

The Sgroi Financial

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Planning for Today and Tomorrow



Seasons Greetings to you and yours



Interest Rates and The Federal Reserve

By Jeff Hahn

Interest is what one pays for the use of another's money. Whether it be a mortgage, credit card, or business loan, when you borrow the lending institution charges you interest to do so. That's why they do it. Likewise, when you make a deposit in any type of bank account, you are in effect loaning that money to the bank. If it's a savings account you get a little interest, a CD pays a little more and a checking account usually nothing at all. But they are all still loans from you to the bank.

The bank then takes the money they have borrowed from you and loans it to others at a higher rate of interest. The difference in interest between what the bank pays its depositors and what it charges on its loans is how the bank earns money. The function of providing a way for those with money to loan it to those who can put it to use is a basic essential of economic activity. The banking system acts as an intermediary and facilitator of that function.

In 1913 Congress established the Federal Reserve as the nation's central bank. Its purpose is to maintain stability of the financial market, regulate the banking system and the money supply. Setting interest rates is one of their key functions. Over this past year there have been a series of interest rate cuts. When interest rates drop, more money becomes available for circulation in the economy which in turn creates economic growth.

Some current examples should help illustrate the point. If you have a home equity line of credit, you have seen your interest rate drop recently. As a result the required monthly payment has also gone down. That means you have more money to spend and that creates economic activity. (We normally recommend you take the opportunity to pay off debt first). Automobile loan rates are very low right now, zero percent in some cases. This has led to banner sales of cars even though the overall economy has been slowing. Still another example would be *(Continued on the next page)*

Letter from the Editor

By Brian Clouden



We would like to thank you, our thousands of clients, new and old, for making H. Joseph Sgroi & Associates your financial planning choice. We have all

worked very hard to make our firm the organization it is today. For this we thank you.

For over 30 years our primary goal has been to serve our clients needs. Continuing this intent we have read your survey responses and are altering the newsletter's format to better serve your expanding interests. While the style will be changing, the quality of content will not.

Beginning with the Spring edition we will be adding a more diversified variety of topics. Some of the newer columns that will be added are, "Question and Answer", "What's Happening", "The Market Square", "Client Corner" and "In the Community". This variation while expanding appeal will also allow us to incorporate some of your ideas.

The last page of the newsletter has been designated for your input. Please write down your ideas or input on the bottom half of the page, cut it and send it to the office. If you prefer you can e-mail your comments by addressing them to info@sgroifinancial.com. So please join in on the fun, and help us make the newsletter a combined effort.

“Interest Rates and the Fed”

(continued from page 1)

corporations, large and small, becoming more willing to borrow money in order to make major investments in their plants and equipment. The cost of such investments is much lower than the profits generated by those investments can be that much higher. All of this activity is what makes up economic growth.

The Federal Reserve System, commonly called The Fed, is headed up by Alan Greenspan. As previously stated, regulating the nation's money supply is one of The Fed's key duties. One of the ways it performs this function is by establishing interest rates within the banking system. The Fed does not directly tell banks what interest to charge on their loans. It does, however, strongly influence those rates by other means.

Banks are required by The Fed to keep, as a cash reserve, a certain percentage of the money that their depositors have given them. They can't just loan it all out. There would be no liquidity within the system if they did. This money is called the reserve requirement or more loosely **“federal funds”**. When they take in deposits or loan payments their federal funds increase. When they loan money out their federal funds decrease. This is monitored on a daily basis.

If at the end of the day a bank finds their federal funds to be short of the required amount they simply borrow some from another bank that has excess federal funds. This is a well organized system and operates on a continuous basis. The banks pay each other interest on these overnight loans and that interest rate is called the *federal funds rate*.

There are also times when banks borrow money directly from The Fed. Interest is charged on these loans also. The rate The Fed charges on these loans is called the *discount rate*. Both the federal funds rate and the discount rate are set by The Fed.

Large banks in the nation's financial centers naturally tend to send out larger amounts of money in the form of loans than they take in on deposit. As a result they also have greater needs when borrowing to meet their reserve requirements. So when The Fed increases the federal funds or discount rates, the banks then have to charge their customers more interest too. Likewise, when The Fed lowers its rates the banks can lower theirs.

The rate that banks charge their best customers is known as the *prime rate*. Mortgages, home equity loans and other credit from the bank is often tied to the prime. This rate differs from bank to bank and is a very good reason why one should shop around when

borrowing.

The adjusting of interest rates by The Fed is a broadly followed activity. Some times it is even headline news. When they lower interest rates their intent is to increase economic activity. On the other hand, The Fed will raise rates to slow economic growth. Unsustainable growth in the past has led to a “boom and bust” economy. This can bring about imbalances of production and consumption which in turn can lead to inflation.

The Fed's management of the economy by adjusting interest rates and regulating the money supply (along with other activities) is commonly referred to as **“Monetary Policy”**. It is important to realize that Monetary Policy is distinctly different from “Fiscal Policy”. **Fiscal Policy** is the taxation and spending by the federal government. As such, Fiscal Policy is enacted by Congress and implemented by the Executive branch. It is completely political in process and intent. The Fed, on the other hand, operates independently in setting monetary policy. This independence was granted deliberately to help insulate The Fed from the irrationalities of the political scene.

However, the effects of Monetary Policy and Fiscal Policy are very much connected. Lower interest rates and lower tax rates will both put more money into the economy and generate economic activity. Conversely, higher taxes and interest rates will slow the economy. Government spending - Fiscal Policy - which puts money into the economy can be an economic stimulus. Our feeling is that such stimulus programs have very limited effectiveness. Because governments produce nothing, they can only redistribute money from one group to another.

