Turning Inflation Into Wealth Mini-Course

Reading Five:

A Right Jab & A Left Hook

This Reading Is Exclusive To This Course

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Tonight's feature is a three part boxing exhibition, where Inflation will take on three investors in a row. His first opponent will be the honorable and fair-haired Peter followed a dollar-denominated investment strategy. Inflation's second opponent will be a newcomer, David, aka "the Rock", an all-tangible asset investor known for his steady strength. The final match of the night will feature a title bout between Inflation and his tricky nemesis, Scott, aka "the Pickpocket".

The boxing matches are identical to our last reading, except for the addition of David. Peter takes his $100, and invests it all in a loan to Scott. David believes in "neither a borrower nor a lender be", so he invests his entire $110 in a tangible asset. Scott is our initial lightweight with beginning savings of only $10, which he uses in combination with Peter's loan to purchase a $110 tangible asset.

The results of the three fights are presented on the next page, in nominal dollars.

Boxing With Inflation

Exhibit 1C: 3 People, Nominal Dollars Before

	Starting Assets	Starting Debt	Starting Net Worth	Starting Share of G & S
Peter	100	0	100	45%
David	110	0	110	50%
Scott	110	100	10	5%
Total	320	100	220	100%

Nominal Results (No Inflation Adjustment) After 90% Loss in Value of Dollar

	Ending Assets	Ending Debt	Ending Net Worth	Ending Share of G & S
Peter	100	0	100	5%
David	1,100	0	1,100	50%
Scott	1,100	100	1,000	45%
Total	2,300	100	2,200	100%

G & S = Goods & Services

Careful review of the chart above on a line by line basis with real dollar vision should telegraph all the punch lines in today's readings, but just in case a nuance or two has been missed, we will go through a fight by fight description.

The Glass Jaw

Peter invested without regard to inflation. Using our boxing simile, this is like standing in the ring with your eyes shut, leaning forward a bit, with jaw extended and hands down by your side. Because you don't realize that you have an opponent. One punch from Inflation was all that it took, and Peter was down for the count. The worst of the damage was done before Peter even realized he was in fight.

Peter

	Assets	Debt	Net Worth	Share of G & S
Start Dollars	100	0	100	45%
End Nominal $	100	0	100	5%
End Real $	10	0	10	5%
	Glass Jaw			

Peter could have tried to get back up and preserve more of what was left of his assets – but even flat on his back, he didn't understand he was in a boxing match. He thought he was a victim of the economy. He was encouraged in this belief because there were so many tens of millions of people like Peter, that inflation had knocked flat on their backs. So, he just stayed on his back until his $100 is only worth $10, and 90% of his real wealth is gone. He only has 10% of the purchasing power he was planning on from his investments during retirement, and his purchasing power, his relative ability to outbid David and Scott for goods and services, has fallen from 45% of real wealth down to only 5%.

Peter is most people, and an inflation "Glass Jaw" is how most people (and most pension plans) are investing for the long-term and retirement. This is usually true even when inflation is included in the assumptions. A financial strategy based on a 3% inflation assumption is an assertion that we already know the results of the match: inflation will remains weak and under control for the rest of our lives. It says that we know the future, and that none of the powerful threats to dollar that we see today or looming with the retirement of the Baby Boom – ever materialize. And we are so sure of this – we are betting everything we have on it – without even thinking about the alternatives all that much.

Right Jab

Inflation came after David, but could never land a solid punch or take him down. That is because "the Rock" had a steady right jab going, which kept Inflation from getting close enough to inflict real damage. The right jab consisted of a 100% tangible asset portfolio, whose value was not related to the dollar. Inflation's power was based on changes in the value of the dollar, and separating his portfolio from the dollar was the key to David's defense of the purchasing power of his assets.

"Defense" is the key word here, because that is all David was able to do. That may seem an odd statement to many people, when we look at the nominal dollar section of the chart below. David started with an asset worth $110, and by the time the boxing match was over – his asset was worth $1,100. That sure looks like a $990 profit, which would represent a delectable 900% return on investment.

(Unfortunately, that is the way the government views it for tax purposes, which will become a key component of later readings.)

David

	Assets	Debt	Net Worth	Share of G & S
Start Dollars	110	0	110	50%
End Nominal $	1,100	0	1,100	50%
End Real $	110	0	110	50%
	Right Jab			

However, when we adjust for the purchasing power of what $1,100 will buy, as shown with the real dollar numbers – our profit disappears. David can only cash out for the same $110 in goods and services that he had when he started. Which makes sense – the whole idea of the tangible asset was to preserve wealth independent of the value of the dollar, and the investment performed exactly as planned. David started with rights to 50% of the goods and services relative to Peter and Scott, and David ended with 50% of the rights. He maintained.

David's powerful right jab did it's job in keeping inflation at bay, it left him in much better shape than Peter -- but it didn't make him any money in real terms either. Particularly when the Inflation Tax is taken into account.

Left Hook

Inflation came straight after Scott as well, but couldn't close – because Scott had a powerful right jab going. His right jab was in fact identical to the right jab of David's, with the same $110 tangible asset that was worth $1,100 in nominal terms when Inflation had done its worst.

