

Episode 95: Understanding Inflation

00:00

Bob French

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00:06

Bob French

The first step is to discover your retirement income personality. Start by going to Risaprofile.com/Style and sign up to take the industry's first financial personality tool for retirement planning.

00:40

Bob French

Inflation is a risk that all retirees face, and it sure has felt risky lately.

00:46

Wade Pfau

Hi, everyone. Welcome to retire with style. I'm Wade, and I'm joined by Alex. And today, as well, by Bob French. And we're going to be talking about inflation, but it's been a long time since I've been on the show. Alex. Did you really? Are you just saying that.

01:08

Alex Murguia

I've referred people to it already?

01:12

Wade Pfau

Yeah, I could tell Alex was having to be patient to get through every single part of the adv, but it was definitely a very interesting series of episodes. I learned a lot.

01:23

Alex Murguia
Did you really?

01:24

Bob French
Are you just saying that I've referred people to it already?

01:28

Wade Pfau
Right.

01:29

Alex Murguia
Well, I mean, the reality is that a lot of folks just want to know, okay, what am I getting into when using an advisor? And I don't think they realize that there is actually a codified pamphlet that brochure that advisors have to give to folks to make them more informed. And it's one of those things that the realization is, I don't think anyone really reads this and they actually should. And so we just forced the issue a little bit and now it's in the archives. But the summer is over, so no more vacations. And, you know, now it's just Alex. And I wonder how many of them thought themselves, man, why couldn't it just be just Wade and Alex go on vacation.

02:18

Wade Pfau
Too? But the summer is over, so no more vacations. And we are back for the fall season. This is really the season premiere in that regard. And of course, we've got Bob French for those key ratings and the demos and the that's right, Nielsen ratings and everything else with sweeps month. It's September sweeps. We've got the heavy hitters, and we're all here.

02:43

Alex Murguia
Bob Wade is flexing his comedic muscle. Oh, my goodness.

02:51

Bob French
He is not saying anything. Just saying we can look at the comments we get here.

02:59

Alex Murguia
It's sweet. Sweet. Hey, by the way, I binged on.

03:04

Wade Pfau

One piece, the new live action one.

03:08

Alex Murguia

Yeah, well, the anime is great. It's like one of the all time grades. And my kids got me into that, and then they had the live action, so I had to see it. It's pretty good for those of you scoring at home.

03:20

Wade Pfau

Okay. Yeah. I have yet to watch any live action versions because they had as well.

03:26

Alex Murguia

Yeah, they kind of run away from those, the kids. But I don't know. I'm not a snob. Live action snob I thought it was pretty good, actually.

03:34

Wade Pfau

But you're making a pop culture reference about something that happened since the 1970s. I'm impressed. And that's going to come up in today's episode being on inflation. Alex with all, but other than the last couple of years, alex is the only one who has inflation in his living memory. So he's going to have to tell us young people what it's all about.

04:08

Bob French

Wade really has been resting here. He's saved us all up.

04:13

Alex Murguia

He's been like, let me call out. No, let me write it down and wait for the podcast. No, let me write this down. He's got a lot of emails that are like, note to self. But Bob is putting together a series of discussions that he's going to be doing with the retirement researcher community, with McLean Asset Management, and so we thought it'd be great to have Bob on to provide us a preview of all that and to have a little arc. Go on. We're never making this is going to be like ten episodes on inflation.

04:41

Wade Pfau

No, we're going to talk about inflation and that is something that for many people, we haven't really seen much of it since the mid, early to mid 1980s until the last couple of years were reintroduced to the idea of inflation. But Bob is putting together a series of discussions that he's going to be doing with the retirement researcher community, with McClain Asset Management, and so we thought it'd be great to have Bob on to provide us a preview of all that and to have a little arc. It's going to be a few episodes, we never know in advance how many exactly, but we're going to get started today to talking about inflation and the role and the importance of inflation on financial planning and of course, with a particular focus on retirement income as well. But today partly will be for setting the stage of what inflation is, how it's measured, some of the different types of CPI indices.

05:35

Wade Pfau

We'll have a little quiz on the CPIU and CPIW and CPIE and so forth and just really get a sense of what inflations look like historically as well. So, welcome back to the show, Bob. We've not had you in a while. It's great to have you here.

