POLARIS
WEALTH ADVISORY GROUP

Polaris Perspective

For more information or to schedule an introductory consultation contact us at: info@polariswealth.com I (800) 268-9046 I www.polariswealth.com

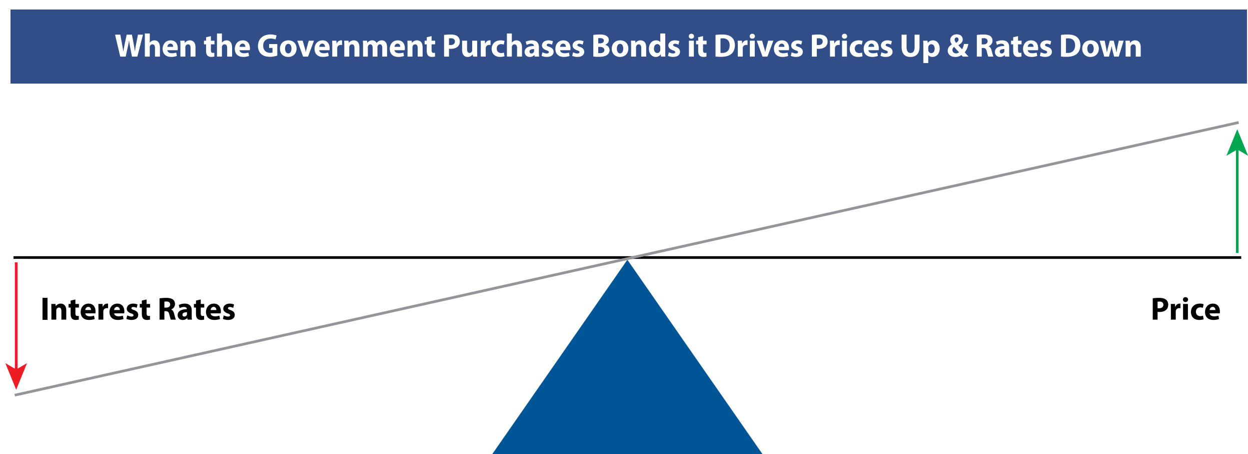
Tapering

If you have been reading the news, you've heard talk about "tapering." The media and analysts alike are asking, "When should the Fed begin tapering?" The better questions are: What exactly is tapering? Why should we care about it? What financial impact might it have on you as an investor?

What is Tapering?

In order to understand tapering, it is imperative to understand a little bit about how the Federal Reserve works. One of the Federal Reserve's jobs is to ensure the stability of our country's financial system, including containing systemic risks in our financial markets. They have historically done this by controlling the overnight lending rates to banks, called Fed Fund Rates, and by controlling liquidity at the bank by requiring banks to hold a specific amount of money in cash at the bank, called reserves.

During the Great Recession the Federal Reserve did something it had never done before; it began buying treasuries on the open market. A new financial term surfaced, called "quantitative easing." Why did they resort to buying our own bonds? It was a last resort effort that had two positive impacts on our economy. First, it added liquidity into our market. If someone buys something from you, they get the item, you get cash. When the government bought bonds, it put cash in the market. The second impact is the additional demand drives prices up and yields down. As you can see from the illustration, there is an inverted relationship between bond prices and yields. The additional demand forced the prices of bonds up, which meant that yields dropped.



A significant amount of lending is based upon the 10-year treasury. When yields drop on the 10-year treasury it means the cost of borrowing is going down. Lowering borrowing costs translates into higher profit margins or a reallocation of how one is spending their money. Quantitative easing stimulated the economy by adding liquidity into the markets and it made borrowing less expensive.

Polaris Wealth Advisory Group is a federally registered investment advisor. The information, statements, and opinions expressed in this material are provided for general information only and are subject to change without notice. This material does not take into account your particular investment objectives, financial situation, or needs, is not intended as a recommendation to purchase or sell any security, and is not intended as individual or specific advice. Investing involves risk and possible loss of principal capital. Diversification does not ensure a profit or protect against a loss. Past performance is no guarantee of future returns. Advisory services are only offered to clients or prospective clients where Polaris Wealth Advisory Group and its representatives are properly licenses or exempt from licensure. No advice may be rendered by Polaris Wealth Advisory Group unless an investment management agreement is in place.

