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### Investment Planning

## What's Your 'What If' Inflation Scenario?

This article was written for Wells Fargo Advisors.

Small tweaks to your portfolio now could buttress your savings against a future rise in the inflation rate.

Inflation is not an issue right now. The Consumer Price Index (CPI), which measures prices for a broad range of items, increased a mere 0.4 percent during the 12 months through November.<sup>1</sup>

Still, many investors have grown increasingly worried about the prospects for a higher inflation rate down the road. They argue that currently low interest rates, large federal budget deficits and a weakening dollar could cause prices to rise significantly in the next few years. (Economists generally agree that in the near term, the weak economy will likely keep a lid on inflation.)

If you hold a well-diversified portfolio, some of your assets are already likely to hold up well during periods of rising prices. That said, you may want to review your investments for their ability to withstand higher inflation rates in the future. Consult your financial advisor: He or she may suggest initiating or adding to positions in the following types of securities, which generally offer a degree of protection against increases in the inflation rate.

### STOCKS

The potential for significantly higher prices places a premium on real investment growth — that is, returns that outpace inflation. Stocks have the best track record for generating real returns

over long periods: The S&P 500 produced an after-inflation annualized gain of 6.4 percent between 1926 and 2008, while bonds and cash produced real annualized returns of just 2.3 percent and 0.7 percent, respectively.<sup>2</sup>

What's more, the S&P 500 stock index outpaced inflation during all 65 rolling 20-year periods between 1926 and 2009.<sup>3</sup> Bond returns lagged inflation in 16 of those 20-year stretches,<sup>4</sup> and cash investments trailed inflation in 20 of them.<sup>5</sup>

The upshot: Given the prospect for higher inflation, you might consider equities for a somewhat larger portion of your long-term savings.

### INFLATION-PROTECTED BONDS

Bonds' total returns often suffer when prices rise. The reason: Most bonds pay a fixed amount of interest each year, and higher inflation decreases the buying power of those payments. As a result, when inflation seems likely to rise, investors generally won't pay as much to purchase a given bond — causing its price to fall.

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## What's Your 'What If' Inflation Scenario? continued

That said, bonds play an essential role in your portfolio, regardless of the inflation outlook. To protect your fixed income allocation from being hurt by rising prices, consider holding a variety of bonds.

**If you hold a well-diversified portfolio, some of your assets are already likely to hold up well during periods of rising prices. That said, you may want to review your investments for their ability to withstand higher inflation rates in the future.**

In particular, you may want to consider Treasury inflation-protected securities (TIPS) or funds that hold them. TIPS, which are backed by the full credit of the U.S. government, adjust their principal values twice a year to account for inflation. The bonds' interest payments are calculated as a percentage of their principal, so a higher principal value boosts the interest they pay investors. The inflation adjustments are taxed as income, so it's generally best to hold these securities in a tax-sheltered account.

### COMMODITIES

When inflation rises, the prices of raw materials tend to rise as well. Investing in commodities therefore may give your portfolio a boost during inflationary periods. But remember, commodities can be extremely volatile, and it is important to keep your holdings in the sector diverse. A basket of investments held through a fund may be one way to spread out your exposure without concentrating on any one asset.

Speak to your financial advisor about the proper level of commodities exposure you should maintain given your specific circumstances.

In truth, it's likely best not to make any dramatic changes to your portfolio in anticipation of higher inflation — the best strategy is to maintain a well-diversified portfolio and keep your eye on your long-term goals. Your financial advisor can help you determine whether or not some small tweaks to your investment strategy might help you reach your financial goals if inflation does rise significantly, while still keeping you on track should inflation remain low.

<sup>1</sup> Bureau of Labor Statistics.

<sup>2</sup> Ibbotson *S&P 500 Classic Yearbook*.

<sup>3</sup> Ibid.

<sup>4</sup> Ibid.

<sup>5</sup> Ibid.

