The way back is closed, only the path forward remains open

There are different types of change

It's a trite phrase to say *"change is the natural order of things,"* sounds too much like an excuse.

Worse yet, it serves to mask the different types of change - and how the best approach for dealing with one type of change is the worst for another.

Different types of change are distinguished by two attributes:

- Speed or pace
- Smoothness or direction

Speed or pace

Speed or pace is either fast or slow. Most of the time, change proceeds slowly. Telecommunications provides a ready example.

For fifty years, telecommunications developed at a slow but steady pace. But then, with the development of integrated circuits (silicon chips), the Internet, lithium batteries, and the World Wide Web, the pace of change moved from slow to fast.

Automobiles and personal travel provide a second example.

Integrated Financial Partners, Inc.
200 Fifth Avenue, Suite 4010 • Waltham, MA 02451
Phone 781-890-3045 • Website https://integrated-partners.com/

Once again, for fifty years, automobiles developed at a slow but steady pace. But then, with the development of integrated circuits (silicon chips), lithium batteries, ultra-lightweight composite construction materials, and artificial intelligence, the pace of change moved from slow to fast.

Smoothness or direction

A different type of change is related to smoothness and/or direction. Often the distinction is seen most clearly when our system either bends or breaks. The early 1900s provide an excellent example.

1914-1921
- Creation of the Federal Reserve
- Russian revolution
- Global pandemic (The Spanish Flu)
- Great Depression of 1920
- World War I

- Depended on other nations for capital
- Largely an agricultural economy
- Developing superior manufacturing techniques allowing it to grow its exports

- Shifted to a provider of capital to other nations
- Era of the roaring 1920s
- Optimism, rapid growth, and purchase of cars

The pressures resulting from the global pandemic, world war, and economic depression during the years 1914-1921 helped change the direction of the US economy and the priorities of American society. While the creation of The Federal Reserve System in 1914 helped facilitate that directional change. A more recent example unfolded during the mid-1900s.

Integrated Financial Partners, Inc.
200 Fifth Avenue, Suite 4010 • Waltham, MA 02451
Phone 781-890-3045 • Website https://integrated-partners.com/

1929-1946

- Great Depression of 1929
- World War II
- Eight-year drought - The Dust Bowl
- ENIAC began the computer revolution
- A scalable market for U.S. Treasury bonds was developed

- Large and rapidly growing economy
- Relatively separate from the rest of the world, endeavoring to remain apart and uninvolved

- Leader of the Free World
- Major provider of capital to other nations
- Nation builder

The pressures resulting from the 1929 Depression. The environmental disaster of the eight-year drought, and WWII fundamentally changed the direction of the US economy and meaningfully altered the preferences of American society. The change that unfolded during these years was more akin to the breaking of a bone and its subsequent resetting.

Best method for dealing with change

Life provides valuable lessons. We've learned that when managing through change defined by speed or pace, it's best to just keep doing what's worked so well in the past. Maybe we tweak our approach at the edges to account for recent developments. But we stick with what has proven itself out through the test of time. OK, maybe when the speed of change ramps up from slow to fast we have to be a bit more nimble, and perhaps tweak the edges a bit more aggressively, but that's about it.

In contrast, when managing through change defined by a directional shift, breaking instead of bending, or just a simple discontinuity, the worst possible approach is the one described above. Continuing to do what worked so well in the past almost assures that we'll faceplant.

The best approach when facing a change of direction is to forget everything we think that we know and start with a clean sheet of paper. Such an approach requires that we ask: "What's the game, rules, players, field, and their relative strengths and weaknesses?" By asking this question, we're admitting that we can't predict the future, but we can narrow it down to a small number of possible outcomes and assign probabilities to each.

How does this relate to investments?

Investment is no different. We experience remarkably long periods of smooth, flexible, unidirectional change, mostly slow, but sometimes fast. Success, during such periods, is best accomplished by continuing to do what worked so well in the past. At the edges, we seek to lower costs, improve tax efficiency, and make tiny adjustments for recent new developments.

But . . . occasionally (and thankfully not very often), investments experience a directional change or breakage instead of bending. Success during these periods requires that we set aside what worked so well in the past and seek an approach that best harmonizes with the inherent new realities. Individuals often have a hard time making these shifts if they've become emotionally attached to what worked so well in the past. Similarly, organizations often have a hard time making such shifts if they have monetary incentives tied to solutions from the past. Such individuals and institutions inevitably faceplant - and by so doing, create opportunity for the rest of us.

