Regions Wealth Podcast

Episode 41: Factoring Inflation Into Your Financial Plans

Inflation is on the rise, impacting consumers around the globe. But how long is it expected to persist, how big of a concern should it be? In this episode, Wealth Planning Executive Bryan Koepp joins us to discuss what's driving inflation in 2022, how it's impacting the average American household, and why focusing on your personal balance sheet is key to surviving inflation.

Episode Transcript

Sarah Fister-Gale:

Welcome to Season 4 of Regions Wealth Podcast, the podcast that tackles life's challenges with financial experience. I'm your host Sarah Fister-Gale.

Inflation is on the rise, impacting not only Americans, but consumers around the globe. Between February 2021 and 2022, the consumer price index rose by 7.9% according to The Bureau of Labor Statistics. Meanwhile, in the 19 countries using the Euro, inflation hit 7.5% in March 2022, while in Britain, prices rose by 5.4% at the end of 2021.

So, just how long is inflation expected to persist, and how big of a concern should it be?

Joining me remotely is Bryan Koepp. He's a Wealth Planning Executive for Regions Bank. Bryan, thanks for joining us today.

Bryan Koepp:

My pleasure.

Sarah Fister-Gale:

In this episode of Regions Wealth podcast, we're discussing inflation, how long it's expected to persist, and what steps individuals should take to remain on-track during this time. We've taken some frequently asked questions from a bunch of people, and developed a character who needs your help. Let's listen.

Hank:
"Hey. My name is Hank, and, uh, I'd like to ask a few questions about inflation. So I'm constantly hearing conflicting information about it all, um — online, in the papers, on TV — and that's making it pretty hard to determine just how concerned I should be. While I do know what inflation is, I'd really like to understand this topic a lot better than I do right now."

Sarah Fister-Gale:

So this is a great place to start. Before we go too deep into the topic of inflation, let's talk about the economy in general. How is the US dollar doing at this moment, and what is the economic forecast looking like ahead?

Bryan Koepp:

Well, I think this is a great place to start, and really when we think about the overall state of the economy, the fundamentals are generally pretty strong. Unemployment is low, and we're coming out of the pandemic and people are back in the workforce, but we still are having supply chain issues globally, and I think that's very much apparent in regards to the papers and TV and the media and what they're reporting.

Supply chain structures worked for decades, but coronavirus really tested that. And I think both domestically and internationally, governments and private companies alike are working through those issues. So you take on of top supply chain, other geopolitical issues at this time, and that's really added to the prospect of probably less growth this year than initially predicted when we started 2022. That being said, and you had mentioned the US dollar, even though there's been a slight depreciation in the dollar since the pandemic started, if you want to measure that as March or April, 2020, overall, it's still one of the strongest currencies on the globe, so that's a great place, in essence, to be.

The story for 2022 and beyond, is going to be the question of interest rate hikes, and that's occurred. And we look into the future and there's likely going to be more. So in summary, the dollar is one of the strongest currencies. We've got a number of geopolitical events, which may act as mitigators regarding where the economy goes. And overall, other than supply chain, the fundamentals of our economy are pretty good.

Sarah Fister-Gale:

So Bryan, from a general standpoint, what is inflation?

Bryan Koepp:

From a textbook definition standpoint, inflation is really the depreciation of purchase power over time, relative to supply and demand economics. And so, what we always want to think about here is what I would call dimensions. And so, when you have things like cash expenses and cash flow, those things aren't really linear. The cost of goods and services, and we've seen this in the marketplace, increase, and what happens then is that the currency that you have, dollars or whatever that may be, results in an overall depreciation of that asset or capital, whether it is currently strong or not.

Inflation sometimes is misunderstood, and the reason for that is if you think about history, we've really been in a deflationary cycle for a significant period of time. And so in many respects, we're now making up for lost time today. Some inflation is a good thing, and if you think about wages going up, that's a good thing, but it needs to be measured and it needs to be predictable in regards to where prices and services go. And I think that's a glaring issue and concern for a lot of people at this time.

