

# Inflation Before and After Retirement

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## In Focus

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Inflation has averaged 3% in the U.S. for most of the 20th and 21st Centuries. The distribution of inflation over ten year periods is very uneven (lumpy), much like stock markets. The pattern has gone like this: rising inflation begets lower inflation and lower inflation begets rising inflation. Do you recognize the principle behind those words? It's Hyman Minsky's, "Certainty breeds uncertainty and vice versa." You are not in the least bit concerned about the inflation of 20, 30, 40 years ago, but should you be?

Inflation, or the broad raising of prices and wages in catch up with each other, tends to remain in one direction over periods of 10 to 30 years or so. Rising inflation tends to compress into shorter but more volatile periods than falling inflation. So what does all of this discussion say about what we face in the next 10-30 years?

- If you're not retired, it will be helpful to find a job where your salary and benefits can at least keep pace with inflation.
- If you're retired, your options are fewer; you have less control over your income.

You are not helpless in either scenario, though. The employed person can upgrade job skills in search of a better salary and working conditions and can direct investments to at least match inflation. The retiree with some savings can direct them to investments which match or exceed the rate of inflation. But pensions and Social Security may no longer be the inflation-protected income they might have been in the last 20-30 years, since 1970's inflation ravaged pensioners' incomes and companies and government added some cost of living benefits. Is that it? No more tools in the inflation-fighter's tool kit?

Remaining tools are plentiful, but they rely on more than education and investment. They rely on lifestyle changes. For example, you can change your eating habits (no, not the dog food option) which substitutes less costly food for more expensive food. This includes growing your own fruits and vegetables. You can downsize living expenses by living with others in co-housing, by finding smaller quarters, etc. You can sell your car and use alternative means of transport. If healthy enough, you can work part-time. Do you find these lifestyle changes Draconian? If so, let's look into what we can do for you as investment advisors.

What is "expected" inflation over the next 10-30 years? It's anyone's guess, but it's not likely to be anywhere as low as it's been over the last 20 years or so. That does not mean that inflation will run away, either. More likely it is a "return to trend" - to the 3% rate. If we do return to trend, you will likely see 4% and 5% inflation for a time, after the current crisis subsides. If the U.S. dollar ceases to be the world's major reserve currency (most world goods are priced in dollars) you could see an uptick of inflation as goods would cost more (assuming that the dollar weakens). Ouch... another hit to your pocketbook.

It's anyone's guess what the perfect inflation hedge might be. We'll tell you what we're doing now, but first, let's make it clear that we don't see inflation as an immediate concern. There are too many people buying less than they did in the past few years and paying down debt, and there is too much unemployment (a tragedy) to be concerned about American inflation right now. China, India, Brazil and many other "emerging" market economies are another issue entirely.

- Until recently we've had substantial gold investments
- We invest in energy-related industries
- We invest in medical care (when we can find good dividends)
- We invest in other industries which have the power to raise prices when input costs rise

Our plan may not be perfect, but at least it's a plan. Now, here's a list of things that you should not do if you anticipate rising inflation, which is usually accompanied by rising interest rates in both short-term and long-term bonds and CDs and which hurt the value of inflation-sensitive investments:

- Be very wary of annuities. They should be bought near the peak of inflation (1981), not at nadirs of inflation such as we now face.
- Investing solely in CDs and bank instruments leads to pernicious inflation. You suffer no immediate shock but your purchasing power drains away slowly but relentlessly.
- You should not follow the temptation to take a lot of risk - in second mortgages, for example. Their nominally high rates mask serious risk if the payer defaults.

We are careful to advise you when you retire that taking about half of the income your account generates in dividends and interest preserves enough for us to reinvest, so as to provide you with cost of living (COLA) increases. Taking much more than half of generated dividend and interest income will likely pinch the power of your account to provide COLA - when you need it most. Note that we are not projecting anything in price appreciation of your securities. Price appreciation may in fact happen over long periods of time, but in periods of 5-20 years or so, price inflation cannot be taken for granted. And so we don't speculate.

We don't want you to feel daunted by the specter of rising prices and inflation. Rather, we want to assure you that we indeed have a plan to meet inflation's challenge and that you, too, have a number of options far more numerous than the few we listed above.

Thank you for investing with us.

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