Fox-Smith Wealth Management Quarterly Commentary

Fourth Quarter - 2021

“Inflation, Social Security, and CPI”

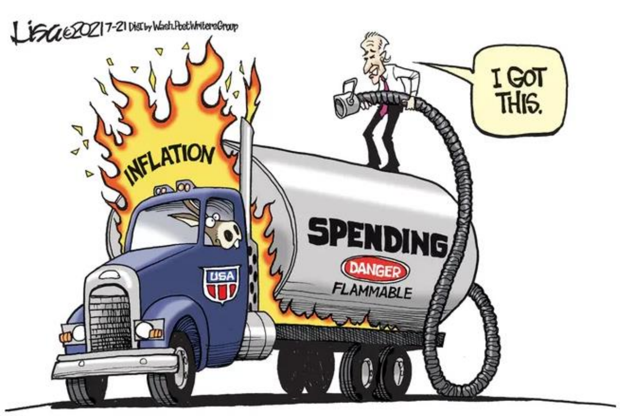
Economic Outlook and Market Commentary – Gustin D. Fox-Smith, AIF®, ChFC®

Six months ago, in my May 2021 commentary, I focused my entire article on the signals telling us that inflation was coming. In fact, I even called inflation “unavoidable” due to the mounting price and demand factors we saw in global economic data. When I made this prediction, I felt I was speaking into an empty room since no-one in the government or media agreed with me. Even worse, all sources I could find were saying the exact opposite, that the Fed had inflation “under control” and that there were no inflationary pressures to be seen.

Fast forward to the third quarter of 2021, which just came to a close, and sadly, I have been vindicated. Given the choice, I would have chosen a healthy, low inflation economy over being proven right, but that is not how it is playing out. And now, we are being told by most sources that inflation is only “transitory” and that it will be with us for only a “season” and then will go back down. That may be true, depending on your definition of “Season” and “Transitory”. Both terms only mean something is not permanent, so there is a lot of room for interpretation. But it is clear what is meant when these words are used is that inflation will be a blip and we will go back to normal within a few weeks or months. Unfortunately, I don’t think you should buy into that prognostication either, more on that later.

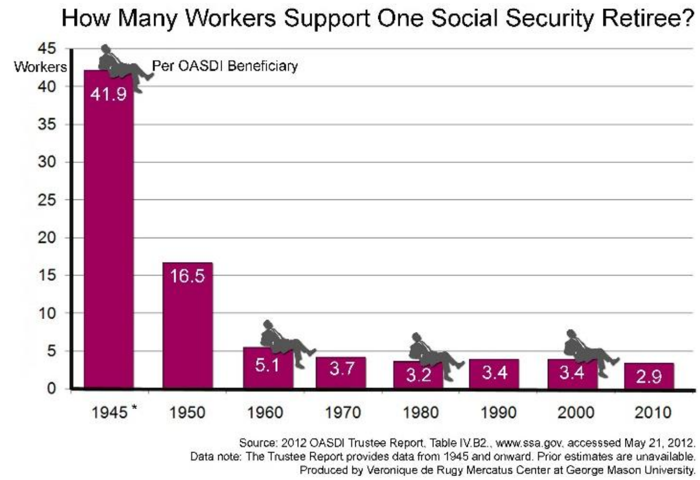
The official inflation rate published by the U.S. government currently stands at 5.4%. That rate is worrying enough, being it is the highest rate reported in nearly 20 years. But all it takes is a visit to the gas station or grocery store to become painfully aware that this is not an accurate measure of increasing prices. The government uses a formula to calculate the Consumer Price Index (CPI), which is the officially reported inflation rate. There has been some monkey business going on for 40 years when it comes to the formula for CPI and it has everything to do with Social Security.

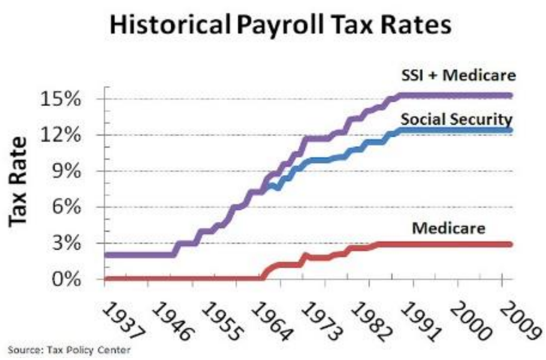
The Social Security program was launched in 1935 and began collecting payroll taxes through FICA in 1937. The first benefits were not to be paid out until 1942 which would have given the program 5 years to collect revenues. It should have been ample time to amass plenty of capital to be self-sustaining due to the much shorter life expectancies of the era. But sadly, the new revenue source was commingled with general treasury funds and was spent faster than it could be taken in. The “Social Security Trust Fund” we often hear about was always empty as a result.



