



► ASK CADENCE: YOUR
LATEST QUESTIONS
ANSWERED 1-6

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Cadence *clips*

FOCUSED ON WHAT MATTERS MOST.

Ask Cadence: Your Latest Questions Answered

Q What's the deal with the Fed? Does all this raising and lowering of rates actually help the economy?

By Casey Clarke

Short Answer: Not really. The true role of the Fed is to orchestrate and backstop the banking system. By encouraging lending, money supply rises, and economic activity follows. Unfortunately, so does inflation. Therefore, inflation – or as the Fed calls it, stable prices – is part of the deal. Control over short-term interest rates is more of a side show and arguably does more harm than good.

Full Answer: The question of whether or not the Federal Reserve actually has the ability to steer the economy and influence the wellbeing of the average American has been a debate ever since its formation in 1913. On one side of the debate stage, you have the argument that without the Federal Reserve acting to promote maximum employment and stable prices, along with the original objective of banking oversight, the economy would suffer periodic recessions as a result of undu-

lating boom and bust cycles. On the other side of the stage, you have those making the point that despite the efforts of the Fed, we've consistently seen boom/bust cycles, high inflation, bouts of high unemployment, and to boot, extreme gaps in socioeconomic status – all despite the Fed's dual mandate to help avoid these things. Seems like a fairly easy debate to settle, doesn't it?

A couple observations worthy of pointing out when it comes to assessing the levels of efficacy and altruism with respect to Fed actions are:

- 1) Narrative versus reality of interest rate moves – The narrative and heuristic around the Fed's most popular and visible tool of interest rate setting is that raising the overnight lending rate will slow economic activity and thus, inflation, while lowering it will stimulate growth and inflation. The reality however is that higher interest rates are more consistent with both growth and inflation, and lower rates more aligned with economic sluggishness and disinflation, if not deflation. When one thinks this through, it's actually fairly intuitive. Growth and

inflation come first via separate but often overlapping cycles, thus pushing up interest rates as those cycles mature. Risks increase toward the end of cycles as the easy and safe loans have already been made – lenders start demanding more return from the more heavily indebted and less creditworthy in exchange for their capital. Rising inflation as a result of increasing money supply via the expansion of bank lending also pushes interest rates up. So, the business and inflation cycles drive rates, not the other way around.

If anything, one could make the argument that raising rates to artificially high levels can actually create more future inflation by discouraging capital investment in goods. Less investment, less supply, higher prices. The same would be true in reverse. Artificially low rates today could lead to overinvestment and cheap prices down the road. The consequence however is that overinvestment via debt can also lead to bankruptcy of the very companies we depend on for goods, so lower prices 3 to 5 years from now could lead to dramatically higher prices 5 to 10 years from now. The unnatural suppression of borrowing rates at the wrong point in the business cycle encourages debt-financing when it makes the least sense to do so, and when these businesses fail, they can no longer contribute goods to the supply pool; the end result is higher prices for those things still in demand. We are in the midst of this situation right now. The artificially low interest rates post-financial crisis left so many firms over-indebted and gun-shy for such a long period of time, we are currently facing one of the largest capital underinvestment stories in natural resources that we've seen in modern times.

- 2) Bailouts – We've had an opportunity to witness a lot of irresponsible activity in the banking sector over the last few decades, and what's been a common theme is that the largest banking institutions get recapitalized and bailed out while the smaller ones get rolled up into the larger ones. Additionally, very few consequences find the executives at these larger institutions for this irresponsible behavior. This strongly aligns with the original intent of the Federal Reserve – to be lender of last resort when (big) banks get into trouble and to make sure the close calls of the 1907 financial panic never again present an existential risk to the public (or bankers). I'm being somewhat cheeky, but the factual point here is that every time a bank is bailed out by the Federal Reserve regardless of the merits of that rescue, the bill goes to the taxpayer in the form of inflation. Why inflation? Because every bailout essentially involves new printed money without any corresponding losses or destruction of money that would have otherwise accompanied a banking failure. Every bailout leads to more money in the system which leads to more inflation, and as we've all come to learn very well in recent years, inflation is a tax that disproportionately affects those without millions and billions in net worth.

