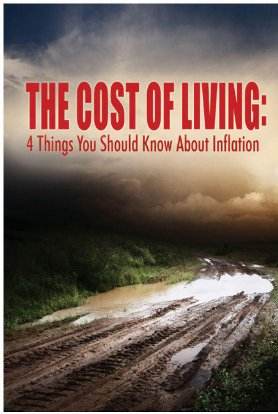


The Cost of Living:
4 Things You Should Know About Inflation

Many overlook the impact that inflation can have on retirement. This E-book will highlight 4 things you should know about inflation and how it could affect you in retirement. The 4 things that will be discussed are:

1. The annual inflation rate from 1973 to 2014. What do you think inflation has averaged over the last 41 years?
2. How your purchasing power could erode more quickly than you think. Guess how many years before your purchasing power could decrease 50%?
3. What things cost in 1936-1985?
4. Do taxes and inflation give you a negative return? Find out by answering 3 questions.

In short, you are about to learn what few people know about inflation. Sit back and enjoy since retiring with potentially more money later may have just gotten a little easier.

1. Inflation has averaged 4.1% from 1973-2014.

Source: U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index: Urban Wage Earners & Clerical Workers(CPI-W), U.S. City Average; 12 month change from Jan 1,1973 to Jan I, 2015; annual percentages totaled and divided by W.V.H., Inc.

Inflation can be potentially more devastating than a Federal or State Income Tax increase or loss of premium due to market downturns and fluctuation. Many individuals and couples do not take inflation into account when they plan for retirement. Those who do assume inflation rates of 1%, 2% or 3%.

It is understandable that many assume a low inflation rate. After all, inflation in 2012, 2013, and 2014 (according to the Bureau of Labor Statistics) was 1.5%, 1.6% and 0.3% respectively. However, as President Reagan once said, “Inflation is like a virus in the bloodstream. Sometimes active, sometimes dormant, but leaving the patient weaker after every new attack.”

Let’s look at 2 scenarios.

Scenario #1: An individual assumes 2% inflation, saves accordingly, and inflation averages 4.1% like it has since 1973-2014. Result: The individual will have less purchasing power since things cost more than expected. In an attempt to adjust to the loss of purchasing power, suddenly, 3-day trips might become 2-day trips or dinners might become lunches with smaller portions.

Scenario #2: The individual assumes 4.1% inflation, saves accordingly, and inflation averages 2%. The individual is likely to have more purchasing power, be able to maintain their lifestyle, and be more likely to not outlive their money.

Let’s look at the Exhibit Titled Inflation 1973 to 2014.

Do you remember in 1980 when inflation was 11.7% and first class postage was only 15 cents? How did postage increase over 200% between then and today’s 49 cents? The answer is inflation in spite of inflation being modest during the years 1991 to 2014.

In the last 5 years, inflation was only 1.7%, 3.2%, 1.7%, 1.5% and 0.3%. Did it feel like low stable inflationary times to you when a gallon of gas each December moved erratically from $2.78 to $3.84 to $3.14? Did your medical care costs or medical insurance premiums increase more than 0.3% in 2014?

Exhibit 1
Inflation 1973 To 2014

1973	9.3	1984	3.2	1995	2.6	2006	1.8
1974	11.7	1985	3.8	1996	3.0	2007	4.6
1975	6.9	1986	1.0	1997	1.3	2008	-0.5
1976	5.2	1987	4.1	1998	1.6	2009	3.3
1977	6.6	1988	4.5	1999	2.9	2010	1.8
1978	9.4	1989	5.2	2000	3.7	2011	3.1
1979	14.0	1990	5.5	2001	0.9	2012	1.5
1980	11.7	1991	2.4	2002	2.6	2013	1.6
1981	8.2	1992	3.2	2003	1.8	2014	0.3
1982	3.6	1993	2.4	2004	3.0	2015	?
1983	3.6	1994	2.9	2005	4.1	2016	?

