Investing for Inflation

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When preparing to save for investments like college or retirement, it is important to calculate the effect of inflation. It may not seem like a big deal for the near term, but over time it can have a direct impact on future plans. For example if the inflation rate averaged at 3% annually, over 20 years it would raise a $2 gallon of milk to $4.20. Or when looking at more expensive purchases, a $5,000 washer/dryer would be $8,000 and a $10,000 car could theoretically cost $16,000.

There are a number of influences that have an effect on inflation, so it's important to understand how inflation can make an impact on investment goals.

WHAT IS INFLATION?

Inflation is the increase of price levels over time. The most common measure of inflation is known as the Consumer Price Index, or CPI, which measures the change in prices of basic consumer goods and services. Inflation causes the value of the currency to decrease, which means that the currency will buy fewer goods than previously.

HISTORICAL INFLATION

The CPI has been tracked by the United States government since 1913. Eighty-four of the last ninety-seven years have been inflationary. There have been three periods of extreme inflation and two periods of extreme deflation.

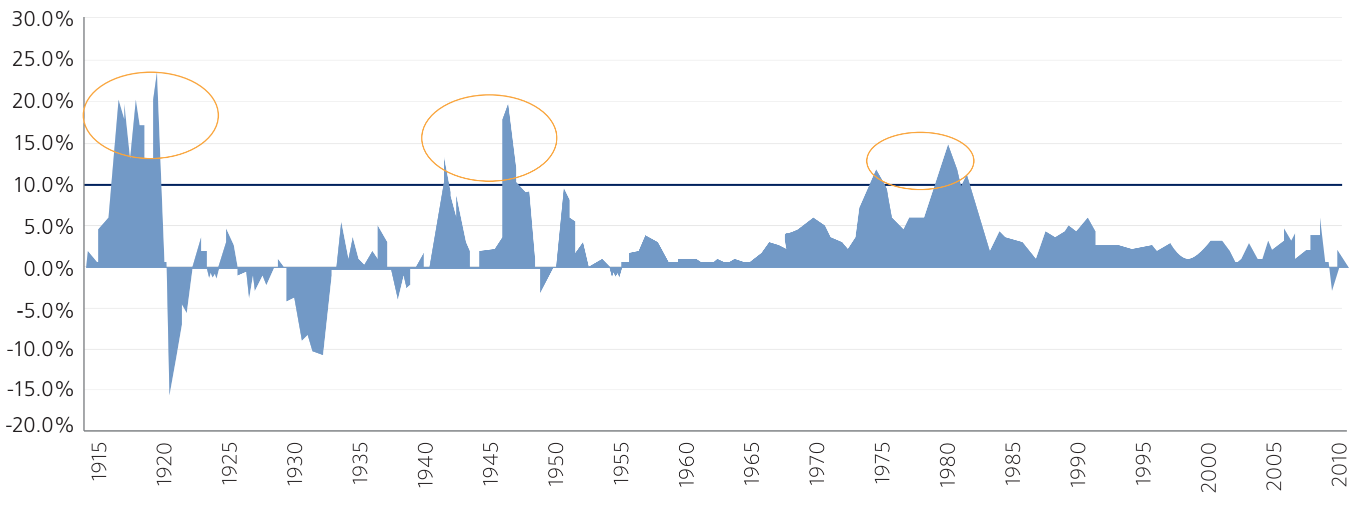
The following is a summary of three periods of time in 20th century United States history where inflation reached double-digits:

1. Late Teens: The United States government printed money to help finance World War I. For the four years between October 1916 and September 1920, inflation fluctuated between 10.7% and 23.7%

2. 1940s: Following economic expansion after the Great Depression and during World War II, the United States national debt soared from $16 billion to over $260 billion resulting in inflation rates reaching 19.7% in March 1947.

3. 1970s to Early 1980s: The Vietnam War resulted in expansive monetary and budgetary policies from 1969 to 1973. In addition, wages and demand were increasing as well as the price of oil.

