The Thoughtful Investor™

Second Quarter 2021

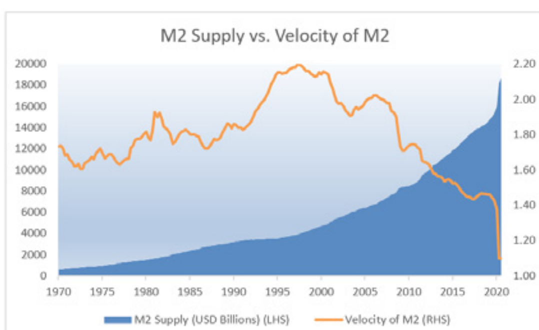
Inflation on Our Minds

In 2020, the amount of money in the U.S. economy increased by more than $4 trillion, a one-year increase of more than 26% in M2 — a measure of the money supply that includes cash, checking deposits, and easily convertible near money. Another $2.3 trillion (12%) increase is already built in the Federal Reserve planning for 2021. That's a lot of money.

According to the Fed, the purpose of the money is to spur the economy and drive employment up, moving money into the consuming public. The problem with this plan is that "created" money all too often ends up producing inflation. In 2009 and 2010, the *Wall Street Journal* reports that China's money supply grew by 23%. By July of 2011, inflation had increased from 1.8% to 6.5%[1].

Many economists point to the lack of inflation in the U.S. to date as proof that the increase in M2 does not affect inflation. The U.S. at an average annual inflation rate of 1.8%, is still below the Fed's 2.0% average inflation target. But there's also not a lot of evidence that the new money has made it into circulation and had a opportunity to impact prices. Thanks to the Covid lockdowns and economic uncertainty, Americans have been spending less on non-essentials and saving more than ever. Banks tightened standards in 2020 for commercial and industrial (C&I) loans, along with many other lending products, because of the uncertain economic outlook, worsening of industry-specific problems, and reduced tolerance for risk. As a result, new loan originations faltered.

Velocity is a measure of the number of times that the average unit of currency is used to purchase goods and services within a given time period. For example, when you purchase a pair of shoes, your money may be used by the store owner to purchase more inven-tory, providing the manufacturer with funds to purchase more raw materials. Comparing the growth of M2 (money supply) with the velocity of M2, shows money creation has outstripped the willingness to spend. With velocity at an all time low, money isn't making the world go round.



There is also the belief at the federal level that increasing money supply is not inflationary. Fed Chairman Jerome Powell made clear February 23, 2021, that he did not think increased stimulus spending would trigger higher inflation:

"Inflation dynamics do change over time but they don't change on a dime, and so we don't really see how a burst of fiscal

continued on page 2

1 The Money Boom Is Already Here, by John Greenwood and Steve H. Hanke, The Wall Street Journal, Feb. 21, 2021.

Cashing Out the Appreciation in Your Home

2020 left homeowners with a number of reasons to cash out on the appreciation in their home ranging from the desire to move to a new area of the country to record increases in their home's value over the last few years, the ability to work remotely or even deciding to retire.

Another reason might be to take advantage of a tax break for homeowners included in the 1997 Taxpayer Relief Act. The legislation enabled homeowner couples to receive up to $500,000 in gains on the sale of their principal residence tax free. For singles, the tax break is $250,000. The home must have served as the owner(s)'s principal residence for two of the preceding five years.

Before 1997, homeowners had to "roll over" the proceeds on the sale of a home into the purchase of a new home to avoid capital gains taxes, or wait until age 55 to sell for a one-time opportunity to eliminate taxes on up to $125,000 of their accumulated real estate gains.

One key reason for taking advantage of the ability to cash out on your real estate gains now is that there is no guarantee how long this particular tax break will be around. The catch of course is that you have to make certain you have somewhere to live once you sell. Record price increases around the country are in part a result of a housing market with a limited inventory of homes for sale. Before taking any action, you also want to talk with your financial or tax consultant on how the sale will affect your overall financial position and your potential taxes.