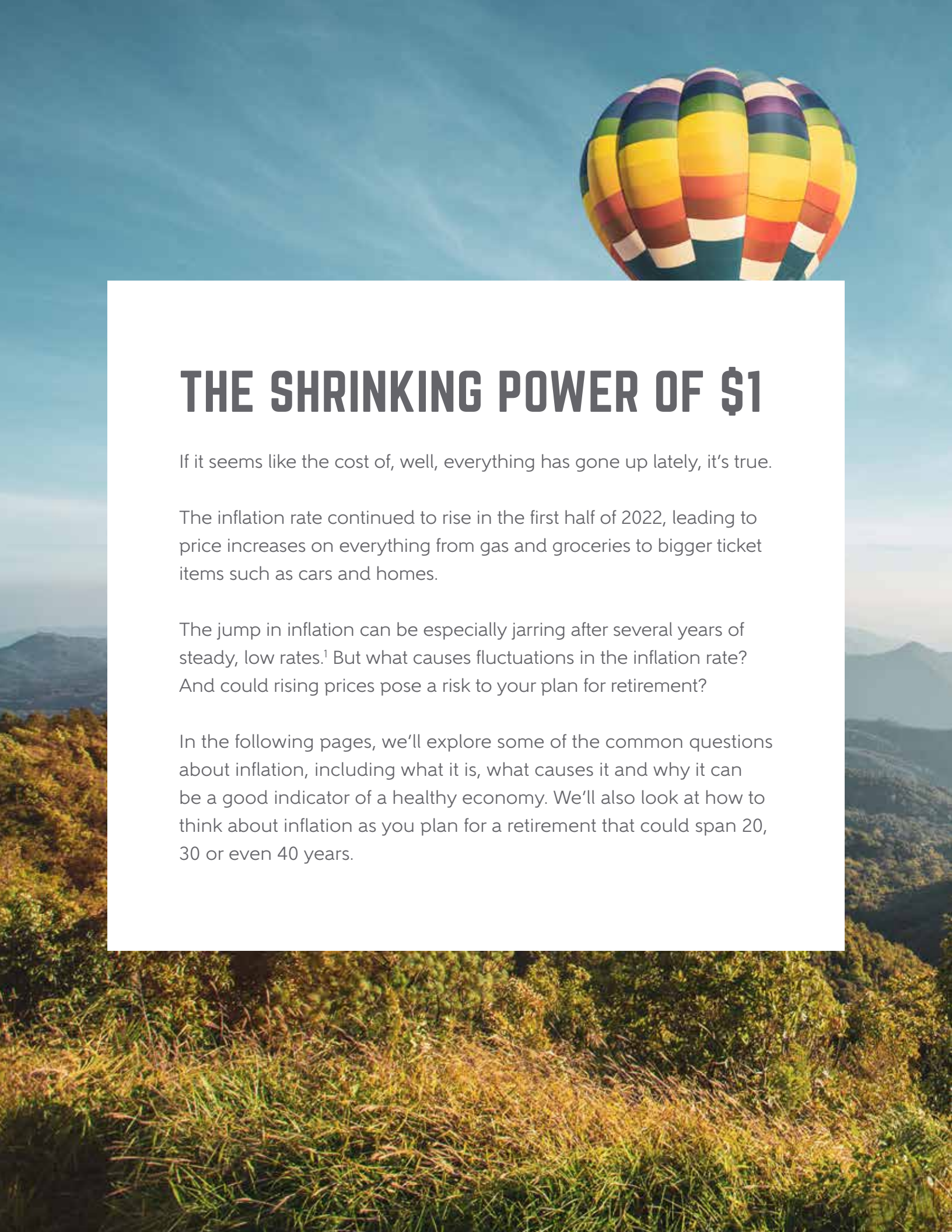
Inflation & Your Retirement

RETIREMENT INCOME STRATEGY RESOURCE

WEST ADVISORY GROUP, INC.



