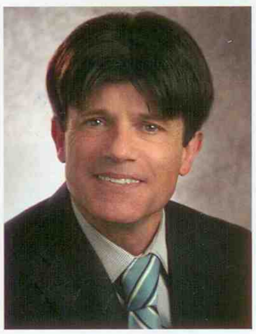
From time to time Insights will feature articles written by industry professionals who are not affiliated with Inland. This edition, we are happy to include the following article written by Robert S. Smith.

The Best Inflation Hedge Money Can Buy



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As this goes to press, fear and uncertainty are still with us. This, despite nearly a trillion dollars in new stimulus spending; or perhaps because of it.

In its efforts to revive the economy and move consumers off life support, the Fed increased the money supply by $691 billion in the last twelve months. This is almost double the average annual money supply growth from 2000 to 2007. And this includes only the first half of the TARP package and none of the coming "stimulus" package.

Despite being without historical precedent, these actions have not had the desired effect. This is largely because the epicenter of the current meltdown is the banking sector. Despite flooding the market with money, the Fed is not getting its usual traction with consumers because banks are hoarding cash.

Not only are banks hoarding cash, but investors are too. This is evidenced by the current price of U.S. Treasuries. By any normal means of valuation U.S. Treasuries are remarkably over valued. The 30-year Treasury bond now pays the lowest yield in its history.

This stampede to Treasuries is driven by fear. The popular media and political class are rife with descriptions of looming global depression and deflation reminiscent of the 1930s and Japan in the 1990s. As a result, investors fearful of a sustained global economic downturn and subsequent deflation are hoarding money in U.S. Treasuries. However, these historically low yields offer no protection against the return of inflation. At current levels, U.S. Treasury yields imply inflation will be around 0% the next ten years.

However, with a huge increase in the money supply and nearly one trillion in new spending on the way, it's hard to see how this is possible. All this funding and spending could be viewed as positive by investors, were it not for the law of unintended consequences. And the greatest concern here of course is inflation. Inflation is a phenomenon caused by creating too much money. The Federal Reserve Bank has certainly been doing this in an unprecedented way and it is far from certain they can contain the inflation that historically results. But then perhaps the Fed sees inflation not as a problem, but rather, as part of the solution. Think about it, what better way to bail out debtors and clear out an excess housing inventory than through inflating the value of hard assets and at the same time diminishing the value of debt claims? This is precisely what inflation does.

I don't paint this scenario to depress you but rather to alert you as to why you need to think defensively. The "irrational depression" following in the wake of the "irrational exuberance" of the housing market bubble can get our economy into serious trouble. The new stimulus package is an attempt to reverse this downward spiral and rekindle investors "animal spirits." Because "animal spirits" is not a number but a state of mind it is neither rational nor permanent. When this mass psychosis reverses itself, an unprecedented amount of cash will come back into circulation. We will have too much money chasing too few goods and services – a prescription for rampant inflation.

To protect yourself from the inevitability of a "stagflation" cycle similar to what Johnson, Nixon and Carter left us with in the late '70s and early '80s, the only option is an allocation to hard assets. In it's simplest form, inflation inflates the value of hard assets while diminishing the value of cash and other soft assets. However, most hard assets are expensive to buy, sell and own. As such, they often result in a negative cash flow situation rather than positive.

This is what makes direct ownership of TIC or DST interests with non 1031 specific money so attractive. With their investment grade credit tenants, remote management and positive cash flows, these properties represent one of the most attractive hard asset classes available. The underlying commercial real estate should hedge your principal against inflation inspired erosion. The increasing cash-on-cash return often associated with these properties should also maintain the integrity of your cash flow and purchasing power in the face of increasing costs for goods and services.

These attributes say little or nothing about the desirability of being secured by real property as a landlord in the face of our current wave of bankruptcies and possible nationalizations. While stockholders are wiped out and return on bondholder debt becomes problematic, TIC/DST owners at least have a building to rent.

We must also consider expiration of the Bush tax cuts at the end of 2010. With a President who believes it is only fair to "spread the wealth" and a government apparatus in desperate need of more revenue, there is a real possibility that both marginal income tax rates and the capital gains tax may increase. Here again TIC/DST ownership for non-1031 specific money shines. The very tax advantaged nature of the cash flow many of these properties provide allows you to keep more rather than less of your income. When this is coupled with the capital gains tax sheltering currently provided by the 1031 opportunity, it is a hard combination to beat.

As far as defensive strategies for investing in an uncertain economy are concerned, direct ownership of TIC/DST interests with non 1031 specific money is one of your best diversification tools. If inflation does become a serious issue, as a hard asset, its value should increase protecting principal. The increasing cash-on-cash return associated with these properties should also protect your buying power against erosion in the face of higher cost goods and services. Finally, the very tax advantaged nature of the cash flow they create and the capital gains tax protection provided by Section 1031 of the Internal Revenue Service Code should allow you to keep more of what you make if and when the property is sold at a profit. Not a bad prescription in these troubled financial times.

The very tax advantaged nature of the cash flow many of these properties provide, allows you to keep more rather than less of your income. When this is coupled with the capital gains tax sheltering currently provided by the 1031 opportunity, it is a hard combination to beat.