FINANCIAL DESIGN STUDIO

DESIGNED FOR LIFE

SEPTEMBER 2021 NEWSLETTER

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THINKING AHEAD FOR OPPORTUNITIES TO GIVE

Our team believes in the power of giving to others in a variety of ways! At this time of year we are starting to think of these ways you can give but you need to plan ahead so you don't miss them. Let's team together, as a community, to have the largest impact possible!

Here are two ways we invite you to get involved with us! We will match one gift or box per family that you donate to any nonprofit organization before 11/30/2021. Simply send us a picture of you dropping off, buying, or preparing your gift so we can match your gift donation!

Here are the deadlines to join in each of the opportunities:

- Gingerbread houses can be bought until December 1st to benefit **A Better Life for Kids.**
- Operation Christmas Child Boxes need to be filled and returned by November 22nd.

Please let us know if you want to come pick up a box or if you need more information for either of these opportunities!

CAN THE FED EVER NORMALIZE POLICY AGAIN?

BY: ROBERT STOLL, CFP® CFA

> *"It is an unquestionable fact that about every ten years there occurs a vast and sudden increase of demand in the loan market, followed by a great revulsion and a temporary destruction of credit."*
>
> **John Mills, On Credit Cycles and the Origin of Commercial Panics (1867)**

Watching the Federal Reserve make monetary policy reminds me of the folktale, The Little Engine That Could, except in reverse. If you recall that tale, the Little Engine was trying to bring lots of good things – toys, dolls, and fruit - to kids on the other side of the mountain. But she didn't think she was strong enough to get to the other side of the hill. "I think I can, I think I can, I think I can…" After a lot of effort, the Little Engine was successful and everyone was happy!

The Federal Reserve is the "Grinch" version of this tale. They're warning investors they're going to take the punchbowl away that has propelled stock markets to one record high after another. But unlike the Little Engine, they've never been able to take ALL the goodies away before the next crisis hit. Not only have they not made it up the hill, but when they slide back to the bottom, they end up further away than they were before!

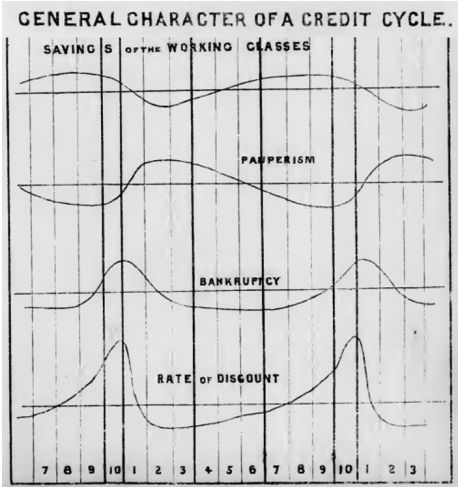
In this month's newsletter, we discuss what the Federal Reserve means when it says it's going to "taper" bond purchases. And we'll lay out some reasons we think the Fed will once again fail to normalize monetary policy, and why the risks of a policy failure are higher than they've been in a long time.

Wash, Rinse, & Repeat: Federal Reserve Monetary Policy since 2000

The benefit of age is that you learn that life moves in certain predictable rhythms. Mark Twain was right when he said, "History doesn't repeat itself, but it often rhymes." That's been the case with the Federal Reserve since the Internet Bubble burst in early 2000.

The bursting of the Internet Bubble was met with a policy response from the Fed that was unheard of. They took short-term interest rates from over 5% to just 1%. That didn't stop stocks from dropping almost -50% from their early 2000 highs, but it caused a bonanza in the housing market as mortgage rates collapsed.

In 2004, Fed Chairman Alan Greenspan climbed into his proverbial Little Engine and told markets he's starting to take the punchbowl away. He did, raising rates all the way back to 5% by early 2006. But taking away the punchbowl laid bare the bubble the Fed had blown in the housing market, leading to the 2007-2009 Great Financial Crisis.