Over the last year or so interest rates have been dropping. The Fed has cut its rates ten times to their lowest levels in forty years. This has been good for those who borrow and not so good for folks who save. Those of you who invest in fixed income investments such as money market accounts, CDs, annuity contracts and the like have seen your returns decrease. So while the economic need for interest rate reductions has been pretty obvious there are some disadvantages.

Income producing investments are an important part of a diversified portfolio. Even in these days of low interest rates there are high quality choices available. We hope this information is helpful in understanding the current economic environment and look forward to meeting with you in the future. J J J J J

A personal letter from Joe

Dear Friend,

With the holidays upon us, I'd like to take this opportunity to wish only the best for you and your loved ones. This is my very favorite season and I hope you all enjoy it.

I also want to express my good wishes and prayers for the members of our armed forces serving here and overseas. A number of them are clients. I spent the Christmas of 1968 in Vietnam when I was in the Air Force and would have given anything to be home with Betsy and my son Patrick for his first Christmas.

I continue to be impressed by the outstanding job of the administration in the fight against terrorism. They have rallied the world to see that terrorism is globally eliminated or so reduced that the threat is no longer the danger it was. For sure there is a long way to go, but the support they are receiving from all countries, from England to China, Russia to Mexico and all points in between, is remarkable.

This leads us into the single most important factor as far as investing is concerned, one word - confidence! When there is confidence in the market people invest. Over this past year we have seen The Fed cut interest rates ten times. Rates right now are at their lowest in forty years. This will help our economy recover and start to grow. The tax cuts of this past year should do the same. In addition, the market has a history of recovering from the sudden shock of national disasters as well as a history of recovering after bear market down turns. Furthermore, the pension law changes enacted this year could significantly increase the amount of money going into retirement plans. My personal opinion is that the market is currently oversold and that the market improvements seen since September 24th will continue.

Having said that, I do not think the advances will be like the year after year double digit increases that we saw in the nineties. It will likely be bumpy and somewhat nerve wracking (like it usually is). However, for long term investors, I believe the stock market remains a place to be.

In October we held a seminar on the state of the market and several hundred of you attended. Thank you all for coming. Thanks also to the investment companies and their representatives who made presentations. This included Brian Whalen from Putnam, Rich Zajkowski from American Skandia, Jim Adams from MFS and Charlie Petit from Oppenheimer. They not only represent great companies, but just as important, they are great people. Thanks again, guys.

This has been a unique and challenging year for all of us. My firm continues to expand and we are working harder than ever to improve the service you receive. Soon we will have our website up and running, our computer system has been upgraded yet again and we hope to have summary statements for you in the near future. Through all of this years ups and downs though, the support received from all of you, the best clients in the world, has been incredibly gratifying.

You have my most heartfelt thanks and wishes for the happiest of holiday seasons.



A handwritten signature in black ink, appearing to be the name 'Joe' written in a cursive, looped style. The signature is located at the bottom right of the page.

Pension Contribution Increased Limits

By: John Clouden

Over the next five years a person's ability to save inside pension plans will gradually increase to unprecedented levels. The contribution limits for 401(k), 403(b), 457 and IRA plans will be rising and each of these plans will have different catch-up provisions for those age 50 or older. We have received numerous phone calls asking about the new limits. For your convenience the following chart illustrates contribution amounts by plan through the year 2008.

Contribution Limits for						
Year	403(b), 401(k) & 457 Plans	50 and older Catch-up	Simple IRA Plans	50 and older Catch-up	IRAs (Roth & Traditional)	50 and older Catch-up
2002	\$11,000	\$1,000	\$7,000	\$500	\$3,000	\$500
2003	\$12,000	\$2,000	\$8,000	\$1,000	\$3,000	\$500
2004	\$13,000	\$3,000	\$9,000	\$1,500	\$3,000	\$500
2005	\$14,000	\$4,000	\$10,000	\$2,000	\$4,000	\$500
2006	\$15,000	\$5,000	\$11,000	\$2,500	\$4,000	\$1,000
2007*	\$15,000	\$5,000	\$11,000	\$2,500	\$4,000	\$1,000
2008*	\$15,000	\$5,000	\$11,000	\$2,500	\$5,000	\$1,000

*limits will be subject to increase, in \$500 increments, thereafter for inflation, except IRAs they will not be subject to increase until after 2008.

Sour Cream Coffee Cake By Robin Clouden

2 tbsp. Flour	½ c. Butter	1 tsp. Baking Soda
2 tbsp. Brown Sugar	1 c. Sugar	1 tsp. Baking Powder
½ c. chopped walnuts	3 eggs	1 tsp. Salt
2 tsp. Cinnamon	1 tsp. Vanilla	1 c. Sour Cream
2 apples, peeled and sliced thinly	2 c. Flour	



Mix together flour, brown sugar, chopped walnuts and cinnamon. Set aside.

Cream butter, sugar, eggs and vanilla. Add flour, soda, baking powder and salt. Add sour cream.

Pour half the batter into greased tube pan. Top with sliced apples. Sprinkle with ¾ of cinnamon mixture. Pour rest of batter over apples. Sprinkle with remaining cinnamon mixture.

Bake at 350 for 35 – 40 minutes or until center tests done.

Drizzle with ¾ cup of confectionary sugar mixed with 2 – 3 tbsp of milk when cooled.

Please put your comments about the Newsletter below, cut on the above line and
send it to the office.
(or email us at info@sgroifinancial.com)
