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Building Wealth, Despite Covid-19

Financial advisors and their clients are navigating the economic waters of inflation, rising interest rates, and a volatile stock market.

By Gene Rebeck
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When Covid-19 hit the United States in alarming fashion in March 2020, many people had the sinking feeling that the nation was heading toward a recession, perhaps a very deep one. Lockdowns did trigger a recession for a few months. But that was followed by what Carol Schleif describes as "a post-World War II kind of boom." She's the Minneapolis-based deputy chief investment officer for Chicago-based BMO Financial Group's Family Office practice.

While the pandemic shocked the economy, for investors—including those with retirement accounts—the past two years have been quite extraordinary.

"At the beginning of 2021, no one expected the S&P 500 to be up [by] close to 28 percent by year's end," Schleif says, particularly since broad reopening [of the economy] has been pushed back several times due to the Covid variants. During 2021, the S&P 500 hit 70 record highs, most recently on Dec. 29. The market was also nerve-rackingly volatile as investors reacted to Delta, Omicron, inflation reports, and the Federal Reserve's hints of interest rate increases.

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Still, Schleif and other wealth managers have been amazed by the resilience demonstrated by businesses, the stock market, and the overall economy. Profit margins for public companies as a whole are higher than they were in 2019. "Markets have done a really good job absorbing all the supply chain issues, all the social issues, all the commodity increases, the tightness in the labor market," she notes.

What should people anticipate in the 2022 economy? Individuals and families seeking to build their wealth still face many uncertainties as they plot their investment strategies. Many experts have said they expect the stock market will cool off this year, and a few of them anticipate a crash. Even if the nation returns to some kind of economic and investment stability, numerous things have changed. And more civic and business leaders have called for the need to address the racial wealth gap in the U.S.

Booming stock prices and inflation

Inflation hit a nearly four-decade high in 2021, thanks largely to supply shortages, including for key components such as semiconductors. Labor shortages also have put pressure on prices as companies struggle to hire enough qualified workers. While inflation is worrisome, in 2021 it also reflected surging consumer demand and rising wages. "Moderate inflation, especially early on in the cycle, if it's for the right reasons, can be a useful thing for companies and for citizens," Schleif argues.

This notion runs counter to commonly held views about inflation. "People are trained psychologically through their economics classes to be fearful of inflation, thinking back on what happened in the '70s," Schleif says. "But that wasn't typical inflation either." A rise in prices, she adds, "can be good because it gives companies the ability, if it's happening in a strong environment like this one, to have some pricing power and pass on cost increases to customers. And it gives employees bigger wage gains, which is happening, too." Inflation and supply shortages certainly didn't dampen consumers' holiday spirit: According to a Mastercard report, 2021 holiday retail sales rose 8.5 percent from 2020.

Like many observers, Schleif believes that inflation will level off as sources of supplies loosen up and employers find ways to automate processes rather than make higher-priced hires. Still, she believes inflation is likely to remain above 2 percent "for a very long time, partly because once you put wage increases through, you're not going to take them away, though the increases might flatten out."

Inflation's durability has naturally put the Federal Reserve in an even brighter spotlight than usual. For months, investors have been expecting the Fed to use its power to raise interest rates this year to tamp down inflation. In 2022, individuals and families are facing two big, interrelated wealth management challenges: staying ahead of inflation and maintaining portfolio returns in a higher-interest environment.

Seeking stability

Like many private wealth advisors, Ginger Ewing gets calls from clients asking about the stock market's astonishing 2021 performance—and whether the bull market will come to a screeching halt. Ewing is managing partner at Shine Wealth, a franchise of Minneapolis-based Ameriprise Financial with offices in Wayzata and Eagan. "We all have this investor PTSD after the Great Recession," she says, "and then [again] when Covid hit, when we saw these fast record drops and then these fast recoveries."

The traditional way to hedge against the risk of a bear market is through portfolio diversification, balancing stocks with conservative fixed-income investments—namely, bonds. Bond returns are historically lower than those of stocks, of course. But except for some risky forms of debt, bondholders don't lose money.

Still, the returns on safety-first investments like bonds and CDs are way behind inflation. From a long-term perspective, "one of the best ways to prepare for inflation is to have stocks in your portfolio," Ewing notes. But short-term? "Equities are not a great inflation fighter," she says. "If inflation really starts to take off, the markets are going to respond to that, and equity prices will be more volatile."

It's a particularly challenging environment for retirees. "If you're 65 and you have a 20- or 30-year time horizon, you still have long-term money," Ewing says. "And that long-term portfolio still needs to address inflation risk. You also need a short-term portfolio to address market risk. If you need your money in the next two to three years, it likely should not be in stocks; it should be in something that's much more conservative." That noted, she adds that "even retired people still have a long-term portfolio, and they need to address risk of inflation as long-term."

A longer time horizon is, of course, a big advantage for younger investors. "The longer your time horizon, the more volatility you can withstand," notes Aaron Howe, managing director and financial advisor at RBC Wealth Management's Wayzata office. Investors able to take the long view profited from the stock market's record-setting 2021 performance without fretting much about the occasional market plunges.

