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FOCUSED ON WHAT MATTERS MOST.

Smart People Thinking the Same Way

By Casey Clarke

The only thing worse than a group of nitwits sharing silly ideas is a group of smart people all thinking the same way. The dullards are quickly discovered as such, but the smart people tend to command an undiscerning following. What's also evident is that individual thinking tends to be more intelligent than intelligent people thinking together. The reason for this is groupthink. The assumption that because someone is intelligent, their thinking is sound and it's this assumption that short-circuits others' thinking. In this way, groups of highly intelligent people can give village idiots a good run for their money, which of course makes the line between smart and dumb a very fine one.

When it comes to money and markets, there is never any shortage of groupthink on display, which makes us especially keen in noticing it elsewhere in the world as well. It's pervasive. So long as there are humans who defer to other humans, and have a natural inclination for taking short-cuts, there will always be groupthink. In some cases it's as simple as following and belonging, while in others it's also a function of expectation or pressure to fall in line. In the corporate world, managers and employees are expected to "toe the company line" even if deep down they feel differently. Financial incentive can be a powerful factor in driving how one thinks and how strongly they fall in line with the group. Security, financial incentives, and blind trust all play a role.

We've written fairly consistently about the role the Federal Reserve has played in financial markets and society more broadly. Our view is that the Fed's easy money policies in recent years have done tremendous damage to both and have helped to create the inflation we're grappling with today and the societal wealth inequality that's fueling much of the social divide. Those closest to the monetary spigot have received the vast majority of the benefits while those toward the bottom of the wealth strata have received very little. As the great economist Lacy Hunt has said on a number of occasions, at the Fed "there can be no dissent". It's one line of thinking that supports the notion that the Federal Reserve can steer the U.S. economy, control prices, and drive employment outcomes by yanking monetary levers. If you work at the Fed, and you disagree with this, well then, your services aren't quite as valuable to the cause.

This hyper-aligned institutional thinking has created a situation at the Federal Reserve and other global central banks where opposing views haven't been fosters, discussed, or entertained. As a result, the Fed's actions have contributed to the following:

- Financial markets reaching over 100-year highs in valuations – aka, biggest bubble in U.S. history.
- U.S. debt reaching ~$33 trillion or ~122% debt to GDP. History suggests countries cannot come back from these levels without major turmoil. Low interest rates and federal reserve asset purchases have enabled this accumulation of debt by the government.
- Inflation. First inflation in asset markets (which benefits the wealthy), then inflation in prices within the real economy (which devastates the less wealthy and poor) in an effort to stave off financial system collapse.
- The exacerbation of the wealth-divide due to the Cantillon effect, those closest to the easy money spigot receiving the majority of the benefits.
- Social strife. Wealth inequality drives resentment, disenfranchisement, and division. Division drives "us versus them". "Us versus them" further fuels and entrenches groupthink.

Putting the central banking variable aside, groupthink has always played a key role in driving investor behavior as well. After all, the thundering herd and relative uniformity of thought is what creates bull and bear markets and extremes on both sides. The belief that stocks can rise without limit and that any tumble will lead to rescue has created a ubiquity of optimism among investors that has helped perpetuate the bull market of the last 13 years (which there's a good chance ended early 2022—We'll soon know). "Everyone's doing it, so I may as well too", is how the thinking goes. Ask the average stock market investor why he or she feels stocks (broadly speaking) are a good investment for the long term and you'll likely get a blank stare. A sure sign that thinking isn't a big part of the equation. On the other hand, investments that the like-minded herd leaves behind, especially for long periods of time, can be tremendous opportunities. Our clients and readers will know that broadly speaking, we feel examples of those opportunities currently are commodities and natural resource stocks. But, how can we be sure that the fields the herd isn't grazing in are safe? Maybe they're right to keep their distance? Here's the way to think about it. The herd is myopic. No one buffalo can see beyond the rear-end in front of it. All it knows is that the buffalo it's staring at is still grazing. Meanwhile, the old pasture the herd left years ago has regrown its vegetation. Waking up to this fact takes time, but eventually, one by one, the herd moves on. The moral here is that intelligence and rational thought can drift over time, but fortunately they're cyclical, and it's this process that creates new opportunities for long-term investors. In weighing them, here are some things to consider:

