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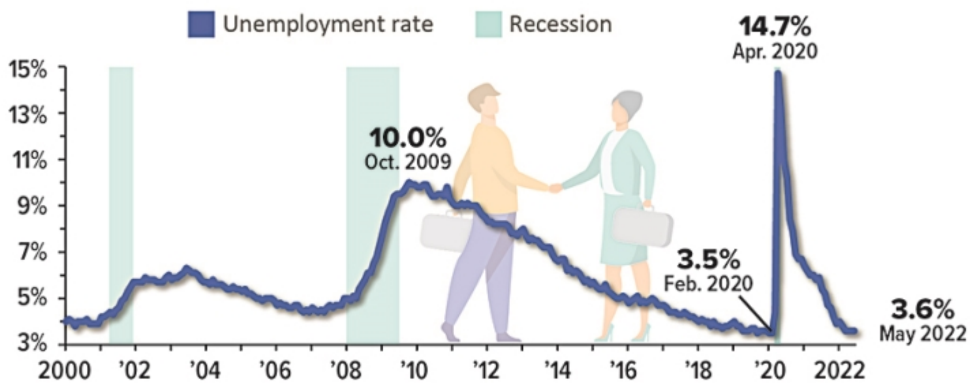
Check out John Stewart's thoughts on "Stocks Shrug Off Inflation" below.

Quick Recovery for Unemployment Rate

The U.S. unemployment rate skyrocketed to 14.7% in April 2020 when the economy shut down in response to the pandemic. This was by far the highest rate since the current tracking system began in 1948. Fortunately, employment has recovered at a record pace — the unemployment rate was just 3.6% in March, April, and May 2022, nearly the same as before the pandemic.

The official unemployment rate only reflects unemployed workers who are actively looking for a job. A broader measure that captures workers who want a job but are not actively looking, as well as part-time workers who want full-time work, dropped from 22.9% in April 2020 to 7.1% in May 2022.



Source: U.S. Bureau of Labor Statistics, 2022; National Bureau of Economic Research, 2022

Stocks Shrug Off Inflation

Inflation accelerated yet again in the month of June as reported earlier this week. The headline Consumer Price Index (CPI) came in at a rate of 9.1% over last year's level. This has pretty much cemented another 0.75% increase in the Fed Funds rate later this month when the Federal Reserve meets again. In fact, there is a not significant chance of a full 1.0% increase being implied by the Fed Funds futures market. This initially caused the stock market to drop sharply, as many market participants see the risk of tighter monetary policy driving the economy into a recession. Nevertheless, dip buyers quickly came into the fray and bid equity prices higher, sensing that expectations may have become too pessimistic relative to reality. The S&P 500 index finished more than 3% off its lows for the week, but was still down about 1% compared with the previous week's close. I suppose you can either see the glass as half full or half empty depending on your viewpoint. At this juncture, earnings reports will take over as the next catalyst for stock prices with a large number of companies set to report second quarter results next week. The key will be whether or not analysts see fit to begin slashing estimates for the third and fourth quarters in response to the reports. If estimates take another leg lower, so could the stock market.

I like to talk about risk management a lot because at the end of the day, good investment management is in fact good risk management. It is important to remember when managing an investment portfolio that pretty much anything is possible; don't get into the trap of thinking that something could never happen. Some investors will expose themselves to a substantial amount of risk by taking a large position because they think a certain outcome is impossible. Usually, it's an entirely different risk that you couldn't see coming that ultimately comes back to bite you. It reminds me of a story about a gambler who lost regularly. One day he hears about a race with only one horse in it, so he bets his life savings. Halfway around the track, the horse jumps over the fence and runs away. Always remember that there's no such thing as a "sure thing".

The labor market has held up remarkably well so far this year with the headline unemployment number near a record low of 3.6%. However, murmurs of layoffs have begun with a modest uptick in recent initial jobless claim numbers, which would coincide with a further deterioration of the economy. Given that full employment is one-half of the Fed's dual mandate (with the other being price stability), any labor market weakness would provide some cover for the central bank to take a less-hawkish tone toward monetary tightening. Our view is that the Fed will be done with their rate increases by September as the economy softens and inflationary pressures begin to moderate. While the time between now and then could continue to be extremely volatile, we may be getting closer to some light at the end of the tunnel for beleaguered investors. For the time being, however, we continue to recommend defensive posturing throughout client portfolios.

Inflation Protection for Investment Dollars

For the 12-month period ending in May 2022, the Consumer Price Index for All Urban Consumers (CPI-U) — the most widely used measure of inflation — increased 8.6%, the fastest pace in 40 years.[1] The rate may trend downward as the Federal Reserve raises interest rates and supply-chain issues improve. But inflation is likely to be relatively high for some time.

High inflation not only hits consumers in the pocketbook for current spending, it also has a negative impact on the future purchasing power of fixed-income investments. For example, a hypothetical investment earning 5% annually would have a *real return* of –2.5% during a period of 7.5% annual inflation. This rate of return might be further reduced by taxes.

One way to help hedge your bond portfolio against inflation is by investing in Treasury Inflation-Protected Securities (TIPS).

How TIPS Fight Inflation

The principal value of TIPS is automatically adjusted twice a year to match any increases or decreases in the Consumer Price Index. If the CPI-U moves up or down, the Treasury recalculates your principal to reflect the change. A fixed rate of interest is paid twice a year based on the current principal, so the amount of interest may also fluctuate. Thus, you are trading the certainty of knowing exactly how much interest you'll receive for the assurance that your investment will maintain its purchasing power over time.

