

# EFA Update



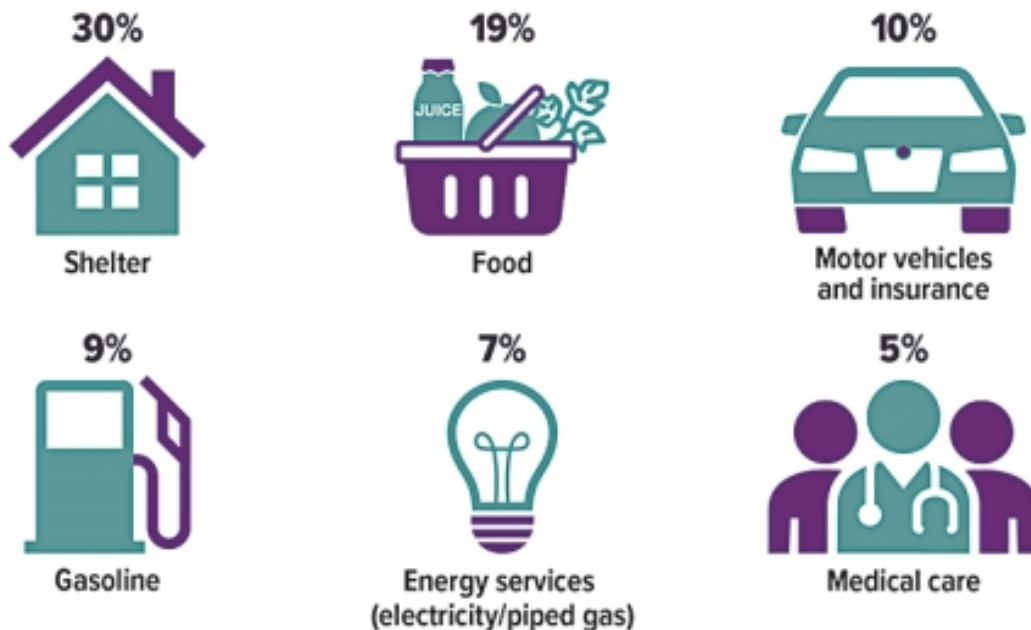
**BRADLEY ERICKSON**  
Investment Advisor Rep.  
Erickson Financial Advisors  
2812 17th Ave South • Suite F • Grand Forks • ND  
701-772-1681  
brad@ericksonfinance.com • www.ericksonfinance.com



## The Top Six Inflation Drivers of 2022

In June 2022, the 12-month rise in the Consumer Price Index (CPI) peaked at 9.1%, the fastest pace in 40 years, before dropping to 7.7% in October. This bout of inflation has been driven in large part by steep price hikes for essentials, hitting many U.S. households where it hurts the most. In fact, more than three-fourths of the annual increase in the CPI can be attributed to these six categories.

### Contribution to the 12-month, 7.7% increase in consumer prices, October 2022



Source: U.S. Bureau of Labor Statistics, 2022

# Balancing Stocks and Bonds in One Fund

Maintaining an appropriate balance of stocks and bonds is one of the most fundamental concepts in constructing an investment portfolio. Stocks provide greater growth potential with higher risk and relatively low income; bonds tend to be more stable, with modest potential for growth and higher income. Together, they may result in a less volatile portfolio that might not grow as fast as a stock-only portfolio during a rising market, but may not lose as much during a market downturn.

## Three Objectives

Balanced mutual funds attempt to follow a similar strategy. The fund manager typically strives for a specific mix, such as 60% stocks and 40% bonds, but the balance might vary within limits spelled out in the prospectus. These funds generally have three objectives: conserve principal, provide income, and pursue long-term growth. Of course, there is no guarantee that a fund will meet its objectives.

When investing in a balanced fund, you should consider the fund's asset mix, objectives, and the rebalancing guidelines as the asset mix changes due to market performance. The fund manager may rebalance to keep a balanced fund on track, but this could create a taxable event for investors if the fund is not held in a tax-deferred account.

## Core Holding

Unlike "funds of funds," which hold a variety of broad-based funds and are often meant to be an investor's only holding, balanced funds typically include individual stocks and bonds. They are generally not intended to be the only investment in a portfolio, because they might not be sufficiently diversified. Instead, a balanced fund could be a core holding that enables you to pursue diversification and other goals through a wider range of investments.

You may want to invest in other asset classes, hold a wider variety of individual securities, and/or add funds that focus on different types of stocks or bonds than those in the balanced fund. And you might want to pursue an asset allocation strategy that differs from the allocation in the fund. For example, holding 60% stocks and 40% bonds in a portfolio might be too conservative for a younger investor and too aggressive for a retired investor, but a balanced fund with that allocation could play an important role in the portfolio of either investor.

