Your Conservative Advisory Firm Since 1990 *Second Quarter 2016*

Not on My Watch - Keeping a Great Depression at Bay

Could interest rates in the U.S. go negative? If they do, the rationale may be the memory of the Great Depression.

The Great Depression began 90 years ago in the United States as an ordinary recession in the summer of 1929. Today it is remembered primarily in old photographs and movies, and the pain has faded from public memory. The impact of the Great Depression still lingers, however, in the minds of economists, and particularly the minds of the economists who manage the Federal Reserve Bank system. If there is one thing they do not want, it is a rerun of the Great Depression under their watch.

Trying to pin down the cause of the Great Depression has spawned countless books, but at its most basic, people stopped spending. To limit stock market speculation, the Federal Reserve had increased interest rates, which reduced interest sensitive spending. Then the stock market crash reduced wealth and consumer spending substantially. Banking panics in the early 1930s resulted in cash hoarding that wasn't helped when the Federal Reserve also deliberately contracted the money supply and further raised interest rates. The Revenue Act of 1932 increased American tax rates greatly in an attempt to balance the federal budget, and by doing so it dealt another blow to the economy by further discouraging spending.

How bad was the resulting contraction in spending? Between the peak and the trough of the downturn, industrial production in the United States declined 47% percent and real gross domestic product (GDP) fell 30%. (In contrast, during the next worst U.S. recession, 1981-1982, GDP fell 2%.) The U.S. experienced the near-total breakdown of a previously affluent economy for ten hard years. There was nothing romantic about the breadlines, peddlers on street corners, shuttered factories, rural poverty, and so-called Hoovervilles where homeless families sought refuge in shelters of salvaged wood, cardboard, and tin. 2.5 million people fled the Plains states as the Dust Bowl stripped topsoil from the land. Unemployment exceeded 20% in a society where 21% of the workforce was employed in agriculture.

To prevent a second Great Depression, the most common prescription is to keep people spending and limit saving. To keep people spending, the Federal Reserve has two basic strategies - (1) Promote inflation, which feeds the benefit of buying now to avoid paying more in the future. This means avoiding deflation, which would make goods cheaper the longer one waits, and potentially reduce wages. (2) Make saving unattractive. Removing the incentive to save by dropping interest to zero or below is one tool to do so. The catch is the low interest rates have to offset consumer concerns about the direction of the economy. The slow U.S. recovery is one sign that interest rates have limited utility as consumers stubbornly continue to save and spend judiciously.

A Word to Young Investors

You have the investor's best friends at your side - Time and Compounding. The sooner you put them to work for you, the easier it will be to build wealth.

When it comes to investing, the most important tool you have is time. A relatively small investment can become a sizable retirement fund given time and the impact of compounding.

Compounding is the process of earning interest on interest and dividends on dividends, over time. At first, your money grows relatively slowly, then with increasing speed as compounding takes effect.

One of the all-time great examples of the impact of compounding is the question...Which would be the better compensation plan?

- $100,000 per year with 10% annual increases
- One penny the first month, with your pay doubling with each successive month?

In three years, the individual who chose the $100,000 salary with 10% annual increases would have received $331,000 in compensation. The individual who chose the penny and saw her income double each month would have received $343 million dollars. Naturally, that's compounding to an extreme. But the same basic principle holds true at lower rates of appreciation.

The sooner you put your savings and investment plan into action, the longer your money goes to work for you. And the longer compounding has to work its math, the more substantial your nest egg can become.

Suppose you start saving $2,000 a year at age 19 and continue doing so for ten years before you stop adding to your account. At the same time, your twin waits until age 29 to start saving and then sets aside $2,000 a year for the next 36 years until he is 65. If you both earn 7% annually on your account, at retirement your investment of just $20,000 will have compounded to $337,774. Your twin will have invested more than $74,000, but ends up with $318,674, despite saving for 26 more years. The earning leverage of the early years made all the difference.

To enhance the power of compounding, you want to minimize the impact of taxes. After all, every dollar you pay in taxes reduces the amount you have to compound. That's why it's important to invest as much as you can in tax-deferred retirement accounts, or a Roth IRA where earnings accumulate tax free.

Understanding the value of time and compounding is one step toward accumulating a healthy retirement fund, but the most important step is to do something. Until you set up a plan of steady contributions using an investment approach that works for you, you are letting time and the value it can bring slip away.

Nothing happens unless someone does something. Whether it's for your own retirement or a young person's, call me today and let's put a plan in place to build financial security.

The compounding examples cited above are hypothetical and used for illustrative purposes only. Investment results fluctuate and past performance is not indicative of future results. The possibility of loss exists along with the potential for profit.

Sincerely,

Brian R. Carruthers, CFP®, CMT

Brian R. Carruthers & Associates
Your Conservative Advisory Firm Since 1990
301 Forest Avenue
Laguna Beach, California 92651-2115 USA
Telephone: 1-949-464-1900
www.gobcafunds.com
brian@gobcafunds.com

Brian Carruthers & Associates, 301 Forest Avenue, Laguna Beach, CA 92651

SafeUnsubscribe™ {recipient's email}

Forward this email | Update Profile | About our service provider

Sent by brian@gobcafunds.com in collaboration with

Try it free today