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Cadence clips

FOCUSED ON WHAT MATTERS MOST.

Return of Capital

By Casey Clarke

There have always been and will always be points in time where investors pivot from wanting return on their capital to just plain wanting their money back. The exact factors that take the collective emotional state from greed to fear are different every time and impossible to predict, but so long as humans remain in control of their own decision-making, along with their full array of emotions, arrive they will. We can think about these swings between greed and fear over multiple timeframes – ranging anywhere from intra-day to the very long term, almost generational cycles. We can also think about the suite of factors driving emotions along this spectrum of timeframes as fewer and more simplistic in the near term and growing more numerous and complex as we get toward the longer-term part of the spectrum. An example of this might be one's decision to buy a stock today only to see it immediately drop in price later that afternoon. There will be some level of fear, but probably not enough to liquidate an entire portfolio. Rather, if over twenty years of investing, that same investor came to learn that these fluctuations almost never amount to lasting losses, and markets always bounce back in short time, then it will take substantially more to induce true panic and fear that leads to action. Importantly, however, when fear-inducing factors ARE sufficient to create genuine angst and panic after years of being rewarded for ignoring it, the corresponding reaction isn't just to sell a couple portfolio positions, but rather to demand a total return OF capital. It's our contention that because of all the learned experience over the last 15 years, specifically around complacency and markets always bouncing back, we are primed for one of these return of capital moments where investors indiscriminately sell whatever they can in an effort to keep their portfolio values from falling further. It's a bit akin to a game of chicken with a car. The more times you've played the game and have experienced your friend swerving out of the way at the last minute, the less likely you are to panic the next time. Eventually, however, a driver comes along who is deranged enough to hold his line, and by the time you realize it, you have to react much more violently to escape disaster if you manage to escape at all. Being conditioned for complacency inevitably leads to much bigger mistakes and more violent reactions when they eventually occur.

We could delve into the host of factors to watch out for that have the potential to trigger this return of capital cycle, but it wouldn't accomplish much. When markets are complacent, they shrug off almost everything. Remember, market participants have been conditioned not to take risk seriously, because it seems never to amount to anything. Perversely, this even means that the prospect of World War III fails to rattle markets. It likely won't be until investors en masse are impacted directly in some way that markets begin to assess risks rationally. Whether that's some sort of threshold level of unemployment, market loss, or global conflicts making their way closer to our shores, what every investor should be prepared for is the suddenness of risks materializing all at once after years of not. Trying to arrest a sudden, widespread selling panic in today's historically stretched financial markets could be akin to trying to catch a massively ripened coconut dropped from 100 feet. A five-foot drop, reflective of normal market conditions? No problem. Bend at the knees, absorb some of the energy, and keep it from slipping through our grasp and exploding on the ground. Good luck pulling that off from 100 feet. The law of inertia says save your arms and hands and let that one go. Although policy makers, corporate leaders, and other public figures who are financially incentivized to maintain the status quo would prefer you believe otherwise, there is nothing they can do to keep the inevitable from eventually happening. Complex systems always find their way toward entropy. It's because we intentionally seek to avoid conflicts that aren't in our clients' best interests that we can say, rest assured, those at the top of the financial food chain will make sure they see the return of their capital before the average Joe even thinks it important to get the return of theirs. That's just the way it works. The people closest to the financial spigot and its flow of capital into and out of the economic system see and can react to the direction of flow first. This doesn't mean the rest of us have to get "hosed" – we just need to evaluate conditions objectively and think a few steps ahead. We can control that.

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Here's how we do it. First, rather than staring longingly at those giant coconuts way up there in the tree, we think about what happens when they eventually fall - which history, human nature, and cycles inform us that they almost certainly will. Inertia will not be our friend if we spend too much time directly underneath that big, heavy, overly-ripe coconut. We've talked about reverse indexation and passive flow reversal being factors that can perpetuate the carnage within the biggest, most popular parts of the stock market. Unless our plan is to hold these things for 20 to 30 years before selling, there are issues. Second, we think of and consider investments that are more akin to fruit on much lower branches of the tree. Sure, they can fall and bruise some, but the speed at which they fall given their lower altitude makes them much more catchable or salvageable in the event they slip through our fingers.

