

MAY 2010

Investors are facing a 40 per cent drop in wealth over the next ten years if they do not put their funds into inflation protected investments such as inflation-linked bonds or in property and utilities, according to New Zealand Funds Management.

Principal and Investment Strategist, David Wilson, says Treasury's forecast for the Consumers Price Index to jump to 5.9 per cent for the year ending March 2011 is a threat to many investors' retirement. "The threat is real and is a risk that many investors underestimate."

Inflation erodes investors' returns over time. At 5 per cent inflation a year, \$1.00 invested will be worth only \$0.60 cents in ten years. "Investors with a five year plus timeframe are probably underestimating the impact inflation may have on their portfolio. A fixed interest security paying 7 per cent p.a. before tax may, after tax and inflation, not provide a return at all for an investor. So while the headline figure of 7 per cent p.a. interest may look attractive to an investor, the actual real return could be nil"

Wilson says inflation-linked bonds and defensive shares in property and utilities should, however, compensate an investor for inflation rises.

There are two large inflationary risks on the horizon, one from Asia and in particular China, and the other is from Europe and the US due to their excessive printing of money.

Over the past 12 months, China's inflation has risen from -1.5% p.a. a year ago to 2.8% p.a. This strong demand is having an impact on Australia with their Reserve Bank increasing interest rates and confirming that its economy is operating at full capacity.

The indebtedness of European countries such as Greece is also leaving these countries with two choices: cut spending or print money. Since cutting spending creates a risk that the economy could stall, prompting further declines in government tax revenue, the easiest solution is to print money. "This is exactly what both the US and the UK did when they quantitatively eased last year. But printing money devalues your monetary base and creates inflation as people seek hard assets or currencies."

Wilson says the global economy therefore is entering a phase where inflation is likely to rise. "It will be hard for New Zealand to not import this inflation. The only way we can escape is to allow the New Zealand dollar to appreciate, but this clearly will have significant implications for the productive sectors of the economy"

While Wilson says there are no guarantees when investing in inflation-linked bonds and shares in property or utilities, in almost all inflation scenarios, clients should be far better off than if they invested in term deposits or fixed interest.

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