Sarah Fister-Gale:

You said we're making up for lost time in regard to the environment today. What does that mean in terms of the economy in general, and how the US dollar is doing?

Bryan Koepp:

If you think about really the fundamentals of our economy, it's generally really strong. Unemployment is low and we're coming out of the pandemic and people are coming back to work. But I think everyone would agree that one of the glaring issues that still exists is our supply chain. And if you think about our supply chain structure, that's worked exceptionally well internationally for the past couple decades, but when the coronavirus pandemic hit, it tested it. And invariably, that test has not gone exceptionally well. So consumers, nations, and their governments are really still working through those issues. So you take supply chain and now you add some additional geopolitical issues that have begun to ignite and evolve. Those mitigating factors will probably stunt a little bit of the growth that was initially predicted when we started 2022.

But that takes us to the dollar. And so, going back to the beginning of the coronavirus pandemic, there's no doubt there's been a slight depreciation in the dollar, but it's still very much safe to say that the dollar is one of the strongest currencies in the world. And that's a great thing. So what we'll see in conjunction with both the economy and the dollar is really how interest rates will impact both of those things. And so what we do know is that we've seen an increase, we're going to see more increases, and you put all those things together and ultimately that's how our year is going to play out.

Sarah Fister-Gale:
And Bryan, what does inflation impact?

Bryan Koepp:

I think it's safe to say that inflation impacts everything. And so it really kind of comes down to how you measure it and where you look. So, the question regarding goods and services, you think about the fact that there's multiple levels there. So if you're a consumer, does that expense get passed on down to you, or is it absorbed by the company for a period of time while they're making those goods and disseminating them to the community for purchase?

So what we've seen is the difference between big companies and smaller companies. Bigger companies have had the ability to absorb inflation. Inflation really began to crop up in mid 2021 and towards the end of the year now into 22. And keep in mind that those bigger companies had balance sheets that had flexibility due to the coronavirus pandemic. They had maybe less expenses that were accounted for on those balance sheets. So they've had the ability to absorb some of that and not necessarily pass it on to consumers. But I think that we're seeing now, that's kind of changing.

Smaller businesses, meanwhile, may not have had that type of flexibility. So they've been in a little bit more of a heightened price cycle for a much more significant period of time. So I think that what we're seeing is really the double impact of the fact that inflation, in essence, is growing at a level we haven't seen in several decades, and then as previously mentioned, you take the geopolitical factors, add that to the supply chain, and it's pretty much everywhere. And so, whether it's food stuff or gasoline, it really becomes the focal point of what you're doing and what you're buying on a day to day basis.

The other point that I would remind everyone of too, is that inflation is measured often by the Consumer Price Index, but that doesn't necessarily account for every consumer product that you may purchase. So, invariably, inflation may hit your pocketbook more or less, depending upon the things that make up your consumer purchases.

Sarah Fister-Gale:

So you’ve mentioned supply chain disruption and geopolitical events, but at a general level, are there any other factors that drive inflation?

Bryan Koepp:

I think the first thing is, it's supply and demand economics. So whether you're renovating your home or you're purchasing some type of product that is subject to supply chain considerations, if demand outweighs supply, and you also have a chase for those goods, what's going to happen is the cost will go up. I think a perfect illustration of this would be the chip situation with cars. Right now, the used car market is unbelievable in the sense that because there is such a lack of supply of them, current dealerships are paying premiums to buy those cars to be able to have supply to sell, at an increased cost.

So again, to me, primary factors are the basic supply and demand economics, which makes up our environment. As well, we always want to think about mitigating factors, and I'd mentioned this before, so geopolitical considerations, petroleum, fertilizer, food stuff. You think about parts of the world where certain products are farmed. These things create price spikes and price decreases depending upon their lack of, or severity. So you add that to simple supply and demand and that creates volatility. Last year the FED said that inflation would be transitory. However, I think we all can agree that probably isn't the case anymore, but it doesn't mean that we're in a permanent environment either. I think it's key to really think about cashflow and priorities to make sure that you're in the best position, no matter how the economy turns.

