

Understanding Inflation

PRICE INCREASES

It's normal in a stable economy to see various price increases. However, inflation happens when prices continue to increase over a sustained period. When the demand for products and services exceeds availability, producers increase prices.

DOLLAR VALUE DECLINES

Because the amount of goods and services a given amount of money can buy falls with inflation, the dollar is less valuable. Commonly known as the time value of money, inflation decreases the value of the dollar over time, making what you have today worth less in the future.

STEALTH THREATS

Inflation poses a hidden threat to investors because it chips away at investment returns. Fixed income securities are especially vulnerable since the interest or coupon payment generally stays the same until maturity. That decreases the purchasing power of the interest payments as inflation rises. For example, an investment that returns 2% before inflation in an environment of 3% inflation will actually produce a negative return (-1%) when adjusted for inflation.



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