LIBERTY
Asset Management, Inc.

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Inflation, et al.

To some extent, most of us are familiar with the concept of price inflation. We see its impact over the years as the prices of our purchases slowly increase. However, "inflation" is just one member of a whole family of terms. Here are some of the most important "-flation" words and what they mean for you and the economy.

Inflation: Inflation occurs when the cost of goods and services rises, resulting in a loss of purchasing power. This can be the result of more currency being circulated in an economy or an increasing pace of economic growth. In the United States, the Federal Reserve targets a 2 percent inflation rate to promote steady growth, easy borrowing and predictable pricing.

Deflation: Deflation is when the general cost of goods and services falls. It is typically caused by a slowing economy or a widespread drop in production costs. Unlike inflation, the Federal Reserve does not recognize deflation as part of a healthy economy and tries to avoid it. When people believe prices are going to fall, they delay their purchases until things become cheaper. If this behavior becomes routine, it can lead to a "deflationary spiral," where postponed consumption slows the economy, lowers demand and forces prices to continue falling. Notably, Japan has struggled with deflation repeatedly since the end of its economic boom in the early 1990s.

Stagflation: Coined during the Energy Crisis of the 1970s, stagflation is the uncommon event when an economy simultaneously experiences limited growth and rising prices. During that crisis, rapidly increasing oil prices both drove up the cost of goods (inflation) and forced consumers to make cuts to their spending (stagnation). While there are no benchmarks for when stagflation officially occurs, the Energy Crisis featured six fiscal quarters of shrinking GDP and a peak inflation rate of nearly 12 percent.

Shrinkflation: A type of sales marketing, shrinkflation occurs when the price of a product is kept the same but its size or content is decreased. A recent publicized example of this was the change to Toblerone chocolate bars in the UK. Much to the chagrin of consumers, the signature "mountainous triangles" were reduced by about 10 percent per package without any change to the candy's resale price.

Hyperinflation: This refers to a period of extreme inflation when the money supply grows much faster than GDP, flooding the market with excess currency. A common litmus test for hyperinflation is when the inflation rate exceeds 50 percent in a month. One of the most famous examples of hyperinflation happened in Germany during World War I, when the German Papiermark was reduced to one trillionth of its former value in less than 10 years.

Disinflation/Reflation: This pair of terms is used to describe changes in the inflation rate. Disinflation indicates that the inflation rate is declining, while reflation indicates that the inflation rate is increasing. Disinflation should not be confused with deflation, since disinflation only indicates that prices are increasing less than before; however, disinflation could lead to deflation if it continues long enough to turn the growth rate negative.

Biflation: Also known as "mixed inflation", biflation is the simultaneous (and usually temporary) presence of both inflation and deflation in an economy. As seen in the Great Recession of 2008, this can occur when an economy attempts to recover from a downturn by putting stimulus money into circulation. Necessities, like food and gas, are always in demand and inflate with the increasing money supply. Long-term goods, on the other hand, must continue to cut prices until consumers are confident in the economic recovery.

