

BUSINESS

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Money manager likes TIPS funds for protection



Edward McIlveen

Among the many worries investors are grappling with, one looms large for Ed McIlveen. Higher-than-expected inflation is a

real threat that may require some serious defense, said McIlveen, director of performance analytics and research at Francis Investment Counsel in Pewaukee.

The federal government's huge stimulus plans are likely to spur inflation. Yet the international financial crisis has blurred market expectations about inflation.

"The market is implying inflation will be 1.3 percent or so. But we believe it will be higher over the next 10 years and that it could return to more historically normal levels of 2.5 percent to 3 percent on an annualized basis - or even higher," McIlveen said.

The official measure of inflation, the Consumer Price Index, rose just 0.24% for the 12 months ended Feb. 28. Despite the small advance, some individual components showed bigger jumps.

Transportation declined the most, down 11%, but food and beverages rose 4.8%, and education and communication increased 3.65% over that same period, McIlveen said. Medical care, housing, and other goods and services rose 2% or more, he said.

Federal Reserve Chairman Ben Bernanke said in February that he should be able to rein in inflation when it picks up.

"I'd say, 'perhaps.' But now we've got a situation where there's a lot of money chasing a limited number of goods," McIlveen said.

He sees an oversupply of money compared with production levels, which usually means higher prices. When costs rise and companies can't pass the increases on to suppliers or customers, earnings suffer. And that hurts investors, McIlveen said.

To protect against inflation, investors can seek out stock managers who adjust their portfolios accordingly or turn to Treasury Inflation Protected Securities (TIPS).

"With TIPS you're covered in a wide range of economic scenarios," McIlveen said.

In a strong economic recovery, commodity prices - and inflation - would likely increase. Stagflation brings no growth, but higher inflation. And if the recession continues, you've got an investment that holds securities backed by the full faith and credit of the U.S. government, he said.

Vanguard Inflation-Protected Securities Fund

(VIPSX, \$12.16) has a low annual fee of 0.20%. Its managers stay close to the Barclay's Capital U.S. Treasury Inflation Notes Index, but actively manage security selection, McIlveen said.

The shares have traded in a 52-week range of \$10.77 and \$12.97.

"We believe the expertise of Vanguard's fixed-income group adds value, and the low cost makes it a winner," he said.

The biggest risk he associates with TIPS investments is the possibility of deflation, which would drive TIPS' returns down, he said.

McIlveen said he would recommend that investors near retirement put no more than 15% to 20% of their portfolios in TIPS. Investors who are 10 or more years away might allocate about 5% of their portfolio to TIPS, knowing stocks will also hedge inflation over the long-term.

McIlveen also suggested other TIPS funds for investors who want a more actively managed option, or those who want to trade during the day.

BlackRock Inflation Protected Bond Portfolio (BPRAX, \$10.32) buys TIPS and other inflation-indexed bonds of varying maturities issued by the U.S. and other governments. This fund's managers actively choose securities, have solid expertise and have turned in good relative performance, McIlveen said.

Shares of BlackRock have traded in a range of \$9.13 to \$10.94 in the past year.

The fund has higher fees of 0.63% and a front-end load, which may be waived depending upon an individual's relationship with his or her broker, he said.

iShares Barclays U.S. Inflation Protected Securities Fund (TIP, \$103.08) is an exchange-traded fund that tracks the Barclay's Capital U.S. Treasury Inflation Notes Index. Shares have traded between \$84.14 and \$110.00 in the last 52 weeks.

ETFs are mutual fund alternatives that typically are linked to an index. They offer a diversified basket of stocks in a given area and trade like stocks. Unlike mutual funds, they're priced continuously throughout the day.