And why must the banks be bailed out or rolled up rather than allowed to fail? The easiest explanation is because our economy and financial system is based on debt for growth. A common misconception is that the Federal Reserve prints money to inject into the system, but this isn't entirely true. They infuse reserve assets into the banking system, but it's the banks that actually leverage those reserves to print money into creation via loans and credit. With a 10% reserve requirement (prior to March 2020) in place, banks can lend 90% of customer deposits, which in turn, creates an equal amount of new deposits within the banking system. So, an initial \$1 million in deposits allowed for \$900,000 of new loans, which simultaneously created \$900,000 of additional deposits. Of course, this can be repeated multiple times as newly printed deposits create new lending opportunities, and as long as each bank keeps 10% of their customer deposits in cash or Treasury assets, they are considered compliant. That 10% rule however was pre-2020. The current reserve requirement is now 0% with the new regulatory framework for keeping banks compliant being a much more nebulous capital ratio that looks at bank equity relative to the quality of its loans/assets. So long as the balance sheet and its many components looks up to snuff, the bank is free to lend away.

The easiest way to think about this is by imagining that debtors in unison discovered fiscal religion and all the outstanding loans were suddenly paid off - the money supply would rapidly approach zero. This is because in a fiat system where the money isn't backed by anything other than the "legal tender" status imparted on it by the government, there is truly nothing behind it other than faith. It is lent into existence, and therefore if paid off, will be retired

out of existence. Now, it's impossible for that many loans to be paid off simultaneously of course, but widespread bank failures would have a similar effect on the money supply. Thus, the need to keep the charade going with bailouts, and to never allow inflation (money supply) to drop to contagion-catalyzing levels. Yes, in this respect, the banks are too big to fail. A more accurate way to put it however is that the system created by the Federal Reserve's actions over a century has become too big to fail.

So, in the end, the raising and lowering of overnight lending rates are more of a side show than a main event. If anything, these actions are more likely to disrupt the normal ebb and flow of natural cycles than to compliment them. The biggest role of the Fed is by far its ability to steer as well as backstop the banking system via money creation and bailout. This comes at the extraordinary long-term cost of price and asset inflation, which we are suffering the very real effects of now. It's odd that more people don't recoil after hearing the Fed utter the words "price stability", when their stated objective is to actually keep inflation at 2% and their primary role is to facilitate never-ending money creation (otherwise known as... inflation). One wouldn't be blamed for wondering who it is the Fed actually serves.



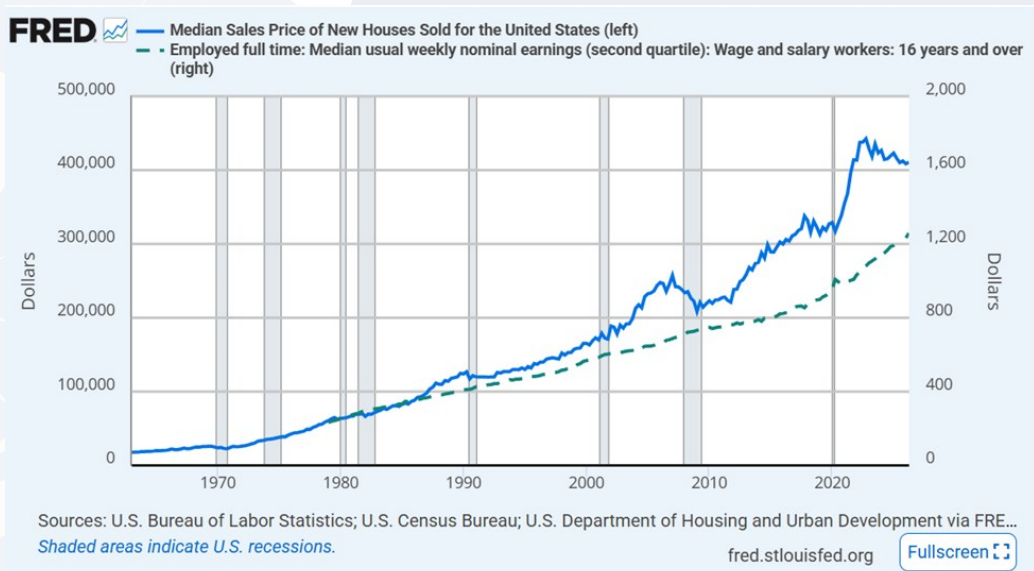
How will the recent interest rate increase by the Fed affect the housing market?