Average annual inflation rate is the total of all the annual percentages above added together and divided by the number of years in the period 1973-2014. In this example, the answer is 173.40 divided by 42 = 4.128%: rounded off to 4.1%

Source: U.S. Department of Labor, Bureau of Labor Statistics, Jan. to Jan. CPI -W, Urban Wage Owners & Clerical Workers; U.S. City

2. Your $1,000 Could Lose 50% Of Its Purchasing Power.

Sources: Bankrate.com showed a site average results range for 5 –Year CDs from 0.93% to 2.25% on Feb 21st, 2015. The CPI-W Index from the Bureau of Labor Statistics for 1973- 2014 shows an average inflation rate of 4.1%

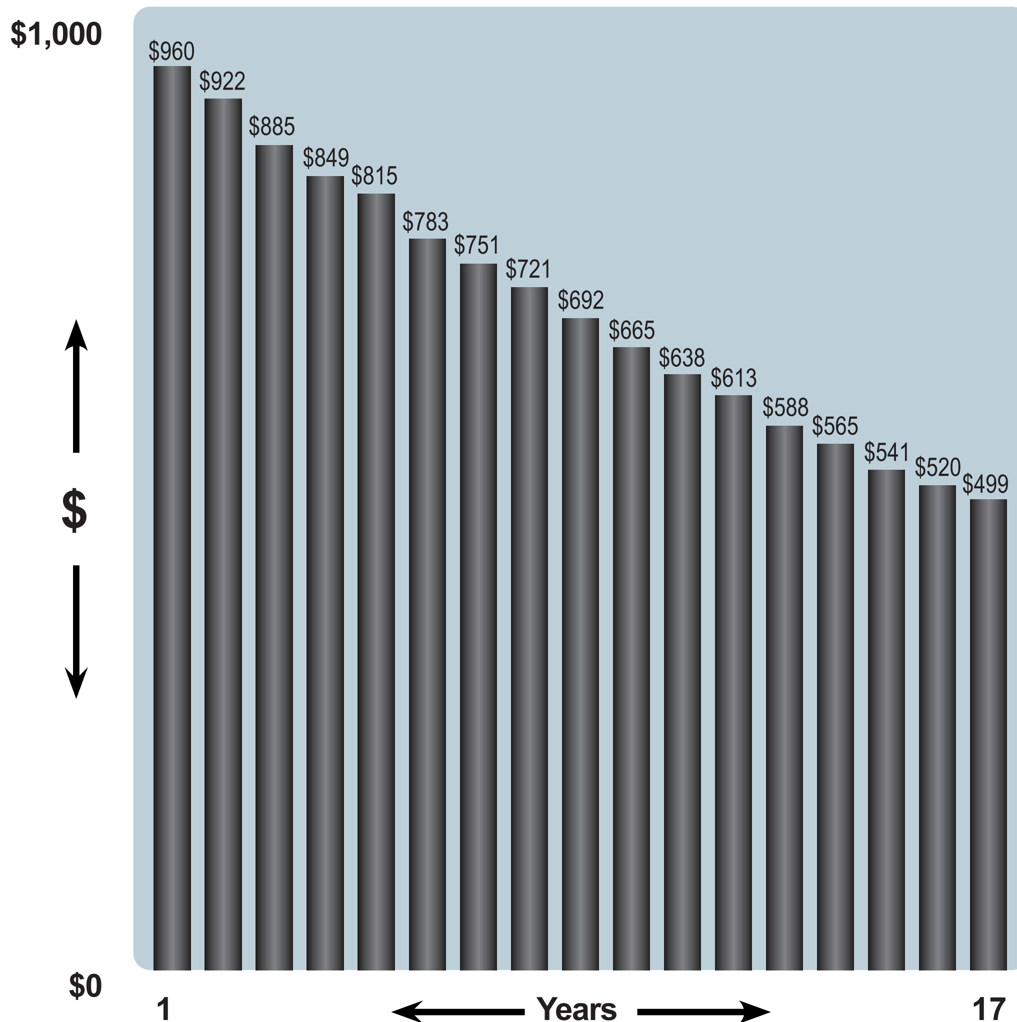
Let's assume an individual has $100,000 in a 5–Year Bank CD paying 1.5% interest compounded annually. Each year, they will earn $1,500. If they are in a combined Federal and State income 33% tax bracket, they will pay $500 in income taxes. To summarize, they earn $1,500 in bank interest, pay $500 in taxes, and have $1,000 left over.