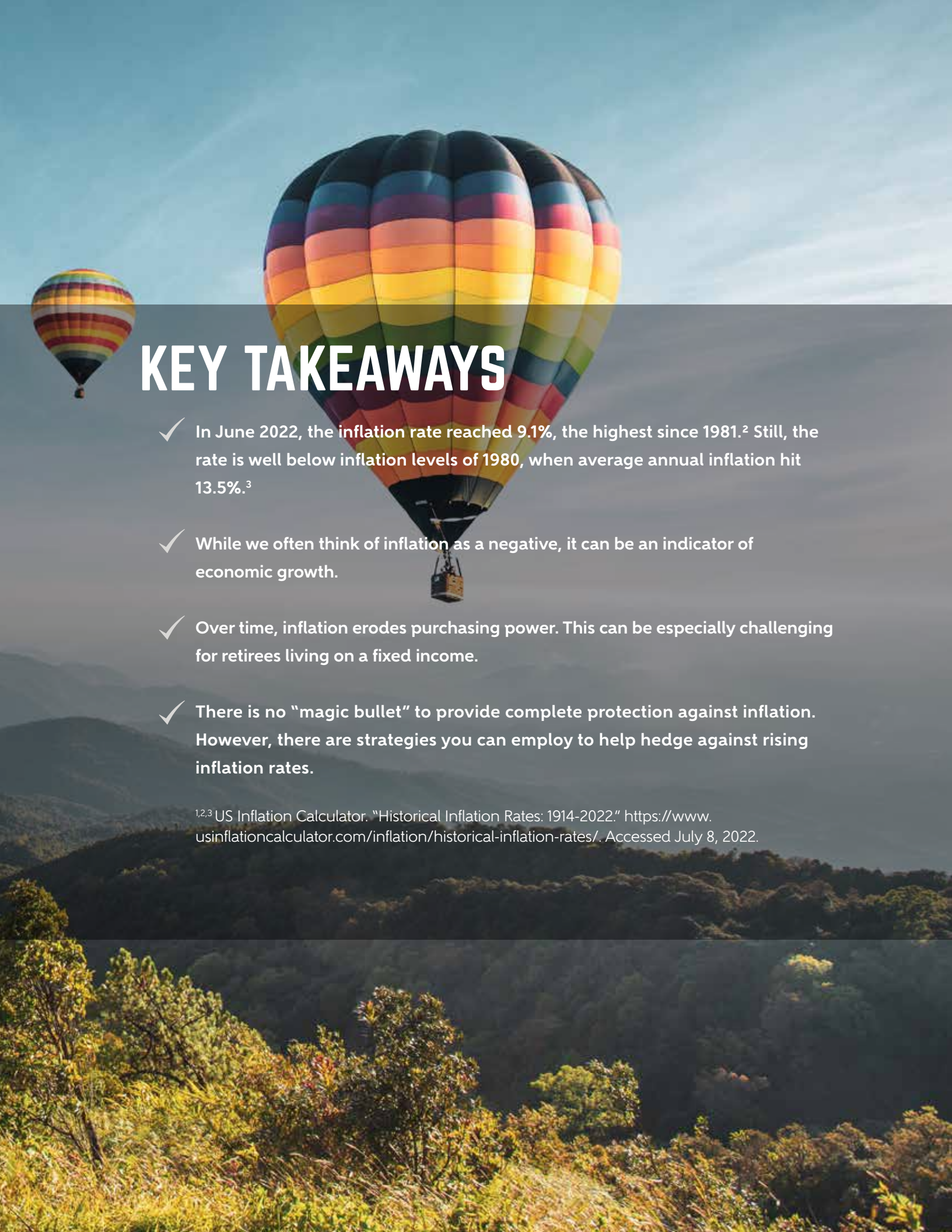
THE SHRINKING POWER OF $1

If it seems like the cost of, well, everything has gone up lately, it's true.

The inflation rate continued to rise in the first half of 2022, leading to price increases on everything from gas and groceries to bigger ticket items such as cars and homes.

The jump in inflation can be especially jarring after several years of steady, low rates.[1] But what causes fluctuations in the inflation rate? And could rising prices pose a risk to your plan for retirement?

In the following pages, we'll explore some of the common questions about inflation, including what it is, what causes it and why it can be a good indicator of a healthy economy. We'll also look at how to think about inflation as you plan for a retirement that could span 20, 30 or even 40 years.



KEY TAKEAWAYS

- In June 2022, the inflation rate reached 9.1%, the highest since 1981.[2] Still, the rate is well below inflation levels of 1980, when average annual inflation hit 13.5%.[3]
- While we often think of inflation as a negative, it can be an indicator of economic growth.
- Over time, inflation erodes purchasing power. This can be especially challenging for retirees living on a fixed income.
- There is no "magic bullet" to provide complete protection against inflation. However, there are strategies you can employ to help hedge against rising inflation rates.

[1,2,3] US Inflation Calculator. "Historical Inflation Rates: 1914-2022." https://www.usinflationcalculator.com/inflation/historical-inflation-rates/. Accessed July 8, 2022.

WHAT EXACTLY IS INFLATION?