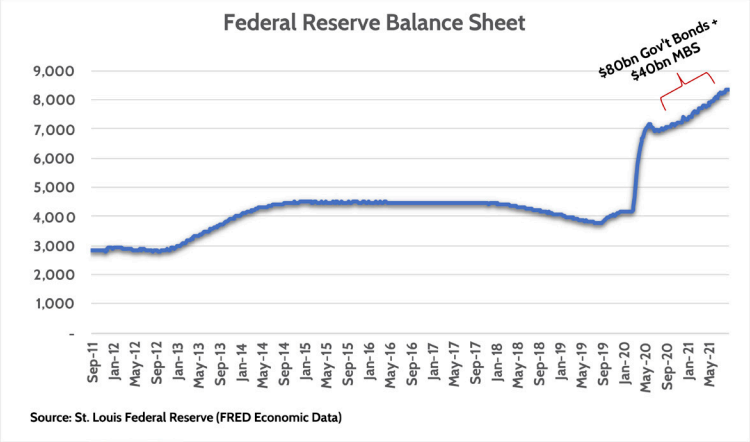
I won't bore you with the play-by-play of the following dozen years of policy failures. But the basic story has been the same. Fed responds to crisis with unprecedented easy monetary policy...which blows a bubble somewhere in financial markets...they then try to return policy to normal...only to find that normalizing policy pops the very bubble they blew. Rinse & Repeat, just like this old graph shows.

What Does the Fed Mean When it Says it Will "Taper" Bond Purchases?

On August 27, Federal Reserve Chairman Jerome Powell told an audience of central bankers and economists that the Fed was ready to "taper" their bond purchases. This is a big deal, because it's the first sign that they're thinking about taking the punch bowl away. But what is "tapering?"

When COVID hit in March 2020 and the global economy shut down, the Fed wanted to make sure that the financial system wouldn't freeze up. So they began buying U.S. Government bonds ("Treasuries") to the tune of $80 billion a month and another $40 billion per month of mortgage-backed securities ("MBS"). This has increased the size of their balance sheet by over $1 trillion.

When the Fed talks about "tapering" purchases, it means that it will start buying fewer bonds in coming months. So instead of buying a combined $120 billion of bonds per months as they're doing now, they'll buy $100 billion, or $80 billion. Something like that. They'll still be buying bonds, just at a slower rate.

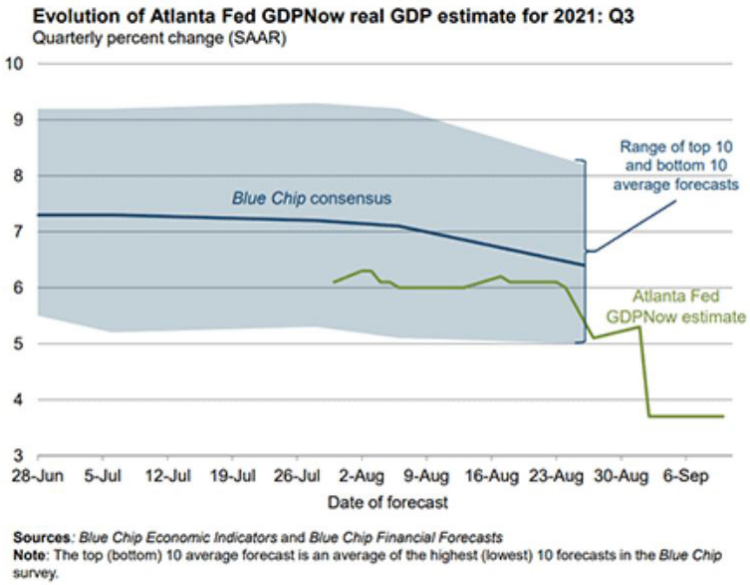


Even though they'll still be providing a lot of support to bond markets, the significance of tapering is that it draws investors' attention to future interest rate hikes. In the last 20 years, each interest rate hike cycle has ended in tears as it popped bubbles in the financial system. Investors know this, which is why this baby step towards 'normalizing' monetary policy matters so much.

