JFL Total Wealth Management

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Monthly Economic Update

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The Rise of Interest Rates:

An Investor's Perspective

Jerry Lynch

When reviewing the current environment for interest rates, almost all analysts are in agreement that they will continue to rise in the future. Short term interest rates, which in recent years were at historically low levels, have already risen. The Federal Reserve has already increased rates once this year, and at the end of a 2-day policy meeting, on May 2, the Federal Reserve decided unanimously to hold interest rates steady at the target range of 1.5 to 1.75%. Their notes said this decision was based on inflation recently moving close to the U.S. Central Bank's target and that, "on a 12-month basis is expected to run near the Committee's 2% objective over the medium term."

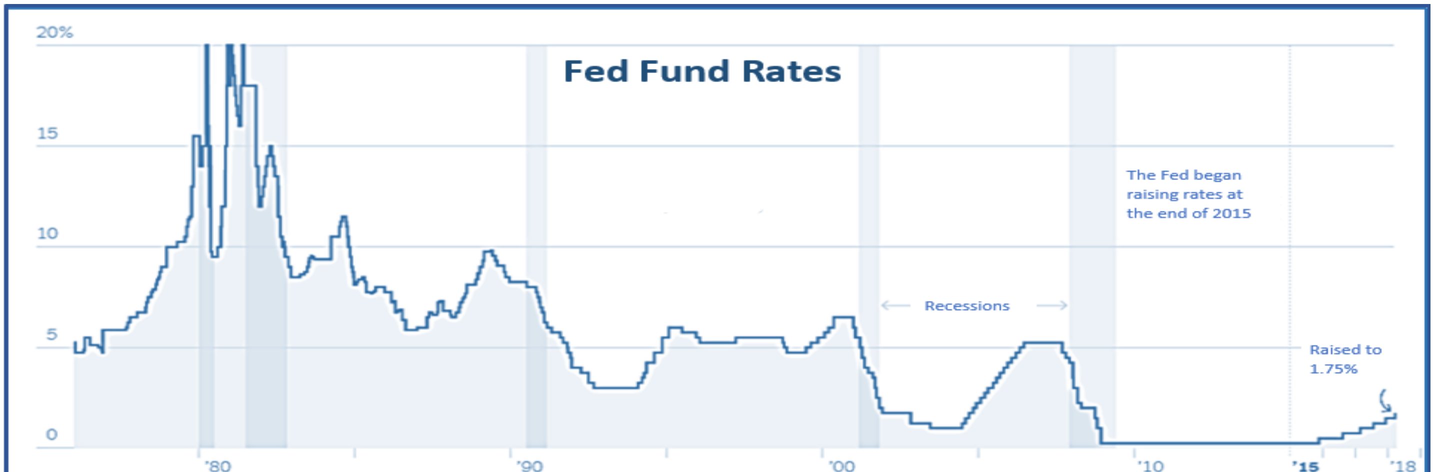
(Source: reuters.com 5/2/2018)

As suspected, during the May meeting, the new Federal Reserve Chairman Jerome Powell confirmed that they will continue a middle of the road approach to monetary policy and steadily increase rates. They are still on track to fulfill two additional rate increases, one in mid-June and one later this year. Most economists are confident the Fed will raise rates at the next meeting in June. However, some analysts feel that there is a possibility of two more raises after that one in 2018.

(Source: Associated Press 5/2/18)

Inflation Outlook

Inflation is at the center of the U.S. economy, because the Federal Reserve is closely monitoring whether consumer price increases will accelerate and force it to raise interest rates more sharply this year. Greg McBride of Bankrate.com stated, "The Fed pledges to maintain their gradual pace of rate hikes despite inflation moving close to their 2% objective, with some wiggle room for it to run slightly above that." He also added that, "the movement in inflation will squarely shift the outlook to four rate hikes, rather than just three, by the time 2018 draws to a close."



Source: Federal Reserve Note: Rate is the federal funds rate until Sept. 27, 1982, the federal funds target rate until Dec. 15, 2008, and thereafter it is the upper limit of the federal funds target.

Ian Shepherdson, Chief Economist at Pantheon Macroeconomics, wrote in a research note after the meeting, “The Fed is telling markets that it won’t overreact to a run of higher numbers just as it didn’t overreact to the run of five straight downside surprises last year.”

