

Protecting the value of your money

Don't ignore the corrosive impact rising prices can have on your investments

Inflation is an economy-wide sustained trend of increasing prices from one year to the next. The rate of inflation is important as it represents the rate at which the real value of savings and an investment is eroded and the loss in spending power over time. Inflation also tells investors exactly how much of a return their investments need to make for them to maintain their standard of living.

To avoid losing value, your savings and investments need to grow at the same rate as prices are rising. In the current climate of lower interest rates, however, achieving this could be a challenge. During periods of rising inflation, those who save into deposit accounts may look to redirect their savings into investments in a bid to achieve potentially better returns, but it's important to appreciate the risks. Unlike cash bank accounts, investments can fall as well as rise, and you could get back less than you invest, or lower returns than you might otherwise have achieved.

Interest rates on deposits in Cash Individual Savings Accounts (ISAs) have generally remained below inflation over the past few years. Some savings accounts offer higher rates, but most pay interest below the current rate of UK inflation – even if you tie your money up for three years.

INVESTING IN BONDS

If you are prepared to take on some investment risk, you could consider investing in a bond fund.

Bond funds invest in a basket of IOUs issued by governments and/or companies looking to raise cash. When someone invests in a bond, they are essentially lending the bond issuer their money for a fixed period of time. During the bond's life, they will receive a fixed rate of interest, known as the 'coupon', and when it matures, those who invested when the bond was first issued should get their original capital back.

However, it's important to understand that your investment is not guaranteed. If the issuer gets into financial trouble, it could fail to meet its interest payments or even repay your capital. If that happens, you could get back less than you invest or nothing at all.

While you can invest in an individual bond at launch, they are also bought and sold on the open market, so you can invest at any stage in a bond's life. But remember, if you buy a bond after it has been first issued, you will pay its market price, which could be higher or lower than its issue price.

On the secondary market, bond prices change regularly, and as a result the yield on offer will also alter,

so the rate of interest you receive will be dependent on its price at any given time. In addition, when it matures, the capital repayment will be the amount which was paid when it was initially issued and again – this could be higher or lower than what you paid. If you sell, you will get the market price, and that may be less than you paid.

Broadly speaking, bonds are typically viewed as a lower-risk than shares and generally offer a relatively steady and predictable income, though some bonds do carry higher risk than some shares. Opting for a bond fund can help you diversify your risk, but these portfolios come in many guises, and as such some will carry greater investment risk than others. Generally, they will all hold bonds that are at various stages of their life and therefore will vary in value.

INVESTING IN SHARES

An inflationary backdrop may be less harmful for equity investors because during such periods, companies will often increase their product prices when the underlying costs start to rise. As a

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result, company earnings may have the potential to keep up with inflation, but there can be no guarantee of this, and some companies may fail in inflationary times. If you are considering investing in the stock market, remember that the value of the shares that you buy can fall as well as rise, and you could get back less than you invest.

But opting for a fund which invests in a wide spread of stocks is going to be less risky than putting your money into just a handful of shares. While you could invest in a low-cost tracker fund, which will simply mirror the performance of a particular index, such as the UK's FTSE 100, equity income portfolios also aim to deliver a steady income stream as well as capital growth.

These vehicles invest in the shares of dividend paying firms, or companies that tend to share their profits with their shareholders, and investors can opt to either take the income or instead re-invest it. It is vital to understand that dividends are not guaranteed: they depend on the companies' profits and those companies can decide to cut or cancel their payouts altogether, all of which can also cause share prices to fall.

INVESTING IN PROPERTY

Property in general is another asset class known for typically staying ahead of the cost of living over the long term. But while buying a property outright is quite an elaborate step to take to beat inflation, you can still access the asset class by going for a fund, which invests directly in bricks and mortar.

By doing so, it helps you to not only diversify your portfolio away from just bonds and shares but also spread your money across a broad range

of properties, such as office buildings as well as industrial and retail parks. This can help with diversification by ensuring that if one or more buildings are unoccupied for a period of time, the other properties can still generate income.

The rents paid by tenants, which are often linked to inflation, can provide a stable and sometimes rising income, while over time property values could potentially appreciate. However, commercial property prices can be volatile, and when the economic backdrop becomes uncertain, many buildings may fail to attract a sufficient number of tenants, or tenants could become solvent and default on rents, which means values and investment returns are very likely to fall. ■

TIME TO REVIEW YOUR CURRENT PORTFOLIO?

Inflation can have a corrosive effect on the money that you've set aside for your future. Rather than rising in value, as you might hope, your savings could be being slowly diminished. If you would like to review your current portfolio, please speak to us – we look forward to hearing from you.

Source data

[1] *Consumer Intelligence conducted an independent online survey for Prudential between 20 and 21 June 2018 among 1,178 UK adults*

[2] <https://www.ukfinance.org.uk/house-purchase-activity-slows-in-june-but-remortgaging-activity-remains-high/>

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