By Casey Clarke

Short Answer: In the near term, it makes buying a house more expensive. In the longer term, to the extent that raising interest rates "slows the economy" faster than otherwise would be the case, it could assist in bringing home prices down.

Long Answer: Housing has undoubtedly been a victim of the Federal Reserve policy we discussed above in that the expanding money supply via the banking system has fed through directly to higher housing prices. We're now at the point where affordability is a serious problem for most. Lower rates helped to offset rising prices, but we've reached the point - certainly with higher rates - where there's just no more wiggle room. The quarter point increase in interest rates in September will only add fuel to the fire in terms of housing affordability. For a \$750,000 30-year fixed mortgage, a jump from 7% to 7.25% raises the monthly payment \$127, to \$5,116. The silver lining, if there is one, is that this recent increase in rates may help to catalyze the only long-term solution to the housing affordability issue - a decline in house prices themselves. Higher interest rates aren't the problem with the housing market; prices are. As is evident in the chart to the right,

since 2000, median home price increases have out-paced median wage increases fairly steadily with the only retracements back toward parity being during economic slowdowns. Home prices need to come down. And, whatever needs to occur with respect to the economy and markets for that to happen, must be allowed - on some level - to play out. We can't have it both ways.





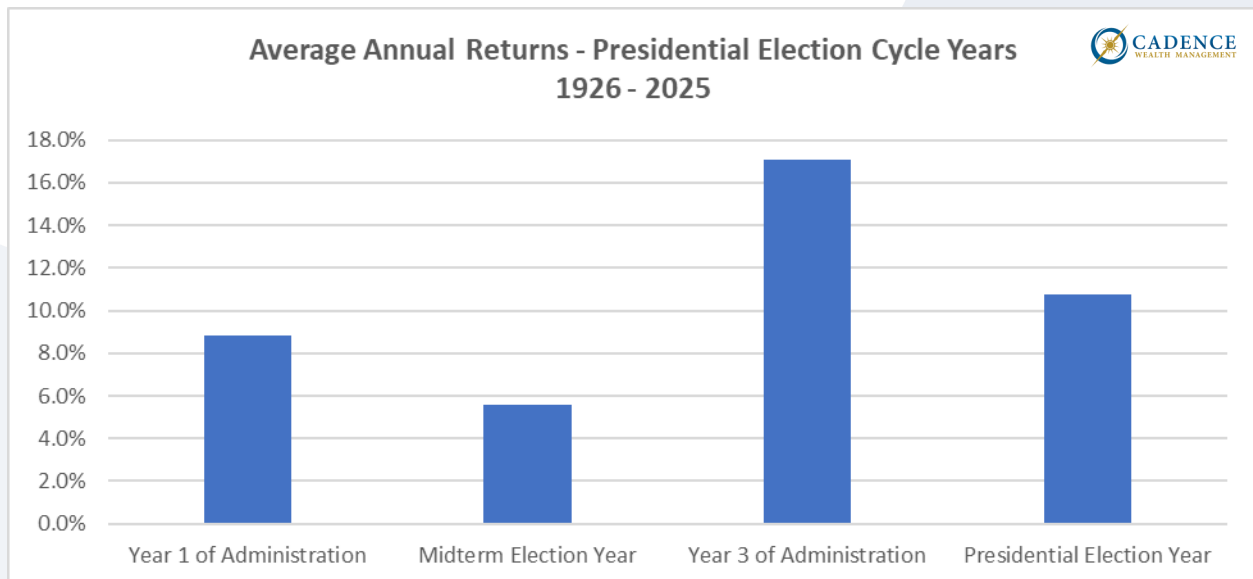
How Might the Midterm Elections Impact the Stock Market?

