The Newsletter of FPA of Greater Kansas City

News&Views

November 2023

FINANCIAL PLANNING ASSOCIATION

GREATER KANSAS CITY

IN THIS ISSUE:

CAREER LISTINGS

Visit the FPA of Greater Kansas City Careers Page for a full list of available positions.

WELCOME NEW MEMBERS

Christian Dunker
Peter Hughes
Nation Morin

FPA of Greater Kansas City

PO Box 4303
Topeka, Kansas 66604
(303) 867-7181
BJohnson@OneFPA.org
www.fpakc.org

Why Interest Rates Could Stay Higher for Longer and What it Means for Investors

One of the biggest topics of discussion this year has been the rapid increase in bond yields to levels not seen since 2007. Bond yields had been in a downward trend for 40 years until mid-2021, but have since reversed course. In this piece, we examine the pros and cons of higher bond yields and offer some considerations for investors.

The long-term history of US Treasury bond yields provides valuable insight into the current situation. During WWII and up until 1951, the Federal Reserve capped treasury yields in order to finance war debt. During the 1950s, 10-year Treasury yields were generally in the 3% to 4% range. Beginning in the mid-1960s, yields began a long-term upward trend. Government spending and deficits increased dramatically to pay for the Vietnam War and “Great Society” programs. The 1970s were turbulent and highlighted by a series of oil embargoes, rapidly rising inflation, and several policy missteps at the Federal Reserve. That culminated in a peak 15.81% yield on the 10-year Treasury bond in 1981. The period was characterized by high inflation as 76 million Baby Boomers entered the workforce from the mid-1960s to the early 1980s. Those Baby Boomers started families and bought homes en masse. Demand for goods and services skyrocketed, while the economy’s available supply could not keep up.

Following that period, bond yields began a long-term, downward trend beginning in the early 1980s. Growth in the working age population began to slow. Computers were introduced, enabling dramatic leaps forward in the economy’s ability to meet fluctuating demand. For better or worse, offshoring of manufacturing made goods cheaper. China became the world’s factory, with labor costs at a fraction of domestic labor. While government budget deficits continued to trend up, foreign buyers of treasuries were always there to buy and finance the burgeoning deficit. When a major financial crisis hit in 2008, the Fed stepped in to buy trillions of dollars of government debt to artificially keep interest rates low. When the COVID Crisis hit in 2020, the Fed once again stepped in to artificially lower yields to near zero. Except for short bouts of inflation during the 1990s and the mid-2000s, it trended down to close to 2% for 40 years.

That all began to change in 2020. A series of massive spending bills (totaling $6.2 trillion) aimed at supporting businesses and individuals during COVID lockdowns kept the economy from collapsing, but increased the deficit and supply of Treasury bonds. The Federal Reserve lowered benchmark interest rates to zero and purchased $4 trillion in bonds to artificially lower yields. The combined $10.2 trillion fiscal and Fed stimulus dramatically increased the money supply and consumer demand. At the same time, supply chains and availability of workers struggled to keep up with the surge, thereby triggering an inflation spike to 9.1%. The Fed and government officials insisted inflation was transitory, but they were wrong. To counter this inflation, the Fed has now raised rates 11 times for a total of 5.25 percentage points, taking the benchmark rate to its highest level in some 22 years. In response to the Fed and massive new Treasury bond issuance, yields have surged to their highest level since 2007.

There are several underlying factors that could keep inflation and bond yields elevated for the foreseeable future. The main factors are higher baseline inflation, a tight labor market, a hawkish Fed, and long-term budget deficits.

Inflation and bond yields are positively correlated since bond buyers typically demand higher yields to account for higher inflation. An economy that had been accustomed to steady 2% long-term inflation may have to adjust to 3%-4% as long run trends reverse. The 40-year trend of manufacturing offshoring to China and other low-cost centers is reversing. In a rare bout of political consensus, both parties increasingly agree that China is becoming too hostile and more goods should be produced domestically. Labor costs in low-cost countries have also increased as emerging market living standards rise. While the positives of “onshoring” are many,

continued on next page

production costs in the US are much higher than in emerging markets. Economists agree that onshoring will increase the baseline of inflation, though the magnitude is unknown.

