Getting Personal With Inflation and Investing

Inflation is not just a concern for economists and Bank of Canada bureaucrats. Investors should keep a careful watch on it as well. For example, those planning for their future retirement need to factor in how inflation will erode their purchasing power in the years ahead. They should start preparing now for a higher cost of living in the future.

Inflation triggers central banks to hike their rates in an attempt to dampen an overheating economy in which prices for commodities, food and materials are rising too quickly. This forces banks and other lending institutions to raise interest rates on mortgages and household debt.

Canada's core inflation rate is about 2% – a reasonably good figure by world standards, but a misleading one. While it may be a helpful figure for economists plotting monetary policies, for individual investors the official inflation rate doesn't tell the whole story about their personal living costs. Statistics Canada reports much higher cost increases for many of our essential goods and services. Such items as gasoline, electricity and insurance coverage increased substantially in 2010 – gasoline prices alone rose on average 13% last year.

Investors should be paying more attention to their personal inflation rate. That's what your own household is experiencing based on personal lifestyle choices and the cost of living in your region. Transportation, groceries and housing costs vary widely across the country. With Canadians now averaging a 150% debt to income ratio, there is cause for concern about what will happen if interest rates rise to counter the threat of inflation.

Here are a few things every household can be doing:

Get a handle on debt

Work out a plan to review all household debt, paying attention to the interest rates on your mortgage, lines of credit, and credit cards. Now is the time to begin looking for ways to bring those figures down. The less debt you have and the closer to the prime rate you borrow money at, the better off you are, especially if bank rates begin to rise. Talk with your bank or financial advisor about the possibility of renegotiating a specific loan rate or the advisability of switching from a variable to a fixed-rate mortgage.

Some financial institutions now offer umbrella or all-in-one banking services that can consolidate banking functions under one roof so that debt payments and chequing and savings accounts operate in unison and reduce monthly interest costs.

Calculate your own household inflation rate

Try to work out your personal inflation rate. Itemize the top fixed and discretionary household expenditures and compare what you're paying now to last year. This will give you a better idea of how much your real cost of living is going up. For instance, if the cost of a tank of gas was $66 last week and $60 last year, that's a 10% increase in your personal inflation rate. Were that rate to continue into the future, the cost of filling up the family car would rise to $120 within seven years. This ballpark calculation gives you a rough idea of how your basic, personal costs of living are increasing. It also focuses on future expenses down the road and helps highlight the kind of income you'll need or lifestyle adjustments that might become necessary in the future.

Inflation-proof investments

There is no such thing as an inflation-proof investment. But investors can take measures to protect themselves. Risk-averse investors, particularly those nearing and in retirement, will need to be especially careful of what inflation can do to them if their investments can't keep pace with inflationw. Investors using bond ladders will want to stagger the maturity dates at shorter intervals.

For equity investors, companies that are able to pass on their cost increases to customers and corporations that have low debt offer some safety in an inflationary environment. Precious metals can also be a good hedge for investors in inflationary times.

If global or personal inflation is a concern, talk to your Raymond James financial advisor. Discuss what actions can be taken to protect and prepare your investment portfolio for a tomorrow that will likely be more costly than it is today.

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