Investor Insights & Outlook

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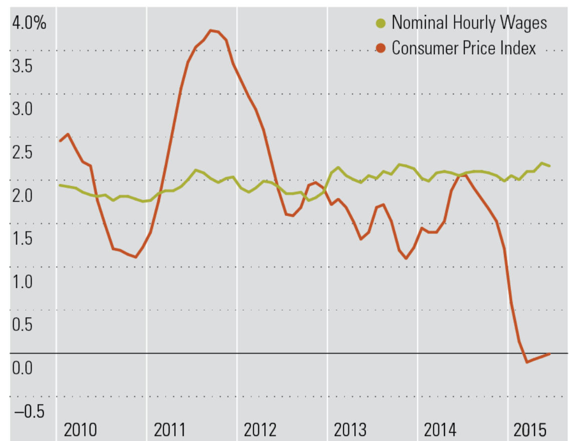
Inflation and Hourly Wage Growth

Wage growth is an important leading metric of consumer behavior, as higher wages increase disposable income, which in turn drives more spending. The chart depicts nominal hourly wage growth and the inflation rate (represented by the consumer price index) since 2010. Both metrics are on a year-over-year basis, and averaged for 3 months in order to smooth out the monthly seasonality.

What really stands out is that nominal hourly wages have been growing at a steady 2% rate for many years now, and they have recently accelerated just slightly to about 2.2%. What contributed to a huge increase in the real wage growth (not shown on the chart), however, was the collapse of the inflation rate that began in the second half of 2014, driven by lower oil and gasoline prices.

Inflation and Hourly Wage Growth,
Y/Y, 3-Month Average



Source: Bureau of Labor Statistics, Morningstar.

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Advisor Corner

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How to Read the Panicky Market

Some of the most entertaining times to be a long-term investor are those periods when short-term investors are looking over their shoulders for an excuse to sell. They're convinced that the market is going to go down before they can get out, and so they jump on any bad news that comes across their Bloomberg screen.And, of course, the last couple of days have been a marvelous time to see this in action. With all the economic drama playing out in the world, there were plenty of opportunities to panic. The Greek Prime Minister has resigned! Sell! China devalued its currency a few days ago by 2%! Head for the hills! Chinese stocks are tanking yet again! Get out of American stocks while you can! The Fed might raise short-term interest rates from zero to very nearly zero! It's the end of the world!Of course, a sober analyst might wonder whether a change in governance in a country whose GDP is a little less than half the market capitalization of Apple Computer Corp. is really going to move the needle on the value of U.S. stocks—especially now that Greece seems to have gotten the bailout it needs to stay in the Eurozone. Chinese speculators are surely feeling pain as the Shanghai Composite Index goes into free-fall, but most U.S. investors are prohibited from investing in this tanking market. If the market value of PetroChina, China Petroleum & Chemical and China Merchants Bank are less valuable today than they were a week or a month ago, does that mean that one should abandon U.S. stocks or that U.S. blue chips are somehow less valuable?What makes this dynamic entertaining—and sometimes scary—is the enhanced volatility around very little actual movement. You see the market jump higher and faster, lower and faster, but generally returning to the starting point as people realize a day or two later that the panic was an overreaction. Despite all the jitters investors have experienced over the past nine months, despite the drop on Friday, the S&P 500 is only down about 4% for the year, and was in positive territory as recently as August 19.If you want a broader, more rational picture of our current economic situation, read this analysis by a long-term trader who now refers to himself as a "reformed broker" in Fortune magazine: http://fortune.com/2015/08/20/american-economy-worries/ He talks about the "terrible news" that it hasn't been this cheap to fill your gas tank in over a decade, and business that rely on energy to manufacture their goods are now forced to figure out what to do with the excess capital they're not spending on fuel.Oh, but it gets worse. American corporations are struggling under the burden of enormous piles of cash they don't have a use for. They may have no choice but to return some of that money in the form of record dividends. It seems that unemployment is so low that wages for American workers are going up, and that could raise consumption and demand for products and services.Meanwhile, contributions to 401(k)s are up dramatically, housing starts and the construction sector are booming, America's biggest global economic competitor (China) is reeling, and the Federal Reserve might decide that it no longer has to keep short-term interest rates low because the economy has recovered. The author apologizes (tongue in cheek) for bringing us all this terrible news, but hey, we can always sell our stocks and get out until conditions improve. Right?Nobody would be surprised if the U.S. stock market suffered a 10% or even a 20% short-term decline, this year, or perhaps next year. But what can you do with that information? Nobody would have been surprised if this had happened at any point in the long bull market that doubled your stock investments, and nobody can predict whether Friday was a signal that the market will take a pause, or if this week will bring us another wave of short-term euphoria measured mostly in sighs of relief.These short-term swings provide entertainment, but very little useful information for a mature investor. If you aren't entertained by watching people sell in a panic and then panic-buy their way back in when they realize things aren't quite so dire, then you should probably watch a movie instead.

