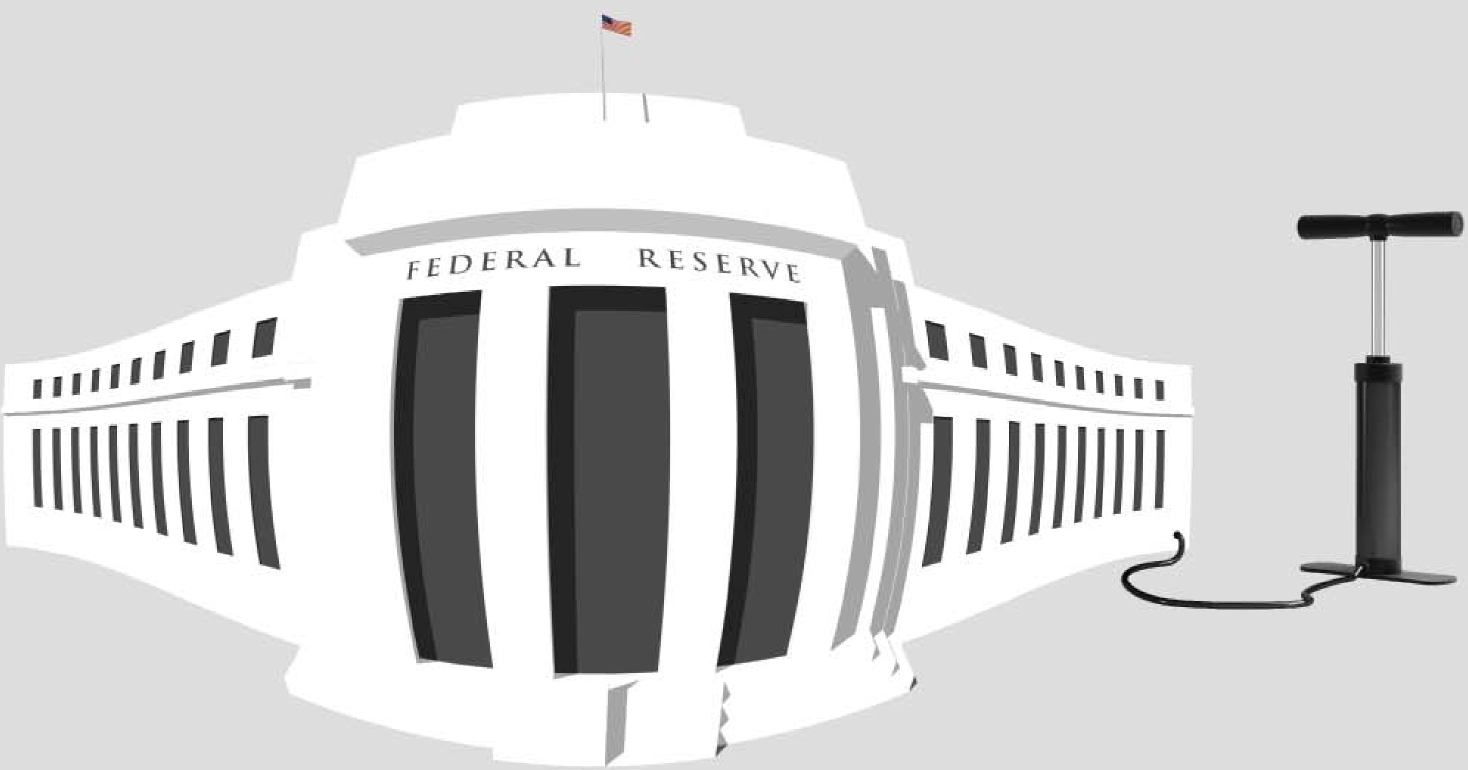
Five Step Inflation Survival Guide

By Michael Albertson, President, TradeWell Tax & Financial



Five-Step
Inflation Survival Kit

How Inflation Erodes Purchasing Power

While moderate inflation is generally economically healthy, higher inflation may foreshadow a more dramatic decline in future purchasing power.

During good times, businesses and consumers often spend more and demand more, which permits producers to raise their prices. If an economy grows too rapidly, though, prices can increase too quickly – creating an upward, inflationary price spiral.

Meanwhile, investors typically aim to increase their long-term purchasing power. Inflation puts this goal at risk because investment returns must first keep up with the rate of inflation in order to increase real purchasing power. For example, let's say the economic environment is characterized by a 3% rate of inflation, as measured by the Consumer Price Index (CPI). An investment earning 2% will actually produce a negative return (-1%) once earnings are adjusted for inflation.

www.tradewelltax.com | 260-490-2084

Fighting Inflation

Inflation affects all aspects of the economy, from consumer spending, business investment and employment rates to government spending, tax policies, and Federal Reserve forward-looking statements.