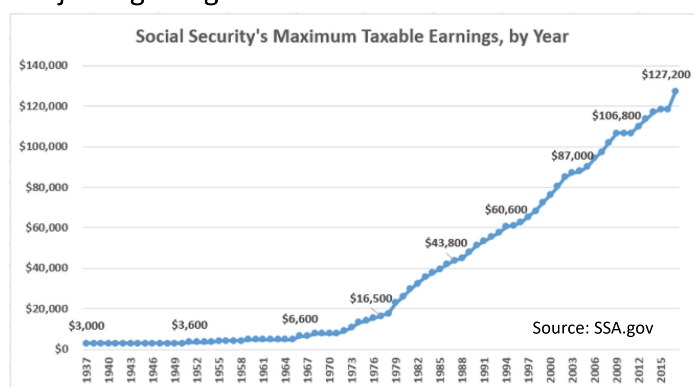
Because of this, when the first retiree filed for benefits, they were paid using active worker’s FICA taxes and the program has been run with current workers paying the benefits of retirees ever since. This still kept the program solvent for decades due to a steadily growing population, but that is where the problem lies.

Early in the Social Security program's history there were scores of workers paying into the system to support few beneficiaries. In 1945, there were nearly 42 workers supporting each beneficiary. By 1960, the number of workers per retiree was 5.1 and by 1975 it had dropped to just 3.2 workers per beneficiary. At this point the program was beginning to pay out more than it was taking in and it was clear to everyone that the future of the Social Security system was not certain. Today it is even more tenuous as 2.6 workers currently support each retiree, and it is projected to drop below 2 within the next two decades.



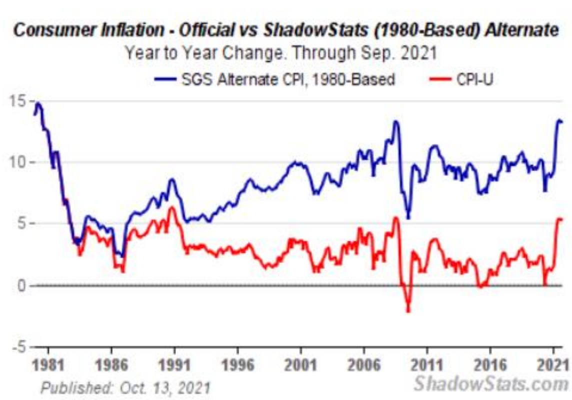


The government has taken numerous actions since then to shore up the program. They have increased the retirement age, decreased benefit payout rates, increased the FICA tax rate, added employer matching, and raised the income cap upon which FICA taxes are paid. All of these things were clearly understood by the public and helped to increase the revenue side of the ledger for the program. The far more insidious strategy Congress has employed was targeted at controlling the expense side of the ledger and they have been tweaking and adjusting things to this end since 1981.



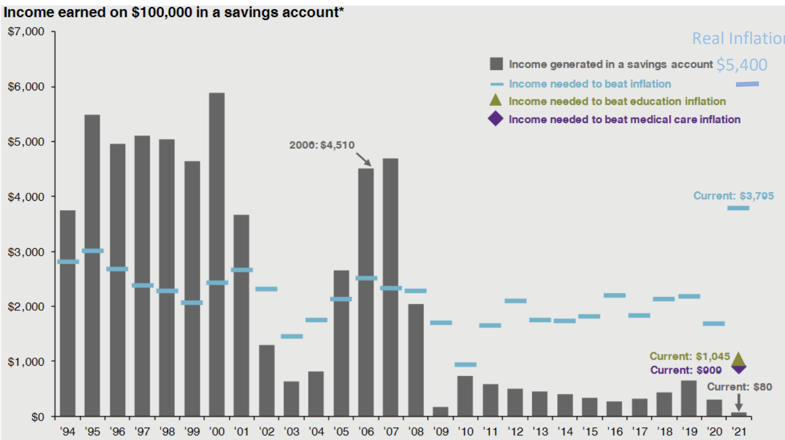
Those of you that collect Social Security benefits know that you receive a cost of living increase each year, but did you know that the amount your payments grow is based solely upon the change in CPI from year to year?

