faith . discipline . patience

Inflation has been a challenge for income investors for a long time.

According to Standard & Poors, since 1991, inflation averaged 2.39% per year.

Let's say you started this 30 year period with a $1,000 annual fixed income payment. Barring default, the interest payment in year 30 would also be $1,000.

But because of inflation the purchasing power dropped to just under $500.

That means losing half the value of your investment income.

So, after these 30 years you'd either have to look for additional income elsewhere or cut your spending in half to match your reduced purchasing power.

How about dividends?

By Standard & Poors' measures stock dividends grew by 5.89% per year over the same period. Thus, if you started with dividend income of $1,000, in the thirtieth year you'd receive over $5,500 per year.

Adjusting for inflation you'd still be earning about $2,800 annually.

That's 5.6 times better than the interest payment.

Naturally, the principal value of the bond will have been much more stable and in the end matured at the original face value.

However, the stock principal, according to politicalcalculation.com, grew more than 11-fold as measured by the S&P 500 index.

OK, so much for the past. What about the future?

A 10-year government bond as of this writing pays 1.30% per year which, curiously, happens to be the exact dividend yield of the S&P 500.

If history rhymes, the stock dividend payment would grow nicely over the next ten years while the fixed income payment would remain constant.

So, if the stock principal stays flat or even loses a little bit the total return would exceed that of the bond investment. That's a pretty low bar for stocks, don't you think?

I know, I know, stocks bounce around, sometimes dropping like a rock. But if you can train yourself not to react and sell but hold on your chances, based on history, of recovering your losses are significant.

Finally, stock dividends are most often taxed at a more favorable rate than interest payments. Yet another argument in favor of stocks.

For the long run, then, I think you're better off owning stocks than bonds. And if inflation rises even more so.

Good luck.

Jorgen Vik, CFP®
CERTIFIED FINANCIAL PLANNER™
Partner
SKV Group, LLC

1405 Rolkin Ct., Suite 202
Charlottesville, VA 22911
toll free 844.391.3610
tel 434.328.8040
fax 434.234.3789
www.skvgrp.net

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1405 Rolkin Ct., Suite 202
Charlottesville, VA 22911
toll free 844.391.3610
tel 434.328.8040
fax 434.234.3789
www.skvgrp.net