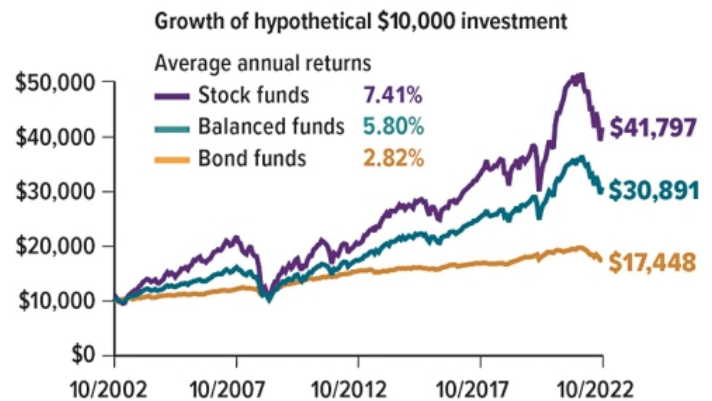
## Heavier on Stocks or Bonds?

Balanced funds typically hold a larger percentage of stocks than bonds, but some take a more conservative approach and hold a larger percentage of bonds. Depending on your situation and risk tolerance, you might consider holding more than one balanced fund, one tilted toward stocks and the other tilted toward

bonds. This could be helpful in tweaking your overall asset allocation. For example, you may invest more heavily in a stock-focused balanced fund while you are working and shift more assets to a bond-focused fund as you approach retirement.

## Lower Highs, Higher Lows

During the 20-year period ending in October 2022, balanced funds were less volatile than stock funds, while producing higher returns than bond funds.



Source: Refinitiv, 2022, for the period 10/31/2002 to 10/31/2022. Equity funds are represented by the Thomson US: All Equity - MF Index, balanced funds by the Thomson US: Balanced - Domestic - MF Index, and bond funds by the Thomson US: All Gen Bond - MF Index. The performance of an unmanaged index is not indicative of the performance of any particular investment. Individuals cannot invest directly in an index. The results do not include the effects of fees, expenses, and taxes. Rates of return will vary over time, particularly for long-term investments. Past performance is not a guarantee of future results. Actual results will vary. Investments seeking to achieve higher yields also involve a higher degree of risk.

Keep in mind that as you change the asset allocation and diversification of your portfolio, you may also be changing the level of risk. Asset allocation and diversification are methods used to help manage investment risk; they do not guarantee a profit or protect against investment loss.

The return and principal value of all investments fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Bond funds, including balanced funds, are subject to the same inflation, interest-rate, and credit risks associated with their underlying bonds. As interest rates rise, bond prices typically fall, which can adversely affect a bond fund's performance.

*Mutual funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. You should read the prospectus carefully before investing.*

# Fixed for Life: What Can an Annuity Do for You?

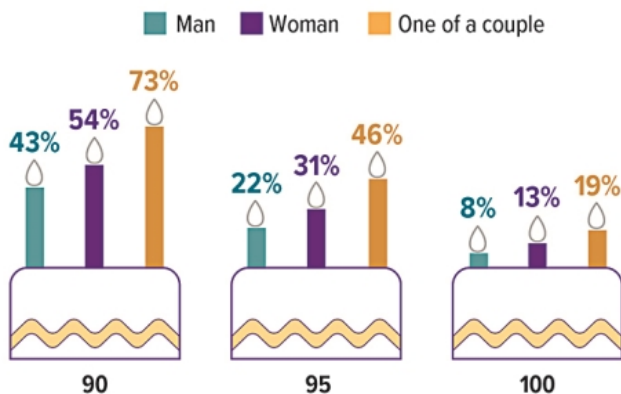
With stock and bond markets both faltering over the past year, it's easy to see why more near-retirees have a newfound appreciation for fixed annuities — insurance contracts that guarantee a specified rate of return. A fixed annuity maintains its value regardless of market conditions, and yields on these products have risen in response to the higher interest-rate environment.

When you purchase a fixed annuity, you are shifting the risk for future investment returns to the insurance company. It's also a way to create a pension-like income stream for retirement, starting right away or when you are older.

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## A Long Retirement

Probability that a healthy 65-year-old will live to the following ages



Source: Society of Actuaries and American Academy of Actuaries, 2022

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## Income for Now or Later

An *immediate fixed annuity* is usually purchased at the beginning of retirement, often with a lump-sum premium. The fixed payments start within 12 months from the date the annuity is purchased and continue for the duration of the contract.

With a *deferred fixed annuity*, you can make a series of premium payments, and the income is delayed until a future date of your choosing. This type of annuity can be used to save for retirement or to provide income in your later years. The income payments reflect the value of the premiums paid, the annuity's compounded return, and the length of the payout period (or your life expectancy). Thus, the longer you defer your annuity, the higher the payout can be.