So, if you want to control the rate of increase of expenses for the program, all you have to do is slow the growth of CPI, which our government has been doing regularly for 40 years. As it is calculated today, the CPI formula either eliminates or severely minimizes the price increases of entire classes of goods and services and these changes have been made steadily by nearly every president since Reagan. Today, the prices of housing, energy, food, healthcare, and technology can all jump significantly and there is little change in the CPI as a result. The chart below shows the official (manipulated) CPI as reported by the government since 1981 (the red line). It also shows the real inflation rate if it was still calculated honestly the way it was prior to 1981, (the blue line). And, as you can see, the real inflation rate today would be 13% based on the original CPI formula which almost matches the high set in 1980-81.



That is a very long-winded way to say, "Inflation is a lot higher than they say it is."

The one positive that came out of the high inflation period of the late 70's and early 80's, as long as you didn't need a mortgage loan, was that interest rates climbed with the inflation rate so you could still save money you earned, put it in a bank savings account and earn enough interest to at least keep pace with inflation so you weren't losing buying power every year. That is what is different in the current environment. Interest rates have stayed extremely low. In fact, the average bank account has not paid enough interest to stay ahead of inflation since 2008 with this year giving us the widest gap in history. Today the average $100,000 savings account will pay only a measly $80 in interest while inflation will steal $5,400 in buying power (or $13,000 using original CPI!). (See the chart below) So at the end of this year that $100k in the bank will grow to $100,080 but will only be able to buy goods worth $94,670 ($87,060 in reality). And, sadly, we haven't even seen the worst of it. And, unlike the last time we had high inflation, I do not expect to see 14% mortgage rates and bank CD's paying 10% this time around. We have become much more globalized in the last 40 years and any rate north of 6% or so would see Swiss, Canadian, and Chinese banks falling over themselves to come and loan us money, which should help keep rates reasonable this time.



Source: JP Morgan Guide to the Markets

In my view, the claims of transitory inflation are a fairy tale. The raw global data I monitor that gives me a head start on so many things in the markets also provides numerous data points that, when put together, paint a very solid picture of future prices. The data includes, among other things, raw commodity prices, energy costs, manufacturing activity and capacities, oversea shipping rates, wage and labor factors, currency valuations, and much more. The specific data we watch is not important, but what is important is knowing that an increase in these inflationary factors does not typically result in an increased price on store shelves for at least 9 months and sometimes up to a year. While the rate of increase in these data points has slowed in recent months, it has not ceased its upward climb for even a month. This means that, even if the leading data leveled off today, we would still see steadily increasing prices and inflation through May of 2022 or longer. So, it is my view that any talk of inflation being an extremely short-term problem is not only wrong, but it requires anyone who claims to be an economist to be willfully ignorant of what is happening.

OK, if inflation will be with us for a while, what should you do? You are nearly certain to lose on an inflation adjusted basis if you keep money in the bank or own government and corporate bonds. Stocks generally help your money keep up with inflation, but certain sectors often outpace it by broad margins. Rest assured, because of our early recognition of the problem, we have already made numerous changes within our managed accounts to address and profit from inflation long before it became official.

A New Way to Thank You for Your Referrals

One of the best things about this business is, once you have some loyal clientele, you don't need to spend time and money on marketing. If you always place your client's interests first and live your life with integrity, your clients become your friends and eventually become like family. Then, if you also produce good results, your loyal clients will refer you to their friends and family members and your practice will grow organically, requiring no marketing budget.

Financial Trivia

Last quarter's trivia question was:
"When Windows 1.0 was first launched in 1986, the cost of the software was $100. If you bought $100 of Microsoft stock instead of Windows on the release date, what would your investment be worth today?

Answer: $46,400
We had a few guesses but no correct answers this quarter 😊

This quarter's question:

Who was the first woman to own a seat on the New York Stock Exchange and in what year did she join the exchange??

E-mail your answers to Erin at erin@fswealth.biz and we will award a prize to the first correct answer *(Be honest, no "googling" it!)*

We have been blessed with clients that love to tell everyone they know about us and what we can do to help them. Because of this, since 2007 when the firm consisted of just Gus running a solo Advisor office serving just 30 families, we have grown into a business that employs 10 professionals to deliver high touch financial services to roughly 1400 families who have entrusted us with over $300 million to manage. We have grown 2,445% in just 14 short years and all of that growth came without hosting a single sales seminar or doing any advertising. It came because of you and I couldn't be more grateful.