As for fixed-income investments, Howe recommends that investors look closely at the risks. "If you buy an individual bond and it has a maturity date and you don't have any problems along the way, you'll get your coupon and you'll presumably get your money back after the bond matures," Howe says. "If you're buying into a mutual fund or a pool of fixed-income assets, you may run into some difficulties if interest rates go up dramatically."

One question Howe suggests investors ask in this environment: Are there investments that have some floating features with interest rates rather than fixed features? These could include short-term floating-rate fixed-income investments like bank preferreds, Treasurys, and corporate and municipal bonds. Some banks also offer floating-rate investment vehicles. "Make sure that what you own is appropriate relative to your risk tolerance," Howe suggests. "It's one thing to have a rising interest rate security, but you also want to be sure that your principal is going to be returned."

All told, fixed-income investors are feeling ensconced between a rock and a hard place. "Inflation and rising interest rates tend to decrease the value of [fixed-income] assets, and they don't pay very much interest right now," notes Mark Berger, company principal and financial advisor at Plymouth-based Berger Financial Group. With stocks better able to weather inflation, retirees should consider adding a bit more of certain types of stock to their portfolios, Berger says. That approach, he adds, "might actually be more conservative" than bonds, at least in the short term.

More cautious investors might want to manage their equities position risk through an index fund, which tracks a stock index such as the S&P 500. "That way, you're not picking one single area of the market," Berger says. He adds that while tech is currently the largest sector within the S&P 500, the index is "diversified enough so that you're not making a bet on one specific sector or stock."

A diversified portfolio, with holdings in a variety of stocks, bonds, and other assets, is a strategy that wealth and investment advisors have long stressed. But there's another kind of diversity that the wealth advisory industry has only begun to address.

Spreading the wealth

In November, Minneapolis-based U.S. Bank published "Building Black Wealth," a research study that sought to better understand the financial needs, goals, and challenges of Black Americans with at least $25,000 in investable assets. This nationwide study surveyed 4,024 Asian, Black, white, and Hispanic consumers of all ages, asking them how they think about financial success and wealth and about their relationships with wealth management and financial services providers.

According to the study, 61 percent of Black respondents said that their financial situation improved during the pandemic. But they're less optimistic that the racial wealth gap will shrink in the next decade.

"The racial wealth gap is something every single American should care about," says Greg Cunningham, U.S. Bank's senior executive vice president and chief diversity officer. "It's a drag on the economy—for everybody."

In addition, 79 percent of the survey's Black respondents believe that there are institutional roadblocks slowing their ability to accumulate wealth. Communities of color, and the Black community in particular, have what Cunningham calls a "well-earned mistrust" of the financial industry. In February 2021, U.S. Bank instituted Access Commitment, a bankwide initiative whose mission is to close racial wealth disparities. It also seeks to make its wealth management services more welcoming and inclusive. It aims to build trust among Black families and individuals seeking to build their wealth.

One of the ways that U.S. Bank is addressing the trust issue is to hire and develop more Black financial advisors. In February 2021, U.S. Bank named Scott Ford president of its affluent wealth management business. Gunjan Kedia, U.S. Bank's vice chair for wealth management and investment services, believes that hiring Ford, who had been JPMorgan Chase's wealth management regional director for Long Island and several New York City boroughs, has helped make the bank more attractive to Black professionals, who in the past "might have chosen to work somewhere else."

Like financial advisory businesses generally, U.S. Bank tailors its planning to each client's risk tolerance, time horizon, financial means, and financial goals. "We have trained all of our advisers to understand the unique sensitivity [the Black affluent] community has to tangible assets and to generational wealth," Kedia says, "and to make sure we are having those conversations in a more upfront and intentional way."

Addressing the distinctive challenges and dreams of Black families as they seek to build their wealth is likely to change the ways that financial services firms operate. Still, many wealth management best practices will remain the same for everyone, regardless of race. As Howe puts it, it's good to go back and look at your plan, where you hold your assets, why you have those assets, and whether they're matching up with your goals. He recommends focusing on those elements and tuning out some of the daily noise about unpredictable possibilities, black swans, and falling skies.

Bumpy ride in 2022?

As American companies and consumers enter the third year of the Covid-19 pandemic, there is growing pressure to find strategies that help people live with Covid-19 on an ongoing basis.

How Americans adapt to existing alongside the virus certainly will have a paramount impact on the U.S. economy this year, and their actions will have a ripple effect on Wall Street. But one of the biggest short-term economic challenges is attempting to rein in inflation. The stock markets showed tremendous volatility on Jan. 24, because markets were reacting in advance of the Federal Reserve's Federal Open Market Committee meeting.

By midday on Jan. 24, the Nasdaq Composite Index had plummeted by 4.9% and the Dow was down 3.25% in what the *Wall Street Journal* characterized as "investor anxiety." The markets ultimately rallied, but there could be bumpy times ahead.

The Federal Reserve's dual mandate is maintaining stable prices and full employment. Yet it's unclear whether interest rate hikes by the Fed will indeed be the primary solution to bring down inflation.

While Fed Chair Jerome Powell has his steady hand on the tiller of monetary policy, it's much more difficult to predict what President Biden and Congress will do in 2022 on the fiscal policy front. The political environment is chaotic, and the midterm elections may stymie most policymaking efforts.