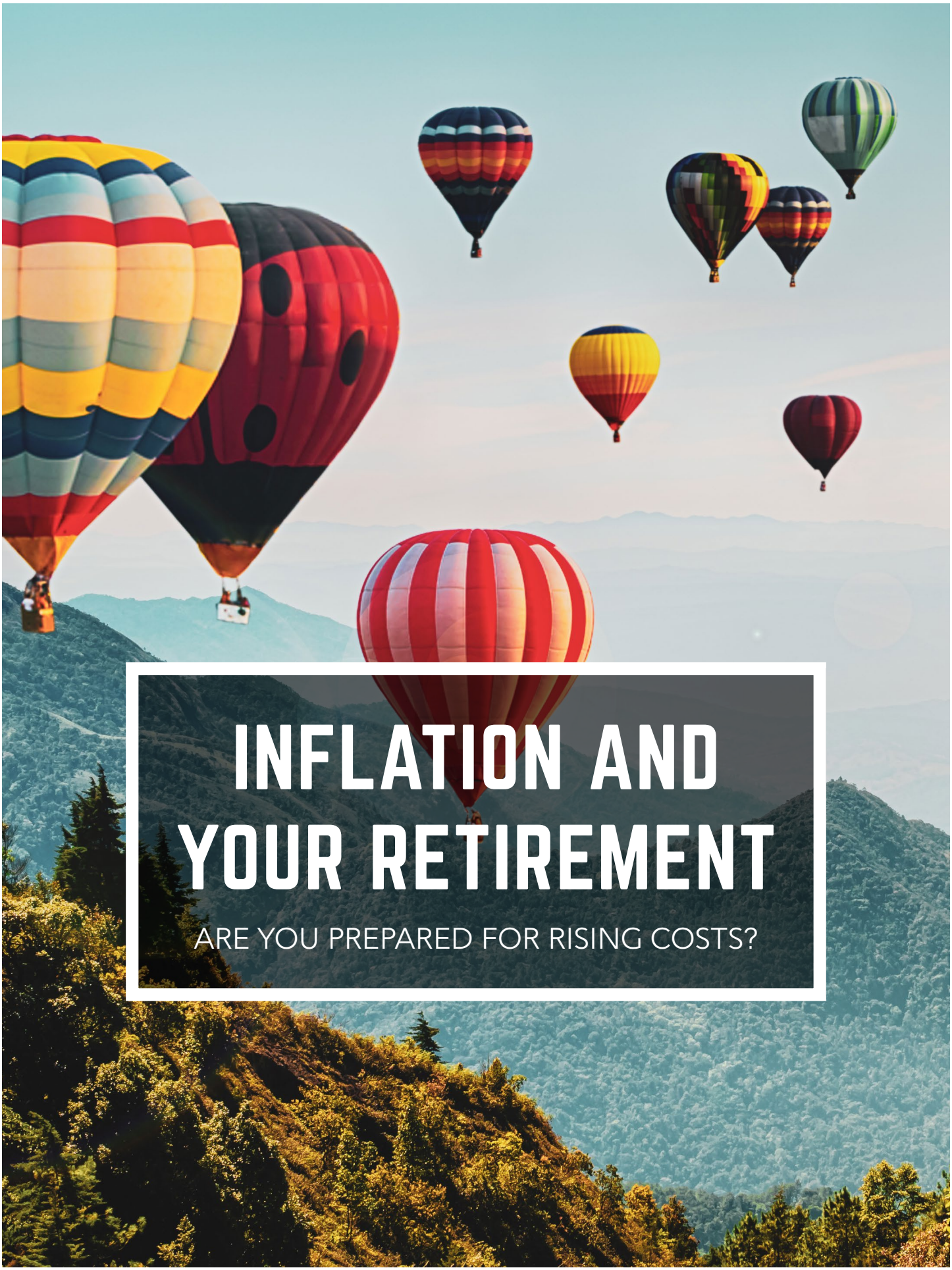


INFLATION AND YOUR RETIREMENT

ARE YOU PREPARED FOR RISING COSTS?



