INFLATION

THE SILENT VILLAIN THAT COSTS DEARLY OVER TIME.

When saving for retirement or any other long-term objective, there are really only three things that determine the outcome; amount invested, time and the rate of return you earn. However, two other components determine the purchasing power of that future sum of capital, whether it be for a capital expenditure or regular income; inflation and taxation.

Taxation can be controlled somewhat by choosing the right account in which to save within (TFSA vs RRSP vs Insurance etc.) Inflation however varies over time and can have a devastating effect on your future purchasing power. Let's take a look at how to combat this silent destroyer of wealth.

If you save/invest in familiar fixed income products like GIC's, Government bonds or bond funds, you likely do so because you feel they are safe. Recall though that interest is affected by taxes (non-registered account) and even with a 3% rate of interest over time – your net return can be negative. If you earn $55,000 per year, your marginal tax rate is 30% and you will lose about 1% of your interest to tax. Most are aware of that reality. However, few think about or even realize that if the consumer price index (inflation) was increasing at a rate of 2.5% per year, your money would have decreased in "real terms" by that amount. Since tax has already taken 1% out of the 3% return, we now see your after-tax return of 2% is reduced by another 2.5% which means a negative (0.50%) return. Compound this out over 20 years and your $1 today only buys 90 cents worth of goods then. Put another way, your standard of living will take a step back instead of forward down the road.

To drive this point home, ask yourself or someone else - what did a postage stamp cost 30 years ago? How about a big Mac? Answer; 38 cents, $2.15 respectively. Want another example, what did Netflix cost five years ago? And today? This is inflation!

When you see the damage inflation does over time, you quickly realize most fixed income investments only offer the illusion of safety and should be used only for shorter term investment goals. Alternatives such as bank stocks or the parent company of our Big Mac example, McDonalds, or a Real Estate Investment Trust all have provided dividend payouts that increased to keep pace with inflation whilst enjoying an increasing share price over time. What about risk you ask? Certainly over a few years (where you should use a GIC or bond) stocks can and do fluctuate in price. However, if you are investing for the longer term, then the risk declines exponentially.

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Have your cake today and be sure you can afford another one at your retirement party by paying attention to inflation and matching the objective to the investment – whether they be public or private in nature. An accredited and experienced independent advisor can help ensure the right match is made.

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