I deeply believe in the power of gratitude and what expressing thanks can do to improve our lives. As such, we have always sent a small token of appreciation, usually a sweet treat, to your home in return for referrals. While the treats were always appreciated, I felt there had to be a better way to show our gratitude to you while also thanking the potential client you referred to us for taking the time to meet with us. Additionally, I wanted the expression of thanks to have a positive impact on our local community.

To meet these goals, we recently launched a new policy to say "thank you" in a unique way for your referrals. Each time you refer someone to us, Fox-Smith Wealth Management will make $100 available to be donated to charity. $50 will be directed by you immediately when you make a referral and $50 will be directed by the person you referred to us when they attend their first meeting with any of our Advisors. Please note that the donations will be made regardless of whether or not the prospective client chooses to hire us.

All charitable donations under this program must be made to one of the charities on our approved list which I have provided below.

All of the charities on our list meet or exceed standards we have set regarding transparency, management, and a minimum percentage of donated funds that are allocated to programs serving their stated causes. Additionally, whenever possible we have selected organizations that are local and serve those living in Colorado and the Rocky Mountain states, so the donations benefit people in our local area. The few national organizations are listed due to the importance of their mission and a lack of local charities that have similar objectives. Once again, thank you for being such a huge part of our success and for telling others about us. It is an honor and a grand compliment. And I look forward to seeing the donations we send out on your behalf become larger and larger.

Get To Know Your Fox-Smith Wealth Management Team

In order for you to better know your team that are here to serve you at Fox-Smith Wealth Management, we will highlight one of our team members each quarter. This quarter we are featuring one of our newest, yet exceptionally vital team member who has become an essential asset to Fox-Smith Wealth Management:

Cynthia Griggs

Office Coordinator
Operations Specialist

Cynthia was born in San Diego, CA, but quickly moved to Colorado at age 4. She has lived all along the Front Range, from Colorado Springs to Longmont, but her favorite place to live is the "People's Republic of Boulder". Growing up, Cynthia loved dancing and was always involved in music and the arts. In fact, she learned to play 5 different instruments as a teenager because she attended 3 middle schools and 3 high schools in the span of 2 years. Each time she moved schools, the school either didn't have a need for the instrument that she played, or they didn't have a band or orchestra. Cynthia was happily officially adopted by her awesome family at the age of 21, all of whom are so lucky to have such a wonderful person as her in their lives.

Cynthia attended CU Boulder and studied sociology and dance. She dabbled in accounting before finding her way into the finance industry with her position at Fox-Smith Wealth Management. She is currently studying for her SIE and Series 7 Registrations. When Cynthia is not providing exceptional client care, scheduling services, and generally assisting in all areas of the company, she can be found running her own truly remarkable photography business, Singe Photography, (https://singephotography.com). Cynthia's incredible ability to capture the essence of her subjects in unique and creative ways is unmatched!

You may have, also, recently seen Cynthia on the cover of the Daily Camera, featured for her other, newest passion: disc golf. You can see her cover photo and article regarding this wonderfully fun pastime at: https://www.dailycamera.com/2021/10/01/boulder-womans-disc-golf-club-creates-legacy-inspiring-longmont-players/

Through all of Cynthia's adventures and unique interests, her most fervent advice is to take time after high school to figure out what you like doing before you take on a load of student loan debt. Hopefully all of our clients are already planning for this if they have younger children; and if not, Cynthia is here to help you schedule a time to talk about this with your finical advisor.

We are truly fortunate to have Cynthia as part of our team at Fox-Smith Wealth Management! She has excelled in every area she has touched, and her warm and service-oriented persona is a genuine pleasure.

~ Disclosures and Definitions ~

Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them. Changes in the CPI are used to assess price changes associated with the cost of living.

The Dow Jones Industrial Average is a widely followed market indicator based on a price-weighted average of 30 blue-chip stocks that trade on the New York Stock Exchange which are selected by editor of The Wall Street Journal.

The S&P 500 Index is a capitalization-weighted index made up of 5000 widely held large-cap U.S. stocks in the Industrials, Transportation, Utilities and Financial sectors.

The Russell 2000 index is an index measuring the performance of approximately 2,000 smallest-cap American companies

The EAFE Index is a stock index offered by MSCI that covers non-U.S. and Canadian equity markets. It serves as a performance benchmark for the major international equity markets as represented by 21 major MSCI indices from Europe, Australasia, and the Middle East.