

# Farmers Trust Company

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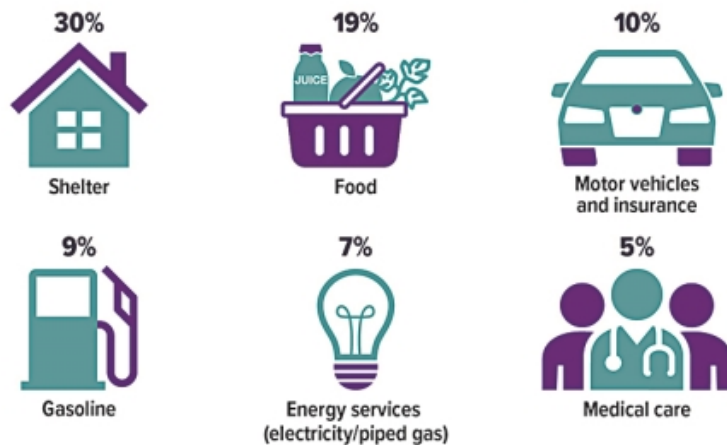


Be sure to check out John Stewart's **2023 Market Outlook** below!

## The Top Six Inflation Drivers of 2022

In June 2022, the 12-month rise in the Consumer Price Index (CPI) peaked at 9.1%, the fastest pace in 40 years, before dropping to 7.7% in October. This bout of inflation has been driven in large part by steep price hikes for essentials, hitting many U.S. households where it hurts the most. In fact, more than three-fourths of the annual increase in the CPI can be attributed to these six categories.

Contribution to the 12-month, 7.7% increase in consumer prices, October 2022



Source: U.S. Bureau of Labor Statistics, 2022

# 2023 Market Outlook

Last year was a challenging year for investors. However, now that it's 2023, everyone wants to know if the worst is behind us and we can look forward to better days. The consensus narrative – what most economists, market forecasters and pundits think – is that the first half of the year could be challenging followed by a recovery in the back half of the year. While that's certainly possible, the market rarely goes according to such a nice and neat predetermined plan. Perhaps the opposite could be true? Or something we can't even imagine at this point in time. The good news (we hope) is that stocks and bonds should provide some yin and yang for portfolios like they're supposed to do, as opposed to both moving in the same direction (lower) like they did last year. If the economy holds up and stocks do well, bonds might struggle a bit, but if the economy deteriorates and stocks underperform, your bonds should do their job in 2023 and provide some balance and diversification benefits.

As first quarter earnings season kicks off, we will be closely watching the changes to future earnings estimates coming from Wall Street analysts. These numbers have been steadily trending lower for the past few months, and until we see some stabilization in earnings expectations for 2023 it will be difficult to expect a sustainable rally in equities. For example, as of October 1st, 2022, S&P 500 aggregate earnings were expected to rise 2.5% in the first quarter of 2023 and 0.6% in the second quarter. Currently, expectations are for a 6% decline in the first quarter and a 7% decline in the second quarter. The good news is that lower expectations are easier to beat, but stock prices will continue to be vulnerable as long as those numbers continue to deteriorate.

As always, managing risk will be paramount this year, as we expect market volatility to remain elevated almost regardless of whose forecast for the economy ends up being correct. With that being said, you should probably keep enough cash on hand for any expenses you might expect this year; that way you don't put yourself in a position of being forced to sell investments at an inopportune time. You should also probably make sure that your portfolio is positioned so that you can sleep at night. If you're a nervous nelly then you should probably not have 80% of your money invested in the stock market. Even though the road might be a bit bumpy, sticking to a disciplined investment strategy over time is the only reliable way to reach your financial goals.

# Debt Optimization Strategies

To help improve your financial situation, you might consider reducing your debt. Before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including interest rates, payment requirements, and any prepayment or other penalties.

## Start with Understanding Minimum Payments

You are generally required to make minimum payments on your debt, based on factors set by the lender. Failure to make the minimum payments can result in penalties, higher interest rates, and default. If you make only the minimum payments, it may take a long time to pay off the debt, and you will have to pay more interest over the life of the loan. This is especially true of credit-card debt.

Your credit-card statement will indicate your current monthly minimum payment. To find the factors used in calculating the minimum payment amount each month, you can review terms in your credit-card contract, which can change over time.

The minimum payment for credit cards is usually equal to the greater of a minimum percentage multiplied by the card's balance (plus interest on the balance, in some cases) or a base minimum amount (such as \$15). For example, assume you have a credit card with a current balance of \$2,000, an interest rate of 18%, a minimum percentage of 2% plus interest, and a base minimum amount of \$15. The initial minimum payment required would be \$70 [greater of  $(\$2,000 \times 2\%) + (\$2,000 \times (18\% \div 12))$  or \$15]. If you made only the minimum payments (as recalculated each month), it would take 114 months (almost 10 years) to pay off the debt, and you would pay total interest of \$1,314. For consumer loans, the minimum payment is generally the same as the regular monthly payment.

## Make Additional Payments

Making payments in addition to your regular or minimum payments can reduce the time it takes to pay off your debt and the total interest paid. Additional payments could be made periodically, such as monthly, quarterly, or annually.

Using the previous example (\$70 initial minimum payment), if you made monthly payments of \$100 on the credit card debt, it would take only 24 months to pay off the debt, and total interest would be just \$396.