No one will forget the extreme labor shortages of 2021-2022. Going out to eat or trying to get anyone to fix something became a frustrating adventure. There were simply not enough people available to fill vacant jobs. While the situation has improved since those turbulent years, the unemployment rate has remained below 4% since December 2021. Economists generally agree that under 4% unemployment means the labor market is extremely tight. Overall, gross wage increases have outpaced the historical trend since 2000. Unionized workers are demanding aggressive wage increases and entry-level fast food workers increasingly make upwards of $15/hour. Longer-term demographic trends will continue to keep available labor supply low. Over the last decade, the growth of the non-working-age population – those aged 0 to 14 and 65 and older – has outpaced the growth of the working-age population. The non-working-age population grew by 13.1 million, a 12.9% increase, while the working-age population increased by a modest 6.4 million or 3.1%. As Baby Boomers retire in mass, there are simply not enough workers to replace them. The bottom line is the labor market should remain tight for years to come.

Outsized budget deficits will likely persist, triggering an enormous new supply of Treasury bonds. An unfortunate side effect of COVID spending was once unthinkable budget deficits. The deficit in 2022 was $1.4 trillion and the shortfall for the just concluded 2023 fiscal year was $1.7 trillion. The Congressional Budget Office has official projections here. To summarize, deficits could get much worse over the next 30 years primarily due to the uncontrolled growth of entitlement program spending and the rapidly increasing interest cost on Treasury debt. The government will need to issue massive amounts of new Treasury bonds to finance deficits. The financial press is finally citing new Treasury supply as a major cause for higher yields. Further contributing to higher yields, the biggest buyers of Treasury debt have started pulling back. The Federal Reserve has at times been the biggest buyer; however, they are now net sellers of $90 billion per month in government-backed debt. Banks are paring back on Treasury purchases as the banking system is shrinking. Japan is the biggest foreign buyer of Treasuries, but the country is slowing the rate of purchases and buying more Japanese bonds due to their higher yields. The same applies for China, the second biggest holder of Treasuries, who has decreased holdings by 45% in the last 10 years. Just when new Treasury issuance is exploding, the biggest institutional buyers are pairing back. It’s worth noting that if new Treasury issuance to finance deficits increases significantly more than current forecasts, bond yields could go much higher.

The Federal Reserve has more power than anybody to influence bond yields by setting benchmark overnight lending rates. In an effort to tame inflation, the Fed has increased its benchmark lending range to 5.25% – 5.50%. Though they are likely close to ending these increases, the Fed is loath to cut rates until it sees inflation sustain at 2%. The economy has stayed much stronger than anticipated, mainly due to the extremely tight labor market and government stimulus. There are no immediate signs of a recession, so expect the Fed to keep benchmark rates elevated for the foreseeable future. One of the root causes of high inflation in the 1970s to the early 1980s was the Fed not keeping benchmark rates high enough to cool it. Today’s Fed was too slow in recognizing inflation, but often cites the mistakes from the 1970s in recent communications. If benchmark rates stay high, so will bond yields.

The same institution that can keep interest rates elevated can also lower them in response to a recession. Offsetting all of the factors conspiring to keep rates and yields higher for longer could be the Fed’s response to a recession. A severe economic downturn will typically lower the demand for goods and services, which would lower inflation or even cause deflation. Though the 1970s were an exception to this, the likely outcome would be a taming of inflation and cuts to the Fed’s benchmark interest rates. Bond yields would naturally decrease. However, we don’t know when the next recession will occur. The likely cause of the next recession would be consumer borrowing rates getting so high that people can’t afford things such as new mortgage and car loans. Higher borrowing costs could cause a wave of corporate bond defaults for overleveraged borrowers,

continued on next page

cascading into increased layoffs. Geopolitical tensions could also trigger a “flight to quality” wave of treasury buying, resulting in lower yields.

