

## ***Inflation Expectations – are they real or perceived?***

As we ring in the New Year, there are numerous concerns as to what the economic future will bring. Many of you are anxious about the growing budget deficits as well as the extensive growth of hard currency coming out of government printing presses. Clients believe these two factors will have far reaching effects on the quality of their lives and the adequacy of their savings.

**The implications of both, if left unchecked, may lead to higher taxes, and a significant loss of purchasing power from our wages and savings.** This is a very real long term threat that could begin to affect us during the next 5 years.

Inflation has historically resulted from excessive economic growth overwhelming our nation's capacity to produce enough goods and services to meet demand. During these past booming economic periods of full employment, wage and price inflation have occurred due to demand exceeding supply. That said the next cycle of inflation may be very different from those we have experienced in the past. With too much hard currency in circulation and China holding trillions of dollars in US debt, the value of the US dollar will likely decrease. As a result, our unemployment rates could remain uncomfortably high while price inflation creeps back into the US economy. This is a scary thought!

Investors concerned about real wealth need to find the right trade-off between expected real returns (total return minus inflation) and the amount of risk they are able to tolerate. Portfolios designed to outpace inflation require exposure to higher compensated risk factors in order to achieve the necessary expected real returns. Emphasizing stocks are an obvious strategy to achieve this exposure for those investors able to tolerate the related risk. Investors with lower risk tolerances should place more emphasis on fixed income instruments such as short-term bonds or TIPS (Treasury Inflation Protected Securities), which provide stability to a portfolio through low real return volatility.

Economic theory does not support or provide a compelling argument that commodities, gold, and oil will deliver higher returns and substantial diversification benefits as proclaimed by some proponents. Additionally, because these assets have such large return variances, adding them to a typical stock and bond portfolio is likely to increase, rather than decrease, the real-return volatility of the overall portfolio.

At Glass Jacobson, we strive to build these risk management attributes and a prudent decision process to achieve your portfolio objectives. Please call us if you have questions.