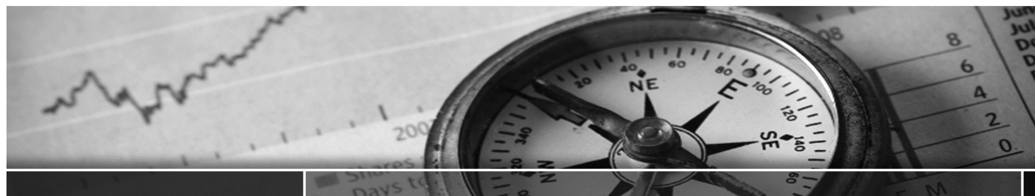

Farmers Trust Company

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Deal or No Deal?

After months of "getting close to a deal" with China, the trade negotiations between the Trump administration and Chinese officials seem to have hit a bit of a speed bump. As it happens, this has caused the equity markets to hit a bump as well, after a low-volatility rise in April took the S&P 500 index to a new all-time high. Meanwhile, interest rates have remained stubbornly low with the yield on a 10-year Treasury note back below 2.5%. The past week's equity market volatility notwithstanding, the bond market and the stock market have been sending divergent signals for much of 2019. Both the overall level of interest rates, as well as the shape of the yield curve (short rates versus longer-term rates), are suggesting that fixed income investors are less convinced than equity investors that a re-acceleration of economic growth is in the offing. One could argue, however, that low rates are part of the equation keeping valuation levels on stocks at the higher end of their historical range. This is especially true when it comes to "growth" stocks whose cash flows are presumably going to be much larger farther out into the future.

One of the consequences of all the geopolitical theater is that it distracts many investors from the actual dynamics unfolding throughout the global economy. We continue to see the next several quarters being characterized by a slowdown in year-over-year economic growth alongside upward inflationary pressures. This is not an environment that makes the Federal Reserve Bank’s job very easy, and it will likely lead to more volatility in the financial markets, both on the downside as well as the upside. It also makes being allocated to the right sectors very important, as this environment tends to create the widest level of dispersion between various types of assets.

Our sector-level recommendations have held relatively consistent over the past several months. One should favor inelastic demand via the Energy sector while avoiding elastic demand in the Materials sector. Overweight price setters like the Real Estate sector while underweighting price takers like the Consumer Staples sector. Lastly, invest in stable cash flows from Utility stocks while limiting your exposure to unstable cash flows in Financial stocks.

Farmers Trust Company May 2019 Newsletter

How Does the Federal Reserve Affect the Economy?

How to Recover from a Mid-Life Financial Crisis

How much money should a family borrow for college?

What is a college income-share agreement?

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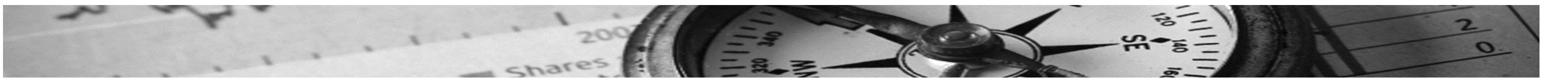


How Does the Federal Reserve Affect the Economy?

The Fed's mission

The Federal Reserve is the central bank of the United States. Its mission is to provide the nation with a safer, more flexible, and more stable monetary and financial system. For more information on the Federal Reserve, visit [federalreserve.gov.](federalreserve.gov)

FOMC meeting schedule

The Federal Open Market Committee meets eight times a year. Scheduled FOMC meetings in 2019: January 29-30, March 19-20, April 30-May 1, June 18-19, July 30-31, September 17-18, October 29-30, and December 10-11.

If you follow financial news, you've probably heard many references to "the Fed" along the lines of "the Fed held interest rates," or "market watchers are wondering what the Fed will do next." So what exactly is the Fed and what does it do?

What is the Federal Reserve?

The Federal Reserve — or "the Fed" as it's commonly called — is the central bank of the United States. The Fed was created in 1913 to provide the nation with a safer, more flexible, and more stable monetary and financial system.

Today, the Federal Reserve's responsibilities fall into four general areas:

- Conducting the nation's monetary policy by influencing money and credit conditions in the economy in pursuit of full employment and stable prices
- Supervising and regulating banks and other important financial institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers
- Maintaining the stability of the financial system and containing systemic risk that may arise in financial markets
- Providing certain financial services to the U.S. government, U.S. financial institutions, and foreign official institutions, and playing a major role in operating and overseeing the nation's payments systems

How is the Fed organized?

The Federal Reserve is composed of three key entities — the Board of Governors (Federal Reserve Board), 12 Federal Reserve Banks, and the Federal Open Market Committee.

The Board of Governors consists of seven people who are nominated by the president and approved by the Senate. Each person is appointed for a 14-year term (terms are staggered, with one beginning every two years). The Board of Governors conducts official business in Washington, D.C., and is headed by the chair (currently, Jerome Powell), who is perhaps the most visible face of U.S. economic and monetary policy.

