PRENTIS
WEALTH MANAGEMENT GROUP
of Wells Fargo Advisors
280 Park Avenue South, 27W
New York, NY 10017
(212) 953-7633
(212) 953-7634 Fax
(877) 773-6847 • 877-PRENTIS
www.prentiswmg.com
peter.prentis@wfadvisors.com

Peter D. Prentis, CFP®
Managing Director – Investments
Michael Prentis Knuff, CFP®
Senior Vice President – Investments
J. Stuart Bevan
Senior Vice President – Investments
Andrew Bevan, CFA®, CAIA®
Financial Advisor
Joseph Bennett
Vice President
Senior Registered Client Associate
Edita Mertira
Senior Registered Client Associate

FINANCIAL CONCEPTS
WINTER 2020

Why Inflation Can Be Good

Most people don't have a kind word to say about inflation, and those on fixed incomes hate it. It makes everything more expensive; and when you're living on an income that never rises, your standard of living suffers.

But ask most economists and they'll tell you that, within limits, inflation is good, and its opposite — deflation — is bad. How can that be?

The broad definition of inflation is a general increase in prices. Deflation is the opposite — a general fall in prices.

When we say general, we're referring to the prices of most goods and services. This is an important distinction because prices of some things move in a different direction from most.

For example, regardless of what's happening to the price of food or clothing, prices generally fall for new, high-technology items after a number of years. That's usually because manufacturers achieve economies of scale and are able to pass the associated savings along to consumers, and/or because they have invented new, less expensive ways to make the latest gadget. It also happens when more manufacturers come into the market and compete against established makers on the basis of price.

There can also be regional differences in the prices of some goods. An example is real estate, where prices may be falling in areas that are experiencing a high rate of job losses, while prices may be rising in areas where the job market is booming.

Three Measures of Inflation

Continued on page 2

Dear Friends, Family, and Clients,

As we head into the New Year and a new decade, we all have much for which to be grateful. Looking back, it has been quite an amazing decade. For those who have reached out, the team and I want to thank you for your recent calls and emails. We very much appreciate that you appreciate our appreciation (of your assets)!

With markets at an all-time high, most of our regular readers can likely predict what advice will follow:

1. Stay disciplined: Bull markets can engender a sense of excessive self-confidence, complacency, and irrational exuberance just as bear markets can promote paranoia and pessimism.

2. Review and rebalance: When markets are strong, as they have been, equity allocations creep up. Our approach is to periodically rebalance toward your target asset allocation. Regular reviews will help you feel confident in the progress you are making with your plan and how your investments are contributing to achieving your goals.

3. We want to hear from you: Please be sure to update us on any life changes (births, deaths, marriages, babies, new homes, new jobs or retirement). We want to know if anything has changed recently that could impact your financial future and your long-term plan.

SECURE ACT Notification: Attached, please find a document highlighting the main aspects of this new bill — ***Key IRA Impacts of the 2019 SECURE ACT,*** *Wells Fargo Advisors.* Many details to this new bill are being analyzed for new planning strategies. As such, we will keep you posted as more information becomes available. For now, please review your retirement plan beneficiary designations to ensure they are in line with your wishes and in keeping with this new legislation.

As always, feel free to reach out to us with any questions or concerns.

Best,

Peter, Mike, Stuart, Andrew, Joe and Edita

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Why Inflation

Continued from page 1

1. The Consumer Price Index (CPI). This is the figure most Americans think of when they think about inflation. It's calculated monthly by the Bureau of Labor Statistics, based on the prices of a basket of some 80,000 different goods and services that most consumers buy in markets all across the country.

The Bureau of Labor Statistics categorizes those goods and services as:

- ❍ Food and beverages (including at-home and restaurant meals)
- ❍ Housing (rent of primary residence, owners' equivalent rent, furniture)
- ❍ Clothing (including jewelry)
- ❍ Transportation (new vehicles, airline fares, gasoline, motor vehicle insurance)
- ❍ Medical care (prescription drugs and medical supplies, physicians' services, eyeglasses and eye care, hospital services)
- ❍ Recreation (televisions, toys, pets and pet products, sports equipment, admissions)
- ❍ Education and communication (college tuition, postage, telephone services, computer software and accessories)
- ❍ Other goods and services (tobacco and smoking products, haircuts, and other personal services)

The CPI also includes sales and excise taxes, utility fees, and highway tolls. It excludes investments like stocks, bonds, and insurance, as well as income and Social Security taxes.

You'll sometimes hear about core inflation. This is a derivation of the CPI that excludes the goods that have volatile prices, like food and fuel. The idea is to avoid outlying, short-run price changes that mask longer-term trends.

2. GDP deflator. Based on changes in Gross Domestic Product (GDP), this is a broader measure than the CPI because it includes every kind of good and service the economy produces and delivers. For example, it includes raw materials and industrial goods, like steel, factory equipment, and investment services. It's expressed as a percentage that reduces the nominal new price of a good or service to reflect the quantity of goods. The GDP deflator is regarded as a more accurate measure of price trends throughout the *entire* economy.

