MarketWatch

How inflation Might impact Your Retirement

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It’s coming for your money, whether you ignore it or not

By

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This is part two of a three-part series on retirement income planning. Part one addressed **life expectancy assumptions,** part two is about how inflation might impact your retirement and part three will be about a portfolio strategy designed to address those two variables.
Inflation is more or less ignored by the average retiree despite the price of just about everything tripling during their working years. This is likely because while the prices were tripling, their income was increasing at a faster pace, so it almost didn’t matter. In other words, you could afford to ignore it. You can’t any longer. Remember: Retirement doesn’t include promotions that come with big pay raises.

If I asked you what the prices of various goods were about three decades ago, you could probably rattle off some pretty accurate guesses. Let’s review what some of the prices were 30 years ago.

•Postage stamp: $0.25

•Gallon of gas: $0.97

•Average price of a new car: $15,350

I could go on, but you get the picture. What do those things cost today?

•Postage stamp: $0.55

•Gallon of gas: $2.73

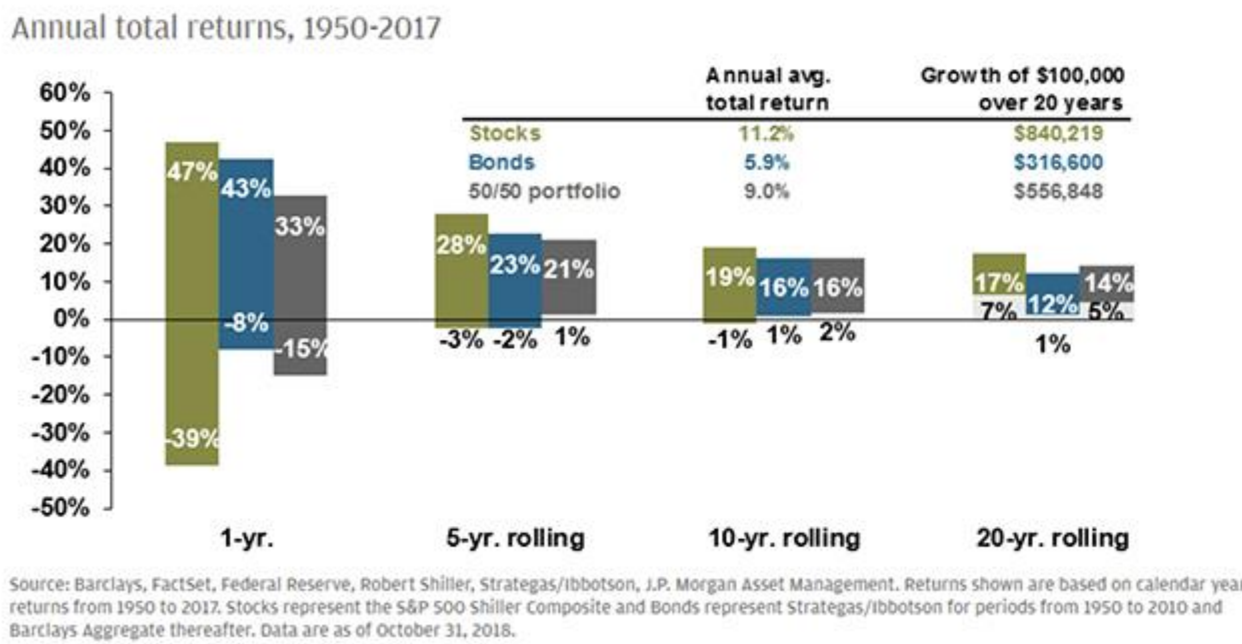
•Average price of a new car: $36,590

Over the last 30 years, the price of most everything has at least doubled if not tripled. Historically speaking, we know that inflation is going to happen throughout our retirement, but we have a natural inclination to ignore it because it doesn't happen overnight. We only really care about things that can and do happen overnight, not about what occurs over the long term despite the significant income erosion that inevitably occurs.

What follows below is a brief detour, but my purpose will become clear in a moment.
Two examples that I find psychologically fascinating:

First, we ignore inflation despite the fact that it's been present in our lives the entire time we've been alive. We only care about what's happening here and now. But if we look at the long term, we can see the extremely powerful impact it could have on our long-term retirement.

Secondly, we worry about the volatility of the stock market **SPX, +0.30%** at any given moment because markets collapse quickly and investors often mistake it as a permanent loss of capital. Yet if we look at the long term, such as over the span of the career of today's retirees, it's clear that they're worried about an issue that historically doesn't even exist. Let's look at what has historically occurred over various rolling periods in the following chart from **J.P. Morgan**.



The range of annualized returns becomes less volatile with an extended investment horizon.
As we can see, short-term volatility can be dramatic, but over the long term — which just about everyone reading this article should be concerned about — there hasn't been *little* risk, there has been *no* risk historically speaking.
This is not a way of saying this is what will occur over the coming 20 years, but it is a way of saying that this is the only thing that has occurred over nearly the entire time you've been alive.

For what it's worth, I realize that two of the three biggest declines in the history of the stock market have occurred as you have been nearing the finish line (a blessing in disguise for dollar-cost averaging), so it's still actively in your rearview mirror. But if you drive your car looking in your rearview mirror, eventually you will crash. Fighting the last battle is never a way to win a war.

Detour complete.
You must approach retirement planning with objectivity and a total understanding of the issues at hand that you will inevitably face as you move into your retirement years. Given the fact that inflation has been around for the entirety of our country's history, it seems likely it will continue throughout your retirement as well.

But if you do nothing to prepare for this inevitability, you will likely seal your fate. You can choose to ignore this or plead ignorance, but neither approach will help you. You must land on a portfolio approach that will provide the confidence you need to ensure, historically speaking, that you will have an ever-increasing income stream that will grow as your income needs grow.

Then, and only then, can you possibly find comfort that longevity isn't actually a risk, but a goal to strive for. A privilege where you might get to have a long relationship with your great-grandchildren.

OK, you get it now. You know that you are likely to live a long life and that inflation can have a significant impact on that long life. What can you do about it? Create a specific portfolio strategy that might ease some of the stresses that come with investing that can effectively address the impact inflation can have on a long life.