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Korbitz Financial Planning Newsletter

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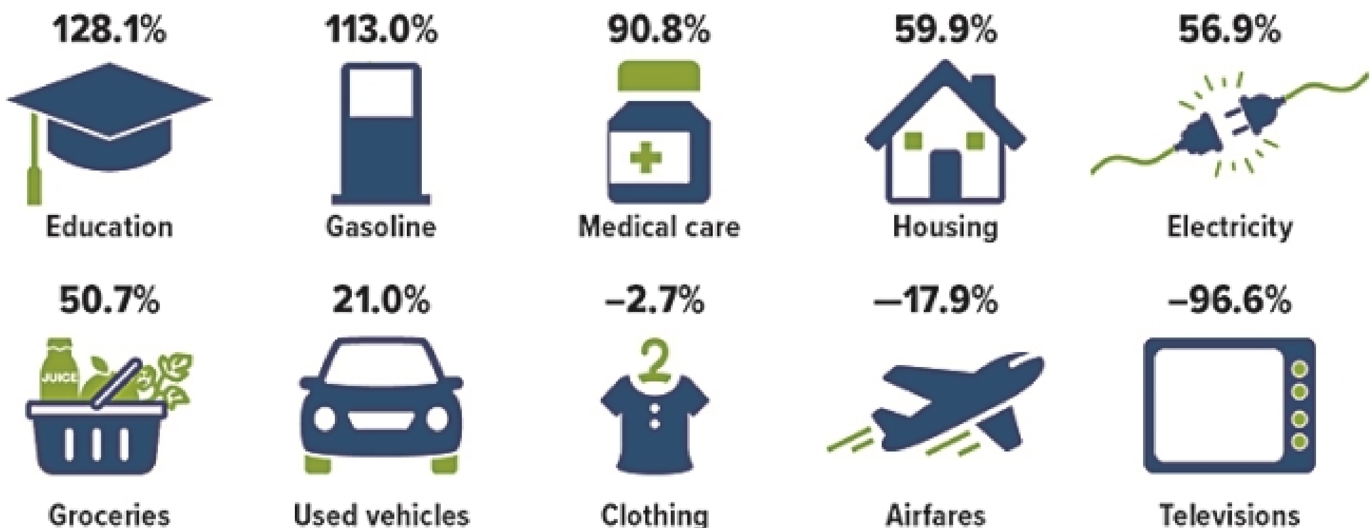
To my clients and friends: In this newsletter I am focusing on two very topical issues - inflation and the fluctuations of stock and bond markets. I have incorporated a "Potpourri" article which touches on a number of issues. The final article highlights the importance of reviewing your credit reports and what you need to do if you find an error.

Wishing you a happy Spring!

Eric

Two Decades of Inflation

After being largely dormant for the last decade, inflation roared back in 2021 due to various factors related to the pandemic and economic recovery. For perspective, it may be helpful to look at inflation over a longer period of time. During the 20-year period ending September 2021, the Consumer Price Index for All Urban Consumers (CPI-U), often called *headline inflation,* rose a total of 53.8%. While the prices of some items tracked the broad index, others increased or decreased at much different rates.



Source: U.S. Bureau of Labor Statistics, 2021 (data through September 2021)

Potpourri

WAR: When I started to draft this newsletter, Russia had not yet invaded Ukraine. That attack has unsettled many of us, with good reason. The death, destruction and people trying to flee their country is very hard to watch. How will this war end? History tells us that most geopolitical conflicts end fairly quickly, and that stock markets react positively when those conflicts do end. Vanguard put out a Perspective titled "Ukraine and the Changing Market Environment." You can find it at Vanguard.com. We know that recessions, pandemics and wars happen periodically, and we should not be shocked when markets decline or are volatile. I would urge you to stick to your plan during times like these.

EXPECTATIONS: January and February saw declines in most stock indexes, and we all need to remember that stocks go down as well as up. We have just come off a very prosperous year for investments. In fact, the last 12 years have been quite spectacular for investors. I want to use this opportunity to try to reset expectations. It is unlikely that we will see in the next 12 years the type of investment returns we have seen in the last 12 years.

BONDS: The vast majority of my clients have at least some of their money invested in money market accounts, CDs or bond funds, which are referred to as “fixed income” investments. A fundamental principal of bond investing is that when interest rates fall (as they have over most of the decade of the 2010s) bond values rise. When interest rates rise (as they have in the past year) bond values fall. We have seen decreases in some bond funds over the last year ranging from 1-5%. All investments involve risk. That means they can all go down. Not every investment goes up every year, and that is true for bond funds as well as stock funds.

