Spectrum FINANCIAL PARTNERS | Commonwealth

The Full Spectrum News

~ SUMMER 2022 ~

IT'S MORE THAN THE MATH. IT'S YOUR PATH.

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ROUGH START FOR EQUITY MARKETS IN 2022

If you pay any attention to such things, you have surely heard news stories blaring about the dramatic drop in the U.S. stock market to start the year (at the time of going to press, the S&P 500 had fallen more than 20% from its high), high inflation, and fears of a recession on the horizon.

What's going on?

> **Let's start with Inflation.** The consumer price index rose 8.6% in May, the highest rate since 1981 according to CNBC. There are many potential culprits for this. Moody's provides a useful list in the accompanying table and places most of the blame on the war in Ukraine and COVID.

> Why is inflation a problem?

- Obviously, no one likes to pay more for stuff and higher prices this year have been very noticeable in the supermarket and at the gas station.
- It can feed on itself as current high inflation creates expectations of high future inflation which can become a self-fulfilling prophecy.

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ROUGH START FOR EQUITY MARKETS IN 2022 *(Continued from page 1)*

- Relatively high inflation makes business planning more difficult as it makes the future costs of inputs and labor uncertain. (Target's recent announcement that it will offer many consumer durables on sale due to too much inventory may be partially due to inflation and related supply chain disruptions.)

Decomposing Consumer Price Inflation

Yr-over-yr % through May '22 on seasonally adjusted CPI

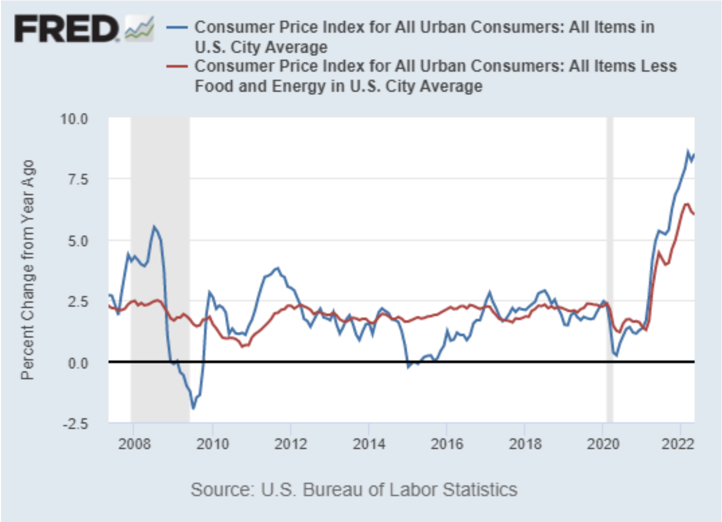
TOTAL	8.5
Russian invasion of Ukraine	**3.5**
Direct impact of higher commodity prices	2.8
Indirect impact of higher commodity prices	0.7
COVID-19 pandemic	**2.0**
Stressed supply chains	1.5
Reopenng effect	0.4
Labor shortages	0.1
Affordable housing crisis	**0.6**
American Rescue plan	**0.1**
Energy regulation	**0.0**
Money Supply	**0.0**
Corporate price gauging	**0.0**
Other	**2.3**

SoucesL BLS, Moody's Analytics

> **What is the role of the Federal Reserve?** The Federal Reserve has a statutory obligation to pursue the dual objectives of maximum employment and stable prices. The Fed's stated average inflation target is 2.0%.

Because the target is an average, the Fed will tolerate inflation below and above 2.0% for some (not formally defined) periods of time, but (it appears that) they don't want to see 8.0% for any length of time. So, the Fed is aiming to lower inflation by:

- Raising the federal funds rate and
- Stopping the purchase of Treasury and agency securities.Roughly speaking, each of these actions is expected to increase interest rates, decrease economic activity which is expected to lead to lower inflation.



> **Which finally brings us to the U.S. stock market.** Higher interest rates, or the expectation of higher interest rates, lead to lower stock prices because the calculated fair value of those companies (by stock analysts for example) goes down. This mechanism is more pronounced with growth stocks (versus value stocks).

Indeed, year-to-date (May 31) while the overall large company index Russell 1000 lost 13.72%, Growth lost 21.88% as compared to Value which only lost 4.52%.

In addition, many people worry that the Fed will overshoot its target and slow economic activity so much that we fall into a recession (negative economic growth). A recession would lower corporate earnings and further weigh on the outlook for stock.

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ROUGH START FOR EQUITY MARKETS IN 2022 *(Continued from page 2)*

Returns of three different U.S. Stock Market Indexes as of May 31, 2022

	YTD	One Year	Three Year (annualized)
Russell 1000 Growth TR	-21.88%	-6.25%	18.31%
Russell 1000 TR	-13.72%	-2.71%	16.03%
Russell 1000 Value TR	-4.52%	0.93%	12.7%

> **A final observation:** While losses and volatility in equities year-to-date may be trying your resolve, try putting things in perspective. True - returns in the market this year have roughly wiped away a full 12-months of gains. But, even including that loss, **the Russell 1000 has gained an annualized 16% over the last three-year period.** This rate is well above the annualized average return of 10.5% (for the S&P 500, which tracks a similar set of securities as the Russell 1000) between 1957 and 2021.

