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FINANCIAL MANAGEMENT



Wake Up And Smell The Inflation

*One bright day, in the middle of the night
Two dead boys got up to fight.
Back to back they faced each other,
Drew their swords and shot one 'nother.
A deaf policeman heard the noise,
And came to arrest the two dead boys.
If you don't believe this story's true,
Ask the blind man, he saw it too! ~Author Unknown*

Confused about inflation? Don't worry, you're not alone.

Government statistics say inflation is moderate at only 1.6% over the past year. But our gas, food and medical bills tell us otherwise.

[Measuring Inflation](#)

To measure inflation, the government looks at price gains in eight categories: Apparel, Education, Food, Housing, Medical, Recreation, Transportation, and "Other".

Each category is given a weighting based on a typical U.S. household's income that is spent on it. Food gets a 15% weighting, housing 42%, medical 6%, transportation 17%, and so on. Prices are then checked regularly to identify trends.

[Inflationary Trends](#)

Take food. Last October, food prices rose 1.5%. This January, they rose 1.8%. That's an increase in pace of 20% (forget the math, just trust me on the numbers).

Transportation prices rose 5.29% last October, and 5.42% this January, an acceleration of 2.5% - much less than the 20% for food. But that's scant comfort because we still paid 5.4% more for gas, while we only paid 1.8% more for food.

While food and transportation are necessities, categories like apparel and recreation are more discretionary. So it's not surprising that apparel prices stayed practically unchanged, housing rose only

0.4%, and increases in medical and recreational expenses also slowed – blunting the sharp increases in food and transportation.

Put it all together, and you get inflation at 1.63% for January versus 1.5% last October.

The bottom line is that prices rose at a quicker pace than three months ago. For you and me, it simply means that inflation is increasing and the purchasing power of our dollar is declining at a more rapid pace than three months ago. Not good at all, particularly in a stalled economy with high unemployment and a virtual freeze on wage increases!

[Sleep With The Enemy](#)

I am reminded of a simple, yet brilliant idea I learned many years ago - if your electricity bill starts rising, buy shares of your electricity provider. You need electricity, and your provider knows this. If electricity generation costs rise, your provider will simply pass the increase on to you while making sure its profit margins remain intact. These profits either get distributed as dividends or cause shares to rise. If you hold shares, the dividends or stock appreciation compensate you for some or all of the increase in your bill.

So higher investment returns from capital gains, interest income or dividends can help you beat inflation.

Now, applying this concept to rising fuel costs, consider buying Oil company stocks. As a shareholder, you will see stock price appreciation and higher dividends. This has, in fact, already happened. Chevron shares, for example, have risen from the mid \$80s last October to over \$100 today.

However, first know all the facts and risks, or talk to a good advisor before implementing this strategy.

[Buy Short Maturity Bonds](#)

Investors can also buy short-maturity bonds to protect against inflation, and roll maturing principal into higher yielding bonds over time (called *laddering*).

Avoid long maturity bonds – they lock you into lower yields for long periods of time. Like a frog in a vat of low heat but rising temperature water that dies a slow painless death, long bond investors get the comfort of *nominal* principal preservation and interest payments, but get killed on purchasing power.

Dividend stocks and short-term bonds are two strategies to protect you from inflation.

Pay close attention to the economic world around you and speak to experienced advisors, and you will discover ways to beat the system and not just be its hapless victim.