However, once past the inevitable recession-induced decline in interest rates, it is unlikely that we will see another 40-year trend of lower bond yields. The structural implications of $1 trillion-plus budget deficits for decades to come, along with the resulting massive new treasury debt supply, could reset baseline bond yields to higher than the average over the past two decades.

Higher bond yields can be a good or bad thing depending on what type of asset you have. The main drawback is that stocks tend to suffer when bond yields are high because stocks now have stiff competition in the marketplace for returns. For example, if your risk tolerance is low to moderate and you can earn a guaranteed 5.50% return on a one-year treasury bill, stocks don’t look nearly as attractive as when the same bond yielded under 1% for long periods between 2008-2021. Stocks in companies that don’t have a long-term track record of steady earnings growth tend to struggle the most in high-rate environments. The S&P 500 index has struggled since bond yields started increasing sharply in June 2021. The annualized total return (with dividends included) since then has been a paltry 1.3%. Stocks in good quality companies can do well in higher rate environments, but will almost always struggle when interest rates are trending up.

Another drawback of higher yields is the decrease in the market value in bonds issued in times of lower yields. For example, an older bond with a 2% coupon that once traded at $100 would decline in market value to compete with newer bonds with 5% coupons. If you don’t need to sell the older bond before maturity, this isn’t a big concern. However, if you need to sell before maturity, you will likely take a loss. The key to mitigating losses on older bonds is to have owned shorter maturities. Shorter maturities under 5 years won’t decline in value nearly as much as longer maturities.

There are meaningful positives to a higher bond yield environment. The great news is that bond investors are finally being compensated with significantly higher yields and cash flows. Almost all treasury bond maturities trade close to a 5% yield, so an investor can earn a solid return with essentially a zero percent chance of default. For high quality investment grade corporate and municipal bonds that have an extremely low default risk, an investor can earn a 6% yield to maturity on virtually any part of the yield curve. Inflation can erode the real value of coupon payments; however, the real yield (which subtracts current inflation from yields to give investors an after-inflation yield is 2%-2.5%) is at its highest level since mid-2007. As recently as May 2022, real yields were negative.

Investors with a lower risk tolerance or retirees wanting steady, low risk cash flows now have great options in bonds. The primary goal for most individual investors is to save for a prosperous retirement. As you get into your 50s, the percentage of bond holdings should start increasing to around 40% or more, depending on your particular situation. A typical retiree might have close to 50% to 70% in bonds. Now appears to be an excellent time to lock in bond yields. We outline the best way to structure a bond portfolio in a previous article on bond ladders, which you can read here.

The other piece of good news is that we are pretty far away from the peak 9.1% inflation. Though inflation remains higher than anyone wants, we are optimistic it will settle within a 3%-4% range that both the stock and bond markets can handle. The period between 2008-2021 will probably be remembered as one of ultra-low rates that benefitted stockholders at the expense of bondholders. However, slightly higher rates are something the stock market can get used to as evidenced by their good performance during the 1980s-1990s, when bond yields were higher than they are now. Bond buyers should be the happiest of all. Now, it’s possible to lock in very low volatility assets from risk free or high-quality bond issuers at attractive rates.

Brian Murray, CFA,MBA
The EFT Store, Inc.

JANUARY CHAPTER MEETING

January 24, 2024

11:30 a.m. - 2:00 p.m.

Embassy Suites Olathe

This meeting sponsored by:

American Century Investments®

How Real Retirement Spending Patterns Change Traditional Retirement Withdrawal Strategies

Dr. Derek Tharpe

This presentation examines how real retirement spending patterns change traditional retirement withdrawal strategies. Specifically, commonly used retirement spending assumptions are compared to actual retirement spending patterns of retirees. This comparison reveals that typical assumptions of constant real spending often overstates retirement spending. As a result, commonly assumptions may overstate retirement savings need. Accounting for more realistic retirement spending results in higher safe withdrawal rates than prior research has typically indicated. Typical assumptions also fail to account for the potential to make adjustments in retirement

Economy as Artful Dodger: How Much Longer?

