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Cadence *clips*

FOCUSED ON WHAT MATTERS MOST.

Investing Confidently

By Casey Clarke

There's no shortage of metaphors for how difficult it can be to navigate and manage the emotion associated with financial markets. Steering a plane through turbulence, a ship through churning water, holding on for dear life on the back of a convulsing bull. Riding out market volatility is one of the most difficult tasks in investing, and the one that probably gets investors into the most trouble when it comes to realizing good long-term returns. A close second, however, is investing in the wrong things at the wrong times. Peter Atwater, in his book The Confidence Map, talks about how anxiety and poor decision making come at times when feelings of certainty and control are both low. This is certainly the case when markets, and by extension our portfolio values, are dropping quickly for reasons we can't ascertain. When this happens, we eventually seek more certainty and control whether through constructive or destructive action.

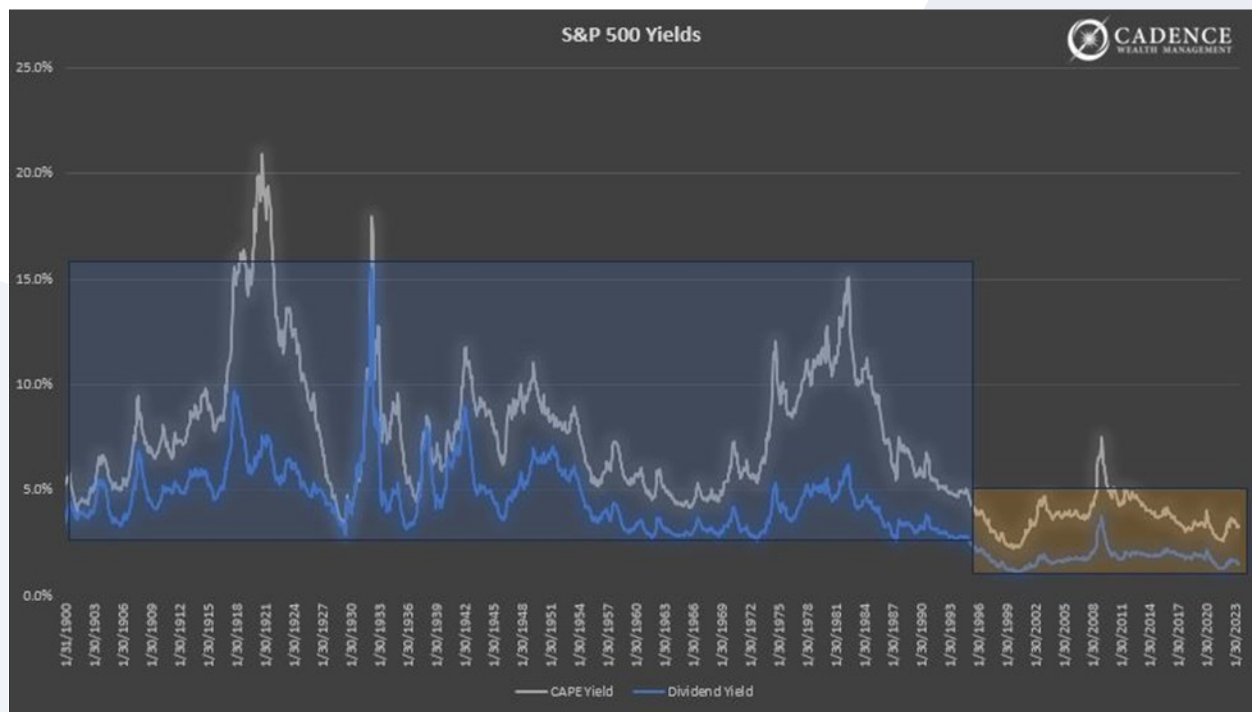
What if, however, we made financial decisions with information that helped us feel more certain and in control? What if, on some level, we had tomorrow's paper today? Of course, we can't predict any course of events in a complex world with certainty, but we can use fundamental financial concepts to help ground us and guide us through the storm clouds, navigate the rough seas, and absorb the harsh impacts of the bull with greater calm than we'd otherwise have. Knowing we are investing in something that represents a "good value" can go a long way not only to delivering long-term investment results, but allowing us to stay the course with confidence. Not knowing we're investing in something that represents "poor value" makes us blind to risk and subjects us to poor long-term results due to buying assets at too high a price and repeated reactive buying and selling along the way resulting from low levels of confidence.

