

BUSINESS

401(k) Adviser: As inflation rises, so should the amount you save for retirement

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401(k) ADVISER

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If you haven't already done so, it's time to consider how rising inflation might affect your 401(k) plan saving and investment strategy.

While always present, real inflation risk has not been something investors have had to deal with since the '70s. That means investigating the proper saving rate and investment strategy for an inflationary environment is uncharted territory for most.

Two forces are at work that explain much of the price increases we are experiencing: increasing global demand for natural resources and irresponsible U.S. governmental policies.

Emerging countries hold two-thirds of the world's population and possess economic growth rates two to three times that of the United States. As these populous countries prosper, they consume significantly larger quantities of natural resources. The world's inability to keep up with the global increase in demand for natural resources is one of the reasons prices are moving higher.

A second cause of inflation is irresponsible U.S. governmental spending that has helped weaken the dollar. Because our elected officials routinely spend more money than they raise in taxes, our national debt now measures in the several trillions of dollars.

Like any borrower, the deeper the United States goes in debt, the less willing others are to lend it money. The world's lessening confidence in the United States manifests itself in a

weaker dollar, which accelerates the inflation of the cost of goods we import, most importantly oil.

Until the rest of the world slows its rate of economic growth, and the U.S. gets in better control of its spending, expect inflation to stick around. A recent study by Legg Mason showed that, over the past 150 years, inflationary periods have lasted more than 15 years on average.

The first 401(k)-related question you should be asking is: "If the cost of living is going up, am I saving enough to be able to stop working at a reasonable age?" With the cost of gas, food and health care rising much more rapidly than just a few years ago, retirement has gotten meaningfully more expensive.

Yet, it is extremely difficult to save more for retirement when filling a gas tank feels more like making a mortgage payment.

A new 401(k) plan administrative innovation may help. It's called "Automatic Escalation." While not yet available through all plans, here's how it works: Let your employer know you're interested, and every year your 401(k) deferral is automatically increased by 1%.

Because it happens automatically, most people don't even realize they are saving more for retirement, and they adjust their spending habits accordingly.

Inflation also wreaks havoc on investment strategies.

Many fund strategies that performed well in the '80s and '90s, a period of steady growth and low inflation, fared poorly in the '70s - the last prolonged period of inflation in this country.

Some fund categories that should hold up reasonably well in an inflationary

economic environment include TIPS bond funds, some "growth" stock funds and commodity/natural resources funds.

Also, look to increase your overseas equity holdings with an eye toward emerging markets. Historically, stock markets have grown in line with their underlying economy. I believe that many foreign markets will grow faster than the U.S. reflecting their rapid economic expansion.

Fund categories that will most likely struggle during a period of prolonged inflation include bond funds, large-cap U.S. stock funds and U.S. REIT funds.

Successful investing is all about looking forward and trying to anticipate where things are headed. Too many people approach investing by looking at where things have been and how they have performed in the past.

The next 10 to 15 years are going to be nothing like the '80s and '90s. Now is a great time to re-evaluate your 401(k) saving and investment strategy based on an outlook that contains an expectation of increased inflationary pressures.

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