Next are 12 regional Federal Reserve Banks that are responsible for typical day-to-day bank operations. The banks are located in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. Each regional bank has its own president and oversees thousands of smaller member banks in its region.

The Federal Open Market Committee (FOMC) is responsible for setting U.S. monetary policy. The FOMC is made up of the Board of Governors and the 12 regional bank presidents. The FOMC typically meets eight times per year. When people wait with bated breath to see what the Fed will do next, they're usually referring to the FOMC.

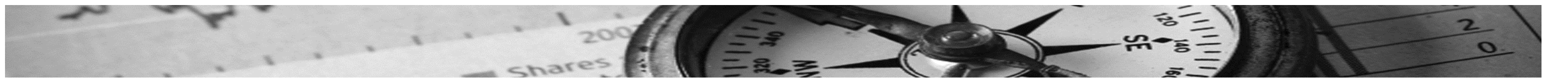
How does the Fed impact the economy?

One of the most important responsibilities of the Fed is setting the federal funds target rate, which is the interest rate banks charge each other for overnight loans. The federal funds target rate serves as a benchmark for many short-term interest rates, such as rates used for savings accounts, money market accounts, and short-term bonds. The target rate also serves as a basis for the prime rate. Through the FOMC, the Fed uses the federal funds target rate as a means to influence economic growth.

To stimulate the economy, the Fed lowers the target rate. If interest rates are low, the presumption is that consumers can borrow more and, consequently, spend more. For instance, lower interest rates on car loans, home mortgages, and credit cards make them more accessible to consumers. Lower interest rates often weaken the value of the dollar compared to other currencies. A weaker dollar means some foreign goods are costlier, so consumers will tend to buy American-made goods. An increased demand for goods and services often increases employment and wages. This is essentially the course the FOMC took following the 2008 financial crisis in an attempt to spur the economy.

On the other hand, if consumer prices are rising too quickly (inflation), the Fed raises the target rate, making money more costly to borrow. Since loans are harder to get and more expensive, consumers and businesses are less likely to borrow, which slows economic growth and reels in inflation.

People often look to the Fed for clues on which way interest rates are headed and for the Fed's economic analysis and forecasting. Members of the Federal Reserve regularly conduct economic research, give speeches, and testify about inflation and unemployment, which can provide insight about where the economy might be headed. All of this information can be useful for consumers when making borrowing and investing decisions.



How to Recover from a Mid-Life Financial Crisis

Only 48% of workers ages 45 to 54 are confident that they will have enough money to last throughout their retirement.

Source: 2018 Retirement Confidence Survey, Employee Benefit Research Institute

A financial crisis can be scary at any age, but this is especially true when you're in your 40s or 50s. Perhaps you're way behind on saving for retirement or have too much debt from unnecessary spending. Or maybe an unexpected challenge, such as a job loss, illness, or break from the workforce for caregiving responsibilities, took a direct hit on your finances.

Regardless of how you got to this point, it's important to develop a strategy that will help you re-establish financial stability.

Regain control

Start by accepting the reality of your situation. This may be easier said than done when you'd rather avoid the anxiety, stress, and guilt that you may feel when you have money issues. It's okay to feel these negative emotions as part of the recovery process. They are likely to pass with time as you come up with a plan to regain control.

Review your spending

Another step is to create a budget to help establish a positive cash flow. If you're spending more money than you earn, you'll need to cut back on your discretionary spending immediately. If you've made cuts and your monthly income still isn't enough, you'll need to figure out a way to cut your fixed expenses or increase your income.

Reduce your debt

It's likely that debt is one of the reasons why you're facing a financial crisis. One survey found that people between the ages of 45 and 54 reported the highest amounts of debt overall, totaling $134,600.[1]

To reduce your overall debt, identify the amount and interest rate for each obligation you have. Then tackle it by paying off the debt with the highest interest rate first, then the next highest, and so on.

You might also consider restructuring your debt. This involves negotiating new repayment terms with creditors so you can meet your monthly expenses and pay off your debts within a reasonable amount of time. If you can't afford to hire a professional credit counselor to help you manage or restructure your debt, check with your local Consumer Credit Counseling Service (CCCS) office or another nonprofit credit counseling service to receive assistance at low or no cost.

You should also consider other options, such as seeking part-time work for extra income or liquidating assets, that can help you pay off debt more quickly.

Rebuild your funds

Chances are you've drained your emergency savings fund. If so, you'll need to build it back up. Otherwise, you'll risk racking up credit card debt or dipping into your retirement savings when the next crisis hits.

It's okay to start small. Set aside a percentage of your paycheck each pay period to go into your cash reserve. Continue adding money after reaching your goal.

Revisit your financial relationships

In order to prevent another financial crisis, what changes will you need to make to your current financial relationships? Consider the following.