The "Poor Value" Assets

The argument for stocks today, which is really an argument for tech stocks since they make up such a large proportion of the popular indexes, is that perpetual innovation will drive productivity and profits and by extension, economic growth. Even if this were true, which downward trends in productivity and economic growth suggest it isn't, an investment's future return is primarily a function of the price paid for it today. Of

course, a company growing at astronomical rates can grow into expensive prices, but that's rarely the case, especially toward the end of a long-term investment cycle. Below, is a chart of 133 years of S&P 500 earnings and dividend yields. We've broken the time period into two boxes. The first is the period of time from 1900-1995, 95 years of financial history spanning two world wars, multiple economic cycles, bear markets, periods of invention and innovation. What's clearly observable is the ebb and flow between markets offering low yields (expensive) and higher, very attractive yields (cheap). The average dividend yield on the S&P 500 was 4.6% and earnings yield, 7.9%. Earnings yield is a total profit return per share that can be reinvested by the company for growth, paid out in dividends, or a combination of both.

Now the orange box on the right, spanning just under 30 years. This one clearly looks different. Both dividend and earnings yields, with the exception of a few months in 2008 and 2009, have been below the low point of the prior 95 years for the entire time! The average dividend yield has been 1.8% and earnings yield just 3.7%. In other words, based on the price of the S&P 500, investors have been barely earning anything on their investment when looked at from a dividend and profit perspective. Viewed another way, the majority of the return from the stock market over the last 30 years has been through valuation expansion rather than actual corporate profitability and yield. This is critical.



Why This Matters

Just like in the 90 years prior, when valuation expansion reverses due to changing variables and investor mindsets, valuation contraction begins to take yields higher. You can see that process playing out briefly in 2008 and 2009 where valuations got more attractive for the first time in a while. That brief move to reasonably attractive historical yields (not super attractive) required a more than -50% loss in the S&P 500 as well as losses in many bond categories. What would happen if valuations contracted enough to bring yields back into the middle of their 90-year ranges? We'll just say that would either lead to severe losses or a long, protracted period of no returns from the stock market, like we saw at prior low points in 1907, 1929, 1968, and 2000. All of these periods were followed by markets that took more than 10 years to recover losses. We would expect no different this time when that trip to higher yields begins.

The Alternative – "Good Value Assets"

Take everything you just read and reverse it when thinking about commodities at this point in time. For the last 12 years or so, all the attention and speculation has been in financial markets. The Fed's easy money policy has supported the biggest and longest lasting bubble we've seen in U.S. history (as is clear by the chart above). For that duration of time, commodities have been largely starved of attention and capital, resulting in lower prices and underinvestment. The underinvestment bit directly limits future supply, which all else being equal, sets the stage for higher prices. Add demand to the equation, and you have a new bull market, which we believe we're in the nascent stages of now. You can see from the chart below which looks at the Reuters/Jeffries Commodity index relative to the S&P 500 that during the last two difficult stock market periods (valuation contraction), commodities outperformed. Beyond outperforming on a relative basis, most commodities generated positive absolute price gains during those two periods. For investors basing their long-term decisions on the attractiveness of the price of an investment rather than the popularity of it, those two periods could have been tremendously productive for their financial situations and planning rather than detrimental to it. It's our opinion that the next five or ten years will be no different.

Bottom Line

The stock market, mainly tech, represents about the worst investment it ever has over more than 100 years. The day the tide turns doesn't much matter, because we know that when it does, the damage done will be too great to justify the gamble. As normal as the current situation feels, it just isn't. We have 95 years of extremely rich American history to support the notion that the last 30 are an aberration. Hoping that somehow we've departed from that 95 years of financial history, and those norms, isn't justified, nor a course of action that we feel would be productive. That course, according to Atwater, would put someone squarely in the high anxiety/low confidence quadrant as they lack both certainty and control over the course of events to come. In building an investment game plan that limits speculation and prioritizes price, value, and long-term investment cycles, we can shift the certainty and control functions just enough to experience meaningful gains in confidence. When we know we own a good investment at a fair price, we intuit that volatility (always unnerving) will be short lived and limited. An expensive invest-

ment, no matter how popular, garners no such confidence. Knowing what you own and why has never been more important. Every investment will fluctuate in value from day to day or month to month. Downward volatility in attractive assets will be self-limiting as time goes on, whereas that of speculative, "poor value" assets will not be. Keeping a big-picture perspective from month to month is crucial throughout this process; it's the key to maintaining confidence. And, there are plenty of reasons to be confident. Opportunity abounds.

