The Retirement Group LLC
PARTNERS IN RETIREMENT

RISING INTEREST RATES

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The connection between interest rates and the "*Effects of Inflation*" is fundamental, and monitoring their fluctuations is important.

Interest Rates

In recent years, the Federal Reserve has been gradually raising the benchmark federal funds rate, with the exception of 2019. The Federal Open Market Committee (FOMC) attempts to influence inflation and economic growth by controlling interest rates. Consumers and investors should be aware of the impact of increasing interest rates.

With 2019's the target federal funds rate at 1.5% to 1.75%, lump sum payouts may have gone up by as much as 5% or more. Therefore, It is critical to review your retirement plan with a financial professional." They will help explore the optimal pension benefits.

What is The Federal Funds rate?

The federal funds rate is the interest rate at which banks lend money to each other overnight to maintain legally required reserves. The reserves are a percentage of a bank's deposits required to be kept on hand. Therefore, when one bank does fall below the minimum, another bank lends them funds near the federal funds rate. This instrument serves as a benchmark for short-term rates and influences longer-term rates as well.

In terms of your retirement benefits, the federal funds rate influences how your payout is calculated. In addition, your hire/rehire/retirement date may alter whether you are grandfathered in to receive specific rates.

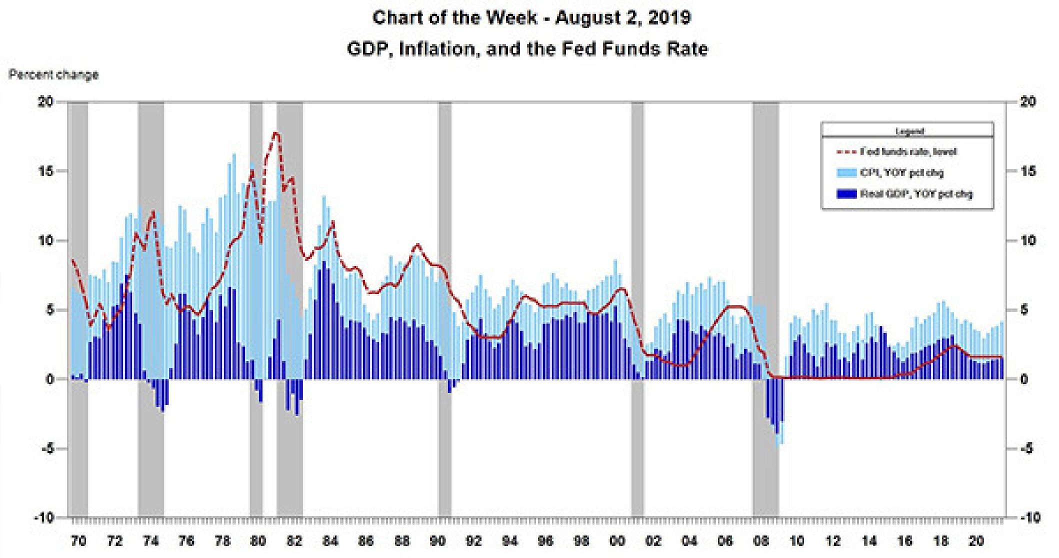
Why does the Fed adjust the Federal Funds Rate?

The Federal Reserve and FOMC aim to maximize employment and maintain price stability through monetary policies. Adjusting the federal funds rate allows the central bank to affect economic growth and inflation. The FOMC raises the federal funds rate in an effort to slow the economy and delay inflation, which can rise rapidly if an economy grows too quickly. As a guideline, the Fed has set a 2% annual inflation rate as healthy economic growth.

For example, in December 2008 (the most recent recession), the FOMC dropped the federal funds rate to a 0.00% to 0.25% range in an effort to stimulate the economy and generate job growth. The recovery has been slow and inflation remains low until recent years, so the FOMC has incrementally raised the target.

Lately, with signs of a strong economy like low unemployment rates, the FOMC justified raising the federal funds rate while inflation remains below 2%. In the future, the Fed aims to move inflation and interest rates to a “normal” environment in hopes of a smooth transition from emergency measures.

Note: Notice the years of dramatic change (1980's/2008) and recall your experience, how were you affected?



To find out more information on Lump Sum vs. Annuity pension benefits, click on our e-brochure *"Lump Sum vs. Annuity"*.

How does Rising Interest Rates affect Pensions?

In defined benefit plans, current and future retirees are offered a lump sum payout or a lifetime monthly pension benefit. Often these plans have billions of dollars worth of unfunded pension liabilities and in order to get the liability off the books, they pay the lump sum.