POLARIS
WEALTH ADVISORY GROUP

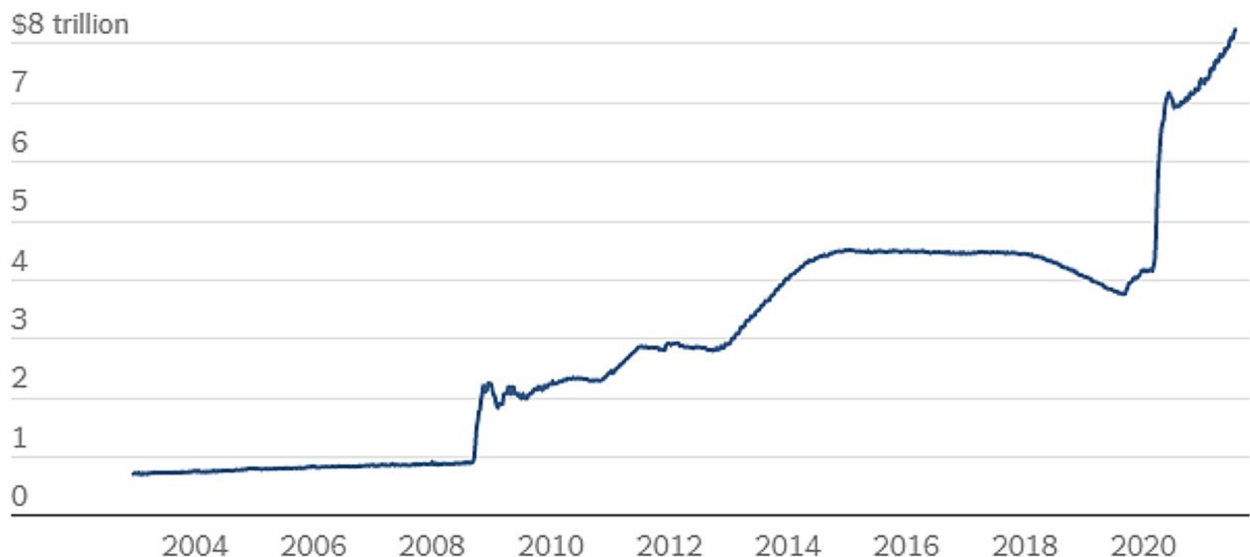
Polaris Perspective

For more information or to schedule an introductory consultation contact us at: info@polariswealth.com I (800) 268-9046 I www.polariswealth.com

Continuing our lesson, the Federal reserve continued to purchase bonds from 2008 until finally ending their purchase program during the 4th quarter of 2014. They amassed a $4.5 trillion portfolio of fixed income during this six-year buying spree.

Governments around the world shuttered their windows and shut down in an attempt to control the spread of the worldwide pandemic. We immediately spiraled into a massive recession. Our government acted with never seen before speed to support the economy. The Fed dropped rates to zero percent and immediately bought several trillion bonds to secure this market. They then restarted their bond purchase program.

Currently, the Federal Reserve is purchasing $120 billion of bonds per month. As you can see in the chart provided, the Federal Reserve now has a portfolio of over $8 trillion in bonds.



Source: Federal Reserve • By The New York Times

Why Should I care about it?

The current bond purchase program has provided needed stability and liquidity during the worldwide pandemic. The trillions spent buying bonds was a necessary evil given the circumstances. The issue is adding this kind of stimulus and liquidity to the economy can quickly turn into inflation. The Federal Reserve is tasked with operating with incomplete and delayed information. A misstep by the Federal Reserve could have a material impact on our economy.

Polaris Wealth Advisory Group is a federally registered investment advisor. The information, statements, and opinions expressed in this material are provided for general information only and are subject to change without notice. This material does not take into account your particular investment objectives, financial situation, or needs, is not intended as a recommendation to purchase or sell any security, and is not intended as individual or specific advice. Investing involves risk and possible loss of principal capital. Diversification does not ensure a profit or protect against a loss. Past performance is no guarantee of future returns. Advisory services are only offered to clients or prospective clients where Polaris Wealth Advisory Group and its representatives are properly licenses or exempt from licensure. No advice may be rendered by Polaris Wealth Advisory Group unless an investment management agreement is in place.

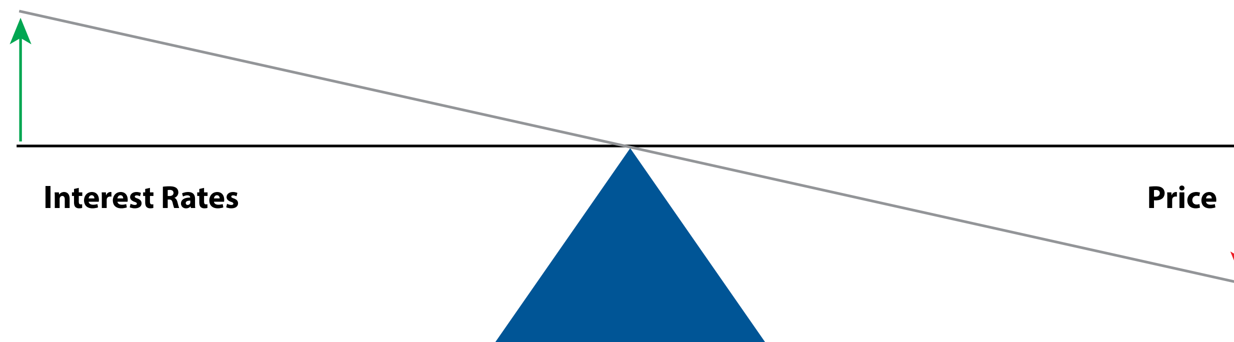
POLARIS
WEALTH ADVISORY GROUP

Polaris Perspective

For more information or to schedule an introductory consultation contact us at: info@polariswealth.com | (800) 268-9046 | www.polariswealth.com