- Is there a dominant narrative that led to this particular investment being neglected somewhat unfairly? For most natural resource and commodity investments, the green, sustainable, or clean energy movement/narrative helped to divert money away from otherwise very profitable and societally valuable companies. Everyone's been led to think in one direction and has thus neglected any thinking in the other.
- Is there a future for these companies/investments? In the case of the commodity sector, yes, and without question. The world has always and will always need commodities. As the energy experts at Doomberg say, "energy is life". As such, commodities are life. At least life as we're accustomed to living it. The idea that we can use less energy and fewer commodities going forward is counter to the concept of human flourishing. The only way we use fewer resources down the road, based on current technologies is to

consciously choose to reduce the global population dramatically. No serious person would consider that a viable strategy worthy of acting on. To anyone who does I say, "You first".

- Are prices attractive enough to make this a strong investment rather than a speculation? For most commodity categories, the answer is yes. Prices generally are as cheap as they were back in the 2000-2002 timeframe when commodities started a 10-year bull market where they outperformed stocks by extremely wide margins. Intuitively this makes sense given the dramatic underperformance to stocks over the last 12 years. Cycles tend to cycle. It's important to clarify how important the concept of price and value are to long-term investment performance. A terrific idea, story, or company at the wrong price can make for a lousy investment. Those things that appear attractive today, at some point in the future, won't any longer.

- Are there conflicts of interest at work preventing others from seeing this? Yes. Wall Street makes the vast majority of its money dealing in stocks and bonds. And because financial media caters to Wall Street, it also has an interest in promoting investment in stocks and bonds. There will always be a bias towards promoting those things that drive profitability. Hot narratives (where the start-ups and private capital are focusing on such things as AI and green energy currently), as well as stocks and bonds more generally will be where the investment industry attempts to steer the herd. Understanding this is critical.

Something that's also important to realize as you work through this process of evaluating really important investment implications is that you won't have much support from peers or proof that you've made the right choice – at least not early on. All you'll have is historical precedent, logic, and your own due diligence to guide you. If you're seeking approval, then you're out of luck, because if your friends or coworkers haven't done the work, they won't understand where you're coming from. They might conceptually grasp why gold, silver, or a copper mining company might be a good investment long term, but because they're hearing more about Nvidia or Nasdaq from the media, the internet, and their other friends, they have no reason to believe there's anything wrong with the status quo.

Phases of a Turn

Below is a price return chart of silver from early on in the last commodity bull market, which we now know with the brilliance of hindsight ran from 2000 until the summer of 2011. An investor putting money into commodity-related positions in 2000 might have justified that move by looking at the relative cheapness of those investments compared to the more popular stock market – technology stocks in particular. You'll notice that between the beginning of 2000 until the end of June 2003 silver declined -13%, and if that blue line represented the balance of your investment portfolio, you'd probably be slightly concerned about the lack of progress. Even if you did your homework and you concluded that silver (you could substitute with most commodities, but we'll use silver to make the point) had a much better risk/reward profile than technology stocks, you'd surely be wondering if you missed something that others

got right. No proof, no validation from others. A very lonely 3.5 years it would have been. The temptation to invest in something with better performance would have been strong.