Depending on lifespan, the initial lump sum is typically less money than regular pension payments over an entire retirement. However, if interest rates increase by 1% it could decrease the lump sum offer by approximately 8-10%. Conversely with the three most recent drop in interest rates, Q1 2020 will have the highest lump sum pension benefits in years. Other factors such as income needs, need for survivor benefits, and tax liabilities often dictate the decision to take the lump sum.

"Every pensions situation is different, so a cash flow analysis will reveal how a pension choice will affect you now and 30 years out".

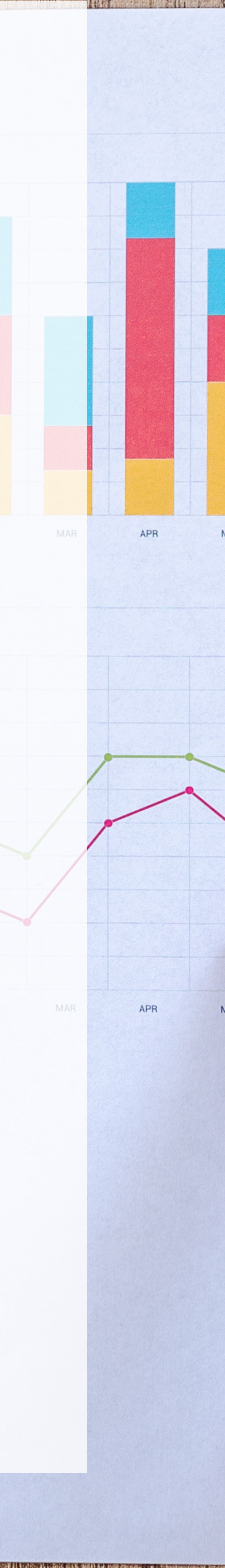
What about Investments

Interest rate changes can have broad effects on investments, but the impact tends to be more pronounced in the short term as various markets adjust to the new level.

The bond market in particular is directly affected by interest rate changes. Bonds are loans issued by an entity to raise capital. The purchaser of the bond pays the face value (usually $1,000), and this amount is redeemed at the maturity date, along with possible coupon payments incrementally. When interest rates rise, the value of existing bonds fall because investors prefer newer bonds paying a higher interest rate than past bonds paying a lower rate. Longer-term bonds tend to fluctuate more in price due to the uncertainty of yields in the future and reluctance to lock up money.

Equities are more indirectly affected by interest rate fluctuations. Earnings potential more or less directs stock prices, so a stable economy benefits the overall market most. On the other hand, companies that borrow heavily will face high costs as interest rates rise, hurting their bottom line.

When the market fails to predict or confirms Fed interest rate changes, markets react temporarily. The economic performance with the new adjustment is critical. As long as the fundamentals of the economy doesn't drastically change, our long-term perspective and investment decisions will uphold financial goals, time horizons, and risk tolerance.

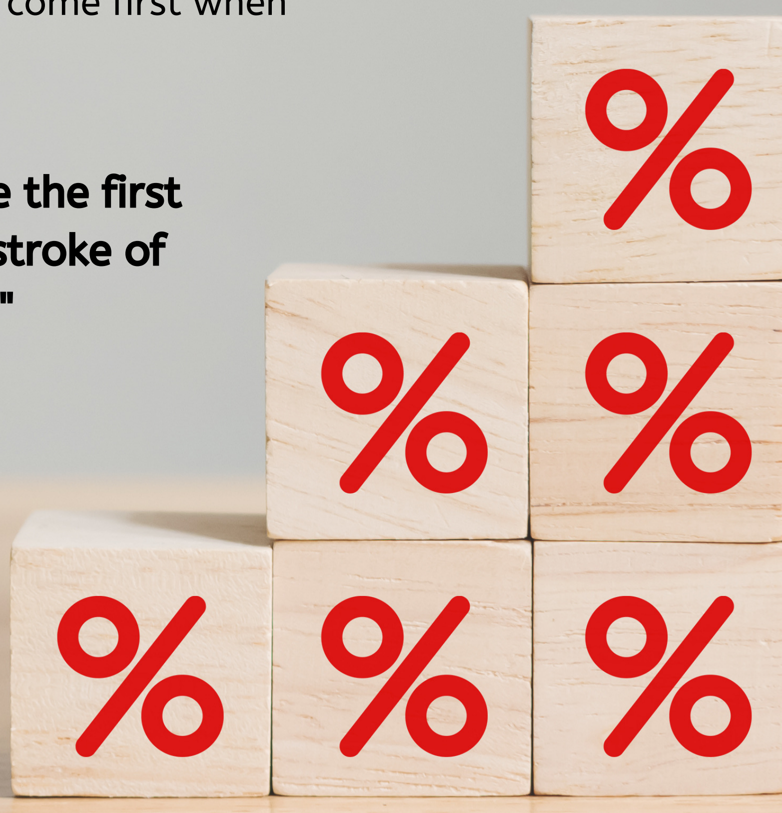


How will Consumer Interest Rates be affected?