While the conventional wisdom is that interest rates are going to continue to rise from here, that does not mean it will happen. There have been some prolonged periods of low interest rates in the US.

We work with a “total return” concept in modern finance and that means that some funds will do better, and some will do worse, than your average rate of return.

I would urge you to keep your overall portfolio in mind when looking at rates of return. Try not to focus on the one fund or stock that did better (or worse) than everything else.

VANGUARD: Vanguard has two types of accounts, at a basic level. The “original” Vanguard accounts are what I will call a “mutual fund” account because the only thing you can own in these accounts is Vanguard mutual funds. The other, newer, type of account is a “brokerage” account. Within a brokerage account you can own Vanguard mutual funds, and you can also buy non-Vanguard mutual funds, Exchange Traded Funds (ETFs), stocks and more. Several years ago Vanguard started encouraging clients to “transition” the mutual fund accounts to brokerage accounts. I would not recommend that clients voluntarily transition mutual fund accounts to brokerage accounts. If Vanguard eventually forces us from mutual fund accounts to brokerage accounts, so be it. But for now, I would suggest sticking with the original mutual fund account if you have one. There are things you can do with a brokerage account that you cannot with a mutual fund account. By the same token, there are things that you can do with a mutual fund account that you cannot do with a brokerage account. This would include regular exchanges between funds, and getting your 1099s much more quickly than with a brokerage account.

How do you know which account you have? To determine which account you have you can look at the title of the account. If it is a brokerage account it will say that in the account title. If the account title does not say “brokerage” then it is a mutual fund account. Again, if you have a mutual fund account, I would keep it. If you have already transitioned to a brokerage account, I would leave it as is.

Following the Inflation Debate

During the 12 months ending in June 2021, consumer prices shot up 5.4%, the highest inflation rate since 2008.[1] The annual increase in the Consumer Price Index for All Urban Consumers (CPI-U) — often called headline inflation — was due in part to the "base effect." This statistical term means the 12-month comparison was based on an unusual low point for prices in the second quarter of 2020, when consumer demand and inflation dropped after the onset of the pandemic.

However, some obvious inflationary pressures entered the picture in the first half of 2021. As vaccination rates climbed, pent-up consumer demand for goods and services was unleashed, fueled by stimulus payments and healthy savings accounts built by those with little opportunity to spend their earnings. Many businesses that shut down or cut back when the economy was closed could not ramp up quickly enough to meet surging demand. Supply-chain bottlenecks, along with higher costs for raw materials, fuel, and labor, resulted in some troubling price spikes.[2]

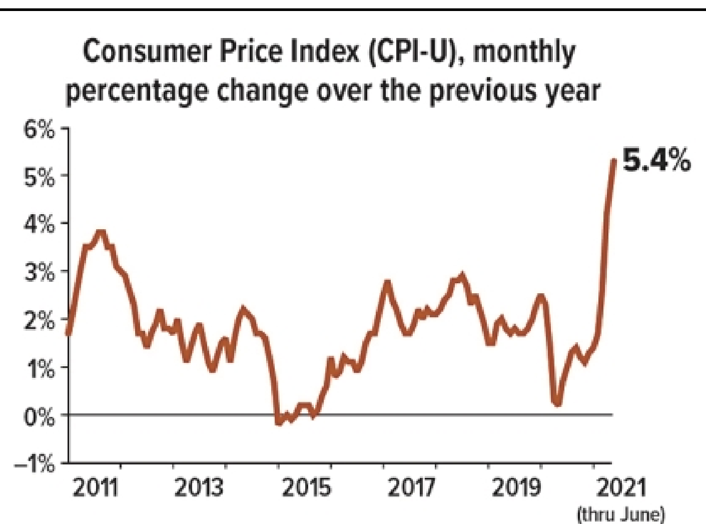
Monitoring Inflation

CPI-U measures the price of a fixed market basket of goods and services. As such, it is a good measure of the prices consumers pay if they buy the same items over time, but it does not reflect changes in consumer behavior and can be unduly influenced by extreme increases in one or more categories. In June 2021, for example, used-car prices increased 10.5% from the previous month and 45.2% year-over-year, accounting for more than one-third of the increase in CPI. Core CPI, which strips out volatile food and energy prices, rose 4.5% year-over-year.[3]