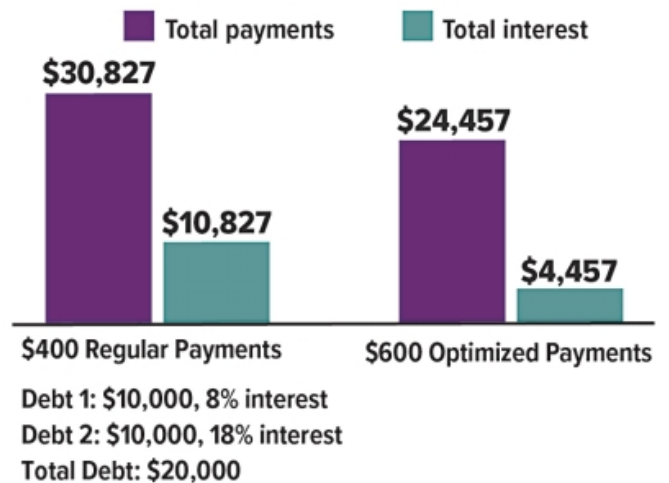
Here's another example. Assume you have a current mortgage balance of \$300,000. The interest rate is 5%, the monthly payment is \$2,372, and the remaining term is 15 years. If you make regular payments, you will pay total interest of \$127,029. However, if you pay an additional \$400 each month, it will take only 12 years and one month to pay off the mortgage, and you will pay total interest of just \$99,675.

## Pay Off Highest Interest-Rate Debt First

One way to potentially optimize payment of your debt is to first make the minimum payments required for each debt and then allocate any remaining dollars to debt with the highest interest rates.

For example, assume you have two debts, you owe \$10,000 on each, and each has a monthly payment of \$200. The interest rate for one debt is 8%; the interest rate for the other is 18%. If you make regular payments of \$400, it will take 94 months until both debts are paid off, and you will pay total interest of \$10,827. However, if you make monthly payments of \$600, with the extra \$200 paying off the debt with an 18% interest rate first, it will take only 41 months to pay off the debts, and total interest will be just \$4,457.

## Pay Off Highest Interest-Rate Debt First



## Use a Debt-Consolidation Loan

If you have multiple debts with high interest rates, it may be possible to pay them off with a debt-consolidation loan. Typically, this will be a home-equity loan with a lower interest rate than the rates on the debts being consolidated. (Note that a federal income tax deduction is not currently allowed for interest on home-equity indebtedness unless it is used to substantially improve your home.) Keep in mind that a home equity-loan potentially puts your home at risk because it serves as collateral, and the lender could foreclose if you fail to repay. There also may be closing costs and other charges associated with the loan.

*All examples are hypothetical and used for illustrative purposes only and do not represent any specific investments or products. Fixed interest rates and payment terms are shown, but actual interest rates and payment terms may change over time. Actual results will vary.*

# The Inflation Experience Is Painful and Personal

Inflation is a sustained increase in prices that reduces the purchasing power of your money over time. According to the Consumer Price Index (CPI), inflation peaked at an annual rate of 9.1% in June 2022, the fastest pace since 1981, before ticking down to 7.7% in October.<sup>1</sup>

The CPI tracks changes in the cost of a market basket of goods and services purchased by consumers. Items are sorted into more than 200 categories and weighted according to their "relative importance," a ratio that represents how consumers divide up their spending, on average. Basic needs such as shelter (33%), food (14%), energy (8%), transportation (8%), and medical care (7%) account for about two-thirds of consumer expenditures. Because the CPI is a comprehensive measure of prices across the U.S. economy, the index also contains many items that an individual consumer may purchase infrequently, or not at all.

Wide variations in spending patterns help explain why some consumers feel the sting of inflation more than others. This means that the extent to which you experience inflation depends a lot on where you live, as well as your age, health, income, family size, and lifestyle. In effect, your personal inflation rate could be significantly higher or lower than the average headline inflation rate captured in the CPI. Consider the following examples.

- In October 2022, the 12-month increase in the cost of shelter was 6.9%.<sup>2</sup> Shelter carries the most weight of any category in the CPI, which made fast-rising home prices and rents a top driver of inflation over the previous year. A first-time homebuyer, or a renter who signs a new lease, is likely to feel the full impact of these hefty price increases. However, a homeowner with a fixed-rate mortgage is generally insulated from these rising costs and might even benefit financially from home-equity gains.
- Gasoline surged 17.5% during the 12 months ended in October 2022.<sup>3</sup> Individuals who rarely drive, possibly because they are retired or work remotely, might have been able to shrug off the price spike. But for drivers with long commutes, filling up the gas tank regularly might have put a sizable dent in their households' finances, in some cases forcing them to cut back on other purchases.
- Food and beverage prices rose 10.9% over the same 12-month period, a trend that clearly affects everyone.<sup>4</sup> But rising food costs tend to put more pressure on the budgets of lower-income households because they spend a greater share of their income on necessities and typically have smaller financial cushions. Plus, shoppers can't easily switch to lower-cost options if they are already relying on them.<sup>5</sup>

1-4) U.S. Bureau of Labor Statistics, 2022

5) Federal Reserve, 2022

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## IMPORTANT DISCLOSURES

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