In Exhibit 2, we show how $1,000 loses purchasing power each year based on a 4% inflation rate

As you see in the exhibit, $1,000 can have the purchasing power of $960 after one year, $815 and $665 after 5 and 10 ten years and $499 in year 17; more than a 50% loss in purchasing power. Some might think that 17 years is a long time away but doesn't 1998 seem like almost yesterday? Well, 1998 was only 17 years ago.

What can you do about lessening the impact that inflation can have on your retirement dollars? That is discussed later in this E-Book in the Problem/ Potential Solution section.

Exhibit 2
How Your Purchasing Power Decreases
(average rate of inflation from 1973- 2014 was 4.1%)



Assumptions: 4% inflation; 33% federal tax bracket

3. What did things cost the year you were born?

In Exhibit 3, you will see what things cost in 1936-1985. Far more importantly, we have 3 questions to ask you.

1. Do you think that the cost of postage, a car, and a home will cost more in 10 years than they do today?
2. What are you doing about that problem?
3. Would you like to learn how to lessen the impact inflation could have on your retirement dollars?

Exhibit 3

What Things Cost				
Year	Newspaper	1st Class Stamp	Car	Home
1936	3¢	3¢	$695	$3,825
1937	3¢	3¢	$750	$4,000
1938	3¢	3¢	$753	$3,800
1939	3¢	3¢	$867	$3,700
1940	3¢	3¢	$828	$2,938
1941	3¢	3¢	$840	$2,938
1942	3¢	3¢	*	$3,529
1943	3¢	3¢	*	$3,868
1944	3¢	3¢	*	$4,238
1945	3¢	3¢	$1,030	$4,645
1946	3¢	3¢	$1,020	$5,080
1947	5¢	3¢	$1,200	$5,577
1948	5¢	3¢	$1,660	$6,112
1949	5¢	3¢	$1,362	$6,170
1950	5¢	3¢	$1,299	$7,354
1951	5¢	3¢	$1,362	$7,113
1952	5¢	3¢	$5,065	$8,090
1953	5¢	3¢	$2,679	$8,486
1954	5¢	3¢	$2,638	$8,901
1955	5¢	3¢	$2,395	$9,337
1956	5¢	3¢	$1,367	$9,795
1957	5¢	3¢	$1,467	$10,274
1958	5¢	4¢	$1,695	$10,777
1959	5¢	4¢	$1,561	$11,305
1960	6¢	4¢	$1,627	$11,900

What Things Cost				
Year	News-paper	1st Class Stamp	Car	Home
1961	6¢	4¢	$2,464	$12,340
1962	7¢	4¢	$1,595	$12,797
1963	7¢	5¢	$2,494	$13,270
1964	7¢	5¢	$1,455	$13,761
1965	10¢	5¢	$1,959	$14,270
1966	10¢	5¢	$3,399	$14,798
1967	10¢	6¢	$2,365	$15,346
1968	10¢	6¢	$2,597	$15,913
1969	10¢	6¢	$3,175	$16,501
1970	10¢	6¢	$2,652	$17,000
1971	15¢	6¢	$3,395	$18,836
1972	15¢	8¢	$2,796	$20,870
1973	15¢	8¢	$4,281	$23,124
1974	15¢	8¢	$2,408	$25,621
1975	15¢	10¢	$2,999	$28,388
1976	20¢	13¢	$3,220	$31,454
1977	20¢	13¢	$3,588	$34,849
1978	20¢	13¢	$4,299	$38,613
1979	25¢	18¢	$10,654	$42,783
1980	25¢	15¢	$8,085	$47,200
1981	25¢	15¢	$6,194	$49,654
1982	25¢	20¢	$13,491	$52,236
1983	25¢	20¢	$9,399	$54,952
1984	25¢	20¢	$13,489	$57,810
1985	25¢	22¢	$8,999	$60,815

