Worried about inflation and your investments? Consider this info

Q: The current US inflation rate is running about 2.8%, yet my advisor wants to add Treasuries Indexed for Inflation (TIPS) to my retirement account. Does this make sense?

A: Having TIPS in your tax deferred portfolio will add value and safety. They're not tax efficient, so not always a good match for after tax investments.

Known to be negatively correlated to stocks, these bonds are low-risk investments backed by the U.S. Treasury. Their par (or face) value increases with inflation, as measured by the Consumer Price Index (CPI), while the interest rate remains fixed.

Think of inflation as a loss of purchasing power by rising prices of goods and services. This economic term means you have to spend more to fill your gas tank, buy milk or get a haircut. Inflation increases your cost of living.

When demand outpaces supply the result may be inflation. And inflation doesn't affect everything the same way. Home prices fell 31.8% while the price of gas increased to an average $4.11 a gallon during the financial crisis of 2008. Typically electronics lose value, but try buying a new TV the day before Super Bowl. With Hurricane Katrina in 2005, the demand for gas didn't change but the supply constraints increased the price to $5 a gallon.

Over the last 10 years, the cost of prescription drugs increased 3.7% and higher education increased 4% while the price of that TV dropped 17% (except the day before the big game.)

The Consumer Price Index (CPI) is the most widely used measure of inflation, but it doesn't include food and energy. It's not the same as inflation. But it is used for Social Security payment adjustments.

The Bureau of Labor Statistics (BLS) evaluates prices monthly and generates the current CPI. It then compares that number to last year's index and the difference is the increase or decrease in inflation.

Inflation matters in your retirement plan. US Core Inflation averaged 3.6% from 1957 until 2018, reaching an all-time high of 13.6% in June, 1980 according to Trading Economics.

Remain invested during retirement. Incorporate inflation into your planning by selecting a diversified mix of investments that will keep pace with inflation. Money markets and bank savings accounts don't provide enough growth to outpace inflation. The right mix of assets will provide an income for your unique goals and needs.

During retirement there is a need to build a cost-of-living adjustment into a budget. Retirement calculators use Monte Carlo simulations that project inflation rates. Even though Social Security uses CPI, that index doesn't include food and energy. We all need to eat and most people need more income than Social Security provides. TIPs are a good diversifier and provide protection against inflation.

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