THE SHRINKING POWER OF $1

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

The inflation rate jumped in the first half of 2021, 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 nearly a decade 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 May 2021, the annual inflation rate reached 5%, its highest level in nearly 13 years.[2] Still, the rate is well below inflation levels of the late 1970s and early '80s, when average annual inflation was as high as 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] US Inflation Calculator. "Historical Inflation Rates: 1914-2021." https://www.usinflationcalculator.com/inflation/historical-inflation-rates/. Accessed June 11, 2021.
[2] Ibid.
[3] Ibid.

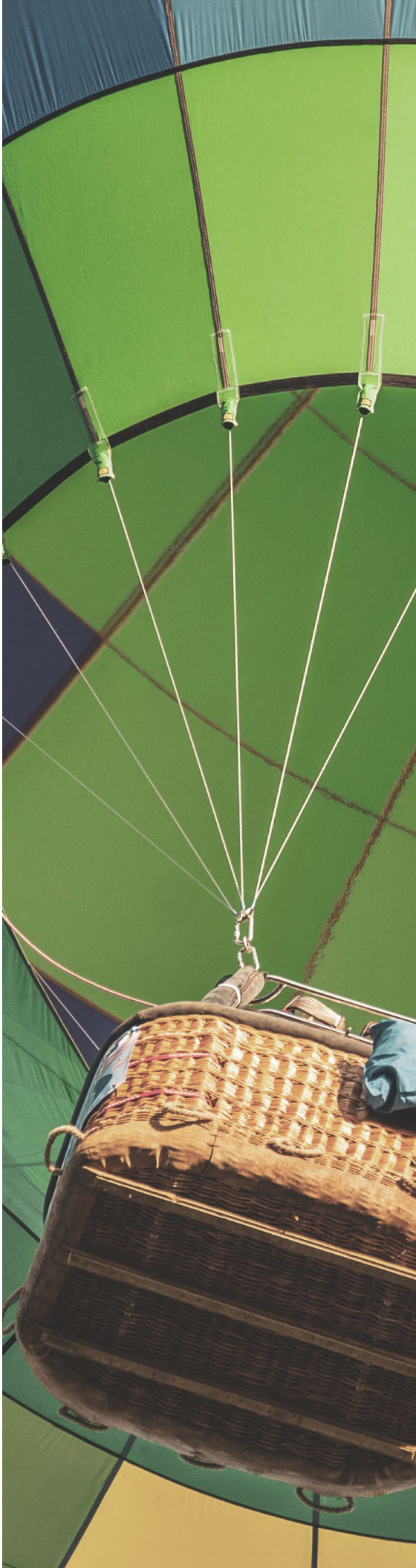
WHAT EXACTLY IS INFLATION?

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.

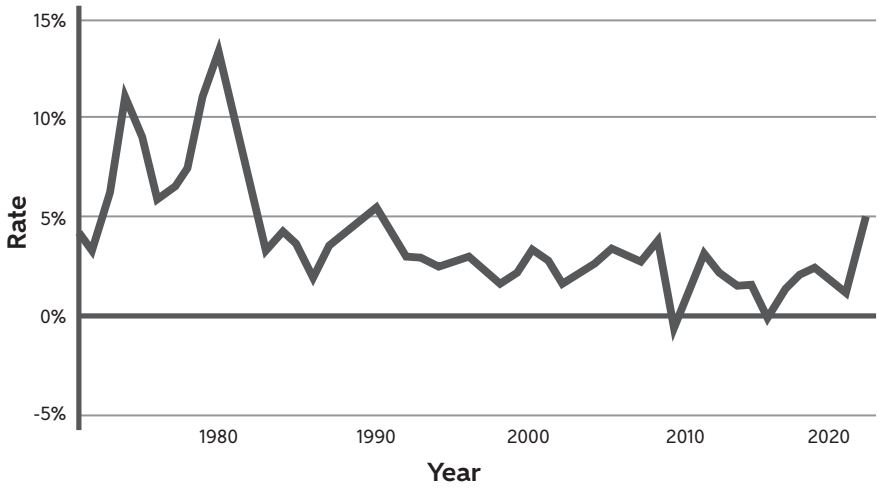
The inflation rate is usually indicated as a percentage. For example, the U.S. average annual inflation rate in 2020 was 1.2%.[4] Generally speaking, a steady inflation rate of 2% indicates a healthy, growing economy, and this 2% average level is the U.S. Federal Reserve's target.[5] A very low or even 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: 1914-2021." https://www.usinflationcalculator.com/inflation/historical-inflation-rates/. Accessed May 17, 2021.
[5] Ramsay Lewis. Business Insider. May 6, 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 May 17, 2021.
[6] US Inflation Calculator. "Historical Inflation Rates: 1914-2021." https://www.usinflationcalculator.com/inflation/historical-inflation-rates/. Accessed May 17, 2021.



