MarketWise

WHAT STUBBORN INFLATION COULD MEAN FOR THE U.S. ECONOMY

April proved to be a turbulent month for the stock market. The S&P 500, our preferred equity index benchmark, shed 4.16% from the March close, the first down month we have seen since last October. Thankfully, the market's stellar start to the year tempered the losses somewhat, ending April still up 5.57% year-to-date. Much of the volatility came from slightly higher than expected inflation data, carrying with it worries that the Federal Reserve will have to keep rates higher for longer, which has been a common market reaction since the Fed began raising interest rates 2 years ago. As we've covered near-ad-nauseum in this space, the market overreacts to good inflation data with big rallies and bets that rate cuts are imminent; and flip-flops on worse-than-expected data, with steep selloffs and bets that rates won't get cut at all this year, or perhaps even go up further still. April shows this in action: inflation data off by 0.1% caused the April sell-off (along with some tough earnings from giants like Tesla and Meta, and geopolitical unrest in the Middle East); followed by a rally to start May when Fed Chair Jerome Powell said that rates will likely not go any higher, and that cuts are still on the table for this year. Weaker than expected payroll data drove the rally further (along with new bets for earlier cuts once again), and now we stand just 1.1% down from the end of March. As the market and the Fed continue their tug-of-war, we focus on long-term market performance and are encouraged by solid economic and corporate earnings data that continues to show respectable growth across the economic landscape and corporate environments. Our main article this month, written and provided by Broadridge Advisor Solutions, will dig into the inflation battle in more detail. You can find articles by Broadridge on a wide variety of topics at our website: www.kingdomfs.net.

INDEX	YTD	12 MO.
S&P 500	+5.57%	+20.78%
Dow Jones	+0.34%	+10.90%
NASDAQ	+4.31%	+28.06%
Russell 2000	-2.62%	+11.58%

As of Market Close 4/30/2024 Source: Yahoo Finance Charts

– David J Brunswick III

On April 10, 2024, the U.S. Bureau of Labor Statistics released the Consumer Price Index (CPI) for March, and the increase in CPI — the most commonly cited measure of inflation — was higher than expected. The rate for all items (headline inflation) was 3.5% over the previous

year, while the "core CPI" rate, which strips out volatile food and energy prices, was even higher at 3.8%. The month-over-month change was also higher than anticipated at 0.4%. (1)

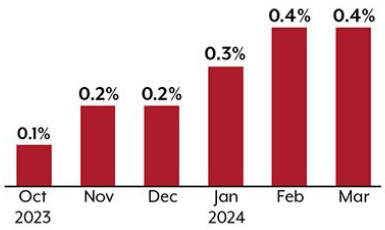
The stock market dropped sharply on this news and continued to slide over the following days, while economists engaged in public handwringing over why their projections had been wrong and what the higher numbers might mean for the future path of interest rates. In fact, most projections were off by just 0.1% — core CPI was expected to increase by 3.7% instead of 3.8% — which hardly seems earth-shattering to the casual observer. But this small difference suggested that inflation was proving more resistant to the Federal Reserve's high interest-rate regimen. **(2)**

It's important to keep in mind that the most dangerous battle against inflation seems to have been won. CPI inflation peaked at 9.1% in June 2022, and there were fears of runaway inflation similar to the 1980s. That did not happen, and inflation declined fairly steadily through the end of 2023. The issue now is that there has been upward movement during the first three months of 2024. This is best seen by looking at the monthly rates, which capture the current situation better than the 12-month rates. March 2024 was the third month in a row of increases that point to higher inflation (see chart). **(3)**

Trending Upwards

A monthly increase in the Consumer Price Index of 0.1% to 0.2% would equate to an annual inflation rate of roughly 2%, which the Federal Reserve considers appropriate for a healthy economy.

One-Month change in CPI



Source: U.S. Bureau of Labor Statistics, 2024 (Consumer Price Index for All Urban Consumers)

High for Longer

While price increases hit consumers directly in the pocketbook, the stock market reacted primarily to what stubborn inflation might mean for the benchmark federal funds rate and U.S. businesses. From March 2022 to July 2023, the Federal Open Market Committee (FOMC) raised the funds rate from near-zero to the current range of 5.25%–5.5%, in order to slow the economy and hold back inflation. At the end of 2023, with inflation apparently moving firmly toward the Fed's target of 2%, the FOMC projected three quarter-percentage point decreases in 2024, and some observers expected the first decrease might be this spring. Now it's clear that the Fed will have to wait to reduce rates. **(4-5)**

Higher interest rates make it more expensive for businesses and consumers to borrow. For businesses, this can hold back expansion and cut into profits when revenue is used to service debt. This is especially difficult for smaller companies, which often depend on debt to grow and sustain operations. Tech companies and banks are also sensitive to high rates. **(6)**

In theory, high interest rates should hold back consumer spending and help bring prices down by suppressing demand. So far, however, consumer spending has remained strong. In March 2024, personal consumption expenditures — the standard measure of consumer spending — rose at an unusually strong monthly rate of 0.8% in current dollars or 0.5% when adjusted for inflation.7 The job

market has also stayed strong, with unemployment below 4% for 26 consecutive months and wages rising steadily.8 The fear of keeping interest rates high for too long is that it could slow the economy too much, but that is clearly not the case, making it difficult for the Fed to justify rate cuts. **(7-8)**

What's Driving Inflation?