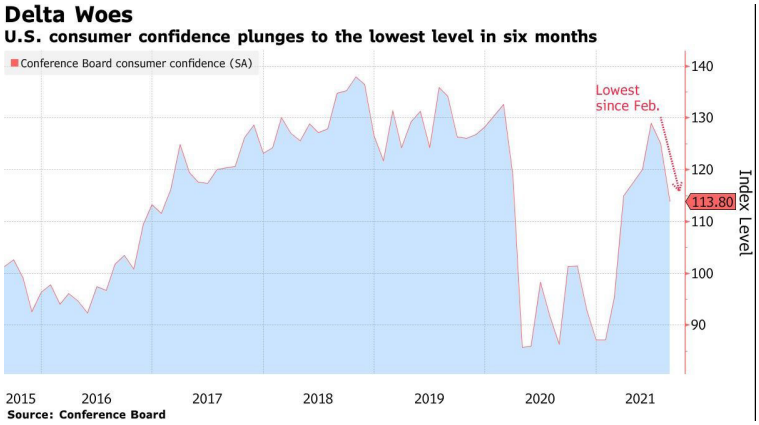
Why the Fed May Not Taper

Making a call that the Fed won't taper their bond purchases when they've expressly said they're going to do so might seem a dumb idea to put into print. But here goes.

First, the economy is already slowing. Wall Street economists started slashing their economic growth projections for the 3rd quarter of 2021 and for full-year 2022. The cuts to the current quarter have been quite dramatic frankly, falling from over 7% expected economic growth to possibly half that level, if the Atlanta Federal Reserve's estimate is correct.



Likewise, consumer confidence has hit the skids after a rapid improvement this past Spring and early Summer. Delta is being blamed for this, but the survey also noted consumer uneasiness with food and gas price inflation (more on this soon.)



The Fed is a political organization above all else. Congress has given them a "dual-mandate" of achieving price stability and maximizing employment. This latter mandate – maximizing employment – has been the Fed's #1 excuse for bastardizing monetary policy with one radical policy after another. I mean, who's against people working??

How are they going to taper into an economic slowdown? Tapering is just another word for "tightening" policy. Politically, tightening policy into an economic slowdown is a non-starter.

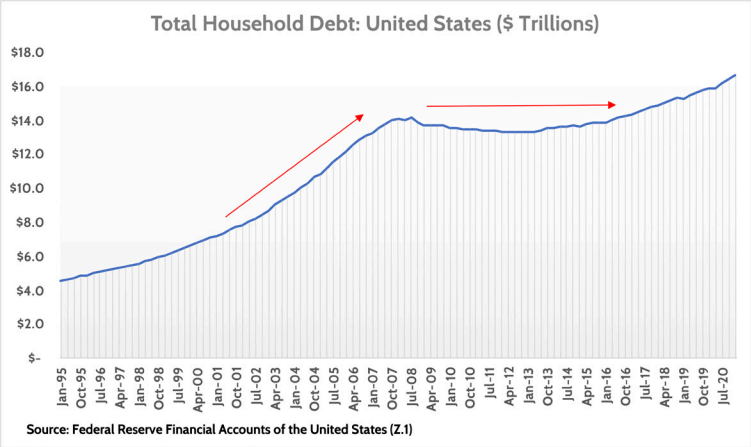
Economic Cycles Always End After a Surge in Credit Expansion

John Mills penned the quote at the beginning of this newsletter all the way back in 1867. The young U.S. economy had suffered one panic after another, and economists were trying to figure out what the common factor was.

Each recession in U.S. history has been unique, but one thing that's often in common is a surge in credit at the tail-end of the boom years. We can go down the list. The Savings & Loan Crisis of the 1980s. The Asia Crisis of the late 1990s. The bursting of the tech investment bubble in 2000. Housing Bubble in 2008. European Debt Crisis of 2011.

When the times are good, borrowers borrow. In each crisis listed above, there was a different 'actor' that got over their skis, gorging on debt in the good times.