At the Federal Reserve's annual Jackson Hole symposium, Chairman Jerome Powell stated that the central bank will most likely begin tapering before the end of the year. Several of the Federal Reserve regional Presidents have been even more vocal about the need to begin considering the tapering sooner. There are good and bad repercussions to this move. The most obviously positive thing from tapering is knowing that the Federal Reserve wouldn't make such a move if the economy was not on solid enough ground to begin the tapering process. The challenge of tapering will be the bond markets reaction. With lowering demand, it is likely that we will see bond prices drop (as seen in the example provided).

If the Government Tapers Their Purchases, Prices Will Drop & Interest Rates Will Go Up



What is the Financial Impact to You?

The debate isn't whether the Federal Reserve will continue buying $120 billion in bonds each month, the question is really when they should start cutting back (or taper) on their monthly bond purchase. If we follow the play book that the Federal Reserve used the last time, they "tapered" a bond buying program it took them over a year from announcing that they were going to cut back on buying bonds to ending the bond buying program entirely. It also led to the "taper tantrum" of 2013. We experienced a spike in interest rates and added volatility in the stock market when the Federal Reserve announced the cut back.

So how do we learn from lessons learned in days past and prepare our portfolios for what seems an inevitable move made by the Federal Reserve?

First, bond investors beware. Less demand for bonds means that prices should drop. The further out the maturity of the bond, the bigger the price drop. Once the Federal Reserve has completely stopped their purchasing of bonds it is predicted that they will try to normalize Fed Fund Rates. In English this means that once they are done buying bonds, they will start raising interest rates. None of this bodes well for bond investors.

Polaris Wealth Advisory Group is a federally registered investment advisor. The information, statements, and opinions expressed in this material are provided for general information only and are subject to change without notice. This material does not take into account your particular investment objectives, financial situation, or needs, is not intended as a recommendation to purchase or sell any security, and is not intended as individual or specific advice. Investing involves risk and possible loss of principal capital. Diversification does not ensure a profit or protect against a loss. Past performance is no guarantee of future returns. Advisory services are only offered to clients or prospective clients where Polaris Wealth Advisory Group and its representatives are properly licenses or exempt from licensure. No advice may be rendered by Polaris Wealth Advisory Group unless an investment management agreement is in place.

Polaris Perspective

For more information or to schedule an introductory consultation contact us at: info@polariswealth.com I (800) 268-9046 I www.polariswealth.com

Higher interest rates can have an impact on real estate values. For example, rising interest rates can have a negative impact on single family home prices. New buyers need new lending. Simple economics would tell you that if there is a higher cost to carry debt, there will be less investors. Less buyers of properties means a drop in prices. It has the opposite impact on rental properties. Less buyers mean more renters. More renters mean higher rents and higher values for these properties. Cheap money, as we've had for 18 months, typically means all real estate rises in price. A rising interest rate environment adds to the complexity of owning real estate. Speak with your Polaris Wealth advisor to learn how it might impact you directly.

Rising interest rates typically slow down the broader economy. As we've discussed, higher interest rates make borrowing more expensive. Higher borrowing rates takes money out of the economy that would have been spent by individuals and corporations. For example, if more of your income is going to pay a higher mortgage rate, then you have less money to spend on discretionary purchases. This could impact companies that are reliant on individual clients. Retail stores would be a good example of companies potentially impacted. If you are spending a few hundred dollars more for your mortgage, that's money that can't be spent on clothes. Companies carrying short-term debt could also be impacted by rising rates. Their increased cost of debt could impact their profit margins.

Conclusion

The past eighteen months have been anything but normal. We do have a few historical mile markers to work from but for the most part we are in uncharted waters. This means we are reliant on good old fashion clinical portfolio management. This means that we rely on our four pillars of investing, fundamental research, technical research, macro-economic research, and following sentiment trends. Being clinical will be crucial in navigating this next chapter of investing. I am confident in our team to successfully get our clients through these uncertain times, while meeting their financial goals.

We are happy to revisit your holdings here at Polaris Wealth or give you a second opinion on how you are investing away from us. Please feel free to reach out to your Polaris Wealth advisor to schedule a meeting.

Polaris Wealth Advisory Group is a federally registered investment advisor. The information, statements, and opinions expressed in this material are provided for general information only and are subject to change without notice. This material does not take into account your particular investment objectives, financial situation, or needs, is not intended as a recommendation to purchase or sell any security, and is not intended as individual or specific advice. Investing involves risk and possible loss of principal capital. Diversification does not ensure a profit or protect against a loss. Past performance is no guarantee of future returns. Advisory services are only offered to clients or prospective clients where Polaris Wealth Advisory Group and its representatives are properly licenses or exempt from licensure. No advice may be rendered by Polaris Wealth Advisory Group unless an investment management agreement is in place.