In setting economic policy, the Federal Reserve prefers a different inflation measure called the Personal Consumption Expenditures (PCE) Price Index, which is even broader than the CPI and adjusts for changes in consumer behavior — i.e., when consumers shift to purchase a different item because the preferred item is too expensive. More specifically, the Fed looks at core PCE, which rose 3.5% through the 12 months ending in June 2021.[4]

Competing Viewpoints

The perspective held by many economic policymakers, including Federal Reserve Chair Jerome Powell and Treasury Secretary Janet Yellen, was that the spring rise in inflation was due primarily to base effects and temporary supply-and-demand mismatches, so the impact would be mostly "transitory."[5] Regardless, some prices won't fall back to their former levels once they have risen, and even short-lived bursts of inflation can be painful for consumers.



Source: U.S. Bureau of Labor Statistics, 2021

Some economists fear that inflation may last longer, with more serious consequences, and could become difficult to control. This camp believes that loose monetary policies by the central bank and trillions of dollars in government stimulus have pumped an excess supply of money into the economy. In this scenario, a booming economy and persistent and/or substantial inflation could result in a self-reinforcing feedback loop in which businesses, faced with less competition and expecting higher costs in the future, raise their prices preemptively, prompting workers to demand higher wages.[6]

Until recently, inflation had consistently lagged the Fed's 2% target, which it considers a healthy rate for a growing economy, for more than a decade. In August 2020, the Federal Open Market Committee (FOMC) announced that it would allow inflation to rise moderately above 2% for some time in order to create a 2% *average* rate over the longer term. This signaled that economists anticipated short-term price swings and assured investors that Fed officials would not overreact by raising interest rates before the economy has fully healed.[7]

In mid-June 2021, the FOMC projected core PCE inflation to be 3.0% in 2021 and 2.1% in 2022. The benchmark federal funds range was expected to remain at 0.0% to 0.25% until 2023.[8] However, Fed officials have also said they are watching the data closely and could raise interest rates sooner, if needed, to cool the economy and curb inflation.

Projections are based on current conditions, are subject to change, and may not come to pass.

1, 3) U.S. Bureau of Labor Statistics, 2021; 2) *The Wall Street Journal,* April 13, 2021; 4) U.S. Bureau of Economic Analysis, 2021; 5-6) Bloomberg.com, May 2, 2021; 7-8) Federal Reserve, 2020-2021

How to Correct an Error on Your Credit Report

According to the Consumer Financial Protection Bureau (CFPB), credit report errors more than doubled during the coronavirus pandemic. In addition, the CFPB found that many pandemic protections which were designed to help consumers, such as loan forbearance periods on federal student loans and federally backed mortgages, ended up negatively impacting their credit reports as a result of complications such as processing delays and suspended payments being marked incorrectly.[1] This is a significant issue for many consumers, because credit report errors may negatively impact creditworthiness and potentially lead to negative financial consequences, such as being offered higher mortgage interest rates or being turned down for a job or an apartment lease.

Fortunately, changes made during the pandemic have made it easier to stay on top of your credit report. Under new expanded rules, you are now eligible to obtain a free weekly credit report from each of the three nationwide credit reporting bureaus until April 20, 2022. To obtain free reports, go to AnnualCreditReport.com where you can fill out an online form, choose the reports you want, and, after answering some security questions, review your reports online.

If you find an error on your credit report, there are steps you can take to correct it. First, contact the credit reporting agency to dispute the error. You can do this online or by mail. Explain why you are disputing the information and be sure to include documentation that supports your dispute. The credit reporting bureau generally has 30 to 45 days to investigate the disputed information. Once the investigation is complete, the credit reporting bureau must provide you with written results. If the credit reporting bureau confirms that your credit report does contain errors, the information on your report must be removed or corrected.

If you do not agree with the credit bureau's investigation results, you can ask that a statement of the dispute be included in your file and in future reports. You can also contact the creditor that reported the information to the credit reporting bureau and dispute it with the creditor directly. If the creditor finds that the information is inaccurate, it must notify each credit bureau to which it has reported the information so the information can be updated or deleted. If you believe the error is the result of identity theft, you may need to take additional steps to resolve the issue, such as placing a fraud alert or security freeze on your credit report.

Keep in mind that correcting a credit report error can often be a time-consuming and emotionally draining process. If at any time you believe that your credit reporting rights are being violated, you can file a complaint with the Consumer Financial Protection Bureau at consumerfinance.gov.

1) Consumer Financial Protection Bureau, 2021

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