



**Scannell Wealth Report
November 1, 2010**

The Markets

What do you think the inflation rate will average in the United States over the next 5 years?

Before you answer that question, here is some additional information to consider. During the peak of the financial crisis back in late 2008, investors were predicting that prices would *decline* by a small fraction of 1% for 10 years, i.e., we would have 10 years of *deflation*, according to a January 29, 2009 Bloomberg article.

To determine what investors expect inflation to average in the future, we simply calculate the difference in yield between Treasury Inflation Protected Securities (TIPS) and a similar maturity U.S. Treasury security. For example, if the yield on a 10-year Treasury was 2.6% and the yield on a 10-year TIPS was 0.6%, then that suggests investors expect inflation to average 2.0% over the next 10 years. This difference of 2.0% is called the “breakeven rate.”

Unlike a regular Treasury security, the principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index. When a TIPS matures, investors are paid the adjusted principal or original principal, whichever is greater, according to the Treasury Department. Hence, TIPS are considered a hedge against inflation, according to *The Wall Street Journal*.

Okay, do you have your 5-year inflation rate guess now? Unlike late 2008, investors now expect inflation to average 1.59% over the next 5 years, according to an October 25 *Wall Street Journal* article. For historical reference, inflation has averaged 3.0% per annum compounded annually from the beginning of 1926 to the end of 2008. On a 5-year basis, it averaged a high of 10.1% per annum compounded annually for the 5 years ending December 31, 1981 according to the Ibbotson SBBi 2009 Classic Yearbook.

By historical standards, the expected 5-year inflation rate of 1.59% is low. However, the Federal Reserve is doing what it can to stoke inflation in an attempt to prevent deflation and as a way to pay down our federal debt using “cheaper” dollars.

Data as of 10/29/10	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	0.0%	6.1%	14.2%	-8.4%	-0.4%	-1.9%
DJ Global ex US (Foreign Stocks)	-0.1	6.5	11.6	-10.0	3.5	3.1
10-year Treasury Note (Yield Only)	2.6	N/A	3.4	4.5	4.6	5.8
Gold (per ounce)	1.8	22.0	26.8	19.5	23.4	17.7
DJ-UBS Commodity Index	1.7	5.8	10.6	-7.1	-2.4	3.6
DJ Equity All REIT TR Index	-1.7	24.4	42.1	-4.8	3.5	11.6

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

INFLATION IS ALIVE AND WELL on college campuses, according to an October 28 report from the College Board as reported by *BusinessWeek*. While consumer inflation may be rising at less than 2% per year, published prices for tuition and fees at in-state public universities rose 7.9% for the 2010-2011 academic year to \$7,605. That's up from last year's increase of 6.5%. Part of the rise is due to cuts in state funding of higher education. Essentially, students are asked to pick up a bigger share of the cost.

If you are planning on sending your kids to one of the elite private schools, be prepared to hand over more than \$200,000 for that 4-year education. For the less affluent, though, financial aid and work programs are available and that could reduce the cost significantly.

One complaint about government inflation statistics is that some people feel they don't accurately reflect what consumers actually buy. The rapid rise in the cost of education is one example of a common consumer expenditure that is rising much faster than the reported government inflation statistics.

Weekly Focus – Stretch Your Brain

Picture an arrow in flight that is moving toward a target. For the arrow to reach the target, the arrow must first travel half of the overall distance from the starting point to the target. Next, the arrow must travel half of the remaining distance and then half of that remaining distance and so on.

For example, if the starting distance was 10 yards, the arrow first travels 5 yards, then 2.5 yards, then 1.25 yards, and so on. By extending this further, you can imagine the resulting distances getting smaller and smaller.

Here's the question: Will the arrow ever reach the target?

See below for the answer.

Best regards,

“Scannell Wealth Management Group”

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this email with their email address and we'll ask for their permission to be added.

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This newsletter was prepared by PEAK

* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.
* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.
* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.
* The Dow Jones World (Ex. U.S.) is an unmanaged group of securities considered to be representative of the non-U.S. stock market in general*
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Answer to Brain Stretcher:

Yes. This is because the sum of an infinite series can be a finite number. We can see that $1/2 + 1/4 + 1/8 + 1/16...$ is moving closer to 1. This series will go to infinity, but each term is getting smaller and smaller. Thinking about it, the terms will approach zero as they get infinitely large, and each term will bring the series closer to summing to 1. At infinity, the sum will be 1 and, hence, the arrow hits its target.

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