Unlike tax-advantaged workplace plans and IRAs, annuities have no annual contribution limits, so they present an opportunity to save as much as you want on a tax-deferred basis. When annuities are purchased with after-tax dollars, only the earnings portion of withdrawals is taxable as ordinary income. You can also invest in an annuity through a qualified (tax-advantaged) retirement plan. In this case, the qualified annuity is subject to the same tax rules as the

qualified plan, so there is no additional tax benefit. For both qualified and nonqualified annuities, early withdrawals prior to age 59½ may be subject to a 10% penalty.

## Annuitization Options

Converting the funds in an annuity to an income stream is called *annuitization*. A deferred annuity contract will specify the date at which you can annuitize and begin to receive payments as defined in the contract, but generally you are not required to do so at that time. Although a guaranteed income is often a sought-after feature of annuities, many owners choose not to annuitize.

Before annuitization, you can withdraw some or all of the annuity funds in a lump sum or a series of distributions. However, surrender charges typically apply if you withdraw more than a specified amount before the end of the surrender period. If you die before annuitizing, your heirs would receive the funds accumulated in the annuity. After you annuitize, you no longer control the funds, so you cannot take lump-sum distributions.

Whether you purchase an immediate or deferred fixed annuity, you'll have options for the income stream you will receive during the annuitization period. A straight, guaranteed lifetime income will provide the highest monthly payments and help protect against the risk of outliving your savings. But payments will typically end when you die, with no funds going to your heirs. A "period certain" provides income for a fixed number of years and will go to your heirs if you die before the end of the period, but you risk running out of income if you live beyond the period. "Life with a period certain" guarantees you a lifetime income along with a period of time in which it can pass to your heirs, but payments are generally lower.

The decision to annuitize — and the option you choose if you decide to do so — will depend on your financial situation, life expectancy, and risk tolerance.

*Annuities have contract limitations, fees, and expenses, and they are not appropriate for every investor. Withdrawals reduce annuity benefits and values. Any guarantees are contingent on the financial strength and claims-paying ability of the issuing insurance company. Investors should be aware that when they purchase a fixed annuity, they may sacrifice the opportunity for higher returns that might be available in the financial markets, and that inflation could reduce the future purchasing power of their annuity payouts. Annuities are not guaranteed by the FDIC or any other government agency. They are not deposits of, nor are they guaranteed or endorsed by, any bank or savings association.*

# The Inflation Experience Is Painful and Personal

Inflation is a sustained increase in prices that reduces the purchasing power of your money over time. According to the Consumer Price Index (CPI), inflation peaked at an annual rate of 9.1% in June 2022, the fastest pace since 1981, before ticking down to 7.7% in October.<sup>1</sup>

The CPI tracks changes in the cost of a market basket of goods and services purchased by consumers. Items are sorted into more than 200 categories and weighted according to their "relative importance," a ratio that represents how consumers divide up their spending, on average. Basic needs such as shelter (33%), food (14%), energy (8%), transportation (8%), and medical care (7%) account for about two-thirds of consumer expenditures. Because the CPI is a comprehensive measure of prices across the U.S. economy, the index also contains many items that an individual consumer may purchase infrequently, or not at all.

Wide variations in spending patterns help explain why some consumers feel the sting of inflation more than others. This means that the extent to which you experience inflation depends a lot on where you live, as well as your age, health, income, family size, and lifestyle. In effect, your personal inflation rate could be significantly higher or lower than the average headline inflation rate captured in the CPI. Consider the following examples.

- In October 2022, the 12-month increase in the cost of shelter was 6.9%.<sup>2</sup> Shelter carries the most weight of any category in the CPI, which made fast-rising home prices and rents a top driver of inflation over the previous year. A first-time homebuyer, or a renter who signs a new lease, is likely to feel the full impact of these hefty price increases. However, a homeowner with a fixed-rate mortgage is generally insulated from these rising costs and might even benefit financially from home-equity gains.
- Gasoline surged 17.5% during the 12 months ended in October 2022.<sup>3</sup> Individuals who rarely drive, possibly because they are retired or work remotely, might have been able to shrug off the price spike. But for drivers with long commutes, filling up the gas tank regularly might have put a sizable dent in their households' finances, in some cases forcing them to cut back on other purchases.
- Food and beverage prices rose 10.9% over the same 12-month period, a trend that clearly affects everyone.<sup>4</sup> But rising food costs tend to put more pressure on the budgets of lower-income households because they spend a greater share of their income on necessities and typically have smaller financial cushions. Plus, shoppers can't easily switch to lower-cost options if they are already relying on them.<sup>5</sup>

1-4) U.S. Bureau of Labor Statistics, 2022

5) Federal Reserve, 2022

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## IMPORTANT DISCLOSURES

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