STEWARD

DECEMBER 2025

A QUARTERLY PUBLICATION OF ALLODIUM INVESTMENT CONSULTANTS ▪ VOLUME 18, ISSUE 4

Interest Rates, Inflation, and Investment Strategy

Part 1: Understanding Interest Rates

Back in March 2022, the Federal Reserve raised interest rates for the first time since 2018, kicking off a historic series of increases to rein in inflation. Over the next 16 months, rates climbed to a 22-year high of 5.25%–5.50%. After holding them steady through most of 2024, the Fed began trimming rates: by September 2025 the target range was cut to 4.00%–4.25%, and then in October to 3.75%–4.00% as the economy cooled and inflation eased.

Along with interest rates, inflation also remains a related topic of conversation. That's what we'll focus on in this multipart series. We'll start with interest rates, followed by inflation, and wrap up by exploring what these influences mean to you, your investments and your strategy.

To steal our own thunder, this series will reinforce the core principles we already incorporate as we help people navigate their financial interests across time and through various market conditions. The news may be evolving, but the timeless tenets driving our patient and personalized advice are enduring and, if anything, even more relevant during periods of increased uncertainty.

What's Up with the Fed Rate?

Almost everyone is familiar with interest rates. That said, far fewer know what to make of the Fed's target funds rate in particular. Everyone from economists, to politicians, to the financial press seems to always be talking about them. Markets rise or fall when the Fed comments on them. They're often treated as synonymous with interest rates in general. They must be important, right?

Well, yes, the target funds rate is important. But not in the way you might expect. As the central bank for the United States, the Federal Reserve is tasked with setting monetary policy to promote "maximum employment, stable prices and moderate long-term interest rates . . . thereby supporting conditions for long-term economic growth." In this supporting role, the Fed uses its target funds rate as one of many "levers" to achieve its aims.

When the Fed increases or decreases the target funds rate by specific points—it's actually establishing a range of rates. The current target range for the federal funds rate set by the Federal Reserve as of November 2025 is 3.75% to 4.00%. Banks and similar financial institutions use the federal funds market to lend and borrow money from one another on an overnight basis. These very short-term loans help institutions meet their reserve requirements or manage daily liquidity needs.

The Federal Reserve doesn't set the exact rate for these transactions but instead sets a target range for the federal funds rate. Banks then conduct these overnight loans within that range, and the Fed uses tools like open market operations and interest on reserve balances to keep the actual rate near its target.

Keeping Time with the Fed

Think of the banking system as an intricate timepiece. Each bank operates independently. Each can choose when or if to lend to or borrow from other banks within the Fed's current target rate range. Each also sets its own, public-facing retail rates.

When banks stay in sync with one another and the Fed, the economy will hopefully keep good time. But if even a few cogs get jammed, it can stymie the entire operation.

When the Fed increases the target funds rate: It's hoping to reduce the flow of excess cash or stimulus in the economy, which in turn can help temper inflation.

When the Fed lowers the target funds rate as it did during the pandemic and the Great Recession: It's hoping to keep stimulating cash flowing through the economy . . . without letting inflation get out of hand.

Along with adjusting the target funds rate: The Fed also can inject or extract cash into or out of the system, in an effort to quicken or slow the wheels of commerce, increase or decrease inflation, ward off a recession, tamp down "irrational exuberance," and/or otherwise spur or check economic activities.

However, we must emphasize: No single entity can just flip a switch to power the economy off and on. The Fed is in a relatively strong position to encourage long-term economic growth through its actions. Often, its actions will trickle down to other types of loans and move them in a similar direction, for the same purpose. But not always, and rarely across the board. As in any complex system, any given move interacts with countless others, with varied results. This is especially so globally, as most countries have central banks and "timekeepers" of their own.

The Fed Rate Isn't Every Rate

To review, the Fed's target funds rate is the rate range at which banks lend each other overnight cash. Rising rates are meant to help unwind earlier stimulus programs, and manage rising inflation by tinkering with the cash flow in our banking systems. But as an admittedly blunt tool, there is an even more tenuous connection between the Fed's rates and the interest rates you personally pay or receive.

For example, as described in this Wall Street Journal video, existing fixed-rate debt such as home and student loans may not be as immediately affected by rising rates, while free-floating credit card debt is more likely to creep quickly upward in tandem with the Fed's rates. It's generally wise to avoid credit card debt to begin with, given their persistently higher rates. It's even more critical as rates rise.

Similarly, you may or may not receive higher rates on interest-bearing instruments such as bonds, CDs, bank accounts, etc. That's because it's the banks and similar entities, not the Fed, who set these rates.

We'll discuss this further in part 3, when we explore the impact of interest rates and inflation on your investment strategies. Time will tell how the future Fed rate will contribute to lowering or raising inflation and the health of the economy. Each era comes with its own challenges and opportunities.

Next time, we'll talk about inflation, and how it factors into our conversation so far.