05:49

Bob French

It's been a little thank you. So, yeah, as Wade just said, well, actually, when this comes out tomorrow, we'll be having in the Retirement Researcher Academy our workshop on managing inflation in your retirement plan. But we wanted to kind of talk about this here because it's a really big topic and it's been, as Wade just said, top of mind in a way that it has not been for the past 30, maybe even 40 years. So it's something that people are starting to really kind of grapple with and it's something Wade, you actually called this out a little while back in your seven risks of retirement planning. This is one of those big seven risks, so we need to be able to deal with it and work with it effectively because it is a fact of life and what we want to do is kind of start with what is inflation?

06:49

Bob French

Why does it exist? What does it even mean? And how do we kind of understand what it might look like going forward? So I think everyone kind of gets inflation to a certain degree. Prices are going up. That's inflation. And that's actually not a horrible definition of it. The cost of goods and services is going up. You need to give someone more money for the same amount of stuff that you had to give them less money for in the past. Now, Wade, with your economics PhD, I'm sure you can give a more precise definition, but yeah, that's kind of.

07:36

Wade Pfau

Yeah, it's just the change in the price level over time, and we generally just think of inflation as being a positive number, that prices are increasing over time. That doesn't have to be the case. You can have

deflation, which can be very damaging to an economy as well as we'll talk about a little bit. But deflation would be the price level is decreasing over time. We don't see as much of that. Although Japan would be an example of a country that has experienced deflation in recent history, in US history, to see deflation, it goes back more to before the Federal Reserve discovered monetary policy, and it was more the gold supply in the world and so forth, determined the price levels and all that sort of thing. But yeah, that's pretty much what inflation is. It doesn't really have to get any more technical.

08:26

Alex Murguia

So could it get less technical? Could it get less technical? Yesterday's price is not today's price.

08:33

Bob French

That's right. And the other one I want to call out there is a lot of the times people talk about shrinkflation where instead of changing prices, they change the volume of something. Your candy bars get smaller. That's also a form of inflation. And actually, we'll talk about this later, but it is picked up in the more formal measures.

08:57

Alex Murguia

Does that happen when you go in the water?

09:02

Bob French

It's shrinkage.

09:08

Wade Pfau

That's a 1990s cultural reference.

09:11

Bob French

That's right.

09:12

Alex Murguia

I'm getting better, I'm getting better.

09:18

Bob French

We're going to settle like, Alex, when did you graduate high school? That's about the time period we're going.

09:22

Wade Pfau

To settle on here.

09:23

Alex Murguia

I think 1990.

09:26

Bob French

Okay. Well, no, I think Seinfeld was a little late there, so you got to pull it back.

09:32

Wade Pfau

Premiered about that time.

09:34

Bob French

But one of the other things to call out inflation is a massively political topic, and it's been massively political since money has existed. You hear about ancient kings and through the Middle Ages debasing their currency or debasing their coinage. That was inflation. There's a lot of other stuff going on there, but that was inflation. As we've gotten into more kind of a debt based economy, it's even more important. Wade, you're from the Midwest, so you probably learned all about this, but the Cross of Gold speech that whole time period, William Jen's, Brian and all that type of stuff that was explicitly about inflation. That was the big political issue of the time. How do you deal with that? It was around being on the gold standard, whether that was a good or a bad thing, but that was almost exclusively there was some trade stuff going on there with it as well.

10:34

Bob French

But that was about inflation. That was about how do we want to grow the money supply? Wade, he said punt? Bimetallism and that stuff continues on today, and that's something we're not going to deal with too much, because you can tell a story on both sides, and all we're going to do is make one side angry. Or make

both sides angry, most likely, if we start getting into that. So we're going to punt and just pretend we don't need to talk about it.

11:12

Alex Murguia

Wait, he said punt? That's not the word we settled on. He even has it here. Bob likes to write meticulous notes and he has lampshade interlude. He literally called it that. Lampshade interlude.

11:27

Bob French

Yeah. I was waiting for you to do this part, Alex.

11:31

Alex Murguia

No, I'll stop, because now you're playing.

11:37

Wade Pfau

Gaslighting but not lamp shading. Before Bob introduced this term to us the other day. Yeah, Bob's like but then I noticed in the notes, bob does bring it up again later. Maybe it's worth just getting the little notes together.

11:52

Bob French

I was figuring we would drift back.

11:54

Alex Murguia

In about the political stuff.