The last thing I'd mention on this front, would be interest rates. Lower interest rates have driven up the price of housing, especially in Metro markets, and if we coupled that with remote work, that's made the prospect of prices in various parts of Metro areas balloon faster than what would be anticipated. I think what's really, really key here, and that goes specifically to real estate prices, is there's an indirect effect regarding interest rates as well on inflation, in regards to the final price tag that you see on the things that we buy and become part of our own personal balance sheets.

Sarah Fister-Gale:

So Bryan, there are some people who fear we're entering a period of extreme hyperinflation. Looking at 2021 and 2022, how does this inflationary period compare to, or differ from, historic inflationary periods such as in the seventies or early eighties?

Bryan Koepp:

I think it's a great question, but something to keep in mind is, it is impossible to have an apples to apples comparison regarding the inflationary period of the late seventies, early eighties to today. And the reason for that is due to a number of things. The first one is, one of the triggers for the seventies inflationary uptick was due to moving away from the gold standard. So, that's something that is not really comparable today, and so, invariably it's different worlds, and how we transact is different.

I think the other thing to consider is the actual measurement itself, which is the Consumer Price Index. That formula has changed numerous times over the past 20 to 30 years. And so you can try to calculate an apples to apples calculation, but I don't believe you'll really truly get there. So for example, gasoline is not included in the current CPI and that's something that obviously is extremely from a market perspective been affected by the current environment that we're in. So I think what triggers the seventies and eighties is that it's extremely fearful, and as well, a majority of Americans haven't really experienced it. Not to date myself, but I was enjoying kindergarten when that was going on. But I think that it causes fear and that's very much understandable.

I think the other thing to keep in mind too... and Hank had the question regarding what I see on TV and media, is it's important to remember that the goal of news headlines is to get viewership. So if you go back to 2008, there's news back then about stagflation and double digit inflation. And what we actually did was we entered into a deflationary environment. So, what's most important right now, and probably where the best, most efficient time is spent and what you can control, is to focus on your personal balance sheet and really, in essence, determine what you should do based upon what you want to accomplish in an elevated inflationary environment.

Sarah Fister-Gale:

That's a really good point. You have so many people trying to figure out inflation's impact on the country or the globe, when really it's your own balance sheet that's important. So the topic of inflation often conjures up those images of German citizens pushing wheelbarrows of cash around in the Weimar Republic, or more recently the current economic crisis in Venezuela. Are there safeguards in place to prevent a similar degree of extreme hyperinflation from occurring in the US?

Bryan Koepp:

I remember going through school and seeing the political cartoons of the wheelbarrow with the cash in it, so I understand the image and I think, obviously, Venezuela is a much more recent example. But I think that we need to think about the United States from a structural perspective is very different from those scenarios. Case in point, and we had mentioned it earlier, is that the US dollar is still one of the strongest currencies in the world. And you take, for example, a situation like Venezuela, which is a communist dictatorship, and it's an economy that's not really well diversified. The United States economy is much more diversified, and that's an understatement. Something else to think about that I think is a good sign regarding the question of hyperinflation or stagflation is that for people that are on Social Security, is that this past year was one of the largest increases in benefits in recent memories. So, keep in mind that if we have a significant year of consistent inflation, that COLA adjustment allows for at least some type of relief for people who have social security as an income source in retirement. Second, the Federal Reserve is going to keep their eye on the current situation, and they're going to mobilize and accelerate recommendations, as need be, to invariably balance the economy and its growth with the inflation question. So I think, while those images from a psychological standpoint would make sense and I think would be concerning, I do believe that our country and our situation here in the United States is a bit different and there should be some solace in that.

Sarah Fister-Gale:

That is comforting. So let's pause here and listen to the next portion of Hank's question.

