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WEALTH MANAGEMENT

Protect Your Retirement from Inflation's Scourge

by Scott Dougan

Increasing signs of higher prices to come warrant a review of your defense posture.

As the weather starts to heat up, prices are also rising across the country. The U.S. Bureau of Labor Statistics reported that the Consumer Price Index for all urban consumers increased 0.3 percent in April and 0.4 percent in May. Over the past 12 months the total CPI increased 2.1 percent, the largest 12-month increase since October 2012. This is leading many to wonder if a spike in inflation is around the corner.

The BLS further reported that the gasoline index rose 0.7 percent in May. The energy index has risen 3.3 percent over the over the past 12 months, and 85 percent of American adults say they are paying more for groceries than a year ago, according to a recent Rasmussen poll. The food index rose 0.5 in May after increasing 0.4 percent in each of the three previous months. Over the past 12 months, food costs have risen 2.5 percent.

Inflation can dramatically and negatively impact one's purchasing power. The effect of rising prices on your finances right now is only part of the picture. Inflation can also harm your future purchasing power, which can be especially difficult in retirement.

This is a particularly pressing concern in the current low-interest-rate environment. Rates are being kept at historically low levels by the Federal Reserve in an effort to boost the economy. That makes it difficult for conservative investors, including soon-to-be retirees and current retirees, to make sure their savings keep up with the rate of inflation. If investments don't grow at the rate of inflation, that money will be worth less in the future than it is now. For example, if you have $100,000 in savings and the inflation rate is 3 percent, in 20 years you would need to have $180,611 just to maintain the same value.

So it's crucial that you protect your dollars and work to keep their purchasing power strong. To that end, here are five tips to shield your nest eggs from potential inflation.

Pay down your debt. If you have substantial loans or debt on variable rates, it is important to consider paying them off or consolidating them, especially during times of rising inflation. Not only will you be paying even more for those things you purchased in the past, due to the decreased value of the dollar, but interest rates may begin to increase with inflation as well.

Realize the benefits of "real" assets. Real assets (such as gold, property and commodities) tend to hold their value, even in inflationary times. Gold and other precious metals have historically served as protection against currency devaluation. Consider diversifying your investment portfolio to include real assets or investment products based on real assets, such as Real Estate Investment Trusts. Real estate historically holds its value better than other investments during inflationary circumstances, but it is not easy to withdraw money from a property if needed. REITs provide better liquidity; however, they may be somewhat volatile for a short-term investor.

Stay ahead of inflation. If you want to invest conservatively, you may need to think twice about the "safety" in bank-issued CDs or other vehicles with set-return rates of interest. The national average APY for a five-year CD is only 0.79 percent, and if you're earning anything less than the inflation rate per year, the account is costing you purchasing power. You may want to consider exploring other safer alternatives that can at least keep up with the Consumer Price Index, such as income annuities with an inflation rider.

Take stock of your investments. Since certain equities can do better than others in times of inflation, you need to be sure you are invested accordingly. Traditionally, energy, commodities and necessary items continue do well in times of inflation. Other investment strategies to consider include Treasury Inflation-Protected Securities and exchange-traded funds. TIPS increase with inflation and decrease with deflation, as measured by CPI.

Fix your fixed income. If you're on a fixed income, inflation can be especially difficult. Although Social Security increases with inflation, you need to structure other fixed-income streams. Options to consider include dividends and laddering. One option: Carefully selected companies with a track record of paying and increasing dividends each year. And by staggering the maturity of fixed-income investments over a number of years, you can position your money to take advantage of opportunities when interest rates go up and reduce risks when interest rates go down.

The usefulness of each tactic will depend on your age, timeline to retirement and risk tolerance. But any indicators of inflation should not be ignored.

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