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RETIREMENT | FEATURE

Inflation Isn't Dead Yet. How to Protect Your Retirement Income.

Rising prices are here to stay. Use these investments to beat the inflation trap.

By Elizabeth O'Brien Follow

For a generation of retirees, inflation was an afterthought. Today, it's a disquieting threat, lurking like a sea monster that may surface again.

It's a valid concern. While the Consumer Price Index is down to 2.6%—from a peak of 9% in 2022—inflation may prove tough to keep at bay. Whether President-elect Donald Trump's policies will reignite price gains remains to be seen. Either way, investors should inflation-proof their portfolios to bolster retirement income.

"It's not just a bump in the road or a blip," says Dan Griffith, director of wealth strategy for Huntington Private Bank in North Canton, Ohio. "It's something you need to plan for."

For now, the market doesn't seem stressed. Treasury bond yields, which partly reflect inflation expectations, climbed after Trump's election on fears that his planned tariffs would increase the cost of everyday goods. But yields retreated after Trump picked Scott Bessent for Treasury Secretary, reassuring investors that his administration may pursue more conventional fiscal policies.

Even if headline inflation returns to the Fed's 2% target, that doesn't mean prices would come down; they would keep rising, albeit at a level more suitable for a healthy economy. Consumers would still be stuck paying more each year for groceries, medical care, and other essentials; it's just a matter of degree—2%, 5%, or something worse.

"It grabs you where you least expect it, like when you get your car serviced," says Philip Richter, president of Hollow Brook Wealth Management. "We've gone through a period that was shocking for people because we had this golden era of benign inflation."

Retirees are particularly vulnerable because they usually don't benefit from rising paychecks. While wage growth has outpaced inflation since mid-2022, retirees who re-enter the workforce often take a big pay cut or work part time, leaving their paychecks stagnant.

Social Security recipients will get a 2.5% boost in 2025. But this cost-of-living adjustment isn't going to cut it for older adults who have had to dip deeper into savings to cope with higher costs in recent years.

The key question is, what will you clear after inflation? That is your "real" return, and it's what counts toward paying the bills. Investors should consider their real return in building their portfolio and monitoring the income it generates, says Eric Gerster, chief investment strategist at AlphaCore Wealth Advisory in Greenwich, Conn.

10-Year Inflation Expectations

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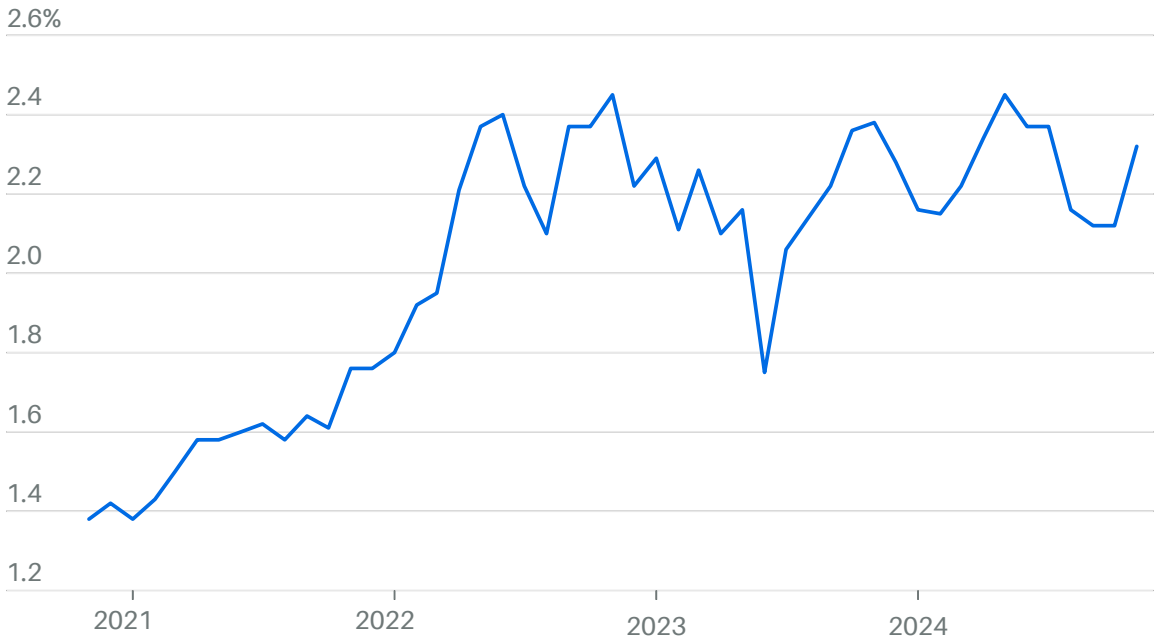
Estimates of where prices are headed have risen based on data from the bond market, inflation readings, and surveys.



