

# Higher Inflation: Rubin

## Advisors should warn investors

BY BRYAN BORZYKOWSKI

The rising cost of oil isn't just hurting drivers' wallets; it's harming Canada's low inflation rate and your clients' financial plans.

According to a new CIBC World Markets report, the price of shuffling goods and raw materials around the world has increased dramatically, and that's driving up inflation.

"Exploding transport costs may soon remove the single most important brake on inflation over the

last decade – wage arbitrage with China," says Jeffrey Rubin, chief economist and chief strategist at CIBC World Markets. "Not that Chinese manufacturing wages won't still warrant arbitrage. But in today's world of triple-digit oil prices, distance costs money."

Rubin says that high transportation costs will affect the Consumer Price Index and, in turn, will "cancel out the East Asian wage advantage."

While rising inflation means your client's day-to-day purchases will be more expensive, it also signals a possible rise in interest rates, which have dropped from 4.5% in March 2007 to 3% today.

Rubin predicted one more rate cut from the Bank of Canada in May, but also predicts the bank will "take back those easings."

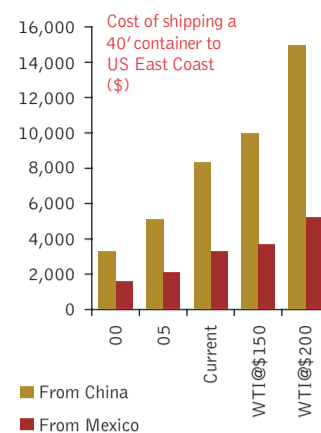
He believes advisors can expect to see "at least 100 basis points

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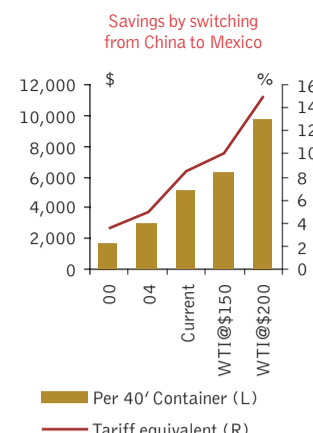
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## SHIPPING COSTS TO U.S.



Source: CIBC World Markets, June 2008



of tightening by the end of next year."

If interest rates rise, your cli-

ents might find fixed income investments more attractive than stocks. Wayne Rothe, a CFP with Alberta-based Wayne Rothe & Associates, says some of his clients have become more risk-averse so they're looking at safer investment vehicles, like guaranteed investment certificates, to park their money. However, he explains that higher inflation could offset the benefits of a GIC, even with the higher interest rates.

Frank Wiginton, a CFP and senior financial partner at TriDelta Financial, says advisors should make sure their clients are in an inflation-protected investment like a bond or preferred share. GICs aren't protected. "GICs are taxed at the highest rate," he says. "There's no way of having any sort of inflationary response, and all you do is end up losing money if half of your 3% return goes to taxes and inflation is 2.5%."

Bonds are a better option, but if your client already owns 10- or 20-year bonds, and interest rates go up, the value decreases. Wiginton says investors should consider short-term bonds when interest rates go up. "They'll be less affected," he says. "The client can hold to maturity and then reinvest in new bonds at the higher rate."

While interest rates can influence investment choices, higher inflation can affect a client's bottom line. To avoid a planning disaster, Wiginton and Rothe both work inflation into their clients' financial plans. Rothe sets inflation at around 4.5%, while Wiginton says most planners use rates between 2% and 3%. But with oil's dramatic rise, he says it "may be time for planners to reassess what rates they use."

Wiginton says advisors and clients need to avoid looking at core inflation, which excludes food and energy, and focus on headline inflation to get the whole picture.

"Clients have to feed themselves, and most people drive cars, so these things have the biggest hit on pocketbooks. [L]ook at the whole inflationary picture." **AER**