Hank:

"So basically, I'm wondering what, if anything, I should be doing differently in response to inflation. My wife and I are both high earners and we're not big spenders, so I can't say we're really feeling the pinch of inflation uh — at least not yet. We're all about saving and investing, and right now, we're laser-focused on two big goals: growing the 529 plans we have for each of our three children, and saving for retirement, which is about 20 years away for both of us. Short-term, we really want to sell our home and relocate to be closer to family. We'd also really like to upgrade our family SUV. But both those goals have been put on the back burner for the time being because we're just not confident that now is a good time to make such big purchases."

Sarah Fister-Gale:

So Bryan, Hank mentions that he and his wife aren't feeling the impact of inflation just yet, but for the average American household, what changes, if any, might they need to make to their household budget to account for inflation?

Bryan Koepp:

This is something that I'm very excited to talk about because this is where we get some control. So the first thing we need to think about is prioritizing, a) what do you need? And secondly, what do you want? So immediately I think that in of itself never an easy question to answer. So I think you need to think about that question in your own way. It doesn't mean you have to budget to the penny. It doesn't mean that you just simply state a number and say, this is what we need. But what we do need to think about is when we see headlines of the CPI is 7%, 8%, whatever the number is, a family needs to translate that into real dollars. So, you've got what inflation is, and you could always apply mathematical models to that. And a great example would be, for every dollar, your purchase power is with 8% inflation, 92 cents. But secondly, theoretically inflation could go down, but costs stay up. So it's thinking about hard dollars, and I think things such as travel and gasoline may be examples of that. So I think thinking about not necessarily a percentage of your current expenses going up, but thinking about specific expenses is most important.

The last mitigating factor that I would add would be shrinkflation. So this is the proverbial, you go to your local grocery store and lo and behold, you get four ounces less potato chips for the same price. When you have a family, invariably, cost will go up because it's going to be in the actual amount that's necessary to meet the need and the want of the family. Couple other things to think about, and this is where interest rates et cetera interact. Credit. Sometimes we have balances on credit cards. Sometimes putting expenses on a credit card to get through a storm is necessary and imperative, but as those balances increase, the minimum payment increases along with the prospect of interest rate increases. That could be even more than inflation. So, keep that in mind when figuring out how are we going to navigate the actual expense load for the family.

As well, I think prioritizing what's most important to you keeps you grounded regarding higher costs. So, it is to a degree an appreciative factor. It's hey, even though costs have gone up, we're doing okay and we're able to accomplish this and that, and that's a great thing. So I would tell you, even though, for a lot of people this becomes extremely tough, try to maintain a positive mindset and focus. And that's going to allow for you to navigate a lot of these issues regarding expenses.

Sarah Fister-Gale:

Hank talks a lot about right now. We're not sure if right now is a time to make big purchases, but what impact do inflation rates have on long term goals? For example, Hank mentioned saving for college and retirement. Should individuals reassess their saving and investment strategy whenever the rate of inflation changes?

Bryan Koepp:

I think reassessing your saving and investment strategy regularly is always a good idea, whether you're in a high inflationary environment or not. I think what's really important as you prioritize expenses is also thinking about prioritizing your long-term goals in regards to savings. So immediately this is a tough question. I've talked to a number of people and immediately the issue is just like, uh-oh, my retirement horizon is going to change and that's a bad thing. That's not necessarily true. And so what you need to think about is that the short term game doesn't necessarily sacrifice the long term goal, so long as we navigate the short term in the right manner. So you never want to, in essence, run a financial plan and simply say, okay, inflation is going to be what it is today over the next 25 years, because it's going to give you a false picture, a false narrative in regards to what you can actually accomplish. So this is something where it's not a buy and hold situation. You're going to need to continue to reassess through this environment where you are, what you should do, and how do you approach that next. And that gives you the best chance to be successful.

So how you do that is through both a quantitative and qualitative test. I would urge for you, with your financial strategist, run numbers based upon a short term environment of increased inflation, with that trailing, and also with adequate expenses based upon what you believe your needs and wants are. That gives you the best picture from a data perspective. But then I don't want you to disqualify the qualitative piece of this either. The “I Test” means something. You ever feel like something just doesn't feel right? Well, that's real, and you shouldn't discount that. So you balance the data and the quantitative with the qualitative, which is family dynamics, priorities. You put that all together and that gives you the best picture to make the best decisions.