Dr. Chris Kuehl

For over a year we have been expecting recession but every quarter seems to stall this development. Consumers still spending, GDP still growing, inflation receding, unemployment still low. Does this continue into 2024? What are the threats and how likely are we to avoid them a bit longer?

Registration Fees:

Members $35

Non Members $99

Continuing Education: CFP® 2 hours approved and Kansas Insurance 2 hours approved

REGISTER TODAY!

FINANCIAL PLANNING ASSOCIATION

Take 5

An update on the programs and services that make FPA *your partner in planning*.

NOVEMBER 2023

Registration Is Now Open for FPA Retreat 2024

Join us May 6-9, 2024, in Tucson, Ariz., at the Loews Ventana Canyon Resort for a unique experience that gets you out of your comfort zone. FPA Retreat 2024 is for passionate financial planners who are eager to embrace change and challenge conventional wisdom. It's an event where you'll explore new horizons and participate in essential conversations that truly matter. So, if you're ready to be a part of a vibrant, forward-thinking community, join us at FPA Retreat 2024. Save now on your registration with special early bird pricing!

Celebrating 50 Years of CFP® Certification

Join us for a look back at the first 50 years of CFP® certification! Ben Coombs, a member of the first CFP® class in 1973, and Lew Walker, a member of the third CFP® class in 1975, share their stories in this video we debuted at FPA Annual Conference 2023 in Phoenix. Watch the video!

CFP Board Wants to Hear from You on Proposed Changes to Sanction Guidelines and Fitness Standards

CFP Board wants your input on proposed changes to its Sanction Guidelines and Fitness Standards that provide guidance on the sanction that might apply to particular misconduct and specific character and fitness standards for candidates for CFP® certification and professionals eligible for reinstatement. While comment letters will be accepted, you can provide your feedback easier than ever with their online survey! It is recommended that you complete the survey by putting yourself in the shoes of the respondent at issue in the survey question and answer from that lens. FPA provided comments on prior proposed changes in 2021, again on related disciplinary changes later that year, and advocated for its members earlier this year regarding Procedural Rules governing the processes for investigating and enforcing alleged misconduct. View those FPA comment letters. Please participate in CFP Board's survey by December 3.

The November *Journal of Financial Planning* Now Available

FPA members can now read the November issue of the *Journal of Financial Planning* to learn about planning for special needs, how to draft a blueprint for business, helping female clients achieve financial independence, mastering emotional conversations, succession planning, couples and insurance, revisiting William Bengen's "SAFEMAX" portfolio withdrawal rate, and much more. Access the latest issue of the *Journal* now.

New Research Reveals How Client Portals Can Revolutionize Financial Planning

Elevate your practice and redefine client relationships with cutting-edge client portals. Dive into the game-changing insights from groundbreaking research by eMoney Advisor and FPA, revealing that Portal Power Users experience reduced financial anxiety, heightened trust, motivation, referrals, loyalty, and soaring client satisfaction. Embrace technology's potential now to shape your financial planning success and transform your clients' financial well-being. Access the report now!

FPA Insurance Program: Protecting You and Your Business

As your partner in planning, FPA wants to help you protect your business and employees through a variety of insurance programs that are exclusively offered to our valued members. Learn about the full menu of programs available to you, including Group Medical Plans, Group Long-Term Disability, Group Short-Term Disability, Group Term Life and Accidental Death and Dismemberment, Group Vision, Group Dental, Business Overhead Expense, Errors and Omissions Insurance, Cyber Liability and Data Breach Insurance, Investment Advisor Surety Bond, among others. All FPA insurance programs are offered through Ryan Insurance Strategy Consultants, one of the profession's leading providers of insurance services. Learn more.