Get Your Insurances Now: These Rates Will Not Last

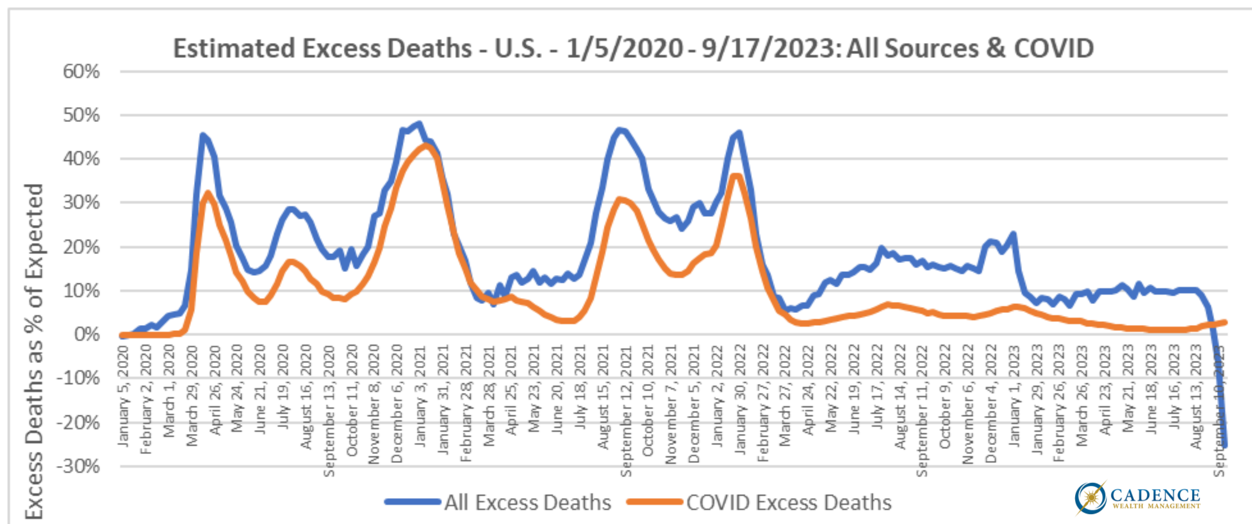
By Steve DeBoth

The insurance industry appears to be on the verge of a price disruption, and not in a good way for American consumers. The price of home and auto insurance has jumped for many markets around the country based on the price of the materials needed to build homes and fix automobiles having jumped skyward, and based on the fact that weather events that can damage property, cars included, have also been increasing. Those are just two of many factors. Expect rates to keep increasing relatively quickly until the industry arrives where it feels it needs to be.

What haven't yet jumped up are rates for life and disability insurance, but there is acknowledgment from industry sources that they will probably have to. I will focus mostly on life insurance for this piece, though there are similar forces at work in the disability insurance market. Insurance companies have been good for quite a while at estimating the number of deaths for the various segments of the population over time. These estimates are what is used to calculate life insurance premiums. Despite their relative skill at calculating an expected outcome and having it be very close to the actual outcome, there are still outliers that can cause their expected deaths to deviate from how many people actually do end up dying over a given timeframe.

There is a concept called "Excess Deaths" that is used to measure how many people have died over a given timeframe compared to how many people were expected to die. I have accessed the data provided by the Organization for Economic Cooperation and Development (OECD), an organization supported by the governments of 37 democracies which collaborate to develop policy standards to promote sustainable economic growth, to put some numbers to this. There are other sources of similar information out there, and their numbers may differ from what the OECD presents, but for the purposes of this piece I judge this data to be accurate enough to safely illustrate my point.

Using the years 2015 to 2019 as the OECD's baseline for expected deaths per year, the past four years have seen an extremely meaningful increase in the number of excess deaths above expected, not only in the United States, but all over the world. The OECD data shows total excess deaths, as well as excess deaths attributed to certain causes. For this analysis, I'm just showing what the OECD considers total excess deaths and those attributed to COVID. The value of either line at any point represents the amount of deaths that week that are considered in excess of expected. So that first blue peak illustrates the United States experiencing 45% more deaths from all sources that week than would be expected using the years 2015 to 2019 as the baseline.



There's no surprise that the excess deaths in the United States have jumped since early 2020 when COVID-19 entered our population. You can see in this chart what you would expect to see: excess deaths jump with every big wave of COVID variants, even after vaccines were rolled out the first half of 2021. But, what might be a surprise is that the number of deaths considered "excess" by the OECD over this time period were not JUST caused by COVID, and for much of this time COVID explains only 50% or less of the excess deaths. It might come as a surprise that excess deaths have remained this high the past couple years, with a relatively small amount of those deaths attributable to COVID.