So doing that and always having the ability to pivot, to have flexibility, and being creative, gets you in the best position to be successful. I'm going to urge for you in this situation is not just to look at your statements, not to just watch the news, because it's very, very easy to get into a pessimistic place. Case in point, if there's a significant market pullback what we know is that generally after that market pullback, there's generally a rebound, and if you're out of the market, you can't participate in that rebound because you're out of those investments and you've actually locked in the loss. All these things are interconnected and that's why thinking about it, again, in a multidimensional format, talking with your professionals puts you in the best position regarding retirement, regarding education, to get to where you need to be.

Sarah Fister-Gale:

I think that's really good advice. It is so easy to be reactive and anxious in times like these, but talking to someone like your wealth advisor can help give you that sense of calm that we all need when we're making financial decisions.

Bryan Koepp:

Yeah. And I think here's something else, it really is just great to walk through those things with somebody to be able to lay out your concerns, be able to say, here's how to progress. And what I would tell you is, financial advisors themselves have the same issues and they do the same. It's always good to talk to somebody regarding the concerns that you have, because I think what it will do is take you out of that pessimistic place and really be able to get to, number one, what do we want to accomplish? And two optimistically, how do we get there?

Sarah Fister-Gale:

So Hank also mentions that he and his wife have delayed the purchase of a new home and a new car. What factors should individuals consider, if any, before making these kinds of significant purchases during periods of inflation?

Bryan Koepp:

There's no doubt that both the real estate market and then as well, the auto market have been frustrating for consumers, and it's not necessarily even a cost frustration, but emotional frustration. I've talked to a number of people that say, I've put in six, seven, eight contracts on homes and didn't get across the finish line. Prepare yourself for that, but don't be pessimistic because you need to also be prepared if you win the contract. Or if the car is available, how are you going to take care and transact?

So, invariably, I think that you need to identify what you want and then prepare yourself to be successful here. So really address what's my budget and what I'm willing to spend here. If you go well and over your cap in a high inflation environment, even though your mortgage rate would be locked in, or your auto loan's going to be locked in, it's going to impact the total picture of expenditures. So, you think about all the things that make a house run, electric, gas, other improvements. You're going to need to put money into these things, and that's going to add to the overall cost. So are you prepared to handle that, both from an economic perspective, but also from a time management and labor perspective? Prepare yourself for that.

You then also think about these in regards to your life in general. How important are they? What puzzle piece do they really represent? And prioritize. And I think that ultimately gets you to the right path in regards to overall happiness because, invariably, inventories go up and inventories go down, but you're going to live in the home that you buy and you're going to drive the car that you purchased, and you need to be happy. Never forget that point.

Sarah Fister-Gale:

That you need to be happy.

Bryan Koepp:

Yes.

Sarah Fister-Gale:

I like that. So, let's listen to part three of Hank's story.

Actor:

"Now, my wife and I are lucky to have a good financial cushion, but my mom, who's retired, is uh really feeling the pressure a lot more than we are. She's been adhering to a strict retirement budget since retiring six years ago, and that budget is now being stretched pretty thin. While she has plenty of financial reserves in place uh — including a very conservative investment portfolio — she's understandably concerned about how this may impact her financial stability down the road. What should someone in her position be doing to adjust?"

Sarah Fister-Gale:

So, Bryan, how does inflation impact those like Hank's mother who are already in retirement and on a fixed income?

Bryan Koepp:

Well, this is a very important question and facing a lot of people, I do say, regionally and nationally. So the first thing that you want to look at are, what are your income sources and ultimately then what are your expenses? The second is regarding other income generating assets. For example, if there is a pension, does that pension have a cost of living adjustment or not? Because if it doesn't have a COLA, a cost of living adjustment, then the purchasing power of the pension dollars becomes less. So it's kind of like the example, again, that a dollar right now would be worth 92 cents in purchasing power if inflation's 8%. So that's where inflation is extremely impactful. So assets like that are important. Another one to think about would be that inflation now drives the price of maintenance up, which drives the price of rent up, and invariably, that could be a line item in regards to the overall picture for a fixed income retiree. So those are important considerations.