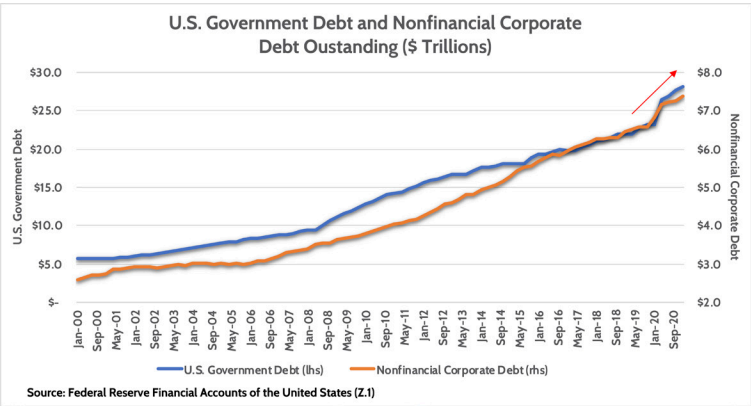
The last big crisis in the U.S. was a consumer-led debt crisis. As mortgage rates plummeted, consumers gorged on mortgage and home equity debt. This debt not only bought bigger homes but also fueled consumer spending.



Here we can see how powerful the Fed's unconventional, low interest rate policy can be. Remember, from 2000 to 2003 the U.S. economy was in recession, stocks were -45%, we had 9/11, and the Iraq War. Can you see any of that uncertainty manifest itself with a cautious consumer borrower during that time? Nope.

The good news, if there is any, is that after a credit bubble bursts, the most aggressive borrowers get religion. They deleverage and stay away from debt like the plague. "I'll never do that again!" And this is exactly what the U.S. consumer has done since the end of the housing crisis. They've done well to fix their balance sheets and today, are in great shape.

So who's getting over their skis with debt today? Everyone else!



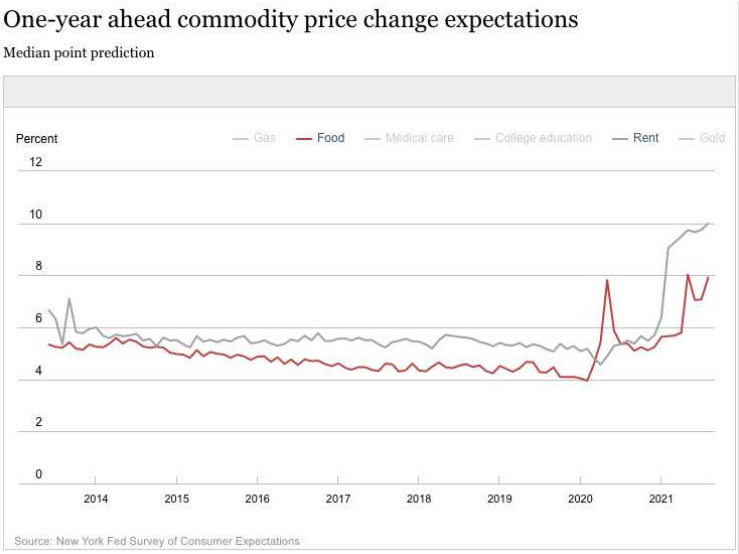
Our government has been spending like a drunken sailor since the housing crisis. Total debt has increased by a whopping $18 trillion in just 13 years.

Likewise, big companies, hedge funds, and private equity funds have taken full advantage of 0% short-term interest rates and the Fed's assurance that it will bail out over-leveraged companies by buying their bonds. How else can we explain the fact that corporate debt increased by almost a trillion dollars during the Coronavirus-induced economic collapse? Insane.

Now ask yourself: "How will the Fed increase interest rates without causing government and corporate borrowers to suffer from higher interest costs?" The answer is, "they can't." Until they're forced to, that is.

Will Inflation Pop the Fed's Bubble?

The Fed has got away with unconventional easing the last 20 years because inflation cooperated. Despite pumping trillions of dollars into the economy, inflation has remained stable at just under 2%. We believe that's changing. More important, consumers (i.e. voters) believe that's changing.



We've all seen and felt higher prices over the last 18 months. What used to be a nagging sense that the cost of living was rising more than official government statistics has become as obvious as ever. The cost of everything is going up, and now it's the important stuff – food, rent, and gas – that's leading the way.