Interest rates and bonds

Interest rates fell from 16% to ½% over the 40 years just ended. 2020 may have ushered in a change of profound dimensions, whereby interest rates now rise for the next 40 years. Why does this matter? When interest rates rise, bond prices fall. Do you want to invest in something whose price will be lower tomorrow than it is today? You might respond *"Well, I'll just buy the bond and then hold it until it matures. By doing so, I'll get my investment back plus some profit. I'll make money."*

There are several problems with this train of thought. The yield (total return) on a 10-year US Treasury bond is 1.70% today. If your combined marginal tax bracket for state and federal income taxes is 40%, inflation is running at 2.36% (the market's current expectation for the next ten years), and expenses and fees consume 1.20%, then your investment in a Treasury Bond is guaranteed to lose you money at a rate of -2.54% per year, every year, for ten years. You would be much better off just spending your money today.

Will interest rates rise?

Will interest rates rise, going up instead of down, over the next several decades? Here are the reasons why:

Unsustainable Present - Interest rates are currently at unsustainably low levels. Current rates are at a level that is only consistent with a permanently shrinking economy, one in perpetual recession.

Shortages - There's been significant underinvestment across a broad range of industrial commodities and fossil fuels. As the global economy comes out of recession and returns to robust growth, a shortage will appear within these markets. Given how long it takes to develop new supplies, it is expected that commodity prices could rise for many years into the future.

Renewables - Most of the developed world has decided to shift from fossil fuels to renewable energy sources. Such a shift is unusually resource intensive, serving to meaningfully shift supply/demand relationships. This is expected to show up in heightened levels of inflation spread over one or two decades.

Protectionism - Many nations and regions of the world are enacting anti-free trade policies, seeking to beggar thy neighbor. This may stop or even reverse the century-long trend of ever-increasing global trade for goods, services, labor, and capital.

Money Supply - Most central banks have grown their money supplies at record-setting levels. Once the global economy returns to normalcy, this money printing may serve to support higher levels of inflation.

Activism - Many of the largest economies have embarked on what looks like a fundamental and long-lasting change with respect to both fiscal (spending money) and monetary (printing money) policy. Governments appear to have both the need and the ability to do so. The need arises from out of health, environmental, and most powerfully, societal motivations. The ability is an outgrowth of the change in political structure across many nations.

Conclusions and next steps

If interest rates rise for the next 40 years, bonds will have embarked upon a path remarkably different from the one just completed. Managing such directional change by continuing to do what worked so well in the past might be the worst possible approach. Solutions exist, but they require starting with the proverbial tableau blanc, looking into the future for answers as to what will harmonize best with a different set of opportunities, risks, and rules of the game.

Your financial advisor has a menu of possible investment solutions. The solution that is most appropriate to your unique needs and circumstances can only grow out of a meaningful discussion with your advisor. Reach out to them, talk with your advisor.

Rob Brown, CFA, PhD
Chief Investment Officer
Senior Vice President
Integrated Financial Partners, Inc.

Important disclosures

It is not possible to invest, directly, in an index.

It is not possible to invest, directly, in any index referred to in this document.

Past performance is not an indicator of future results.

Fees, internal embedded expense ratios, and sales charges have not been subtracted from any of the performance results appearing in this document.

The information in this document is for the purpose of information exchange.

This is not a solicitation or offer to buy or sell any security.

You must do your own due diligence and consult a professional investment advisor before making any investment decisions.

The use of a proprietary technique, model, or algorithm does not guarantee any specific or profitable results.

The risk of loss in trading securities can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. No strategy, including asset allocation and diversification, can assure success or protect against loss. Stock investing involves risk, including loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price. International debt securities involve special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards. These risks are often heightened for investments in emerging markets. International debt securities involve special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards. These risks are often heightened for investments in emerging markets. The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

All information contained in this document is believed to come from reliable sources. We do not warrant the accuracy or completeness of information made available and therefore will not be liable for any losses incurred.

No representation or warranty is made as to the reasonableness of the assumptions made herein.

Investment advice offered through Integrated Wealth Concepts LLC (a Registered Investment Adviser), d/b/a Integrated Financial Partners, Inc.

Integrated Financial Partners, Inc.
200 Fifth Avenue, Suite 4010 • Waltham, MA 02451
Phone 781-890-3045 • Website https://integrated-partners.com/