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## WEALTH ADVISING



### The next financial battle?

KATHLEEN LAVINE | BUSINESS JOURNAL

Scott Sparks, wealth management adviser at Northwestern Mutual-Denver, says he doesn't think inflation will be a financial factor until 2011 or beyond.

## Advisers contemplate facing inflation issues

BY BOB MOOK  
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Given the amount of money the federal government has borrowed in the past year to stimulate the economy, many investors believe that inflation is inevitable.

The big question for many is when.

"I think it's going to be a very big issue," said David Twibell, president of wealth management for Colorado Capital Bank. "We've got all this money that the Fed has printed,

[consumer] demand is picking up, we're already at the upper bounds of where the Fed has said it's comfortable with from [a core] inflationary standpoint, and interest rates are at zero. And we've got a dollar that's falling. Each one of those on its own is inflationary — put them all together and you've got all the ingredients for a significant amount of inflation."

The U.S. consumer price index (CPI) shows no immediate inflation problem —

according to that measure, inflation rose 0.3 percent in October and has fallen 0.2 percent in the past 12 months, according to the Bureau of Labor Statistics.

But some components of the index, such as food and energy, are volatile. In 2008, crude oil prices fell from a high of more than \$145 a barrel in July to less than \$35 per barrel in December, although those sectors have more than doubled since then. Stripped of food and energy, the national CPI has risen

# INFLATION: Gold is typically strong in face of inflation

1.7 percent in the past year.

Gold, a traditional inflation hedge, surged to record highs in November at just under \$1,200 per ounce.

Federal Reserve officials said in early November that they didn't expect to raise short-term interest rates any time soon, citing subdued inflation trends and expectations, among other factors.

But some investment professionals believe that inflation can't stay low forever, partly because of the amount of debt the U.S. government is selling in the form of Treasury securities. As supply increases, prices normally fall. As bond prices fall, yields rise.

"I just don't see how we're going to be able to float \$3 trillion in debt without having ... higher interest rates," said Fred Taylor, a principal at Northstar Investment Advisors LLC in Denver. "Who's going to be able to continue to buy our bonds at 3.5 percent on the 10-year and, say, 4.25 percent on the 30-year with \$100 billion to \$150 billion a week coming onto the market?"

"All the economics training I've had says that when you have this kind of behavior on the behalf of the government, it's likely to lead to inflation," said Gary Hoover, vice president of marketing and sales for Alexander Capital Management Group in Denver. "People are trying to convince us, it seems to me, that there won't be inflation, when intuition is concerned about it."

Others aren't so sure it's going to be a problem.

"We don't think inflation is going to be a major concern in 2010," said Scott Sparks, a wealth management adviser at Northwestern Mutual in Denver. "There is a possibility it's something I might be a little bit concerned about beyond 2011 or 2012. But the narrow fear of inflation, we don't feel that people should change their game plan because of that."

But there's no harm in being flexible, and there are several ways to protect a portfolio from possible inflation, according to the professionals interviewed for this story.

Gold is one investment that traditionally does well in times of inflation. An easy way to participate in the gold market is to buy funds that track commodity prices, or to buy stock in gold-mining companies.

"The way to play gold is through the exchange-traded funds," Taylor said. "The problem with stock is that a lot of gold mining companies hedge their positions, and they're notoriously bad hedgers, so they end up losing a ton of money on the hedge even though the price of the commodity goes up. And they don't pay dividends, typically."

Taylor and other advisers also recommend Treasury Inflation-Protected Securities (TIPS), which pay a fixed annual interest rate. The principal increases or decreases in step with the CPI, so it's a good investment when inflation is rising, but not so good during periods of deflation. You can buy TIPS directly from the government at [www.treasurydirect.gov](http://www.treasurydirect.gov) in increments of \$100. Con-

sider "laddering" your investment so that you are buying bonds with different interest rates that mature at different times. You can also invest in TIPS via mutual funds or exchange-traded funds (ETFs).

Unlike other inflationary periods, such as the 1970s, real estate may not be a good investment if we get another inflationary cycle now, Twibell said.

"In the past, real estate prices have tended to go up in lockstep with inflation," he said. "This may be one of those periods when that doesn't hold true, only because we have so many problems in the commercial real estate market. ... If you're an individual investor buying an individual property, you can find some phenomenal deals and real estate can make a ton of sense. But if you're somebody who's out there buying publicly traded real estate investment trusts through a 401(k) plan or publicly traded equities, that's tough to do right now, I think."

For many investors, the answer may be as simple as keeping a well-diversified portfolio and locking in low rates now on money you're borrowing, such as mortgage loans.

"If [clients] are holding onto variable interest rate debt, we're looking for them to take advantage of the lower rates today by locking in rates now," Sparks said. "Certainly stocks tend to be a better-performing asset class in an inflationary time. Having dividend-paying stocks, and a good mix between your stocks and bonds, is important."

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