This puts the Fed in a bind. Remember, the Fed has two mandates: price stability and maximum employment. The way to control inflation is to slow the economy down, which they're able to do by raising interest rates. But slower economic growth means more unemployment. They're trapped.

If the latest stimulus bill being debated in Congress ends up passing, it will make a bad inflation scenario worse. Advance Child Tax credits are likely to be extended and enhanced. This causes aggregate consumer demand to increase as they're getting free "stimmy" money they didn't get before, and it also causes labor shortages as people aren't motivated to work. Both are inflationary.

The Fed will soon face a couple of bad choices. They can choose to tackle inflation by raising interest rates. But that will mean pushing over-leveraged corporate borrowers and the Federal Government into a position of paying higher interest costs and/or defaulting on their debt. Which, of course, would cause unemployment.

Or the Fed can try to ignore inflation and keep employment at maximum levels. Which means an increasingly unhappy voter base who's seeing their standard of living get whittled away by inflation.

Either of these two bad choices means a very uncertain investment environment. It's why we continue to caution clients not to get too enamored with one record high after another in the stock market.

Lessons From History: Don't Overborrow

We are in very uncertain economic times. The conclusions John Mills drew about economic cycles 150 years ago applies to us today. When times are good, people become overconfident, they overborrow, and then when the cycle ends, they're left in ruin.

Remaining sober-minded and disciplined while everyone else is merrily drinking from the punchbowl is hard. But you're playing the long game. The Fed has given all of us the impression that there's no risk to investing or borrowing. "Hey, if things get bad, the Fed's got our back."

That's been true for the last 20 years, but I'm not so sure that will be the case in the future. Inflation is new. It's here. And it's going to put the Fed in a huge bind.

I can't predict when the Fed is going to face its moment, but the recent tapering announcement starts the clock. Investors and borrowers are on notice. The Little Engine that Could is starting to pull the punch bowl away.

OPEN ENROLLMENT – DECIDING BETWEEN MEDICAL INSURANCE PLANS

BY: TREVORE MEYER, CFP®, CKA®

It's open enrollment season again and time for those big bundles of paperwork with pages and terms that confuse more than they clarify. Now I am a financial nerd and I love going through information, but I recognize that not everyone does. That said, I do think it's important that we touch on and review these benefits available to you specifically today. We are going to be talking about health insurance because making the right choice here could save you tens of thousands of dollars for you and your family. As we are going through health insurance, here are five things I want you to be mindful during open enrollment and when reviewing your employer health options.

Open Enrollment Health Insurance Plan Options

1. Premium

The premium is really what you are going to be paying for this coverage. Now it may be expressed in the open enrollment benefit booklet as a monthly or even an annual amount. Typically you are going to have to do some math to work out and see what this is going to cost you on a per pay period basis. All that to say, this is an amount that you are going to have to pay each and every month regardless of whether you go to the doctor or not.

2. Deductibles

The second thing we want to discuss is your deductible. Your deductible is how much you have to pay before the insurance company starts kicking in their share. Typically this deductible can range from a couple hundred dollars to a few thousand. While you may have a high deductible plan this does not necessarily mean you have a bad plan, typically the higher your deductible is the lower your premium will be as well. They are inversely related. Now if you have a low deductible it's very common you have a high premium as well. Again not always but it's typically what we see.

3. Copays/Coinsurance

This is when we are start to get "cozy", pardon the joke, with the insurance company. Every medical expense that we have after our deductible we have to start paying alongside the insurance company. Whether that's going to the doctor and we have a copay of $20 or $50 for that visit or we have a co-insurance amount where we are responsible for 20% of that visit and the insurance company is going to cover the other 80%. Either way this copay or coinsurance is laid out in the benefit booklet and it's important to know what both you and the insurance company are paying. Then you will know how much of every expense you are going to be responsible for.

4. Out-Of-Pocket Maximums

Out-of-Pocket maximums are essentially how much you would be responsible for if you have a really catastrophic event or a series of medical expenses throughout the year, excluding the premium amount above. This out-of-pocket typically does include your deductibles, copays, and coinsurance. As an example: if your out-of-pocket maximum is $10,000 and you have medical expenses that cost $15,000 the most you would pay throughout the year would be that $10,000. Think of your out-of-pocket maximum as a ceiling for how much you can pay throughout the year.