Like all Treasury securities, TIPS are guaranteed by the federal government as to the timely payment of principal and interest. If you hold TIPS to maturity, you will receive the greater of the inflation-adjusted principal or the amount of your original investment.

Pricing-In Protection

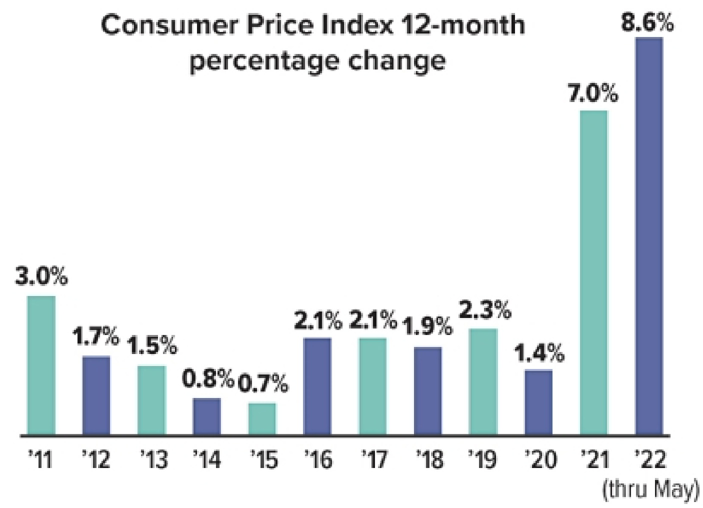
TIPS pay lower interest rates than equivalent Treasury securities that don't adjust for inflation. The *breakeven inflation rate* is the difference between the yield of TIPS and nominal (non-inflation-protected) Treasury securities with similar maturities. It is the premium the investor pays for inflation protection, as well as a market-based measure of expected inflation.

If inflation runs higher than expected, TIPS will earn a better return than nominal Treasury securities. If inflation runs below the breakeven rate, then TIPS have no clear advantage. However, the increased principal due to any level of inflation can still add to the value of your portfolio.

In some situations, TIPS can have negative interest rates that might produce a positive return after the principal is increased for inflation. For example, if a five-year TIPS offers a return of –0.5% while a five-year Treasury note offers a return of 2.5%, the 3% difference between these rates is the breakeven inflation rate. If inflation were to run at 4% over the five-year period, the TIPS would return 3.5% (4% – 0.5%) after adjustments for inflation, 1% higher than the return on the Treasury note.[2]

Eroding Purchasing Power

After an extended period of low inflation, consumer prices spiked in 2021 and 2022 due to supply and demand imbalances as the U.S. economy reopened.



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

TIPS are sold in $100 increments and are available in maturities of 5, 10, and 30 years. As with all bonds, the return and principal value of TIPS on the secondary market will vary with market conditions, are sensitive to movements in interest rates, and may be worth more or less than their original cost. When interest rates rise, the value of existing TIPS will typically fall on the secondary market. Changing rates and secondary-market values should not affect the principal of TIPS held to maturity.

You must pay federal income tax each year on the interest income from TIPS plus any increase in principal, even though you won't receive the principal and interest until the bonds mature. For this reason, investors might consider holding TIPS in a tax-deferred account such as an IRA.

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

2) This hypothetical example of mathematical principles is used for illustrative purposes only. Rates of return will vary over time, particularly for long-term investments. Actual results will vary.

The Potential Benefits of Roth IRAs for Children

Most teenagers probably aren't thinking about saving for retirement, buying a home, or even paying for college when they start their first jobs. Yet a first job can present an ideal opportunity to explain how a Roth IRA can become a valuable savings tool in the pursuit of future goals.

Rules of the Roth

Minors can contribute to a Roth IRA as long as they have earned income and a parent (or other adult) opens a custodial account in the child's name. Contributions to a Roth IRA are made on an after-tax basis, which means they can be withdrawn at any time, for any reason, free of taxes and penalties. Earnings grow tax-free, although nonqualified withdrawals of earnings are generally taxed as ordinary income and may incur a 10% early-withdrawal penalty.

A withdrawal is considered qualified if the account is held for at least five years and the distribution is made after age 59½, as a result of the account owner's disability or death, or to purchase a first home (up to a $10,000 lifetime limit). Penalty-free early withdrawals can also be used to pay for qualified higher-education expenses; however, regular income taxes will apply.

In 2022, the Roth IRA contribution limit for those under age 50 is the lesser of $6,000 or 100% of earned income. In other words, if a teenager earns $1,500 this year, his or her annual contribution limit would be $1,500. Other individuals may also contribute directly to a teen's Roth IRA, but the total value of all contributions may not exceed the child's annual earnings or $6,000 (in 2022), whichever is lower. (Note that contributions from others will count against the annual gift tax exclusion amount.)

Roth IRAs offer an opportunity to learn about important concepts that could provide a lifetime of financial benefits.

Lessons for Life

When you open a Roth IRA for a minor, you're giving more than just an investment account; you're offering an opportunity to learn about important concepts that could provide a lifetime of financial benefits. For example, you can help explain the different types of investments, the power of compounding, and the benefits of tax-deferred investing. If you don't feel comfortable explaining such topics, ask your financial professional for suggestions.

The young people in your life will thank you — sooner or later.

For questions about laws governing custodial Roth IRAs, consult your tax or legal professional. There is no assurance that working with a financial professional will improve investment results.