**N/A WWII Sources: W.V.H., Inc.; Annapolis Capital; Morris County Library; Department of Labor; Bureau of Labor Statistics; Board of Governors of the Federal Reserve System; U.S. Census Bureau*

4. Taxes and inflation can devour your interest.

While some say that there are only 2 things for certain: Death and Taxes, we can add inflation to that list of certainties. When inflation is addressed in the manner you are about to see, people are shocked when they see the negative or low return that taxes and inflation can have on their taxable interest.

In the Exhibit 4, we show what happened to a hypothetical Mom and Dad in 1950 and maybe to your Mom and Dad too. Their money in the bank was earning 1.22% interest. If they were in the minimum tax bracket (17.4%), then 17.4% of their bank interest would be paid in income taxes. The balance they would keep, 82.6%. In other words, they would only be keeping 82.6% of their 1.22% in interest, which is 1.01%.

There isn't anything wrong with 1.01% interest IF inflation were 0%. However, in 1950, inflation was 1.30%, which meant that the hypothetical couple was getting a -0.29% in interest. A -0.29%? Yes! When you subtract the inflation rate of 1.30% from the after-tax return of 1.01%, you get a -0.29%.

However, if there is one year far more important than 1950, it is THIS year. Please get a pen and paper and write down the answers to these questions.

Income Tax & Inflation Worksheet

1. Enter the interest rate you are getting on your oldest or newest Bank CD. ____%

2. Enter your Federal & State combined tax bracket. (like 15% 28%, 33%, 38%) ____%

3. Multiply Line 2 times Line 1 and enter the answer here on Line 3. ____%

4. Enter again the % you entered on Line 1 and enter it here on Line 4. ____%

5. Subtract the % on Line 3 from the % on line 1 and enter it here on Line 5. ____%

6. Enter what you think inflation will average in 2015 and enter it on line 6. ____%

7. Subtract the number on Line 6 from Line 5 and enter it here on line 7. ____%

The number on Line 7 is the real interest you are getting after taxes and inflation.

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Next Steps

If you could get interest potentially higher than the number you entered on Line 7 and you could avoid losses of premium due to market downturns and fluctuation, would that be of any interest to you? If so, please go to the Problem/ Potential Solution section of this E- Book.

Exhibit 4

The Real Return That Bank Depositors Received

Year	1950
Interest rate	1.22%
What you keep	82.60%
After-tax return	1.01%
Inflation	1.30%
Actual return	-0.29%

Sources: Federal Reserve, Internal Revenue Service, Bureau of Labor Statistics

Problems/ Potential Solutions

Problems

Exhibit 1

Inflation 1973 to 2014

Problem: If your annual return on savings and/or investments is less than inflation, you could be going backwards.

Exhibit 2

How Your Purchasing Power Decreases Because Of Inflation

Problem: In the example shown in the chart, we saw the problem $1,500 of Bank CD interest diminishing 2 ways. $500 is going to Federal and State income taxes, and then the balance is diminishing in purchasing power because of inflation.

Exhibit 3

What Things Cost the Year You Were Born

Problem: Things are more likely to cost more in the future.

Exhibit 4

Taxes and Inflation can devour your interest

Problem: Low annual or negative annual returns

Potential Solutions: Choosing a tax–efficient alternative where the annual return could match or exceed the annual inflation rate. The stock market is a potential solution if you have a tolerance for risk, the time and money elsewhere to weather the potential fluctuations. For those who have little tolerance for risk or who should have little tolerance for risk because of their age or retirement savings a potential could be a Fixed Index Annuity or Multi-Year Guarantee Annuity. Both types of annuities are issued by insurance companies with some of the insurance companies being highly rated by A.M. Best. Please read How Some People Select Strong Insurance Companies.

