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MARKET MATTERS: Beat inflation by investing … usually

By Joseph Matthews

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We have all heard some iteration of the phrase "hiding money under the mattress." A 2015 study reported that 43 percent of Americans kept their savings in cash. Is there any wisdom to this adage?

Most experts agree that cash should be put aside for short-term needs, necessary expenses and emergencies, and investments should be made for long-term goals, i.e., college expenses, second homes and retirement savings.

Keeping all your savings in cash might be counterproductive, especially when inflation is taken into consideration. Even a slight increase in inflation can quickly add up to a serious loss of spending power.

So, what is inflation? Inflation is a measure of the changing buying power of a dollar. The greater inflation, the less the dollar will buy. As prices of a nation's goods and services rise, there is a commensurate decrease in the purchasing power of the nation's currency. When all of the nation's services and products are considered in a bucket — including food, health care, communications, gas and electricity, etc. — inflation can measure the rising price of the entire bucket over time. Increases in inflation will mean that more dollars are needed to buy the same goods and services.

In the U.S., the Federal Reserve, which regulates the nation's money supply, seeks stability — moderate rates of inflation, low unemployment, and a check on rising prices.

In recent years the Fed has kept inflation relatively stable, but bank interest rates also have been exceedingly low. If the money in savings does not earn sufficiently to offset inflation, then you are losing purchasing power.

For example, prices in 1980 were 197 percent lower than prices in 2017; so, something that cost $2.97 in 2017, would have cost approximately one dollar in 1980. In effect, your 1980 dollar hiding under your mattress lost a huge amount of spending power, and likely would have performed better even if invested conservatively.

The markets also saw positive outcomes over the span of those 37 years. The Dow Jones Industrial Average closed the year 1980 at around 838 points. Comparatively, it closed the year 2018 at 23,327. An investment in a basket of stocks represented by the Dow Jones would have increased exponentially more than inflation, boosting the spending power of that 1980 dollar drastically.

Of course, historical performance is no guarantee of future results. Nevertheless, history does suggest that investing cautiously is a better option than storing all of one's savings in low performance — or no performance — accounts. After all, historically speaking, over decades the stock market has kept going up, despite dips and recessions along the way.

During economic downturns, the Fed initiated a number of programs to help support growth, such as a hold on interest rate increases that began in 2008 and lasted nearly seven years. It only began to change with higher rates coming in 2017. The current rate of inflation, despite the Fed's rate increases, hovers at about a modest 2 percent.

You may think that beating inflation appears to be simple in concept: avoid the mattress. Put your money where it is most likely to earn the highest returns within your personal risk tolerance, and above the rate of inflation. Even though the market showed sharp volatility in 2018 and early 2019, there is the opportunity for greater reward if investors take a sensible, well-advised and well-researched approach.

Dips in the market may offer opportunities, allowing investors to buy equities of solid companies with good earnings records and a stock price pushed down by overall market emotion rather than a new reality within the particular company. A few sectors, in a down market, also bear investigating.

I like, for example, sectors such as transportation, consumer retail and biotech.

It is important to remember that a rising tide really does not float all boats. The equity markets are no exception. Check out companies in some of the nation's fastest-growing industries: Services to buildings and homes, residential construction, professional services (such as accounting, advertising, consulting and research), heavy and civil engineering construction, computer gaming and elder care.

At the same time, the wise investor will remember to keep enough cash on hand to cover emergencies as well as near-term needs. In short, proceed with caution, taking care to consider both short- and long-term goals.

And if you were among those investors spooked by recent market volatility, now may be the perfect time to consider slipping back in.

Joseph Matthews is a Financial Advisor with the Wealth Management Division of Morgan Stanley in Fairfield. He can be reached at 203-319-5165 or by email at joseph.matthews@morganstanley.com. Follow Joe on Twitter @jmatthewsMS.