Eric Hutchens
President & Chief Investment Officer

Headlines

- David Bromelkamp was a featured speaker at two sessions of the 2025 MNCPA Tax Conference in November.
- David Bromelkamp delivered opening remarks at Sustainable Investor Day in Minneapolis, hosted by Calvert Impact, on November 5, 2025
- Share your experience with Allodium by leaving a **Google review** (click on the link)—it helps others who are seeking fiduciary advice.
- Our office will be closed December 25, 2025 and January 1, 2026 for company holidays. For more Allodium's news, visit **www.allodium.com**

Team Highlights

- We are thrilled to announce that Brieanna Olson, Operations & Technology Associate, and her husband Eric Olson, welcomed their first child in October of 2025! Congratulations!

Learn more news about Allodium's team members at **www.facebook.com/AllodiumInvestmentConsultants/**

Upcoming Events

The Psychology of Investing

Webinar: Tuesday, January 27, 2026 at 3:00 – 4:00 p.m.

Join us for our 2026 Investment Forum! To register:

https://us02web.zoom.us/webinar/register/WN_FWnJz4VXRL-bpjfKjb7vYA

Investors often perceive their returns as a purely quantitative result of markets, risk, timing, or expertise. But emotions and behaviors can play an important role in performance. This presentation reviews the history and principles of behavioral psychology and explores the influence of emotion on decision-making. Using real life examples, we compare and contrast an investor's narrative to that of a speculator and offer a framework for bridging behavioral finance and market efficiency. We also cite academic research and employs live audience-participation,experiments to help attendees understand how people perceive investments and improve their thinking about wealth and the future.

Scott Bosworth, CFA®
Head of Speakers Bureau, Dimensional Fund Advisors

Scott Bosworth is Head of Dimensional's Speakers Bureau. In addition to being a frequent presenter at Dimensional conferences and industry events, he manages the firm's primary team of speakers and helps develop messaging around key investment concepts. He has been with Dimensional since 1996, first as a portfolio manager, then working with institutions and large advisory clients. He is a CFA®, and has graduated from James Madison University and earned an MBA from Yale. While at Yale, Scott was a teaching assistant for Kenneth R. French, now a professor at Dartmouth's Tuck School of Business and a consultant to Dimensional Fund Advisors, a Dimensional Director, and a member of Dimensional's Investment Research Committee.

FINANCIAL PLANNING TIP

The Roth IRA — Is it Right for You?

In retirement planning, it is helpful to diversify by tax type as well as by asset classes. Taxable, tax-deferred, and tax-free assets provide more options when taking income from a portfolio in the future. If tax rates are low, taxable assets can be used for income. If tax rates increase, a Roth IRA that is tax-free may be a better option for income.

Contributions to a Roth IRA are made after tax, and all growth, income and distributions are tax-free after age 59½ and if you have held the account at least five years. You can make a Roth contribution up to the April 15th tax filing deadline for the prior year. In 2025, the contribution limit is $7,000 per year for individuals under 50 years of age. An additional $1,000 catch-up contribution brings the total to $8,000 per year for those age 50 or older.

Benefits of Roth IRAs

Tax-free accumulation of wealth. You pay no taxes once an amount has been contributed to the Roth IRA —no tax on capital gains, dividends, or interest income. Also, there is no income tax on distributions, unlike regular IRAs or 401(k)s.

Protection from future income tax rate increases. Locking in the current tax rate may be beneficial if your tax rates increase in the future.

Protection from Medicare surtax. Distributions from a Roth IRA are not subject to the Medicare surtax and are not included in the income threshold used to determine the surtax.

No age requirements. Required Minimum Distributions (RMDs) are not required from Roth IRAs. You can contribute to a Roth as long as you have earned income.

Withdraw contributions any time. You can withdraw the amount that you contributed without penalty or tax. The gains are subject to different rules because they have not been taxed.

Withdrawing gains. You can withdraw gains before age 59½ without penalty in certain situations.

- *Buying a house.* You can access gains without penalty to purchase a home (up to $10,00 per person). However, if you have had the Roth for less than five years, you will still pay taxes on the gains if you are under 59½.
- *Funding college expenses for you, your spouse, children or grandchildren.* Under similar rules as buying a house, you are free to use the amount that you contributed; however, gains are subject to taxation if you are under 59½ and have had the account for less than five years. A 529 is generally recommended as a better option for college expenses.
- *Estate planning.* Leaving a Roth IRA to your children or grandchildren gives them an income-tax-free inheritance. Ask your financial advisor if a Roth IRA is for you.

> "The individual investor should act consistently as an investor and not as a speculator. — Ben Graham"

WE APPRECIATE YOUR INTRODUCTIONS

Do you have a friend or family member who could benefit from independent, fee-only, fiduciary financial advice? We are here to help. Please contact us to arrange a friendly, no-obligation introduction. Our mission is to simplify and improve the financial lives of our clients.

Steward is published quarterly by Allodium Investment Consultants. Please contact **iavraamides@allodium.com** if you have any comments about this publication or wish to be added to or removed from our mailing list.