360INSIGHTS

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Why Is Inflation So Low? (And What to Do About It)

By Jonathan Scheid, CFA, AIF®

Ronald Reagan famously described inflation as being "as violent as a mugger, as frightening as an armed robber and as deadly as a hitman." While the inflation experienced under President Reagan was all those things, inflation over the past decade would struggle to get a ticket for jaywalking.

Since the global financial crisis of 2008 and 2009, inflation has been low. The Federal Reserve, the government agency responsible for keeping unemployment down and prices stable, has been formally targeting a level of 2% inflation since 2012 (and informally since the mid-90s, according to some Fed officials). Their preferred way to measure inflation—Core Personal Consumption Expenditures index (Core PCE)—is currently at 1.6%, well below the 2% target. In fact, it has been below the 2% level for a majority of the past decade.

Low inflation is not limited to the United States. The Organisation for Economic Co-operation and Development (OECD) tracks inflation on its 36 member countries, and the OECD Consumer Price Index is currently at a relatively low 2.47% on a year-over-year basis.

What's Keeping Inflation Down?

Economists believe there are a variety of factors contributing to the low levels of inflation including the expansion of the sharing economy, the changing workplace, globalization and central bank policy. Brief descriptions of each of these factors are outlined on page 4.

Expanding on the central bank policy explanation, many economists would argue that the Federal Reserve is very adept at executing their targeted level of inflation since they have many powerful monetary tools at their disposal. And, the U.S. isn't alone in targeting a specific level of inflation, so inflationary pressures from outside the U.S. will be fairly tame. It is estimated that nine developed economies and 21 emerging market economies are targeting some level of inflation. Most of the developed economies are targeting a similar level to the U.S., as they feel the 2-2.5% level is optimal.

Yet some factors are confounding many economists at the Federal Reserve. The historical inverse relationship between the level of unemployment and the level of wages isn't holding up. That relationship—named the Phillips Curve after its creator, New Zealand economist William Phillips—suggests that if unemployment is low and falling, wages should be rising. This increases the cost of producing goods or delivering services, and companies ultimately have to increase prices to maintain a desired level of profit.

However, even with unemployment currently near historic lows, wage growth is still relatively low. This is confusing economists and it is also contributing to our low inflation.

What to Do About Low Inflation?

A low inflationary economy is usually good to be in, so we should enjoy it while we can. But it is important to remember that while inflation is low, it's still present. Any time there is inflation, the spending power of our cash and investments is at risk of declining.

Additionally, while the measure of inflation the Federal Reserve tracks is relatively low, inflation may not be low for everyone. The cost of medical treatments, prescription drugs and higher education has been rising at a rate much higher than general inflation. Anyone who currently faces these costs or anticipates them in the future should ensure they have a plan to address their specific level of inflation. (continued on page 4)

Important To-Do's Before Sending Your Child Off to College

By Ken Rosenbaum, CPA

The day has come. Your little baby has grown up and is now ready to leave the nest. He or she has graduated high school and is preparing for the next big step. Whether it's college, a gap year, a year abroad or any other life adventure that lies ahead, this time can be filled with emotion for you and your child.

As departure day gets closer, you're probably focusing on last-minute shopping lists and feeling overwhelmed with trying to get everything done in time. It's all too easy for some important tasks to get lost in the commotion. So, here are six items you may have overlooked.

1 Make an appointment with your attorney to create a durable power of attorney document for financial matters and a health-care proxy.

Without them, in most states, you, as a parent, don't have authority to make health-care decisions or manage money for your children once they turn 18. That's true even if you are paying the tuition, have your child on your health insurance plans or claim your child as a dependent on your tax returns. Without such documents in place, if your child is in an accident and/or becomes disabled, even if only temporarily, you might need court approval to act on your child's behalf.

2 Establish a monthly budget for your child.

The precise amount agreed upon in said budget is a personal discussion. However, it is especially important to set clear expectations about who will pay for what expense. Maybe you agree to pay for all school-related expenses and it's your child's responsibility to pay for all or some of the social expenses. Have this conversation early enough to allow your student time to find a good summer job to earn and save money for the upcoming year.

3 Determine whether your child will receive a credit or debit card and set rules around when to use each.

Educate your child about the difference between the two and, based upon your child, decide which is the better option. There are advantages and disadvantages to each. If your child is just starting to learn how to budget and balance a checkbook, beginning with a debit card may be best, especially for general daily expenses. Leave the credit card for larger expenses, such as travel arrangements, and emergencies.