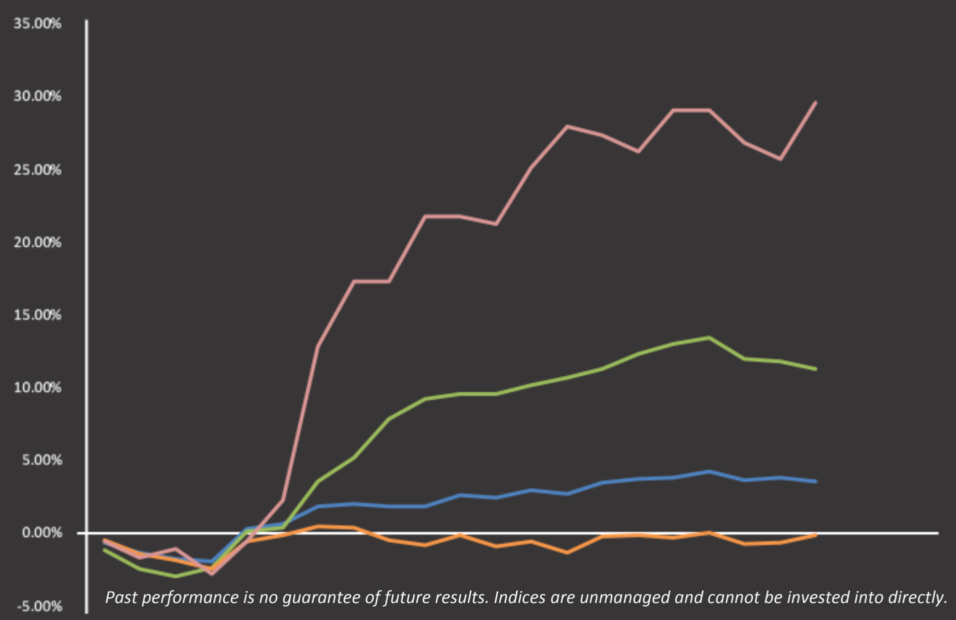
the market at a glance
November

U.S. Large Cap
(S&P 500)
2,198.81 (3.42%) ▲

U.S. Mid/Small
(Russell 2000)
1,322.34 (10.99%) ▲

International Large
(NYSE International 100)
4,753.45 (-0.18%) ▼

U.S. Treasuries
(U.S. 10-Year Treasury Yield Rate)
2.37 (28.80%) ▲



The market in action

- The presidential election of Donald Trump, which defied most projections, sends shockwaves through the world economy as markets scramble to prepare for possible changes to America's fiscal, monetary and trade policies.
- The Dow Jones industrial average surpasses 19,000 for the first time on November 22.
- India's prime minister Narendra Modi unexpectedly declares the immediate abandonment of the existing 500 and 1,000 rupee banknotes, with new 500 and 2,000 rupee notes entering circulation a few days later. The surprise change was intended to help fight corruption and force offshore accounts to repatriate—and pay taxes—on their cash holdings.
- Automaker Volkswagen AG announces plans to cut 30,000 jobs (mostly in Germany) in an attempt to grow profitability following the $15B fine issued by U.S. authorities for its emissions-cheating diesel engines.
- The World Trade Organization (WTO) rules that a tax break offered to Boeing Co. by the state of Washington is a prohibited subsidy. The complaint was originated by Boeing's European competitor, Airbus, which claims the tax subsidies give Boeing an unfair advantage in the development of new aircraft. The WTO had issued a similar ruling against Eurozone tax breaks for Airbus in September.
- Automaker Tesla Motors agrees to acquire solar energy company SolarCity. Controversy and suspicion surrounded the acquisition because it was proposed by Elon Musk—CEO of Tesla, chairman of SolarCity and the primary shareholder at both companies. Musk, however, declined to vote on the deal.
- Samsung Electronics issues a recall for 2.8M of its washing machines following complaints that major components can become detached during use. News of the recall comes just weeks after Samsung's highly publicized recall of its Galaxy Note 7 smartphones.
- Major U.S. banks ask the Supreme Court to provide a ruling that will prevent municipal governments from suing them for predatory lending during the housing bubble. The action comes in response a number of cities making the claim that subprime mortgages led to lost property tax revenue when home values collapsed.

Putting 2016 to Rest

Year-end Financial Checklist

When you're making that year-end list and checking it twice, don't forget to review the following housekeeping items to ring in the new year with financial peace of mind.

--------------------- INCOME TAX ----------------------

☐ ***Review your tax withholdings.***

Have you had a major life change (employment change, marriage/divorce, a new child) that affects your income tax? Check to make sure your tax withholdings have been properly adjusted. Having low withholdings can lead to tax penalties, while having too high of withholdings prevents you from accessing your money until your tax return is filed.