Source: Federal Reserve Bank of Cleveland

You don't have to guess correctly about where inflation is headed. Indeed, even if you tried to be tactical in response to price pressures, you'd have to be right about the economic growth outlook, as well. And returns across asset classes vary widely, depending on the mix of inflation and growth. For example, U.S. small-cap stocks tend to do better in times of high inflation and high growth—averaging 1.3% monthly returns. In periods of high inflation and low growth, small-caps average minus 0.3%, according to research from Russell Investments

Ideally, you'll want a diversified portfolio that will hold up whether price growth blows hot or cold. "I look at this almost like home insurance," says Rand Spero, president of Street Smart Financial in Lexington, Mass. "Would you have more insurance if there are more fires in the neighborhood?"

Stocks

Retirees are often conditioned to be conservative, but stocks should be the bedrock of an inflation-fighting portfolio. From 1926 through 2022, the average annualized inflation-adjusted return of the S&P 500 was 7%, according to Dimensional Fund Advisors .

Most investors are best served by holding a broad index fund with annual fees that are negligible, such as the SPDR S&P 500 ETF Trust or Vanguard Total Stock Market exchange-traded fund.

Growth stocks like Nvidia and other high fliers are trickier. The Magnificent Seven tech stocks now represent about a third of the S&P 500, and their gains have powered its recent surge. But valuations are elevated, and it's unclear whether market leadership will rotate to other areas, such as value stocks and small-caps.

The market has been showing signs of a shift, and Timothy Davis, a certified financial planner at Steward Partners in Boston, expects the trend to continue. For clients with 50% of their portfolios in stocks, he recommends 30% in large-caps and 20% in small- and mid-caps. Two ways to capture that idea are the SPDR S&P MidCap 400 ETF Trust and Vanguard S&P Small-Cap 600 ETF.

Inflation Busters

These investments can help your portfolio retain its purchasing power over time.

EQUITIES		
ETF / Ticker	**YTD Return**	**Yield**
ProShares S&P 500 Dividend Aristocrats / NOBL	14.4%	2.0%
SPDR S&P 500 Trust / SPY	28.3	1.2
SPDR S&P MidCap 400 Trust / MDY	21.7	1.1
Vanguard S&P Small-Cap 600 / VIOO	17.5	1.3
Vanguard Total Stock Market / VTI	27.9	1.2
FIXED INCOME		
ETF / Ticker	**YTD Return**	**Yield**
iShares Broad USD High Yield Corporate Bond / USHY	9.2%	7.0%
iShares Core U.S. Aggregate Bond / AGG	2.9	3.8
iShares Preferred and Income Securities / PFF	10.3	6.1
Vanguard Short-Term Inflation-Protected Securities / VTIP	4.9	2.5
ALTERNATIVES		
ETF / Ticker	**YTD Return**	**Yield**
SPDR Gold Trust / GLD	27.9%	None
Vanguard Real Estate / VNQ	11.2	3.4%

Note: Data as of Dec. 3

Source: Bloomberg

How much should you keep in stocks? It depends in part on your tolerance for pain. Equities periodically have "drawdowns" of 20% or more and may take years to recoup the losses.

While that is unpredictable, some research suggests that investors should gradually build their equity exposure through retirement. A retirement allocation that begins at 30% stock and rises to 60% performs better than a portfolio that remains constant at 60% stock and 40% bonds, according to researchers Wade Pfau and Michael Kitces. The strategy works because increasing the equity portion

over time mitigates "sequence of return risk," or the harm that comes from a market downturn early in retirement.

In practice, many retirees aren't comfortable with a rising stock allocation, says Jamie Hopkins, chief wealth officer at WSFS Bank. While he believes in it philosophically, it bucks convention and "people don't emotionally like it," Hopkins says.

If that's the case, the classic 60/40 portfolio is a good starting place. Those with a higher risk tolerance—or a pension plan or annuity that covers most essentials—may want to bump their stock exposure higher.

Bonds

The core part of any retirees' bond portfolio should be investment-grade bonds, easily accessed through an ETF like iShares Core U.S. Aggregate Bond.

Many advisors also layer in some Treasury inflation-protected securities, or TIPS, though they aren't slam dunks. These government-issued bonds come with terms of five, 10, and 30 years, and have two components: an inflation adjustment that tracks the consumer price index and the "real yield," which is like your baseline income after inflation. Semiannual coupon payments are based on the inflation-adjusted principal.

