skv group

faith . discipline . patience

If it weren't for inflation I'd be a much bigger fan of bonds.

According to the Bureau of Labor Statistics the annual inflation rate as of March is 1.5%.

I know that doesn't sound like much but it could be one of the least appreciated data points in the financial world.

Also, some economists believe all the money Congress and the Federal Reserve is pumping into the economy today may drive up inflation, possibly significantly, over the next two to five years.

Let's assume inflation averages 3%, which is close to the long-term average, over the next five years.

At this rate, a basket of goods costing us $1,000 today would have the following price tags over the next five years: $1,030; $1,061; $1,093; $1,126; $1,159.

Five years is not a long time and, still, inflation could already begin to have a significant impact on a budget.

If your monthly spending budget is $5,000, the same math would drive your expenses up to $5,796 in five years.

How would you come up with the extra $796 in the example above?

If you use investment income as your source of income you might feel squeezed if you rely on bonds. Interest payments are typically fixed. If you receive $5,000 in interest today you probably won't receive more in five years.

Further, adjusted for the same inflation as above, a bond's principal value would decline by more than 14 percent.

"So, are you suggesting stocks for income?"

Only if you can afford setbacks and can handle the roller coaster ride.

It's true that stocks raise their dividends most of the time, and typically by more than the inflation rate. But sometimes, like right now, we see several companies reduce or halt their dividend payments.

Further, the principal value of a diversified stock portfolio in five years is unknown. Historically, most often it's higher after five years but not always.

As an alternative you can buy Treasury Inflation Protected securities, TIPs, or annuities that adjust their value or payment according to inflation.

For inflation adjusted annuities make sure to research the insurance company behind the promise. And expect the payout rate to be lower as the insurance company is taking on the inflation risk.

In the end, you cannot change the course of inflation, but, please, make sure you allow for it.

I don't want you to find yourself short on cash because you forgot prices may go up in the future.

Good luck.

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Stocks are subject to market risk which means their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Investments in equity securities are generally more volatile than other types of investments.

Past performance is not a guarantee of future results.

Investments in fixed-income securities are subject to market, interest rate, credit and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and/or principal. This risk is heightened in lower rated bonds. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity. Bond ratings, issued by private independent ratings services, are a grade given to bonds which is designed to indicate the credit quality of the bond. Bonds rated Aaa through Baa3 by Moody's and AAA through BBB- by S&P, are typically considered to be investment grade. Investors should note that these ratings are subject to change and that an investment grade rating does not insure the bond against default or guarantee the return of principal.

There is no guarantee that dividend-paying stocks will return more than the overall stock market. Dividends are not guaranteed and are subject to change or elimination.

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