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FINANCIAL FITNESS FOCUS

*Because Money Doesn't Come With Instructions...*SM

Where Are Interest Rates Headed?

Various economic forces affect the level and direction of interest rates in the economy. Interest rates typically climb when the economy is growing and fall during economic downturns. Inflation is one of the more influential forces on interest rates, as rising inflation leads to rising interest rates (although at some point, higher rates themselves become contributors to higher inflation), and moderating inflation leads to lower interest rates.

As the U.S. economy continues its slow but sure recovery, the Federal Reserve will, at some point, begin increasing interest rates. Although inflation is still quite benign, a number of experts are still saying that interest rate increases will happen at some point soon; however, no one seems willing to pin a date on a rate increase. Many analysts believe that this will happen sometime this summer, while others say it will be several months later or even not until the beginning of next year.

What are the consequences of rising interest rates for investors, businesses, households, and the government?

For Investors

Bond investors need to remember that all bonds tend to rise in value when interest rates fall, and they fall in value when interest rates rise. Usually, the longer the maturity, the greater the degree of price volatility. If you hold a bond until maturity, you may be less concerned about these price fluctuations because you will receive the par, or face value, of your bond at maturity. Some investors are confused by the inverse relationship between bonds and interest rates—that is, the fact that a bond's price declines when interest rates rise. But the explanation is essentially straightforward:

- When interest rates rise, new issues come to market with higher yields than older securities, making those older ones worth less. Hence, their prices go down.
- When interest rates decline, new bond issues come to market with lower yields than older securities, making those older, higher-yielding ones worth more. Hence, their prices go up.

As a result, if you have to sell your bond before maturity, it may be worth more or less than you paid for it. Many bond experts are saying that the anticipation of an interest rate increase has already been "priced into the bond market". However, bond investors shouldn't be sanguine, thinking that a minor interest rate increase will not have any adverse effect on their bonds, even if they are shorter-term bonds.

Business investment: When interest rates rise, it costs companies more to borrow money to finance investment in new equipment, expansion of a factory or bringing a new product to development. Thus, productivity and profitability can slow down.
Housing: When it's more costly to borrow money to purchase a home, the demand for new housing falls, and fewer homes are built. Residential investment has been a key factor in recoveries from past recessions, so if interest rates are increased too soon, it could make the recovery even slower.

Consumption of durable goods: Because the cost of financing goes up when interest rates rise, the purchases of goods normally bought on credit fall—think cars, motor homes, and boats.

Interest on the government debt: A hike in interest rates will also increase the cost of financing government borrowings. According to an April 10 *Fortune* article it "would easily add between $1 trillion to more than $2 trillion to America's debt over the next decade, compared to a scenario in which rates remain low." The results would be pressure to raise taxes or cut government programs, either of which would reduce economic activity (though the impact would depend upon the particular taxes raised and programs cut). In addition, there could be a reduction in infrastructure spending even further; thus, higher rates could also be harmful to future economic growth.

Savers and lenders: Higher interest rates help savers and lenders, and hurt those who borrow money (or who borrowed in the past with variable-rate loans).

Exchange rates: The value of the dollar relative to other currencies (of countries where interest rates are lower) tends to increase when interest rates go up due to tightening monetary policy. That hurts American exporters and helps importers with the net result that the balance of trade worsens as exports fall and imports rise.

Finally, if raising interest rates has so many negative effects on consumption, investment, government spending and net exports, why undertake such a policy? The answer is that as the economy recovers and reaches full employment, low interest rates could lead to excess demand, an overheated economy and an outbreak of inflation.

Reducing aggregate demand though an increase in interest rates is intended to keep supply and demand in balance and avoid price increases that lead to inflation. If the timing of the

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"Worries are pointless. If there's a solution, there's no need to worry. If no solution exists, there's no point to worry."

-Matthieu Ricard

Interest Rates (Continued)

interest rate increase is just right, the result is full employment without any increase in inflation.

If the Fed moves too soon in raising rates, it could slow the recovery or even send the economy into a stall. This would create higher unemployment for a longer period of time. If the Fed raises interest rates too late, the risk is inflation. Many experts feel that if the Fed is going to err, the more costly mistake could be to raise interest rates too soon, rather than too late.

Thus, the interest rate conundrum continues for the Federal Reserve Board of Governors. Time will tell if the inflation hawks who want to increase rates sooner rather than later will win out over the doves who advise patience.

(Mark Thoma of *CBS Interactive Inc.* provided many data points for this column.)