(Source: www.nytimes.com 5/2/2018)

The *USA Today*, reported on May 7th that, “Consumer credit has been growing solidly as strong job and income growth make Americans feel more comfortable about using their credit cards to make purchases. They also shared that unemployment is at a 17-year-low of 4.1%, and recently there has been a jump in gasoline prices. Just like the Fed, investors should keep a close eye on inflation.

U.S. Treasury Notes

The 10-year U.S. Treasury’s stature as a benchmark comes from being perceived as risk-free. 3% by some economists is viewed as a key threshold for a number of reasons. Three main reasons are: mortgage rates, the stock market and corporate debt. If this rate goes up, it will increase new mortgage rates. Also, if corporate borrowing becomes more expensive, that could lead to corporate projects or expansion being put on hold or cancelled.

The 10-year U.S. Treasury yield on Tuesday, May 1, moved above 3% for the first time since 2014. It’s a psychological level for the markets because we haven’t seen 3% 10-year yields since 2013. “The 10-year is potential competition for stocks,” said David Kass, a professor of finance at the University of Maryland.

(Sources: Fidelity.com 5/2018, www.Macrotrends.net)

“The majority of the rise in Treasury yields so far this year appears to have been due to changes in expectations for interest rates ... Investors are now

counting on faster Fed tightening than previously, which makes sense given the signs that core inflation and wage pressures in the US have increased,” said Oliver Jones, Market Economist for Capital Economics.

(Source: Marketwatch.com 5/1/18)

Remember, while interest rates are up from a year ago, they are still at historically lower levels. 6% is the 60-year average for a 10 Year Treasury.

(Source: Barron’s 5/5/2018)

The Relationship Between Interest Rates and Bond Prices

Yield is a simple concept. It is the current income return you receive when, for instance, you own a bond, as measured by a percentage. If the bond you bought for $1,000 pays you $30 per year — that’s a 3 percent annual yield.

Typically, bond prices and interest rates move in opposite directions. This means that when interest rates rise, bond prices tend to fall, and conversely, when interest rates decline, bond prices tend to rise.

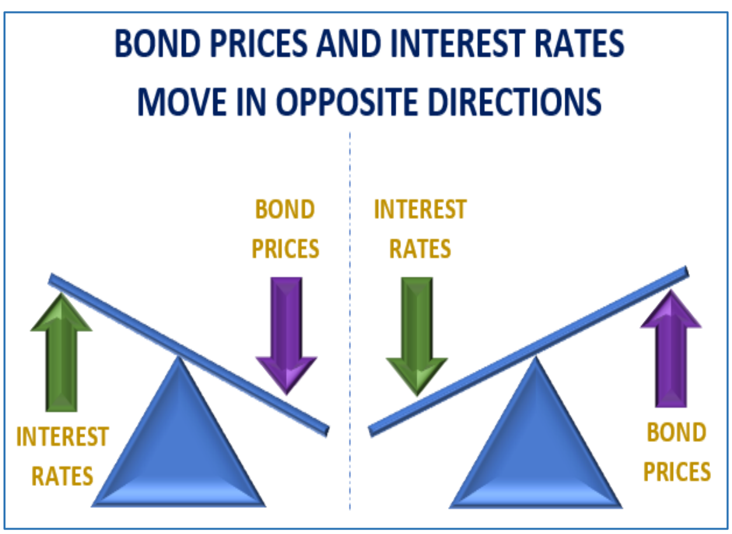
Here’s an example:

Suppose you invest $10,000 in a 10-year U.S. Treasury bond with a 3% yield. That interest rate is fixed, even as prevailing interest rates change with economic conditions—especially the rate of inflation. After five years, you decide to sell the bond, but interest rates have risen and similar new bonds are now paying 4%. Obviously, no one wants to pay $10,000 for a bond yielding 3% when a higher-yielding bond costs the same. So, the bond's value has decreased.

When interest rates decrease, the reverse happens. If interest rates had fallen and new Treasury bonds with similar maturities were yielding 2%, you could most likely sell your 3% bond for more than your purchase price. When evaluating your bond related investments an important piece of information is a statistic known as "duration." In finance, the duration of a financial asset that consists of fixed cash flows, like a bond, is the weighted average of the times until those fixed cash flows are received.

Duration also measures the price sensitivity to yield, the percentage change in price for a parallel shift in yields. Simply said, the longer the duration, the more sensitive a bond is to changes in rates.

Interest rate risk can be simplified by the following statement: when interest rates rise, bond prices fall; conversely, when rates decline, bond prices rise. Therefore, the longer the time to a bond's maturity, the greater its interest rate risk.



