Investment Viewpoints

American Century Investments®

Suggestions for Investors Seeking Inflation Protection:

Investment professionals at American Century Investments® answer common investor questions.

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Market behavior in 2008 and 2009 represented major anomalies. The unprecedented credit crisis and global recession ignited fears about financial market value declines and liquidity, forcing many investors to avoid risk by sitting on the sidelines or overloading their portfolios with cash-equivalent investments, including Treasury bills, money market funds, CDs and bank savings accounts.

Heightened demand for these cash equivalents combined with extraordinary action from the Federal Reserve (the Fed), which pushed the federal funds rate target to a range of 0% to 0.25%, have led to historically low money market yields. With the credit crisis abating, now may be an ideal time to review your overall portfolio strategy to determine whether or not today's money market yield environment is suitable for your goals, time frame and overall risk tolerance.

In particular, if protecting your long-term purchasing power is an important goal, you may want to consider other alternatives, including those designed to protect your money from the harmful effects of inflation.

Q. When does inflation protection make sense for my portfolio?

A. If you want to protect your money's long-term purchasing power, your investment portfolio needs inflation protection. Certain fixed income investments, particularly inflation-indexed securities and international bonds, may deliver inflation-fighting features to your portfolio.

With inflation-indexed bonds, the coupon payments and underlying principal automatically increase to compensate for inflation, as measured by the Consumer Price Index. International investments, including international stocks, may provide protection from a weakening U.S. dollar and the risk of "imported inflation" (the cost of imported goods and services rising as the dollar weakens) by offering exposure to various world currencies.

Of course, with any of these investments, you must be willing to accept potentially higher price volatility in exchange for potentially better inflation protection than money market funds offer.

Investments with a primary objective of inflation protection may be most appropriate if you are:

- Retired and need to preserve your money's principal value
- Concerned about the long-term effects of inflation on your purchasing power
- Interested in diversifying your portfolio*

Q. Inflation is low. Why should I invest for inflation protection now?

A. For two main reasons:

1. We believe there's a strong possibility of higher inflation as the global recession recedes.
2. The cost of some forms of "inflation insurance" is relatively low right now.

Addressing the first point, the massive amounts of monetary and fiscal stimulus working through the financial system run the risk of creating significantly higher inflation and a weaker dollar than are currently priced into the market.

As for the second point, securities offering inflation protection currently appear attractively priced, as indicated by the low breakeven inflation rate (BEIR), the yield difference between traditional Treasuries and Treasury inflation-protected securities (TIPS) of

*Diversification does not assure a profit or protect against a loss in a declining market.

the same maturity. This yield difference occurs because traditional Treasury yields tend to be higher than those of same-maturity TIPS. That's because traditional Treasury yields adjust higher or lower in the market depending on inflation expectations and to compensate for that risk. TIPS' yields, on the other hand, tend to be less dynamic and don't price in expected inflation as much; that risk is compensated for instead with TIPS' principal value adjustments. Most of TIPS' inflation adjustment comes from changes in principal values triggered by actual monthly changes in the inflation rate.

Instead of waiting until inflation once again rears its destructive head, now may be the best time to seek inflation protection in your portfolio because the current value among inflation-indexed securities appears compelling. When the BEIR is less than the expected rate of inflation for the period to maturity, as it appears to be now, TIPS should provide a higher total return than conventional Treasuries of the same maturity.

Q. What are the risks of investing for inflation protection?

A. Unlike money market funds and other cash equivalents, where capital preservation is typically the number-one goal, inflation protection vehicles may experience significant price fluctuation over short time frames.

Like all bonds, the prices of inflation-linked securities have an inverse relationship with interest rates—rising when interest rates fall and declining when rates rise. In addition, in periods of deflation, or falling prices, inflation-linked securities may lose value. They can also lose value when interest rates rise without inflation. Furthermore, non-government inflation-linked securities are subject to credit risk, like all corporate securities—the inability or perceived inability of the issuer to make timely repayments of principal and interest, which may cause their value to decline.

