Setting Sail
Fourth Quarter 2023

Taming Inflation

Inflation is a term that frequently makes headlines in the world of economics and finance, but what exactly is it? In simple terms, inflation is the rate at which the general level of prices for goods and services rises, resulting in a decrease in purchasing power for a given currency. It is a crucial economic indicator that affects everyone, from consumers and businesses to policymakers and investors. It is typically expressed as an annual percentage and is measured by tracking the prices of a basket of commonly purchased goods and services. These items can include food, housing, energy, transportation, and more. To gain a deeper understanding of inflation, it's essential to distinguish between two key types: core inflation and headline inflation.

Headline Inflation

Headline inflation, often referred to as overall or consumer price index (CPI) inflation, represents the broadest measure of price changes in an economy. It includes the prices of all goods and services in the basket, making it comprehensive but also more susceptible to temporary factors. As a result, headline inflation can be influenced by volatile items such as energy and food prices, which tend to fluctuate significantly in response to various external factors.

The inclusion of these volatile components can lead to relatively erratic changes in headline inflation. For instance, a sudden increase in oil prices or a bad harvest leading to higher food prices can cause headline inflation to spike. While these spikes may be temporary and outside the control of policymakers, they can have a significant impact on public perception and economic decisions.

Core Inflation

Core inflation, on the other hand, is a more stable and focused measure of inflation that excludes the volatile elements of the CPI basket, primarily food and energy. By removing these price fluctuations, core inflation provides a clearer picture of the underlying, persistent inflationary trends in an economy.

Setting Sail is written by **Alan S. Campbell, MBA, CFP®** and published quarterly by **Spinnaker Financial Advisors, LLC,** a Registered Investment Adviser. The firm provides ***fee-only*** wealth management services, including investment advisory and management services and comprehensive financial planning and consulting.

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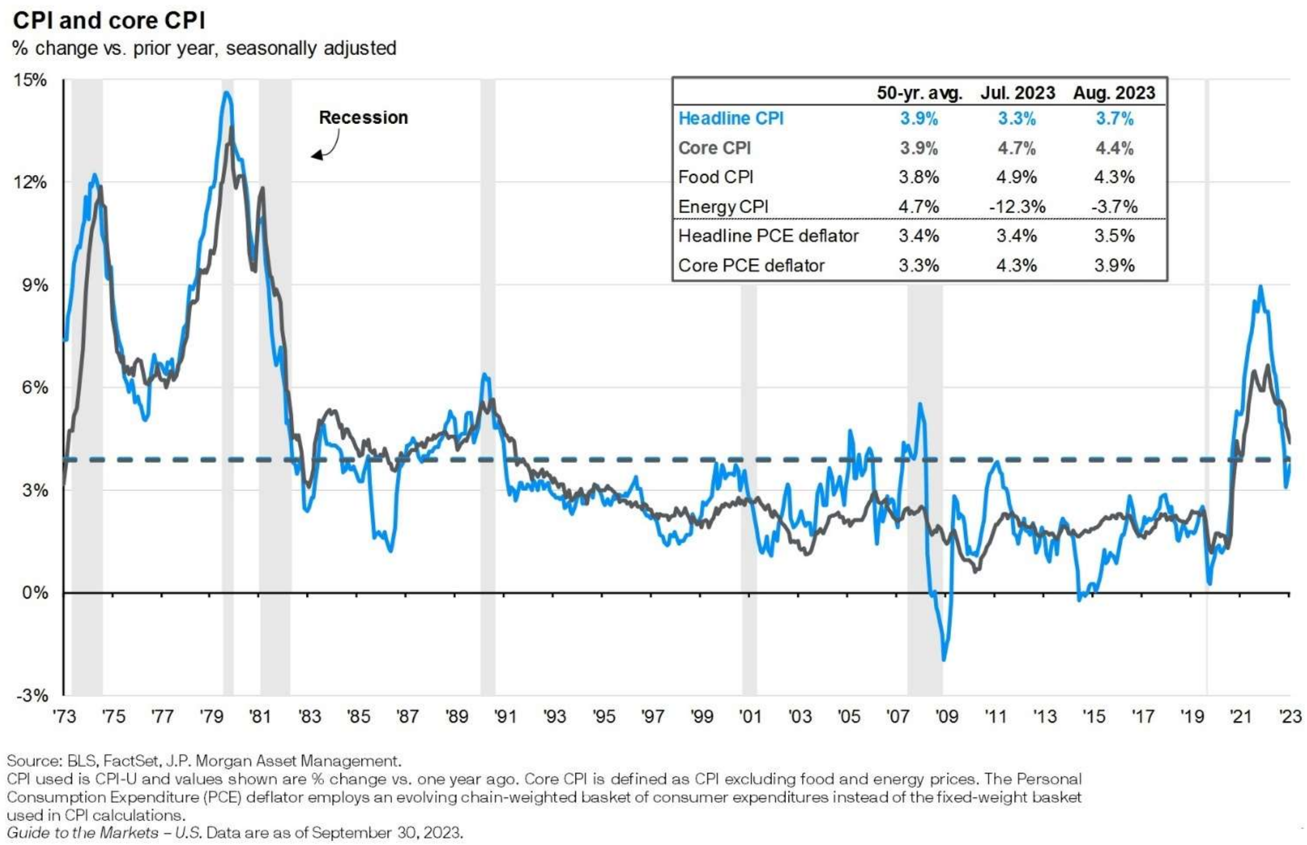
The rationale behind excluding food and energy is that these sectors are often influenced by factors such as weather, geopolitical events, and supply chain disruptions, which can cause prices to surge or plummet for reasons unrelated to monetary policy. Core inflation aims to isolate the trends that are more directly influenced by changes in monetary policy, making it a valuable tool for the Federal Reserve and economists.

