The Dollar Is On Plavix, Lipitor and Cialis

By Editor Test *Wed, Sep 16, 2009*

Given the possibility of higher inflation ahead, the new PIMCO TIPS payout funds may be just what the doctor ordered.

Compared with countries like Argentina, the United States has been unscathed by Weimar Republic-style hyperinflation in the 20th century. But with the price of cars, or tuition at private colleges, or a copy of the *New York Times* up tenfold since 1973, we know what chronic mild inflation feels like.

To put the significance of products like PIMCO's Real Income funds in perspective, it's useful (or at least entertaining) to look back on the history of the CPI in the U.S. Since the start of the 20th century, that history breaks into roughly three parts: an erratic adolescence, a stable adulthood, and advancing sclerosis.

Adolescence, which lasted from 1900 to just after World War II, was troubled by the inflation of 1915 to 1920 and the deflation of 1920 to 1941. Stable adulthood began with the Bretton Woods conferences after World War II, which established the dollar as the world's reserve currency.

From 1947 to 1971, we enjoyed a golden age of almost zero inflation and a currency that was literally as good as gold. Americans could tour Europe on $5 a day and a resourceful child could fill his pockets with nickels, dimes and quarters just by returning empty soda bottles to the grocery store.

This vibrant interlude ended in 1971 when Richard Nixon, pressed by foreign lenders for repayment of Vietnam War loans in gold, abandoned Bretton Woods and set the dollar—though still the world's reserve currency—afloat. Between 1974 and 1982, the CPI-U (for urban) doubled.

The great inflation—or stagflation, since it was not tied to economic growth—of the 1970s was halted when Paul Volcker, the Fed chairman under Presidents Carter and Reagan, hiked interest rates into nose-bleed territory. By 1983, the inflation rate lapsed to a tolerable but higher-than-ideal 2% to 3% a year.

Over the next quarter-century, we grew superficially richer but suffered from advancing financial sclerosis. Steadily falling interest rates allowed a long, luxurious bond rally and an extended bull market in stocks. Meanwhile, the U.S. quietly morphed from the world's largest creditor nation to the world's biggest debtor. Since 1983, the CPI-U has doubled.

The 2008 financial crisis revealed the gravity of our present condition. No longer the muscular workshop of the world, we're using artificial means—the financial equivalents of Plavix, Lipitor and Cialis—to circulate increasingly thinner money. Other nations still consider us too big to fail, but many prognosticators feel that inflation, like Boomers' blood pressure, will escalate big-time.

Hence the interest in owning commodities like gold and securities like Treasury Inflation-Protected Securities or PIMCO's Real Income funds, whose values correlate positively with inflation.

Will we need those products? Who knows; Even if inflation accelerates, daily life in the U.S. may not feel so terribly different. A loaf of bread may cost the same small percentage of our income. But we probably won't be able to tour Europe on less than $1,000 a day.

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