HISTORICAL UNITED STATES INFLATION RATES 1915 - 2010



SOURCE: www.bls.gov

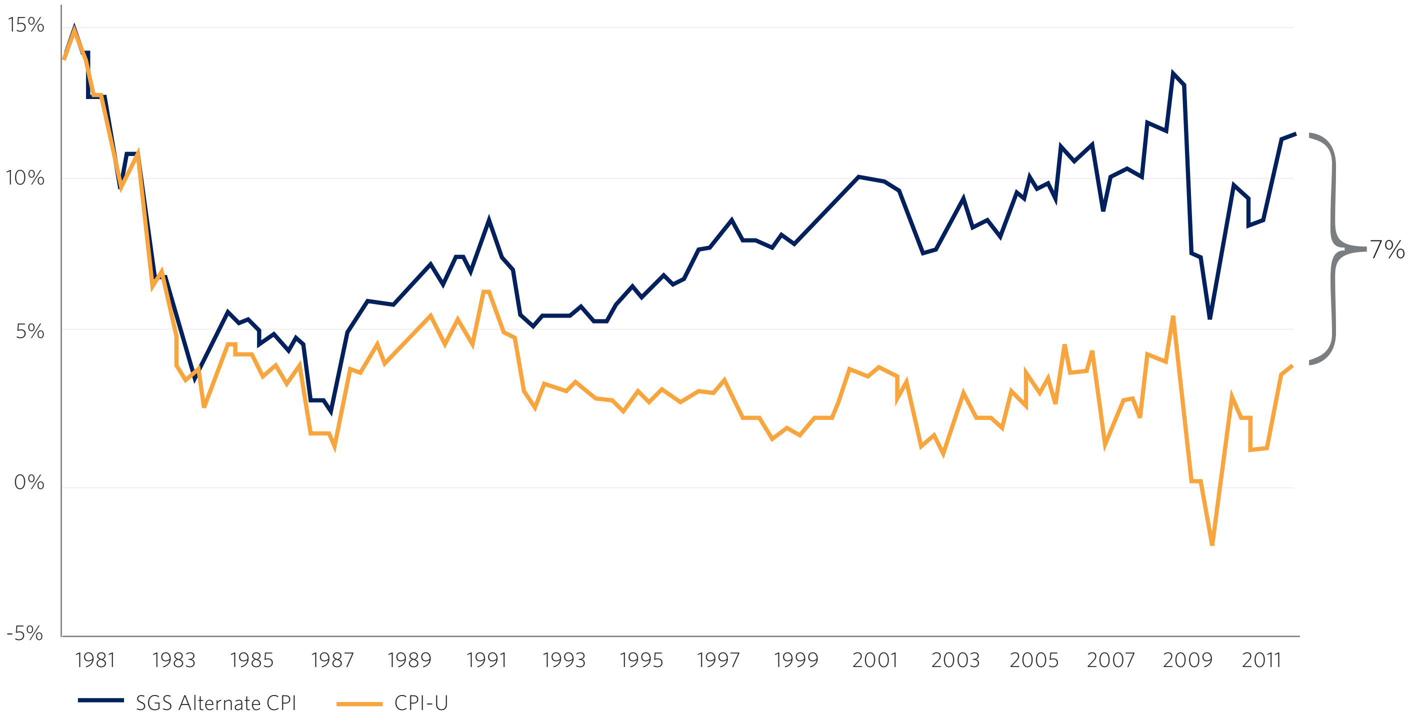
CPI TODAY

The United States Bureau of Labor Statistics has changed the way CPI is calculated by taking out some measures, changing the weight of certain items and substituting goods. A popular example of substitution in the CPI is when steak gets expensive, people downgrade to hamburger meat. The price of hamburger meat is then substituted for the price of steak, and the steak is no longer accounted for in the CPI. This is not to argue whether substitution is right or wrong, but to demonstrate that substitutions can impact the way CPI is calculated.

American Business Analytics & Research performed the CPI calculation that was used in the early 1980s (the SGS Alternate CPI) to provide a view of how inflation would look today, if it were still calculated that way. This difference has grown to roughly a 7% spread between the published CPI and the SGS Alternate CPI calculation circa 1980 (see chart below). The older method of calculating CPI suggests that we are in the midst of significant inflation. If these mounting pressures of inflation burst without investors being prepared, portfolios will be significantly impacted through decreased value in cash holdings and negative returns to their other investments. In other words, if inflation were deemed to be 7% then you would need to earn at least 7% return to stay even.

ANNUAL CONSUMER INFLATION – CPI VS. SGS ALTERNATE

Year to Year Change. Through Aug. 2011 (BLS, SGS)



SOURCE: American Business Analytics & Research Shadowstats.com. Published Sept. 15, 2011

For Investor Use

Past performance is not indicative of future results.

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HIGH INFLATION AND ALTERNATIVE INVESTMENT PERFORMANCE

A study that was done by the International Monetary Fund* tracked how various asset classes performed through inflation between 1973 to 2008. Alternative investments like commodities and gold experienced average returns of 3.8% and 6.9% respectively, while other asset classes, like large cap equities and U.S. treasury bonds, in this study performed negatively.

