Inflation: How to Alleviate the Impact on Your Investments

Redmayne Bentley

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Inflation is a sustained increase in the general price level of goods and services within an economy. Generally, inflation means there is an increase in the cost of living. There are two main measures of consumer inflation in the UK:

Retail Price Index (RPI) - includes mortgage interest payments and tends to be more volatile. A cut in interest rates will reduce RPI.

Consumer Price Index (CPI) - excludes mortgage interest payments.

The persistence of inflation within an economy can have a serious impact on an individual's real rate of investment return. For example, if CPI inflation runs at 2% for 10 years, £1,000 in cash today will be worth just £820.35 at the end of the period. So what can individuals do to take action against inflation?

Index-linked gilts provide inflationary protection to both the capital amount and the income (coupon) stream by being scaled up or down in relation to changes in the RPI. Index-linked gilts are issued by the UK government, therefore, default risk is low and liquidity is high. They can be purchased across a range of maturities to match a specific time horizon. At present, the yields are relatively low but they do offer individuals a degree of certainty over their income stream and projected redemption value at maturity. Less risk-averse investors may wish to target corporate index-linked issues from recognised names. Investors need to be sure of the exact terms and the structure of such bonds to ensure suitability.

Infrastructure funds can act as a useful index-linked proxy. These funds aim to provide stable returns to investors over the longer term, with the objective of providing a relatively high and growing yield (circa 4-6%). Infrastructure funds offer a positive inflation correlation by investing in long-term contracts where income and costs are linked to the RPI. Examples of such funds include the HICL Infrastructure Fund and the John Laing Infrastructure Fund, both of which are investment companies in structure and trade just like any other listing on the stock market.

Equities, particularly those with a strong and growing dividend stream can play an important role when inflation-proofing a portfolio. Defensive sectors such as Utilities, Household Goods and Pharmaceuticals are often able to shift higher costs which they themselves bear onto their consumers, making these stocks an attractive proposition. Investors should consider that equities are a longer-term asset class, where the overall return is derived through both income and capital growth. On that basis, selecting the highest-yielding equity is not always the best way to counteract the effects of inflation over the longer term. Shares can be bought and sold easily through Redmayne Bentley using our execution-only service or, alternatively, you may consider our bespoke investment management services. If you are unsure about the suitability of our services, we are happy to discuss this with you.

Please remember that investments and income arising from them can fall as well as rise in value and you may lose some or all of the amount you have invested. Past performance and forecasts are not reliable indicators of future results or performance.