A quick note on the data: you can see the "All Excess Deaths" line falls off a cliff in September of last year while the COVID Excess Deaths do not. Considering there is no logical reason to believe that in the span of just a few weeks, tens of thousands fewer Americans died than were expected given the trend immediately before those weeks, I believe this to be incomplete data on the OECD's part that they left in the data set to maintain full transparency. I expect these numbers to be revised in future data releases.

The elevated rate of excess deaths above those attributed to COVID over the past couple years definitely matters for insurance rates going forward. The problem for the insurance industry is, in a nutshell, if excess death rates remain elevated, even as COVID death rates have declined, then will continued increased claims on the life insurance benefits they sold that they did not anticipate with their pricing hurt their profitability to the point that they will need to increase the cost of premiums going forward? Given how important their calculations of expected deaths are to how they price their products, an ongoing 10% rate of excess deaths MUST be taken into account at some point.

The Society of Actuaries polls of its members found that in August of 2022, 85% thought excess death rates would continue to 2025. In August of 2023, the same poll found that 79% believed excess death rates will continue through 2026. There is a wide-spread belief among insurance industry observers that insurance companies have been slow to grasp the burgeoning problem while maintaining the belief that "mortality rates always give back, and have for nearly 500 years," according to one insurance industry senior executive.(1)

Society-wide trends are hard to move quickly once set in motion. The causes of the excess deaths not caused by COVID have remained stubbornly high to this point, especially since the spring of 2022, and not just here but in most of the countries around the world. There is evidence that the rate for non-COVID excess deaths in the U.S. have

started to trend down again since the third quarter of 2023, but there is still no belief among many of the organizations monitoring these trends that those numbers will ever get back to where they were pre-COVID. This would cause the insurance industry to increase their expected death rates among the various sectors of the population and then increase the cost of life insurance premiums as a result.

One other factor that is going to move this needle unrelated to excess deaths is the wave of intergenerational wealth transfer that will continue through at least 2040 which will reduce life insurance companies' assets under management by nearly 40%. Even without a permanently increased rate of death among the insured population in America, that decrease in insurance company assets will put pressure on insurance companies to maintain their reserves by any means necessary, including raising life insurance premiums. WITH a continued increase in excess deaths on top of that, the pressure will only grow to pass on that increased "cost of doing business" to the insurance consumer.

So get your life insurance now. Get your disability insurance now as well, as per the U.S. Bureau of Labor Statistics, the number of Americans in the workforce with disabilities has jumped since 2021. The group life and term insurance you may be paying for through your employer resets its rates every year. If all you have is group life and group term, those premiums will increase and will reduce your take-home pay. Unlike group insurance, private insurance rates for life and disability do not increase over their given terms, so if you or anyone you know need more insurance, now is the time. If you do not know if you need more insurance, now is DEFINITELY the time to figure that out by asking your Cadence advisor for help. Not to add further injury here, but a less healthy workforce can only drive health insurance costs up as well, which I advise you work into your financial plans.

On a personal note, I acknowledge this is not really the most entertaining topic to read. Believe me, it wasn't the most entertaining topic to research either. With excess mortality rates up nearly everywhere around the world since COVID hit, and with those rates staying elevated despite COVID death rates decreasing, it just hits home how much we have to look out for ourselves. If you feel losing weight would improve your health and satisfaction with life, make a commitment to yourself to start now. If you feel improving your diet, or limiting your alcohol, or increasing your exercising, or paying attention to your mental health, or being more social or WHATEVER IT IS you know you *should* do to be healthier and happier, you owe it to yourself to get a move on. Do a little research on what you can do to get healthier and happier, if you don't already know, and just be advised that for reasons you can research on your own, people all around the world just don't seem to be as healthy as they were in past years. Sure, some health-related numbers have absolutely improved; I don't want to be an absolute killjoy here. Yet, excess deaths and disabilities remain elevated, so something widespread, or many somethings widespread that are not explained by COVID are occurring, and you owe it to yourself to take a proactive stance on living as healthy of a life as you want to.

(1) Bailey, D. 2023, October 26. 'Excess mortality' continuing surge causes concerns. Insurancenewsnet.com. https://insurancenewsnet.com/innarticle/excess-mortality-continuing-surge-causes-concerns

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