Other alternative investments that perform well during times of higher inflation are those that are benchmarked to the CPI or another key interest rate measure. For example, bank loans have a floating interest rate that is benchmarked to the CPI to provide investors with a real return above the inflation rate. Many debt investments have a floating interest rate that is linked to a major index such as the LIBOR Index allowing the interest income to increase as inflation or interest rates increase.

In addition, direct real estate tends to perform well during periods of higher inflation for two key reasons:

1. Many commercial leases are linked to the CPI to protect the value of the investor's rental revenue.

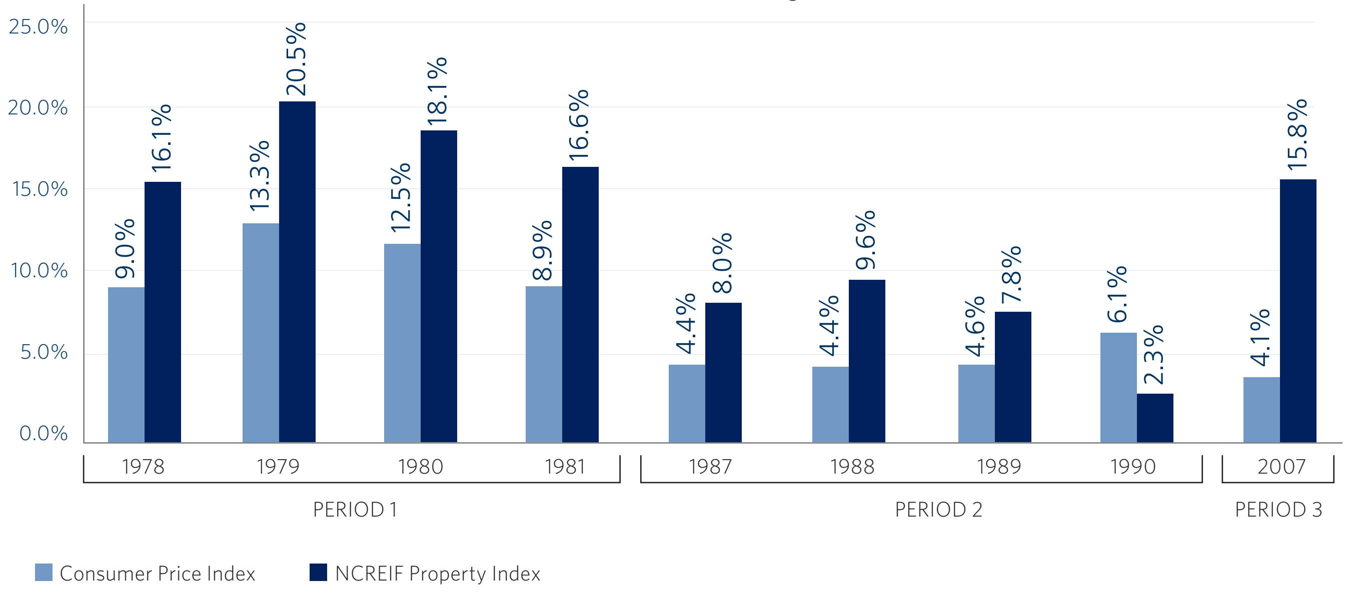
2. Investors often look to tangible and alternative investments in a time when traditional assets are declining in value or to simply provide diversification.

The standard source used to measure the performance of direct real estate investment in the United States is the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index. Based on the NCREIF Property Index, private real estate has continuously outpaced inflation as far back as when the NCREIF Property Index was created in the 1970s. Even in periods of extreme inflation in the 1970s and 1980s, private real estate still outperformed the CPI.

**SOURCE: International Monetary Fund, Inflation Hedging for Long-Term Investors. April 2009*

PERFORMANCE OF PRIVATE COMMERCIAL REAL ESTATE INVESTMENT DURING PERIODS OF HIGHER INFLATION

Year-end to Year-end Change %



SOURCES: United States Bureau of Labor Statistics, NCREIF. Past performance is no guarantee of future results.

PLANNING FOR THE FUTURE

To learn more about inflation and how to use alternate investments such as real estate, commodities, gold and floating-rate securities, contact your financial advisor. Financial advisors are encouraged to visit **www.CNLSecurities.com** or contact CNL Securities, Member FINRA/SIPC at **(866) 650-0650.**

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