AVERAGE ANNUAL INFLATION RATES

1971-2021*



*2021 figure is the average annual rate as of May 2021.

Source: US Inflation Calculator. "Historical Inflation Rates: 1914-2021." https://www.usinflationcalculator.com/inflation/historical-inflation-rates/. Accessed June 11, 2021.

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.

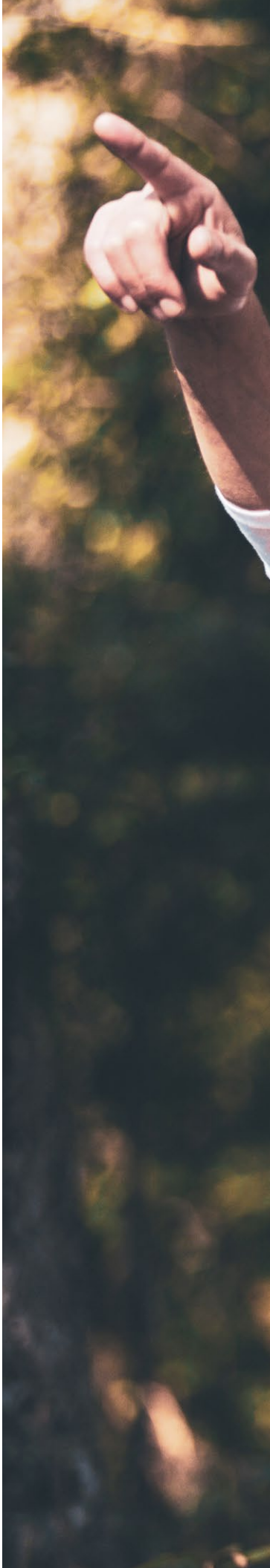
Other factors that contribute to demand-pull inflation include increased government spending and expansion of our money supply in the form of cash and credit. Low interest rates can also be a factor in rising inflation. For the past decade, we've been in a sustained period of low interest rates.[7]

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.

[7] FRED Economic Data. St. Louis Federal Reserve. "Effective Federal Funds Rate." https://fred.stlouisfed.org/series/FEDFUNDS. Accessed May 17, 2021.

[8] Gillian Friedman. The New York Times. April 29, 2021. "Diapers, cereal and toilet paper are getting more expensive. Here's why." https://www.baltimoresun.com/business/ct-aud-biz-nyt-retail-prices-rising-20210429-ohtjpurqq5actfq37xn6nydtl4-story.html. Accessed May 17, 2021.

Americans saw demand-pull inflation play out in 2020 early in the pandemic as consumers' purchases of goods such as toilet paper and cleaning supplies exploded. Companies that produced these items couldn't keep up with the demand, shortages occurred and prices eventually rose.[8]







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. That house, which he still owns, would cost him $250,000 if he bought it in today's dollars – but it's now worth an estimated $652,619.[9] 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 2001 vs. April 2021

Item	Price in 2001[10]	Price in Today's Dollars[11]
1 dozen fresh eggs	$0.93	$1.40
White bread	$1.00	$1.51
Sliced bacon (1 pound)	$3.25	$4.91
Round steak (1 pound)	$3.50	$5.28
Fresh grocery milk (1 gallon)	$2.88	$4.35
Total spent	**$11.56**	**$17.45**

[9] Nathaniel Lee. Business Insider. Nov. 10, 2020. "Warren Buffett lives in a modest house that's worth .001% of his total wealth." https://www.businessinsider.com/warren-buffett-modest-home-bought-31500-looks-2017-6. Accessed May 19, 2021.

[10] 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 May 19, 2021.

[11] U.S. Bureau of Labor Statistics. "CPI Inflation Calculator." https://www.bls.gov/data/inflation_calculator.htm. Accessed May 17, 2021.



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 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.



Prepared on behalf of:

FLETCHER

FINANCIAL GROUP

3800 Cypress St.
West Monrœ, LA 71291

318.387.8918
advisor@fletcherfinancialgroup.net

www.fletcherfinancialgroup.net

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