



GOING LONG

Detterbeck Wealth Management, Inc.



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INFLATION VS DEFLATION - WHAT'S ALL THE FUSS ABOUT?

By Brett Detterbeck, CFA, CFP®

A lot of us are familiar with inflation. It is a barometer of the general direction of price levels. As such, it is a measure of the buying power of a dollar. Periods of low inflation have relatively stable prices and low interest rates and, as a result, are positive for business and the stock market. Periods of high inflation have increasing prices and high interest rates, and tend to be bad for business and the stock market. A growing economy is always characterized by some amount of inflation.



But lately the headlines have focused on its rare counterpart, deflation. Deflation is the opposite of inflation; it is the general decline in prices. Although a widespread fall in prices might be good news for you at the cash register, it can be highly detrimental to the overall economy by stunting its growth. Widespread deflation is usually the result of a collapse in demand that forces producers to keep cutting prices to lure customers and can result in unemployment and recession. Japan has been battling deflation for decades now.

Could this happen to the U.S.? The best gauge for determining the underlying trend in inflation/deflation can be found by studying the Consumer Price Index (CPI). The CPI measures the prices of consumer goods and services and is shown in the table below.

	Jan	Feb	Mar	Apr	May	Year/yr	2003 rate
Core CPI	0.1%	0.1%	0.0%	0.0%	0.3%	1.6%	1.1%
Total CPI	0.3%	0.6%	0.3%	-0.3%	0.0%	2.1%	2.3%

If you were to look at the core rate of CPI, which excludes the volatile food and energy prices, over the past five months, you could see why deflation was making such headlines. The Core CPI had been unchanged in March and April raising fears that deflation was developing. Most of those fears were swept aside when the May number was released showing a 0.3% increase. Overall, year over year inflation looks to be a little above 1%. This is good as it allows interest rates to remain low, and reflects enough pricing power for corporate profits to rise.

Fed officials have said that the risk of falling prices is small. It is true that many manufacturing and retail items have fallen in price in the past several months, however there are many

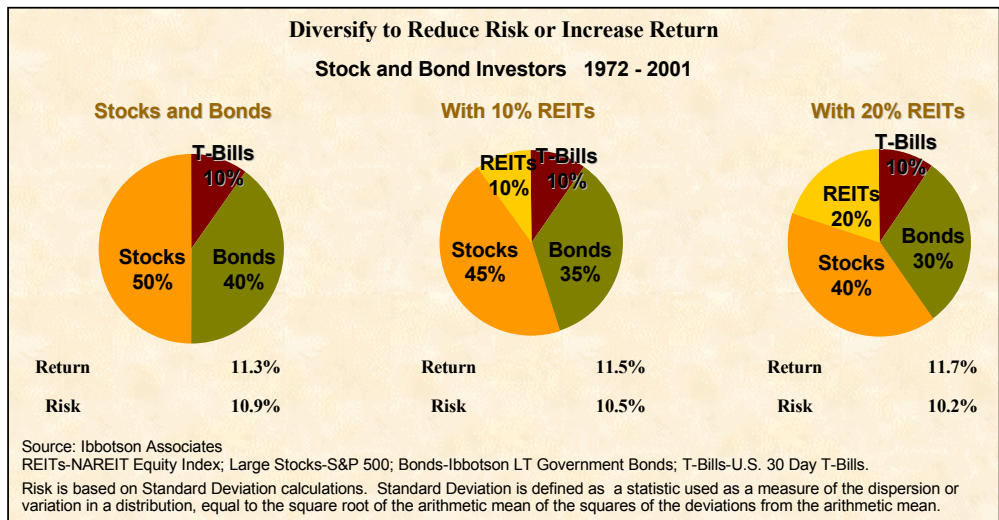
REITS ~ NOT JUST AN ALTERNATIVE ASSET, BUT MAYBE A STAPLE IN YOUR PORTFOLIO

By Brett Detterbeck, CFA, CFP®

A Real Estate Investment Trust, also known as a REIT, is an entity whose primary business is owning and managing real estate properties such as apartment buildings, office buildings, warehouses, shopping malls, hotels, and even golf courses. The goal of a REIT is to generate income from the rent paid by the tenants of the properties it owns. They can also generate gains from capital appreciation when the property is ultimately sold. Since REITs distribute over 90% of its income to its shareholders through dividends, it need not pay any corporate taxes.

There are *public REITS* that trade on major exchanges like the NYSE or the NASDAQ whose prices are subject to the supply and demand of market forces; and *private REITS* that usually have fixed, stable prices but less liquidity.

As you probably already know, we here at DWM preach asset allocation. Empirical studies show that asset allocation decisions account for over 90% of the variation of long-term returns. In other words, it's not what particular security is in your portfolio, but how much of those type of securities mixed with other asset classes make up the entire portfolio. REITS happen to have a low correla-



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tion to equities and bonds. By adding an uncorrelating or low correlating asset to your portfolio mix, you can effectively enhance your overall return and reduce your overall risk of your portfolio. In fact, Ibbotson – a Chicago company specializing in historic asset class returns and other stats – has concurred that a mixed portfolio can be further diversified with a 10-20% allocation toward REITS. (This is in addition to your primary residence.)

Another benefit is that in the case of a financial bump for a company, the priority of payments favors REIT investors. This is because corporations are obligated to pay their operating expenses such as rent, taxes, salaries, etc. before paying stock dividends or even bond interest.

Private REITs in particular have the ability to “pass through” property depreciation to investors which can result in significant tax savings.

And probably the most important benefit characteristic of Private REITs is the additional source of income that these vehicles can provide to investors with considerable net worth yet lacking a steady cash flow. A 7% or greater dividend can be very attractive in a market environment like today where bond rates are near historic lows and where equity returns may seem simply too volatile. Unlike a public REIT, these Private REITs have a fixed price that cannot be affected by an emotional market. Combine that with a 7%+ dividend and it can have a dramatic smoothing effect on your overall portfolio.

In conclusion, if you’re looking for a long-term conservative, non-speculative, tax-efficient investment designed to provide you the potential for current income, wealth preservation, and diversification/less portfolio volatility; a PRIVATE REIT may be just the thing for you. Contact DWM for further information on what may be a staple of your portfolio.



Congratulations to Brett Detterbeck on recently passing the Certified Financial Planner™ exam and becoming a Certified Financial Planner™ licensee.

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industries where prices are soaring including energy and housing, not to mention the services sector. This sector, which accounts for more than 60% of the economy has seen steadily rising prices for some time. Think tuition, insurance, and medical care. It would take a considerable period of subpar economic growth worldwide before generalized deflation took hold here.

It also would have to take a combination of a major stock market dive, a slowdown in US economic growth, and a housing market crash to become a major threat. The last time we saw deflation was during the Great Depression and our economy is completely different from then.



Greenspan has recently been quoted as saying that we are pretty close to price stability, which is the “optimum price pattern to facilitate maximum, sustainable long-term economic growth.” Low and stable inflation is a fertile breeding ground for strong productivity, and that in turn is the best hope for economic growth, rising profits, and rising prosperity. That is most likely the environment that we are in now and will see for the next couple of years.



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