Four Retirement-Portfolio Withdrawal Mistakes to Avoid

Some errors in retirement-portfolio planning fall into the category of minor infractions rather than major missteps. Did you downplay foreign stocks versus standard asset-allocation advice? It's probably not going to have a big impact on whether your money lasts throughout your retirement years.

But withdrawal rate errors can have more serious repercussions for retirement-portfolios. If you take too much out of your portfolio at the outset of retirement, and that coincides with a difficult market environment --you can deal your portfolio a blow from which it may never recover. Other retirees may take far less than they actually could, all in the name of safety. The risk is that they didn't fully enjoy enough of their money during their lifetimes.

Mistake 1: Not Adjusting With Your Portfolio's Value and Market Conditions. Even though the popular "4% rule" assumes a static annual-dollar-withdrawal amount, adjusted for inflation, retirees would be better off staying flexible with their withdrawals.

What to Do Instead: The simplest way to tether your withdrawal rate to your portfolio's performance is to withdraw a fixed percentage, versus a fixed dollar amount adjusted for inflation, year in and year out. That's intuitively appealing, but this approach may lead to more radical swings in spending than is desirable for many retirees. It's possible to find a more comfortable middle ground by using a fixed percentage rate as a baseline but bounding those withdrawals with a "ceiling" and "floor."

Mistake 2: Not Adjusting With Your Time Horizon. Taking a fixed amount from a portfolio also neglects the fact that, as you age, you can safely take more from your portfolio than you could when you were younger. The original "4%" research assumed a 30-year time horizon, but retirees with shorter time horizons (life expectancies) of 10 to 15 years can reasonably take higher amounts.

What to Do Instead: To help factor in the role of life expectancy retirees can use the IRS' tables for required minimum distributions as a starting point to inform their withdrawal rates. That said, those distribution rates may be too high for people who believe their life expectancy will be longer than average.

Mistake 3: Not Adjusting Based on Your Portfolio Mix. Many retirees take withdrawal-rate guidance, such as the 4% guideline, and run with it, without stopping to assess whether their situations fit with the profile underpinning that guidance. The 4% guideline assumed a retiree had a balanced stock/bond portfolio. But retirees with more-conservative portfolios should use a more-conservative (lower) figure, whereas those with more-aggressive asset allocations might reasonably take a higher amount.

What to Do Instead: Be sure to customize your withdrawal rate based on your own factors, including your portfolio mix.

Mistake 4: Not Factoring In the Role of Taxes. The money you've saved in tax-deferred retirement-savings vehicles might look comfortingly plump. However, it's important to factor in taxes when determining your take-home withdrawals from those accounts. A 4% withdrawal from an $800,000 portfolio is $32,000, but that amount shrivels to just $24,000, assuming a 25% tax hit.

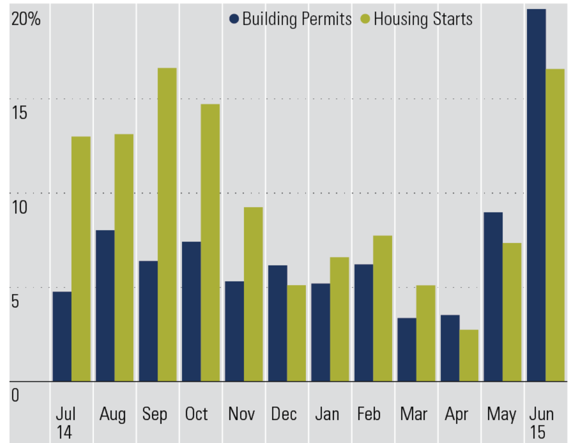
What to Do Instead: It pays to be conservative in your planning assumptions. To be safe it's valuable to assume a higher tax rate than you might actually end up paying.

This article contributed by Christine Benz, Director of Personal Finance with Morningstar.

Housing Construction in Good Shape

The chart depicts the state of the housing construction industry, suggesting that there is still plenty of room to grow in this slow, but steady recovery we've seen so far. The latest starts and permits data from the Census Bureau, however, shows a slightly exaggerated picture, as it is the multi-family category that's been making overall housing construction look better than it is in reality. Both starts and permits picked up in June, as multi-family activity rose sharply amid expiring construction tax incentives for developers in the New York City area. As a result, the housing construction revival is probably not as strong as the numbers seem to currently suggest. Nonetheless, improvements for single-family construction still look healthy, and continue to trend up closer to the 10% rate year over year.

Building Permits Versus Housing Starts
Year-Over-Year Growth, 3-Month Average



Source: Census Bureau, Morningstar.

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