

In a recent interview in *Welling@Weeden*, John Williams, the man behind the website [showstats.com](http://showstats.com), explained that consumer costs are rising faster than the government would have you believe. John Williams' job for over twenty-five years has been to supply Fortune 500 companies with a clearer picture of reality than the government's published statistics. These corporations utilize John's information to plan their business. John Williams argues that the government has tortured one index in particular: the Consumer Price Index, or CPI. The CPI is used to determine the level of inflation that consumers are experiencing. Through the government's "adjustments", the bureaucrats are able to create a picture that is more favorable than it actually is. For instance, in the mid-1980s government allowed for substitutions in the CPI. This does make some sense. If the cost of one product rises like steak, for instance, isn't normal behavior for a person to substitute hamburger for steak if it's cheaper? Though that may sound fine, John William's points out, "The problem is that if you allow substitutions, you aren't measuring a constant standard of living. You're measuring the cost of survival. You can keep substituting down and have people buy dog food instead of hamburger."<sup>1</sup>

Government officials understand that the public wants to hear that inflation is low so the bureaucrats comply willingly. Unfortunately, the problem with a low CPI is that many peoples' standard of living is determined by using the CPI. For instance, social security checks are adjusted upward each year based upon the CPI index. John Williams' argues that social security checks should be 70% higher if a CPI was used without government adjustments.

Based upon John Williams' unadjusted CPI, inflation is running closer to 8%. Though this 8% inflation figure might not be exactly right, it sounds closer to the truth. (e.g. think about gasoline prices, health care costs, natural gas bills, house prices, milk, etc.) This compares to the recently released government CPI number of 1.2% per year. Why is this important? There are two important aspects of this higher inflation number. First, if your personal investments are not compounding at a rate above this, you are going backwards in *real* terms. (What is a *real* interest rate? The rate you receive on your investment minus inflation. Let's say banks are paying 5% and inflation is at 8%. You are now receiving a  $5\% - 8\% = -3\%$  rate of return. You are losing money factoring in inflation). Second, investors tend to take on added risk to alleviate this problem of a negative real rate of return. For instance, investors might choose risky GM or Argentinean bonds at 9% in an attempt to make some money, versus choosing a safer money market account at 4%.

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<sup>1</sup> Williams, John, "Shadowing Reality," *Welling@weeden*, 21, February 2006, 3

One possible solution to protect your investments from inflation, but far from ideal, can be derived from the following table from Sun Valley Gold, LLC.

**Expected Real Return Matrix<sup>2</sup>**

<b><u>Capital Markets</u></b>	<b><u>Gold</u></b>
10%	-8%
8%	-3%
6%	2%
4%	7%
2%	12%
0%	17%
-2%	22%

As you can see from the above graph, when the real rate of return turns negative, gold should perform well. Although it is impossible to know what the Federal Reserve interest rate policy will be in advance, it is quite possible current interest rate policy will continue. Though gold, and especially gold stocks, carry numerous risks, if the current situation persists gold might become an attractive alternative investment.

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March 2006

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<sup>2</sup> Barton Biggs, *Hedge Hogging* (New Jersey: John Wiley & Sons, Inc, 2006) p. 267