11:58

Wade Pfau

It's just a reference to supply and demand, supply and demand determines prices. And part of the political argument is, what does it work? Is it because of the increasing demand for goods and services generated by government fiscal policy being very expansionary? Or is it because of a decreasing supply of goods and services, because of all the different bottlenecks and so forth that were happening with the Pandemic and its aftermath? And ultimately it's going to be a combination of factors. It's not just one or the other. And there it said, now we can lampshade it using bottles.

12:36

Bob French

That's probably going a little too much depth. True. Lampshading here, wade but no, we actually talk about that now. I mean, this is as good a place as any.

12:46

Alex Murguia

I'll say like this because if I tell my buddies, hey, listen to this podcast, we're talking about inflation. A lot of them are going to be like they're going to be thinking because it's so politicized, they're going to be thinking in those terms. What's your general argument, both of you? When someone sort of points to inflation and then draws a line to the current administration, it could be a conservative administration, it could be more of a liberal, it could be a Republican, it could be a Democrat. What do you usually say without the simple answer of, oh, it's too many variables, who can tell? Wade, do you want to take first winning or do you want me to? But when you say it like that, the reality is, I think our listeners kind of blow it off like he doesn't want to deal with it.

13:31

Alex Murguia

Wade, no one's listening. I think there's always that component to it.

13:35

Bob French

Wait, do you want to take first winning or do you want me to?

13:38

Alex Murguia

And don't worry. Wait, no one's listening.

13:40

Wade Pfau

Go first. Guests.

13:45

Alex Murguia

Go first. Look at this guy. Sure.

13:47

Bob French

So the first thing I'll say, and we'll touch on this at some point here, but inflation is back around its historical average. The past year over year, inflation up to this point, it's about 3%. The historical average is about 2.95% per year. So that's about as average as it gets. If we're looking at the big numbers that we saw basically coming out of the Pandemic, it was 2021 and 2022, where we had really big inflation.

14:23

Wade Pfau

I'd say that there were percent range.

14:26

Bob French

Yeah, the big numbers, and especially if you're looking at kind of intra year type of inflation instead of using kind of January to December, if you look I forget exactly which ones it was, but there were some real big numbers in there. What Wade was talking about is absolutely right. There were two sides going on. You know, during the Pandemic, we had all of those stimulus programs. The government was actively throwing money at the economy. They were just dumping money into people's hands. And during the height of the Pandemic, weren't really spending it. But then once we started coming out, we started spending a lot. People didn't save that money for the long term. They went out and did stuff, which was the entire point of those stimulus programs. So that's one side of the equation, pushing up price levels because there was just more money in the economy.

15:22

Bob French

The other side was production. There was fewer goods and services available. People, while they weren't working during the Pandemic, as much supply chains got screwed up. It was more difficult to transport stuff, so there was less stuff to buy. So we had a situation where there was more money chasing fewer goods. Well, as Wade said, that's supply and demand. You're going to need to give someone more money to get the same amount of goods and services. And the political fight is going to be which side dominated, which side or not dominated? That's the wrong word. Which side had a bigger impact? And then how does that move forward from today? It doesn't look like we're going to have really big inflation anytime soon. And we'll talk about how we have no, again, is too strong of a word, but have some inkling of what inflation might look like going forward a little bit.

16:25

Bob French

But the market is saying inflation is going to be actually below average for the foreseeable future. That can always change. That will always change, but it might change in either direction.

16:39

Alex Murguia

Yeah, that's the mortgage estimate, right?

16:43

Wade Pfau

No, I think you covered that quite well. Yeah. At the end of the day, there's many different factors at work and all this is part of what's going on. And we had gotten used to very low inflation going back to 2010 through the Pandemic, where we were averaging even under 2% a year. And so when I wrote the first edition of the Retirement Planning Guidebook, I was talking about adjusting numbers into their real purchasing power when you're doing your budgeting. And it hardly made a difference if the inflation rate is like 1.3% or 1.9%. But then we got hit with the 2000 and 22,021 with significantly higher inflation. And then suddenly it does make a big difference. Because if you spend \$100,000, say, just to make up a number in 2018, the purchasing power to be able to do that now could be \$115,000 or more just because of those big inflation numbers that we experienced.

