provided is 50/50, it may default to the parent or household with the highest Adjusted Gross Income.

5. No Financial Consequences for Contributions Made by Others.

Currently, families are supposed to report "money received or paid" from others on the student's behalf on the FAFSA. This means that if grandparents, other relatives, or people outside the family provided financial support to help pay for college costs, like with distributions from a 529 plan, it should be reported. This type of assistance is considered the students' untaxed income, which increases their total income, and subsequently their EFC.

With the coming changes, money received or paid from someone outside the immediate family will not face any financial consequences, meaning this form of untaxed income will no longer be considered in the Student Aid Index. In short, outside financial support to help pay college costs will no longer jeopardize a student's chances for need-based financial aid.

6. Income Protection Allowance Goes Up.

The FAFSA income protection allowance is an income amount excluded from the financial aid eligibility formula. The parent allowance is for the basic living expenses of a family. Students also have their own income allowances.

The revised form increases the parents' and the students' income protection allowances for the 2024-2025 school year. The parent allowance for a two-person family with one dependent will be $23,330, and $29,040 for a family of three. The income allowance for students will increase it to $9,410. This means that a student can earn up to this amount and not jeopardize aid eligibility.

7. The 2024-25 FAFSA opens in December 2023.

The significant changes to the FAFSA have caused the availability of the FAFSA materials and website to be delayed to December 1, 2023, which is a two-month delay compared to past years. In future years, the FAFSA availability returns to October 1. Users can start or access the FAFSA form by visiting StudentAid.gov and logging in, where they'll see the link to the FAFSA form on their Dashboard.

The Free Application for Federal Student Aid's changes are extensive enough that they will undoubtedly affect most applicants. Overall, the changes are seen to make the distribution of federal student aid fairer, though of course the concept of fair is subjective. Despite all the reported changes, one fact remains the same: because some of the aid that gets awarded is first come, first served, the sooner the form gets completed, the better.