Why a Fixed Index annuity or Multi-Year Guarantee Annuity?

Interest on both types of these annuities is tax–deferred until withdrawn. In a recent 10-Yr comparison between a hypothetical Fixed Index Annuity and a 1-Yr and 5-Yr Bank CD, the Fixed Index Annuity credited higher interest rates than the Bank CD most of the time and out- accumulated a 1-Yr bank CD by 28% and a 5-Yr bank CD by 11%. (Source: Based on line chart created by bankrate.com which showed national average CD rates for 1-Yr CD yields and 5 –Yr CD yields. The Fixed Index Annuity was based on a hypothetical Fixed Index Annuity with 5% cap, S & P 500, Annual Point To Point.)

Other Solutions:

1. Self- realization that it is up to you to control your own destiny.
2. You must stop being too dependent on the government.
3. You must take good common sense approaches.

Good common sense approaches & potential solutions for Retirees and Pre-Retirees

- Begin buying what you need and not what you want.
- Stay away from credit card debt so those things you need do not cost you 22- 25% more.
- Take advantage of tax–deferred Multi-Year Guarantee Annuity or a Fixed Index Annuity with a Lifetime Income Riders

Additional common sense approaches & potential solutions for Pre-Retirees:

- Take advantage of Catch-Up Contributions that the IRS allows people age 50 and older to "Catch Up" and contribute more in their IRA and a lot more in their 401(k).
- Take advantage of an employer matching 401(k) but still stay diversified.
- Pay yourself first every week or month.

Annuities may NOT be an appropriate product for all individuals all of the time. However, it could be a wise choice for individuals when the suitability needs are met.

How Some People Select Strong Insurance Companies:

There are rating services that rate insurance companies according to the insurance company's financial strength and ability to meet its ongoing policy and contract obligations.

A.M. Best is probably the oldest rating agency and the only rating agency that focuses on the insurance industry exclusively.

In Exhibit 5, we have listed the ten A.M. Best financial strength ratings that A.M. Best has given to 1,225 insurance companies in 2014. (Source A.M. Best)

"A++ and A+" (Superior) category is A.M. Best's highest financial strength rating.
"S". (Rating suspended) is their lowest.

All parties should a) evaluate what the other rating services are also saying about the insurance companies they are considering, and b) ask your tax, legal, and other advisors as well to help you select the right insurance company.

Exhibit 5
Guide To Best's Financial Strength Ratings

	Rating	Descriptor
Secure	A++, A+	Superior
	A, A-	Excellent
	B++, B+	Good
Vulnerable	B, B-	Fair
	C++, C+	Marginal
	C, C-	Weak
	D	Poor
	E	Under Regulatory Supervision
	F	In Liquidation
	S	Suspended

Sources: http://www.ambest.com/ratings/guide.pdf

Ratings Disclosure: A Best's Financial Strength Rating opinion addresses the relative ability of an insurer to meet its ongoing insurance obligations. The ratings are not assigned to specific insurance policies or contracts and do not address any other risk, including, but not limited to, an insurer's claims-payment policies or procedures; the ability of the insurer to dispute or deny claims payment on grounds of misrepresentation or fraud; or any specific liability contractually borne by the policy or contract holder.

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Disclosures:

Fixed Index Annuities are not a direct investment in the stock market. They are long term insurance products with guarantees backed by the issuing company. They provide the potential for interest to be credited based in part on the performance
of specific indices, without the risk of loss of premium due to market downturns or fluctuation. They may not be appropriate for all clients.

Annuities are not deposits of, or guaranteed by, any bank and are not insured by the FDIC or any other agency of the US. All guarantees are subject to the financial strength of the issuing insurance company.

Under current law, annuities grow tax deferred. An annuity is not required for tax deferral in qualified plans. Annuities may be subject to taxation during the income or withdrawal phase.

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