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Cadence *clips*

FOCUSED ON WHAT MATTERS MOST.

Failure (A Market Update)

By Casey Clarke

If a child grows up never having experienced failure or hardship, never having witnessed failure or hardship around him, and has had obstacles removed from his path along the way, it's easy to develop the impression that he is exceptional when in fact it's just a matter of time before his thin skin encounters an impediment that defeats him. To the extent that we have benefited from contemporary economic and financial market interventions, we are this child. We have come to expect the removal of impediments from our path; for somebody other than us to do something when calamity strikes. We have adopted a belief that markets always bounce back. History would debate this. Every time these things happen, our resiliency fades and we become increasingly susceptible to negative outcomes.

Society on a larger scale is also this child, and it explains so much of what we're all witnessing around us. The petty issues we bicker over seem to have been spawned from boredom and a lack of genuine problems to worry about. Dependency on government and

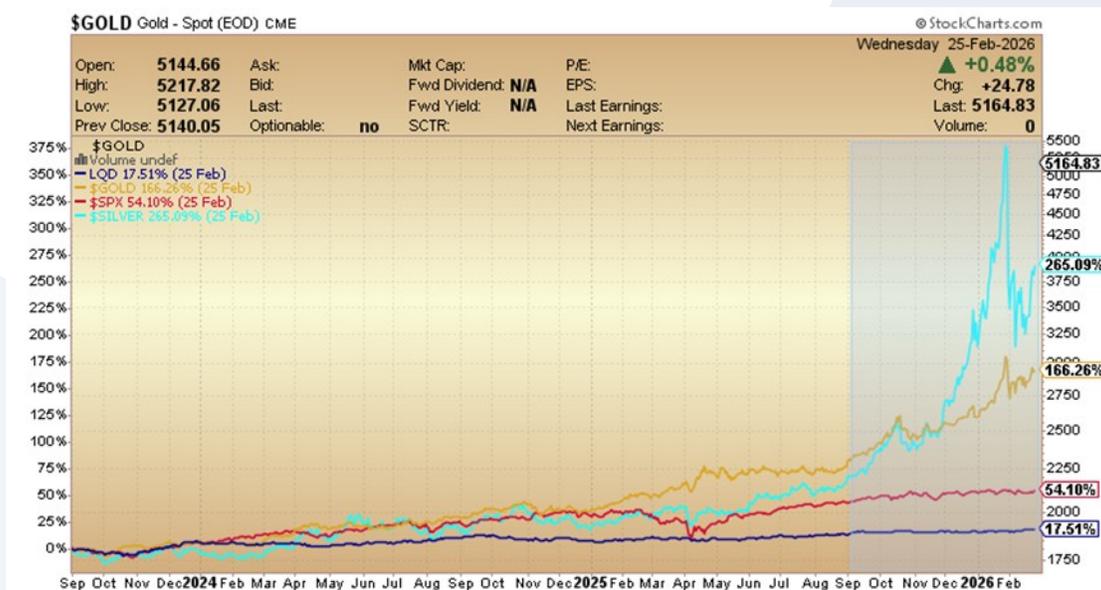
financial authorities to keep our mortgage rates low, jobs intact, and 401(k)s buoyant has created a degree of loyalty to them seemingly superior to that toward neighbors. For anyone familiar with the psychological arts, Stockholm syndrome might fit the bill here. Many of us have become subservient to the very system that has been poisoning our soup and thinning our skin. More stimulus, government spending, bank bailouts, interest rate cuts - please, oh please.

The stock market is also this child, albeit in a more mechanistic way. The money flows and global liquidity that have driven it relentlessly higher over the last 16 years have created a rickety tower of scaffolding that fears the softest breeze. Those depending on this Franken-structure staying upright to continue to service economic and societal stability – the entire western financial system – tremble at the thought of losing it. The inability of markets, economies, institutions, and people to fail, and policy-makers to allow it, has created some of the largest moral hazard and vulnerability across the financial system and society that

we've ever seen. Everything is rickety, soft, and greatly lacking in resiliency and perspective. We lack the durability and character galvanized through hardship and failure, and the financial markets are an incredibly important piece of that puzzle.

This observation serves no purpose if it doesn't somehow influence our behavior for the better. Personally, if we agree with it, we can seek to bolster our resiliency, strive toward self-sufficiency, and evaluate potential risks with more care and scrutiny. Our job as investment managers is to essentially do this very thing within our clients' investment portfolios. Our view remains that the financial system scaffolding (with stocks at the center), if unsupported by intervention, will topple with the first soft breeze. Large investors are likely well aware of this, which is why real assets have dramatically outperformed traditional financial assets over the last year and show no signs of slowing down in 2026.