By Steve DeBoth

Investor anxiety has risen heading into the 2026 midterm elections. Economic policy uncertainty surged earlier this year to more than eight times its long-term average, reflecting heightened concerns over taxes, trade, inflation, interest rates, and government policy.

Equities have remained resilient through much of 2026. As of a couple days ago, the S&P 500 was up roughly 14% for the year. However, the outlook has become less certain as investors reassess the pace of AI investment, elevated equity valuations, war/conflict in the Middle East, U.S. tariffs, and the Federal Reserve's ability to bring inflation under control. How might the midterm elections add to that uncertainty?

A quick internet search can inform you that midterm election years have the lowest historical average return of the four-year presidential cycle. The chart below shows the average returns for each year of the four-year presidential cycle going back the past 100 years:



According to the long-term averages, the best year of a presidential term is its third year; its worst is its second year, the midterm election year, which we are in right now. So, with investor uncertainty rising during the supposedly worst performing year of the presidential cycle, should we change our investment strategy?

Political uncertainty can certainly contribute to market volatility, but the market's underlying drivers are factors such as earnings growth and forward-looking economic indicators. Forces like these form the broader mosaic of the market and ultimately tend to matter far more than the outcome of any individual election. As a result, any impact an election has on the stock market is impossible to predict consistently, and is short-lived as the fundamental forces once again take over.

At Cadence, we are investing, as we have always done and always will, based on the various investment cycles of stocks, bonds, commodities, etc., and the valuations of each individual investment. There is nothing this midterm

election can do to these factors in the short term that make trying to guess what will happen after November 3rd a productive use of time. Whatever will happen cannot be guessed and will not matter in the long run anyway.

This tendency to ascribe different average returns to different election year factors is known as the “Clustering Illusion”, which is defined as “the tendency to overestimate the importance of small runs, streaks, or clusters in large samples of random data (that is, seeing phantom patterns).”^{*} When you look at all the S&P 500’s annual returns, not just election years, from 1926 through 2025, you get an average annual return of 10.5%. When you consider how much the individual annual returns have fluctuated around that 10.5% average, you find that 2 out of every 3 years you would expect the returns to fall between 29.5% and – 8.4% based on a statistical measure called standard deviation. When you fit the returns from the chart into that range, what you find is that ALL of them fall between the normally expected high of 31.1% and normally expected low of -8.3%. This essentially means that all these patterns the pundits are seeing in election-year returns are actually just NORMAL returns, not “special election-year returns,” and not predictive at all.

Picking out patterns like this and ascribing stock market returns to them would also mean that every summer Olympics year and every leap year, the stock market’s average return is 10.8%. It is just as correct to say that 10.8% return is *because* of the summer Olympics, or *because* it’s a leap year as it is to say it is *because* of the presidential election. Just because we think we see a pattern, it doesn’t mean that it actually exists. We would rather focus our investment time and energy on those things that do exist, regardless of how neat and tidy overlaying a pattern on a set of data appears.

^{*} Iverson, Grant; Brooks, Brian; Holdnack, James (2008). "Misdiagnosis of Cognitive Impairment in Forensic Neuropsychology". In Heilbronner, Robert L. Neuropsychology in the Courtroom: Expert Analysis of Reports and Testimony. New York: Guilford Press. p. 248. ISBN 9781593856342.



Recent market movements don’t seem to make any sense. What’s going on there and what’s most likely to happen through the remainder of the year?

