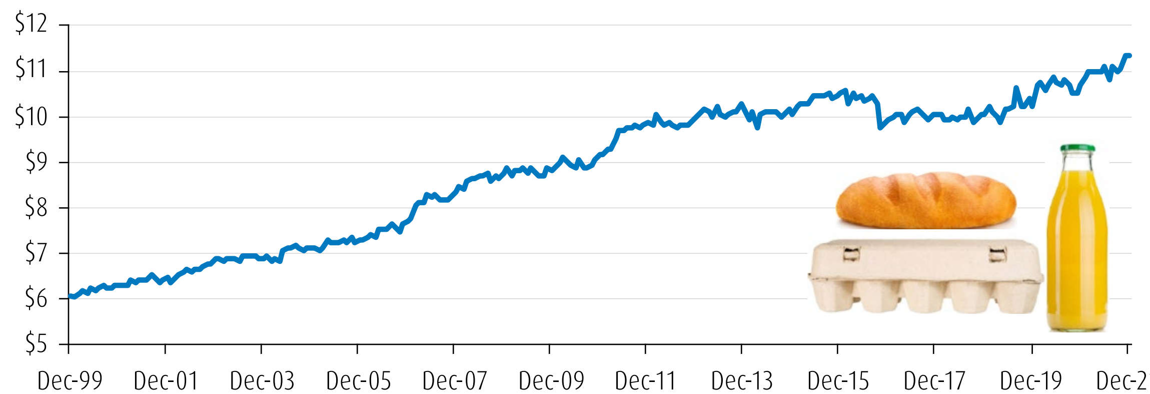
Inflation and Investment Return

What is inflation?

The Bank of Canada targets a **2% annual inflation rate**. This means the prices of goods and services on average increase about 2% every year.

A good example of inflation in everyday life is that the cost of groceries increases over time. This graph shows the price increase of a litre of orange juice, a dozen eggs and a loaf of bread from 1999 to 2019.* This rise in prices is also seen in most other goods and services.

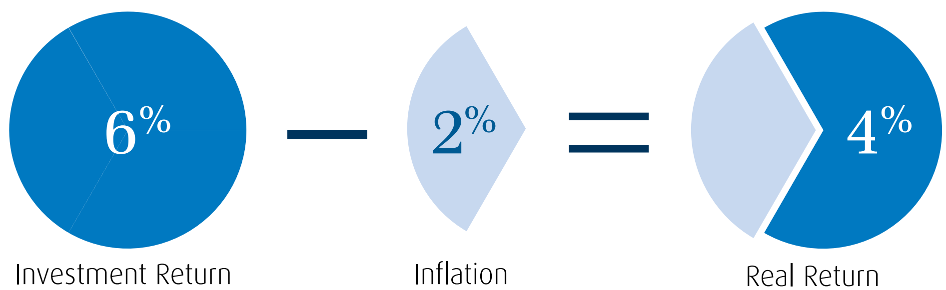


Effect of Inflation: The same amount of money buys fewer goods and services. In other words, inflation makes each dollar worth a little less.

How does inflation affect investment returns?

The return on your statement shows how much your investment has grown. However, this misses the impact of inflation, which reduces the value of each dollar earned. You can find the real return of your investment by subtracting inflation from the investment return.

Example of how inflation reduces investment returns



Bottom Line: Inflation reduces the real value of your portfolio. If your portfolio is not growing by at least the rate of inflation you are losing money (even though the dollar amount of your portfolio is growing).

*Source: Statistics Canada (CANSIM 326-0012). In Canadian dollars.

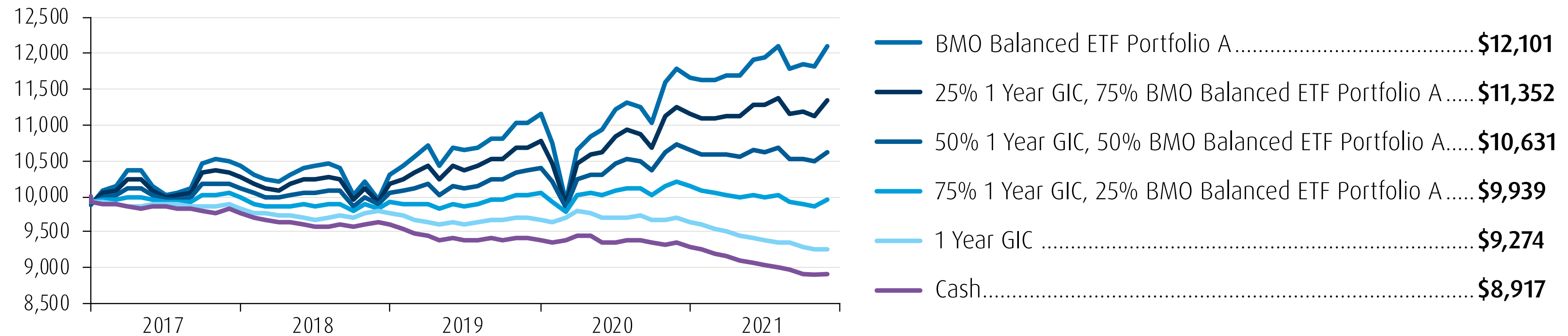
When being too safe is risky

It may be tempting to try and avoid market volatility by staying in cash or very safe investments. Imagine if 5 years ago you had put $10,000 in a safe. Today you would still have $10,000 in bills however they would be worth 11% less since prices had continued rising over those 5 years while the amount of cash stayed the same*.

The effect of inflation can have an even greater impact on fixed income than on equities as the payments of fixed income are fixed. As such including equities in your portfolio can help in achieving investment returns in excess of inflation.

The following shows the effect of inflation on cash, 1-year GICs and portfolios including BMO Balanced ETF Portfolio*.

5-year Growth of $10,000 (inflation-adjusted)



BMO Mutual Funds

A balanced portfolio which includes equity exposure has generated positive inflation-adjusted returns.

*Source Morningstar Direct as at December 31, 2021. Represents a $10,000 initial investment over a 5-year period. Performance of BMO Balanced ETF Portfolio Series A is used. Canadian inflation represented by the CPI monthly return stream. The 1 Year GIC represents an average of 1 Year GIC rates offered in Canada as sourced from the Bank of Canada. These materials are subject to change without notice and, due to the rapidly changing nature of the securities markets, may quickly become outdated. All materials presented are compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. This information is distributed solely for educational purposes, and it is not to be construed as an offer, solicitation, recommendation or endorsement of any particular security, product or service.

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