Lyndhurst
Financial Management

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GUIDE TO

INVESTING AND INFLATION

SAFEGUARDING THE PURCHASING POWER OF YOUR MONEY OVER THE LONG TERM

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GUIDE TO INVESTING AND INFLATION

Safeguarding the purchasing power of your money over the long term

Rising inflation is a concern to investors, as changes in inflation and interest rates affect various asset types in different ways. This is an especially important issue for retirees living on a fixed income.

Millions of Britons could see their savings shrink because they don't know how to shield them from rising inflation. The findings are according to research by YouGov for Zurich which found more than a third (37%) of people aged 18 to 65-plus are in the dark over ways to grow their savings enough to at least keep up with rising prices.

There are a number of different factors that may create inflationary pressure in an economy. Rising commodity prices can have a major impact, particularly higher oil prices, as this translates into steeper petrol costs for consumers.

DEMAND FOR GOODS AND SERVICES

Stronger economic growth pushes up inflation too, as increasing demand for goods and services places pressure on supplies, which may in turn lead to companies raising their prices. The aim of investors is to grow their money at a rate that will meet their goals and comfortably exceed inflation.

Although more volatile, stock market investments have historically performed well, benefiting from the earnings of companies usually rising along with inflation and when dividends are reinvested. It is these dividends that help in the battle to beat inflation, particularly when returns compound.

CONTRIBUTING TO HIGHER INFLATION

The falling pound since Britain's vote to leave the EU in June last year and the 2017 UK general election result is also contributing to higher inflation in the UK, as it makes the cost of importing goods from overseas more expensive.

Rising inflation is eating away at the nation's savings, yet the reality is that many people don't know how to fend it off. A gap in consumer awareness over how some can protect their savings from inflation could mean many people will see their wealth simply drain away.

FINANCIALLY WORSE OFF IN RETIREMENT

Over the long term, this could threaten to leave people financially worse off in retirement, especially when combined with ultra-low interest rates and stagnant wage growth. Of the 4,000 people surveyed by YouGov, more than a quarter (27%) said they believed property was the best way to outpace inflation.

More than one in ten (13%) people thought Cash ISAs could help them maintain their spending power – twice as many as those who said Stocks & Shares ISAs (7%).