17:40

Wade Pfau

So it becomes a lot more important to think about purchasing power and making sure that you're adjusting for the impacts of inflation now that we have a couple of years of high inflation numbers in there. But as you're saying now, markets are it looks like inflation is coming back under control and is more in line right now with historical averages. But as we'll talk about as well, when we look at what the market provides to us to understand what future inflation might be, the market is not expecting that historical average, inflation even below historical averages, somewhere more in the ballpark of two to two and a half percent over the long term. And we'll talk about where that comes from. But yeah, that's really where we are today. But we don't want to skip the whole definition of I mentioned the CPIU and so forth and so let's make sure we cover some of that Bureau.

18:32

Bob French

Of Labor Statistics stuff. But Alex, I cut you off there as no.

18:40

Alex Murguia

Effectively I was going to say when you said the market's not telling you about the market's not signaling inflation, remember, that's just the current estimate of what's happening right now. Of all the players, random information will come in and that's definitely going to change the estimate. But as of right now, everything that is known, this is everyone's best guess.

19:03

Bob French

No, I mean, anytime we talk about market estimates, basically the only number you know it will not be is whatever the market is currently estimating. But that's the center line. We don't know if it's going to be too high or too lower. The number will go up or go down.

19:21

Alex Murguia

That's the life we chose.

19:23

Bob French

That's right.

19:26

Bob French

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19:54

Alex Murguia

Let'S have gone. Sorry.

19:56

Wade Pfau

Also just the idea of inflation in general. That actually what is a good inflation rate for the economy, I guess would be a way to frame that. We don't necessarily want the inflation rate to be zero, right? There can be advantages.

20:12

Alex Murguia

Yeah, that's a good point. The balance between inflation and deflation.

20:15

Bob French

Yeah, I think asking that is one of those loaded questions in economics. But it's above zero. A small handful of percent, I think is probably a fair way of saying it. I don't think too many people would disagree with that. But it's really about finding that Goldilock zone. Obviously we don't want massive inflation. If we had

10% inflation every year, that's not a good thing. But deflation is really bad. As you said, Wade, what we want to be doing is thinking about people's incentives to save. So if we are in a deflationary environment where prices are coming down through time, what that ends up doing is people start hoarding their money effectively. They don't spend. They want to wait as long as they possibly can to make a purchase because it will be cheaper at some point in the future. And that's not good. We need people to go out there and spend their money.

21:24

Bob French

On the other hand, hurts business profit.

21:26

Wade Pfau

Too, because they have to produce the goods and then when they can finally sell them, they are selling them at a lower price. Deflation is really harmful. And so economists and central banks and so forth want to have some positive inflation just to make sure there's a barrier so that you don't slide into the deflation side. When I was going through grad school, a lot of the conversation was around inflation targeting and it seemed at the time like many central banks were either explicitly or implicitly targeting about a 2% inflation rate, which is what the US in the recent past 2021, 2022 aside, had been in the range of like not over 2%. They wanted to keep it under 2%, but close to 2%. And that just can provide more flexibility as well. Not just to avoid deflation, but we know workers don't like to have wage cuts, but if you keep someone's nominal wage, their wage the same and inflation is 2%, that's a 2% real wage cut.

22:31

Wade Pfau

And workers may not complain about a real wage cut, but they definitely complain about a nominal wage cut. And so having some inflation just provides some flexibility in the economy to reduce real prices or real wages in a manner.

22:48

Alex Murguia

So you're saying there's a deep state that's controlling the underlying salaries of everyone through this edifice of inflation. Is that what you're implying there, Wade?

23:00

Wade Pfau

Just that it creates flexibility for capitalists to cut people's wages without those workers realizing.

23:12

Alex Murguia
So is that a year?

23:15

Wade Pfau
Something like that.

23:19

Bob French

On a different note, anyone with a big loan should like inflation because the amount they have to pay on that loan, assuming it's a fixed loan, goes down every time inflation goes up. Speaking of the cross of gold speech, that's what that argument was about. People, farmers who borrowed a ton of money to buy their farm or do whatever they needed, they wanted inflation because the value of that loan went down. The bankers didn't want inflation because the value of their financial asset went down with inflation.

23:58

Alex Murguia

Well, Bob, whenever you say cross of gold, I think of a Neil Young song. I think of a heart of gold in my head. But not everyone is going to know what cross of gold is. And neither do I. Frankly. I don't know the speech that he gave. You want to give a quick 30 seconds, maybe.

