Wye Trust
16 N Washington Street
Easton, MD 21601
Office 410-763-8543
info@wyefinancial.com
www.wyetrust.com

Inflation watch continues

Investors remain nervous about where inflation is headed, and just how "transitory" it may prove to be. In June, the Case-Shiller national home price index posted its largest year-over-year increase since the index was created, 19.1%. The previous record was 14.4% in September 2005. The big jump in the cost of shelter does not get immediately factored in to the consumer price index (CPI), because only a relatively small number of people are buying houses in any one month, but over time the cost of housing will affect about one-third of the CPI. Higher housing prices also drive higher rents.

Gasoline prices have generally stopped rising, even falling a few pennies in some areas, but remain about 41% higher than one year ago. According to the Conference Board survey, consumers now expect overall prices to be 6.8% higher in 12 months. These inflationary expectations have a way of becoming self-fulfilling prophecies at times.

Retirees living on a fixed income tend to be acutely aware of rising prices, as they have less flexibility to adjust their spending. Inflation is the retiree's constant enemy.

Investors have different concerns. They worry that the Federal Reserve will have to raise interest rates to combat inflation, and the increases could be more abrupt than anticipated. Higher interest rates may damage investment portfolios in two ways:

• The value of existing bonds must fall as interest rates rise, as investors seek market rates of return. This leads to losses on paper for bond holdings, which become real losses if the bonds must be sold before maturity.

• The value of stocks may fall, as new bonds become somewhat more attractive when they pay higher interest rates. This effect is less certain, and not all stocks will experience the same negative fallout from an interest rate increase. But with the unusually high price/earnings ratios seen in today's market, some stocks may be more vulnerable to an interest rate hike than expected.

This is a good time to keep a watchful eye on one's investments.