Many investors often put a high percentage of their portfolios in bonds for income or to hopefully generate more stable types of returns. This holds especially true when they are very worried about the economy or other financial issues, or after they have taken a beating in stocks. Unfortunately, in a rising interest rate environment, that logic could present problems.

Four Recommendations to Consider for Investors

1. **Maintain complete liquidity for all short-term and near-term needs.** Liquid accounts in today's interest rate environment will probably not keep pace with inflation. Although it is always important to maintain a liquid component in your portfolio, you should think about what major expenses you will incur in the next two years and consider keeping a larger than typical liquid pool of assets.

2. **Choose shorter terms over high yields.** Although shorter term bonds yield less than longer term bonds, they typically lose less value when rates rise.

3. **Review all of your income-producing investments.** As wealth managers, we help our clients review their income-producing investments. Our primary goal is to match your portfolio to your timelines and personal financial situation.

4. **Monitor your portfolio regularly.** Interest rates can move quickly or slowly. We stay apprised of the Fed and its decisions on interest rates so we can suggest adjustments to your portfolio as needed in a timely and educated manner.

Closing Thoughts

Interest rate risk can be complex. Take, for example, the nuances to reviewing duration, including how to compare the different types of bonds, like investment grade corporate bonds and treasuries. Just because they have the same level of duration, this does not mean that any two bonds will respond identically to interest rate changes. In the case of corporate bonds, their prices are also influenced by the credit quality of the company.

This is where we can help. When overseeing the investments, we recommend to clients, we take economic growth and rising interest rates into consideration.

In today's interest rate environment, a review from a qualified financial advisor can prove to be productive exercise. We are proud of the research we do on our clients' behalf and are always willing to offer a "complimentary" financial review for your friends and associates.

Discuss Any Concerns with Us

If you have any questions, please do not hesitate to ask them. We are always available to review your investment portfolio with you. We will always consider your feelings about risk and the markets and review your unique financial situation when providing any recommendations.

We pride ourselves in offering:

- consistent and strong communication,
- a schedule of regular client meetings, and
- continuing education for members of our team on the issues that affect our clients.

A good financial advisor can help make your journey easier. Our goal is to understand our clients' needs and then try to create plans to address those needs. While we cannot control financial markets, inflation, or interest rates, we keep a watchful eye on them. We can discuss your specific situation at your next review meeting or you can call to schedule an appointment. As always, we appreciate the opportunity to assist you in addressing your financial matters.

Complimentary Financial Check-up

If you are currently not a client of JFL Total Wealth Management, we would like to offer you a complimentary, one-hour, private consultation with one of our professionals at absolutely no cost or obligation to you.

To schedule your financial check-up, please call TJ Scillieri at (973) 439-1190 and we'd be happy to assist you.

Financial Responsibility-
It's Never Too Early to Start

Children and money will always be linked together. From birth to adolescence and from college graduation to having children of their own, children will always be linked to money and finances.

How do children learn to manage money?

Should they learn at school, from social media, their peers, by mismanaging at first, or should they learn from watching their parents?

The answer is a combination of all the above. Children will learn many of their earning, saving and spending habits from a variety of sources. How can you make a difference in preparing your children or grandchildren to comfortably face the multitude of financial challenges they will encounter as they grow up?

At first glance, money seems like a simple concept and one that would not require a lot of education. Children learn about money very early in life, usually by spending it, then hopefully by earning it! **Is it necessary to introduce smart and frugal financial habits at an early age? Absolutely!**

If you take a look at all of the financial difficulties that we encounter as a society, it becomes obvious that there is a need for financial education. We all encounter many opportunities to educate our children and grandchildren about financial responsibility. Through financial education and teaching by setting a strong example, your children or grandchildren could have a leg-up in developing sound financial habits that will hopefully last a lifetime.

We all know the old saying, "Money can't buy you happiness." Please keep in mind that one of the main purposes of having children and grandchildren is to reward you with a lifetime of happiness. **If you help them understand money, you can help eliminate potential stress, financial burdens and emotional strain that the misuse of money can bring.**

Does this mean that you should enroll your 4-year old child or grandchild in a finance class at your local college? No! **But it's never too early to share helpful information when it comes to money.** The goal is not to expect that your child will accumulate great financial riches, but rather to provide sound advice and values so that as adults they can avoid potential financial pitfalls and live comfortably and financially stress-free.

