What you should know about interest rates [Richmond Refreshers]
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Hi, I'm Steve Kulchinski, Associate Financial Advisor with Richmond Brothers.

Whenever you listen to financial professionals, there's one topic that will almost always come up: interest rates. But what do interest rates have to do with your portfolio and wealth?

It turns out, a whole lot.

When you hear the term "interest rates" on the news, it's usually referring to the Federal Funds Rate, which is the rate that banks use when borrowing from one another. This interest rate is the benchmark set by the Federal Open Market Committee (FOMC), and factors in current economic conditions like inflation, employment, and GDP growth.

But why should you care about the Federal Funds Rate?

Because when the country's benchmark interest rate changes, it has a downstream effect on everything from your mortgage to your investment portfolio. In fact, just a one percentage point decline in interest rates can increase disposable income for individuals across the earning spectrum.1

Take, for instance, a home mortgage. Say you're looking to purchase a $346,900 home. With a 7% mortgage rate and a 20% downpayment, your monthly payment would be $1,846. But if your rate decreases by just 1%, you would pay $1,664, a savings of $182 per month. If you factor this change over a 30-year mortgage, you'd save a total of $65,691* in interest.2

Your mortgage is just one example of how an interest rate change can directly affect your wealth. Let's zoom out to see what happens to the economy, and the downstream effects of interest rate changes.

So what happens when interest rates rise?

While economic growth is good, too much of it can lead to an overheated economy where prices are rising and inflation is a concern. In these scenarios, the FOMC is likely to increase interest rates to help maintain economic stability.

However, an increase in the Fed Funds Rate is usually not good for stock prices since corporations have a harder time borrowing money and expanding during high interest rate periods.

One last thing: Don't forget about lag time!

Hopefully, the correlation between interest rates, stocks, debt, and the economy is starting to click. But, you should keep in mind that when interest rates change there is usually a lag time between the policy change and its effect on the economy. According to research from the Federal Reserve Bank of St. Louis, it can take anywhere between 18 months to 2 years for interest rate changes to have an impact on the economy.3

So, the next time you hear about a potential interest rate change, remember that it will take some time before its effects are felt in the economy, and your portfolio.

Before you capitalize on changing interest rates, it's important to understand how your portfolio could be affected. We'd be happy to sit down with you and discuss your current financial plan and how you may be able to take advantage of future changes in interest rates and other important economic factors you should consider.

Richmond Brothers is here to help you build and sustain financial health.

If you have any thoughts you'd like to share, please makes sure to do so in the comments below. Thank you for listening and make it a great day!

Sources

1. https://www.imperial.ac.uk/business-school/ib-knowledge/finance/how-central-banks-interest-rate-rises-affect-the-richest-and-poorest-families/

2. https://www.zillow.com/learn/interest-rate-impact-mortgages/

3. https://www.stlouisfed.org/publications/regional-economist/2023/may/examining-long-variable-lags-monetary-policy

**Example of interest rate savings pulled from Zillow, and is for illustrative purposes only. Exact numbers could vary based off of amortization schedules and rounding used in the calculation of monthly payments.*

Content prepared by Snappy Kraken
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