For the Entrepreneur... Time for a Business Fire Drill!

No doubt you have seen the bumper stickers which read “Eat dessert first, life is so uncertain” or “Man plans and God laughs”. Unfortunately for organizations and humans beings, the unexpected can cause angst, anxiety, anger and loss, even though the unexpected has always been a part of life.

In the case of a business, wise entrepreneurs use scenario planning to ensure that the business team can anticipate and plan for “surprises” few may be currently equipped to manage. Whether it’s called scenario planning or a “fire drill”, the activity can help individuals to develop skills to survive traumas such as natural disasters, death of the owner, market downturns or other upsetting events.

In a well run business, the most common “fire drill” is the one in which the owner(s) and key employees are asked to pretend that the business leader is dead or severely disabled. Who should be informed? Who steps in and what do they do first? What’s next? Who has access to the bank accounts?

For business owners who have set up a formal board of directors, this particular fire drill is less frightening, as the board is normally responsible for succession planning, especially in the event of an emergency or untimely death of a major shareholder/family member/leader. No doubt all business owners can benefit from holding the what-if-I–die fire drill.

However, beyond addressing an owner’s mortality challenges, key leaders in the business might also do some other scenario planning. Perhaps it would be beneficial for the executive team to work with the owner to develop a plan for their eventual financial and emotional independence from the business. Once the plan is designed, before they leave the business formally, the owner(s) “try it on for size” to see if their plan is practical and will work. In actuality, they apply worst case scenarios to their plan(s). For example, if rental income from the building in which the business operates is a keystone to their personal cash flow, what would happen if business slows down and the younger executives or successor owners ask for rent relief? If there are anticipated note payments from the sale of assets, are the terms manageable and what would be the impact if the successors defaulted on the note payments?

In the event a business has multiple shareholders, another example is to review the shareholders’ agreement to see if there are any potential landmines or if the agreement needs to be amended. For instance, if the current agreement has buy out terms with an interest rate set in 2005 at 10%, is that a reasonable interest rate in today’s financial environment? What would the effect be if the agreement was modified and the interest rate was tied to U.S. Treasury rates for the comparable term of the note/loan?

In light of the financial meltdown in 2008 and early 2009, many entrepreneurs are educating their future leaders to understand investment risk. For example, it’s extremely beneficial to teach future business leaders to avoid the temptation of investing surplus business funds in speculative investments which promise incredible returns because “it’s different this time.”

One final example of planning for the unexpected is for an owner to use scenario planning when selecting a key employee for a leadership position in their business. By putting each key employee into the same scenario that requires critical thinking skills, it will quickly become apparent which of the executive team members could deal much better with turbulence than the others.

By holding business fire drills, a business owner can teach individuals to build skills that help management and ownership systems not only to survive major transitions, but thrive on the challenges that surface in the process.

If you are a business owner, is it time for you to hold your own business “fire drill”?

“There’s nothing like a jolly good disaster to get people to start doing something.”

-Prince Charles

Out and About

At the firm…
In February, Matt hosted 14 local business owners and professionals for an event in the CCMI conference room. It was a great opportunity to connect with the members of Matt's group and allow them to see our wonderful working environment.

In mid-May, Matt and Brian will attend the NAPFA (National Association of Personal Financial Advisors) Spring conference in San Diego.

Also in May, Peg and Bob will attend the FPA (Financial Planning Association) NORCAL conference in San Francisco.

The team is looking forward to serving lunch at Father Joe's Village in mid-June.

Monica has been busy planning future firm educational events. She has been looking at new venues throughout San Diego for upcoming events, including our always popular annual Year in Review, Year in Preview in January.

Jessica has been working on a SEO (search engine optimization) project for the CCMI website with a new vendor. The team is hoping to have the initial work completed by this June.

The entire team has also been working to improve the firm's processes and procedures as follow up work from their annual business planning meeting held this past February at Scripps Seaside Forum.

On the home front…
Matt and his wife Alex are looking forward to a relaxing week in Hawaii in early May. Their daughter Elizabeth loves her ballet class and their son Jacob is enjoying his swim lessons. Jacob turned one in February and the Showleys hosted a party to celebrate. In between the activities, Matt has planted their full vegetable garden for the spring. Toward the end of May, Matt will leave for his 10th annual golf trip with college friends.

Brian's family has been on the go! In February, Brian and his wife Nikki took their two oldest children, Emma and Kainoa, on their first ski trip to Brianhead, UT. The kids had a great time and are looking forward to going back next year. In March, Brian took the two oldest kids camping in Zion National Park where they got to hike and sleep in a tent for a few days.