The old joke about core inflation is that it is only useful for people who don't need to heat their homes, drive a car, or eat. However, from a policymaker's perspective, it is a more reliable tool than headline inflation because it can take out the most volatile factors of inflation to make better decisions. The chart below shows both versions of inflation for the last 50 years. The grey line that represents core inflation is much less volatile.



The latest inflation report was released for the month of September. It reported that overall, or headline, inflation is up 3.7% compared to a year ago, and the core inflation rate (which excludes energy and food) is up 4.1% in the same time period. That means that the rate of inflation for food and energy was lower than the core factors and including them brought the CPI headline rate down from the core rate. The inflation rate for energy by itself was negative, meaning that the cost of energy as a group was slightly lower than a year ago. In this situation, the headline inflation figure reported on the evening news could be considered an incomplete metric that is more favorable than it should be.

So, what does this mean for the Federal Reserve's battle with inflation? The Fed has publicly stated that their target for inflation is 2% for core inflation and 3% for headline inflation. Although a lot of progress has been made in the last year, as the headline inflation rate has come down from a peak of 9.1% in June 2022, the Fed would like to see lower inflation before they declare victory.

One of the most common and effective ways the Federal Reserve combats inflation is by raising short-term interest rates, particularly the federal funds rate. The federal funds rate is the interest rate at which banks lend reserves to one another overnight. When the Fed raises this rate, it becomes more expensive for banks to borrow money, which, in turn, leads to higher interest rates throughout the economy.

When interest rates rise, it becomes more expensive for consumers and businesses to borrow money. This discourages spending and investment, which can lead to decreased consumer demand and slower economic growth. The tightrope that the Fed is trying to walk is to reduce economic growth, which will slow down inflation without causing a recession. After over a year of raising rates, they seem to have accomplished both so far. But the job is not done, and we will find out over the next few months if they can stay on this tightrope.

The Transition to Charles Schwab

Over the past Labor Day holiday weekend, our clients' accounts were moved from TD Ameritrade to Charles Schwab as part of a merger between the two companies. We are happy to report that all of the correct positions, balances, and histories of the accounts under our management transferred perfectly to their new home at Schwab. In the process, the old TD Ameritrade 9-digit account numbers were changed to Schwab 8-digit account numbers.

