

Asset Classes and Inflation

In 1985 annual published inflation was 18.4%. At that rate, a price doubles almost every 4 years! While we believe that the inflation of the 70s & 80s is unlikely to return with the same ferocity, there is no doubt that market and geopolitical conditions are fueling higher inflation than the last three decades. While instability creates fear and uncertainty history has taught us that flight to investment safety (traditionally cash and bonds) is completely the wrong approach in increasing inflationary environments.

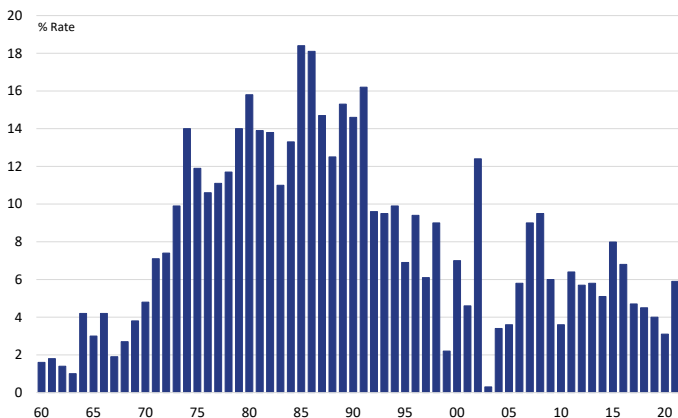


Robin
Gibson

To some of us, 1985 seems like yesterday. Fittingly it was the year of the release of Marty McFly in Back to the Future. We were all humming Madonna's Like a Virgin or Bruce Springsteen's Born in the USA. Would you believe that Microsoft 1.0 was also released that year - and it wasn't exactly well-received? It's a short 37 years ago - well mostly for those of us born before 1980! It was also the year during which

South African inflation peaked at 18.4%.

SA INFLATION RATE



Plotting annual inflation all the way back to 1960 clearly illustrates the structural decline in inflation from the late 1980s driven by global dynamics and the implementation locally of an inflation-targeting monetary policy regime."

Over these past 4 decades inflation has largely declined, led by large-scale industrialization, improved technology, global trade, and largely stable politics. Falling inflation has meant falling interest rates and with it probably some of the

SPEED READ

- Inflation in 1965 was 3% per annum. By 1985 it peaked at 18.4% and yet in 2005 was back at 3.6%.
- Short-term inflation shocks or even a change in medium-term trends is initially disturbing to equity markets but history shows that for long-term investors only two asset classes consistently beat inflation over a sustained period, namely equity (shares) and property.
- The spectre of higher inflation is driving interest rate responses from central banks. This in turn is rattling equity markets across the globe exacerbated by the implications of supply chain disruptions from the Ukraine conflict. This is entirely expected but is seldom a good predictor of company profit growth and resultant equity returns.
- Investors should be looking through short-term volatility and rather evaluating dynamics through historic wars, pandemics, and other disruptions to remind themselves that patience is ultimately handsomely rewarded, and panic is seldom a successful strategy.

best returns ever for global bonds. Looking back in periods of 10 years from 2022 to 1985, bonds often returned equity-like real returns. How fantastic! Equity-like returns with limited risk. Sign me up!

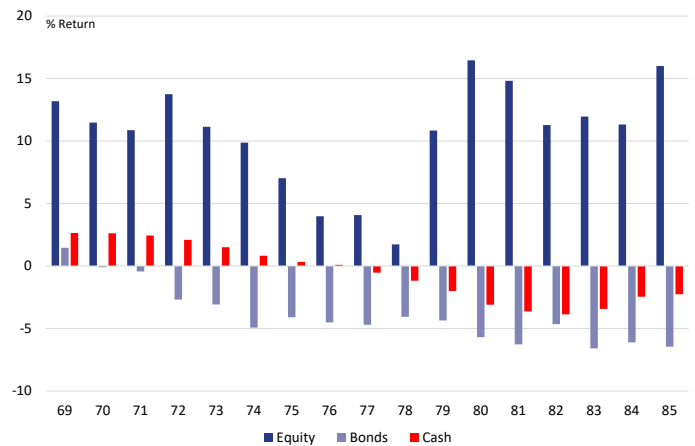
However, a study of history teaches us something quite enlightening. A structural increase in inflation results in rising interest rates which in turn leads to real bond returns (total return minus inflation) being significantly lower than inflation. While we honestly do not think that we are returning to the high-inflation environment that prevailed during the 1970s and 80s because of continuing

technological advancements, there is no doubt that slightly higher inflation is going to be with us for longer than hoped. Consider the following chart. This chart plots real returns from 3 asset classes, namely Equities (the share market with the All Share Index as a proxy), Bonds (with the All Bond index as a proxy), and a 1-year Fixed Deposit. To get a real return, we subtract inflation. We do this to illustrate whether your wealth is growing or declining when we remove the effect of inflation.

Our first chart demonstrated that the period from 1960 through to 1985 saw inflation steadily rising to a peak. This chart then considers how your wealth would have changed had it been invested in either of these asset classes. So, the first bar would represent average annual equity returns for the 10-year period from 1960 to 1969.

The chart demonstrates that equities are by far the preferred asset class, with Bonds and Cash even causing wealth destruction in an inflationary environment. The message for investors is very clear: while volatility is not fun in the

10-YEAR AVERAGE ANNUAL REAL RETURNS



Real returns declined significantly (and were often negative) for both bonds and cash during the high inflation period of the 1970s and 1980s.

short-term, a long-term commitment to growth asset classes is a clear winner in an inflationary environment.



1985 was the year of iconic movies and cultural events, unfortunately, it also had sky high inflation.



Topic: **To be advised**

Natal Midlands

Date:	TBA
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	TBA
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am



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HARVARD HOUSE GROUP



3 Harvard Street, Howick, 3290, South Africa



P.O. Box 235, Howick, 3290, South Africa



+27 (0) 33 330 2164



+27 (0) 33 330 2617



admin@hhgroup.co.za



www.hhgroup.co.za

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