In short, now's the time to stay focused on investing in those things that should be most liquid when panic ensues; those things that aren't widely owned and won't experience historic selling pressure when the flow of money that's funneled into these investments over the last 15 years comes rushing out. Owning the less popular, more reasonably priced, quality investments that people will seek out once they suddenly realize that return of capital is more important than return on capital, is the opportunity here. Here's the critical thing to remember though… If you do this right, you won't find much company, and you have to be okay with that. The eventual reward is not having to share misery with all that company.

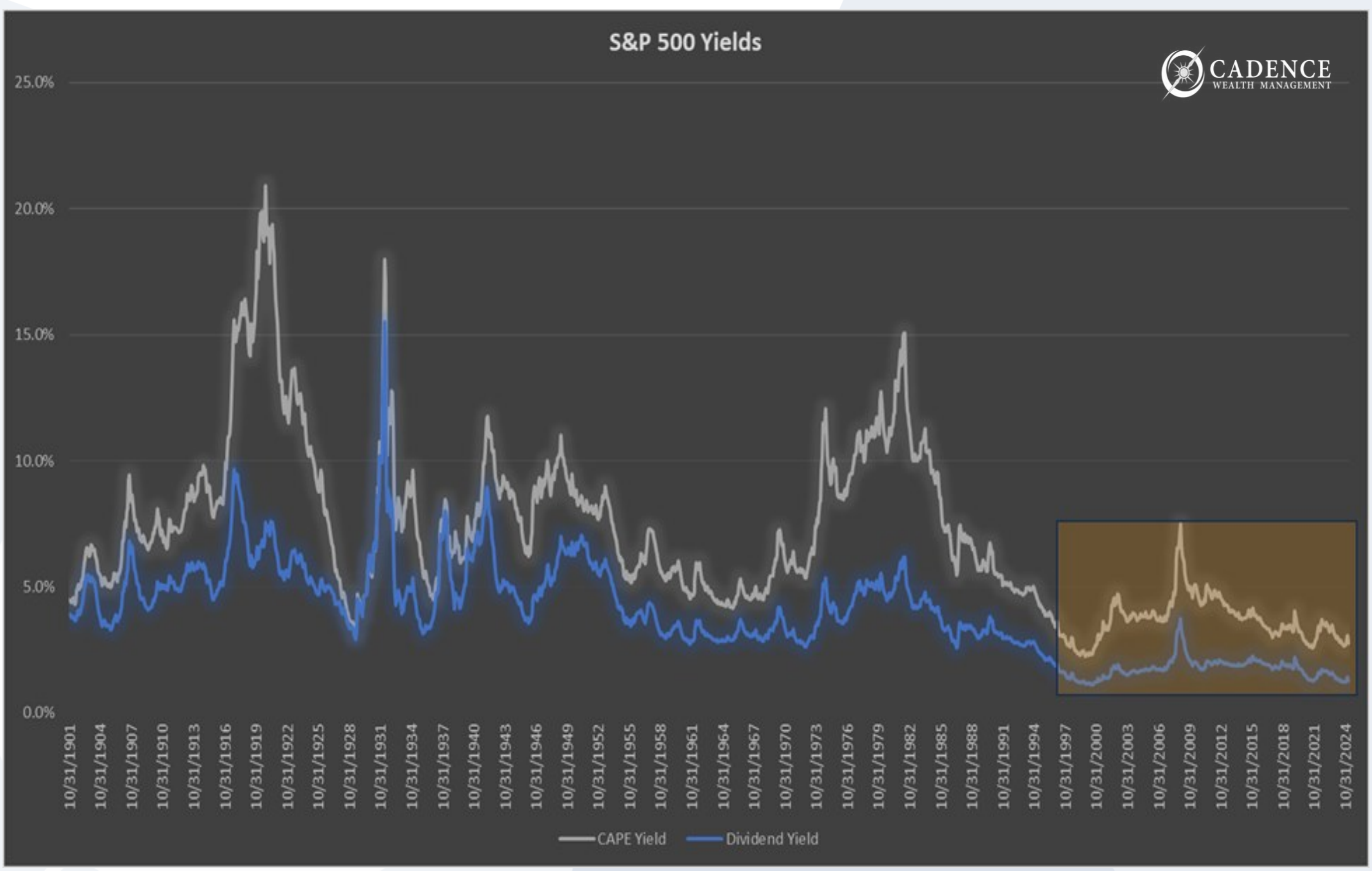
Low Yields = High Risk

By Casey Clarke

For 95 years since 1902, the cyclically adjusted earnings yield for the S&P 500 has averaged 7.9% and the dividend yield, 4.6%. Since 1997, they have averaged 3.7% and 1.8% respectively. Currently, they are 2.8% and 1.3%. Combined, investors could expect to earn 4.1% from corporate earnings growth and dividends, which is a full 8.4% below the long term, almost 100-year average. It is also below the "risk-free yield" of the 10-year U.S. treasury at 4.25%.

Below, we can see just how anomalous this return profile for the market is and has been. Historically, we've seen other low points just before major bear markets in stocks in 1929, the late 1960's (which also lasted for an exceptionally long period of time), and the late 1990's tech stock bubble. It's worth noting that the last period of prolonged, low-yielding stock markets in the 1960's resulted in the largest companies comprising an inordinate share of stock market capitalization ("Nifty Fifty"), cheap commodity prices, and a secular rise in inflation. All of these variables are being observed today. As we can also see in the chart below, as stocks fell over the 14 years from 1968 to 1982, yields rose to much more normal, if not cheap, levels. What doesn't appear in the chart below is that natural resources, the investments neglected in the years prior, performed incredibly well over that same period.