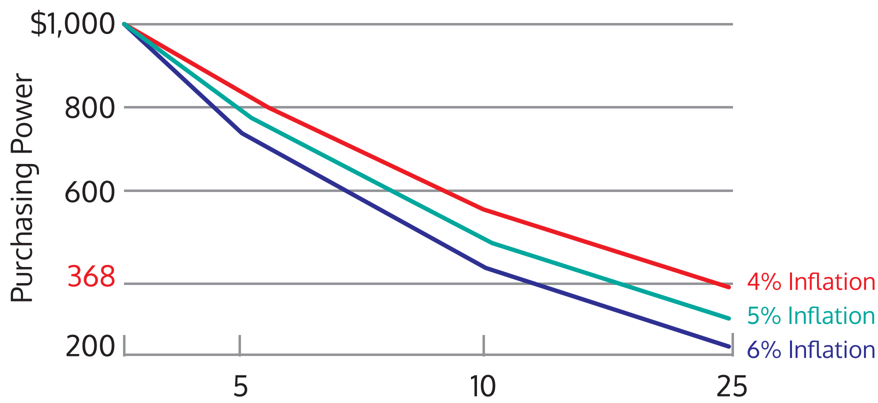
The chart at right presents a dramatic illustrations of how quickly inflation can erode purchasing power over time.

Over the course of 25 years, an inflation rate of 4%, for example, would reduce the purchasing power of $1000 to only $368.

It's important to understand that if your money isn't growing at a rate at least equal to the rate of inflation, you're losing purchasing power.

Decline in Purchasing Power Over Time

What will $1,000 today look like tomorrow?



If you stash $1,000 in a box and leave it there for 25 years, assuming an inflation rate of 4%, when you take the money out, your original $1,000 would only be able to purchase $368 worth of goods!

Source: http://www.handsonbanking.org/financial-education/military/inflation-erodes-purchasing-power/

Buying Less With More

Inflation chips away at real savings and investment returns, which must first keep up with the rate of inflation in order to increase real purchasing power.

After adjusting for inflation, some of the differences in prices are eye-opening.

Since many of us will live to be at least 75 years old,[1] it is helpful to take a look back and compare yesterday's prices – in 1938 – to what we can buy today. After adjusting for inflation, some of the differences in prices are eye-opening. In 1938, a new house on average cost $3900. Today, adjusted for inflation, the price is $245,800. A dime bought a gallon of gas in 1938. Today, it costs on average $3.24.[2]

The Cost of Living: 1938 Versus 2013

Item	Price (1938)	Price (2013) inflation adjusted
New house	$3900	$245,800
New car	$860	$31,252
Average rent per month	$27	$821
Harvard University Tuition per year	$420	$54,496
Gallon of gasoline	$0.10	$3.24
U.S. Stamp	$0.03	$0.45

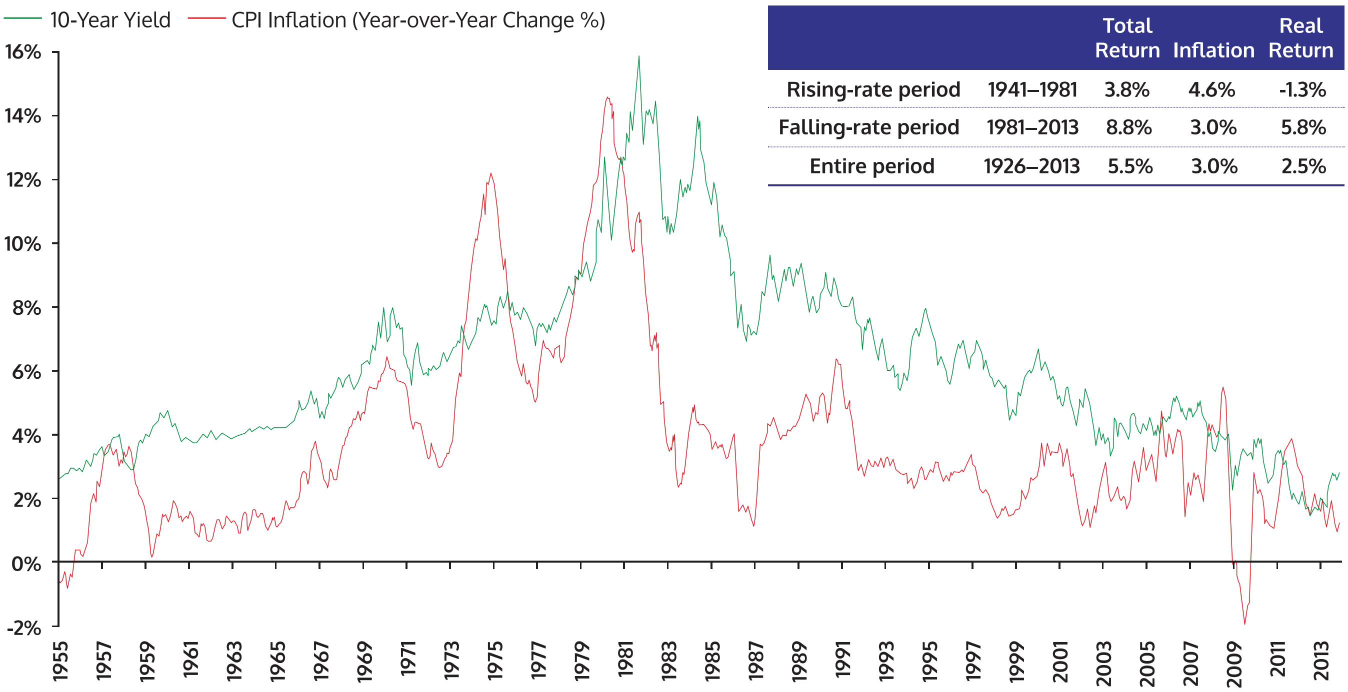
Source: Bureau of Labor Statistics, www.mybudget360.com