INVESTING IN THE STOCK MARKET

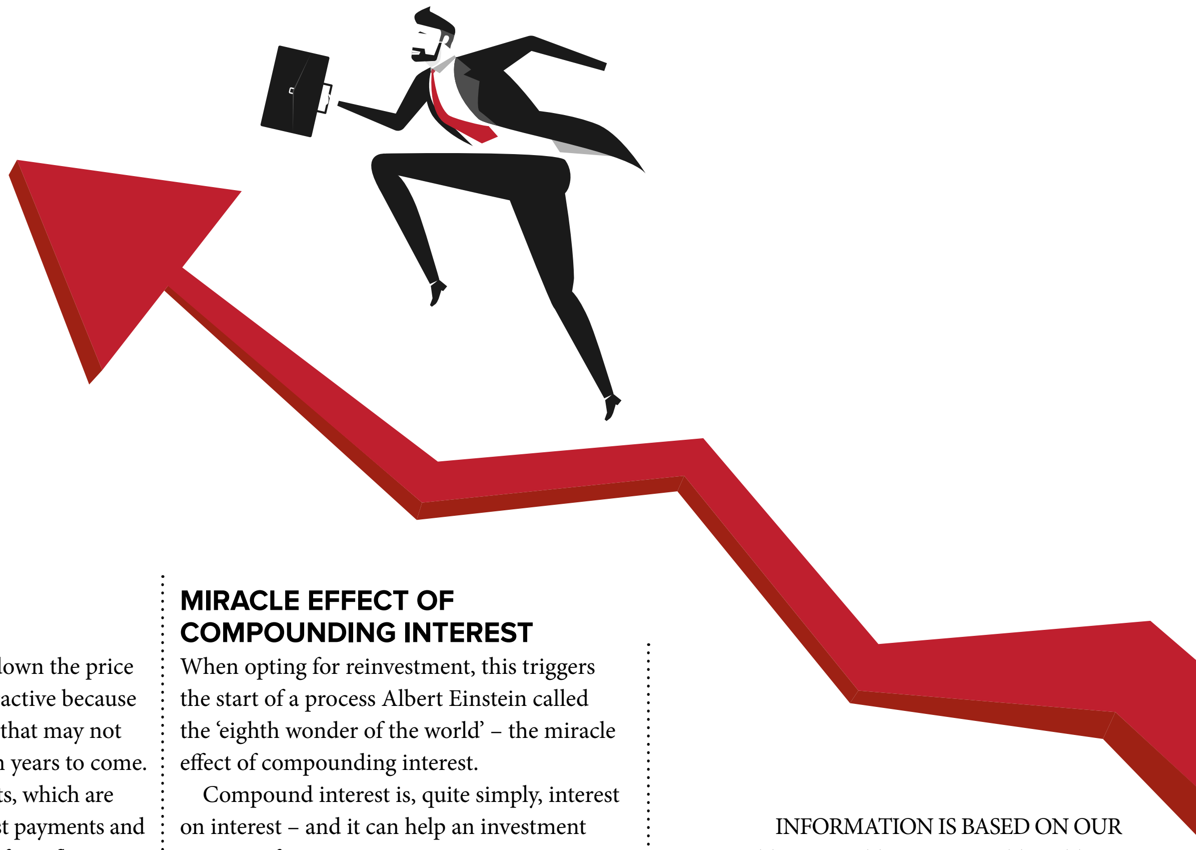
Just 4% of people said investing in the stock market could help outstrip inflation, while only 3% backed savings invested in a pension. Although they come with greater investment risk, Stocks & Shares ISAs typically offer more protection against inflation than Cash ISAs.

Cash ISAs are more appropriate to save money for a rainy day but are less suitable for long-term savings, such as for retirement. From this April, the amount people who can now shelter tax-efficiently in a Cash ISA has risen to £20,000 a year.

LONG-TERM SAVINGS STUCK IN CASH

With a bigger ISA pot to fill, the danger is that some people will leave more of their long-term savings stuck in cash, where they will be eaten away by inflation.

Inflation is bad news for savers, as it erodes the purchasing power of your money. Low interest rates also don't help, as this makes it even harder to find returns which keep pace with rising living costs.



DRIVING DOWN THE PRICE OF BONDS

Higher inflation can also drive down the price of bonds. These become less attractive because you're locked in at interest rates that may not keep up with the cost of living in years to come.

One option is index-linked gilts, which are government bonds whose interest payments and value at redemption are adjusted for inflation. However, if they are sold before their maturity date, their market value can fall as well as rise and so may be more or less than the redemption value paid at the end of their terms.

BETTER PROTECTION AGAINST INFLATION

Investing in equities can potentially provide better protection against inflation than deposit accounts or bonds which aren't index-linked, because companies can raise prices to cover higher costs, which in theory should enable them to grow at the same rate of inflation over time.

Reinvesting dividends is one of the most powerful tools available to an investor to increase returns over time. When purchasing equities, investors can elect how they will receive any future dividends. They can choose between either receiving the cash or using that money to repurchase more company shares.

