HBKS® Wealth Advisors

Inflation: A Key Financial Planning Concern

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MAYBE YOU'RE NOT OLD ENOUGH to remember it, but a Coke used to cost a nickel. It might be slow and gradual, hardly noticeable, but over time, inflation does its work to dramatically increase the cost of almost everything. Those very real cost increases should be considered in your financial and retirement planning.

People who budget for retirement often do so in terms of current costs. If they're spending $5,000 to cover current needs, they might think that's what they'll need in retirement. But they'll need a lot more to cover the same expenses 20 to 30 years from now. For example, after 20 years of three percent inflation, it will take $5,655 to buy what $3,000 buys today.

The last thing you want in retirement is living on a fixed budget with no room for flexibility. Social Security payments increase a small amount each year, but at nowhere near the pace of inflation. Retirees who don't plan for inflation can find themselves liquidating their savings more quickly and could run out of money much earlier than they had thought. It is one of the biggest risks associated with retirement planning. In our retirement planning process, we assume annual inflation of three percent — it averaged 3.22 percent over the hundred-year span from 1913 to 2013.

You can't plan for market swings that alter the value of your investment portfolio. But you can look at certain costs and estimate how inflation will impact them — think healthcare costs, which are increasing about five to six percent annually. You might think that you won't spend as much at age 85 as you do today — your house will be paid off, you'll spend less on cars. But what if you do? Your spending might just shift to other things, such as the costs associated with living longer, including extended care facilities and services. Someone turning age 65 today has a near 70 percent chance of eventually needing some long-term care services. The average cost of a private room in a nursing home in Pennsylvania in 2020 exceeds $10,000 per month and is expected to rise significantly in the years ahead. A holistic financial plan should include protections like long-term care insurance with inflation riders.

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Investing is another tool we use to hedge inflation. Putting savings in a money market at two percent will not keep pace; you'll be slowly losing purchasing power every day. So financial planning for retirement includes investing and diversifying, owning commodities and real assets as well as stocks and bonds to combine as a safety-minded hedge against inflation.

Inflation is a key element in determining how much you will need to save for retirement to accommodate the kind of life you'll want to live.

Inflation has been around two percent in recent years, but two recessions in the last decade of the 20th and first decade of the 21st century have worked to keep inflation abnormally low. We can look back no further than the 1980s to find double-digit inflation. While we can't predict future rates, we can assume that inflation will rise.

Inflation is not the only factor, but a key element in determining how much you will need to save for retirement to accommodate the kind of life you'll want to live. It should be a consideration in your retirement planning.

Call us at 814-459-1116 with your questions and concerns about retirement planning; or email me at CPAllegretti@hbkswealth.com.

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