The moral? Just as high yields don't last forever, neither do low yields – despite how normal or safe they might feel. 124 years of history show pretty clearly just how abnormal the current situation really is. From such low yields, getting back to normal can really hurt.



Summer Moments

So we don't leave you equating coconuts with stock market crashes, let's shift gears a bit. As we welcome July and the warmth of summer days, it feels like the perfect time to pause and appreciate the simple joys this season brings. With that in mind, we're sharing a quick, healthy, coconut-inspired recipe to help you slow down, savor the sunshine, and enjoy the moments that matter.

Tropical Gut-Healthy Smoothie

By Craig Ruff Published on October 9, 2024

Reviewed by Dietitian Emily Lachtrupp, M.S., RD

This dairy-free gut-healthy smoothie features kiwi (a prebiotic) and coconut-milk yogurt (a probiotic) working together to support a healthy gut. Golden kiwis add a lovely golden hue to the smoothie, but green kiwis work just as well.

Ingredients

1 cup frozen mango chunks

½ medium banana, frozen

2 golden kiwis, peeled and chopped (~1 cup), plus more for garnish

½ cup no-sugar-added coconut-milk yogurt alternative

¾ cup bottled unsweetened coconut water

½ teaspoon coconut extract

Directions

Step 1: Add 1 cup mango, frozen banana, chopped kiwis, ½ cup coconut-milk yogurt, ¾ cup coconut water and ½ teaspoon coconut extract to a blender; process until smooth, about 20 seconds.

Step 2: Pour into a glass. Garnish with additional kiwi, if desired.

Nutrition Information

Serving Size: 2½ cups

Calories 328, Fat 4g, Saturated Fat 3g, Cholesterol 0mg, Carbohydrates 74g, Total sugars 53g, Added sugars 0g, Protein 5g, Fiber 7g, Sodium 71mg, Potassium 1,264mg

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