Scott

	Assets	Debt	Net Worth	Share of G & S
Start Dollars	110	100	10	5%
End Nominal $	1,100	100	1,000	45%
End Real $	110	10	100	45%
	Right Jab			
	Left Hook			

Scott had more going for him than just a right jab, however, for Scott also had a left hook. Every time Inflation tried to close – Scott let him have it with a left hook that momentarily knocked Inflation to the floor. Being an economic force rather than an actual person, Inflation would of course bounce right back up, but these repeated knockdowns showed the essential difference between Scott and David: Scott had a offense. Scott was not just trying to fight off inflation and preserve his assets – Scott was quite deliberately turning inflation into real wealth.

Scott's net worth was equal to the difference between the value of his assets, and the value of his liabilities. The real value of his assets was staying even, thanks to his tangible asset right jab. The real value of Scott's debt was plunging with inflation. The harder

Inflation came at him – the faster the value of the debt dropped, and the faster that Scott's real net worth was increasing.

By the time the bout was over, and a dollar was worth ten cents – Scott's nominal net worth had soared from $10 to $1,000. Because he was using two punches instead of just one, even when we adjust for inflation, Scott's real net worth had jumped from $10 to $100. Because Scott went on the offense and quite deliberately positioned himself to exploit the weakness in Inflation's attack – Scott saw his ending rights to real goods and services climb from 5% of the total up to 45%. Meaning substantial inflation radically improved Scott's financial place in life.

(As will be discussed in later readings, Scott's left hook had another benefit going for him – unlike a right jab, which can carry tax disadvantages, a left hook can be used to Reverse the Inflation Tax and generate powerful tax advantages.)

The Control

In our previous reading, we talked about the need for a "control" that would help sort out the answer our dilemma: should Scott's vaulting net worth be attributed to the readily obvious huge increase in the nominal dollar value of his asset, or was it the more obscure real dollar change in the value of his debt? The all-tangible asset investor David was of course our control, and a close examination of the color-coded real dollar chart below provides our answers.

Boxing With Inflation

Exhibit 1D: 3 People, Real Dollars

Before

	Starting Assets	Starting Debt	Starting Net Worth	Starting Share of G & S
Peter	100	0	100	45%
David	110	0	110	50%
Scott	110	100	10	5%
Total	320	100	220	100%

Real Results (Adjusted for Inflation)
After 90% Loss in Value of Dollar

	Ending Assets	Ending Debt	Ending Net Worth	Ending Share of G & S
Peter	10	0	10	5%
David	110	0	110	50%
Scott	110	10	100	45%
Total	230	10	220	100%

Glass Jaw
Right Jab
Left Hook

G & S = Goods & Services

The role of the tangible assets is, in fact, critical. It is the asset that preserves the wealth. However, when we look to real purchasing power of the assets – the nominal 900% profit truly is only an illusion. David, with tangible assets only, succeeded in maintaining the (pretax) purchasing power of his savings, no more and no less. With absolutely identical tangible asset results as Scott, David protected against inflation, but he did not turn it into real wealth, he started and ended with rights to 50% of the goods and services.

Scott preserved wealth through tangible assets and created wealth through understanding how inflation redistributes real wealth. “Redistribution” is the key word here, for we also need to look at Peter, and the underlying source of Scott’s “left hook”. Peter’s net worth decrease was the direct source of Scott’s net worth increase, and the neat symmetry of their real net worth reversal from 45% Peter / 5% Scott to 5% Peter / 45% Scott is no coincidence.

Dollar for dollar, every bit of real wealth that left Peter’s pocket as a lender, went straight into Scott’s pocket as a debtor – as classic economic theory indicates should happen. Peter’s “Glass Jaw” and Scott’s “Left Hook” are just two sides of the same equation, with that equation being the wealth redistribution equation. An unforgiving, unfair and impersonal equation that will destroy the life savings of tens of millions of good people if and when major inflation returns. An equation that you can flip to your advantage and use to turn inflation into wealth in a potentially low-cost and tax-advantaged manner.

Enhancing The Value Of This Reading

This may be a good place to stop and consider your own situation. Are you ready to box? How’s that jaw looking? How about your right jab – do you have a solid defense? How about your offense? Do you have a left hook set up under terms that will minimize your risks while maximizing your benefits on a tax-advantaged basis? If not, just keep reading, because improving your inflation boxing skills is of course the goal of the readings still to come.

When you feel that you've gotten some good value from a reading, whether now or with a future reading, it may be time to ask yourself another question: who else do you know who could benefit from what you have been learning? How many people do you know who have "Glass Jaws" when it comes to boxing with Inflation? Or people who have a solid Right Jab, but no idea their Left Hook exists or how to use it?

This free resource is intended for public education. For it to do its intended work, and help as many people as possible – people need to know about it. So, I have a simple request. Whenever you feel you are getting value – pass that value along to others who can benefit, in the form of a link to the reading or the sign-up page. The cost to you is nothing, the cost to them is nothing, and the value to your friends, family and co-workers could possibly mean the difference between comfort and impoverishment over decades to come.

If A Link To This Reading Was Given By A Friend

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