

News

## Time to rethink inflation protection

by Gabriel Lacroix | Thursday, 9 July 2009

Kiwi investors who shied away from investing in assets which grow with inflation may have to rethink their strategy as fears grow that the government's efforts to prevent a prolonged global recession will instead spark inflation.

NZ Funds Chief Executive, Michael Lang said that since the advent of the Global Financial Crisis (GFC), Kiwi investors have preferred the safe haven provided by banks deposits, Government and corporate bonds. However, these types of investments will be hard hit if inflation rises.

At the beginning of 2009, 10-year US Treasury Inflation Protected Bonds (TIPS) were trading at the same yield as 10-year nominal bonds, Lang says. This implied that US investors believed inflation would average 0% over the next 10 years. However, recently this implied yield has risen to 2% as US investors have shied away from nominal bonds and purchased inflation protected bonds instead,"

He believes a number of international inflation linked bonds such as those issued by the US Treasury and the United Kingdom are at attractive prices and "we're now seeing renewed interest in the strategy as part of diversified financial plan."

His firm has seen a sharp increase in interest for its inflation protected portfolio strategy. "A couple of years ago we began developing an investment strategy designed specifically to protect investors' purchasing power from the impact of a prolonged period of higher inflation. It's been hard to find the right assets as the NZ Government last issued an inflation linked bond in 1999."

He pointed to a recent study published in the *Bank of Canada Review* which shows the main winners of unexpected inflation were young, middle-income households who are holders of fixed rate mortgage debt.

"Inflation effectively reduces the real burden of their debt. The losers are high-income households with no debt and investors who in provisioning for retirement, are holding long-term fixed rate bonds or pension investments whose payouts are not linked to inflation," Lang said.

In his view, companies that do well in an inflationary environment are those that are linked to commodities. "Property investments that are funded with a mortgage tend to offer better inflation beating returns than those funded with cash," he added.