Overcoming the Income Dilemma

Following the market downturn of 2008-2009, the Federal Reserve and overseas central bankers collaborated in an effort to maintain lower interest rates to stimulate investment and revitalize the economy.

Against this low interest rate environment, traditional high-quality securities, represented in this illustration by the U.S. 10-year Treasury bond, occasionally delivered yields that were equal to or lower than the rate of inflation as measured by the Consumer Price Index.

10-Year Treasury Yield and Inflation



		Total Return	Inflation	Real Return
Rising-rate period	1941–1981	3.8%	4.6%	-1.3%
Falling-rate period	1981–2013	8.8%	3.0%	5.8%
Entire period	1926–2013	5.5%	3.0%	2.5%

Sources: CPI: Consumer Price Index. Past performance is no guarantee of future results. Total returns represented by IA SBBI U.S. Intermediate-Term Government Bond Index. Real returns are adjusted by rates of inflation; differences are due to rounding.
Source: U.S. Treasury, Federal Reserve Board, Haver Analytics, Morningstar EnCorr, Fidelity Investments (AART) as of 11/30/13.

Your Five-Step Inflation Survival Kit

As we saw above, even a low rate of inflation can erode your portfolio's purchasing power. To fight inflation now, consider five strategies that may help you off-set the impact of inflation on your portfolio.

1. Focus on What You Can Control
2. Plan for a Longer Retirement
3. Consider Potential "Inflation-Offset" Investments
4. Apply the "Cappuccino Factor:" Saving a Few Dollars More May Help Fight Inflation
5. Take Action Now – and Consider Professional Advice

1 Focus On What You Can Control

First, focus on what you know – and can control – today.

We can't control what happens to interest rates or market events. We certainly can't control the prices of securities. On the other hand, there are ways to help off-set inflation risk that you can control. For example, you can educate yourself on how to allocate assets to build in less sensitivity to inflation-driven interest rate swings. You can also reach out to established investment professionals for counsel on lowering your inflation exposure.

Can't control	Control
Interest rates	Asset allocation
Market events	Degree of knowledge
Security prices	Access to experience