The Consumer Price Index measures price changes in a fixed market basket of goods and services, and some inputs are weighted more heavily than others. The cost of shelter is the largest single category, accounting for about 36% of the index and almost 38% of the March increase in CPI.9 The good news is that measurements of shelter costs — primarily actual rent and estimated rent that homeowners might receive if they rented their homes — tend to lag current price changes, and other measures suggest that rents are leveling or going down. **(9-10)**

Two lesser components contributed well above their weight. Gas prices, which are always volatile, made up only 3.3% of the index but accounted for 15% of the overall increase in CPI. Motor vehicle insurance prices made up just 2.5% of the index but accounted for more than 18% of the increase. Together, shelter, gasoline, and motor vehicle insurance drove 70% of March CPI inflation. On the positive side, food prices made up 13.5% of the index and rose by only 0.1%, effectively reducing inflation. **(11)**

While the Fed pays close attention to the CPI, its preferred inflation measure is the personal consumption expenditures (PCE) price index, which places less emphasis on shelter costs, includes a broader range of inputs, and accounts for changes in consumer behavior. Due to these factors, PCE inflation tends to run lower than CPI. The annual increase in March was 2.7% for all items and 2.8% for core PCE, excluding food and energy. The monthly increase was 0.3% for both measures. **(12)**

Although these figures are closer to the Fed's 2% target, they are not low enough in the face of strong employment and consumer spending to suggest the Fed will reduce interest rates anytime soon. It's also unlikely that the Fed will raise rates. For now, the central bank seems poised to give current interest rates more time to push inflation down to a healthy level, ideally without significant slowing of economic activity. **(13)**

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful. Projections are based on current conditions, subject to change, and may not come to pass.

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GENERATIONAL PLANNING STRATEGIES

BY DAVE BRUNSWICK, JR.

GIVE MORE THAN YOU GAVE

Your favorite charity needs to keep their operations funded. Usually, that means direct donations from those supporting their causes. But what if you could give 2 or even 3 times as much through leverage? How? Life insurance as a charitable gift. Here are some broad approaches illustrating how life insurance can benefit a charitable cause.

Charity as Beneficiary

The most straightforward approach is to designate a charity as the beneficiary of a permanent policy, such as whole life. This type of policy, which covers someone for their entire life provided the premiums are paid, differs from term insurance, which covers someone for a defined period of time (after that set time term insurance policies usually have provisions for continuing coverage, albeit at higher premiums). When making a charity the beneficiary of a permanent policy, the donor retains ownership of the permanent policy and, therefore, has continued access to the policy's cash value.

This strategy can be attractive because the donor can often make a larger gift — of the death benefit — than of smaller gifts of cash. For instance, a healthy adult may be able to purchase a life insurance policy costing a set number of premiums at $100-$200 a month with a $100,000 benefit. That benefit is far greater than what the person could donate at one time.

Some may consider a "survivorship" policy, which covers two lives, pays the death benefit at the death of the 2nd insured, and is typically less expensive than a policy covering only one life. There is added flexibility in that the charity can get the full benefit or simply share in part of the benefit with the family with either type.

Gift of an Existing Policy

Of course, designating a charity as the beneficiary of a life insurance policy means it will take time before the organization receives any money. Those wishing to make an immediate contribution can consider making a gift on an existing policy.

GENERATIONAL PLANNING STRATEGIES

CONTINUED:

For instance, a person may have a permanent life insurance policy that is no longer needed. Instead of surrendering the policy he or she can change the ownership and beneficiary to the charity. If future premiums are needed to continue the policy until the death benefit is received, the donor can make annual cash contributions to the charity. Alternatively, the charity can elect to place the policy on reduced paid up status; surrender the policy immediately; or take a loan against its cash value.

Under this approach the donor could be eligible for a tax deduction for the current year, provided the cash gift is to a qualified charity. Such a deduction would depend on individual circumstances, so donors should consult a tax advisor before making such a move.

Purchase of a New Policy

If no existing life insurance policy is available, the donor might consider buying a completely new policy and designating the charity as owner and beneficiary. Typically, this strategy involves a limited payment policy, where premiums are paid for a set period. The insurer can limit the amount of insurance based on the donor's giving history or charitable obligations.

The donor can make annual cash contributions so that the organization can pay the premiums. As above, the donor will usually be entitled to an income tax deduction for any such contributions, subject to IRS limits. The charity can use the cash contributions or other funds to pay premiums on the policy.

If you would like to explore how this strategy may help you and your charity, please contact us. We would love to help!

Disclosures

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6) *The Wall Street Journal*, April 15, 2024

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10) NPR, April 18, 2024

13) Bloomberg, April 19, 2024

WHO WE ARE

Kingdom Financial Services is a full-service, family owned and operated, Christian rooted financial firm located in Wake Forest, North Carolina. We are associated with G.A. Repple & Company, which is a prominent Christian owned Broker/Dealer in the Southeast. We are trained Planned Giving Consultants with expertise in the areas of investment and financial insurance products and services.



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