2021 Spring Newsletter

Dear client,

I thought it would be useful to explain the way we think about inflation and your investments as I'm not sure I've fully elaborated on this before.

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 gas. Inflation is generally healthy if it's in the 2-3% per year range, but it is 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 will adjust interest rates to control it.

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 advancements in 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. We do this by looking to outperform inflation, rather than outperforming a sharemarket index, such as the S&P ASX200. Outperforming an index isn't necessarily the same as achieving your financial goals, and can sometimes mean having to pay too much for investments to keep up with the index or not being able to adequately diversify.

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 defense, by being used as 'dry powder' for adding undervalued assets to the portfolio and by buffering against rich valuations.

At heart, we remain confident that your portfolio is well positioned to navigate different inflationary 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.

If you would like me to elaborate further on this, or any other matter, I'd be delighted to chat.

Regards

Robert