5. Accounts and Assistance

With each of your health plans you typically have available some benefit whether a health saving account, maybe a deductible reimbursement account, or maybe a flexible savings account for healthcare. It's important to know which plans offer which accounts, because coordinating the benefits and coordinating

your contribution to those accounts is really important to make sure you're getting the best bang for your buck in selecting your plan.

When we talk about assistance, typically we see assistance come in with higher deductible health plans that coordinate with a health savings account (HSA). Keep this in mind because if you are in a higher deductible health plan you are taking on more of the risk as the insured, even if the premium is going to be less. Since your employer is saving on that premium (remember they pay a portion of that premium as well) they are willing to kick in some money for you into maybe an HSA so that you can actually start saving up and building up a nest egg for your future health expenses.

We like to see clients using HSAs more than we do FSAs because HSAs allow you to carry over funds from year to year for future medical expenses as they arise. FSAs are more restricted because you do need to make sure you are using those funds within a short time frame. In the past you only had a year, but some of the restrictions have been stretched out further. We still do encourage you to use an HSA account when they are available.

Open Enrollment Decisions

Each of these variables is a lever that can influence which plan would be the best plan for you. We typically walk through with clients all the available plans their employer offers and go through each of these variables to determine if you expect X number of medical expenses throughout the year or you have a catastrophic year where something significant happens. It's important to understand your potential liability from a medical cost standpoint on all of those plans and make a determination of which plan is best. If you would like some help going through your choices and what is best for you, let us know we would be happy to help!

THE CALENDAR AND THE CHECKBOOK NEVER LIE!

BY: MICHELLE SMALENBERGER, CFP®

Have you ever thought you were doing something only to find out you weren't making the progress you thought you were? For example, you've just run a couple of miles and think you're losing weight. But you get on the scale and there's no difference. Or maybe you're shopping and you have to spend more to save more for a discount. Did you really save anything? Two things that never lie are the calendar and the checkbook. These are two things you can analyze to see if you're spending them where you desire.

Two Places to Check- The Calendar and the Checkbook

First, analyze what you are and have been doing with your time and money. Look at past statements or look at the calendar for the past few weeks and months. Maybe keep a time journal to see where you're spending time for a week or two. Even if you're someone who doesn't like to have a budget that you abide by, you can go back and analyze your habits.

Second, ask questions about what you analyzed. Is this where you thought you were spending your time and money? Is this what you want to be spending on? Or do some changes and adjustments need to be made?

If you noticed that something needs to change, then it's time to just GET STARTED!

We tell ourselves many messages but at some point you have to START! Your time and money relate to each other because they can affect how long you need to save or how much you need to save.

Also, how much you have saved will affect how long your money can last. We've all seen charts where the person who starts in their 20's ends up with so much more money in the long run simply because they started sooner. All other things being equal, they had time on their side.

Analyze, ask questions, and then GET STARTED! Your calendar and your checkbook never lie! If you have any questions or want to get started saving while you have time on your side, reach out to us.

FREQUENTLY ASKED QUESTIONS

Are you a Fiduciary?
Yes, we are! This means we have a duty to act in your best interest. A person acting in a fiduciary capacity is held to a high standard of honesty and full disclosure in regard to the client and must not obtain a personal benefit at the expense of the client.

You're Fee-Only: What does that mean?
We have chosen to be a fee-only advisory firm. This means we do not accept any fees or compensation based on product sales. While we know our clients need products like insurance we do not receive any benefit from any source when you buy a product.

How does Financial Planning Work Virtually?
With advances in technology, it is amazing how much we can accomplish virtually! We are able to share everything we do in person, virtually. We simply use screen sharing and video software so we can see you and look at the same documents, together. Most forms can also be electronically signed.

Are you taking on new clients?
Yes! We are happy to work with friends or relatives that you think would benefit from a Financial Advisor relationship. A quick phone call is all it takes to see if they are a great fit.

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