faith . discipline . patience

Anyone who's visited a home improvement store lately knows what inflation looks like.

According to the U.S. Bureau of Labor Statistics the current annual inflation rate is 4.2%. That's the highest we've seen since 2008.

And I think it makes intuitive sense that prices move up the way we've stimulated the economy over the last year with literally trillions of dollars added to our wallets and corporate coffers.

Therefore, it comes as no surprise that my inbox has seen a spike in warnings about what investors need to do RIGHT NOW to avoid disaster. (Funny how every investment challenge seems to be the biggest threat ever.)

So, if inflation is the problem, what is the solution? Suggested answers include gold, commodities, real estate, TIPs, and managed futures.

But before you log into your account and turn your portfolio upside down take a moment to ask yourself what really changed.

Does your plan not already include an allowance for inflation?

A year ago inflation was slightly under two percent. Predictions vary as to what inflation will be in a year or two. The Federal Reserve talk about transitional factors pushing inflation up right now and, as they see it, inflation should come down again within a year.

As always, no one knows exactly what the future brings.

That said, I am confident traditional fixed income investments like CDs or fixed coupon bonds will likely lose purchasing power due to inflation. The more inflation in the future the more value lost in these instruments.

Which is why I like to say that bonds are risky long-term investments.

So, what to do?

It'll come as no surprise to long-time readers that I think you should include stocks as a long-term inflation hedge.

Historically, according to Morningstar, stocks not only grow more than inflation in the long run but their dividends, as measured by the S&P 500, grow on average two percentage points per year more than inflation.

If this continues your stock dividends should increase its purchasing power while fixed amount interest payments should decrease its purchasing power.

Except for real estate, the other investments mentioned above usually do not grow their payments faster than inflation, if they pay anything at all.

And, contrary to what many believe an investment like gold does not necessarily keep up with inflation for years at a time.

Inflation is nothing new. The rate fluctuates but I doubt we'll experience a permanent high rate for the next many years. If that holds true your portfolio may be fine as it is.

Good luck.

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

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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

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1405 Rolkin Ct., Suite 202
Charlottesville, VA 22911
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tel 434.328.8040
fax 434.234.3789
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