As lonely as it is, you trust yourself and stick to your line of thinking, not because it's yours and because you're stubborn, but because it makes sense and despite your best efforts to find flaws in it, you don't. The next chart more accurately reflects the opportunity that commodity investor in January 2000 likely saw. Once the shift from stocks into commodities got going, it continued to gain steam until after the financial crisis, and the return differential was vast. By the middle of 2010, silver was up more than 240% while the Nasdaq tech index was down more than -40%. The difference in outcome between the intelligent thinker and the group thinker are beyond compare. Quite simply, when it comes to their financial futures, one makes it and the other doesn't. But the really, really important thing to remember with the help of history and hindsight, is that what prove to be little bumps in the larger picture will feel like giant setbacks along the way. This is normal and a function of scale. Any large opportunity, whether investment or otherwise, will have its share of temporary setbacks. Anything worth pursuing always does. What commodity investors have experienced over the last 2 years very closely resembles this 2000-2003 timeframe. Our view is that over time, it will prove a minor stopping point along the way.

Like turning the Titanic, changing the direction of the investment herd takes time. As that direction changes however, not only does the performance of those "unpopular" investments gradually get better, but the emotional experience in holding them does as well as the ever-so-important validation starts to kick in. As the old bubbles gradually deflate in pulses and phases, money flows change, new price trends are born, and the free-thinker on her solitary island starts to gain company. More people come around to a different way of seeing things as cognitive biases are revealed and released. A rebalancing takes place. As we discussed last month, that rebalancing could be messy depending on how extreme things were preceding it, but it allows for necessary and important changes to take place. Part of this change is new opportunities being recognized and realized. The trick for our individual thinker who managed to sidestep blinding groupthink is to avoid it in the future as more and more people come around to seeing things as she saw them. There is a certain intoxication associated with being correct and having a following. One must recognize when the island gets too crowded, the thinking too narrow, and life too comfortable - when what started off as smart is at risk of becoming dumb.

In summary, groupthink is everywhere. It's been the driving force behind central bank policy, it plays a key role in driving bubbles and busts in markets, and you better believe it thrives in other important institutions and aspects of life as well. To change it would be to change human nature. What we must learn to do, however, is recognize where it's happening, how it's affecting the world around us, and adapt. The only way this is possible is if one commits to assessing situations for what they are, not for what one wants them to be. And the only way to do that is to occasionally remove oneself from the warm, cozy company of other, similarly thinking, smart people.

Remember To Include Your Advisor In Your Financial Decisions

By Steve DeBoth

Most times when my clients have to make decisions regarding their finances, they reach out to me asking for help. Occasionally a decision gets made without me, I find out after the fact, and then I have to remind my clients to consult with me for more than just investment management when we are not in the midst of a financial planning cycle. Your Cadence advisor has the ability to help you save quite a lot of money so long as you include him in your plans early enough.

What follows are some examples of financial decisions and situations where you should automatically think to include us. We have helped scores of clients with these decisions, and our experience could make a big difference over time with the dollar figures at play.

Spending on Big Ticket Items

Buying cars and homes are obviously expensive endeavors, and were it just the sticker prices that had an effect on your finances then these purchases would be relatively straightforward. However, each of these decisions comes with its own devils buried in the details, which is why I like having ample time to discuss these purchases with my clients before they commit. For example, you're not just buying a car when you buy a car - you are also buying a loan that must be paid and serviced, you are also buying something that must be insured, and you are also buying something that requires frequent gasoline purchases. All of these incidentals around a car can drive the total cost of ownership far above the purchase price. Most people realize this, but many people aren't as adept at costing it all out and adding it all up, which is where talking to your advisor can help. Maybe there is an acceptable, cheaper alternative? You'll only know that when you add up the total cost of ownership.

When it comes to even larger ticket items like houses, the bigger ones requiring higher real estate tax payments, higher insurance premiums, higher heating and cooling bills, etc., the total costs of ownership above the purchase price will impact your ability to spend and save in other areas for as long as you own that house, frequently decades. Please, use your Cadence advisors to look at the biggest picture possible before you make the purchase. I read stories on a weekly basis of people who bought homes during the pandemic, many, many of whom already seem to be regretting their purchases.