So far this year, silver and gold are up 26% and 19% respectively, while the S&P 500 and iShares Investment Grade Bond Index are up only 1.4% and 1.7% respectively. As the chart below shows, over 2.5 years the gap between real and financial assets stretches out even further, with returns being 265%, 166%, 54%, and 17% respectively. Again, this represents a clear shift in investor preference, and we are amongst those investors – we have been for a while.



Professionally, we have invested through two bear markets in the last 28 years. There were aspects of those experiences that involve failure and adversity and we grew tremendously from them. We maintain a deep interest and commitment to the historical record and learning as much as we can through others' experiences in an effort to gain perspective and glean insights that can inform our views. Our goal is to build self-sufficiency and resiliency into our client portfolio strategies and never fall into the complacency trap that leads to hoping for a redo, a bailout, or some form of intervention. That is almost always a short-term solution with crippling long-term consequences - the kind we've all become very well acquainted with recently.

"Hard times create strong men, strong men create good times, good times create weak men, and weak men create hard times."

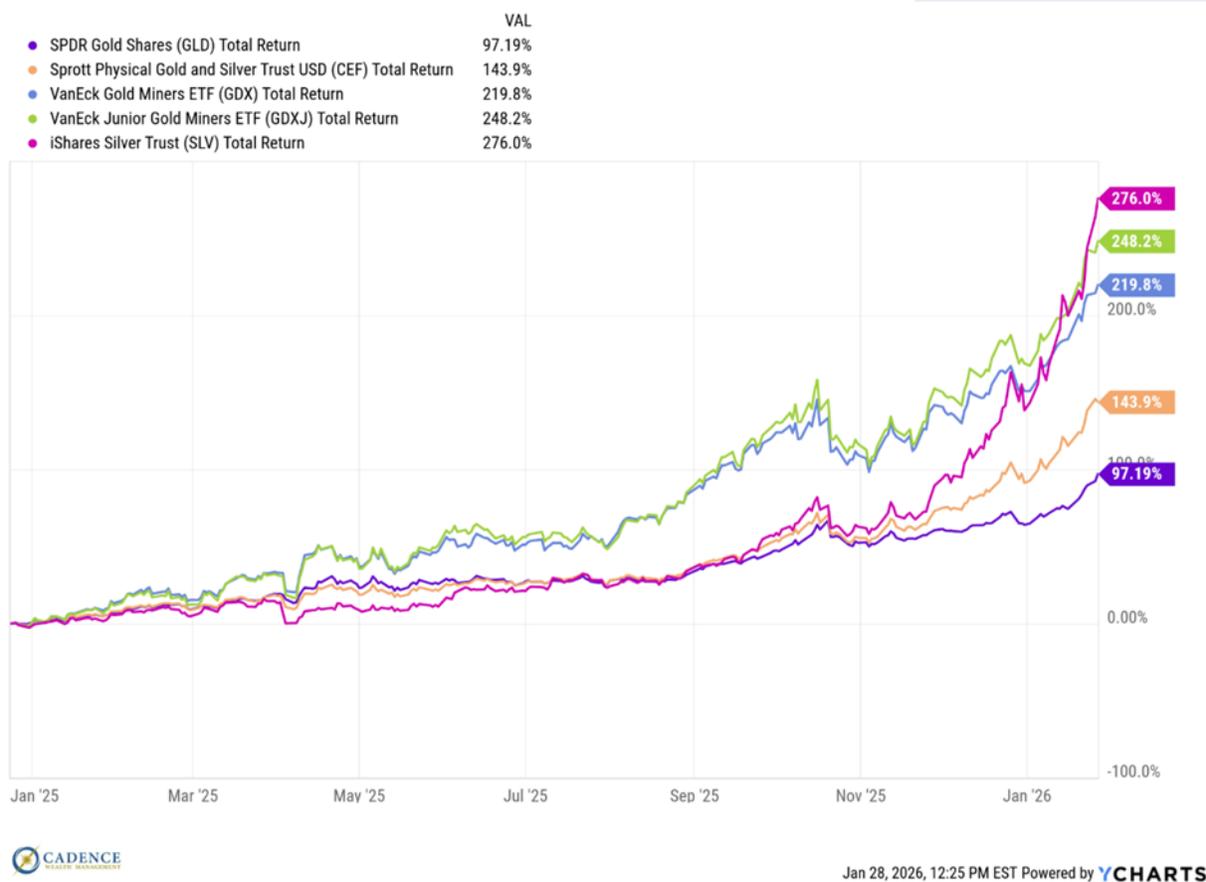
— G. Michael Hopf

Proceed with Caution after a Windfall

By Steve DeBoth

We write a lot about human nature from month to month. Obviously, our clients have exhibited productive attributes by seeking out investment help, by doing financial planning, and by focusing on how to achieve their goals. That doesn't mean they do not also feel the pull of some of the counterproductive aspects of human nature, like greed, rationalization, and "irrational exuberance", they're just usually better at ignoring those pulls. Usually. But even for the most disciplined among us, the safety and security that results from years of good habits can be compromised quickly when one or two bad habits are allowed off the leash.