3. Producer Price Index (PPI). This measures changes in the wholesale prices of goods and services by manufacturers. It's often looked at as a leading indicator to estimate later changes in the CPI.

How Can Inflation Be a Good Thing?

Inflation is a by-product of economic growth, which is the means by which the standard of living rises.

Think of it this way: prices are a function of supply and demand; if businesses post higher prices for their goods and services and they stick, it's because demand is willing and able to pay those prices. One of the ways that people can afford to pay more is if their incomes are rising, which is what happens when they are working for successful companies.

Higher prices are also supported when there is a continually growing number of people with jobs and money to spend. Inflation can also stimulate growth by making existing debt cheaper.

Think of homeowners who stretch their budgets to buy the nicest home they can afford. Over time, if the economy grows, so does their income. If they hold a fixed-rate mortgage, their monthly mortgage payment for principal and interest becomes a smaller and smaller percentage of their income.

As a result, they have an increasing amount of free cash flow to spend on other goods and services. And that, in turn, causes businesses to hire more people.

The Destructive Power of Deflation

Deflation is a general decline in prices — not to be confused with a decreasing rate of inflation — and is a destructive economic force. First, it's a sign that businesses can't pass along higher costs of production.

Second, it results in lower revenue and, if it lasts for several years, cutbacks in production and employment. When people lose their jobs, they spend less, have trouble keeping up with their bills, and even lose their homes.

Third, deflation makes debt more expensive. As incomes and business profits decline, fixed-rate loans become an increasingly larger percentage of cash flow. Banks foreclose on mortgages, increasing the supply of homes and driving down all home values, and some businesses go into bankruptcy. Banks lend fewer loans because fewer borrowers can qualify. People who still have jobs start paying off debt more aggressively.

This further reduces demand for goods and services, and the economy enters a negative feedback loop, feeding negative growth and higher unemployment.

Deflation is one of the major causes of economic depressions. In the 13 years from 1927 through 1939, the U.S. experienced CPI deflation in eight years, with prices falling 8.9% in 1931, 10.3% in 1932, and 5.0% in 1933.

By comparison, during the Great Recession, we experienced only one year of very slight deflation, in 2009, when the CPI fell by 0.4%.

The Inflation Ideal: Low Single Digits

Is there an ideal rate of inflation? Economists suggest that a moderate rate of inflation — in the low-single digits — is optimal for sustained long-term growth. Indeed, the Federal Reserve Bank has said that an inflation rate of 2% is ideal.

Please call if you'd like to discuss this in more detail. ❍❍❍

5 Reasons to Start Saving

Saving money is a bit like exercising. We all know how important it is, but it can be hard to actually get into the habit. If you're interested in getting started with savings, or if you want to save more, here are five reasons to help keep you motivated.

1. You'll Be Prepared for Emergencies — Most Americans don't have enough money saved to cover even relatively small unexpected expenses, such as emergency room co-pays, minor car repairs, or a broken furnace. Without cash on hand to cover these irregular but inevitable costs, you're more likely to turn to credit cards or loans when the need arises. Unfortunately, at that point, you usually need money fast. Not only are you forced to take on debt, but you don't have time to shop around, increasing the chance that you'll end up with an expensive, high-interest loan. Plus, the more debt you have, the more difficult it is to save. The result? A downward financial spiral that can be difficult to pull yourself out of.

2. You'll Be More Independent — Having savings gives you more flexibility and independence. With a healthy amount of savings, you can feel more free to take risks, like starting your own business, heading back to school to train for a new career, purchasing a home of your own, or moving to a new city. Plus, without savings, you're living on the financial edge, and you're more likely to find yourself stuck in situations that you may not be satisfied with — working just to pay off debt, trapped in an unfulfilling job because you can't afford to search for better opportunities, or stuck in a less-than-desirable neighborhood because you don't have the financial resources to upgrade. Committing to savings today, even if it's just a small amount, will start to give you the freedom to make different choices in your life.

3. You'll Be Able to Reach Your Goals — We all have goals. Maybe you simply want to enjoy a comfortable retirement one day. Or perhaps you're dreaming of a second home by the lake, sending your kids to college, or starting your own business. Whatever your dreams, they likely have one thing in common — they probably require some money to become a reality. Few of those dreams are achievable if you don't save for them.

4. You'll Be Able to Earn More Money — Saving isn't just about setting aside what you've already earned. It's also about putting your money to work for you. Depending on where you save and invest your money, you can earn more just by being diligent about saving. Because of the power of compounding earnings, even relatively small amounts can grow significantly, provided you don't touch your principal.

