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Inflation eroding value of investments

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- Inflation is the monetary thief that robs consumers of their current purchasing power and diminishes the future value of retirement nest eggs.

"You need to invest to keep up with inflation," said Roch Tranel, president of Tranel Financial Group, Libertyville, Ill.

The impact inflation has on a person's investment portfolio depends on the type of securities they own. The mix should beat the rate of inflation, currently pegged at 5 percent.

If a bond or CD pays 4 percent annual interest and inflation is running at 5 percent, the investor actually loses 1 percent on the investment each year to inflation - and still must pay taxes on the 4 percent gain, causing a greater loss.

"Inflation is a compelling reason why clients would want to have a stock exposure in their portfolios, depending on their age," said P.J. DiNuzzo, president of DiNuzzo Investment Advisors Inc. in Beaver. He recommends holding 30 percent in stocks.

When stock prices rise due to inflated earnings and revenues, investors have difficulty seeing a stock's true value.

"What investors should be worried about is what are the future expectations for future earnings," said Brian Levitt, an economist and vice president of Oppenheimer Funds in New York. He recommends biotech and medical companies.

"Who has pricing power, foreign exposure and the ability to grow a business in a declining U.S. economy?" he said.

Many investors prefer the safety of bonds. But inflation can devastate a bond portfolio.

"There's nothing worse for a bond portfolio than inflation," said David Twibell, president of Colorado Capital Bank in Denver. "It eats away at the purchasing power of the portfolio, and as the Fed raises rates it also decreases the value of the bonds."

He recommends floating rate bonds -corporate bonds with interest rates that increase based on the London Interbank Offered Rate, so they don't lose principal value.

Bond investors also might consider Treasury Inflation-Protected Securities, known as TIPS. The principal increases with inflation and decreases with deflation.

With an increase in the money supply easy availability of credit, demand for goods rises, causing inflation.

"I expect inflation to continue because the Fed is under pressure to keep interest rates low to combat the credit crisis," said Addison Wiggin, author of "The Demise of the Dollar ... And Why It's Great for Your Investments."

Wiggin recommends that investors focus on buying assets such as natural resources, commodities and gold, because when inflation is rampant prices for those asset classes rise.

James Turk, founder of GoldMoney.com, based in the British Channel Islands, and author of "The Collapse of the Dollar," said the best inflation hedge is not stocks, but gold. Investors who buy the metal are betting that its price will rise faster than inflation.

John Schloegel, vice president of investment strategies at Capital Cities Asset Management in Austin, Texas, predictis that inflation will decrease in the months and years ahead. He says investors should be concerned about deflation.

"We are in a recession and that will lead to a decline in other high-cost items such as gas and groceries," he said. "Those prices will come down in the next six months without the Fed's taking any further action on interest rates."