☐ ***Estimate your AGI.***

Determine your adjusted gross income either on your own or with the help of your tax preparer. Your AGI will help determine your tax bracket, which you'll need for investment and retirement planning.

--------------------- INVESTMENTS ----------------------

☐ ***Consider "locking-in" losses on investments to help diminish taxes on capital gains.***

If your losses exceed your gains for this year, you can use the losses to reduce up to $3,000 of taxable income. If your total losses surpass $3,000, you can roll over excess losses to offset gains in another year. If you have losses from a previous year, calculate how they affect either gains or losses from this year.

☐ ***Check to make sure you didn't make (or plan on making) any "wash sales."***

A wash sale is the sale of an asset followed by a repurchase of a similar asset within 30 days. The IRS does not allow capital losses on wash sales; if you have already made a wash sale, do not plan on the capital losses being available for tax use this year.

☐ ***Check to see when you last rebalanced your portfolio.***

Every year, many people go far too long without making necessary adjustments as they age.

----------------- RETIREMENT ACCOUNTS -----------------

☐ ***If you are retired, make sure you've taken all necessary required minimum distributions (RMDs).***

RMDs may be one of the most important items to review when going over your finances at the end of the year. Standard IRAs require these distributions be taken annually after the year you turn 70 ½; standard 401(k)s require them annually after you retire or turn 70 ½ (whichever is earlier). Failure to take an RMD will trigger a 50 percent excise tax on the value of the RMD.

☐ ***Max contributions to an IRA and employer retirement plan for the year.***

Both IRAs and 401(k)s have annual contribution limits. If you find you have excess savings and have not reached your annual limit, it may be a good idea to make additional contributions. Similarly, you may also consider making greater monthly contributions to your accounts next year, spreading out the cost of contribution. The deadline for IRA contributions is usually April 15 of the following year; 401(k) deadlines may be restricted to the calendar year, depending on your employer.

☐ ***Consider converting a traditional IRA to a Roth IRA.***

Did you have a good tax year? It may be an opportune time to convert a portion (or all) of your traditional IRA to a Roth IRA and pay your taxes at a lower rate. It is important to understand, however, that Roth accounts have contribution limits placed on them, so keeping a traditional IRA might be beneficial. Before making any changes, consider seeking the help of a professional accountant who can help you with the conversion and calculate your new tax liability.

------------------------- GIVING --------------------------

☐ ***Donate to charity as a way to reduce taxes.***

You can lower taxable income by 50 or 30 percent with a gift to a public charity or by 30 or 20 percent with a gift to a private foundation. If your gift exceeds these limits, you can roll over the excess deduction for up to five years.

☐ ***Reduce your estate through gifts.***

You are permitted to give up to $14,000 a year per recipient as an untaxed gift. Gifts above this value will consume part of your lifetime gift/estate tax exemption amount. If a gift directly funds education tuition or pays for qualified medical expenses, it will go untaxed no matter what the value.

------------------- FAMILY FUNDING --------------------

☐ ***Check your flexible savings account (FSA).***

The government only permits a $500 annual rollover in an FSA; any excess funds disappear if unused by the end of the year. If you have extra money in your FSA, you may want to schedule necessary medical or dental procedures before the end of the year.

☐ ***Check your health savings account (HSA).***

HSA funds don't disappear at the end of each year like with an FSA; however, many with few medical needs discover money accumulating in their HSAs much faster than they are using it. Consider reducing your contributions to your HSA if your account has reached a comfortable amount and you know of better uses for your money.

☐ ***Consider contributions to a 529 plan to fund your children's/grandchildren's education.***

529 Plans allow for you to make contributions to a tax-free account that may be used to pay for qualifying secondary education expenses.
(Investors should consider investment objectives, risks, charges and expenses associated with 529 plans before using them. Information about 529 plans is available in their issuers' official statements.)

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