Sources:

Inflation rose 8.6% in May, highest since 1981, https://www.cnbc.com/2022/06/10/consumer-price-index-may-2022.html

Guide to Changes in Statement on Longer Run Goals Monetary Policy Strategy, as amended on August 27, 2020, https://www.federalreserve.gov/monetarypolicy.htm

Monetary Policy Report – February 2022, https://www.federalreserve.gov/monetarypolicy.htm

What is the Average Annual Return for the S&P 500?, https://www.investopedia.com/ask/answers/042415/what-average-annual-return-sp-500.asp

GOOD DEBT V BAD DEBT

In working with clients, we've observed that some people have a "debt allergy." They hate owing money to anybody or anything and pay off debt like student loans and mortgages at an accelerated pace. This attitude is prudent, and we wouldn't try to talk you out of it if you just plain feel better being debt free.

However, if you're open to considering using debt sometimes to advance your financial goals, it may be useful to identify two kinds of debt: "good debt" and "bad debt".

First though, what is debt? Well, Wimpy from the Popeye comic strip taught us the basics. He offers to "pay you Tuesday for a hamburger today." In other words, he wants to borrow 30 cents. (Thanks to the blog, *restaurant-ingthroughhistory.com*, for providing this basis for my guess of the cost of a hamburger in 1929, the year Popeye made his debut in print.)

Borrowing money allows us to buy/eat/use/experience something today and pay for it later. Especially if you don't have enough money today to pay for the thing, that's pretty darn useful.

- o **Good debt** = an investment, buy something that will grow or provide a return, ideally more than the cost of the loan.
  - Education
  - House
  - A business
  - Investment real estate
- o **Bad debt** = discretionary purchases (i.e., Stuff you want, but don't need*.)
  - Could be that new tent, camera, bicycle, cell phone, etc.
  - Maybe the Nordstrom annual sale.
- o **Okay debt** = Gets you something you need, that you don't have the cash for now. (Although we typically recommend saving up an emergency reserve for this purpose.)
  - Replace an appliance that breaks. Fix the roof.
  - A car when your old car breaks down.
  - Pay the deductible on an insurance claim

* We're only commenting on the prudence of taking on a loan (e.g., on your credit card) to pay for these things.

There are several other factors to consider when taking on debt, including your ability to handle the required payments, the terms of the loan, but perhaps considering the purpose of taking on the loan in the first place can provide some clarity on its prudence and your feelings about it.

NOT GETTING TAX DEDUCTIONS FOR YOUR CHARITABLE CONTRIBUTIONS?

Call us to see if a donor-advised fund might make sense for you. When the higher standard deduction amounts went into effect in 2018, many people stopped itemizing deductions on their taxes. This is because the sum of the items to be itemized, most commonly mortgage interest, charitable contributions, and state and local taxes, is lower than the new standard deduction. Consequently, you may not receive any tax benefit for making charitable contributions. If you made enough charitable contributions in the year so your total deductions exceed the standard deduction, then bingo, you've increased your deductible amount.

But what if you don't want to give that much directly to charity in one year? You could give to your donor-advised fund, receive the deduction in the current year, and then disburse the money to charities over time.

Think of donor-advised funds as your personal foundation. You fund it with your assets (can be cash and certain other assets), it can be invested and grow tax-free while it is held inside the fund, and then you can make contributions to charities from the fund in the years ahead – even after your death.

Call us if you want to learn more.

Donor-advised funds

- Deductibility limits of 60% of AGI for cash and 30% of AGI for other assets.
- Can be useful for giving away assets with unrealized long-term gains.
- Gifts to a fund are irrevocable.
- You can make contributions from the fund to charities over time.

NEW AT SPECTRUM

1

Congratulations Krista! Krista joined the partnership and is now an owner of Spectrum Financial Partners, LLC. As everyone who has had the pleasure to work with her knows, Krista is exceptional at her job and an essential part of Spectrum. From the start, our intention was for her to participate in the ownership and the time has finally arrived. Welcome aboard!

2

We deepened our ESG (Environmental, Social and Governance) resources. We now have access to powerful software that allows us to drill into mutual fund and ETF holdings and learn about the ESG scores and details of the companies in our investments. We can run most any publicly traded portfolio through the analysis. Give us a call if you have a portfolio (at your 401k for example) that you would like us to examine.

3

Want us to run an analysis of your tax return to identify possible tax savings? Give us a call and we'll send you a report based on your 2021 filing.

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If you know someone who would like this report, call Krista at 425-598-2919.

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