

The New Hampshire Trust Company

Asset Management & Trust Services

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Inflation Ahead?

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In the face of \$1.8 trillion U. S. budget deficits in the current year and projected \$1 trillion budget deficits for each of the following two years, investors are expecting inflation to return after nearly 30 years in hibernation. The timing of this return is open to debate and will depend on many factors.

There are similarities to the 1970s and now. Both periods experienced government intervention into the free market economy. In 1971 the Nixon Administration instituted a 90 day freeze on wages and prices to counter inflation. This attempt was unsuccessful and both wages and prices continued to accelerate for the remainder of the decade. Today, the Obama Administration has intervened in the financial and auto industries and has plans to overhaul the health care industry, as well as energy through climate change legislation. The outcomes of these efforts, both intended and unintended, will not be known for years. Both periods also experienced spikes in energy and other commodity prices.

While the 1970s can best be described as a period of stagflation, the current recession, which began in late 2007, has been prolonged by the massive deleveraging taking place in the U.S. and global economy. As a result of this deleveraging there is “slack”, unused capacity, in the economy. Wells Fargo’s Senior Economist calculates that non-Fed lending has dropped by \$6 trillion since the third quarter of 2007. The various Fed lending programs have replaced less than 20% of this amount. BMO Capital Markets Economics Research calculates the amount of inflation absorbing slack in the economy should hit its highest level since the late 1940s. These observations and other economic data suggest there are still more deflationary aspects to our current economy.

The greater risk for inflation comes from the commodities that are traded in U.S. dollars. A continued depreciation in the U.S. dollar relative to other foreign currencies could drive energy and other commodity prices higher. Currently, crude prices are well below last year’s highs and gold has not set a new high in over a year partly due to the U.S. dollar’s relative strength during the global financial crisis. There are several reasons to believe the U.S. dollar will depreciate further, including ongoing budget deficits, foreign diversification away from Treasuries, competition from other foreign currencies as a reserve, and ongoing Federal Reserve decisions regarding monetary policy. Of these variables, the Fed’s ability to execute a timely exit strategy from their historic stimulus efforts will greatly influence the level of the U.S. dollar and have bearing on the magnitude of future inflation.

Since the end of 2008, yields on the 10 year Treasury have increased from just over 2% to 3.65%. The inflation expectation on the 10 year TIPS is less than 2%. These rates have recovered to levels seen before the Lehman failure last fall but are still historically low. Nonetheless, our investment committee has had ongoing discussions on how we might invest a portion of our clients’ portfolios to protect against the prospects of inflation and a declining U.S. dollar. Initially, we have identified TIPS, and emerging markets with surplus current accounts, such as those from Asia or natural resource and mining companies, as investments that offer some protection from increasing inflation down the road.

As always we would welcome the opportunity to speak to you about this concept or any aspect of your portfolio.

Thank you to all of our clients who responded to our recent survey. We are delighted to report that we received 46 completed surveys. As you may recall, we had promised to contribute \$25 for each completed survey to our local Community Kitchen. We recently sent a check for \$1,150 to the Kitchen, and know that these funds will be put to good use given the current economic conditions and difficulties that many individuals are facing.



We certainly appreciate the feedback on the surveys, and many of your responses have reconfirmed what we consider to be our strengths. Namely, that we are locally owned and continue to provide you with personalized service and trusted advice.

We also received feedback on areas where we can improve our service. Several of you indicated a desire for more frequent communication from us (both personal and general) as well as more investment related education. Others wanted more information regarding our rationale for investment selections as well as improved online account access. We take your feedback very seriously and we will be working on these issues over the coming months. As always, we welcome your feedback at any time, and view your thoughts and suggestions as an opportunity to provide the services that are most important to you.

Finally, regarding online access, many of you do have your accounts set up for online viewing at any time. If you do not have this option currently, simply call Rhonda at 352-0862 and she can set you up for this free online access.



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Roth IRAs

Benefits & Planning Opportunities *Mike Rafferty, CFP*



In a nutshell, some of the benefits of a Roth IRA include tax-free growth and tax-free distributions under most conditions. In

addition, there are currently no required minimum distributions starting at age 70 ½. A Roth conversion is basically a procedure to change a more typical tax-deferred IRA into a Roth IRA.

Starting on January 1, 2010, there will no longer be any income restrictions on Roth conversions, which will open up this option for many more individuals. Also, as a result of some new tax legislation that was enacted in 2006, any conversions completed in 2010 have an option, according to a recent article in the Wall Street Journal, to “spread the amount converted equally across your 2011 and 2012 tax returns”.

I believe that this option may be worth considering from a tax diversification standpoint. Basically, if you own a number of different types of investments with different tax consequences, you can pick and choose what funds to draw from, based at least in part on your personal tax situation and the existing rules and tax rates that are in effect at that time.

As with any tax law or financial planning strategy, there are numerous complexities to consider. I have purposely kept this short article simple and to the point, but if you have questions or thoughts about how this option might work for you, please call me directly at 352-0863. Also, let me know if you'd like a copy of the aforementioned article that appeared in the Wall Street Journal on June 20, 2009.