After a month of working with Schwab as our custodian, I'd like to share what we have learned and our recommendations for making this relationship with Schwab work as smooth as possible. The best advice we can give is to register for access to Schwab's online account, known as Schwab Alliance. The website is client.schwab.com. If you have not registered yet, please hop on to the website and click on "New user." This will start the registration process. You will need your account numbers, which are available on your monthly statements, or by calling our office.

Schwab Alliance

Even if you do not check your account balances often, Schwab Alliance is the easiest (and sometimes the only) way to make updates to your accounts. For example, any changes to contact information such as address and phone number must be made through Schwab Alliance rather than through your advisors. Also, this is the place to select your paperless settings, which include monthly statements, trade confirmations, tax forms, and shareholder materials. Each of these can be turned on or off independently. If you like getting monthly statements in the mail but don't like to be overwhelmed with fund prospectuses, you can check one box and uncheck the other. These settings can be found under Profile (upper right corner) and then "Paperless."

As digital signatures increase in adoption, Schwab has built these features into their Schwab Alliance platform. Getting a signature for an IRA distribution or a new account application has never been faster or more efficient, but it does require logging on to Schwab Alliance to do so. If you are in a hurry to get funds and we haven't set up a link to your bank account in the past, a simple e-Authorization can get those funds to your bank quickly. However, that functionality is part of Schwab Alliance, so it is nice to have your access set up now.

A common question we have received about Schwab Alliance is how to view both your own accounts and your spouse's accounts without logging into each user's account separately. There is a simple way to do this, but it requires a little bit of setup the first time. The first step is for each spouse to set up their own login to Schwab Alliance. Then, one spouse will share access to their accounts with the other spouse. The sharing spouse needs to log in and click "Profile" (upper right), then "Account Access." To give account access to the other spouse, click the big green button that reads "Give Account Access" and then click "Give view only access." Select the account you would like to share and fill out the contact information for your spouse. They will receive an email with instructions on how to add the account access you have shared with them. This process will need to be repeated for each account you wish to share. Once it is set up, a single login will show all the accounts in one place.

Under the Account Summary tab or the typical landing page after login, you will see all your accounts and balances. The settings gear icon has some great features to explore. From this page, you can give your accounts nicknames, check or uncheck the "include in total value" box, or choose whether to show online or not. Account grouping is also an option. For example, in my personal login screen, I have grouped my children's custodial accounts in a separate group and elected not to show their values in the total household value figure. You can arrange the accounts in whatever way you wish.

Once your Schwab Alliance account is set up and customized, you can access your account on your smartphone by using the "Schwab Mobile" app. The app is an easy way to follow your accounts without booting up a computer. Also, the app has the e-authorization feature to quickly approve one-time withdrawals from your account. If you allow the app to send you notifications, you can be prompted to sign in to approve a withdrawal in a couple of clicks.

Institutional No Transaction Fees

A benefit of using Schwab's platform is that some of the mutual funds in our portfolios can be bought and sold without transaction fees, even if they are an institutional fund with a lower expense ratio. Most mutual funds have multiple share classes of the same fund. A key distinction between the share classes is the internal expenses of the fund and whether they have a transaction fee to buy and sell shares. Typically, the lower expense share class (usually I shares) has a transaction fee but a lower annual expense. If we are buying enough dollars of a fund, it makes sense to pay the fee to get the lower expense. Schwab offers several institutional funds that trade without a transaction fee but still have the lower expenses. We were able to execute intra-class exchanges, which swapped the higher expense funds for a better share class. These exchanges don't trigger capital gains if they occurred in taxable accounts.

After a month of experience with Schwab, my best-case scenario is playing out. The Schwab team has taken the best parts of Schwab and combined them with the best parts of TD Ameritrade. Having a new system will always be a challenge to learn, but in the grand scheme, we are still able to partner with a top custodian that allows us to maintain our independence. That means that we work for and are only compensated by our clients and no one else. We don't have a home office that nudges us to recommend a flavor-of-the-month investment. That freedom is at the heart of what we do. We are grateful and honored to have earned your business, your trust, and your friendship.

It takes no more time to see the good side of life than the bad.

-- Jimmy Buffett (1946-2023)
American musician and singer-songwriter