Q. What role should inflation-protected securities play in my overall portfolio?

A. In addition to their inflation-fighting benefits, inflation-indexed securities can help diversify your portfolio, especially if it's stock-heavy or includes a large weighting toward traditional Treasuries. Not all asset classes are affected equally by inflation. Certainly, higher prices are an enemy of traditional Treasuries, whose fixed coupon and principal payments are particularly vulnerable to inflation.

Inflation also can mean trouble for some stocks, at least in the short term. Rising inflation can send stock prices downward because higher inflation increases costs for corporations—in the same manner it increases costs for consumers. Inflation also can cut into the dividends corporations pay to their shareholders. Over time, though, corporations can raise prices to protect profit margins and dividend payouts as input costs rise. Plus, over the long term, a company's earnings and revenues should increase in line with or greater than inflation.

We believe the greatest odds of investing success hinge on a measured approach that emphasizes experienced investment management targeting a real inflation-adjusted return over time. Such an approach should incorporate inflation-adjusted strategies along with stock, traditional fixed income and money market funds in a manner consistent with your goals, risk tolerance and financial situation.

There are many ways to invest and seek protection against inflation. See the table on the next page to review the benefits and considerations of several alternatives.

Review your alternatives

Contact your financial professional for more information.

Investment	Main Features	Primary Benefits	Risks/Considerations
▪ Inflation-indexed bond funds	▪ Invest in inflation-indexed securities to protect purchasing power	▪ Invest for total return ▪ Yield and principal payments automatically increase to compensate for inflation	▪ Share price may fluctuate ▪ Prices influenced by prevailing interest rates ▪ Not designed for income
▪ Domestic stocks and stock funds	▪ Stocks and related securities of U.S. companies	▪ Over long time periods, stocks have historically outdistanced inflation	▪ Greater price volatility than bonds and bond funds ▪ Best suited for those with long-term time horizons
▪ International bond or stock funds that invest primarily in foreign-currency denominated securities	▪ Invest in the non-U.S.-dollar-denominated debt and/or equity securities of foreign governments and corporations	▪ Seek a high level of total return while providing a potential hedge against inflation and a weak U.S. dollar through exposure to foreign currencies	▪ Greater price fluctuation than U.S. funds ▪ International investing involves special risks, including those related to economic and political conditions, government regulation and currency swings
▪ Real estate and real estate funds	▪ Real estate values and rental income tend to rise in inflationary environments ▪ Real Estate Investment Trusts (REITs) can provide total return through appreciation and dividend income	▪ Property values and rental income have historically kept pace with or exceeded inflation ▪ Help enhance portfolio diversification through low correlation to stocks and bonds	▪ High potential price volatility comes with high return potential ▪ Real estate prices are sensitive to interest rate changes, economic cycles, political agendas, legislative moves and acts of nature
▪ Precious metals and precious metals funds (gold, silver, platinum, etc.)	▪ Precious metals are tangible commodities that have intrinsic value under most conditions	▪ Prices tend to rise during periods of inflation or when the value of the U.S. dollar falls	▪ High potential price volatility comes with high return potential ▪ May be affected by overall market movements, interest rates, weather, international economic and political developments, and speculative trading

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Investment	Main Features	Primary Benefits	Risks/Considerations
▪ Commodities and commodity funds (oil, non-precious metals, agricultural products, wood, paper, rubber, etc.)	▪ Invest in key commodities (such as oil, non-precious metals, agricultural products, wood, paper, rubber, etc.) and/or companies involved in the production of these goods	▪ These are tangible assets that have intrinsic value under most conditions ▪ The high demand/low supply that triggers inflation also tends to drive up commodities prices	▪ High potential price volatility comes with high return potential ▪ May be affected by overall market movements, interest rates, weather, international economic and political developments, and speculative trading

As with all investments, there are risks of fluctuating prices and uncertainty of dividends, rates of return and yields. Current and future holdings are subject to market risk and will fluctuate in value.

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