The prime rate, or the rate at which commercial banks charge their most creditworthy customers, is usually tied directly to the federal funds rate. Actual rates vary greatly for small-business loans, adjustable rate mortgages, home equity lines of credit, auto loans, credit cards, and other forms of consumer credit. All of these types of credit are linked to the prime rate, so they increase simultaneously with the federal funds rate.

On the bright side, with rising interest rates making it more expensive for consumers and businesses to borrow, retirees benefit from higher yields on savings accounts and CDs. Even though banks raise rates faster on charging loans than on paying deposits, theoretically savers will come first when banks have to compete for deposits.

"So far, persistently low rates are the first lucky break for Millennials and stroke of bad fortune for Boomers"



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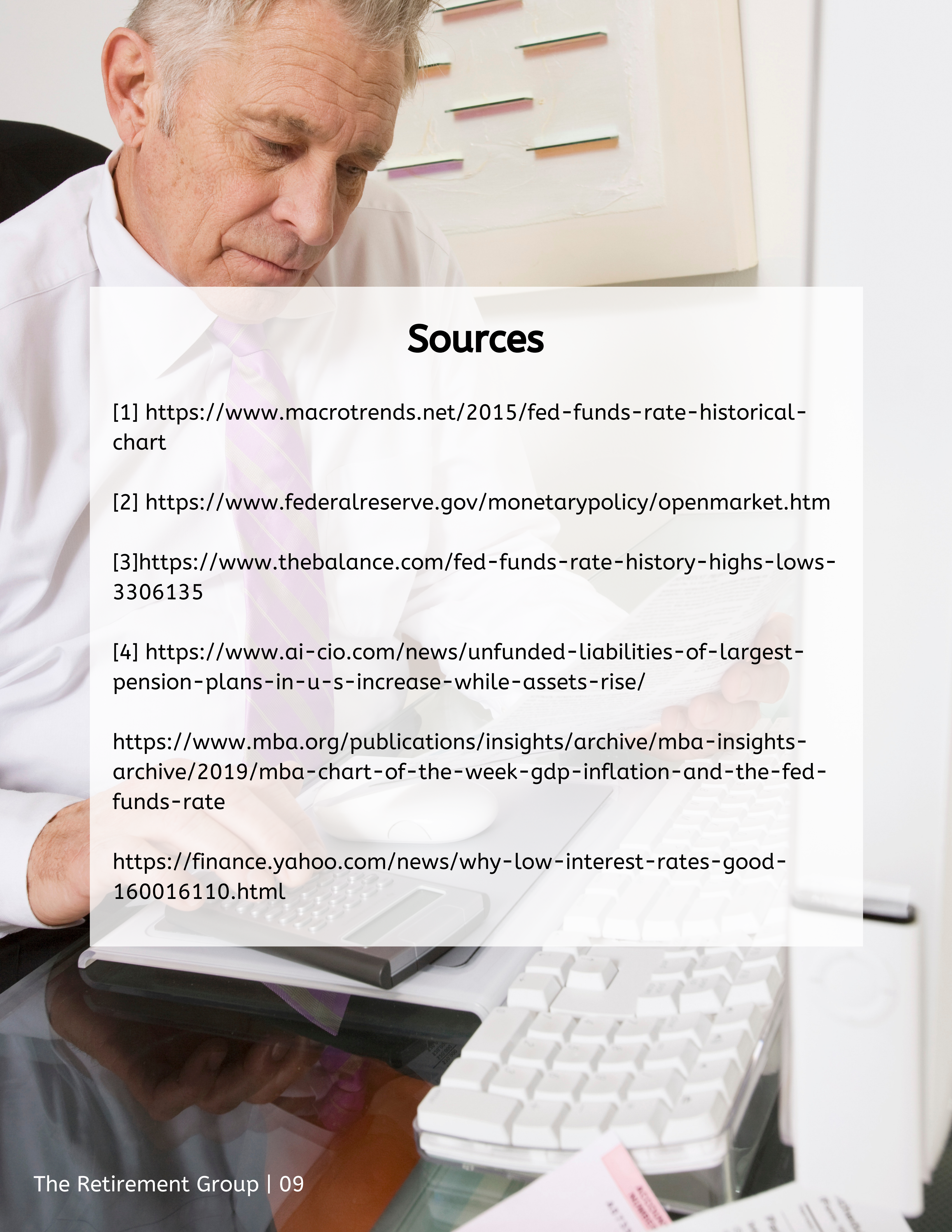

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For more financial information, check out these resources...

What has worked in Investing

Determining Cash Flow Need in Retirement

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