Spending IRA Dollars on Big Ticket Items

Now, if you REALLY want to impact your finances, withdraw a car or a house down payment from an IRA. A few times over the past few years, clients have dipped into their IRAs to extract a lump sum to help them purchase a home, a car, or another big-ticket item. "Dip" here might be a little misleading, as in most of these cases the clients were taking out hundreds of thousands of dollars. After years and years of saving into workplace retirement plans, a lot of people have most of their financial assets tied up in IRAs as opposed to more tax favorable accounts, so this is pretty common. If you are going to remove a lump sum from your IRA for a one-time purchase, especially if it's a very large lump, then contact your advisor before doing anything.

Because the clients came to me first, we were able to find ways of removing the money for the down payments, and then were able to put money back into the accounts within a short enough timeframe that the initial distribu-

tion was no longer fully taxable. Of course, this only works if you have another lump sum you can put back in the IRA, and in the case of buying a house and selling a house, you would need to receive the sale proceeds within 60 days of distributing the down payment amount on the new house. When worked properly, this strategy saves up to hundreds of thousands of dollars.

For a married couple with a taxable income of $79,000, their federal income tax liability on that would be just over $9,000. Were that couple to remove $350,000 from one or more of their IRAs to purchase a home, that would increase their federal income tax liability to just over $95,000, provided the account owner is at least age 59 1/2. If the account owner is younger than that, add the 10% IRS premature withdrawal penalty and the income tax liability increases to $130,000. As long as both of them have large enough IRAs, we can actually strategize a way to have nearly 120 days to get the $350,000 back into the IRAs to reduce the federal income taxes back down to $9,000, saving a whopping $86,000-$121,000 in federal income taxes. This is just one scenario, but it is one that I have faced multiple times already, and there are moves we can make that can end up saving hundreds of thousands of dollars. The timing and amounts of the payments are critical elements to these moves, which is why my clients asked for help.

When to Take Social Security

There are many much-publicized reasons for waiting to take social security as long as possible. A few of the most often mentioned reasons for doing so are:

- Withdrawing from IRAs early may decrease future required minimum distributions if you use qualified dollars for lifestyle expenses before you turn social security on. The taxability of your various income streams is a complicated picture, but there are scenarios where waiting to take social security reduces your income taxes.

- The larger monthly social security benefits you receive by delaying as long as possible will also receive larger monthly cost of living adjustments each year, which will help you keep up with inflation better.

- Your benefits increase 8% per year you delay between your full retirement age, which for those born after 1959 is age 67, and age 70, whereas your investments are not guaranteed to return that in any given year.

- Delaying at least to full retirement age means the IRS will not withhold any percentage of your benefits because your adjusted gross income is too high in a given year, which will happen if you have enough other taxable income and you start receiving your benefits before your full retirement age.

However, there are many scenarios that would make someone have to consider taking social security before age 70, or before their full retirement age, a few of which are:

- Without factoring in the investment gains from the amounts you leave in your retirement accounts by taking social security early, you are still looking at 12 to 14 years before delaying taking social security from your full retirement age to age 70 actually nets you more over the course of your life. There are scenarios where waiting to take until age 70 never nets you more.

- ➲ Health reasons may impact your ability to wait, plus you may not live long enough to reach the 12 to 14 years required to break even on waiting.

- ➲ Social security as a program is uncertain, and perhaps it is better to take as much as you can as soon as you can.

You may have some other specific details about your own cashflow, investments, and other realities that would make taking later or taking earlier more advantageous for you. There is no perfect rule of thumb when it comes to when to take social security, which is why consulting your Cadence advisor before you start is so important.

Lending money to family and friends

My knee-jerk reaction is to say when lending money to family and friends, consider it a permanent gift as opposed to a loan. That is of course not true in all cases, and there may be situations where loaning money to these people in your life may work out just fine. It's a decision complicated by the effects on the relationship by either saying no or saying yes, as either answer leads to some potentially hard feelings on the part of one party or the other. It's a minefield best crossed with the advice of your advisor, even if to just be able to say "my advisor told me I can't afford to do that". Letting us say no for you, if that is what you want to do, may help salvage the relationship.

