**Our thoughts on inflation**

We thought it would be useful to explain the way we think about inflation and your investments as we are not sure we have fully elaborated on this before. This is particularly important at present as we begin to emerge from the impact of the pandemic with inflationary pressures brought about by a shortage of staff (creating wage inflation) and product shortages, raw material shortages and a rebound in oil prices and hence fuel prices which impacts everyone directly and indirectly. The question is ‘is this a temporary rise in inflation or a more engrained change in the inflationary outlook’.

So, to start, let’s talk about inflation. Inflation is a relatively simple concept, used to describe the gradual rise in the cost of goods and services. For example, a loaf of bread or the cost of petrol. Inflation is generally healthy if it’s in the 2-3% per year range, but it is considered to be unhealthy if it falls too low or rises too high (the idea is that we make steady progress over time). For this reason, the central bank, in normal circumstances, will adjust interest rates to control it. However, with worldwide Government debt so high, putting up Interest Rates is a difficult decision.

Inflation is important today because it is currently rising from a very low base, but it’s perhaps rising too quickly. This is understandable, given the reopening of the economy, yet is garnering headlines and has caused some volatility among certain assets.

We should also keep in mind that the job of your total portfolio is to increase your purchasing power over time. Some assets we hold will do better in a period of higher inflation and some will do better in a period of lower inflation. The key is to strike the right balance for your long-term goals and risk tolerance, which is a core part of your financial plan.

On this, the return on cash (interest) typically fails to keep pace with the rising prices of goods (inflation). Therefore, as a long-term pursuit, cash is actually a very bad investment. Hence, unless we have absolute certainty that the markets are nearing the peak, which is extremely difficult, putting everything in cash is rarely a good idea.

We therefore use cash selectively as an investment tool. This is already done within your portfolio, where cash is treated as any other asset class available for allocation. This means that as the attractiveness of other available assets rises relative to cash, cash allocations should fall and vice versa. Therefore, cash plays both offense and defence, by being used as ‘dry powder’ for adding undervalued assets to the portfolio and by buffering against rich valuations.

This brings us to a crucial aspect of wealth creation and preservation – we need to be a step ahead of our own emotions as well as other participants emotions. So yes, cash may feel like the best place in the darkest moments (so-called “cash is king”), but it is a poor choice when considered as a long-term pursuit and only tends to work if we increase it before the market decline occurs.

At heart, we remain confident that your portfolio is well positioned to navigate different inflation environments. We can’t rule out the odd setback (whether due to inflation, covid, or otherwise), but wealth creation is often about avoiding the biggest mistakes, which is why we’re diversified across different assets. We want to “be greedy when others are fearful and fearful when others are greedy”, but we also want to manage risks along the way.

Bringing this together, we want to reiterate that we are aware of the current inflation discussions and your portfolio has been thoughtfully considered in this light.

 Yours sincerely

  

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Directors