# The McCrea - Bollinger Group

## First Kentucky Securities Corporation

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**in-ˈflā-shən -** *a continuing rise in the general price level usually attributed to an increase in the volume of money and credit relative to available goods and services resulting in the loss of value of purchasing power of currency.*

Averaging below 2% in recent years, for most of us inflation has been an economic after thought. However, some of us remember the harmful impact in the 1970s when inflation averaged above 7% causing purchasing power to decline by nearly 50%. Retirees on a fixed income and middle-class workers struggled to keep up with the rapid rise in the cost of living. The higher inflation pushed interest rates to over 15%, further stagnating the economy. After several decades of low inflation, we have recently seen early warning signs that inflation may be on the horizon.

Economist often attribute higher inflation as "too much money chasing too few goods". Throughout the pandemic we have seen disruptions in production (too few goods). To offset these disruptions and stimulate the economy the U.S. government has borrowed and spent an equivalent of an additional 15% of the economy. As a result of this and other governmental efforts money supply has increased by more than 25% (too much money) in the past year. This rapid growth of money supply is roughly double the rate the U.S. experienced during the 1970s.

The government stimulus worked as personal income rose 6.3% in 2020 - the most for any year since 2000. However, according to First Trust, industrial production was 3.3% below pre-COVID levels, and real GDP in 2020 declined 2.5% from 2019.  In other words, demand is good, but supply is still hurting – a perfect recipe for inflation. Dramatic increases in government borrowing and spending makes the return of inflation a very real threat to the long-term health of the US economy.

Most of the early inflation of the past year appears be in the stock market and other investment vehicles that are floating on this sea of new money. Our concern is that further stimulus is creating a sugar high in equities. While we do not see the market as a bubble, we do view it like a balloon that will slowly deflate. Rising inflation is also likely to lead to higher interest rates increasing the near-term risk of bonds.

We currently recommend staying fully invested using your recommended risk balance. While diversification is always important, going forward, how you are diversified will be key. Given the current environment we have been increasing our investments in traditional inflation hedges like real estate, commodities, and materials companies in our portfolios. As always, we will keep you apprised of the risks we see and continue to help you navigate the challenges in the path ahead.

The investment markets are constantly changing. As long-term investors, we look at these changes as opportunities for your overall investment strategy. What is your timetable? How best to balance risk and rewards based on your objectives? What are the important reasons for you to build and protect wealth? We monitor each investor's portfolio against changing market conditions to maximize performance. It is our simple approach to produce wealth for you.

Your Team: Sheree Bollinger, Bruce McCrea, Chris McCrea, Caroline Flatt, & Bryan McCrea

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FIRST KENTUCKY SECURITIES CORPORATION

## How Do Interest Rates Affect the Stock Market

The investment community and financial media tend to obsess over interest rates and for a good reason. Interest rates refer to the cost someone pays for the use of someone else's money.

**The Interest Rate That Impacts Stocks**
The interest rate that most often impacts the stock market is the federal funds rate. Also known as the discount rate, the federal funds rate is the rate depository institutions are charged for borrowing money from Federal Reserve banks. The Federal Reserve makes adjustments to the federal funds rate in order to control inflation.

**What Happens When Interest Rates Rise?**
When the Federal Reserve increases the discount rate, it does not directly impact the stock market. The only direct impact is that borrowing money from the Federal Reserve is more expensive for banks. The impact is due to the fact that any increases in the discount rate have a ripple effect throughout the rest of the economy.

Because it costs financial institutions more to borrow money, these same financial institutions often increase the rates they charge their customers to borrow money. So, individual consumers are impacted through increases to their credit card and mortgage interest rates, especially if these loans carry a variable interest rate. When the interest rate for credit cards and mortgages increases, the amount of money that consumers can spend decreases.

### What Happens When Interest Rates Fall?
When the economy is slowing, the Federal Reserve cuts the federal funds rate to stimulate financial activity. A decrease in interest rates by the Federal Reserve has the opposite effect of a rate hike. Investors and economists alike view lower interest rates as catalysts for growth—a benefit to personal and corporate borrowing. This, in turn, leads to greater profits and a robust economy.

Consumers will spend more, with the lower interest rates making them feel that, perhaps, they can finally afford to buy that new house or send their kids to a private school. Businesses will enjoy the ability to finance operations, acquisitions, and expansions at a cheaper rate, thereby increasing their future earnings potential. This, in turn, leads to higher stock prices.

## By the Numbers

1.) NICE JOB - Justin Thomas, the # 2 ranked golfer in the world, won $2.7 million on 3/14/21 with his win at The Players Championship in Florida, the largest payout from a single golf tournament in history (source: PGA).

2.) NOT GOING – 2.17 million freshmen started college in the fall of 2020, down 13% (327,513 fewer students) from the 2.50 million freshmen that began college in the fall of 2019 (source: National Student Clearinghouse).

3.) Banks repossessed just 1,428 homes nationwide in January 2021. Banks repossessed 78,133 homes nationwide in January 2011 (source: Attom Data Solutions).

4.) Student loan debt in the United States was 90% larger than credit card debt nationwide as of 12/31/20, i.e., $1.56 trillion to $820 billion (source: Federal Reserve Bank of New York).

5.) RELIEF DOLLARS - 36% of stimulus payment money received by Americans from the March 2020 CARES Act was put into savings, while 35% was used to pay down debt (source: Federal Reserve Bank of New York).

By the Numbers is our digital newsletter. If you would like to subscribe please call Krissy at (502) 238-7740 or e-mail Krissy@firstky.com

### The Bottom Line
Although the relationship between interest rates and the stock market is fairly indirect. As a general rule of thumb, when the Federal Reserve cuts interest rates, it causes the stock market to go up; when the Federal Reserve raises interest rates, it causes the stock market to go down. Higher interest rates tend to negatively affect earnings and stock prices. But there is no guarantee as to how the market will react to any given interest rate change.

Any impact on the stock market to a change in the interest rate changes is generally experienced immediately, while, for the rest of the economy, it may take about a year to see any widespread impact. Higher interest rates tend to negatively affect earnings and stock prices. (source: investopedia)