Become a Media Maestro with Media Mastery 2.0

Step confidently into the media spotlight with FPA's new on-demand Media Mastery 2.0. Created in collaboration with AdvisorPR and exclusively hosted on the FPA Learning Center, this comprehensive program empowers you with the skills to master media engagement. Explore PR essentials, craft compelling media materials, and learn the art of successful interviews. Accessible anytime, anywhere, the first module is free for FPA members, and Modules 1-4 are available to FPA members for $99 and nonmembers for $199. Elevate your media presence and start making a lasting impact today! Dive In!

CHAPTER PARTNERS

PLATIINUM PARTNERS

AE WEALTH MANAGEMENT

American Century Investments®

First Trust

GOLD PARTNERS

Allianz

axos® ADVISOR SERVICES

Greater Kansas City Community Foundation℠

SILVER PARTNERS

ASH BROKERAGE

Hines SECURITIES, INC.

FlexShares® EXCHANGE TRADED FUNDS

NORTHERN FUNDS®

MANAGED BY NORTHERN TRUST

2023 BOARD OF DIRECTORS

Chair of the Board
Carrie Ohm, CPFA
OneDigital

President
Ben Skilling, CFP®
UMB

President Elect
Jason Newcomer, CFP®
Dogwood Wealth Management

Secretary/Treasurer
Claudia Gray, CFP®
Stepp & Rothwell, Inc.

Director of Advocacy
Nicholas Gertsema, CFP®, ChFC®, RICP®
Gertsema Wealth Advisors

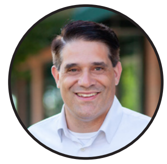
Director of Communications
Conor Kelly, CFP®
The EFT Store, Inc.

Director of Community Outreach
Chris Lilley
The Insurance Partners

Director of Membership
Tylor Willis, CFP®
UMB

Director of NexGen
Landon Warmund, CSLP®
Reliant Financial Services

Director of Partnerships
Jacob Watts, CFP®
Legacy Financial Strategies



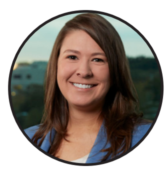
Director of Programs
William Bohne, CFP®
Embark Financial

Directors of Public Awareness
Jack Giardino, CFP®
Inflection Point Wealth Advice

Nolan Keim
Mariner Wealth Advisors

Director of Student Mentoring and Career Development
Andrew Zumwalt, CFP®
University of Missouri

Directors at Large



Jennifer Price, CFP®
Creative Planning, Inc.

Thomas Kaminski, CFP®
Benchmark Capital Group

Jennifer Malone, CFP®, CMFC
BMG Advisors

Eric Martinez, CFP®, MBA, CRPC®
American Century

CALENDAR OF EVENTS

December 7, 2023
NexGen Happy Hour
Top Golf, Overland Park

January 24, 2024
Chapter Meeting
Embassy Suites, Olathe

May 3, 2024
NexGen Mini Gathering
American Century
Kansas City, MO

May 6, 2024
Golf Tournament
Canyon Farms, Lenexa

For a full list of events and registration please visit our website at https://www.financialplanningassociation.org/fpa-greater-kansas-city-events

University of Missouri Extension Seeking Volunteers

Can you help? The Kansas City Metro Tax Coalition and MU Extension are seeking volunteers for the upcoming tax season (January – April 2024). The Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs prepare free tax returns for people who qualify. Volunteers will receive training and certification before they begin working with taxpayers. Even if you don't want to do taxes, there are many ways to serve. You can also earn continuing education credits! Send questions to kcvita@missouri.edu or register online at: https://extension.missouri.edu/counties/urban-west-region/tax-prep/.

Save the dateVolunteer orientation is Saturday, November 11, 2023 10:00am - 11:00am by Zoom. A second session will be available on 12/05 at 6:00pm. Tax law training will be 12/11 through 12/13 by Zoom.