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Dear Clients and Friends:

Economic inflation measures the increase in the price of goods and services over time.

Our money-strapped government has a problem with this definition. It results in figures that are just too high for public consumption. So the Consumer Price Index (CPI) produced by the U.S. Department of Labor has dropped the old, common-sense definition, and moved to a model that reflects changes in the cost to maintain a constant standard of living. It sounds like the same thing, doesn't it? If you're buying the same goods and services, wouldn't that maintain a constant standard of living?

Oh, but those economists are tricky. The new methodology takes into account *changes in the quality of goods* and a concept called *substitution.* If improvements are made in a product, the value of those changes gets stripped out of the price of that item. Plus when prices go up, consumers will find a cheaper item to substitute for what they want. These new ways of thinking about inflation allow the government to report a lower CPI.

What's in it for the bureaucrats? First, Social Security and other payments are linked to the CPI, so a lower inflation rate means the government doesn't have to pay as much in benefits. Also, a lower inflation rate makes the economy look better than it really is.

But for us as investors, we want to know how much prices are rising, plain and simple. That will tell us how much we need to earn on our investments, just to keep up. The government says the CPI went up 2.7% over the last twelve months. By the old definition, real inflation may be double that. It's one more reason not to keep too much money sitting in the bank at 1% or less.

Regards,

Chuck

Charles M. Shackelford