Then we get to investments. So the first thing that I would always recommend here is you don't simply do wholesale changes because of the current economic situation, because there's so many factors that go into that. You need to be really, really careful with that. Secondly would be understanding risk profile in the sense that you could be too risk adverse to generate the income necessary to meet the lifestyle that you have. So right now, for example, bonds are not necessarily a safe haven to generate the income in retirement necessary for a lot of people. So it forces fixed income individuals to have to go into the stock market for dividends and other things to meet the income needs that they have. Those situations are always individual and case by case. And so you need to have that discussion. You can't just take a blanket solution and say, stocks good, bonds bad, and make a change to your portfolio.

So, continue to readdress, don't make changes for the sake of making changes, but be tactical for a specific reason. And invariably, that is how I believe you navigate a really, in essence, tough question for savers, but also individuals that are on fixed incomes in the inflationary environment that we're in.

Sarah Fister-Gale:

And what about the people who are getting close to retirement age? Should they also be reevaluating their plans?

Bryan Koepp:

Well, I think it's always good again, to reevaluate your plan anyway, as you approach your retirement target date. And so what I would recommend is always running a couple of scenarios to say, best case and worst case, and do a number of what ifs to determine some of the curves that life could throw. And as we addressed before, not necessarily think about it as percentage increases to your budget in retirement annually, but more about hard dollar values and seeing those increase over time. Standard of living is extremely important and it should be. So I think the goal should be to maintain that, but maintaining that with guardrails and definition. So again, it's testing the short term for the long term goal and continuing to monitor it. But what I would definitely say though, is that the news of the day does not necessarily mean do a full wholesale change of your retirement goal or retirement plan, but it's good to evaluate it honestly, to give yourself, again, the best chance to be successful.

And I'll mention one other thing, quantitative and qualitative. You can do quantitative testing all day long, and you can do probability analysis that says you have a 93% likelihood of meeting the goals that you have in retirement. That's fine. You need to think about both sides of that equation to give yourself the best life plan and not necessarily just going by the analytical statistics that could come out of a financial plan. And then the retest and reevaluate as time goes along to make sure that you're tracking correctly.

Sarah Fister-Gale:

Thank you for that. So as you know, in each of these episodes, we like to ask our guests to share some key takeaways. What key takeaways can you offer our listeners about how to think about and plan for inflation?

Bryan Koepp:

So I always like to think about things in three. So here would be three key takeaways from our time together today. I think number one, we've lived through levels of high inflation before, so inevitably, it's going to stabilize. Inflation's going to stabilize. Even though there's a number of economic and political factors at play right now, we live in a world and in a country that has a strong economy, and invariably don't overreact to the day to day. Second, it's really important to maintain optimism. If you were to remove yourself from the markets during COVID or in 2008 during the financial crisis, you likely took a significant loss. Those losses rebounded very, very quickly, and if you weren't in the market, you wouldn't have been able to participate in those. Monitor, but don't overreact, maintain optimism. And third, it's always a great time now to prioritize. That allows for you to have a targeted laser focus on the things that are most important regarding your wants and needs. And that's going to allow for you, in essence, to generate positive energy as you achieve those things that are most important to you.

Sarah Fister-Gale:

Excellent. That is great advice. And it's always such a pleasure to talk with you, Bryan.

Bryan Koepp:

My pleasure as always.

Sarah Fister-Gale:

And thank *you* for joining us today. We'll be covering a lot of timely topics this season, from cryptocurrency to capital gains taxes, so don't forget to subscribe to Regions Wealth Podcast on Spotify, Apple Podcasts, Pandora, or your favorite podcast platform. To explore the first three seasons in this series, visit regions.com/wealthpodcast.

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