INVESTING AND INFLATION

GUIDE TO

SAFEGUARDING THE PURCHASING POWER OF YOUR MONEY OVER THE LONG TERM

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Authorised and Regulated by the Financial Conduct Authority.
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 shrunk 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.

**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 are in some cases the best option to protect their savings from inflation.

**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.

**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 ensure a consistent return over time. When purchasing equities, investors can elect how they will distribute their returns, either by paying a fixed amount or by using a dividend reinvestment plan.

When opting for reinvestment, this triggers the eighth wonder of the world – the miracle effect of compounding interest. 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 share price growth. The benefits become less attractive as the gap between dividend and capital gains erodes over time.

**MIRACLE EFFECT OF COMPOUNDING INTEREST**

When investing, the investor must decide how they want to benefit from compounding interest. 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 share price growth. The benefits become less attractive as the gap between dividend and capital gains erodes over time.

The price of bonds is determined by the supply and demand for these financial assets. An upsurge in demand for bonds can cause their price to rise, while a decline in demand can drive their price down.

Investors can choose between holding bonds in an ISA or outside an ISA. ISA investments enjoy tax-free status, while bonds held outside an ISA are subject to income tax and capital gains tax.

When choosing bonds, investors must consider factors such as the bond’s credit rating, its maturity date, and whether it is indexed-linked or not. Indexed-linked bonds provide protection against inflation, while non-indexed bonds offer potential for capital growth.

**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.

**INFORMATION IS BASED ON OUR CURRENT UNDERSTANDING OF TAXATION LEGISLATION AND REGULATIONS. ANY LEVELS AND BASES OF, AND RELIEFS FROM, TAXATION ARE SUBJECT TO CHANGE.**

**THE VALUE OF INVESTMENTS AND INCOME FROM THEM MAY GO DOWN. YOU MAY NOT GET BACK THE ORIGINAL AMOUNT INVESTED.**

**STOCKS & SHARES ISA INVESTMENTS DO NOT INCLUDE THE SAME SECURITY OF CAPITAL THAT IS AFFORDED WITH A CASH ISA.**

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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.