Two important benefits of using a credit card are the ability to create a credit history and better security. Building a credit history can work two ways: you can create a positive credit record or a negative one. A positive credit history will become extremely important for your child in just a few short years. So, pay off the balance every month, don't overspend, don't let your child assume that you will bail them out every time, and help them understand how interest charges and late fees add up and are cumulative. In terms of security, Frank Abagnale, of "Catch Me If You Can" fame, does a good job explaining how consumer protection law treats debit and credit cards very differently.

Some simple steps you, as a parent, can take:

- Co-sign on the card.
- Start with a low credit limit.
- Ensure you have online access to the card.

4 Once on campus, make sure you and your child know where the closest hospital, urgent care and 24-hour pharmacy are located.

Find a good local physician in case your child needs medical attention above what the college health center can provide. Make sure your child carries his or her health insurance card and you have reached an agreed-upon way to pay for any medical expenses. Does your child know when to use the credit card versus the flexible spending or health savings account card?

5 Have your child write down all passwords to any digital profiles, including financial and social media accounts.

Keep this in a safe place at home. Your child may not like this, but explain that you are not doing it to invade privacy, but to protect it in case of an emergency. I recommend you review this list with your child before each new school year in case any passwords have changed.

6 Talk to your insurance agent and ask about covering your child's belongings while they are living on or off campus.

The premiums associated with a dorm insurance policy or a renter's insurance policy vary, but affordable options with an appropriate coverage amount and deductible generally are available.

While my list of must-do items can help ensure you meet certain financial needs before the first day of new student orientation, don't neglect to prioritize the emotional aspect of dropping off your child at college for the first time. This event can be a special opportunity to connect.

Marshall Duke, a professor at Emory University, offers wonderful advice on this topic. He writes: "Such moments are rare. They have power. They give us as parents one-time opportunities to say things to our children that will stick with them not only because of what is said, but because of when it is said....

This is a moment to tell them the big things. Things you feel about them as children, as people. Wise things. Things that have guided you in your life. Ways that you hope they will live. Ways that you hope they will be. Big things. Life-level things.

Duke suggests writing your child a special note. Mail it, the old-fashioned way. He writes: "It will not be deleted; it will not be tossed away; it will be kept. Its message will stick. Always."

At the beginning, it may help to think of your child as a high school student now in college. Your child will need to learn how to become a college student – how to study, how to eat, how to handle money – and thrive amid the greater independence. Remember, your child will learn many of the most important lessons to prepare for life ahead outside of the classroom.

Plan for the Unexpected

As you are packing for a trip to another city, you prudently decide to check the 10-day weather forecast there. If it will be cold, you pack a heavy coat. If it is supposed to rain, you bring an umbrella. You want to be prepared. Similarly, you want a financial plan that anticipates the unexpected.

First you need to plan for sudden, unanticipated expenses, such as home repairs, medical bills, or losing a job. Many experts recommend you have at least three to six months' living expenses saved away and readily accessible for any "surprises" that come your way. In addition, be wary of financial products that make it hard for you to access your money if you need it unexpectedly.

Second, make sure you and your loved ones are properly protected. Depending on your situation, this can include everything from home and car insurance to long-term care and life insurance.

Third, make sure your plan factors in down markets. A well-diversified portfolio built around your comfort with risk can account for and help mitigate some of the impact of market declines.

Rainy days will happen. But the right long-term plan can keep you covered.

This article is an excerpt from a new book, the "27 Principles Every Investor Should Know," coming out in 2019

> **THE SHORTEST PERIOD OF TIME LIES BETWEEN THE MINUTE YOU PUT SOME MONEY AWAY FOR A RAINY DAY AND THE UNEXPECTED ARRIVAL OF RAIN.**
>
> — Jane Bryant Quinn, Journalist

(Why Is Inflation So Low?, continued from page 1) One of the best ways to preserve the buying power of our investments has been to invest a portion of our portfolio in stocks. Stocks have historically generated a rate of return that exceeds the rate of inflation. With the meager interest we get from our savings accounts and low yield our bond investments generate, stocks are left to do the heavy lifting to preserve our purchasing power.

While we don't know if President Reagan's hardened criminal version of inflation will return anytime soon, it is wise to understand the current level of inflation and make the proper plans to combat it.

4 FORCES KEEPING INFLATION LOW

Sharing Economy: With the rise in popularity of companies like Uber, Lyft and Airbnb, the supply of services has increased, which helps keep prices down. With Airbnb, for instance, it's harder for hotels to raise prices when visitors can easily rent apartments and homes from locals.

Changing Workplace: Declining unionization, increased automation and an aging population have made it harder for workers to demand higher wages.

Globalization: Lower cost goods made by lower cost workers has surely contributed to the lower pace of inflation.

Central Bank Policy: With many of the developed and emerging central banks targeting a specific level of inflation (e.g., the Federal Reserve is targeting 2% in the U.S.), they seem to be delivering on their goal of moderately low inflation.