MIRACLE EFFECT OF COMPOUNDING INTEREST

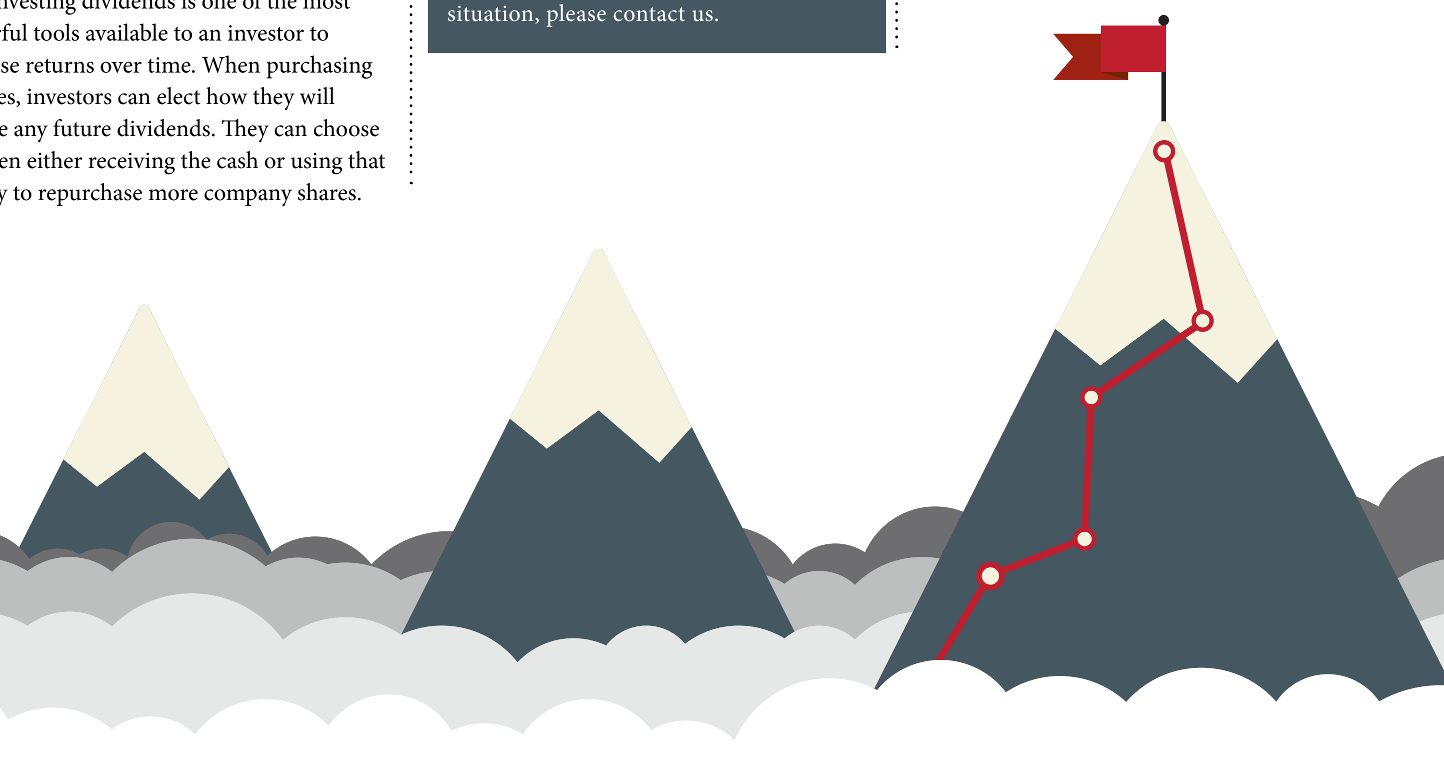
When opting for reinvestment, this triggers the start of a process Albert Einstein called the 'eighth wonder of the world' – the miracle effect of compounding interest.

Compound interest is, quite simply, interest on interest – and it can help an investment grow at a faster rate.

By reinvesting dividends, you give your equity holding the potential to earn even more dividends in the future. The value of compounding increases over time and accelerates shareholder value, especially when share prices increase. ■

PREPARING YOUR PORTFOLIO FOR INFLATION

Inflation may finally be returning, and should it continue to rise there will be a number of opportunities open to investors. To discuss your particular situation, please contact us.



NEED HELP KEEPING YOUR SIGHTS ON INFLATION?

Whatever your investor profile – from first-time investor to experienced retiree – you need to keep inflation in your sights.

To assess the best weapon to use for your particular situation and requirements, please contact us.

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