24:16

Wade Pfau
You shall not crucify mankind upon a cross of gold.

24:23

Bob French

You probably know the whole thing.

24:26

Alex Murguia

It was the best of times.

24:28

Wade Pfau

It was but no, in the late 1890s well, in the early 1890, there was a significant depression and part of it was based on the gold standard and that the supply of gold was not keeping up with the demand for gold. So it was a deflationary environment. And that hurts at the time, farmers who were needing to borrow to get what they need to farm. And then if there's deflation, like you said, then they're going to be selling their

goods, their products at a lower price. So they wanted easier credit, easier an easier monetary supply. And so that's where the whole conversation around silver came into play. And then William Jennings Bryan was the presidential candidate in the 1896 election. That really took up that kind of populist cause of wanting more expansionary monetary policy. It was this idea of like wall street versus the real business people who are doing the real production of goods and services in the economy and not wanting to benefit wall street at the expense of the farmer and the main street business person.

25:41

Wade Pfau

So not wanting to crucify mankind upon a cross of gold, that's where the line comes from.

25:49

Alex Murguia

Got you. Well, I am glad that we no longer have that problem between wall street and main street. I'm glad we resolved that 130 years later.

26:02

Bob French

Yeah, it's amazing how we solve all of these major political problems.

26:07

Alex Murguia

I'm glad we're not revisiting that anymore. All right. Thank you, Wade.

26:15

Wade Pfau

You're welcome.

26:16

Alex Murguia

I'm ready for my right.

26:19

Bob French

Yeah, I was. Wade, you grew up in the midwest. I guess that is a much bigger deal out.

26:27

Wade Pfau

But honestly, I don't think William Jennings Brian has much play anymore. I don't think the fact that I'm from the midwest somehow gives me a stronger link. Okay. He was of course also known for the Scopes monkey trial. He was.

26:50

Alex Murguia

There we go. Don't worry, Bob, they're creating a musical. You're going to love it.

27:02

Bob French

But let's jump in. We've kind of gone all sorts of different ways here, but why don't we talk a little bit about how we actually measure inflation? So as Wade referred to there's a whole bunch of different measures of inflation done by the Bureau of Labor Statistics, the CPI, and then there'll be some letter after, you know, Consumer Price Index. So what the Department of Labor, Bureau of Labor Statistics will do is they'll go out, they'll create a basket of goods and services, just a bunch of stuff that a normal person in whatever category they're looking at would go out and buy in their day to day life. And then they figure out how much it costs. And then they track that through time and they anchor it at some point and then say, well, this is now. In 1981 it cost \$100 to buy this stuff.

27:58

Bob French

In 1982 it was \$103.7 to buy this stuff. And then they just track that through time. And that's how we measure inflation. The normal one or the one that gets talked about a lot is the CPIU, which is Urban. What's the official wording on this, Wade?

28:23

Wade Pfau

It's all urban consumers.

28:25

Bob French

Yeah.

28:25

Wade Pfau

All urban consumers.

28:26

Bob French

All urban consumers. And they have ones for wage earners and different areas of the country. But one that's really important for us is the CPIE, which is the Elderly Urban Folks. So they don't have farmers, since we've been talking about farmers a lot, apparently, but Urban Wage earners, urban Elderly people over 62 and everyone but the CPIU kind of All Urban People.

29:01

Wade Pfau

And that's the one that the CPIU is. What if you hear CPI on a news report, that's what they're talking about, CPIW. Just as a trivia note, that's what they use for Social Security, the CPIW is Urban Wagers and Clerical Workers, which really makes no sense. Like we're using a more limited supply of workers for Social Security benefits meant for retirees. But right, the CPIE, it's an experimental index. It doesn't have official status. It just adjusts the basket of goods and services more for what elderly people consume. And so there's more of a weight towards health care expenses, health insurance and housing. And when those factors have a bigger weight, what we've seen historically is the CPIE index actually increases a little bit faster, a faster clip than the CPIU.

29:52

Bob French

Index, though not by nearly as much as I anticipated before I actually looked at the numbers. It's actually a relatively small effect. It's been in place. They have data going back to 1983, and compared to the CPIU, again, that kind of headline inflation type of number one dollars in 1983, it would cost the same amount of goods you could buy for one dollars. In 1983, using the CPIU up today, it came out at \$3.13. If we're looking at the basket of goods from the CPIE, it was \$3.33. So over the past was that 40 years? We're talking about a difference of so it's not massively different as a lot of people probably would have guessed. As I would have guessed before I went in and looked at the numbers myself, the correlation is really high between the two.

