

# **THE WEEKENDER**

*have a good one*

## **STAYING AHEAD OF INFLATION IS A TRICKY AFFAIR**

INFLATION is probably the greatest single reason we should invest wisely because it will play a significant role in the eventual purchasing power of every rand saved for retirement.

For this reason it's important to know how to protect a portfolio against its long-term effects.

The most publicised effect of inflation is the destruction of the purchasing power of your rand. If your grandparents had put your inheritance under the mattress in the 1980s you would be disappointed that they had not rather invested it in your name.

The other negative effect is the uncertainty that flows from varying inflation rates or rates that increase too quickly.

Such an environment will dissuade people from saving or investing, because the future value of money is uncertain and spending it now at least has an element of predictability. Such a trend can even lead to the scarcity of goods and services.

This was seen clearly in Zimbabwe. Rapidly rising prices will motivate consumers to buy things as quickly as possible. Such consumer behaviour disrupts normal spending patterns and expectations for operating margins, with which businesses plan and invest in capacity.

On the other hand, inflation can have positive effects as well. It may prevent an economy from slipping into a recession as consumers are motivated to keep spending money now rather than forfeiting wealth over time due to inflation. The goal here, expressed in many an ad campaign, is to convince consumers to "buy now before prices rise again".

Secondly, debt remains constant in monetary terms even as inflation increases, so if the purchasing power of money decreases, you can pay off your debt faster if you can ensure your income keeps track of inflation.

Why should you protect yourself against inflation?

At first glance, the obvious answer is that your wealth will deteriorate in value if you do not. However, prices do not rise in a straight line and the tempo at which prices inflate is not a foregone conclusion — so the factors that influence inflation need to be monitored carefully.

In today's global environment, for example, the US Treasury and many other central banks around the world have been printing money at unprecedented rates. The ratio of the US budget deficit to gross domestic product is at the highest level since the Second World War.

These factors have already had an effect as the dollar has declined sharply against other major currencies in the past few weeks.

Investors are wary of the spectre of inflation that surplus money combined with a low interest environment foreshadows. With the dollar as the world's reserve currency, this would have an effect on almost all commodity prices and could reintroduce inflation into the world economy. In the wake of the financial crisis, the past year or two has actually seen deflation as most commodity prices fell from dizzy heights . Oil is still trading at less than 50% of its highs last year.

This raises the question: how should you protect your portfolio against inflation? There are many theories — from hoarding gold, to investing in inflation-linked bonds or plain old equity investments, as companies should be able to pass on the effects of inflation to customers and therefore sustain their real earnings.

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