Maddox Oliver practicing his throwing arm.

Monica and Cole Larson at the St. Augustine Mother-Son Luncheon.

Finally, in April Brian's family went to Disneyland for a few days to celebrate Emma's 8th birthday with Mickey and Minnie.

In anticipation of the arrival of their first child in July, Jessica and her husband Mike have been busy finishing up some home improvement projects. Jessica has been finding time to relax by painting a sea life themed mural for the nursery.

Monica is busy planning a party in May for Cole's high school graduation from St. Augustine. She also spends the occasional Saturday morning with husband Mike at the swap meet looking for fun, funky, vintage finds. Hopefully this busy family of four will find time for vacation in June.

Emily and Kenny are busy planning Maddox's first birthday party, which will be a small gathering of family in late April. Both Kenny and Emily's mothers will be in town to help celebrate.

Wendy is planning for Kris' high school graduation in June. She continues to volunteer at school events when she can to support the programs. Eric continues to fill the house with his piano music and has started to take golf lessons and loves it! Cole traveled with the varsity lacrosse team to the East Coast and enjoyed the team bonding experience.

Peg and Bob spent a relaxing week in Maui in March. In April, they were blessed with their newest grandchild, Elizabeth Margaret Eddy who will go by "Margot". They spent a week in San Francisco helping to care for Margot's big sister Lucy, so the proud parents Sean and Alison could rest and settle in. Jessica and Ryan Eddy adopted a puppy named Duke. Baby daughter Madison has found a fast friend in Duke, who has already taken to napping near her after a long day of mischievous puppy adventures.

"In order to maintain a well-balanced perspective, the person who has a dog to worship him should also have a cat to ignore him."

-Peterborough Examiner

Tax Tips and Planning Pointers

$ ABLE Act

The ABLE Act, short for "Achieving a Better Life Experience," provides the ability to more easily create tax-free savings accounts for individuals with disabilities without compromising their benefits. It was signed into law by President Barack Obama in December 2014. Now the law requires states to create their own regulations before accounts can be officially set up. The Treasury Department still has to finalize regulations sometime later this year. In short, this legislation permits ABLE accounts to be established on behalf of a disabled person to pay for disability-related expenses, including housing, education, employment training, health care and transportation. These accounts may be set up for individuals diagnosed with a qualified disability prior to their age 26 no matter how old they are now. An account balance of up to $100,000 won't impact the beneficiary's eligibility for SSI (Supplemental Security Income) benefits. These accounts can be used in concert with Special Needs Trusts. It is not yet clear what freedom the federal government will give to states to interpret the law. As the provisions of the law are made clearer, any updates will appear in this section of future CCMI newsletters.

$ Financial Calendar

Now that tax season is hopefully behind you, set up your own financial calendar to stay focused on financial fitness during the rest of this year. This calendar will prompt you to pay your estimated income taxes on time, periodically pull a personal credit report, have annual tax planning done, reset your annual budget, plan for large purchases, and check on your 401(k) plan allocation before the end of 2015. There is a variety of financial calendars available either in app form or online.

$ Employee Benefits

Double check on your employee benefits; although enrollment period in the fall may seem far away, researching employee benefit programs such as funding a Flexible Spending Account with pre-tax dollars, or acquiring additional life insurance or disability coverage are good reasons to prepare well in advance for selecting benefits of fourth quarter of 2015.

$ Tax Refunds

If you received a tax refund, before you spend it on some consumer product, consider applying the refund to any credit card balances or bolster your emergency fund. Check your W-4 to make sure your income tax withholding is appropriate for your earnings situation this year so there are no big tax bills due in April of 2016 or to avoid having huge tax refunds –that is money you could have used wisely all year long.

$ Spring Cleaning

Now is the time for spring cleaning. Take stock of your belongings to decide what you still need and what you can donate or resell. Be sure to get a receipt for items donated to qualified charities. To get the inspiration you need to attack closets, drawers, bookcases and the garage, pick up a copy of The Life-Changing Magic of Tidying Up by Marie Kondo.

$ What New on CCMI's website?

Please visit http://www.myccmi.com/ccmi-money-matter/ to read our most recent blog posts:

- Reflections on a Semester in Korea
- The Hidden Costs of Having a Baby
- What to Keep / What to Toss

"All you need is love. But a little chocolate now and then doesn't hurt."

-Charles M. Schulz

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