### Together, we can discuss:

- Gauging your portfolio's risk for higher rates of inflation
- Diversifying your assets with an eye toward your investing horizon
- Creating an investment strategy that takes into account the possibility of rising prices

*Asset allocation/diversification cannot eliminate the risk of fluctuating prices and uncertain returns or guarantee a profit or protect against a loss in a down market. The investment(s) discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances.*

*Stocks offer long-term growth potential but may fluctuate more and provide less current income than other investments. An investment in the stock market should be made with an understanding of the risks associated with common stocks, including market fluctuations.*

*Fixed income investments are subject to interest, credit and market risk. Interest-rate risk means the value of fixed income investments will decline as interest rates rise. Credit risk is the possibility that the borrower may not be able to repay interest and principal. Low-rated bonds generally have to pay higher interest rates to attract investors willing to take on greater risk. Market risk is the fact that the bond market in general could decline due to economic conditions, especially during periods of rising interest rates.*

*Buying commodities allows for a source of diversification for those sophisticated investors who wish to add commodities to their portfolios and who are prepared to assume the risks inherent in the commodities market. Any purchase represents a transaction in a non-income-producing commodity and is highly speculative. Therefore, commodities should not represent a significant portion of an individual's portfolio.*

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## Personal Finance

# A Different Kind of ‘Prenup’

This article was written for Wells Fargo Advisors.

By starting a conversation about finances before sharing a lifetime together, a couple can build a solid foundation for the future.

Money can seriously stress out a relationship — and financial matters are commonly cited as a reason for divorce. That’s why it’s crucial for engaged and newly married couples to have open, honest discussions about their finances sooner rather than later.

“Talking about money might not be at the top of newlyweds’ to-do lists, but it ought to be,” says Olivia Mellan, a therapist and money coach who works with couples. “Finances often are ignored until they become a problem.”

Taking the following steps — ideally before you walk down the aisle or visit city hall — can help you and your spouse create a happy, harmonious financial life together:

- **Share your financial information.**

To make smart financial choices together, each of you needs to know the current status of the other’s financial situation, including existing savings, income and expenses, including debt payments. Get copies of credit reports from [annualcreditreport.com](http://annualcreditreport.com) (you can get one free report a year from each of the three major credit bureaus). Then go beyond the hard numbers and discuss your attitudes toward money. “Opposites attract — and that’s true for money personalities too,” notes Mellan. “Spenders often end up with hoarders. It’s very important to know how you and your partner view money so you can make good compromises together.”

- **Discuss your goals.** You’ve probably tackled the big items already, such as whether you want to have children. But don’t forget often-overlooked issues such as what you want out of life now and down the road, when (or if) you plan to retire, and the goals and dreams you hope to fund with your financial resources — be it a new house, regular travel or furthering your education. Those fundamental life details will inform a whole host of financial decisions, from how to budget to the best ways to save and invest for the future.

**Opposites attract — and that’s true for money personalities too. Spenders often end up with hoarders. It’s very important to know how you and your partner view money so you can make good compromises together.**

- **Share the financial duties.** One spouse often takes the reins when it comes to paying bills, balancing the checkbook and making investment decisions. Instead, consider rotating those duties every few months or once a year. That approach helps give each of you detailed knowledge of your overall financial picture. “It’s good to know that if something bad happens to one of you, the other person won’t be in the dark about your money, bills and investments,” says Mellan.
- **Decide whether to merge your finances.** Traditionally, married couples open a joint checking account and merge their finances. While that approach remains popular, some couples these days (often

those getting remarried or with children from previous marriages) choose to maintain separate accounts. Still others opt for a hybrid approach — each holding some “independent money” in individual accounts along with funds in a joint account for all shared expenses. There’s no one correct approach here. Do what works for you as a couple.

- **Build an emergency fund.** The recent recession was a perfect reminder of the importance of having an emergency fund to help see you through rough financial times and unexpected problems such as a job loss. Add up your living expenses for a typical month and build an emergency fund big enough to cover at least six months’ worth of costs.
- **Get help if you need it.** People have strong attitudes and emotions about money. Suddenly having to consult with someone else on financial matters may not be easy. If you’re unsure how to progress, consider asking married friends and family members for advice or options. A financial advisor can help you map out budgets and savings plans that reflect your individual and shared goals.

Whatever route you choose, make sure you communicate openly and honestly about your money matters, and check in with each other regularly on key issues to make sure you’re both still on the same page. “Regular money talks — say, once a month or quarter — will head off big problems and make your life together a lot better,” concludes Mellan.

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