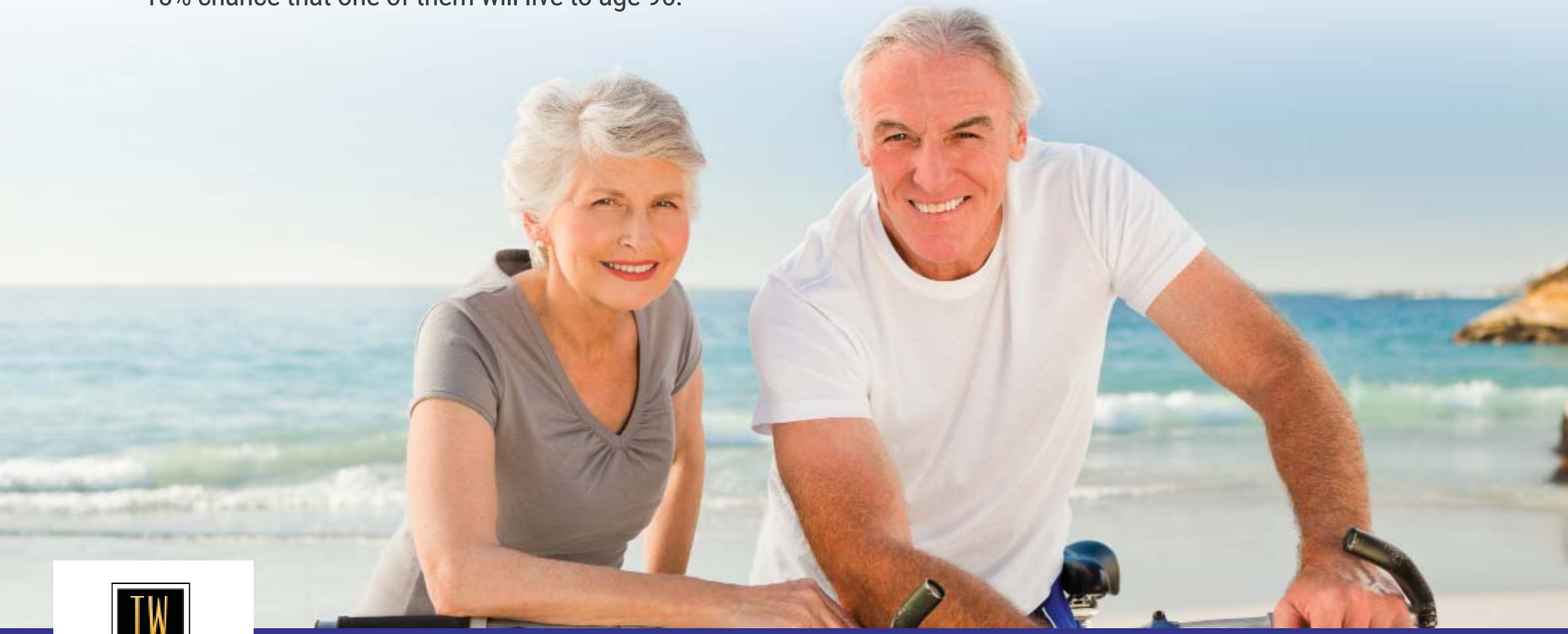
2 Plan for a Longer Retirement

Every day for the next 19 years, 10,000 baby boomers will reach age 65.[3] This rise is anticipated through 2050, when the numbers of those aged 65 and over will soar past 80 million, followed by a dramatic drop in the ratio of individuals from 20 to 64 versus those 65 and up; from 4 to 1 in 2015 to 2.6 to 1 by 2050.[4]

Thanks to healthier lifestyles and breakthroughs in medical technology, life expectancy for Americans has increased significantly during the past half-century. While it's good news that you can expect to live longer and have a better quality of life, it also means your investment portfolio may need to last for 30 years or more.

For example, here's the likelihood of 65-year-olds living to certain ages, according to figures from the Society of Actuaries:[5]

- Male. A 65-year-old man has a 41% chance of living to age 85 and a 20% chance of living to age 90.
- Female. A 65-year-old woman has a 53% chance of living to age 85 and a 32% chance of living to age 90.
- Couple. If the man and woman are married, the chance that at least one of them will live to any given age is increased. There's a 72% chance that one of them will live to age 85 and a 45% chance that one will live to age 90. There's even an 18% chance that one of them will live to age 95.



3 Consider Potential "Inflation-Offset" Investments

Some investments have more sensitivity to the rising cost of living than others. Traditional bonds, for example, can lose some of their underlying principal in rising rate environments. On the other hand, inflation-linked bonds are explicitly tied to changes in inflation. In 1997, the U.S. introduced Treasury Inflation-Protected Securities (TIPS). TIPS help protect investors from inflation because both their principal and their interest payments adjust as the prime metric for inflation, the Consumer Price Index (CPI) changes.

Common stocks may be a good investment relative to inflation over the very long term, because companies can raise prices for their products when their costs increase in an inflationary environment. However, over shorter time periods, stocks have often shown a negative correlation to inflation and can be hurt by unexpected inflation. When inflation rises suddenly or unexpectedly, it can heighten uncertainty about the economy, leading to lower earnings forecasts for companies and lower equity prices, too.

The chart at right compares how $1 investments in a variety of choices over a 40-year period would have grown, after adjusting for inflation, as measured by the CPI.

