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When the Fed Talks Inflation, Bond Investors Listen

What the Fed's new policy may mean for you.

Most recently, you may have read that Federal Reserve Chair Jerome Powell announced a change in how the Fed views inflation. In the past, the Fed said it would consider adjusting short-term rates when inflation approached 2 percent. But in light of 2020's many challenges, the Fed's new policy may allow inflation to run above 2 percent for a period of time before any shift in monetary policy is considered.[1]

For many, bonds are a critical component of their overall investment strategy. So any change in Fed policy regarding inflation may influence a portfolio. That's why it's so important to understand that the market value of a bond will fluctuate with changes in interest rates. In other words, when interest rates rise, the value of existing bonds will typically fall.[2]

There's no doubt this will be a subtle change for many. But for bond investors, the policy shift may indicate that the Fed has given itself more flexibility in the future.

But, what does that mean for the outlook for the bond market as a whole? It's unclear. However, lower levels of unemployment in recent years have not led to higher inflation. This new phenomenon runs counter to the Phillips curve, a concept which states that inflation and unemployment have a stable and inverse relationship. With this data in mind and the changes announced by Chairman Powell, it could be argued that the Fed believes the relationship between unemployment and inflation has changed.[3]

Keep in mind that if an investor sells a bond before maturity, it may be worth more or less than the initial purchase price. By holding a bond to maturity, an investor will receive the interest payments due plus your original principal, barring default by the issuer. Investments seeking to achieve higher yields also involve a higher degree of risk.

Citations

1. Schwab.com, August 27, 2020
2. Asset allocation is an approach to help manage investment risk. Asset allocation does not guarantee against investment loss.
3. Investopedia.com, May 19, 2019

Ouch: September's Market Correction Hurt

Here's what you need to know. In theory, investors understand that stock market corrections are part of the investing process. But experiencing a setback—like the one we've witnessed in the past four weeks—can raise a lot of shoulda, woulda, coulda questions.

From its intraday high on September 2 to its intraday low September 23, the Standard & Poor's 500 Index dropped more than 10%. The Nasdaq Composite dropped as much as 14% as technology stocks bore the brunt of the selling.[1]

Should I have done something differently? Would I do it again? Could I avoid this part of the investing process?

These are natural questions, in hindsight.

During the four-week stretch, it's important to remember the market grappled with several big-picture issues. Hopes for an additional fiscal stimulus faded as legislators appeared deadlocked. And investors learned that the Federal Reserve plans to keep short-term interest rates low for an extended period of time.

The Fed signaled that interest rates would not be increased "until labor market conditions have reached levels consistent with the committee's assessments of maximum employment and inflation has risen to 2% and is on track to moderately exceed 2% for some time." Some don't see this happening until 2023.[2]

Keep in mind that investing involves risks, and investment decisions should be based on your own goals, time horizon, and tolerance for risk. The return (continued on page 2)

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and principal value of investments will fluctuate as market conditions change. When sold, investments may be worth more or less than their original cost.

For some investors, stock market corrections can feel like the "start of something bigger." Or they can feel like "it's different this time." If you're concerned about the recent market volatility, give us a call. We'd like to hear what's on your mind.

Citations

1. CNBC.com, September 26, 2020
2. The Wall Street Journal, September 16, 2020

NO Required Minimum Distribution (RMD) for 2020

1. CARES Act - The Coronavirus Aid, Relief, and Economic Security Act, **waives required minimum distributions during 2020** for IRA account and retirement plans, including beneficiaries with inherited accounts.

2. SECURE Act of 2019 -The Setting Every Community Up for Retirement Enhancement **raised the age for RMD's from 70½ to 72.** This is the age when you must begin taking RMDs from a traditional 401(k) or IRA. If you turned 70½ years old on or after January 1, 2020, this law's changes apply to you and you do not have to begin taking RMDs until April 1 of the year following the year that you turn 72.

What Are Stock Splits?

(continued from page 1)

Here's what you need to know.

Recently two high-profile companies—Apple and Tesla—had stock splits, which makes it a great time to discuss what's involved when a company announces a stock split.

The Securities and Exchange Commission says, "Companies often split shares of their stock to try to make them more affordable to individual investors. Unlike an issuance of new shares, a stock split does not dilute the ownership interests of existing shareholders."[1]

Back in August, Apple Inc. announced its 4-for-1 split of its common stock, and trading began on a split-adjusted basis on August 31. Tesla Inc. also announced its 5-for-1 split, which also begin trading on a split-adjusted basis on August 31.[2,3]

When a company declares a stock split, a shareholder's total market value will remain the same. For example, say you own 100 shares of a company that trades at $200 per share. If the company declares a 2 for 1 stock split, you will own a total of 200 shares at $100 per share immediately after the split. If the company pays a dividend, your dividends paid per share will also fall proportionately.[4]

There is also a "reverse stock split." If a company declares a reverse split, it plans to reduce the number of outstanding shares, such as a 1 for 2 split. A reverse stock split tends to occur with companies that believe their stock price is too low to attract investors.[5]

Will more companies consider a stock split? That's hard to say. Some companies prefer a higher stock price. Perhaps the best-known high-priced stock is Warren Buffett's Berkshire Hathaway Inc. It's Class A shares trade for more than $300,000 a share.[6]

In the days leading up to a stock split, you're likely to hear a lot of opinions about the companies. Over the years, we have found that it's best to ignore that chatter and stick with an investment approach that's in line with your personal situation.

Citations

1. SEC.gov, 2020
2. Investor.Apple.com, July 30, 2020
3. ir.Tesla.com, August 11, 2020
4. Dividends can be stopped, increased, or decreased at any time by a company's board of directors.
5. FINRA.org, 2020
6. Investopedia.com, February 19, 2019