31:00Alex Murguia
Absolutely.**31:01**

Wade Pfau

Yeah, I think part of that is, well, health care costs do rise faster than the overall inflation rate, but then in that elderly basket, there's a smaller weighting towards education expenses and college tuition. And then that's another for the general index. That's another factor that tends to grow faster than the CPI as well. So I think that might be part of the explanation there. Why using the same numbers you mentioned, Bob, that implies for the CPIU since 1983, 2.85% is an average increase versus 3.1% for the CPIE.

31:39

Alex Murguia

I do think though, if you looked at the chart though, Bob, in 2018, around that time, there was a significant spike in the CPIE. Yeah, I think it was like all the pickleball equipment that people were buying what happened?

31:56

Bob French

Yeah.

32:00

Alex Murguia

I think that added half a percent to the entire CPIE. On the backs of my mother in law, too. On the back of my mother in law. She's like supporting the whole damn index.

32:14

Bob French

Going into that healthcare stuff, all those pickleball injuries. But no, I mean, one of the interesting things is you can slice and dice the numbers and there's really no difference in the sub periods. There are spikes and they don't move exactly the same, but over any reasonable length of time. Yeah, it's basically the same story. That might change in the future, obviously, especially as Wade called out, both healthcare and education change their inflation rates through time. Those are probably some of the biggest differences between the CPIU and the CPIE. Everyone buys groceries, everyone drives, everyone does a lot of the same things, but those are going to be the biggest differences in what those baskets look like.

33:16

Alex Murguia

Okay.

33:17

Bob French

But yeah, it's pretty similar. And as we've called out, if we take a look at what the historical numbers have looked like, the CPIU, we have data on that going all the way back to '26. The historical average was just under three. It was 2.95% on annual basis. And what we've been seeing, like we said at the beginning this past year or so, it's about 3%, it's about average. It's about as close to average as anything in finance and economics gets.

33:56

Bob French

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34:37

Bob French

Well, we already talked about what happened in 2021 and 2022, so let's start talking a little bit, Wade, about how do we think inflation will move going forward. We. Already called out what we think will happen. But how do we get there? How do we know that?

34:58

Wade Pfau

Yeah. So we want to know expected inflation what do people expect inflation to be in the future? And that used to be a really challenging question until 1997 when the United States government introduced treasury inflation Protected securities or Tips which provide a real rate of return plus whatever inflation ends up being. And then that allows us to see we can look at treasury yields on traditional treasury bonds and treasury notes and bills and so forth and then we can look at the real interest rates on Tips and look at the difference between them and that suddenly gives us a pretty good estimate. There may be a few other factors at work, but overall, we have a pretty good sense of what the market is baked in as an inflation rate because it's all about the supply and demand of people looking. If I believe inflation is going to be higher, I want to buy Tips to benefit from that.

35:56

Wade Pfau

Then maybe we should give a number to put a little bit of formalism around that. So Bob, you did put together the current yield curve but it was very.

36:08

Bob French

Complicated math it was addition and subtraction.

36:11

Wade Pfau

Here but yeah, let's look at the 20 year number from the yield curve you put together which is pretty current right now. What's the 20 year treasury yield just.

36:26

Bob French

For all the compliance folks? This is as of 95. So the night before we're recording this the nominal yield on the 20 year treasury was 4.56 the yield on Tips was 2.2. So the expected inflation over the next 20 years so just the annualized rate over the next 20 years is expected to be 2.54% so just a level.

36:58

Alex Murguia

Set here to make sure. So if you take the nominal 4.56 subtract out the Tips yield which you can buy and all of that $2.245 - 2.2$ gives you two and a half percent 2.54% so the difference is now why would there be a difference? Again, because Tips adjust for inflation on a yearly it resets for inflation for you. So the market is not going to give you the nominal 20 plus resetting for inflation. So the market subtracts out the expected inflation to make sure that it's a wash.

37:37

Bob French

More direct it's not the market doing it investors are looking at this and saying how much am I willing to pay for that inflation protection? So this is where we get to that marginal investor idea. The marginal investor is willing to pay up to whatever they think inflation will look like over that 20 years and no more.