In simplest terms, inflation is the increase of prices in an economy over time. Inflation can be a good thing; after all, without inflation, our wages would remain the same. But inflation is also often responsible for pushing up the cost of the things we buy.

The problem? This increase in costs generally outpaces increases in our income. As a result, our bills are higher, but our income has stayed the same. In short, our dollars just don't go as far as they once did.

The inflation rate is usually indicated as a percentage. For example, the U.S. average annual inflation rate in 2020 was 1.2%.[4] Generally speaking, a steady inflation rate of 2% indicates a healthy, growing economy, and this 2% average level is the U.S. Federal Reserve's target.[5] A very low or even negative inflation rate (also known as deflation) could mean the economy is stagnant or, worse, in a recession. (The last time the U.S. experienced a year of deflation was 2009, when the annual rate averaged -0.4%.[6])

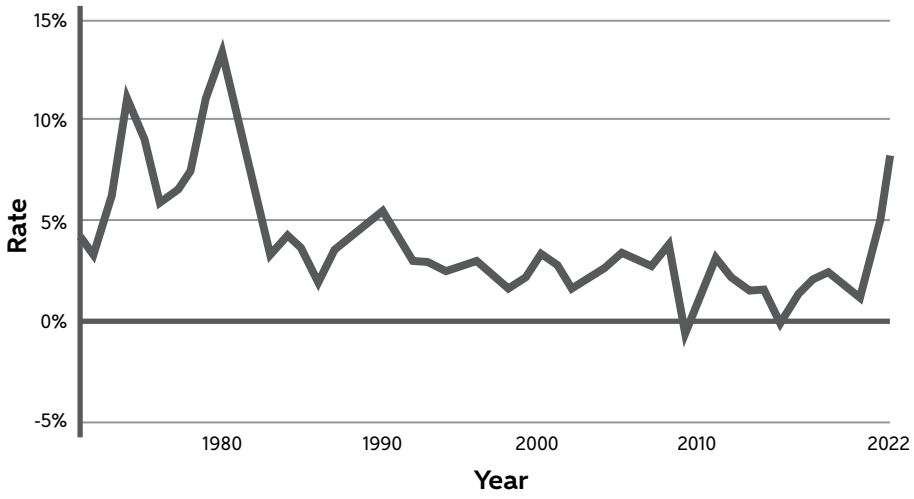
[4] US Inflation Calculator. "Historical Inflation Rates: 1914-2022." https://www.usinflationcalculator.com/inflation/historical-inflation-rates/. Accessed July 8, 2022.

[5] Ramsay Lewis. Business Insider. Nov. 11, 2021. "What is inflation? Why the cost of goods rise over time and what it means for the value of your money." https://www.businessinsider.com/what-is-inflation/. Accessed July 8, 2022.

[6] US Inflation Calculator. "Historical Inflation Rates: 1914-2022." https://www.usinflationcalculator.com/inflation/historical-inflation-rates/. Accessed July 8, 2022.

AVERAGE ANNUAL INFLATION RATES[7]

1971-2022*



*2022 figure is the average annual rate as of May 2022.

[7] US Inflation Calculator. "Historical Inflation Rates: 1914-2022." https://www.usinflationcalculator.com/inflation/historical-inflation-rates/. Accessed July 8, 2022.

WHAT CAUSES INFLATION?

Let's go back for a minute to Economics 101. The most common cause of rising prices is demand-pull inflation, which is when consumer demand for goods increases beyond the available supply of those goods. Manufacturers can't meet demand for any number of reasons: lack of raw materials, worker shortages, production bottlenecks, etc.

Demand-pull inflation can also occur when people start spending more. As people spend more and demand outstrips supply, consumers begin to expect inflation to happen. They may end up spending more today in anticipation that prices will be higher tomorrow. It's a cycle that indicates a healthy, growing economy.

Other factors that contribute to demand-pull inflation include increased government spending and expansion of our money supply in the form of cash and credit. Low interest rates can also be a factor in rising inflation. For the past decade, we've been in a sustained period of low interest rates.[8]

The other common type of inflation is cost-push inflation. In this case, manufacturers can't get the raw materials they need to produce their products and, therefore, can't meet the demand for those products. They're forced to raise prices as a result.

[8] FRED Economic Data. St. Louis Federal Reserve. "Effective Federal Funds Rate." https://fred.stlouisfed.org/series/FEDFUNDS. Accessed July 8, 2022.