TIPS perform better when investors foresee higher inflation. Yet if interest rates rise rapidly and exceed inflation expectations, real yields rise and bond prices fall. If sharp enough, these falling prices can more than cancel out the rising inflation adjustment, leading to a negative total return. This happened in 2022, when TIPS shocked some investors by returning minus 11.85%.

The bonds look more attractive today. TIPS are currently yielding about 2% on top of inflation. The current break-even for a five-year TIPS is around 2.3%, meaning that inflation would need to average 2.3% or more over the next five years for a five-year TIPS to outperform a similarly dated Treasury bond.

What's more, investors who buy individual TIPS and hold them to maturity never have to worry about losing money. Even if there is deflation, you never receive less than your original principal when the bond matures.

Ideally, spending needs should guide the investment. Say a retiree requires $60,000 a year to cover basic expenses and receives $40,000 from Social Security, so the gap is $20,000 a year.

A 70-year-old might build a TIPS ladder to a conservative life expectancy of 95—$20,000 a year multiplied by 25 years means a $500,000 investment in the TIPS ladder. TIPSladder.com is a free resource for constructing TIPS ladders, recommended by advisors and economists.

Spero uses this approach, buying individual TIPS for clients. When a bond matures, clients use the proceeds for living expenses rather than reinvesting it. "This is definitely a safety move," he says, adding that it isn't designed to increase wealth but to protect it and stay ahead of inflation.

ETFs offer easy access to TIPS for investors who prize liquidity. One good approach is to have about a quarter to 30% of your bond portfolio in TIPS ETFs, says Christine Benz, director of personal

finance and retirement planning for Morningstar. That allocation can stay constant regardless of the prevailing rate of inflation, she notes.

Retirees can match their own time horizon to the TIPS maturity. For example, those looking for income in the next couple years might choose a fund like the Vanguard Short-Term Inflation-Protected Securities ETF, which has an effective maturity of 2.5 years.

For a little extra income, consider small allocations to high-yield bonds and preferred securities. Low-cost ETFs with attractive current yields include iShares Broad USD High Yield Corporate Bond and iShares Preferred and Income Securities. Bear in mind that these funds would likely lose value if corporate credit falters in a deteriorating economy.

Alternatives

Aside from stocks and bonds, many advisors recommend a small allocation to tangible assets such as commodities and real estate as inflation hedges. Rental leases rise with inflation, as do the dividends issued by real-estate investment trusts, or REITs. Funds like Vanguard Real Estate offer easy and low-cost exposure to REITs that own office buildings, hotels, and other properties.

Commodities are also commonly considered an inflation hedge. An analysis by Goldman Sachs found that a one percentage-point surprise increase in U.S. inflation has, on average, led to an inflation-adjusted gain of seven percentage points for commodities; meanwhile, that same trigger caused stocks and bonds to decline three and four percentage points, respectively.

Gold's record as an inflation hedge is mixed. The yellow metal typically performs best in times of crisis, when inflation is high and geopolitical tensions constrain supply, according to Goldman Sachs. If a trade war breaks out, gold could protect against potential stock market declines, Goldman says, and it has upside potential if concerns about the debt mount.

Most advisors recommend that clients keep no more than 5% of their portfolios in gold. Some strategists shy away from it altogether. "Gold doesn't pay a dividend," says Doug Ornstein, director at TIAA Wealth Management, who prefers REITs and other dividend payers as inflation hedges.

Energy has the strongest record of real returns when inflation surprises to the upside, according to Goldman Sachs, which sees opportunity in oil as a geopolitical/inflation hedge. Oil and gas stalwart Exxon Mobil is a "dividend aristocrat," in the rarefied territory of companies that have raised their dividends for 25 consecutive years or more. It currently yields 3.48%, and analysts at Morningstar say the stock is undervalued. What's more, many view the Trump administration as positive for oil and gas stocks.

Retirees in particular should focus on companies with a long record of growing their dividends. The ProShares S&P 500 Dividend Aristocrats ETF owns a basket of those stocks, which are considered relatively high quality. Richter also favors the more conservative companies, including stocks like Johnson & Johnson.

None of these moves guarantee total returns above inflation, especially if stocks go through a long downturn. But building a portfolio around your spending needs, assuming inflation rises at least 2.5% a year from here, is a good way to get some protection.

Write to Elizabeth O'Brien at elizabeth.obrien@barrons.com