5. You'll Be Happier — Money isn't the only thing that can make us happy. But there's evidence that *saving* money, even in small amounts, can make us happier. In contrast, having debt (often a consequence of a lack of savings) tends to lead to unhappiness. ❍❍❍

Your Parents' Estate Plans

Estate planning can be a difficult subject to discuss with your parents. You don't want to seem concerned about how much money they may eventually leave you, while they may fear you are interfering with their finances. But to help ensure their estate is settled quickly according to their wishes, family members should have some basic information. You don't need to know the specifics, but you should find out:

- **Where important estate planning documents are located.** Make sure documents are in place so their wishes will be carried out. Find out if they have a durable power of attorney and a healthcare proxy. With a durable power of attorney, they designate someone to control their financial affairs if they become incapacitated. A healthcare proxy delegates health care decisions to a third person when your parent is unable to make those decisions. Usually, this document also outlines procedures to be used to prolong life.
- **How to contact their advisors.** Ask for a list of names, addresses, and phone numbers of lawyers, accountants, and financial advisors.
- **Their rationale for distributing their estate.** Often, when heirs understand why an estate is being distributed in a particular manner, it can prevent problems among those heirs. If your parents are reluctant to discuss now, suggest they leave a personal letter with their estate-planning documents.
- **Preferences for the future.** Find out where your parents would like to live if they're not physically able to live in their current home. Do they want to move in with relatives or live in an assisted-living facility? Discuss in detail what procedures they want performed to prolong life in the event of a terminal illness. Determine their preferences for funeral arrangements. ❍❍❍

6 Life Insurance Mistakes to Avoid

Many families are in danger of being under-insured or have no life insurance protection at all. While some of this can be explained by a lack of urgency in younger people to purchase insurance, there are also some holdouts who don't really understand how it works. For the life-insurance seekers, here are some costly mistakes to avoid:

Mistake #1: Thinking you can't afford life insurance. The abundance of options available to people of all ages, income levels, and health status can make life insurance attainable for people who may have believed it was only for the wealthy. In fact, the complications and sudden expenses of unexpected death can unfortunately mean that your family may not be able to afford *not* having the security of a life insurance policy.

Mistake #2: Relying entirely on an employer-sponsored life insurance policy. While it is convenient, opting to only utilize the group life insurance policy through work will almost certainly not provide you with enough coverage. Unlike traditional life insurance, group life insurance disbursements over $50,000 can be considered taxable income and your loved ones will have to make do with less after taxes. Group life insurance will also not provide coverage if you are changing jobs, experience unemployment, or have to leave your position due to illness.

Mistake #3: Purchasing inadequate coverage. People often prioritize their discretionary spending over insurance coverage when making their budget, which can lead to insufficient funds being used for insurance. Review your budget and determine if the amount of coverage you've chosen is really enough for your family's needs and if you can afford the difference in premiums for better coverage.

Mistake #4: Choosing the wrong type of insurance. There are significant differences between term and whole life insurance, and these differences can affect the affordability, length of coverage, tax implications, versatility, and customization of your policy. Review any policies you have and make sure they still meet your needs. If not, they may be convertible so you can work with your agent to adjust your policy to better suit your circumstances.

Mistake #5: Not updating your beneficiaries. A lot can happen in just a few years, and if you do not review your beneficiaries on a regular basis, there is a chance they no longer match up with your wishes. This is especially true if there has been a divorce, birth, death, or family dispute in recent years. Beneficiaries on life insurance policies generally override wills, so keeping this up-to-date is particularly important. Include contingencies in case your primary beneficiary passes away or if one or more of your beneficiaries is a minor and will need a guardian or a trust to handle disbursements until they come of legal age.

Mistake #6: Not seeking professional advice. Life insurance can be complicated and to make sure you have not overlooked something important, such as the tax implications for your loved ones, it may be wise to consult with a licensed professional. This will allow for peace of mind that you have selected the best policy for yourself and your family's needs.

Please call to discuss your life insurance needs in more detail. ❍❍❍

MARKET DATA

Indicator	Oct-19	Nov-19	Dec-19	Dec-18	Dec-17
	Month-end				
Prime rate	4.75	4.75	4.75	5.50	4.50
Money market rate	0.71	0.57	0.58	0.56	0.33
3-month T-bill yield	1.62	1.56	1.52	2.47	1.45
20-year T-bond yield	2.00	2.07	2.25	3.03	2.66
Dow Jones Corp.	2.90	2.85	2.84	4.40	3.13
30-year fixed mortgage	3.33	3.28	3.31	4.16	3.51
GDP (adj. annual rate)#	+3.10	+2.00	+2.10	+2.20	+3.40

Indicator	Oct-19	Nov-19	Dec-19	2019	2018
	Month-end			% Change	
Dow Jones Industrials	27046.23	28051.41	28538.44	22.3%	-5.6%
Standard & Poor's 500	3037.56	3140.98	3230.78	28.9%	-6.2%
Nasdaq Composite	8292.36	8665.47	8972.60	35.2%	-3.9%
Gold	1510.95	1460.15	1523.00	18.8%	-1.1%
Consumer price index@	256.76	257.35	257.21	2.1%	2.2%
Unemployment rate@	3.50	3.60	3.50	-5.4%	-9.8%

— 1st, 2nd, 3rd quarter @ — Sep, Oct, Nov Sources: *Barron's, Wall Street Journal*

4-YEAR SUMMARY OF DOW JONES INDUSTRIAL AVERAGE, 3-MONTH T-BILL & 20-YEAR TREASURY BOND YIELD

JANUARY 2016 TO DECEMBER 2019