38:03

Wade Pfau

And that's where if I'm an investor in the bond market wanting to buy a 20 year treasury this is where the supply and demand comes into play. If I believe as an investor that inflation will be higher than the two and a half percent I'd want to buy Tips because I would expect them to then provide a higher yield than Treasuries would provide. If I believe inflation is going to be less than two and a half percent, I'd want to buy a traditional treasury because I would expect it to provide a higher overall yield over those next 20 years. And it's not just expectations, because there's also the risk component that if I'm trying to fund a spending goal that may rise with inflation, even if I may favor the Tips, because I want that additional inflation protection just in case. It's going to be more harmful to the retiree if inflation is higher than they expect than if inflation ends up being lower than they expect, although not necessarily deflation, but lower than the two and a half percent break even rate that's available in the market right now.

39:12

Wade Pfau

And I did just pull that 20 year case out at random, but then I realized after doing that's the number that gives us the highest inflation is expected to be the highest over the next 20 years of any of these. All the rest of the break even numbers are under two and a half percent. They're more in the ballpark of 2.3% for them. Even that over the next 30 years. The baked inflation rate in the market right now is a 2.28% annualized inflation rate over the next 30 years. So markets are, investors participating in the markets are expecting inflation to be lower than that 3% number we see right now and lower than the historical average.

39:56

Bob French

Even going to the other side, the really short term, I mean, we're looking at again expected. We know basically it's not going to be this, but this is our best guess of 2.3%. Again, substantially below the historical average, substantially below what we've seen. And again, this is especially where we start getting into politics. Some people are really going to like that idea. Other people are going to have other stories to tell about that.

40:33

Alex Murguia

Well, the only thing I would add to this is remember, this is a basket of goods. That's not to say you don't go into the store and see eggs skyrocketing and then say to yourself, hey, I just heard this podcast, 2.5% the hell are they talking about? You know what I mean, that kind of thing. You are going to see pockets of things. This is the dinner table conversation where it's not good enough just to say, oh, eggs are high, so inflation is crazy.

41:05

Wade Pfau

They're exhausting some prices faster than others.

41:08

Bob French

Yeah, well, eggs have started come back down. But you're absolutely right, every industry has got its own stuff going up. So there was problems with eggs. It was something with the supply chain, I don't know what it was. Eggs were really expensive for a little while. Now they're coming back down next month. It could be, I don't know, yogurt, it could be cars are really expensive right now. I'm getting emails from car dealerships asking me to trade in my car now because they want people to come do stuff because prices are really high, because the car supply chain is really screwed up right now. But that's always been true. There's always something going up, something's really cheap, something's really expensive. But inflation is a broad issue, or at least how we really should be thinking about it is a broad component. What's the whole goods and services that we're buying?

42:15

Bob French

What are we actually paying to live rather than each individual item?

42:22

Alex Murguia

All right, so, Bob, what do we do with so we laid the groundwork for inflation. Where do we take this on this Retire With Style podcast?

42:30

Bob French

That's right. So, you know, the next question obviously is, okay, inflation exists. What do we do about it? Because as much fun as it is to talk about economic history, that doesn't do much for your retirement plan. So the next episode we want to start digging into how do we deal with it? How do we build our plan to accommodate the fact that there is inflation? How do we build that so that we can have the life we want without not running out of money, but not having as much money as we want to spend, having our real purchasing power reduced through time? And there's going to be different approaches, as you might imagine. You're going to be talking about this in terms of the Risa Quadrants, how different people might want to approach that problem.

43:28

Alex Murguia

Great angles.

43:29

Wade Pfau

Wade. So there we've got people that tune in next week. Absolutely. I don't like a bar introduced.

43:45

Alex Murguia

Sorry. Wait.

43:46

Wade Pfau

Alex is excited for the next episode. We'll continue this series next time on Retire with Style. We'll get deeper into how to manage inflation as part of a retirement income plan. So thanks, everyone for listening. Thanks for joining us, Bob. And we'll catch you all next week on Retire with Style.

44:07

Alex Murguia

Thanks, everyone.

44:10

Bob French

Wade and Alex are both principals of McLean Asset Management and retirement researcher. Both are SEC

registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you, consult your financial advisor. All investing comes with a risk, including risk of loss. Past performance does not guarantee future results.