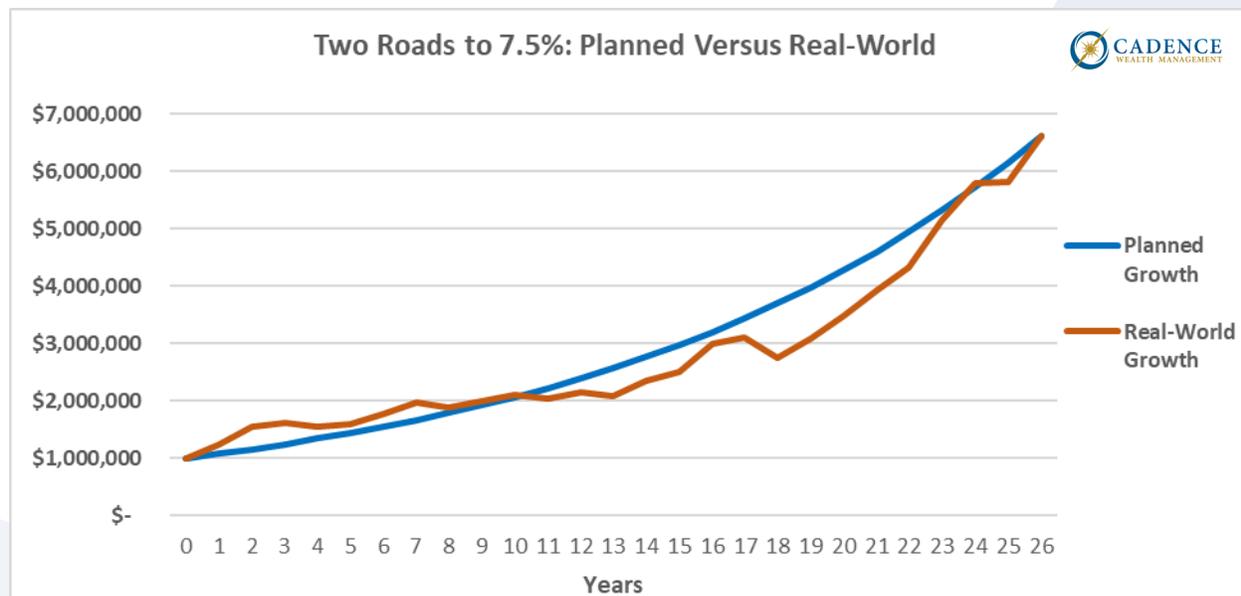
Consider last year, where investors exposed to in-favor sectors received what felt to be windfall returns. A chart I used for last month's article entitled "What Happens When You Catch the Tiger by the Tail?" shows just how much the precious metal investments Cadence advisors used for their clients last year grew:



The average gain of the precious metal indexes in client portfolios was 197%, but many other investment areas did well too. The average gain among the major stock categories we track was over 21% last year, and the average among the major bond categories was over 6%. 2025 was a bountiful year, and bountiful years can introduce unique temptations. When you are staring at an investment balance that is 10%-15%, or more, higher than where your plan says you need to be to achieve your goals, that extra money can look awfully, awfully tempting. If you have more money than you need, what's the harm in spending a bit more than you planned?

Consider someone who retired with \$1,000,000, and whose financial plan said needed to earn at least 7.5% per year to never run out of money. To fill the gap between their fixed income and planned expenses, they'd calculated they'd need to withdraw 3% per year from their investments. Over the course of 26 years, this plan would have them withdrawing a little over \$1.5 million in total. As we know, no investment mix returns exactly 7.5% per year, so in reality there will be good years and bad years that in the end could still deliver that 7.5% average annual return.

