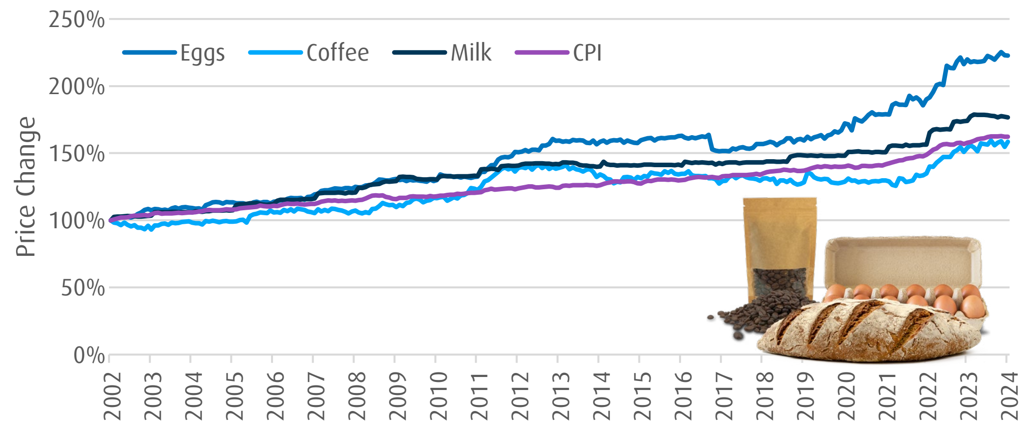
Inflation and Investment Return

What is inflation?

The Bank of Canada targets a **2% annual inflation rate**. This means the prices of goods and services on average increase about 2% every year.

A good example of inflation in everyday life is that the cost of groceries increases over time. This graph shows the price increase of eggs, milk and coffee from 2002 to 2024. The increases of all products and services, including groceries, are captured in an all-encompassing metric called the Consumer Price Index (CPI).* This rise in prices is also seen in most other goods and services.



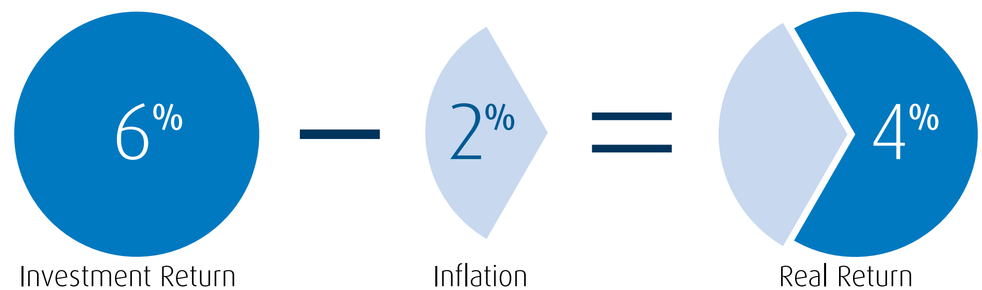
*Source: Statistics Canada. In Canadian dollars.

Effect of Inflation: The same amount of money buys fewer goods and services. In other words, inflation makes each dollar worth a little less.

How does inflation affect investment returns?

The return on your statement shows how much your investment has grown. However, this misses the impact of inflation, which reduces the value of each dollar earned. You can find the real return of your investment by subtracting inflation from the investment return.

Example of how inflation reduces investment returns



Bottom Line: Inflation reduces the real value of your portfolio. If your portfolio is not growing by at least the rate of inflation you are losing money (even though the dollar amount of your portfolio is growing).

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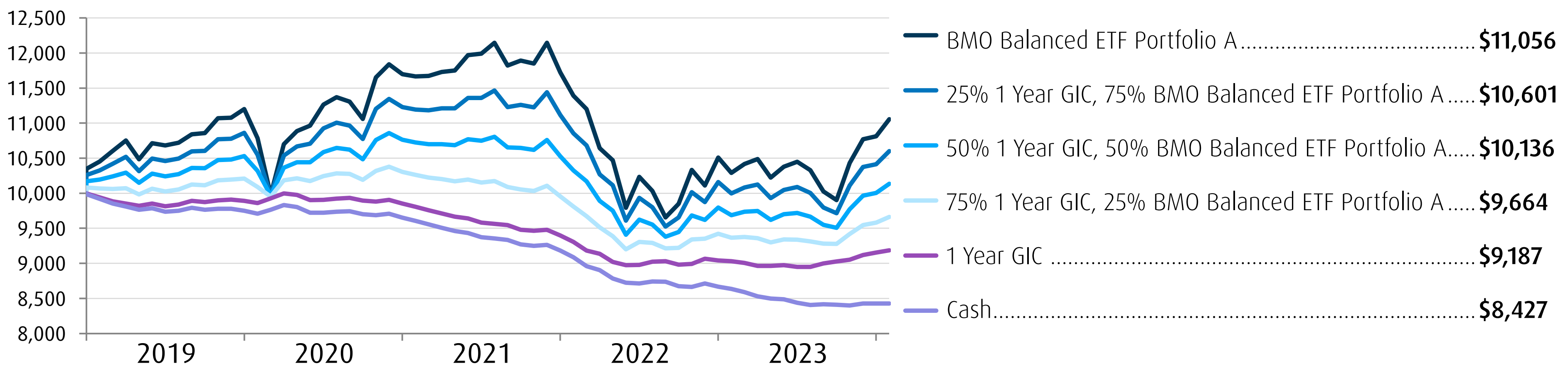
When being too safe is risky

It may be tempting to try and avoid market volatility by staying in cash or very safe investments. Imagine if 5 years ago you had put $10,000 in a safe. Today you would still have $10,000 in bills however they would be worth almost 16% less since prices had continued rising over those 5 years while the amount of cash stayed the same*.

The effect of inflation can have an even greater impact on fixed income than on equities as the payments of fixed income are fixed. As such including equities in your portfolio can help in achieving investment returns in excess of inflation.

The following shows the effect of inflation on cash, 1-year GICs and portfolios including BMO Balanced ETF Portfolio*.

5-year Growth of $10,000 (inflation-adjusted)



This graph illustrates the impact to an initial investment of $10,000 from Jan 1, 2019 to February 29, 2024 in the BMO Balanced ETF Portfolio (Series A) and a 1-Year GIC. It is not intended to reflect future returns on investments in the BMO Balanced ETF Portfolio (Series A).

*Source Morningstar as at February 29, 2024. Represents a $10,000 initial investment over a 5-year period. The annualized rates of return for BMO Balanced ETF Portfolio Series A as at February 29, 2024 for 1, 3, 5, and 10 years and since inception are 10.08%, 2.60%, 4.47%, 4.83% and 5.30%. Canadian inflation represented by the CPI monthly return stream. These materials are subject to change without notice and, due to the rapidly changing nature of the securities markets, may quickly become outdated. All materials presented are compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. This information is distributed solely for educational purposes, and it is not to be construed as an offer, solicitation, recommendation or endorsement of any particular security, product or service.

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A balanced portfolio which includes equity exposure has generated positive inflation-adjusted returns.