AFTER FACTORING IN INFLATION'S IMPACT
12/31/77 to 12/31/11

$1 Invested in Each of These Categories	Would Have Growth to…
Stocks	$9.98
60% Stocks/40% Bonds	$5.54
Gold	$2.51
Cash Equivalent	$1.83
U.S. Dollar	$0.28

This chart is for illustrative purposes only and does not reflect the performance of any investment. Sources: Stocks are represented by S&P 500 Index; Bonds are represented by Ibbotson Associates SBBI Long Term Corporate Index; Cash Equivalents are represented by the P&R 90-Day U.S. Treasury Index; Gold is represented by the S&P GSCI Gold Spot Index; U.S. Dollar is represented by the growth of the nominal dollar beginning in 1978, taking inflation into account. Inflation is calculated using the CPI. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

Many real and commodity-based assets, such as housing, precious metals, commodities and commodity indices, may help cushion a portfolio against the impact of inflation because their total returns tend to increase in an inflationary environment.

4 Apply the "Cappuccino Factor:" Saving a Few Dollars More May Help Fight Inflation

By modifying spending habits only slightly, you can uncover a significant source of investment dollars for your nest egg and – according to your investment choices – potentially outpace the rate of inflation.

This "cappuccino factor" can add up quickly if you get in the habit of redirecting dollars from your short-term, discretionary purchases to your long-term investment program.

HOW SMALL AMOUNTS OVER THE SHORT-TERM MIGHT GROW INTO SIGNIFICANT WEALTH OVER THE LONG-TERM

Spending preference	"Cappuccino factor"	Estimated savings	Growth over 30 years at 4% a year
Go to the movies twice a month	Go to the movies once a month	$11/month $132/year	$8257
Weekly car wash	Bimonthly car wash	$12/month $144/year	$9009
Buy cappuccinos about 20 times a month	Elects to buy a cappuccino 10 times a month – and redirects the difference to savings	$30/month $364/year	$22,519
Routinely orders "take-out" numerous times a month	Dine out once-a-month	$45/month $540/year	$33,799

These hypothetical examples of savings in a tax-deferred account are based on a 4% annual rate of return compounded at the same rate as contributions over a 30 year period and are not meant to reflect the performance of any investment product. All numbers are in today's dollars. Your own investment returns may be more or less than these examples, and income taxes and penalties may be due when you withdraw from your account. You may not be able to invest the contribution at the same rate as periodic savings because of investment minimum requirements. This table is not intended to imply the performance of any product. Investing in this manner does not ensure a profit or guarantee against loss in declining markets. Calculations based on following calculator: http://www.planningtips.com/cgi-bin/savings.pl

5 Take Action Now – And Consider Professional Advice

The sooner you redirect a few dollars more to your investment and savings plans, the more money you may have to grow over time. As the "cappuccino factor" examples showed, the effect of compounding your investment earnings can be quite dramatic. In fact, Albert Einstein called the effect of compounding "the greatest mathematical discovery of all time."

That's because compounding may help you outpace inflation by earning money not only on your savings, but also on any income dividends or capital gains that your portfolio accumulates. The sooner you take action: to control what you can, plan for a longer retirement and diversify your portfolio with investments that have the potential to off-set inflation, the better off you could be.

You don't have to go through this experience alone, either. If you decide you have neither the time or background to make confident investment choices, consider hiring a qualified professional advisor. Together, you can explore ways to temper inflation's impact through thoughtful allocations to strategies that can help preserve and grow your nest egg.

If you would like to know more about designing an investment management strategy customized to your needs, contact Mike Albertson at mike@tradewellfinancial.com or call her at 260.490.2084.

The views expressed are those of the author only. They do not represent an offer to buy or sell securities or make any investment recommendations.

Mike Albertson, Martin Carbaugh, John Redmaster and Heather Foster are investment adviser representatives of, and advisory services are offered through, USA Financial Asset Management Corp., a registered investment adviser. Additionally, Martin Carbaugh and John Redmaster are registered representatives of USA Financial Securities. Member FINRA/SIPC. USA Financial Asset Management is located at 6020 E Fulton St., Ada, MI 49301. Tradewell Tax & Financial is not affiliated with USA Financial Asset Management or USA Financial Securities.

1. Society of Actuaries Retirement Participant 2000 Table. https://personal.vanguard.com/us/insights/retirement/plan-for-a-long-retirement-tool
2. Bureau of Labor Statistics, www.mybudget360.com
3. Pew Research, December 29, 2010
4. Population of Americans Aged 65 and over, in millions. (NP-T4) Projections of the Total Resident Population by Age Groups. Health Service Research.
5. Calculations are based on mortality data from the Society of Actuaries Retirement Participant 2000 Table. https://personal.vanguard.com/us/insights/retirement/plan-for-a-long-retirement-tool