SAGE VIEW

UNDERSTANDING THE IMPACT OF INFLATION

Inflation happens when the prices of goods and services increase and purchasing power decreases — in other words, you are able to buy fewer goods and services for the money you spend. Inflation also occurs as a natural part of the business cycle and accompanies economic growth. It has the effect of deteriorating the value of an asset or income stream.

Where inflation really becomes a concern is over longer periods of time. In fact, at a 3% inflation rate the cost of supporting everyday life will double in approximately 23 years!

As longevity continues to increase, many of us will experience prices doubling three times during our adult lives – twice during our working years, and again during retirement for those who live into their late 80's.

We cope with inflation fairly readily while we're working because wages also tend to gradually increase over time, serving as a natural offset to inflation. Inflation continues in retirement, but potentially has a much greater impact during that life phase because you wont have the benefit of recurring, and growing, employment income as a buffer.

So, we must prepare for future inflation during our working years. The first step is to save diligently and meaningfully, setting aside money from every paycheck and increasing your savings rate over time is critical. Your employer's retirement plan is an excellent way to automatically "pay yourself first". Many programs now offer the ability to automate or schedule savings increases, this is a great way to gradually enhance your savings over time. In 2015, the annual IRS maximum savings limit is $18,000.

Once you have committed to saving, investing your money is also vital. Investing is the best way to offset the effect of inflation diminishing purchasing power. While your investment asset mix should always reflect your risk tolerance, it's imperative to consider inflation in your long-term investment strategy. Equities (stocks) and real estate investments are asset classes which offer the best potential to outpace inflation over time, so it's important to have at least a moderate amount (e.g. 20%-30%) of these in your portfolio even for conservative investors.

We all must be aware of inflation's effects on our hard earned dollars and take a few simple steps to stay ahead of it. Save regularly, schedule periodic increases, and review your portfolio allocation to ensure you have enough exposure to equity and other investments which beat inflation over time.

Even a modest 2% inflation rate significantly increases costs when you're thinking about what you might spend each month decades in the future.

	TODAY	IN 20 YEARS
Food at home	$312	$463
Food away from home	$225	$334
Household Utilities	$304	$451
Apparel	$150	$223
Gasoline	$226	$336
Health care	$248	$369
Entertainment	$236	$351
TOTAL	$1,702	$2,528

Source: Bureau of Labor Statistics Consumer Expenditures Report 2011, which details average household spending