[9] Wailin Wong, Darian Woods and Adrian Ma. NPR. June 17, 2022. "The debate over what's causing inflation." https://www.npr.org/2022/06/17/1105927579/the-debate-over-whats-causing-inflation. Accessed July 8, 2022.

Americans have seen demand-pull inflation and cost-push inflation play out during the pandemic and into 2022. As consumers' purchases of several items – everything from homes and cars to toilet paper and cleaning supplies – exploded, those who produce these items haven't been able to keep up with demand, and so shortages occur and prices eventually rise. Additionally, the price of a good or service (like gas, for example) increased dramatically because the cost of producing it is higher.[9]

WHAT ELSE DO I NEED TO KNOW ABOUT INFLATION?

Inflation can offer an opportunity to pay less for something that will grow in value over time. Take real estate, for example. Billionaire investor Warren Buffett famously bought a house in Omaha for $31,500 in 1958.[10] That house, which he still owns, would cost him $318,000 if he bought it in today's dollars.[11] But it's now worth over $1 million.[12] That's a pretty good return on his investment.

The real challenge with inflation can present itself when individuals begin building a retirement plan. No longer getting pay raises from a job, many retirees live on fixed income sources, including savings, Social Security and retirement accounts. If your income remains the same over 20 years of retirement and inflation grows at the rate of 2% per year, you may have a shortfall as expenses outpace income in your later years.

THE COST OF A SACK OF GROCERIES

April 2002 vs. April 2022

Item	Price in 2002[13]	Price in Today's Dollars[14]
1 dozen fresh eggs	$1.03	$1.66
White bread	$1.02	$1.64
Sliced bacon (1 pound)	$3.24	$5.21
Round steak (1 pound)	$3.50	$5.63
Fresh grocery milk (1 gallon)	$2.76	$4.44
Total spent	**$11.55**	**$18.58**

[10] Amanda Garcia. Go Banking Rates. July 29, 2022. "11 Ways Warren Buffett Lives Frugally." https://www.gobankingrates.com/net-worth/business-people/ways-warren-buffett-lives-frugally/. Accessed Aug. 2, 2022.

[11] U.S. Bureau of Labor Statistics. "CPI Inflation Calculator." https://www.bls.gov/data/inflation_calculator.htm. Accessed July 8, 2022.

[12] Douglas County, Nebraska Assessor. July 1, 2022. "Douglas County, Nebraska Property Record." https://douglascone.wgxtreme.com/java/wgx_douglasne/static/accountinfo.jsp?accountno=R1026290000. Accessed July 8, 2022.

[13] Ben Wittstein. Stacker.com. Nov. 17, 2020. "The cost of goods the year you were born." https://stacker.com/stories/1227/cost-goods-year-you-were-born. Accessed July 8, 2022.

[14] U.S. Bureau of Labor Statistics. "CPI Inflation Calculator." https://www.bls.gov/data/inflation_calculator.htm. Accessed July 8, 2022.

WHAT CAN I DO TO PREPARE FOR INFLATION IN MY RETIREMENT PLAN?

While you can't completely get ahead of inflation, there are a few things everyone can do to help protect against prolonged high inflation rates:

1. AVOID LONG-TERM FIXED-INCOME INVESTMENTS.

Fixed-income investments – such as corporate bonds, money markets and Treasurys – pay a specific amount. If you own these investments for 15, 20 or 30 years, inflation may eventually outpace the return and negatively impact your retirement income.

2. LOOK FOR EQUITY STOCKS THAT CAN PASS THROUGH INCREASED EARNINGS.

During times of high demand, companies can increase prices and positively impact earnings. They may pass these earnings on to investors.

3. LOOK FOR STRATEGIES TO PROVIDE GUARANTEED INCOME.

Some products with guaranteed payouts, like fixed index annuities (FIAs), are insurance products that may be able to help your savings to outpace inflation. An FIA combines the benefits of tax deferral with the potential for interest earnings based on positive changes in an external index (a measurement of a section of the stock market) without actual participation in the market. Annuities may be subject to restrictions, surrender charges, holding periods or early withdrawal fees, which vary by carrier. With some annuities, you can pay for an optional rider that helps your payouts keep up with inflation.

4. SPEND WISELY.

Are you considering a big purchase, such as a new home or car? If you think it might be more expensive later because of inflation, it may be a good idea to make the purchase today.

5. MEET WITH YOUR FINANCIAL PROFESSIONAL.

If you're retired or planning to retire soon and want to maintain your current standard of living, it's time to take action against rising inflation. Let's meet to discuss strategies to help protect your savings and address the main concerns posing a potential risk to your future.

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