Trusts and Powers of Attorney Can Create Delicate Situations

It is important that you grant someone you trust the authority to make financial decisions on your behalf should your own abilities slip. For non-qualified accounts, this can be accomplished by attaching powers of attorney to the account, or by having the account be owned by a trust. Qualified accounts cannot be owned by trusts, with very few exceptions, necessitating the attachment of powers of attorney. Creating the ability for someone to step in and manage your assets for you has to be accomplished BEFORE you can no longer make decisions for yourself.

If a trust's trustees are of different generations, say for example a parent and a child, you have to be aware that each trustee has the ability to make decisions over what occurs inside the account, as well as has access to what is inside the account starting the day powers are attached to the account. Likewise, retirement accounts that have durable powers of attorney attached to them give the power of attorney the right and the ability to make decisions over those accounts as soon as the paperwork is filed. The powers of attorney you grant someone else do not kick in when you can no longer make your own decisions; they are live from the get-go. If you are giving these powers to someone other than a spouse, you have to trust that they will not access these accounts for their own benefit.

Of course, the way around this is to have your spouse as your co-trustee and durable power of attorney, if you are married, but this also creates its own complication. Should your spouse pre-decease you, or should your spouse also lose their ability to make sound financial decisions, then someone like a doctor, or an entity like a court of law will have to intervene to allow for any successor powers of attorney to be granted those powers.

I realize this all sounds like a hassle, but it is still very important that you give someone you trust permission to manage your financial affairs in the event you lose your own ability to do so. There are obviously things to navigate here related to whom you give these powers, and that is why working with your Cadence advisor to get this taken care of is so important.

Home Equity Lines of Credit and Other Floating Rate Loans

This one may be a little late considering where interest rates have gone over the past year, but many people do not fully understand the risks in taking out loans whose interest rates can fluctuate. Adjustable rate mortgages and home equity lines of credit are two of the more common and more obvious culprits, but there are others. Before taking out a loan where the interest rate can reset, especially where it can reset higher, talk to your advisor. If you have one of these loans currently, then you now understand how much more expensive repayment can be after those rates jump upward.

Changing Jobs

A lot of decisions have to be made both before and after switching jobs, and your advisor can help you with all of them. Frequently, the new job will come with different benefits than the current job. Your advisor can help you compare what you're currently getting with what you would with the new job. I have had multiple instances where clients and I have looked at seemingly good professional moves, only for the new benefits not to add up to what they at first appeared. It's easy to see a new salary is higher than an old one, but it is more difficult to see that lower 401(k) matches and more expensive health insurance can actually work against you financially, even when adding back in the higher salary. Before making a job move, let's make sure the benefits and not just the new compensation structure level will benefit you to the degree you think it will.

Likewise, when that job change is made, new benefits have to be selected and retirement plan investment options must be chosen. Additionally, decisions may have to be made with the newly vacated job's 401(k) plan. Do you roll it into the new job's plan, do you leave it where it is, or do you roll it out into an IRA? Consult with your Cadence advisor to help you with all of these decisions.

These are just a handful of decisions that can have major impacts on your finances, especially over the long term, but by no means is it an exhaustive list. These kinds of decisions usually get automatically folded into financial plans during an active planning cycle, but they should not be forgotten during the years you may not be doing formal planning. Easily tens of thousands, and in some cases hundreds of thousands of dollars hang in the balance, and few people can shrug off the effects of decisions costing them extra hundreds of thousands of dollars. We want to help you with these decisions. Personally, I prefer to handle them within a formal planning process, so I know for sure that a decision being made over here isn't going to have an outsized impact to some other piece of your financial puzzle over there. However, regardless of the process used to make these decisions, please make your financial advisor aware when you do have decisions like this in front of you. Let's work together to keep you on track.

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