Here are several things that you can teach your children or grandchildren about money that can help them.

Educate and empower your children or grandchildren to become regular savers and investors.

Take an active role in teaching children to keep more of the money they earn. Teach them to be thoughtful in what they spend their hard-earned money on. Everyday spending decisions that they make can have a great impact on their financial future more so than many of the investment decisions they will make in their lifetime. Teaching children how to think about saving money rather than spending it on toys and trendy items can hopefully prepare them for later in life when those decisions are about sport cars or swanky vacations.

Communicate openly and regularly about your values on spending and saving money.

It is your responsibility to share with your children or grandchildren how to save money, let it grow, and most importantly, when and how to spend it in a timely and wise fashion. These types of discussions should not be a one-time lecture, but rather consistent and regular dialogue so the lessons learned become part of that child's personal fabric.

Teach your children the difference between a need and a want.

One of the most difficult concepts for children to understand is the difference between a basic need versus a want. Helping them rationalize and learn the difference will teach them about how to spend and allocate their money so that as they grow into adults they have a healthy relationship with money. It is okay to allow children to give in at times to wants and wishes, but there is a clear need to distinguish the difference. Many adults struggle with this balance and sink into debt because they cannot distinguish and control their spending habits on frivolous wants, versus frugally spending it on needs. While our society encourages us to spend, spend, spend, and buy items that are not necessities, it is your responsibility to teach your children financial education. Share with them that they should first look to meet their everyday needs, plan for emergencies, grow their savings, and finally consider spending their money on "want" items.

Introduce the concept of saving versus spending.

It might not be appropriate for you to dictate what your child saves versus spends, but it is certainly helpful for you to teach the concept of earning interest and potential growth on savings. Consider opening an interest bearing account with the money children save at home or possibly offer them a small interest amount on money you save for them. Show them how you calculate that interest and have them watch it grow! Some parents even offer to match what their children save on their own so they are encouraged and "bonused" for saving their money. The bottom line is this: it is your responsibility to introduce to your children the value and benefit of delaying immediate gratification, and opting for saving that money.

Use your own regular shopping trips as opportunities to teach your children or grandchildren about the value of money.

For many children, going to the supermarket is one of their earliest and most frequent spending experiences. Groceries and household items are an important use of our earnings and spending smarter at the grocery stores can help the family better allocate monies to different areas. When possible, use coupons and look for sales as ways to show children strategies that help them reduce the recurring but necessary spending. Make it fun and have them search out coupons on items that you regularly use. Another learning tool is to show them how to compare unit prices and values. Try to train them to constantly look for ways to save and avoid being wasteful. One strategy is to plan your supermarket trip and purchases by making a list in advance and then teach your children not to impulse buy.

Alert children to the dangers of borrowing money and paying interest.

Unfortunately, many times the bank of mom and dad, or grandpa and grandma, typically do not charge interest on large or small loans. Therefore children or grandchildren never learn how expensive it is to borrow money! It is never too early to teach children that paying for something over a long period of time with a 12-18% interest rate means that, although the buyer may pay less up-front or per month, they pay far more for the purchase over the time of the loan.

Think about establishing regular family discussions about finances.

This can be especially helpful for pre-adolescents and teenagers. It can provide the time to discuss topics like cash, checks and credit cards. You can talk about wise spending habits and the proper use of credit, a problem that plagues many people later in life who have not learned this lesson. It is helpful as well to discuss what is happening both nationally and locally in the economy and how it can affect or change your thought process about economizing. **We always remember what Benjamin Franklin said, "A penny saved is a penny earned." Keep in mind that although that penny saved is a penny earned, it won't help you as much at the end of the day if you still owe a dollar!**

Review your allowances and expectations.

Many experts differ on whether or not allowances should be tied to household chores. Some say children will learn more about personal responsibility if they are not paid for helping out at home. Others feel it teaches a valuable lesson about working and earning. One way to solve this issue is to let your children know that good grades and regular help around the house is expected as a price of family life. You may consider paying your children for chores outside of the daily duties, such as washing the family car or working in the garden.

Conclusion

There is no assurance that any child will accumulate financial savvy. **Your true goal is to provide guidance and help your children or grandchildren prior to adulthood learn the basics of personal finance.** While we can never fully guarantee any results, you will hopefully leave a far greater legacy with this information than those who choose to ignore this topic. It is never too early or late to sit down and discuss finances with your loved ones. Financial responsibility is a necessary, life-long skill.