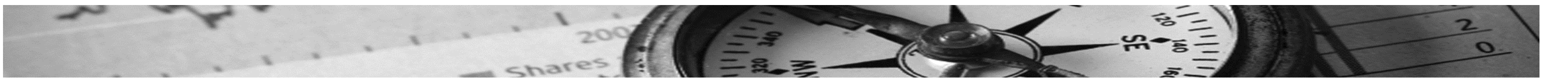
- **Career.** Do you need to increase your income with a second or a part-time job? Is there room for growth in your current career, or should you consider additional education or training to help boost your earnings?
- **Home.** Do you currently live in an expensive location? Does it make sense to downsize your home or move to a lower-cost area?
- **Family.** If you're financially supporting adult children, can you reduce or discontinue it? Similarly, if you support your elderly parents, can your adult sibling(s) share the financial burden of care?
- **Habits.** Do you overspend to reward yourself? Are you an emotional shopper? Do you buy things you actually want, or are you just trying to keep up with the Joneses?
- **Health.** Can you make a lifestyle change to improve your health to help avoid future issues and potentially reduce medical costs?

Some of these changes will require careful research (e.g., moving or changing careers), whereas others can be easier to implement (e.g., avoiding shopping sprees or reducing aid to adult children).

Reassess your finances periodically

As you get back on the right financial track, it's critical to monitor your progress. Failure to do so in the past might have contributed to your crisis, so make it a habit to periodically review your finances. You might benefit from working with a financial professional who can help you stay on track with your financial goals as your situation changes.

[1] 2016 Survey of Consumer Finances, Federal Reserve Board (most recent data available)



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How much money should a family borrow for college?

There is no magic formula to determine how much you or your child should borrow for college. But there is such a thing as borrowing too much. How much is too much? One guideline is for students to borrow no more than their expected first-year starting salary after college, which, in turn, depends on a student's particular major and/or job prospects.

But this guideline is simply that — a guideline. Just as many homeowners got burned in the housing crisis by taking out larger mortgages than they could afford, families can get burned by borrowing amounts for college that seemed reasonable at the time but now, in hindsight, are not.

Keep in mind that student loans will need to be paid back over a term of 10 years (possibly longer). A lot can happen during that time. What if a student's assumptions about future earnings don't pan out? Will student loans still be manageable when other expenses like rent, utilities, and/or car expenses come into play? What if a borrower steps out of the workforce for an extended period of time to care for children and isn't earning an income? There are many variables, and every student's situation is different. A loan deferment is available in certain situations, but postponing loan payments only kicks the can down the road.

To build in room for the unexpected, a smarter strategy may be for undergraduate students to borrow no more than the federal student loan limit, which is currently $27,000 for four years of college. Over a 10-year term with a 5.05% interest rate (the current 2018-2019 rate on federal Direct Loans), this equals a monthly payment of $287. If a student borrows more by adding in co-signed private loans, the monthly payment will jump, for example, to $425 for $40,000 in loans (at the same interest rate) and to $638 for $60,000 in loans. Before borrowing any amount, students should know *exactly* what their monthly payment will be. And remember: Only federal student loans offer income-based repayment (IBR) options.

As for parents, there is no one-size-fits-all rule on how much to borrow. Many factors come into play, including the number of children in the family, total household income and assets, and current and projected retirement savings. The overall goal, though, is to borrow as little as possible.

What is a college income-share agreement?

A college income-share agreement, or ISA, is a contract between a student and a college where a student receives education funding from the college today in exchange for agreeing to pay a percentage of future earnings to the college for a specified period of time after graduation. The idea behind ISAs is to minimize the need for private student loans, to give colleges a stake in their students' outcomes, and to give students the flexibility to pursue careers in lower-paying fields.

Purdue University was the first college to introduce such a program in 2016. Under Purdue's ISA program, students who exhaust federal loans can fund their education by paying back a share of their future income, typically between 3% to 4% for up to 10 years after graduation, with repayment capped at 2.5 times the initial funding amount.[1]

A handful of other colleges also offer ISAs; terms and eligibility requirements vary among schools.

ISAs are considered friendlier than private student loans because they don't charge interest, and monthly payments are based on a student's income. Typically, ISAs have a minimum income threshold, which means that no payment is due if a student's income falls below a certain salary level, and a payment cap, which is the maximum amount a student must pay back relative to the initial funding amount. For example, a payment cap of 1.5 means that a student will pay back only 1.5 times the initial funding amount. Even with a payment cap, a student's payment obligation ends after the stated fixed period of time, regardless of whether he or she has fully paid back the initial loan.

[1] *U.S. News & World Report,* September 26, 2018

1 COLLEGE GIVES FUNDS TO STUDENT

2 STUDENT USES FUNDS TO COMPLETE SCHOOL

3 STUDENT GETS JOB AFTER GRADUATION

4 STUDENT REPAYS COLLEGE BASED ON INCOME

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