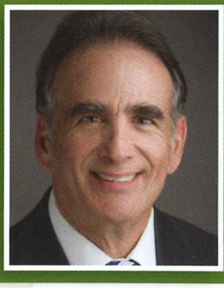


FINANCIAL FITNESS

Inflation: What Does It Mean For You?

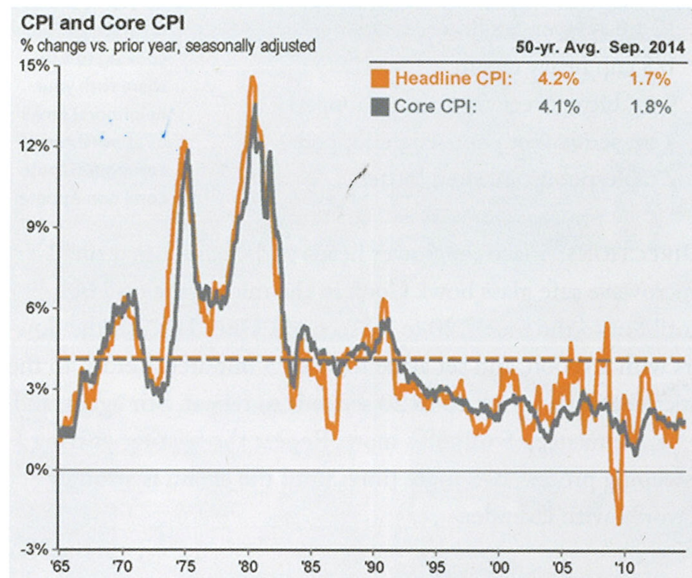
By Rocky Mills, North Ranch Resident

What is inflation? How is it measured? And, most importantly, what does it mean for you and your family?

In its simplest form, inflation is the rise in prices of the things you buy. If a 16-ounce steak at your favorite restaurant cost $40 last year and it's now going for $41, the cost of that steak has inflated by $1, or 2.5%.

There are a number of statistics that attempt to measure how the price of all goods and services in our economy have risen. The most well known is the Consumer Price Index (CPI). The chart at right shows the CPI for the last 50 years. "Headline" CPI is what is most commonly reported – it incorporates a thorough set of goods and services. "Core" is "Headline" CPI reduced by the more volatile food and energy components.

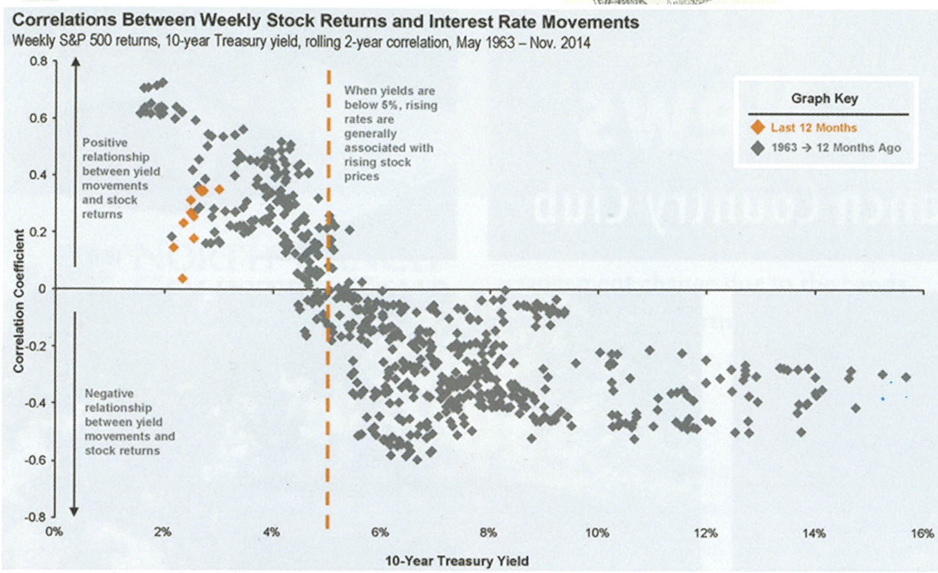
You'll see that the CPI – both Headline and Core – has averaged above 4% for the last 50 years. We're currently well under half of that at 1.7%.



Source: BLS, FactSet, J.P. Morgan Asset Management.

What does inflation mean for you? For most people, it's a dual-edged sword. On the one hand, it's like a tax that reduces your spending power – the same income from last year will buy a slightly smaller basket of goods and services this year. But "slightly" becomes huge when you compound the inflation rate over a long period. For example, 4.1% inflation over the last 50 years means that you're paying 7½ times as much for a typical item today versus 1965!

On the other hand, inflation tends to drive up the value of some of the things you own, such as equities and real estate. Let's take this a bit further. Inflation is a key determinant of interest rates. When we have low inflation, we typically have low interest rates. And the impact of low interest rates is also dual-edged. On the one hand, low rates mean you'll earn very little on savings or other fixed income vehicles. On the other hand, low rates allow businesses to profit more and make more business investments, both of which may translate into higher valuations.



Source: Standard & Poor's, U.S. Treasury, FactSet, J.P. Morgan Asset Management.

On this latter point, the analysis at left shows that interest rates up to 5% correlate with upward movement in stock prices. Rates above 5% correlate with negative stock market returns.

Robert A. "Rocky" Mills is a registered representative with and securities offered through LPL Financial, Member FINRA/SIPC. Investment advice offered through Westlake Investment Advisors, a registered investment advisor and separate entity from LPL Financial.

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