By Casey Clarke

Short Answer: Markets have become increasingly complex and easy to manipulate with the proliferation of derivatives markets. Additionally, given the stakes involved in some markets moving in certain directions, the motivation to manipulate is certainly present. Investors must take a longer view when investing based on fundamentals and consider short-term price swings as more noise than signal. Given this, our view of things through year-end is in uncertain, but we continue to favor the current trend of real assets outperforming financial assets. Our confidence in that call increases with the length of time over which we’re assessing things. The biggest risk of steep losses continues to reside in the broad, tech-centric, stock market indexes, in our opinion.

Long Answer: If there’s one thing that we’ve learned about a system that operates as outlined above—one that is largely centrally planned by a big bank through member and smaller banks via perpetual money creation by way of credit and loans—it’s that fundamentals frequently lose their relevance. A company isn’t profitable and has tons of debt? No problem, just give them another loan to keep going. Country X can’t make their loan payments to U.S. banks? No problem, just restructure their debt or roll it into a new, larger loan so they can avoid default and make payments for a little longer. Here’s the really frustrating one for us... Want to keep a market from moving in an inconvenient direction due to fundamentals? Easy. Just get a large trading desk to place big bets in the derivatives markets to use leverage dynamics to move markets in the desired direction. What J.P Morgan was found guilty of and admit-

ted to doing for 8 years between 2008 and 2016—manipulating the price of various precious metals markets—other large financial institutions could absolutely still be doing today. Recent activity in paper energy market prices appears highly inconsistent with what we’re seeing in real world energy prices. In short, what many are actually paying for energy products is much higher than what those products are listed for in financial marketplaces. Regardless, it wouldn’t be anything new or much of a surprise if prices for energy, commodities, or anything else for that matter wasn’t tracking their underlying fundamentals. Unfortunately, this is the system we’re operating in and must learn to deal with. We’ve found that the best way to adapt to this reality is to stretch out our timeframe and increase our tolerance for short-term, unexplained price behavior. In the end, the rubber band of reality always snaps back.

News out of the Middle East is almost impossible to keep up with: Oil’s flowing out of the strait again. Wait, now it’s not. Hold on, it now appears it might be... a little... with billions of dollars of military support infrastructure to escort it out safely. This is narrative noise designed to confuse and obfuscate, and none of it changes the fact that supply and flow have undergone major disruption since March, strategic reserves have been drawn, and we’re coming up on winter in the northern hemisphere. And none of this yet incorporates the refining capacity that has been strategically removed in Russia. We’re intentionally staying out of the weeds on the finer details because, not only are they seemingly unknowable, but they ultimately don’t matter as much as the broader theme - we have far less supply and flow than we did coming into 2026. All this against the backdrop of low capital investment in new supply in recent years, old infrastructure, and commodity prices across the board that are very low relative to money supply, stocks, gold, and most other benchmarks, and we’re looking at the makings of higher prices in the coming months for natural resources. Whether those prices are higher next month or next year nobody knows, but odds are that it takes more work keeping them down than it does getting them up.

On the bond front, we’re seeing interest rates accelerate higher across the board, which for a heavily indebted country (as well as Western countries), isn’t great for economic activity. We’ve opined before that bonds are much more important to policy-makers than stocks given the size of the bond market and its importance in supporting the dollar, banking system, and totality of global finance, so the fact that bond yields are threatening a prison-break to the high hills could lead to some very interesting policy responses. What seems evident is that the markets are losing confidence in the Fed’s ability to control inflation. If this is true, that perception control no longer works, then the only way to assure borrowing rates come down would be to bring inflation down by slowing the economy, deflating stocks and housing, and ramping up production of commodities to reduced input costs over time. Fed Chair Kevin Warsh’s quarter point increase in rates in September certainly doesn’t dispel this hypothesis as a possibility.

Ultimately, the geopolitical activity around the world involving the U.S. has had a common theme – it is all centered around securing control of natural resources, which supports our outlook for a continued shift in focus from financial paper assets that created the wealth of yesterday to real assets that will provide a more tangible measure of true wealth tomorrow. The rest is noise.

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