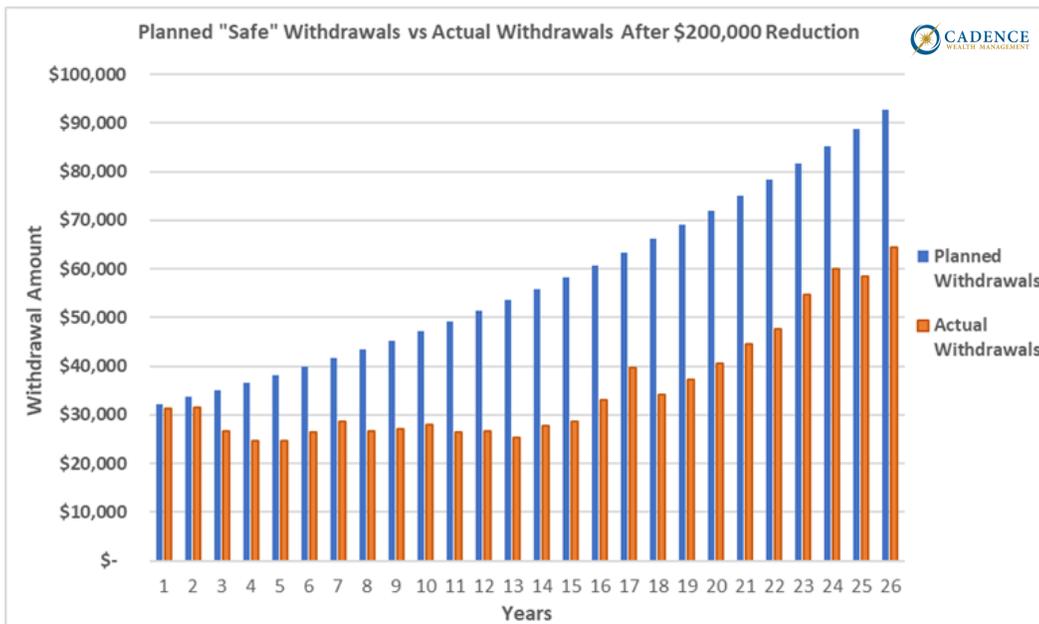
We're lucky in that we have a crystal ball and can see that with regular rebalancing, the investor will earn that 7.5% per year over the next 26 years. Real-world returns jump around, but for this lucky investor, they are on a path that will get them what they need, though the road to 7.5% for them will not be the smooth route illustrated in the plan:



We know that this investor will ultimately earn what they need to never run out of money, and we also know that the early years of real-world returns will put them ahead temporarily, but not forever. Unfortunately, the investor cannot see the next 26 years like we can, so the early bumper years probably look like a windfall after two very strong years of 24% and 25% asset growth right off the bat. They're now way ahead of where they'd planned on being, even after withdrawing the 3% to cover expenses, with an "extra" \$380,000 they hadn't counted on. What to do, what to do...?

At this point, it's easy to give into temptation and go off-plan. This investor rationalizes that after such good discipline and wise investing, why shouldn't they take advantage of this "extra" \$380,000? Let's replace some vehicles for newer ones, let's upgrade the kitchen, and let's take a couple of extra, very nice trips this year – we've earned it! They are even comforted with the fact that instead of spending the entire \$380,000 windfall, they're only going to withdraw \$200,000 extra from their accounts, with some of that going toward taxes, because again, they are disciplined and wise.

Unfortunately, we know that the \$380,000 isn't actually "extra", as there are some years coming that will actually put them behind their planned 7.5% average annual return. They still need to make their 3% withdrawals every year, and they'd planned on a pretty routine annual cashflow. After taking the \$200,000 out at the beginning of year 3, the withdrawals over time compared to what they'd planned on taking look something like this:



Over time, they are not able in many years to take out nearly as much as they'd planned, and probably have to cut back going forward. There are some lean years in there, where the actual withdrawals are half of what was planned. The uneven, real-world investment returns plus the \$200,000 they pulled out are now potentially causing some real issues. They'd planned on pulling \$1.5 million out of their investments during their retirement, but instead only pull around \$925,000, a full \$570,000 less than they'd planned. Even if we add back in the \$200,000 extra they pulled out early on, their investments still generate around \$370,000 less in safe withdrawals over time. Some real decisions will have to be made, and their retirement lifestyle possibly severely impacted. If the \$200,000 went toward things they'd planned on spending all along, it's not going to be so bad; they just paid for some things early. But never count human nature out: when staring at what feels like a windfall, it's very, very easy for some of that windfall to find its way to pay for unnecessary things, that may not bring any additional happiness.

Last year was a bountiful year, but before you eye last year's returns as being above and beyond what you need, check with your advisor. If any of that balance is burning a hole in your wallet, let's discuss what is a safe "extra" amount to withdraw. I am not saying not to enjoy the fruits of your labor, just do so with the knowledge that the path to the investment returns you need will bounce around. You will have better than average years, and worse than average years. Maybe one or two really good years will allow you to upgrade your lifestyle, or take that extra trip. I certainly hope that happens. Before considering whether or not to spend a portion of a much bigger investment balance than expected, discuss what is safe with your advisor. A responsible way to spend some of that "extra" would be to update your financial plan to see what the bounty of last year and any additional years to come will allow you to achieve, before you take more than you should and actually compromise your future plans. Larger than expected investment balances are a good problem to have. Let's make sure the extra that's in there today will not be needed for leaner than expected years down the road before we splurge.

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